

FLIP, OPIS, and BLIPS: Current Issues in Tax Shelter Litigation From the Plaintiff's Perspective

The plaintiffs in *Jacoboni, Hupman, and Hughes*, allege they relied on the advice and direction of their "trusted advisors," each of whom bears an outstanding professional pedigree, like KPMG, BDO Seidman, Brown & Wood, and Wachovia Bank.

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It is appropriate to begin by quoting from the 17th century English satirist and poet Samuel Butler:

With books and money plac'd for show
Like nest-eggs to make clients lay,
And for his false opinion pay.¹

In October of 2003, the United States General Accounting Office estimated that illegitimate tax shelters cost the federal government more than \$85 billion dollars in lost tax revenues since 1989.² A recent PBS Frontline special, entitled "Tax Me If You Can," put it this way: the "rampant abuse of tax shelters since the late 1990's" has resulted in "an avalanche of bogus transactions — created by some of America's biggest and most respected accounting firms, law firms, and investment banks — that [have] ... aggressively marketed to big corporations and wealthy individuals."³ According to John "Buck" Chapoton, a former Treasury Department policymaker in the Reagan administration, such tax shelters "simply were financial mechanisms for creating losses — tax losses, not economic losses."⁴

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SENATE REPORT: EXPOSING THE ROLE OF TAX PROFESSIONALS IN THE UNITED STATES TAX SHELTER INDUSTRY

A building concern within the U.S. government over the late-1990s proliferation of "tax-shelter" promoters by "blue-chip" accounting, law, and banking firms and institutions appeared to reach a crescendo in 2002, when the U.S. Senate Permanent Committee on Investigations of the Committee on Governmental Affairs (the "Governmental Affairs Committee") initiated an in-depth investigation into the "development, marketing, and implementation of abusive tax shelters by professional organizations."⁵ The Governmental Affairs Committee's investigation revealed "overwhelming" evidence that a leading accounting firm, KPMG, had assumed an "aggressive role in promoting and profiting from generic tax products sold to individuals ... later determined by the IRS to be potentially abusive or illegal tax shelters."⁶

BLIPS, FLIP, OPIS AND SC2: TAX SHELTERS UNDER FIRE

The four KPMG case studies analyzed in the Senate Report were the Bond Linked Issue Premium Structure ("BLIPS"), the Foreign Leveraged Investment Program ("FLIP"), Offshore Portfolio Investment Strategy ("OPIS"), and the S-Corporation Charitable Contribution Strategy ("SC2").⁷ KPMG sold these four investment products to at least 350 individuals

between 1997 and 2001 for fees in excess of \$124 million.⁸ By June of 2002, however, the IRS had caught on to KPMG's various tax gambits, and the agency began an intense review of more than 250 individual tax returns employing the BLIPS, FLIP, and OPIS strategies. Once these reviews were conducted, the IRS determined that each amounted to "potentially abusive or illegal tax shelters."⁹

Not surprisingly, after reviewing the taxpayers' individual tax returns, the IRS then turned its attention to the progenitor of these tax shelter strategies, KPMG.¹⁰ The IRS investigation dovetailed with the one underway in the U.S. Senate, with both the IRS and the U.S. Senate focusing on BLIPS, FLIP, and OPIS. These three tax "strategies," sometimes called

paper losses for taxpayers, using a series of complex, orchestrated transactions involving shell corporations, structured finance, purported multi-million dollar loans, and deliberately obscure investments."¹³

Once known to the IRS, BLIPS, FLIP, and OPIS were quickly classified as "listed transactions," and each became the subject of IRS notices denoting them as "potentially abusive tax shelters."¹⁴ So classified, the IRS began requiring taxpayers who used these products to pay back taxes, interest, and penalties.¹⁵ Once the taxpayers learned that the IRS intended to disallow the deductions created by KPMG's tax strategies, more than a dozen taxpayers filed suit, seeking recovery against KPMG and other professionals under various theories, including RICO, common law fraud, professional malpractice, and breach of contract (hereafter, the "taxpayer suits").¹⁶

KPMG sold four investment products to at least 350 individuals between 1997 and 2001 for fees in excess of \$124 million.

