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Wider Look at Tax Shelters Offered by Deutsche Bank

By LYNNLEY BROWNING
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A federal investigation of Deutsche Bank's role in questionable tax shelters has widened to include a broader array of shelters than previously known, according to people briefed on the inquiry.

Deutsche Bank, Germany's largest bank, has been under investigation as an outgrowth of the criminal inquiry into the accounting firm KPMG, but the investigation has recently widened to include the bank's links with other firms, and to include shelters not covered in the KPMG case, specifically shelters known as digital options. Digital options involve complex offsetting trades in foreign currency options to produce losses.

Deutsche Bank has been in talks with federal prosecutors in Manhattan over its tax shelter work. In August, KPMG reached a \$456 million deferred-prosecution agreement with prosecutors and admitted criminal wrongdoing over four types of shelters, some of them ones that Deutsche Bank worked on. A smaller German bank, HVB, has also settled with prosecutors. But Deutsche Bank's extensive role in the creation and sale of questionable tax shelters may complicate its negotiations.

Deutsche Bank declined to comment. The bank has said in the past that the transactions it arranged for tax shelters were regular and ordinary.

Prosecutors are examining how Deutsche Bank helped to make and sell a digital option shelter called Cobra to more than 1,100 wealthy investors around 1999 and 2000, say the people who have been briefed on the inquiry. They are also looking at the bank's similar role in making and selling a close cousin to Cobra known as Homer, named after "The Simpsons" television character, and sold through Bank One, and at a related shelter called M.L.D., for market-linked deposit.

J. P. Morgan Chase, which acquired Bank One, declined to comment.

Many aggressive tax shelters look alike, and over the late 1990's through recent years different promoters had various names for their own shelters, although they were typically updated versions of existing shelters.

Cobra, which stands for currency options bring reward alternatives; its close cousin Homer, for which stands for hedge option monetization of economic remainder; and M.L.D. are all regarded by the Internal Revenue Service as variations of a widely used abusive tax-avoidance strategy known as Son of Boss. The I.R.S. has never considered any Son of Boss shelter valid for deductions, and banned them by September 2000. Deutsche Bank has been accused in lawsuits of continuing to promote shelters that were variations of Son of Boss after that date.

Details about these shelters are outlined in internal documents that have emerged in civil litigation against Deutsche Bank that has been brought by wealthy investors who bought the questionable tax shelters.

David Deary, a lawyer in Dallas who has filed lawsuits against Deutsche Bank in Federal District Court in Manhattan and in a Texas state court, among others, on behalf of wealthy

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investors who bought digital options shelters, said that "Deutsche Bank was the driving force behind every tax strategy that involved digital options, and without Deutsche Bank, none of these tax shelters could have been sold and implemented."

One internal document that has emerged is an October 2001 PowerPoint presentation of Homer that outlines the steps that Deutsche Bank and the law firms of White & Case and Jenkens & Gilchrist took to put the shelter together for individual clients. The eight-page document breaks down the shelter into nine sequential stages, each containing multiple steps such as "pretrade" document creation, "options to trust" and "partnership liquidation." The names of Deutsche Bank or the two law firms appear next to the steps.

The document indicates that the core workings of Homer revolved around Deutsche Bank's arranging trades and loans that were preordained to lose money. The I.R.S. considers such transactions to be a hallmark of an abusive tax shelter. The document also describes how Deutsche Bank transferred the losses between trusts and partnerships, to generate artificial losses. Over all, the document depicts, through a maze of boxes and arrows, how Deutsche Bank worked side by side with White & Case and Jenkens & Gilchrist to carry out the shelter.


Jenkins & Gilchrist provided legal opinion letters blessing many of the digital options shelters. Three current or former lawyers of Jenkins are under scrutiny by investigators. Jenkins & Gilchrist declined to comment.

A spokesman for White & Case said that the firm "has not and does not prepare tax shelter strategies."

Like Cobra and M.L.D., Homer used artificially generated losses to offset legitimate gains, but it channeled the losses through tax-exempt personal trusts set up for that purpose. Deutsche Bank engineered the losses through trades in options that were designed to lose money.

Signs that prosecutors are looking at these shelters can be seen in a February letter from prosecutors to Larry Jacobs, a tax lawyer who represents investors who bought digital options shelters in a lawsuit brought in Texas state court in Houston. The letter, included in the court docket, refers to White & Case and to the former Bank One as "entities which were involved with the tax shelter transactions at issue in the pending criminal investigation." Prosecutors sent Mr. Jacobs the letter asking him to postpone his civil lawsuit, which was scheduled to go to trial in September, saying that the proceeding could interfere with the continuing criminal investigation.

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