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Rubber Stamps

How Lawyers Helped Drive The Boom in Tax Shelters

**R.J. Ruble Blessed Products
From KPMG the IRS Says
He Had Role in Developing**

Rich Trade in Opinion Letters

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Theodore Swartz faced a huge tax bill in 1999 after selling his tour business. So the Seattle businessman was interested when KPMG LLP proposed setting up an offshore entity that would create losses to offset some income without actually risking a penny, according to a suit he later filed.


To clinch the deal, the accounting firm said lawyers from Brown & Wood in New York would review the tax shelter and write a letter saying it would likely pass muster with the Internal Revenue Service. Taxpayers use such "opinion letters" if the IRS challenges their returns to show they relied on impartial legal advice, and perhaps head off stiff fines.

"KPMG said, 'Don't just trust us, trust this big law firm that will give you independent advice,' " says Duncan Turner, Mr. Swartz's lawyer. Mr. Swartz paid KPMG \$250,000 to shelter \$18 million in gains.

But there was a problem. The Brown & Wood lawyer who signed the letter, Raymond J. "R.J." Ruble, had helped KPMG develop and market the same tax shelter he blessed as a supposedly independent authority, according to the IRS, Senate investigators and e-mails they obtained from Mr. Ruble and KPMG. That rendered Mr. Ruble's letter useless to Mr. Swartz when the IRS declared the tax shelter improper in 2000.

The proliferation of tax shelters during the 1990s boom cost the U.S. Treasury tens of billions of dollars. Much of the blame has fallen on accounting and tax-advice firms. Mr. Ruble's story shows that lawyers also helped drive the tax-shelter boom amid the big-money ventures that defined the decade. The IRS has proposed tightening rules relating to opinion letters, but Sen. Carl Levin, a Michigan Democrat who has led an investigation of shelters, argues that Mr. Ruble's case shows the proposal doesn't go far enough.

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Senate Permanent Subcommittee on Investigations

Tax lawyer Raymond J. Ruble invoked his Fifth Amendment rights and declined to testify before a Senate subcommittee investigating tax shelters.

Tax lawyers are supposed to offer clients arm's-length assessments of whether the IRS would likely accept losses generated by shelters created by other tax experts. In the 1990s, some lawyers became more active in the process, churning out cookie-cutter letters attesting to the legitimacy of shelters they worked on.

Mr. Ruble signed hundreds of letters for about a dozen different shelters -- three for KPMG -- generating tens of millions of dollars in fees. His law firm, which in a 2001 merger became part of Sidley Austin Brown & Wood, fired him last October, accusing him of violating the firm's partnership agreement.

A federal grand jury in New York and the IRS are now investigating KPMG and its dealings with Mr. Ruble and his former law firm. The IRS also is trying to recoup taxes it says were illegally avoided via shelters they worked on. Mr. Swartz and at least five other individuals are suing Mr. Ruble, his former law firm, KPMG and others, alleging they were misled into buying tax shelters that have since been rejected by the IRS.

Called before the Senate Permanent Subcommittee on Investigations in November, Mr. Ruble invoked his rights under the Fifth Amendment to avoid testifying. Through his attorney, Jack Hoffinger, Mr. Ruble declined to comment for this story. Mr. Hoffinger says the opinion letters were written "in good faith." He adds: "Both R.J. and his firm understood that these opinion letters were valid. The IRS doesn't always agree with tax opinions, but that doesn't make the opinions invalid."

In a written statement, the law firm says it stands behind the substance of the opinion letters. However, during the Senate hearings, Tom Smith, a managing partner before the merger, said the firm had no role in promoting the tax shelters. He called Mr. Ruble "a lone wolf" and "a rogue partner." A spokesman for KPMG says the firm "has taken strong measures to reorganize and restructure its tax practice." He adds, "Simply put, we are not doing today what we did years ago."

