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Tech Company Settled Tax Case Without an Audit

By DAVID CAY JOHNSTON

Remy Welling is a senior auditor for the Internal Revenue Service with 22 years' experience. But when she was handed the file on a company suspected of underpaying its taxes, it contained something she had never seen before in such a case: an agreement to close the audit before it had even begun.

Instead of being given tax returns to examine, Ms. Welling was asked to sign off on a secret deal worked out by other officials at the I.R.S. The deal, she ultimately calculated, would allow a Silicon Valley company and its top executives to escape at least \$51 million in additional taxes that she was convinced they should have paid.

Moreover, the agreement required the I.R.S. to cooperate with the company, a relatively small semiconductor maker named [Micrel](#), in keeping its shareholders uninformed on some basic terms of its stock-option plan, which Ms. Welling said enriched the four top executives by as much as \$20 million in total.

For I.R.S. agents, nothing is more sacred than the privacy of a tax return. Revealing information about an audit can open an agent to criminal prosecution.

But Ms. Welling has decided to discuss what happened to her in this case, she said in an interview, because she believes that it represents a particularly striking example of how outside influence and internal obsequiousness is corrupting the integrity of the tax system.

She is willing to risk going to jail, Ms. Welling said, to bring the issue to public attention.

"Someone has to tell the public about what is going on inside the I.R.S.," Ms. Welling said, adding that she is about to be fired for going outside the agency by taking her complaint to the F.B.I. and the Securities and Exchange Commission.

I.R.S. officials, citing privacy concerns, declined to discuss any aspects of Ms. Welling's case or the agreement with Micrel Inc. of San Jose, Calif., which had revenue last year of \$241 million.

But their handling of the case suggests that they believe that Ms. Welling has overreacted. And they insist that I.R.S. procedures have been carefully constructed to protect the corporate tax collection process against misconduct.

"It is essential that we maintain the independence and integrity of the audit process," Mark W. Everson, the I.R.S. commissioner, said. "The I.R.S. has long-established standards and safeguards designed to ensure that there is no undue influence over decisions by our enforcement personnel."

Micrel's case, Ms. Welling contends, raises questions about those safeguards. The stock-option matter came to the attention of the tax agency early in 2002, when it was approached by a former top I.R.S. official, James Casimir, who represented Micrel as a partner at PricewaterhouseCoopers, the accounting firm.

Mr. Casimir, without disclosing initially whom he represented, sought help in avoiding a big tax bill that Micrel had discovered it owed because it ran its stock-option plan for several years in violation of the law.

The company, in court papers later that provided figures never reported to shareholders in official filings, estimated that its extra tax bill could have been even larger than Ms. Welling calculated - as much as \$58 million, of which \$14 million would be an immediate cash drain.

Stock options provide the right to buy company shares profitably at a later date at a predetermined price. To take advantage of favorable tax and accounting rules, companies are required to set the price to employees at a level no lower than the value of the stock on the day the grant is made.

Micrel's plan, however, let employees select the lowest price for the stock within 30 days, a position that made the options potentially more valuable.

Mr. Casimir, along with a lawyer working for Micrel, asked the I.R.S. to give the company and its employees relief from taxes owed and additional interest because Micrel was prepared to disclose voluntarily what it considered an unintentional mistake that had been approved by its accounting firm. Tax law includes a provision allowing companies to seek such relief, but it is typically invoked only for minor flaws like typographical errors. In most cases when companies come forward, they avoid penalties but are required to pay additional taxes.

I.R.S. lawyers, without knowing the company's identity, agreed to provide relief. Then they learned the company's name and upon checking found that Micrel had already been selected for audit on a different matter. The agreement was sent to the auditing division.

The Micrel audit - which was supposed to focus on how the company accounted for an acquisition - began in November 2002, when Ms. Welling was called into the San Jose office of her supervisor, Ron

Yokoo, and handed the Micrel file.

"Usually, they just give you the tax returns to be examined," she said, "but sometimes there is a memo about looking into specific issues that have been identified. There were no tax returns in the file, and I was told they were not available."

But then she noticed a two-page document in the file titled "Department of the Treasury-Internal Revenue Service closing agreement on final determination covering specific issues."

Ms. Welling said she protested that the closing agreement, which would have settled the stock-option matter, could be considered only after Micrel's full tax returns had been examined.

"An auditor cannot sign off on an agreement closing an audit before the audit," she said. "That's just not legal, not proper."

An article about Ms. Welling is scheduled to appear today in the electronic version of Tax Notes, a trade magazine, at www.taxanalysts.com.

Ms. Welling said she did some research and found a directive from Larry Langdon, who was then the I.R.S. commissioner for large and medium-size businesses. It stated that no closing agreement could be signed in cases where taxpayers were seeking a refund of more than \$2 million until the staff of a Congressional tax committee had been consulted.

