**IN THE UNITED STATES DISTRICT COURT**
**FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

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| R. ALEXANDER ACOSTA, U.S. SECRETARY OF LABOR<br><br>Plaintiff,<br>vs.<br><br>JOHN KORESKO, et al.,<br><br>Defendants | C.A. No.: 2:09-cv-0988-WB |

**ORDER**

AND NOW, this day of , 2019, upon consideration of the motion of certain plan sponsors of benefit plans whose assets were held in the REAL VEBA and Single Employer Welfare Benefit Plan Trusts ("the Trusts"), and any responses or objections thereto, it is hereby ORDERED that:

1. All future distributions from the Trusts to plan sponsors, plans, plan participants, or plan beneficiaries shall be made without deducting or withholding any sums for possible tax obligations;
2. Wilmington Trust, the Court-appointed trustee of the Trusts, shall not set aside or withhold any of the Trusts' assets for possible employer tax obligations related to the distributions;
3. Wilmington Trust shall issue Forms 1099-Misc with respect to all future distributions and shall reissue Forms 1099-Misc for all past distributions from the Trusts;
4. Wilmington Trust shall file the necessary documents with the Internal Revenue Service to

reprocess all past distributions on Form 1099-Misc; and

5. As such funds become available, Wilmington Trust shall distribute to plan sponsors, plans, or plan participants the funds previously used or set aside to satisfy tax obligations. These distributions shall be treated as future distributions as provided in paragraphs 1-3 above.
6. This order is without prejudice to:
    a. Any party's position with respect to the proper tax treatment of the distributions; and
    b. Disputes concerning prior tax-related withholdings and funds previously used or set aside to satisfy tax obligations.

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Wendy Beetlestone, J.

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**AMENDED MOTION OF CERTAIN PLAN SPONSORS FOR AN ORDER REQUIRING THAT ALL DISTRIBUTIONS FROM THE REAL VEBA AND SINGLE EMPLOYER WELFARE BENEFIT PLAN TRUSTS BE REPORTED AS 1099-MISCELLANEOUS INCOME**

Mida, Inc.; Harry H. Monokian, D.M.D., P.A.; Howard Greils, M.D. Inc.; Mario Magcalas, M.D., P,A.; Charles Parsons & Assoc., Chtd.; LGS Specialty Sales, Ltd.; M. & E. Zenni, Inc.; Tobey Karg Sales Agency, Inc.; David C. Spokane Orthodontic Assoc., P.C.; Morgen & Oswood Construction, Co., Inc.; Carson's Steak Warehouse and Saloon, Inc.; Harvey A. Kalan, M.D., Inc.; Wilshire Palisades Law Group, P.C.; Olouakan Comluct, Inc.; Powercom Electrical Services, Inc.; Resource Realizations, Inc.; Engineered Systems & Products; Pamela K. Erdman, M.D. Inc.; Anthem Medical Management; A-Tech Concrete Co. Inc.; and DVB Management, Inc. (collectively "Movants"), by and through their counsel, move this Honorable Court to issue an order requiring that all distributions from the REAL VEBA and Single Employer Welfare Benefit Plan Trusts be reported to the Internal Revenue Service ("IRS") on form 1099-Miscellaneous and that all distributions be made without any withholdings.

In support thereof, Movants aver as follows and incorporate the attached memorandum of law.

1. Movants are plan sponsors of benefit plans whose assets were held in the REAL VEBA and Single Employer Welfare Benefit Plan Trusts ("the Trusts").

2. In 2013, the Court appointed a Trustee to control the Trusts and, at all times relevant to this motion, Wilmington Trust ("Wilmington") has functioned as that Trustee. At all times, direction has been provided by the Court. As such, Wilmington has effectively been a Directed Trustee within the meaning of the Employee Retirement Income Security Act of 1974 ("ERISA").

3. Since 2015, the Court has been engaged in liquidating the Trusts and determining appropriate and equitable methods for allocating the Trusts' assets among the various benefit plans whose assets were held by the Trusts.

4. On or about March 15, 2017, the Court adopted an equitable allocation method that came to be known as the Unified Model.

5. The Court-appointed forensic accountants, Marcum LLP, were then directed by the Court to calculate each plan's share and distributed the calculations in the form of an Explanation of Account, Plan Sponsor Statement and Distribution Election form sent to each plan sponsor. The share was expressed as a percentage of the Trusts' assets.