Mr. Ruble, 59 years old, doesn't fit the stereotype of a tax lawyer, colleagues say, in part because of his youthful demeanor and affability. He grew up in Beacon, N.Y., about 75 miles north of New York City, and now lives in Glen Cove, Long Island, with his wife and two children.

After graduating from the University of North Carolina at Chapel Hill, Mr. Ruble took out loans and worked part time to pay for law school at New York University. In 1993, after having spent much of his career advising corporations on international tax codes, he joined Brown & Wood, a firm with strong ties to Wall Street, as a partner. Soon, he began specializing in tax shelters for individual clients.

Shelters have long been used to offset taxable income. They're acceptable to the IRS if the activity that generates the losses has a real economic purpose, such as an investment that could produce a gain. The most recent crop employed complex financial transactions such as currency trades through offshore partnerships and was promoted by sophisticated marketing machines. The IRS has called many of these shelters "abusive," or improper, because they didn't appear to do anything other than generate fake losses for tax

purposes.

KPMG was at the forefront of the tax-shelter business, employing a dozen people to develop shelters. It also ran a telemarketing center that pitched shelters to wealthy individuals. In 1997, Mr. Ruble and KPMG discussed a business relationship.

"This morning," Mr. Ruble wrote in a December 1997 e-mail to KPMG partner Randall Bickham, "my managing partner, Tom Smith, approved Brown & Wood LLP working with the newly conformed tax products group at KPMG on a joint basis in which we would jointly develop and market tax products and jointly share in the fees, as you and I have discussed."

Mr. Bickham reiterated that sentiment in a December 1997 memo to a colleague: "The primary objective of the alliance between KPMG and Brown & Wood should be to build a mutually successful business based upon products that are jointly developed."

Mr. Ruble's attorney, Mr. Hoffinger, declined to comment on this and other e-mails made public by the Senate. Mr. Bickham, who no longer works for KPMG, didn't return numerous calls seeking comment. A woman who answered his home phone without identifying herself said Mr. Bickham was "not interested" in commenting.

Mr. Smith, the Brown & Wood managing partner, told the Senate subcommittee he didn't approve such an arrangement and says that the firm didn't sign an agreement with KPMG. Mr. Ruble wasn't supposed to be "involved in the design of these products," Mr. Smith testified. "It was our understanding that there was absolutely no efforts on our part to market or promote those products."

Mr. Smith's description of the process, however, indicates there's no clear line between giving advice and being actively involved in developing a shelter. "I guess if he saw something there to improve the product, he might have passed that on," Mr. Smith testified.

In early 1998, KPMG set up a "working group" that included some of its partners, Mr. Ruble and two former KPMG executives who ran an investment-advice firm called Presidio Advisors, according to KPMG e-mails. The team developed a tax shelter known as the Offshore Portfolio Investment Strategy, an IRS agent said in a filing in federal court in Chicago related to the agency's investigation. Presidio's two partners didn't return calls for comment. One of them told the Senate they believed there was a chance buyers of their shelters could earn a profit.

Clients paid KPMG a fee that was often based on the size of the tax-deductible loss generated by the shelter. Senate investigators say that's evidence the transactions had no purpose other than avoiding taxes. KPMG then paid Mr. Ruble's law firm a fee of about \$50,000 for each opinion letter. "We have decided as a firm that [a] B&W opinion should be given in all deals," a KPMG partner

RAINMAKER		
Raymond J. Ruble's law firm, Brown & Wood (later merged with Sidley Austin), earned big fees on opinion letters backing KPMG tax shelters later rejected by the IRS.		
SHELTER NAME	FEES (MILLIONS)	NO. OF OPINIONS WRITTEN
BLIPS	\$13.2	180
OPIS	\$6.4	72
FLIPS	\$3.4	62

Note: Fee figures are estimates
Source: Sidley Austin Brown & Wood

wrote in an e-mail to a colleague.

