

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

J. WINSTON & SHERI S. KRAUSE)
Plaintiffs,)
)
V.) CIVIL NO. 08-CA-865 SS
)
UNITED STATES OF AMERICA)
Defendant)

ORAL DEPOSITION OF
J. WINSTON KRAUSE
SEPTEMBER 30, 2009
VOLUME 1



ORAL DEPOSITION OF J. WINSTON KRAUSE, produced as a witness at the instance of the Defendant and duly sworn, was taken in the above-styled and numbered cause on September 30, 2009, from 9:00 a.m. to 12:57 p.m., before Mary Lou Taylor, CSR, in and for the State of Texas, reported by computerized stenotype machine at the offices of Krause & Associates, LP, 504 W. 13th Street, Austin, Texas, pursuant to the Texas Rules of Civil Procedure and the provisions stated on the record or attached hereto.

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ALSO PRESENT:

Ms. Moha P. Yepuri

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 2002 KAAS return for December 26-31

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 Krause & Associates 1065 for 2002

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Government Exhibit No. 16 107
 Information questionnaire from Jenkins & Gilchrist

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 Document to Mr. Beery outlining structure of Krause's
 companies

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 Individual customer information form from Gamma Trading
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Government Exhibit No. 19 113
 Account information non-entity form for RBC Dain Rauscher

Government Exhibit No. 20 115
 Document for KAAS

Government Exhibit No. 21 118
 Document regarding the execution of the partnership
 agreement for Advanced Strategies

Government Exhibit No. 22 120
 Letter from Mr. Beery to Krause regarding establishing
 entities and trading relationships

Government Exhibit No. 23 121
 Letter from Krause to Jenkins requesting documents for
 the owners of Sierra Microwave Technologies

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Strictly Confidential document

taking the deposition of my client, and they were taking my deposition. I was a fact witness; in other words.
Q. Okay. Have you ever had a lawsuit that you initiated where you had your deposition taken?
A. Probably not.
Q. A lawsuit filed against you where you've had your deposition taken?
A. No.
Q. Nevertheless, you're familiar with the deposition rules; is that correct?
A. Yes, sir.
Q. If you need a break, just ask for it. My only request is that you ask for a break after an answer to a question, not after a question. If you need anything clarified, repeated, you need me to speak up, slow down, just let me know, I'll be happy to do that.
A. Sounds great.
Q. Is there any reason you can think of as you sit there, that you couldn't give your best and most honest testimony today?
A. None.
Q. Give me your full name, please?
A. James Winston Krause.
Q. And your current employer?
A. Krause & Associates, LP.

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MR. J. WINSTON KRAUSE,
having been first duly sworn, testified as follows:
EXAMINATION
QUESTIONS BY MR. BLACKER:
Q. Mr. Krause, my name is Jonathan Blacker; I'm a lawyer for the United States of America. This is my co-counsel, Moha Yepuri. This deposition is being taken in a case in which the United States has been sued by you for a refund of federal tax penalties and interest -- penalties and interest. You're representing yourself in this matter; is that correct?
A. You know, my firm is representing me and I'm -- there's no other lawyers.
Q. You're representing your wife as well?
A. Yes.
Q. Have you ever taken a deposition before?
A. I have.
Q. In what context?
A. Well, as a -- as a lawyer representing clients.
Q. Have you ever had your deposition taken?
A. I have.
Q. In what context?
A. Primarily as the lawyer for somebody that was

Q. Can you give me your home address?
A. 3605 Balcones Drive, B-a-l-c-o-n-e-s, Austin, Texas.
Q. How did you prepare for today's deposition?
A. By just showing up.
Q. Did you have any discussions with anyone?
A. No, sir.
Q. Did you look at any documents?
A. None.
Q. Can you take me through when you graduated from college, please?
A. December 1977.
Q. And from what college did you graduate?
A. University of Texas.
Q. And where did you go to law school?
A. Southern Methodist University.
Q. And when did you graduate from there?
A. May 1982.
Q. Do you have any other degrees?
A. No, sir.
Q. What was your degree from at the University of Texas?
A. BBA in accounting.
Q. And take me through your employment history beginning after your graduation from Southern