"basis-shifting" tax shelters, operated similarly. And, as the U.S. Senate's investigation concluded, "BLIPS was developed as a replacement for OPIS which was developed as a replacement for FLIP."¹¹ All three products "function[ed] as 'loss generators,' meaning they generate large paper losses that the purchaser of the product then uses to offset other income, and shelter it from taxation."¹² BLIPS, FLIP, and OPIS, the Senate Report declared, created "phony

SHELTER PURCHASERS (NOW TAXPAYER PLAINTIFFS) LOOK TO THE COURTS FOR RELIEF AND ACCOUNTABILITY

Several patterns emerged in many of the taxpayer suits against KPMG and other related defendants. First, many of the taxpayers were owners of family businesses or were entrepreneurs, completely unsophisticated in tax matters; they had sold their businesses to third parties, and were facing large capital gains taxes as a result.¹⁷ Second, KPMG had devised sophisticated selling techniques, such as the utilization of opinion letters from well-known law firms, to con-

¹ Hudibras, Part iii, Canto iii, Line 624.

² U.S. General Accounting Office, *Challenges Remain in Combating Abusive Tax Shelters*, GAO-04-104T (October 21, 2003).

³ Frontline/PBS, *Tax Me If You Can*, www.pbs.org/wgbh/pages/frontline/shows/tax/etc/synopsis.html (February 19, 2003).

⁴ Id.

⁵ United States Senate Permanent Subcommittee on Investigations Committee on Governmental Affairs, *U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals, Four Case Studies: FLIP, OPIS, BLIPS, and SC2* (released on November 18 and 20, 2003) (hereafter, the "Senate Report").

⁶ Id., p. 2.

⁷ Id., p. 3.

⁸ Id.

⁹ Id., p. 3 (citing *U.S. v. KPMG*, Case No. 1:02MS00295 (D.D.C., July 9, 2002), ("Declaration of Michael A. Halpert," Internal Revenue Agent, ¶37).

¹⁰ See, e.g., *U.S. v. KPMG*, 2004 WL 964953 (D.D.C. 2004).

¹¹ Senate Report, p. 5.

¹² Id., p. 6.

¹³ Id.

¹⁴ FLIP and OPIS are the subject of IRS Notice 2001-45 (2001-33 IRB 129)(August 13, 2001); BLIPS is covered by IRS Notice 2000-44 (2000-36 IRB 255) (September 5, 2000). On May 5, 2004, the IRS announced a settlement initiative for "taxpayers who invested in an abusive tax shelter commonly known as 'Son of Boss' . . . [a tax strategy] aggressively marketed in the late 1990's and 2000 to companies and high net-worth individuals." IRS.gov, "IRS Offers Settlement for Son of Boss Tax Shelter," (IR-2004-64, May 5, 2004)(IRS press release). It is generally believed that the IRS intends to capture the BLIPS transactions within the scope of this latest settlement initiative.

¹⁵ Senate Report, p. 6.

¹⁶ See, e.g., *Loftin v. KPMG*, Case No.: 03- CVS-16882 (Wake Cty., N.C. Sup. Ct. 2003)(FLIP and BLIPS); *Hupman v. KPMG*, Case No.: 03-CVS-9006 (Wake Cty., N.C. Sup. Ct. 2003)(FLIP); *Hughes v. KPMG*, Case No.: 03-CVS-1726 (Wake Cty., N.C. Sup. Ct. 2003)(FLIP); *Jacoboni v. KPMG*, Case No. 6:02-CV-510 (M.D. Fla. 2002)(OPIS); *Swartz v. KPMG*, Case No.: C03-1252 (W.D. Wash. 2003)(BLIPS); *Thorpe v. KPMG*, Case No.: 5-030CV-68 (E.D.N.C. 2003)(FLIP/OPIS). The author's law firm represents plaintiffs in the Loftin, Hupman and Hughes actions.