Moreover, it wasn't easy for a client to seek advice from anyone other than Mr. Ruble's firm. According to a suit filed by members of the Thorpe family, of Rocky Mount, N.C., KPMG "barred plaintiffs from seeking independent tax advice" on the ground that the shelters were valuable and proprietary. Some plaintiffs say they were required to sign confidentiality agreements; the Thorpes say they were told the deal would be off if they disclosed details to anyone. KPMG said Brown & Wood would attest to the legal details and would "protect the plaintiffs," according to the Thorpes' suit against KPMG, Brown & Wood and Presidio. The suit is awaiting trial in North Carolina state court. KPMG declined to comment on the suit.

The Thorpe family, which made a fortune in tobacco and owned an investment company, was sold an Offshore Portfolio Investment Strategy shelter that KPMG promised "worked" under IRS rules, according to their suit. Mr. Ruble's letter "was the centerpiece of the whole deal," says James Gilreath, the Thorpes' lawyer.

Some in the working group considered the OPIS shelter aggressive. The IRS requires accounting firms to register shelters that might be considered improper based on its past directives. Mr. Ruble and KPMG scheduled a meeting on March 4, 1998, to discuss whether the shelter should be registered. A KPMG employee's notes from that day indicated, without attribution, that Brown & Wood thought OPIS "must" be registered because the "risk is too high." The shelter wasn't registered, according to the IRS, and both KPMG and the law firm declined to say why.

Mr. Ruble issued opinion letters on 72 OPIS transactions. Investigators say they were written in close cooperation with KPMG. "If you have a KPMG opinion, you should also have a B&W opinion; we do ours, and they use it as a factual template," a KPMG partner wrote in an e-mail to a colleague who was marketing the shelter.

The IRS formally announced in August 2001 that "tax benefits purportedly generated by [transactions such as OPIS] are not properly allowable."

As for Mr. Ruble's opinion letters, federal Judge Thomas Hogan wrote that "there is little indication that these are independent opinion letters that reflect any sort of legal analysis, reasoned or otherwise." He added, "In fact, [they] appear to be nothing more than an orchestrated extension of KPMG's marketing machine." The judge's comments were part of a ruling in May approving an IRS demand for documents from KPMG.

Mr. Ruble's shelter practice earned his firm millions of dollars in 1998 and he had become a central player in the industry, introducing shelter experts to each other. "I'm beginning to feel like a dating service," Mr. Ruble joked to Mr. Bickham in an e-mail.

That industrywide recognition helped Mr. Ruble extend his tax-shelter business beyond KPMG. A shelter known as the Option Partnership Strategy, for example, arose out of an early 1998 conversation with a Price Waterhouse LLP accounting partner, Mr. Ruble said in an affidavit filed in an unrelated suit against another lawyer. Brown & Wood issued at least 116 opinion letters blessing the OPS shelter, the IRS says in court documents. The tax agency later announced that OPS was "substantially similar" to other improper shelters, a signal that the IRS would disallow losses stemming from it.

A spokeswoman for what is now PricewaterhouseCoopers LLC says the firm has settled with the IRS without admitting or denying wrongdoing and no longer sells tax shelters.

Mr. Ruble then cut a lucrative deal. A trust he controlled "developed" a shelter that came to be known as custom adjustable rate debt structure, or CARDS, according to a marketing agreement Mr. Ruble signed with Chenery Investments, a San Francisco firm. Under the agreement, the Ruble trust got 20% of the fees generated by the shelter. Mr. Ruble's law firm says he didn't inform his partners of the deal with Chenery.

Brown & Wood was paid separately for favorable letters, which were based on a "canned" fill-in-the-blank opinions crafted by Mr. Ruble, according to a suit that a CARDS buyer, IAL Aircraft Holding Inc., filed in federal bankruptcy court in Miami. The suit said Brown & Wood collected \$500,000 on the CARDS sale to just this buyer. Mr. Ruble's attorney declined to comment on the CARDS transactions or Mr. Ruble's trust. A Chenery employee referred calls to an outside attorney, who didn't return calls seeking comment.