1 Methodist?

2 **A. From college graduation through law school, I**

3 **worked for Arthur Andersen & Company in their audit**

4 **department. I left there about a month before law school**

5 **and went to work for John Connally's presidential**

6 **campaign, did that for about a month, and then law school**

7 **-- after law school -- well, during law school, I worked**

8 **at General American Oil Company, and then I also worked**

9 **for, in my last year of law school, a small oil and gas**

10 **law firm that I can't remember the name of. I think**

11 **there were a couple of them in there, actually.**

12 **After law school, I came back to Arthur**

13 **Andersen & Company to work in their tax department. And**

14 **after that I went to Dallas and worked for a company**

15 **named Dearing Max -- Dearing Massey Company. And was**

16 **there for a couple of years, '84 to '86, moved to Austin,**

17 **worked for a firm here named Weeks, Chapman and Buford.**

18 **And after a couple of years it became Weeks and Buford.**

19 **In 1990 that firm broke up and a little firm**

20 **named Buford and Krause organized. It stayed together**

21 **for three years, and then in 1993, it was -- you know,**

22 **Winston Krause, Attorney at Law. Since then it's been**

23 **either that or, you know, Krause & Associates. For a lot**

24 **of the time, I've had professional staff lawyers working**

25 **for me as employees. But no partners.**

Q. Do you recall any of those cases that you worked on?

A. No. They wouldn't be -- they wouldn't be like litigation cases; they'd be like, you know, planning engagements, you know, researching a position to take on a return, you know, there was some estate planning, some prominent Houston families. I guess there was one, Mesa Royalty Trust, I had a little piece of that.

Q. Okay. After Arthur Andersen, I think you mentioned you went to work for Dearing Massey Company?

A. Yes, sir.

Q. What is that company?

A. That was a company that represented some professional athletes, real estate syndications and did some sporting event promotion, organization, undertaking the events and that kind of thing.

Q. What did you do for them?

A. Well, I was in-house lawyer and we worked on, you know, the player contracts, although I wasn't the negotiator on that, Perry Dearing was. And then tax compliance. We hired outside firms to put together private placement memorandums, but I would be involved with gathering information and reviewing their work and that kind of thing and -- and then any of the in-house duties for trying to make sure that we complied with

1 Q. Okay. What did you do for Arthur Andersen when

2 you were in their audit department?

3 **A. I worked primarily on the Transco audit from**

4 **eight in the morning until 10 o'clock at night, seven**

5 **days a week for about six months.**

6 Q. And, Transco, are they an oil and gas firm?

7 **A. Primarily pipeline.**

8 Q. And then you mentioned during law school you

9 worked for General American Oil?

10 **A. Uh-huh. Yes, sir.**

11 Q. What did you do for them?

12 **A. Just helped out in the legal department; just**

13 **kind of a clerk job, law clerk.**

14 Q. Preparing contracts, reviewing contracts?

15 **A. Leases, a little bit of title work.**

16 Q. And you went back to Arthur Andersen where I

17 believe you said you worked from '82 to '84?

18 **A. Yes, tax department.**

19 Q. And what did you do in their tax department?

20 **A. Well, prepared tax returns, was involved in**

21 **planning, research, anything that the partners asked me**

22 **to do.**

23 Q. Any specific clients you worked for?

24 **A. Not that I recall. I did feel like I had the**

25 **opportunity to work on some pretty cool cases though.**

securities law were the things that I did.

Q. So were you familiar in securities law -- the securities laws at that time?

A. Yes, sir.

Q. Then you went to work for -- after Dearing Massey Company, you went to work for a law firm, Weeks, Chapman and Buford?