¹⁷ See, e.g., Hupman Amended Complaint, ¶11; Hughes Complaint, ¶13.

vince uncertain buyers that the tax strategies were legitimate, risk-free investment products.¹⁸ Third, the Governmental Affairs Committee “uncovered disturbing evidence of measures taken by KPMG [and other professionals] to hide its tax product activities from the IRS and the public.”¹⁹ According to the Senate Report, KPMG never registered or voluntarily disclosed a single one of the disputed tax products.²⁰

SHELTER PROMOTERS LEARN IT PAYS NOT TO FOLLOW THE LAW

The documents attached to the Senate Report reflect KPMG’s brazen efforts to promote FLIP, BLIPS and OPIS. In one of many eye-grabbing internal KPMG emails attached to the Senate Report, a senior KPMG tax professional “advocated in very explicit terms that, for business reasons, KPMG ought to ignore federal tax shelter requirements and not register the OPIS tax shelter product with the IRS, *even if required by law*.”²¹ In the email, the KPMG official assumed that OPIS qualified as a tax shelter, subject to IRS registration requirements.

Nonetheless, no such registration occurred. And, notwithstanding the legal requirements for OPIS registration, this KPMG official advised his colleagues that the IRS was not vigorously enforcing the registration requirements, declared that KPMG’s fees would exceed any penalties for noncompliance with the law, and remarked that “industry norms” had evolved to the point where almost no one was complying with the registration requirements anyway. At one point the email reads:

[F]inancial exposure to the firm [KPMG] is minimal: Based upon our analysis of the applicable penalty sections, we conclude that the penalties would be no greater than \$14,000 per \$100,000 in KPMG fees. Furthermore, as the size of the deal increases, our exposure to the penalties decreases as a percentage of our fees. For example, our average [OPIS] deal would result in KPMG fees of \$360,000 with a maximum penalty exposure of only \$31,000.²²

The email goes on to say that “the rewards of a successful marketing of the OPIS product (and the competitive disadvantages which may result from registration) far exceed the financial exposure to penalties that may arise.”²³ Over the next five years, the Senate Report asserts, KPMG repeatedly rejected opposing views on disclosure and registration issues, and even overruled the head of KPMG’s Department of Professional Practice in going the opposite way.

To make matters worse, the Senate Report also reveals that KPMG “appears to have used improper

reporting techniques on client tax returns to minimize the information that could alert the IRS to the existence of its tax products.” As one KPMG professional put it: “What will our explanation be when the Service and/or courts ask why we suddenly changed the way we prepared grantor trust returns/statements only for certain clients? *When you put the OPIS transaction together with this ‘stealth’ reporting approach, the whole thing stinks.*”²⁴ Several months later, the same writer told his colleagues: “You should all know that I do not agree with the conclusion ... that capital gains can be netted at the trust level. I believe we are filing misleading, and perhaps false, returns by taking this reporting position.”²⁵

BLIPS, FLIP, and OPIS, the Senate Report declared, created “phony paper losses for taxpayers, using a series of complex, orchestrated transactions involving shell corporations, structured finance, purported multi-million dollar loans, and deliberately obscure investments.”

KPMG TO ITS TAX PROFESSIONALS: “SELL, SELL, SELL!!”

Another KPMG email, thanking the SC2 shelter development team (and made public through the Senate investigation), efficiently expresses the atmosphere surrounding the marketing of the shelters: “I want to personally thank everyone for their efforts during the approval process of this strategy. It was completed very quickly and everyone demonstrated true teamwork. Thank you! Now lets SELL, SELL, SELL!!”²⁶ Taken as a whole, the exhibits to the Senate Report attest to the “sales” environment that appeared to pervade KPMG’s tweaking of its tax products headed to market.

