Forbes

September 20, 2004

SECTION: Pg. 131 Vol. 174 No. 5

LENGTH: 1442 words

HEADLINE: The Doctors' Deductions

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HIGHLIGHT:

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For nearly three decades San Diego dentist-turned-insurance-agent L. Donald Guess sold financial planning and products to dentists and doctors nationwide through seminars, medical convention booths, deals with doctors' groups, a "Doctors National Advisory Board" and a network of independent "financial counselors"/insurance agents. Operating with a family of companies known as "**Xélan,**" he offered such routine services as asset allocation and pension administration. But beginning in the mid-1990s he also advised doctors on how they could accumulate the "critical capital mass" needed to maintain their lifestyle in retirement. How? By paying current income taxes only on those earnings they planned to spend immediately and diverting all "surplus" income into a half-dozen "deductible" **Xélan** savings plans.

Now hundreds of doctors are being audited by the Internal Revenue Service, and the government has summoned records from the Vanguard Group, SEI Investments, AmerUS Life Insurance and Johnson Lambert & Co. CPAs, which would enable it to finger for audit all 2,000-plus docs who participated in one or more of the six programs. Meanwhile, the IRS is investigating whether **Xélan** has been promoting abusive tax shelters. A federal grand jury in San Diego is also looking into its activities. There's no indication customers are targets in the criminal probe, says Washington tax lawyer Michael C. Durney, who represents 210 of the doctors under audit.

If the IRS decides the **Xélan** plans violate tax law and the courts agree, it could become the biggest tax mess for doctors and dentists since the shelter craze of the early 1980s, when they loaded up on jojoba bean research partnerships and master music recordings.

The six disputed **Xélan** programs aren't quite so fanciful. Instead, like some shelters sold recently to other high-income professionals and owners of small businesses, they merely stretch existing tax breaks for insurance, employee benefits and even charity. There's the **Xélan** 419 Employee Welfare Benefit Trust, the **Xélan** Supplemental Disability Equity Trust, the **Xélan** Malpractice Equity Trust, the **Xélan** Medical Savings Equity Plan, the **Xélan** Long Term Care Trust and the **Xélan** Foundation.

Even if **Xélan's** programs are vindicated--as its lawyers say they should be--the investigation is unpleasant for the doctors under audit. They're being bombarded with document requests by an IRS now determined to crack down on shelters for high earners. **Xélan** has filed six lawsuits to quash the summons, arguing the IRS doesn't need all the doctors' names to determine whether the programs are abusive. But Seattle tax lawyer John M. Colvin, who represents **Xélan** in those suits, admits the odds are against **Xélan,** given recent government victories in other shelter summons cases.

Meanwhile, some **Xélan** clients who have nothing to do with the questioned programs are also suffering. In 1998 and 1999 **Xélan** persuaded 300 docs to buy viaticals--contracts in which terminally ill folks sell the future death benefits from their life insurance policies at a discount. **Xélan** pitched these as safe investments backed by a surety bond company. Then the viatical company that packaged the contracts went under, the surety company turned out to be a fraud, and the sick people didn't die on cue. So **Xélan** formed the Viatical Liquidity Liability Co. to buy out the doctors' contracts for $50 million over ten years, agreeing to dedicate 20% of its future commissions to the buyout.

But in June, citing fallout from the investigation, four of the **Xélan** companies filed for Chapter 11 bankruptcy protection. VLLC filed, too, saying it couldn't make good on its promises to the viatical investors. "I never bought into the tax shelters in the 1980s," laments a retired eye doctor who sank $1 million from his IRA into the **Xélan** viaticals. "It was a goal of mine to go through life and not fall for a stupid scam and boy, did I fall." He says he trusted **Xélan** because he had seen it at medical conventions for 25 years.

The first wholesale audits of **Xélan** doctors began in 2002, after the IRS got (improperly, **Xélan** claims) a list of hundreds of **Xélan** Foundation contributors during an audit of the charity. **Xélan** had told doctors that their tax-deductible contributions to the foundation's "donor advised" funds could be used to pay them for "teaching, research and other pro bono work" at their usual rate and to make education loans to their kids that might be forgiven if the kids did volunteer work. The doctors could even elect to volunteer now and defer payment until they needed extra income in retirement. A 2002 internal IRS memo suggests that doctors shouldn't be allowed deductions for funds that *could* be used for such personal purposes even if they hadn't actually been used that way.

In one of the few individual **Xélan** audits it has completed, the IRS denied $262,433 in 1998 charitable deductions that North Palm Beach, Fla. neonatologist Setty G. Viralam claimed against his $3 million income and hit him with a 20% penalty. He's fighting the bill in Tax

Court. Other audits likely won't be concluded until the IRS develops a consistent position on **Xélan** deductions, Durney says.

The foundation itself is appealing within the IRS' exam division a recommendation that its charitable exemption be yanked. And it has toned down its act. It has stopped making education loans and is limiting doctors' charitable pay to 60% of their normal rate, Colvin says.

In mid-2003 **Xélan** ended altogether another one of the disputed programs--its 419 Welfare Benefit Trust, which at its height in 2001 had 773 participants. **Xélan** told doctors it was terminating the trust because IRS regulations had "changed dramatically." But the government contends in papers filed in court in August that the IRS put taxpayers on notice in 1995 that it would disallow plans "structured like the **Xélan** 419 Welfare Benefit Trust Program" and in 2000 put such plans on a list of tax shelters subject to special reporting requirements. Colvin insists **Xélan's** plan, as it was structured, wasn't covered by those notices.

Either way, **Xélan** encouraged the doctors to stick gobs of pretax money in the plan. Jay Kevin Selznick, a Las Vegas maxillofacial surgeon, says in a lawsuit he filed in May against Guess, **Xélan** and AmerUS' Indianapolis Life unit that Guess persuaded him in 1999 to cancel his existing life insurance and have his medical corporation put $300,000 a year, pretax, into the Section 419 trust for five years to purchase a $10 million whole life policy from Indianapolis Life. The idea, of course, was to pay big premiums with pretax, instead of aftertax, dollars. Selznick says in his suit that Guess knew (or should have known) the program wouldn't hold up under IRS scrutiny, but instead Guess provided him with a "selectively incomplete" tax opinion blessing it. (Indianapolis Life and Guess deny liability.)

Most doctors are sticking with **Xélan's** defense of the plan. But Selznick is in an unusual spot: Last year he pleaded guilty to one count of willfully filing a false return, conceding that from 1996 through 1999 he failed to report $940,000 in practice receipts that he had funneled into a personal account. After he repaid the IRS $246,000 and cooperated with IRS criminal investigators looking into **Xélan** (including taping conversations), he was spared any jail time.

The largest **Xélan** plan under investigation, with more than $400 million in assets and the most participants, is the supplemental disability plan. Doctors were told that in addition to buying regular disability insurance, their practices could pump--pretax--up to 100% of their excess earnings into a supplemental disability plan offered by the Doctors Benefit Insurance Co., a Barbados insurer owned by several **Xélan** doctors. After seven years they could get back up to 96% (now 94%) of premiums plus investment gains on those premiums, all of which would then be taxable. The malpractice, long-term-care and medical-expense programs operate in a similar fashion.

The government says it is still investigating whether these plans qualify as insurance or are impermissible deferred compensation schemes. And, if they are insurance, how much of the premiums are properly deductible up front.

Durney, the doctors' lawyer, insists **Xélan** has strong legal support for these four plans. "We'd like very much for the IRS to review the underlying plans before it assumes they're wrong and subjects all these doctors to very intrusive audits," he says.

Brace yourself, docs. The IRS is not known for its friendly bedside manner.