6. The Plan Sponsor Statements also calculated a proposed initial, partial distribution based on these percentages, but Marcum recommended that 12.5% of Estimated Available Assets be held back as a reserve against potential future liabilities and expenses. Neither the Unified Model, adopted by the Court, nor the Plan Sponsor Statements and related documents, made any reference to how the distributions should be treated for tax purposes or to any deductions beyond the recommended reserve.

7. After an objection process, on November 28, 2017, the Court ordered Wilmington to transfer

the titles of identified policies to named individuals or entities and make the initial distributions as set forth in the Plan Sponsor Statements and as modified during the objection process to provide, *inter alia*, that distributions would be made to participants in addition to plans or plan sponsors. *See e.g.*, Orders, ECF Nos. 1619, 1619-1, 1620, 1620-1, 1631, 1631-1, 1632, 1632-1.

8. In or about August 2018, Wilmington began making the court-ordered initial cash distributions. Wilmington treated the distributions as amounts paid to a plan sponsor or an employee through an employee benefit plan and, for that reason, in certain cases, made payroll tax deductions from the distributions and used the Trusts' assets to pay employer's payroll taxes.

9. Numerous plan sponsors, including Movants, and plan participants, as well as the Department of Labor ("DOL"), have objected to these deductions.

10. Though DOL has taken no position regarding the appropriate tax treatment, it has asserted that funds should not be withheld and that the Trusts' assets should not be used to pay any claimed employer's share of payroll taxes.

11. The positions taken by plan sponsors and participants largely fall into two groups:

a. Plan Sponsors who have previously paid taxes on the amounts they contributed to their plans due to reclassifications of the contributions made by the Internal Revenue Service ("IRS") assert that the distributions being made to participants should not be taxed at all except to the extent the distribution exceeds the amount previously disallowed as a deduction of the Plan Sponsor. Any such excess amount should be taxed as capital gains.

b. Plan sponsors who did not previously pay taxes on their contributions assert the distributions to participants should be treated as ordinary business income, not as

taxable distributions from an employee benefit plan, and, hence, FICA and Medicare payroll taxes should not be withheld.

12. The Court has requested and received briefs from the interested parties concerning the appropriate tax treatment, but the IRS has not intervened or taken a position.

13. As a consequence, the Court has not ordered a second distribution of the Trusts' assets.

14. A substantial amount remains available for distribution. Upon information and belief, approximately $18.6 million plus amounts previously set aside for tax obligations could be distributed to the victims of the Koresko scam but for the dispute over tax treatment.

15. Movants submit that the issue can and should be largely resolved by ordering Wilmington to:

a. Make all future distributions without any deductions;

b. Report all future distributions and past distributions to the IRS via Form 1099-Misc;

c. File the necessary documents with the IRS to reprocess past distributions on Form 099-Misc; and

d. As they become available, distribute to plan sponsors, plans, or plan participants as future distributions any amounts previously used or set aside to satisfy tax obligations.

16. As is explained more fully in the memorandum accompanying this motion, this will permit funds to be distributed promptly while leaving the tax consequences to be resolved by the recipients and the IRS.

Wherefore, Movants respectfully request that, after providing all plan sponsors with notice and an opportunity to object, the Court order that:

1. All future distributions from the Trusts to plan sponsors, plans, plan participants, or plan beneficiaries be made without deducting or withholding any sums for possible tax obligations;
2. Wilmington may not set aside or withhold any of the Trusts' assets for possible employer tax obligations; and
3. Wilmington shall issue 1099-Misc reports with respect to all future distributions and all past distributions from the Trusts;
4. Wilmington shall file the necessary documents with the Internal Revenue Service to reprocess past distributions on Form 1099-Misc; and
5. As they become available, Wilmington shall distribute to plan sponsors, plans, plan participants, or plan beneficiaries the funds previously used or set aside to satisfy tax obligations. These distributions shall be treated as future distributions as provided in paragraphs 1-3 above.

Movants further request that the order be without prejudice to:

a. Any party's position with respect to the proper tax treatment of the distributions; and

b. Disputes concerning prior tax-related withholdings and funds previously used or set aside to satisfy tax obligations.