One exhibit, which has become a centerpiece of the evidence in taxpayer lawsuits against KPMG, is an email cleverly titled after one of the FLIP/OPIS

¹⁸Senate Report, p. 9.

¹⁹Senate Report, p. 13.

²⁰Id.

²¹Senate Report, p. 13, Ex. 3. (Emphasis added.)

²²Id.

²³Id.

²⁴Senate Report, p. 14, Ex. 10. (Emphasis added.)

²⁵Id. (Emphasis added.)

²⁶Senate Report, Ex. 6.

developers and after the children's game "Simon Says."²⁷ This email, the "Simon Says" Memorandum, written in March of 1998, by KPMG's number two official in its Tax Service Practice, highlighted a number of technical flaws in FLIP and provided the backdrop for an even larger, more pointed discussion, which centered upon the question of which of two KPMG tax offices should get credit for the development of FLIP's successor, the equally dubious OPIS strategy. The email describes KPMG's quest to develop a successor to FLIP, which "took on an air of urgency when [the head of KPMG's Department of Professional Practice ("DPP")] Larry Delap determined that KPMG should discontinue marketing the existing [FLIP] product."²⁸ The email contains this stinging critique of the FLIP product:

Once the taxpayers learned that the IRS intended to disallow the deductions created by KPMG's tax strategies, more than a dozen taxpayers filed suit, seeking recovery against KPMG and other professionals under various theories, including RICO, common law fraud, professional malpractice, and breach of contract.

Simon was the one who pointed out the weakness in having the U.S. investor purchase a warrant for a ridiculously high amount of money — well in excess of the strike price ... It was clear, we needed the option to be treated as an option for Section 302 purposes, and yet in truth the option [used in FLIP] was really illusory and stood out more like a sore thumb since no one in his right mind would pay such an exorbitant amount for such a warrant.²⁹

The "Simon Says" email goes on to say that:

As you may know, the Cayman entity (in both FLIP and OPIS) is nominally owned by an NRA (non-resident alien). Under the FLIP structure, there was

a real question as to whether an NRA was truly an equity holder . . . and in most respects looked like a service provider or debt holder. *If that were true, either of those two characteristics would have lead to a tax disaster.*³⁰

According to the Senate Report, the March 1998 "Simon Says" email was written after "the bulk of FLIP sales."³¹ Even so, after March 1998, KPMG went on to sell ten more FLIP strategies to clients in 1998 and 1999, earning more than \$3 million in fees for its efforts.³² Unfortunately for taxpayers sold the FLIP and OPIS "products," in August 2001 the IRS issued Notice 2001-45,³³ identifying both strategies as "potentially abusive tax shelters." Shortly thereafter, the IRS began auditing and penalizing taxpayers for using "illegal tax shelters."³⁴ Undoubtedly, most of the KPMG clients sold one of these "basis-shifting" or similar tax shelters had no inkling that the "investment products" promulgated by their trusted advisors might be disallowed by the IRS, or worse, that the client-taxpayers might find themselves liable for interest and onerous penalties as a result.

NOT JUST "BEAN-COUNTERS" ANYMORE: DEVELOPING A CULTURE OF TAX SHELTER SALESMANSHIP WITHIN KPMG

In fact, KPMG went to great lengths to discredit or diminish any criticism leveled at the tax shelters it was selling. Elaborate sales techniques were used to create an allure of exclusivity and credibility around the products. For instance, KPMG professionals were told, in September of 1999, that:

[A] number of people are looking at doing BLIPS transactions to generate Y2K losses. We currently have bank capacity to have \$1 billion of loans outstanding at 12/31/99. This translates into approximately \$400 million of premium. This tranche will be implemented on a first-come, first-served basis until we fill capacity. Get your signed engagement letters in!³⁵

On July 14, 2000, a memorandum was sent to the "Tax Partners and Tax Management Group," from a senior KPMG tax professional, "strongly encourag[ing] full participation" in a KPMG tax product sales seminar entitled "Selling with Confidence: Skills for Successful Selling - Positioning."³⁶

KPMG also held extensive meetings for the purpose of overcoming client resistance to its tax products, such as the SC2. One KPMG document, entitled "SC2 — Sticking Points and Problems: Suggested Solutions," contained responses to common client

²⁷Senate Report, Ex. 11.

