TAX PROCEDURE: SOMETIMES IT'S WHO YOU KNOW, NOT WHAT YOU KNOW

Posted on **September 28, 2017** by **Jim Malone**

A sophisticated taxpayer avoided liability for an accuracy-related penalty in connection with a foreign currency options shelter because he relied upon advice from a friend and former colleague. *Tucker v. Comm'r*, 2017 Tax Ct. Memo LEXIS 184 (Sept. 18, 2017). While *Tucker* also addresses economic substance issues surrounding the shelter, the penalty determination is more intriguing.

The taxpayer, Keith Tucker, had an accounting degree and a law degree. 2017 Tax Ct. Memo LEXIS 184 at *2. After working in the tax practice at KPMG, he moved on to a variety of different business positions, serving as an investment banker, working in private equity, and holding positions as a financial services executive. At times relevant to his tax case, he was the chief executive of a mutual fund company, Waddell & Reed. *Id*. at *3-*4. Waddell & Reed established a financial planning program for its executives, and KPMG was retained to manage it. A friend of Tucker's, Eugene Schorr, ran the program. Schorr was recommended for the position by Tucker; he had a bachelor's degree in accounting and a master's degree in taxation. *Id*. at *4-*5.

Tucker and other Waddell & Reed executives held highly appreciated options, and KPMG began to develop a tax strategy to offset the anticipated gains that would be realized upon exercise. *Id.* at *7. Schorr referred Tucker to Timothy Speiss, a member of KPMG's "Innovative Strategies Group." *Id.* at *8. Tucker relied upon Speiss because Schorr recommended him. *Id.* at *9. Speiss, who would assert his Fifth Amendment privilege against self-incrimination at trial, developed a tax strategy to offset Tucker's gains from his options with losses derived from a short options strategy, but the IRS issued Notice 2000-44, 2000-2 C.B. 255, which designated that approach as a listed transaction. *Id*. at *11-*12. Ultimately, Speiss suggested a foreign currency transaction that involved the use of options; this was implemented at the end of 2000. *Id*. at *14-*15.

On his tax return for 2000, Tucker claimed a loss from the transaction of $39,188,666, which was disallowed by the IRS. This adjustment to his return created a tax deficiency of $15,518,704; the IRS also imposed an accuracy-related penalty of $6,206,488 under section 6662 of the Internal Revenue Code. *Id.* at *1.

Mr. Tucker received a variety of tax advice in connection with his 2000 return. KPMG told him that the foreign exchange transaction was not covered by IRS Notice 2000-44. *Id*. at *24. It also signed his return. Brown & Wood prepared two tax opinions that the taxpayer viewed as "an insurance policy." His return was filed before both opinions were ready, but KPMG told him that was not a reason to delay filing. *Id*. at *26-*27. Both opinions were backdated. The taxpayer never reviewed them. *Id.* at *27.

Speiss, the architect of the foreign currency transaction at issue, prepared a 48-page memorandum for KPMG's files that described the basis for the tax treatment on Tucker's return; it did not purport to be a tax opinion. Mr. Tucker never read the Speiss memorandum. *Id*. at *27-*28.

Schorr created a four-page file memorandum that Tucker read before filing his 2000 return; the memorandum summarized internal KPMG discussions on Tucker's foreign currency transaction and why it was not covered by IRS Notice 2000-44. The memorandum also indicated that Speiss had conferred with Brown & Wood to create Tucker's foreign currency transaction. The memorandum indicated that Tucker could face penalties of up to $4 million and advised him to hedge his penalty exposure. *Id*. at *28-*30.

After determining that Tucker's foreign currency transaction lacked economic substance, the Tax Court addressed the penalty. After quickly determining that the enhanced 40% valuation misstatement penalty was potentially applicable, the Tax Court turned to the taxpayer's reasonable cause/good faith defense. Id. at *79. On the facts, Tucker appeared to face an uphill fight:

- The backdated tax opinions came from a law firm involved in designing the shelter transaction;
- The taxpayer was financially sophisticated; and
- The taxpayer was informed that he had penalty exposure before he filed the return claiming losses from the foreign currency transaction.

Tucker contended that he reasonably relied upon professional advice in claiming the losses on his return. Because reliance on a promoter of a tax shelter is not deemed to be reasonable, the court focused on the factors that make an individual a promoter, as follows:

An adviser is not a promoter when he has a long-term and continual relationship with the client-taxpayer, does not give unsolicited advice regarding the tax shelter, advises the client only within his field of expertise and not because of his regular involvement in the tax shelter transactions, follows his regular course of conduct in rendering his advice, and has no stake in the transaction besides his regular hourly rate.

Id. at *82-*83 (citations omitted).

Applying these principles, the Tax Court concluded that Tucker was not liable for a penalty because he relied upon his friend Schorr. The court cited Tucker's long-standing relationship with both Schorr and KPMG, as well as the fact that Schorr and KPMG both ran his company's financial planning program. *Id*. at *83. The court emphasized that Tucker had not specifically requested a tax strategy and had told KPMG that he did not want to engage in a transaction that would draw scrutiny from the IRS. *Id*. at *84. The court also concluded that Tucker believed KPMG would look out for his interests since they had terminated the earlier strategy in response to IRS Notice 2000-44. *Id*.

Since Tucker's friend Schorr was a competent tax professional who had access to the specifics of the transaction, reliance upon his advice could establish a defense to the penalty. *Id.* at *86. Schorr was not a promoter because he did not have a financial interest in the transaction. *Id.*

The Tax Court also emphasized the adverse impact that KPMG's advice had had on the taxpayer, noting that Tucker believed he had been misled, that he had lost his job as a consequence of his participation in the transaction that it designed, and that he had received a settlement payment from KPMG to compensate him for loss of future earnings capacity. *Id*. at *85-*86. Given Tucker's relationship with Schorr, the court concluded that he was less likely to question KPMG's advice. *Id.*

The court also excused the taxpayer's failure to review key documents associated with the foreign currency transaction, noting that he depended heavily on his personal assistant. The Tax Court also rejected the government's argument that Tucker should have read IRS Notice 2000-44:

Respondent argues that Mr. Tucker should have read Notice 2000-44, supra. Mr. Tucker, who had experience with insurance tax matters in the early part of his career, left the tax field in 1984 and focused entirely on the financial services industry. Mr. Tucker relied on KPMG because he believed that he would not understand the technical tax implications of the FX transaction. Despite his background, C.P.A. license, and law degree, Mr. Tucker had little understanding of the complicated tax issues involved in the FX transaction.

Id. at *88-*89 (footnote omitted).

This is a case that could easily have come out differently on the penalty determination. The Tax Court was apparently swayed by the taxpayer's testimony; plainly, he was very well prepared by his lawyers.

It will be interesting to see if the government elects to appeal. The court's determination appears to rest largely on factual determinations, which are difficult to overturn on appeal as they are subject to the clearly erroneous standard of review. In some circuits, however, the ultimate conclusion of a fact-sensitive determination such as reasonableness is subject to plenary review as a mixed question of law and fact. This could be a case where the determination of the standard of review becomes particularly important on appeal.

For practitioners, the case is a reminder of the pivotal importance of the taxpayer's testimony in penalty cases.

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