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PhillyDeals: IRS continues to review Vanguard's tax structure

By Joseph N. Distefano, Inquirer Staff Writer

The Internal Revenue Service and the Securities and Exchange Commission are still reviewing allegations that Vanguard Group Inc.'s unusual business structure operates in violation of federal tax law, according to attorneys for former Vanguard tax lawyer David Danon, who brought the allegations to the agencies' attention in 2013.

The IRS and SEC have not announced complaints against Malvern-based Vanguard and don't comment on possible ongoing investigations. Vanguard spokesman John Woerth declined to comment.

"The IRS has confirmed that Mr. Danon's submission remains open after two years. We believe that the IRS will be issuing a Notice of Proposed Adjustment to reflect this, if it has not done so already," Stephen Sorensen, a Los Angeles lawyer representing Danon in his IRS and SEC complaints alongside Milwaukee-based Brian Mahany, wrote in a recent letter to the SEC.

In the letter, Sorensen estimated the IRS tax adjustment Vanguard will have to pay will total more than \$1.7 billion, which would require the company "to take money from its mutual funds to pay the past due taxes and penalties."

Vanguard, with worldwide assets of about \$3

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trillion, collected customer fees totaling more than \$3.7 billion in 2014, according to an estimate by founder John C. Bogle.

Unlike other mutual fund groups that are owned by investors, Vanguard Group is a private company owned by its funds. The company says this helps ensure it acts in the best interest of the fund shareholders.

Danon says he, as a Vanguard tax lawyer since 2008, concluded by 2012 that the group had underpaid federal and state income taxes by more than \$1 billion, by undercharging its own mutual funds for management services, ensuring it operates on a nearly break-even basis and pays little income tax.

Danon says that violates tax-code requirements. Related companies (such as Vanguard Group and its funds) must pay higher, market-level prices for services, he argued. Danon also says Vanguard set aside a \$1.5 billion "contingency fund" that wasn't taxed or shared with shareholders.

According to court filings, Danon says he complained to his boss that he couldn't endorse Vanguard's tax practices. He says he was told in January 2013 he would be terminated by June.

That January, Danon alerted the IRS to his tax allegations. In May 2013, he also reached out to the SEC. He alleged to the SEC that Vanguard was failing to alert fund shareholders about its potential tax liability, and not crediting fund shareholders with their share of the contingency fund.

Danon also filed a whistle-blower complaint in the state of New York, where he says Vanguard also avoided taxes. Danon hopes to be awarded

a share of back taxes or penalties. Bloomberg reported last year that Sherri Hunt, a Citigroup whistle-blower represented by Mahany, collected \$31 million after suing her former employer in a mortgage-fraud lawsuit that resulted in a \$158 million settlement with the government.

At a Feb. 13 hearing before New York Superior Court Judge Joan Madden, lawyer Heidi Wendel, representing Vanguard, said, "We have very strong arguments that show Mr. Danon is completely wrong" about Vanguard tax frauds. Before having to air those arguments, Vanguard wants Danon's state case thrown out, alleging he violated attorney-client privilege and confidentiality rules by suing his former employer.

Asks Sorensen: "Why wouldn't Vanguard simply say - both to the judge and to the public - that it is not currently under audit" by the IRS, as a result of Danon's allegations?

If Vanguard could say the IRS approves of its tax structure, Sorensen added, "it would be game over" for Danon's complaint. ■