A. Yes, sir.

Q. Was that around 1986?

A. It was in August of 1986.

Q. And what did you do for that firm?

A. I was a business lawyer. I worked on tax cases. And they weren't cases where there was litigation, it was, you know, primarily plannings, estate planning. We did have one jeopardy assessment case that I spent a lot of time on, you know, but pretty muchly whatever a fellow named Sam Buford asked me to do. And I generally worked on his clients.

Q. Is that when your -- did you start to kind of gravitate towards the tax area when you went to work for Buford?

A. Well, I had -- I became a CPA after -- or during my first time at Arthur Andersen & Company. And so, you know, I mean, that doesn't automatically, you know, mean tax, I mean, but at the same time when I went

1 to SMU, I took a lot of graduate tax course. They have a
 2 graduate -- they have a --
 3 Q. LL.M.?
 4 A. LL.M. program there. And so I got to take some
 5 of the graduate tax courses. And so, you know, once I
 6 got out -- then I went to work for Arthur Andersen &
 7 Company in their tax department, so that's pretty
 8 intensive. You know, and then with Weeks and -- Weeks,
 9 Chapman and Buford, if there was any, you know, tax
 10 aspect to, you know, a matter, then I was the guy for
 11 that. Of course Sam Buford was, you know, a CPA also and
 12 he might have had an LL.M. in tax, I don't recall at this
 13 time, but he and I would work on things and I would get
 14 the assignment first and work it up and he would look at
 15 it and that kind of thing.
 16 Q. Did you do tax work at Dearing Massey Company
 17 as well?
 18 A. You know, we did a little bit of tax planning
 19 for the clients. I was in charge of doing the compliance
 20 work, the tax returns. It wasn't a lot of tax planning
 21 to do. I was involved in, you know, -- and even though I
 22 wasn't writing the tax opinions that went into the
 23 private placement memorandums because we had outside
 24 counsel doing that, I was involved with, you know,
 25 helping put it together.

non-practicing, I don't have to do CPE, they just want my
 money.

Q. So are you a CPA today?

A. I'm a non-practicing CPA.

Q. And as you sit here today, what would you
 consider your primary areas of practice, legal
 practice?

A. My primary areas are tax-affected corporate
 work, tax-affected partnership work, regular old plain
 corporate work, some contracts, a little bit of real
 estate, too many real estate lawyers to compete with
 them, so, you know, I might not try to get that kind of
 thing. But, you know, I feel like my value-add is the,
 you know, tax-affected transaction work and then some of
 the tax dispute.

Q. Is it fair to say that your primary focus is in
 the tax area?

A. Yes.

Q. You mentioned you were -- or you were appointed
 to serve on the Texas Lottery Commission by Governor
 Perry; is that correct?

A. Yes, sir.

Q. How did that come about?

A. I got a letter saying that the governor wanted
 to appoint me to something and I didn't know what -- what

1 Q. And so Weeks, Chapman and Buford became Buford
 2 Krause; is that right?
 3 A. Well, it became Weeks and Buford.
 4 Q. Okay.
 5 A. And so I continued doing there what I was doing
 6 at Weeks, Chapman and Buford.
 7 Q. Same type of --
 8 A. Business focus with some tax. At that point I
 9 had some tax refund claims that I was prosecuting and,
 10 you know, had a couple successful cases and that kind of
 11 thing. And that was back during, you know, a lot of work
 12 after the '86 tax law came in and a lot of transitions
 13 with corporations, you know, and that kind of thing and
 14 so -- a lot of focus on that area.
 15 Q. And I believe you mentioned in nine -- Weeks
 16 Buford and then it became Buford Krause?
 17 A. Yes, sir.
 18 Q. Were you the same -- were you doing the same
 19 types of things when it was Buford Krause?
 20 A. Corporate, tax, estates.
 21 Q. And in '93 you struck out on your own; is that
 22 right?
 23 A. Yes, sir.
 24 Q. Do you keep up with your CPA certification?
 25 A. Well, I do. But only because I'm

to ask for, and so I finally got a call saying, Well,
 would you serve on the Lottery Commission? And I said,
 As long as it doesn't take more than a day a month.