Respectfully submitted

s/Ira B. Silverstein
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**MEMORANDUM OF LAW IN SUPPORT OF AMENDED MOTION OF CERTAIN PLAN SPONSORS FOR AN ORDER REQUIRING THAT ALL DISTRIBUTIONS FROM THE REAL VEBA AND SINGLE EMPLOYER WELFARE BENEFIT PLAN TRUSTS BE REPORTED AS 1099-MISCELLANEOUS INCOME**

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## Introduction

Since 2015, the Court has been engaged in the complicated task of liquidating the REAL VEBA and Single Employer Welfare Benefit Trusts ( the "Trusts"). The Trusts held the remaining assets of the employee benefit plans that had participated in the arrangement known as the REAL VEBA created, marketed, and operated by John Koresko. Koresko's repeated conversion of benefit plan assets led to the instant action, instituted by the United States Secretary of Labor, in which the Court has found that Koresko breached fiduciary duties imposed by the Employee Retirement Income Security Act of 1974 ("ERISA"). As partial remedy, the Court has removed Koresko from any position of authority and engaged in the liquidation process that gives rise to this motion.

Though this action was brought to address violations of ERISA, arrangements such as the one at issue here have been primarily tax driven and have given rise to substantial controversy over the tax advantages the arrangements claimed to provide. Koresko's REAL VEBA was no exception. He marketed participation in the REAL VEBA as a vehicle for treating premiums paid to purchase cash value life insurance as legitimate business expenses. He claimed this was accomplished because the arrangement was designed to qualify as a "ten or more employer benefit plan" that, under Internal Revenue Code § 419A(f)(6), was exempt from the limitations on fringe benefit deductions made part of the tax code overhaul of 1984.

The IRS, however, has, since 2002 at the latest, adamantly disputed the claimed tax efficacy of virtually all 419A(f)(6) plans and has aggressively pursued companies that have claimed fringe benefit deductions based on contributions to such plans. This fifteen-year pursuit has resulted in drastically varying circumstances for companies that claimed the deductions. These varying results are largely the cause of the complications and disagreements concerning the

appropriate tax treatment of distributions to plan participants that give rise to the instant motion. The motion proposes a tax neutral approach that will permit distributions to continue without having to unravel and address the complex and varied tax situations of the plan sponsors and participants. Not only would embarking on such a task likely necessitate the equivalent of hundreds of separate tax determinations, but it would also not result in rulings that would be binding on a most crucial party, the IRS. The approach being proposed would essentially leave the tax determinations to the individual plan sponsors, participants and the IRS.

**The Procedural Background**

The procedural background is set forth in the motion itself. Movants incorporate that recitation and will not burden the Court with repeating it here.

**The Varying Tax Circumstances of Plan Sponsors and Participants**

Plan sponsors find themselves in widely varying tax circumstances vis-à-vis their contributions to the plans they established under the aegis of the REAL VEBA. Some plan sponsors were alerted early on to the controversy concerning the legitimacy of the deductions promised by 419A(f)(6) plans and, though they continued to pay the insurance premiums, they stopped deducting the premiums as business expenses attributable to fringe benefits.

A second group of plan sponsors were audited by the IRS before the DOL commenced the instant action or before they became aware of it and of Koresko's conversions. Many decided to settle with the IRS. Counsel for Movants has been advised that the IRS was quite inflexible in these settlements and virtually every one of these plan sponsors was not allowed to take a deduction for the contributions made to the Trusts. Instead, they were required to take into the income of the

plan sponsor the full amount claimed as business expense deductions for fringe benefits. They were also assessed interest and penalties. The main benefit of these settlements to the plan sponsors was that it cut off the continued accrual of interest and penalties.

Many other members of this group were persuaded by Koresko that he should represent them before the Tax Court and that he would easily defeat the IRS in that forum. At some point, some of these plan sponsors realized they were being misled and hired new counsel, but the settlements varied depending on when the settlement was negotiated. Those plan sponsors who settled before the extent and nature of Koresko's conversions became known in 2013 likely had the full amount of their contribution disallowed as a deduction for business expenses associated with fringe benefits and were required to include in the plan sponsor's income the full amount contributed to the Trusts and pay penalties and interest. Those plan sponsors who settled after 2013 were given better deals, only being required to include in income the amount of the disallowed contribution that they would ultimately receive as a distribution from the Trusts. Movants are unaware of the status of IRS cases that have not been settled.

