

MEDIA ADVISORY: Tax Problems Loom in the College Admissions Scandal

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Caplin & Drysdale, Chartered

The criminal charges of more than 50 individuals, including parents and college athletic coaches, arising from an alleged fraudulent scheme to secure choice slots for their children at elite colleges, has rocked the world of college admissions. While salacious allegations of criminal behavior by celebrities and the wealthy reverberate through the national media, ***the tax exposure of the charged defendants, and any other individuals not yet identified publicly, has been largely ignored.***

The government has alleged so far that affluent parents contacted an organization called “The Key” (officially known as The Edge College & Career Network, LLC) to arrange admittance for their children to certain selective colleges. The Key provided “side doors” for the children to gain admittance, including:

- Paying a third party to take college entrance exams instead of the child;
- Paying proctors to modify the scores of the child’s college entrance exam;
- Paying a third party to take college classes on behalf of the high-school child to use those grades to help the child’s college application; and
- Paying varsity coaches and administrators at colleges to identify, falsely, the child as an athletic recruit to ease the child’s admission to the college.

The parents directed some payments for these services to The Key’s affiliated charity, The Key Worldwide Foundation (“KWF”), which is tax-exempt under section 501(c)(3). This provided the parents with the added, but illegal, benefit of a tax-deductible contribution to the charity, or enabled them to utilize funds previously deducted and held in a donor-advised fund.

These unlawful deductions carry the risk of civil and possibly even criminal action against a number of involved parties. Parents could face criminal actions for willful tax evasion or filing a false tax return, civil monetary penalties for fraud or inaccurate returns, and tax and interest due on disallowed deductions. In addition, very large payments could potentially be characterized by the IRS as taxable gifts from the parents to their children. Any professionals who knowingly or negligently advised taxpayers or prepared returns as to these unlawful deductions could face ethical sanction, monetary penalties, or if the conduct is egregious, criminal charges for assisting a client in filing a false return. KWF, and any other purported charity like it, faces risks of criminal and civil action, and charity directors could face personal monetary sanction. The charity itself is likely to lose its tax-exempt status.

Options for Affected Individuals and Entities

The IRS is already involved in the case; one of the primary actors has pled guilty to conspiracy charges that include allegations of tax fraud. Under IRS policy, it is also too late for the arrested parents to rectify their own tax situation without facing potential criminal tax charges.

However, there may be time for other affected individuals or entities to act, including parents who may have wrongfully deducted purported charitable contributions, professionals who may have been aware of this and assisted them, or even other college consulting companies (and related charities) who may have engaged in similar conduct. These parties may have the option of mitigating the potential criminal and civil consequences of prior unlawful, even criminal, conduct. Depending on the circumstances, such persons may be eligible to make a voluntary disclosure to the IRS under a longstanding policy whereby the IRS will not prosecute taxpayers who come forward on a timely basis to correct prior tax non-compliance. The IRS recently published new guidelines on this policy laying out the general procedural and penalty approach that would likely apply.

To the extent that any involved party may be too late to qualify for a formal voluntary disclosure, there may be other options to minimize the risk of serious repercussions from the non-compliance. Indeed, even in the context of the ongoing criminal cases, tax charges may be a somewhat more lenient basis for a guilty plea.

Conclusion

The IRS Criminal Investigation Division appears to be involved in the continuing investigation, and we can expect that the government may seek additional criminal and civil penalties against both those charged and others. Affected individuals should consider rectifying their prior non-compliance.

Caplin & Drysdale offers extensive experience in criminal and civil tax controversy and the taxation of exempt organizations. Our lawyers regularly advise individuals and organizations facing criminal and civil tax exposure, including in connection with exempt organization tax issues, and our firm has handled thousands of voluntary disclosures.

For more information, please contact:

Victor A. Jaramillo
Tax Controversy
202.862.8851
vjaramillo@capdale.com

Meghan R. Biss
Exempt Organizations
202.862.7866
mbiss@capdale.com

Alison F. Egan

Moshe A. Dlott

Attorneys

Victor A. Jaramillo

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