"That Langdon memo bought me a few more days of delay," Ms. Welling said. "But the pressure and harassment to sign off kept increasing."

In response to further pressure to sign off on the audit, Ms. Welling, 50, complained all the way up the chain of command to Mr. Everson, the I.R.S. commissioner. She contended that Mr. Casimir was wielding undue influence over the agency's decision making.

An e-mail trail shows that an aide to Mr. Everson read the complaint but evidently never informed Mr. Everson, who said he was unaware of it. A similar complaint to the Treasury Department's inspector general was also closed with no action, other than the complaint being shown to the same bosses she had accused of misconduct. The inspector general inadvertently disclosed Micrel's name. Ms. Welling also complained to the staff of Senator Charles E. Grassley, Republican of Iowa, the chairman of the Senate Finance Committee.

Frustrated by her failure to change what she considered an illegal decision, Ms. Welling went to the F.B.I. In memos at the time, Ms. Welling wrote that Mr. Yokoo told her that she had no choice but to sign off on the Micrel closing agreement and that resistance would be futile.

She wrote that Mr. Yokoo told her: "We better give Jim Casimir what he wants. He won't stop at

anything."

Mr. Yokoo did not respond to requests for comment.

Mr. Casimir, who was the I.R.S.'s national director for appeals before he retired in 2000, is one of many former senior tax agency officials who later took jobs with major accounting and legal firms representing clients before the I.R.S. But in contrast to the practice at other government agencies, such "revolving door" situations are not closely monitored at the I.R.S. or well known outside it because all audits, by law, are handled in secret.

In one e-mail message to an I.R.S. official, Mr. Casimir wrote that "I was amazed how quickly" his request for favored treatment for Micrel had moved through most of the bureaucracy.

Mr. Casimir, asked about Ms. Welling's contentions that he wielded undue influence inside the agency on behalf of Micrel and other clients, laughed them off.

"Isn't that nice," he replied sardonically. "I wish it were so."

Mr. Everson, the I.R.S. commissioner, said the agency made no attempt to track contacts by its former executives on behalf of clients. He said he would oppose any such tracking as interfering with their rights.

In response to inquiries, Micrel executives set a date for an interview, then canceled it and said they would have no comment. The company said yesterday that it would not comment on what it considered confidential matters.

Tax officials acknowledged that I.R.S. procedures require that closing agreements come after an audit, not before. But later, in a written statement, the I.R.S. said, "There are situations where the timing and use of closing agreements can vary."

Mr. Langdon, who retired last year, said in an interview that any I.R.S. agent asked to sign a closing agreement before an audit should complain. He also said that he and his deputy, Deborah Nolan, who succeeded him, had developed a procedure for employees to take complaints up the chain of command, as Ms. Welling did.

When no one acted on the complaints, or took the time to explain to Ms. Welling why they might not have merit, Mr. Langdon said it was appropriate for her "to become suspicious" about the integrity of the audit process.

This is only the third time in a decade that details of a corporate audit have become known, all of them in cases where longtime I.R.S. auditors said they found extensive tax evasion.

In all three cases, the auditors were overruled after meetings between senior I.R.S. officials and former officials of the agency who had gone to work at accounting and law firms. The other cases involved two big oil companies, [ChevronTexaco](#) and [Unocal](#). Each company said it filed correct tax returns, though ChevronTexaco paid \$675 million to settle its dispute

In Micrel's case, Ms. Welling concluded after she got the returns through a routine request to the recordkeeping department that \$51 million was owed for just three years because of the flawed stock options.

Micrel, according to papers it filed in a lawsuit against its former auditors, adopted the methodology because of complaints from newly hired employees that sharp rises and drops in its stock price created unfairness among the staff.

Starting in 1996, the company issued 9.2 million options using this technique, a letter written by one of its lawyers says.

Micrel has never told stockholders exactly why its stock-option plan was flawed. Early in 2002, it disclosed in general terms a problem with its option program that caused it to restate its earnings from 1998 through 2001, lowering reported profits by \$12.9 million, or nearly 10 percent. Micrel shares closed yesterday at \$9.48, down from about \$25 when it disclosed the problem.

"The company has no intention," a Micrel lawyer wrote to the I.R.S., requesting the closing agreement, "of making any such agreement publicly available."

Micrel is suing its former accountants, Deloitte & Touche, over the matter. According to the lawsuit, Micrel "became aware" of the 30-day pricing idea in 1996, asked Deloitte about it, and won approval from the accounting firm to use the technique.

Micrel, in the court papers, said Deloitte assigned it a new partner in December 2001, who said he had discovered that the plan was improper six months earlier while helping on an acquisition for the company.

Micrel then fired Deloitte, saying it gave bad advice in 1996 and should have revoked its approval as soon as it discovered the flaw.

Deloitte has denied any wrongdoing in its filings. It declined to comment.