²⁸Senate Report, Ex. 11.

²⁹Id. (Emphasis added.)

³⁰Id. (Emphasis added.)

³¹Senate Report, p. 45.

³²Id.

³³2001-33 IRB 129, August 13, 2001.

³⁴See "Settlement Initiative for Section 302/318 Basis-Shifting Transactions," IRS Announcement 2002-97 (2002-43 IRB 757)(October 28, 2002).

³⁵Senate Report, Ex. 18.

³⁶Senate Report, Ex. 22.

objections, such as “Too Good to Be True,” “I need to think about it,” and the “John F. Brown Syndrome.”³⁷ Under the rubric of these techniques, KPMG personnel were told to adopt a “get-even approach . . . near estimated tax payment time when the shareholder is making or has made a large estimated tax payment and is extremely irritated for having done so.”³⁸ To counter the “John F. Brown Syndrome,” named “after an infamous attorney who could not get comfortable with anything about the strategy,” KPMG tax professionals were told to consider this approach in dealing with the client:

If we have dealt with this particular attorney before and we know he will not approve of the transaction, we should tell this to the client and either walk or convince the client not to use the attorney or law firm for this deal.³⁹

The Senate Report details the pressure put on KPMG offices to sell identified tax products.⁴⁰ To sell its tax products, the Senate Report concludes, KPMG abandoned its purported status as “a disinterested tax advisor,” in favor of “hard-sell tactics [such as] making misleading statements to their clients”⁴¹ and using tax “opinion letters as a marketing tool.”⁴² KPMG viewed legal opinion letters as a vital element in its sales strategy. So vital, in fact, that “in the case of FLIP, [KPMG] agreed to pay Sidley Austin Brown & Wood a fee in any sale where a prospective buyer was told that the law firm would provide a favorable tax opinion letter, *regardless of whether the opinion was actually provided.*”⁴³ One KPMG tax professional explained the KPMG/Brown & Wood business

arrangement as follows: “Our deal with Brown and Wood is that if their name is used in selling the strategy they will get a fee. We have decided as a firm that [a] B&W opinion should be given in all deals.”⁴⁴

SHELTER PURCHASERS LOOK TO COURTS, WHILE IRS LOOKS AT THEM

Between the detailed Senate Report and its accompanying 93 exhibits, the parade of court cases giving rise to judicial determinations about various aspects of KPMG’s sales of tax shelters to taxpayers,⁴⁵ and media exposés like the one that ran on Frontline, a disturbing portrait has emerged, based on substantial evidence, “that the development and sale of potentially abusive and illegal tax shelters [has] become a

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lucrative business in the United States, and professional organizations like major accounting firms,⁴⁶ banks, investment advisory firms, and law firms have become major developers and promoters [of them].⁴⁷ Not surprisingly, KPMG’s clients, taxpayers now facing IRS audits and actions against them, have turned to the

³⁷Senate Report, Ex. 21.

³⁸Id.

³⁹Id.

⁴⁰See, e.g., Senate Report, p. 51.

⁴¹In *Jacoboni v. KPMG*, 2004 WL 882041, p. *19 (M.D. Fla. 2004), for instance, the court reported that the plaintiff had “presented evidence that KPMG misrepresented its [FLIP] strategy to be ‘bullet-proof’ and presented assurances that KPMG was ‘on the hook’ if there ever was a problem with the IRS.”

⁴²Tax opinion letters are intended to “provide written advice explaining whether a particular tax product is permissible under the law and, if challenged by the IRS, the likelihood that the tax product would survive court scrutiny.” Senate Report, p. 60. Needless to say, tax opinion letters provided by someone (such as a law firm or KPMG) with a financial stake in the transaction at issue “ha[ve] traditionally been accorded less deference” as a taxpayer defense before the IRS or in a correlate court action. Id.