Q. Had you met the governor prior to --

A. I've known the governor a number of years.

Q. What are your duties on the Texas Lottery
 Commission?

A. Well, the Lottery Commission does two things.
 It regulates charitable bingo and then it executes the
 lottery. You know, and so, you know, what I do on the
 Commission is we make decisions having to do with bingo,
 charitable bingo regulation and, you know, disputes and,
 you know, they've got little administrative cases going
 on around that. On the lottery side, it's -- it really
 just more of a kind of an oversight function because
 we've got 300 to 400 staff and they're doing all the work
 and then, of course, lotteries -- a lot of what the
 lottery does is run by a company named GTECH. It's the
 biggest contract in state government.

Q. Okay. You were admitted to the Texas Bar; is
 that correct?

A. Yes, sir.

Q. And you were also authorized to practice before
 the Tax Board?

A. Yes, sir.

1 Q. Supreme Court? US Supreme Court?

2 **A. You know, when I was a young lawyer, I got a**

3 **certificate saying that I was authorized to practice**

4 **there, but as I've recently found out, you know, those I**

5 **guess have some kind of shelf life and so --**

6 Q. Understood. What about the 5th Circuit?

7 **A. Yes, sir.**

8 Q. And Western District of Texas?

9 **A. Yes, sir.**

10 Q. And the Court of Federal Claims?

11 **A. No -- well, you know, back in the day, I got a**

12 **certificate saying I was admitted there but I would be**

13 **surprised if it was still current.**

14 Q. You don't have any active cases before the

15 Court of Federal Claims?

16 **A. No.**

17 Q. And you're Board certified in tax law, estate

18 planning and probate law?

19 **A. Both areas.**

20 Q. So tax law is separate from -- there is tax law

21 and there is estate planning and probate law?

22 **A. Yes, sir.**

23 Q. So you have two Board certifications?

24 **A. Yes, sir.**

25 Q. Any others?

recognize this document?

A. Yes, sir.

Q. These are the responses to -- your responses to the US Interrogatories and Request for Production; is that right?

A. Yes, sir.

Q. Is that your signature?

A. It is on the front and it is on Page 11.

Q. You prepared these responses; is that right?

A. I did.

Q. Now if you turn to Page 3 of the -- well, let me back up. Can you describe the transaction that's at issue in this matter?

A. I will try to. I -- it's been a long time since I looked at anything having to do with it. I will say that I felt like I was pretty familiar with it at the time that the transaction was executed. And, you know, but it's been -- it's been many years since then, and since the underlying tax is not in dispute, I haven't felt the need to go and refresh my recollection on that. That said, the transaction was a -- an investment that involved some digital options. There were a couple of digital options and soto some extent they offset and, you know, a banking house up in New York executed them. A fellow named Paul Daugerdas arranged that, and he wrote

1 **A. No, sir.**

2 Q. How long have you been Board certified?

3 **A. Well, the best of my recollection, became**

4 **certified in tax law in '89 and the best of my**

5 **recollection, I became certified in estate planning or**

6 **probate law in either '92 or '96.**

7 Q. '92 or '96?

8 **A. Or '96, or '94, anywhere in there.**

9 Q. Do you recall when you took the test?

10 **A. Early '90s. Tax law, late '80s.**

11 Q. What is your understanding of this lawsuit that

12 you filed?

13 **A. My understanding of this lawsuit is that there**

14 **are some penalties that have been imposed that in my**

15 **opinion were improperly imposed.**

16 Q. You're not disputing the tax in this matter; is

17 that right?

18 **A. Correct.**

19 **(Government Exhibit No. 1**

20 **(marked for identification.**

21 Q. If we can, take a look at the first exhibit,

22 and they should be separated by the yellow sheets of

23 paper.

24 **A. Yes, sir.**

25 Q. We'll call this Government Exhibit 1. Do you

the tax opinion that I relied upon. And so -- the

transaction is -- was pretty sophisticated and so --

that's the extent of my understanding at this time.

