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KPMG settles big tax shelter case before trial

AMOUNT IS CONFIDENTIAL, but investors who sought $500M are 'very pleased'

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ACCOUNTING GIANT KPMG and investors seeking nearly $500 million in damages caused by the firm's fraudulent tax shelters settled a suit a week before it was to be tried in Fulton County State Court.

The case was one of the last—and largest—Georgia outgrowths from KPMG's admission in 2005 that it sold the bad shelters—and paid the U.S. Department of Justice hundreds of millions of dollars to avoid criminal charges.

The amount of the settlement is confidential, but James Butler Jr. of Butler, Wooten & Fryhofer said his client, who was seeking more than $281 million in damages and more than $200 million in the lost value of the company he claimed KPMG enticed him into selling, "is very pleased with the settlement."

"It's the most difficult, most challenging case—and the most fun I've had—in 36 years of practicing law," said Butler, who's had a hand in many major verdicts.

Butler's co-counsel, Bondurant Mixson & Elmore partner H. Lamar "Mickey" Mixson, said his firm and Butler Wooten had worked together years earlier on an unrelated case, *Six Flags v. Time Warner*, which resulted in a $454 million verdict. Mixson said he was pleased when Butler asked him to assist in representing the KPMG plaintiffs, Christopher and Angelina Cohan, who formerly owned the Golden State Warriors basketball team.

"We got such good result in the Six Flags case, it was like the Dream Team got together again," said Mixson, whose firm has represented other plaintiffs suing KPMG over the ill-fated tax shelters.

"The other cases were probably, in the aggregate, more like $100 million, $120 million," Mixson said. "They were mostly in Fulton State Court, too. All of the other cases also settled, ironically enough, shortly before trial."

King & Spalding partner L. Joseph Loveland, one of a team of lawyers representing KPMG, referred inquiries to his client. KPMG spokesman Tim Connolly said there would be no comment.

The just-concluded case began in 1996, when plaintiff Christopher Cohan began seeking buyers for his California company, Sonic Cable TV. KPMG had handled Cohan's accounting affairs for several years, and Max Gray, one of its partners who had retired that year, remained a "close and trusted adviser and attorney" to Cohan, the plaintiffs said.

James Butler

Reaching out through Gray, KPMG advised Cohan that it could save him tens of millions of dollars in taxes on the $200 million sale of Sonic through a complex "integrated shareholder-corporate transaction" strategy. That was a tax product KPMG marketed to dozens of high net worth clients between 1996 and 2002 that it later admitted were fraudulent.

"KPMG explicitly represented that its 'tax products' were entirely legitimate, and that it could structure such a sale to minimize Cohan's tax liability in a way that was legal and would work," the plaintiffs' portion of the pretrial order said.

The deal closed in 1998, with KPMG "orchestrat[ing] the entire tax strategy for the Sonic transaction," the order said. "KPMG then prepared, signed, and induced Plaintiffs to sign and file Plaintiffs' tax returns for 1998… . KPMG also prepared and signed a fraudulent tax return for Sonic."

KPMG netted $24 million for its efforts in putting together the deal, according to the complaint in the case.

In 2002, the Internal Revenue Service warned KPMG that several of its tax shelters were fraudulent. But KPMG did not tell Cohan that the IRS had identified its tax products as fraudulent, according to his filings.

"Even five years after the Sonic transaction, KPMG was emphatically telling Cohan's lawyers (who were defending him against the IRS) the tax strategies were entirely legitimate," the pre-trial order said.

In 2005, KPMG entered into a deferred prosecution agreement with the Department of Justice, paying $456 million in fines, restitution and penalties to avoid criminal prosecution. The same year, the IRS issued notices of deficiency to the Cohans and a family trust.

By the time the IRS had finished investigating the Cohans and litigating its claims in 2010, the family had paid more than $281.8 million in taxes, penalties, fees and interest, according to the plaintiffs' portion of the order.

The "actual out-of-pocket loss" to the Cohans exceeded the $200 million they made on the Sonic sale.

The Cohans also blamed KPMG for coaxing then into selling Sonic, although their own filings acknowledge that Christopher Cohan had hired a firm to sound out potential buyers for the company two years before it was sold.

"Because they accepted and followed KPMG's advice, [the Cohans] also lost Sonic—their business that was generating over $20 million per year cash flow in the 1990s," the plaintiffs' account said. "If KPMG had told the truth and not committed this misconduct, plaintiffs never would have sold Sonic."

Using cable industry data to "conservatively" estimate Sonic's value and the loss to the Cohans from its sale, they added another $218 million in damages.

In January 2012, Butler and firm colleagues George Fryhofer III and John Morrison III, along with a team of Bondurant Mixson lawyers including Mixson, Lisa Strauss, John Rains IV, Tiana Mykkeltvedt and Manoj Varghese, filed suit in Fulton State Court. They accused KPMG of breach of contract, fraud, negligent misrepresentation, breach of fiduciary duty, accountant professional negligence and violation of Georgia's racketeering statute. The racketeering claim was dismissed on summary judgment.

KPMG was represented by a team of King & Spalding lawyers including Loveland and John Brumbaugh, Robert Stonebraker and E. Claire Carothers of the Atlanta office, and Patricia Maher, Kevin Dinan and Timothy Sullivan of its Washington branch.

KPMG's response pleadings concede that the shelters it recommended to the Cohans were "improper and illegal," but denied that the Cohans had been damaged by their use.

Christopher Cohan, according to the defense portion of the order, was looking for a tax shelter as he sought to sell Sonic before ever meeting with KPMG, in order to provide funding for his Golden State Warriors NBA basketball team. Cohan, it said, "was already committed to selling their company and doing so utilizing a similar tax strategy that, ultimately, would be determined to be improper and illegal."

"KPMG also denies that Plaintiff reasonably relied on advice from KPMG, and the opinions of KPMG and others that it was 'more likely than not' that the tax strategies would be allowed by the IRS. ... Plaintiff Christopher Cohan is a sophisticated investor who had utilized tax strategies before, including the 1989 sale of Sonic's Alaska properties, and understood the risk that using such strategies would not withstand scrutiny if audited by the IRS or California authorities."

KPMG also argued that, although the Cohans had been forced to pay hundreds of millions in taxes, fines and penalties, they still saved on the strategies and benefited from the delay in paying the IRS.

"Plaintiffs ultimately settled their tax liability for $55 million less than they would have paid in taxes without using the tax strategies," the defense portion of the order said. "In addition, Plaintiffs had the use of approximately $135 million in money that should have been paid in taxes in 1998 for more than a decade, and Plaintiffs have therefore not shown that the payment of interest and penalties actually produced any loss to Plaintiffs."

A mediation in November was unsuccessful, and trial was set to begin Jan. 7 before Fulton County State Court Judge John Mather when KPMG contacted the plaintiffs' team about a settlement the Sunday before trial, Butler said.

"We settled on the final figure Monday morning," he said.

The case is *Cohan v. KPMG LLP*, No. 12EV014325.

This story has been changed to reflect the following correction: "The Jan. 21 story, 'KPMG settled big tax shelter case before trial,' misstated that lawyer Jim Butler called on Mickey Mixson at Bondurant, Mixson & Elmore to assist in representing the plaintiffs. The plaintiffs contacted both Butler and Mixson's firms, which had worked together on another big case."