⁴³Senate Report, p. 61.

⁴⁴Declaration of Richard E. Bosch, IRS Revenue Agent, In re: John Doe Summons to Sidley Austin Brown & Wood (N.D. Ill., October 16, 2003), ¶18, citing an email dated October 1, 1997,

from Gregg Ritchie to Randall Hamilton. Exhibit 36 to the Senate Report is a July 20, 1999 KPMG email, which amplifies the fact that a close relationship existed between KPMG and Brown & Wood, insofar as tax product marketing was concerned; this email states: “If you have a KPMG [tax] opinion, you should also have a B&W opinion. We do ours and they use it as a factual template for their opinion, usually within 48 hours.” For a summary of the KPMG/Brown & Wood relationship in a particular case, see *Loftin v. KPMG*, 2003 WL 22225621 (S.D. Fla. 2003).

⁴⁵See, e.g., *Jacoboni*; *Loftin*; *Doe v. Wachovia*, 268 F.Supp.2d 627 (W.D.N.C. 2003); *United States v. KPMG*, 2004 WL 964953 (D.D.C. 2004).

⁴⁶Although this article has concentrated almost exclusively on KPMG’s tax shelter promotion, other major accounting firms, law firms and banks appear to have followed nearly identical tracks, marketing basis-shifting and other tax shelters to taxpayers. Many of these shelters have been subsequently disallowed or called into question by the IRS. See, e.g., *United States v. BDO Seidman*, 337 F.3d 802, 805 (2003) (involving IRS enforcement of summonses against accounting firm BDO Seidman for allegedly failing to disclose potentially abusive tax shelters it promoted).

⁴⁷Senate Report, p. 1.

court system, seeking redress for what taxpayer-plaintiffs contend is a fraud committed against them.

A CRUCIAL QUESTION IN TAX SHELTER LITIGATION: WHAT ARE THE DAMAGES?

Once litigation in *Jacoboni*, *Loftin*, and other actions commenced, one of the first questions that emerged related to damages and the scope of the remedial scheme available to the plaintiffs. To date, the litigation surrounding FLIP, OPIS, BLIPS, and related tax shelters has not produced a definitive damages framework for the plaintiffs. In dicta from the *Jacoboni* opinion,⁴⁸ the Magistrate Judge (in a portion of his Recommendation not adopted by the United States District Court Judge on review) made this observation: “The appropriate measure of damages payable to plaintiff (as opposed to the IRS), should plaintiff prevail, may well include reference to the tax liability actually incurred, although disputed issues of set-off and mitigation, including but not lim-

related to the negotiation settlements between the taxpayers and the IRS.⁵⁰

In *Jones I*, a case involving damages in a tax shelter situation, the court allowed the plaintiffs to recover the investment and management fees and costs associated with the tax shelter product they were sold; the *Jones II* Court affirmed on this point.⁵¹ The *Jones I* Court also alluded that, if it had been presented with proper proof, it would have allowed the plaintiffs to recover any “tax savings” they may have obtained through legitimate tax planning techniques (“[f]ailure to reduce [plaintiffs’] taxable income could be [a] compensable injury on the facts of this case”).⁵² However the *Jones* plaintiffs presented no such evidence, and so, the court declined “to speculate on the tax savings [the plaintiffs] might have enjoyed with competent financial advice.”⁵³ Likewise, it appears that taxpayer plaintiffs have ample support for the position that interest assessed against them, by the IRS, constitutes compensable damages.⁵⁴

PLAINTIFFS ARGUE THEY ARE DUE THE “BENEFIT OF THEIR BARGAIN”