Q. Do you know how -- as a result of that transaction, you took an ordinary loss on your 2002 tax return; is that right?

A. Yes, sir.

Q. Do you know how that loss was generated?

A. Well, there was a loss that was caused because of the options offsetting. And I believe that there was a partnership involved and that increased the basis of the partnership interest, which caused I think some internal assets to have their basis to increase and then I guess sold generating a loss.

Q. Is that the extent of your understanding; any more specifics you can give me?

A. Well, I'm sure that as we talk about it, it will -- my recollection will be refreshed but that's what I think it is right now.

Q. Are you relying on the facts and representations outlined in Jenkins' opinion that you mentioned for purposes of this lawsuit?

A. No.

Q. Take a look at the answers to the discovery if you would, please, specifically on Page 4, Interrogatory

1 No. 7, you were asked to describe contributions made to
2 an entity called Krause & Associates and that should be
3 Advanced Strategies?

4 **A. -- Strategies. Uh-huh.**

5 Q. And you point to the capital contributions set
6 out in the Jenkins and Gilchrist legal opinion; is that
7 right?

8 **A. Yes, sir.**

9 Q. Is that where your understanding of where the
10 capital contributions came from?

11 **A. That would be a source that I would rely upon
12 if I was required to go back and refresh my recollection
13 about the capital contributions.**

14 Q. Any other sources that you can think of?

15 **A. No, not that exist anymore.**

16 Q. Interrogatory No. 8, you were asked about the
17 business purpose for various entities?

18 **A. Uh-huh.**

19 Q. Of course, you're familiar with those entities,
20 Krause & Associates Advanced Strategies, Krause Holdings,
21 Inc., Krause Management, LC; is that right?

22 **A. Yes.**

23 Q. And when asked about the business purpose of
24 those entities, you also state that -- or you point to
25 the business purposes set out in Jenkins Gilchrist

**A. Just me and probably Krause & Associates and
maybe Krause Management.**

Q. But in terms of the business purposes for these
entities, you point to the Jenkins Gilchrist legal
opinion; is that right?

**A. Well, they -- each of these had, you know,
business purposes other than for this transaction. But
I'm sure at the time that the transaction was going down,
Jenkins, you know, asked for some business purpose, you
know, and whatever I told them, they -- I assume they
accurately transcribed and put in their legal opinion.**

Q. Okay. Turn to the Interrogatory No. 9 if you
would, please. When asked about your understanding of
the nature and amount of the financial non-tax benefits,
you also point to the Jenkins legal opinion and the
financial non-tax benefits described in there.

A. Yes, sir.

Q. Is that where you're getting that information
from, is from Jenkins --

**A. Yes, if -- if anything that I had told Jenkins
at the time, I -- I am relying on the assumption that
they accurately recorded and put in their opinion. And
so, I wouldn't think that that opinion describes anything
that is different than what I would know.**

Q. Is there any other source outside of the

1 legal opinion?

2 **A. Yes, sir.**

3 Q. Are there any other sources for the business
4 purposes of --

5 **A. Well, Krause Holdings, Inc. is a corporation
6 that, you know, continues to serve as a general partner
7 for other partnerships that I have. Those are, you know,
8 there is at least one real estate limited partnership
9 that it's a general partner of.**

10 Q. What limited partnership is that?

11 **A. It's called Mursch Partners.**

12 Q. How do you spell that?

13 **A. M-u-r-s-c-h, Mursch Partners, LP. And Krause
14 Management, LC, if I'm not mistaken, might be the general
15 partner entity for Krause & Associates, which is a
16 limited partnership. Krause & Associates Advanced
17 Strategies was a partnership that, you know, existed to
18 -- with which we provided services to clients that, you
19 know, involved more specialized, you know, matters than
20 we were undertaking in Krause & Associates, just the
21 general law firm. And it doesn't exist anymore as far as
22 I know. At least no tax returns have been prepared for
23 it, you know, for seven or eight years.**

24 Q. Who else was involved in Krause &
25 Associates Advanced Strategies; was it just you?

Jenkins legal opinion that you could point me to that
would describe the financial non-tax benefits you're
expected to get out of the transaction at issue in this
matter?

