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COLUMN ONE

## Snared by Their Shelters

*Thousands of wealthy Americans are paying dearly for questionable tax-avoidance schemes, and blaming the experts who proposed them.*

January 10, 2005 | Evan Halper | Times Staff Writer

As one of the state's top energy regulators, Michael Peevey is familiar with complicated schemes. Now he finds himself caught in one.

In the late 1990s, he started and sold his own energy company, came away with \$10 million in stock from its new owner -- a company called Applied Energy Systems -- and plenty of advice. At the advice of accountants, he put the proceeds into an investment plan that promised to shield his windfall from taxes and produce an additional \$1 million for a gift to UC Berkeley, his alma mater.

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"I was assured the transaction was low-risk and safe," recalled Peevey, now the president of the state's Public Utilities Commission.

A few years later, he and his wife, Assemblywoman Carol Liu (D-La Canada Flintridge), heard from the Internal Revenue Service. By the agency's accounting, the couple owed Uncle Sam \$2.36 million. The state would soon be demanding \$1.1 million on top of that.

Peevey is now suing his accounting firm, Arthur Andersen, for \$30 million. The firm, Peevey said, "let me down, and I think they took advantage of our long-standing relationship."

Tax evaders or victims, the La Canada Flintridge couple have landed in the middle of a national uproar over questionable tax shelters. Peevey and Liu are among thousands of wealthy Americans who used the sophisticated strategies to avoid paying billions of dollars in taxes.

Ordinary taxpayers are the ones harmed by this, says a former head of the Internal Revenue Service. "Everybody is paying 15% more than they should be to cover these free riders," said Charles Rossotti, who ran the IRS for five years until 2002.

Investigators say they are only now learning just how widespread the abuses are.

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In California, state officials began to crack down last year, figuring they could collect an additional \$90 million in back taxes. Regulators were stunned when they collected \$1.3 billion from 1,200 taxpayers.

### Los Angeles Times

And now, California tax officials have put 40 more auditors on shelter investigations to see just how far the trail leads.

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Federal agents, meanwhile, are sharing leads with investigators in California and other states on more than 28,000 taxpayers known to have used tax-avoidance schemes. One particular shelter that was mass-marketed to millionaires is believed to have cost the federal treasury \$6 billion.

Michael Peevey's tax turmoil began in the summer of 1999 at a meeting in downtown Los Angeles with several officials from Andersen.

Peevey was facing a \$3.5-million tax bill for his windfall and wanted advice on the best way to cash out his stock -- and make a gift to UC Berkeley. He said he wanted to accomplish this without paying the government more than necessary.

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The accountants told him he could pay next to nothing, he said. Their strategy was rooted in a tax law intended to promote gifts to charity.

The plan called for Peevey and Liu to set up a charitable trust in Georgia. Under the terms of the tax-free trust, the couple would swap Peevey's company shares for other stocks. Accomplishing it all added thousands of pages of documents to their return. Andersen's interpretation of the tax code suggested that this would ultimately erase the capital gains taxes owed by Peevey.

After two years, the trust would be dissolved, and profits from it would go to Berkeley. And the initial \$10-million investment would go back to Peevey and Liu, tax-free.

Months later, trouble began: Alarmed by trusts like the couple's, the IRS issued retroactive regulations prohibiting them. Now, taxpayers caught in the web of IRS and state tax investigations are scurrying to shift blame onto the partnerships that created the shelters.

Peevey, 66, said they were blindsided by their accountants.

"Arthur Andersen was one of the largest accounting firms in the world," Peevey recalled. "It had an excellent reputation and had represented me in conservative tax planning for roughly 15 years. I felt safe and secure."

At the time, Andersen was also the accountant for energy giant Enron. Andersen has since collapsed in the wake of the accounting scandal that led Enron into bankruptcy. Andersen does little now but handle the mountain of lawsuits following the collapse.

Andersen spokesman Patrick Dorton calls Peevey's lawsuit "an ill-advised attempt to protect his own and his wife's political futures."

Peevey's lawsuit is one of several filed by wealthy taxpayers nationwide against well-known accounting, law and banking firms, claiming they were duped into believing it was OK to skim millions off their returns. Tax attorneys predict they are the front end of a wave of hundreds of lawsuits that will be filed as more taxpayers are caught and forced to settle up.

"People are now having to pay the government, and they are extremely angry," said David Deary, a Texas attorney who represents 300 plaintiffs who are paying millions in back taxes and interest as part of a settlement with the IRS. Deary's clients typically paid hundreds of thousands of dollars to buy into the shelter plans.

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