One of the central remaining damage issues concerns the potential recovery of “benefit of the bargain damages.” In this context, “benefit of the bargain” damages means recovery of the difference between the purported “value” of the tax strategy sold by KPMG (and its cohorts) and the strategy’s true worth (as determined by the amount of deductions allowed by the IRS). The recoverability of benefit of the bargain damages finds some support in a Supreme Court case, *Randall v. Loftsgaarden*.⁵⁵ In *Loftsgaarden*, the court ruled that, when rescissionary damages are obtained under section 10(b) of the Securities and Exchange Act of 1934, no offset on the amount owed by a defendant to the defrauded investor is required for the amount of tax benefits received by the investor, while owning the security, even if the security was sold as a tax shelter.⁵⁶ By extension, the tax-

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ited to Plaintiff’s conduct and settlement with the IRS, remain to be resolved.”⁴⁹

The *Jacoboni* Magistrate Judge’s comments regarding recoverable damages in FLIP-type cases has not been tested by any reported court decision to date. However, it seems reasonable to assume that plaintiffs in these cases will be entitled to recover “out-of-pocket” damages from KPMG and other related defendants, such “out-of-pockets” including all transactional, investment, advisory fees and costs related to the formation and execution of the tax strategies, as well as the attorney and accounting fees

⁴⁸The present posture of the *Jacoboni* litigation is worth noting. There, in a recently published opinion, the *Jacoboni* Court reached the same ultimate conclusion as the courts in *Loftin* and *Swartz*, and dismissed the taxpayer plaintiffs’ RICO claims on grounds that they were barred by the federal Private Securities Litigation Reform Act (PSLRA), codified at 18 U.S.C.A. §§ 1962, 1964(c). *Jacoboni*, 2004 WL at *3-6; see also *Loftin*, 2003 WL at *4-7 and *Swartz*, slip op., p. 6. Once the federal RICO claim raised by plaintiff *Jacoboni* was dismissed, the court then declined to exercise supplemental jurisdiction pursuant to 28 U.S.C. § 1367, and dismissed the remaining state law claims without prejudice. *Jacoboni*, 2004 WL at *10. The case is being refiled in the Florida state court.

⁴⁹*Jacoboni*, 2004 WL at 19.

⁵⁰See *Jones v. Childers*, 1992 WL 300845 (M.D. Fla. 1992)(“*Jones I*”), aff’d in part, rev’d in part, 18 F.3d 899 (11th Cir. 1994)(“*Jones II*”).

⁵¹*Jones I*, 1992 WL at *23-24; *Jones II*, 18 F.3d at 915.

⁵²*Jones I*, 1992 WL at *23.

⁵³*Id.*

⁵⁴See *Jones I*, 1992 WL 300805 at *23-24; *Ronson v. Talesnick*, 33 F.Supp.2d 347, 354 (D.N.J. 1999)(taxpayer entitled to recover interest in accounting malpractice actions); *Jobe v. Int’l Ins. Co.*, 933 F. Supp. 844, 860 (D.Az. 1995).

⁵⁵478 U.S. 647, 106 S.Ct. 3143 (1986).

⁵⁶*Id.*, pp. 663-64; 106 S.Ct., p. 3153.

payer plaintiffs would argue, even if the IRS were to grant some portion of the improperly taken deductions through the shelters,⁵⁷ KPMG should not receive any correlate damage or mitigation offset because “it is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them.”⁵⁸

Under *Loftsgaarden’s* principles, plaintiffs, like Jacoboni, will undoubtedly argue that the amount of recoverable damages should be measured by the total amount the taxpayer had to pay the IRS due to the failed tax strategy promulgated by KPMG and its cohorts. This remedial theory must be distinguished from a taxpayer simply seeking to recover taxes paid to the IRS (which were owed anyway) - as opposed to the taxpayer seeking to recover the benefit of the bargain (the tax savings) promised by shelter promoters.