A. No, sir.

Q. What about any other document outside of
Jenkins' legal opinion that would describe the business
purposes for the entities that we discussed on a previous
page?

**A. Well, you know, other than the fact that at
least two of the entities are still in existence and I
can tell you what their business purpose is today.**

Q. What about back in 2002 when you -- when the
transaction was undertaken?

**A. Probably I would have to rely on the Jenkins
and Gilchrist legal opinion, what it said there, for
factual basis.**

Q. And then finally on Interrogatory No. 10 when
asked about the tax benefits, you again point to the tax
benefits described in the Jenkins' opinion; is that
correct?

A. Yes, sir.

Q. Is there any other document outside of the
Jenkins' opinion you can provide me that talks about the
tax benefits you expected to receive?

1 **A. No, sir. Once the opinion came in, you know,**
 2 **it looked like it contained all the source documents and**
 3 **everything and, you know, I think that we just -- we**
 4 **chose to keep that because it looked a lot neater and**
 5 **cleaner than the messy file and so we didn't want to keep**
 6 **duplicates of things and so that's the record that I**
 7 **have.**
 8 Q. Do you recall what documents you gave to
 9 Jenkins to support the facts and representations they
 10 made in their opinion?
 11 **A. Not other than what is included in the binders,**
 12 **I mean, one binder should have been the legal opinion and**
 13 **the other one should have been, you know, source**
 14 **documents that included, you know, I guess partnership**
 15 **agreements and things like that as well as the trade**
 16 **confirmations.**
 17 Q. Right. We'll get to that. You -- on
 18 Interrogatory No. 12, when asked about the
 19 representations, you again point to the representations
 20 that were made in the Jenkins' legal opinion; is that
 21 right?
 22 **A. Yes, sir.**
 23 Q. And were representations that you made to
 24 Jenkins that they then put into the legal opinion?
 25 **A. Yes, sir.**

initiative.
 Q. Did you receive a copy of the settlement
 initiative?
A. Yes.
 Q. And you didn't -- did you choose not to do
 that?
A. I -- I thought that I would be rejected if I
tried to participate and so I just didn't.
 Q. But you were aware of it?
A. Yes, oh, yes.
 Q. Do you know who Frank Henna is?
A. Say his name again?
 Q. Frank Henna?
A. Frank Henna? No, sir.
 Q. What about a company called Sierra Microwave
 Technologies?
A. Oh, yes.
 Q. Is it Mincho Tsankov? Is that how you
 pronounce his name?
A. Mincho is right. I -- I'm not sure how to say
his last name.
 Q. You know him though, right?
A. Yes, sir.
 Q. Stephen Turpin?
A. Yes.

1 Q. Any other documentation outside of the Jenkins
 2 legal opinion that you can provide me that would outline
 3 the representations?
 4 **A. Not that exists anymore.**
 5 Q. Do you recall any fees that you paid for
 6 purposes of this transaction?
 7 **A. You know, I'm sure I paid some fees but I just**
 8 **don't recall and I'm not making any claim about that.**
 9 Q. And the answer to Interrogatory No. 15, when
 10 asked about that, you state that there were no fees paid,
 11 you don't recall paying any fees to Jenkins and
 12 Gilchrist?
 13 **A. That's right.**
 14 Q. What about Dain Rauscher?
 15 **A. No. Dain Rauscher I think there was just some**
 16 **accounts, they didn't actually provide the services.**
 17 Q. What about Gamma Trading?
 18 **A. You know, I just don't recall paying anybody**
 19 **anything actually.**
 20 Q. Have you represented other taxpayers who are
 21 involved in similar transactions?
 22 **A. You mean like the Jenkins deal?**
 23 Q. Yes.
 24 **A. Oh, I've got a couple clients that were**
 25 **involved, and they settled up in the settlement**

