Refco Aided Grant Thornton in Illegal Tax Shelters (Update3)

Oct. 14 (Bloomberg) -- Two units of futures broker Refco Inc. helped the company's auditor, Grant Thornton LLP, provide clients with a tax shelter declared illegal by the IRS, two taxpayers claim in a lawsuit.

Joseph Stechler, 53, and his wife Gail claim in a suit in federal court in Newark, New Jersey, that Grant Thornton, their tax accountant, sold them a ``digital-options strategy'' developed by the Diversified Group International, or DGI, to create a paper loss for tax purposes. Refco, under investigation for securities fraud, processed the option transactions.

``The Refco defendants, with the assistance of DGI and the Grant Thornton defendants, advised and instructed the plaintiffs to buy and sell digital options on the Nasdaq 100 index and the exact amounts to be invested in each option,'' the Stechlers claimed in their June complaint.

Other clients have claims involving tax shelters in which Refco was a participant, said the Stechlers' attorney, David Deary, of the Dallas firm Deary Montgomery DeFeo & Canada LLP, who represents more than 20 claimants.

Refco is on the brink of collapse after disclosing on Oct. 10 that former Chief Executive Officer Phillip R. Bennett covered up $430 million in bad debts. Refco said today that it was shutting down its biggest unit, Refco Securities LLC.

Yesterday, Refco placed a 15-day moratorium on all business at its Refco Capital Markets Ltd. and hired Goldman Sachs Group Inc. as a financial adviser. Bennett was arrested and charged with securities fraud Oct. 12.

The Strategy

The strategy involved options that were intended to create assets with an artificially high tax basis, allowing their later sale to be treated as a loss, the taxpayers claim. Refco's role was to guarantee that the transactions resulted in no risk to the investors, the suit says.

The Refco units named in the suit are Refco Capital Markets Ltd. and Refco Capital LLC. Marcia Horowitz, an outside spokeswoman for Refco, didn't return a voicemail message seeking comment on the 2005 suit. DGI, which is in arbitration with the Stechlers over their claim, was not sued, Deary said.

``Like most of all the major accounting firms, we have been named in tax shelter suits,'' said Grant Thornton spokesman John Vita in a statement. Chicago-based Grant Thornton, the fifth- largest U.S. accounting firm by sales, is opposing the Stechlers' claims in court.

Tax Advice

The Stechlers, who live in Teaneck, New Jersey, and Jerusalem, consulted a Grant Thornton tax partner in 2000 after Joseph Stechler's company received ``large capital gains'' from stock sales that year, they said in their complaint. They claim the firm failed to warn them that the Internal Revenue Service had said that similar tax shelters were improper. Stechler is president of Stechler & Co., an Englewood, New Jersey-based investment firm.

The Stechlers' tax return was audited and they were forced to settle with the agency in 2004, paying the full tax plus a penalty, they claim. They seek the return of $1.5 million they say they paid in fees to Grant Thornton, DGI, Refco and others, including the Sidley Austin Brown & Wood law firm, plus unspecified damages. The complaint does not specify how much the full tax was.

In addition to the New Jersey case, there are suits in federal court in Chicago and Texarkana, Texas, which make similar claims against Refco on behalf of taxpayers. Grant Thornton is not a defendant in those suits.

$75 Million Settlement

Last year Deary was one of the lawyers who negotiated a $75 million settlement between a class of

1,100 taxpayers and the law firm Jenkens & Gilchrist, a Dallas firm that provided legal advice on tax shelters. Deary's firm represents at least 175 taxpayers with claims against accounting firms, banks and law firms, it claims on its web site.

In August, KPMG LLP, the fourth biggest accounting firm, agreed to pay $456 million to the government to avoid prosecution in connection with the firm's sale of tax shelters to 601 wealthy clients from 1996 to 2002. Eight former KPMG executives and a former Sidley Austin partner have been indicted.

The case is Stechler v. Sidley Austin Brown & Wood, 05-cv- 3485, U.S. District Court, District of New Jersey, (Newark)

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