In the instance of Jacoboni, KPMG promised a tax strategy that would create \$30 million of tax losses to offset a similar-sized capital gain subject to federal taxation.⁵⁹ Hence, allowing benefit of the bargain damages would entitle the plaintiff to a sum equal to KPMG’s end of the bargain — in plaintiff Jacoboni’s instance, \$30 million.⁶⁰ The “benefit of the bargain remedy, a hallmark of contract law, functions to “place the plaintiff in the position he would [have been] in if the contract had been fulfilled.”⁶¹ Under this rule, the plaintiff would be “entitled to the loss of its bargain, similar to a recovery based on a warranty.”⁶² Applied to the FLIP, OPIS, and BLIPS line of cases, plaintiffs would argue that they paid tax shelter defendants for a product that would create losses to offset taxable capital gains, and they are, therefore, due to defendants fraud and breach of contract, entitled to damages approximating the amount of capital gains tax liability absent any tax strategy.

To date, the benefit of the bargain rule applied to these particular tax shelter facts has yet to occur. Undoubtedly, they will and will ultimately be reflected in future appellate decisions. At the trial level, though, courts will be presented with dueling argu-

ments: the benefit of the bargain theory in contract, which, if applied, would entitle plaintiffs to the value of the tax benefits they paid handsome fees to receive, or the defendant promoter’s alternative methodology, grounded primarily in tort, which would limit benefit of the bargain damages to only those necessary to restore the plaintiff to the position she occupied prior to the defendant’s tortious conduct. (So the argument goes: “she’d have had to pay the taxes anyway, even if we hadn’t sold the tax shelter”). This type of election, as between theories of recovery, has traditionally been the province of the plaintiff (the “master of her complaint), and it remains to be seen how the courts will address such thorny issues.

CONCLUSION

As the Senate Report makes manifest, there is an “important difference between selling a potentially abusive or illegal tax shelter and providing routine tax services.”⁶³ This distinction, while perhaps apparent to tax professionals, was not apparent to the many family business owners and entrepreneurs that bought tax products like FLIP, OPIS, BLIPS and SC2. These purchasers, such as the plaintiffs in *Jacoboni, Hupman, and Hughes*, allege they relied on the advice and direction of their “trusted advisors,” each of whom bears an outstanding professional pedigree, like KPMG, BDO Seidman, Brown & Wood and Wachovia Bank. To the taxpayer plaintiffs, the trust they placed in these financial advisors appears to have been misplaced.

Many in the U.S. tax profession now contend that “the worst tax shelter abuses are already over, so there is no need for investigations, reforms, or stronger laws.”⁶⁴ The burgeoning litigation between taxpayers and the shelter purveyors, and the findings of the Senate Report, point in the other direction. Not to mention the billions in lost revenue to the United States Treasury where it is left to “average U.S. taxpayers to make up the difference.”⁶⁵ ■

⁵⁷Under the IRS’ “Settlement Initiative for Section 302/318 Basis-Shifting Transactions,” IRS Announcement 2002-97, taxpayers in FLIP-type tax shelters were given an opportunity to settle their tax deficiency on relatively favorable, as opposed to potentially Draconian, terms - including an allowance by the IRS to the taxpayer of 20% of the benefit of the claimed “basis-shift.” KPMG has argued that the tax shelter plaintiffs’ damages should be reduced by the amount of any IRS concession allowing a portion of the tax savings to remain.

⁵⁸*Id.*, p. 663, 106 S.Ct., p. 3153.

⁵⁹Jacoboni, 2004 WL at *11-12.

⁶⁰See *Gregg v. U.S. Industries, Inc.*, 887 F.2d 1462, 1465 (11th Cir. 1989)(benefit of the bargain equals the “difference between what [the plaintiff] would have received had the agreement with [the defendant] been carried through to completion and what he actually received”).

⁶¹*Ashland Oil, Inc. v. Pickard*, 269 So.2d 714, 723 (Fla. 1972).

⁶²*Laney v. American Equity Investments*, 243 F.Supp.2d 1347, 1354 (M.D. Fla. 2003).

⁶³Senate Report, p. 2.

⁶⁴Senate Report, p. 3.

⁶⁵*Id.*