At the same time, Mr. Ruble continued working with KPMG, which was anxious to build on its success with OPIS. "The strategy is to co-develop products with ... Brown & Wood," KPMG's Mr. Bickham told a colleague in an August 1998 memo. "The respective participants [have] agreed to commit the resources to participate in our internal product development group as well as to become active participants in the marketing process."

By early 1999, it had become hard to say who was creating the shelter and who was drafting the opinion letter approving it. As Mr. Ruble and KPMG discussed a new shelter -- the Bond Link Issue Premium Structure, or BLIPS -- Mr. Bickham said in an e-mail that he and Mr. Ruble had decided "that we should first draft the base of an opinion letter ... before getting everyone together" to work out the details.

Some KPMG partners feared BLIPS wouldn't pass IRS scrutiny. "I feel it is important to again note that I and several other partners remain skeptical" that the IRS would allow losses associated with it, wrote Mark Watson, a partner in the firm's Washington tax review group, in an e-mail.

Both the accounting firm and Mr. Ruble's firm nonetheless issued letters blessing BLIPS. They compared drafts "to make sure we each cover everything the other has," Mr. Ruble said in a September 1999 e-mail to Mr. Bickham and another KPMG partner. As a result, KPMG and Brown & Wood issued letters with numerous nearly identical paragraphs.

KPMG eventually sold BLIPS shelters to 186 taxpayers, including Mr. Swartz, the tour operator, and collected more than \$50 million in fees, Senate investigators say. Mr. Ruble signed 180 BLIPS letters and Brown & Wood collected \$13.2 million in fees. The IRS now says BLIPS is also "substantially similar" to other improper shelters.

In all, Mr. Ruble's shop issued more than 600 favorable opinion letters on 13 different shelters now under IRS scrutiny, Mr. Smith, Brown & Wood's managing partner, told the Senate. The three KPMG shelters -- OPIS, BLIPS and one other -- generated \$23.1 million in fees from 314 letters, making Mr. Ruble one of the firm's top five revenue generators, according to a partner. Mr. Ruble's friends say he lived an inconspicuous lifestyle, wearing modest suits and driving a 1993 Subaru even though he was earning more than \$750,000 a year, not including income from his CARDS agreement.

As the IRS started paying more attention to shelters in 1999, Mr. Ruble's Brown & Wood colleagues began worrying about his opinion-letter-writing practice. The firm started requiring that a second lawyer review shelter transactions before issuing a favorable opinion. In 2000, as the IRS's clampdown on shelters was tightening, the head of Brown & Wood's tax practice suggested the firm get out of the individual shelter business, according to someone familiar with the matter.

It didn't do that until mid-2001. In merger talks with Chicago-based Sidley & Austin, the two law firms agreed not to write shelter opinions for individuals, Mr. Smith testified.

When Mr. Ruble submitted his billing records at the end of 2001, the law firm discovered he was still signing opinion letters, Mr. Smith testified. Asked why, Mr. Ruble told Mr. Smith the deals had been inked before the merger, Mr. Smith said.

At about the same time, the IRS offered amnesty to anyone who would admit using improper shelters and identify the promoters. Eighty taxpayers pointed to Mr. Ruble's firm, according to IRS court filings. The IRS began striking down shelters he worked on and clients started filing lawsuits.

As Brown & Wood prepared last October to defend itself against a series of civil suits, it discovered a deposition in which a Chenery executive described Mr. Ruble's CARDS agreement. That was the first time the partners learned Mr. Ruble was making money on the side, according to a letter written by Sidley Austin to the IRS. A partner confronted Mr. Ruble. He refused to discuss the matter and offered to resign, three people familiar with the matter say.

On the night of Oct. 23, 2003, the law firm's executive committee met by conference call and decided to expel Mr. Ruble from the partnership "for breaches of fiduciary duty and violations of the partnership agreement," as the firm described it in a press release. "The expulsion in no way relates to the substance of opinions at issue in current litigation," the release said.

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