Finally, quite a few plan sponsors have never been audited and have never paid any taxes on the amounts they contributed. Needless to say, the manner in which the Court-ordered distributions should be treated for tax purposes varies markedly for each group.

**The Ordinary Income or Wages Dispute**

Yet another issue complicates determining the appropriate tax treatment. When plan sponsors have been audited, the IRS has taken the position that the deduction was improper and should be disallowed. The result of disallowing the deduction, as discussed above, was to increase the company's income for the year of the contribution. Since virtually all of the plan sponsors were

small, closely held companies formed as S corporations or limited liability companies, the increase in company income was passed through to the owner as ordinary income. On the other hand, Wilmington determined, upon advice of counsel, that the Court-ordered distributions to participants from the Trusts are payments to participants that should be treated as a payment from an employer to an employee. Whether Court-ordered distributions are treated as payments from an employer to an employee made through an employee benefit plan or just as the return of business income improperly invested in the Trusts is of great significance. Business income is not subject to FICA and Medicare assessments, but taxable payments to an employee from an employer made through an employee benefit plan are.

Though Movants have contested Wilmington's determination that the distributions are payments made due to the employment relationship, for the purposes of this motion they do not seek a ruling on the question. Rather, Movants suggest that neither side can be certain as to what position the IRS will take or which way the Tax Court would rule if the IRS and a recipient of one of the distributions litigated the issue. And, since the IRS is not a party, any attempt by this Court to resolve the issue would not be binding.

**The Virtues of the Proposed Solution**

Movants submit that any attempt to determine the appropriate tax treatment of each distribution in the current context would inordinately delay distribution, would necessarily involve overly burdensome and time consuming procedures, would be inordinately expensive for the participants, would require substantial use of the Court's resources, and would not be binding on the IRS, all to produce a result that would, at best, be a temporary stop gap until the tax issues were addressed dispositively by way of plan sponsor submissions to the IRS and the IRS' response. The

proposed solution, outlined below, would avoid this wasted effort while not prejudicing either the plan sponsors and plan participants, or the IRS. The proposed solution also has the virtue of simplicity.

Movants propose that (i) all future distributions from the Trusts to plan sponsors, plans, plan participants, or plan beneficiaries be made without deducting or withholding any sums for possible tax obligations; (ii) Wilmington be ordered not to set aside or withhold any of the Trusts' assets for possible employer tax obligations; (iii) Wilmington should issue 1099-Misc reports with respect to all future distributions from the Trusts;[1] (iv) Wilmington should takes such steps as are necessary to reprocess all past distributions on Form 1099-Misc; and (v) as they become available, funds used or set aside for tax obligations shall be distributed to plan sponsors, plans, plan participants, or plan beneficiaries and be treated as future distributions.

Movants further propose that: (i) the order be without prejudice to any party's position with respect to the proper tax treatment of the distributions, and without prejudice to disputes concerning prior tax-related withholdings and funds previously used or set aside to satisfy tax obligations, and (ii) that before final adoption, all plan sponsors be notified of the proposed order and be given an opportunity to object.

By proceeding in this fashion, the victims of Koresko's scam will receive a substantial additional distribution without further delay and will receive a future distribution of amounts previously withheld; Wilmington will have the benefit of a court order to protect it from claims that it should have withheld payroll taxes; the IRS will be advised of the distributions via the forms 1099-Misc and will be able to take any steps it deems appropriate if it determines taxes are owed;

[1] The in-kind distributions are the insurance policies transferred to plan sponsors, plans, or plan participants. Wilmington has advised Movants that these distributions have yet to be characterized in any reports to the IRS.

the Court's resources will be preserved for more appropriate disputes; and any disputes will be resolved directly between the actual parties-at-interest, the plan sponsors, participants, and the IRS.

## CONCLUSION

For the above reasons, Movants respectfully request that, after opportunity for comment and objection by all plan sponsors and participants, their motion be granted.

/s/ Ira B. Silverstein
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**CERTIFICATE OF SERVICE**

I hereby certify the foregoing has been filed on April 26, 2019 with the Clerk of Courts using the Court's CM/ECF system, which will send a notice of filing to all parties of record.

/s/Ira B. Silverstein
By: Ira B. Silverstein