Q. Troy Rodriguez?
A. Yes.
 Q. Did you advise them regarding a transaction
 that was marketed by Jenkins and Gilchrist?
A. You know, the answer to that is going to be
something along the line of, you know, I stood on the
sidelines while Jenkins advised them.
 Q. Did you bring them to Jenkins?
A. You know, they knew about Jenkins and so I
didn't make the -- I didn't talk to them about it
initially although, you know, once they decided to do
that then since I was their local lawyer I was the
go-between.
 Q. Did you receive any fees as a result of that?
A. I'm sure I did.
 Q. And what about John Keating; do you know John
 Keating?
A. Yes, I do.
 Q. Did you advise him regarding a transaction
 similar to the --
A. Again, I was kind of the local lawyer and kind
of the go-between. He was looking for his advice on this
kind of thing from Jenkins and Gilchrist.
 Q. Were these transactions similar to the
 transaction you entered into?

1 **A. I believe they were similar.**
 2 Q. So they were digital option transactions as
 3 well generating a loss for tax purposes?
 4 **A. If they weren't digital options, then they were**
 5 **some kind of options.**
 6 Q. Are you familiar with the treasury short sale
 7 transactions?
 8 **A. Yes.**
 9 Q. Did any of these clients enter into a treasury
 10 short sale transaction?
 11 **A. Not that I'm aware of.**
 12 Q. When you say you stood on the sidelines, you
 13 actually advised them and helped prepare documents for
 14 purposes of completing the transaction; is that right?
 15 **A. Well, what I would do is if they, you know,**
 16 **needed some kind of a company consent that I would**
 17 **prepare that. I would gather up the company documents,**
 18 **the organizational documents and send them on. I would**
 19 **receive requests, you know, from Jenkins to gather up,**
 20 **you know, factual information and I would work with the**
 21 **client to gather that up and transmit it.**
 22 Q. Did you prepare payments for any of these?
 23 **A. No.**
 24 Q. Did you review opinions for any of these
 25 clients?

regular tax-affected corporate, you know, work in the
regular law firm. So estate planning and a corporate,
you know, tax, you know, you know, more focused on tax
savings being more effective for tax purposes and that
kind of thing. So that was the focus of that.
 Q. Why would you need an entity different from
 Krause & Associates to do that?
A. To make it seem like I was adding more value to
clients.
 Q. But you were the only one involved in --
A. Yes.
 Q. -- KAAS and Krause & Associates?
A. Yes, sir.
 Q. And do you recall who the partners of KAAS
 were?
A. Well, it would have been Crowley Krause
Management as the general, and then it would have been
either me as the limited or Krause & Associates as the
limited.
 Q. And you ran the daily operations of KAAS; is
 that right?
A. Yes, sir.
 Q. Do you recall what your percentage ownership
 was?
A. 99.99 percent.

1 **A. I would be remiss in not reviewing them.**
 2 Q. Did you review any of the Jenkins' opinions?
 3 **A. Absolutely.**
 4 Q. Do you handle your own personal investments?
 5 **A. Such as they are, yes.**
 6 Q. Going back to Krause & Associates Advance
 7 Strategies; do you recall when that was formed?
 8 **A. That had actually been in existence for about**
 9 **two or three years prior to it participating in the 2002**
 10 **transaction.**
 11 Q. And describe the business of Krause &
 12 Associates in a little more detail if you could,
 13 please?
 14 **A. Krause & Associates is --**
 15 Q. I'm sorry, Krause -- I'm going to refer to
 16 Krause & Associates Advanced Strategies as KAAS?
 17 **A. Okay.**
 18 Q. So in -- Krause & Associates is your law
 19 firm?
 20 **A. Yes.**
 21 Q. So if you could describe the business of KAAS a
 22 little more -- in a little more detail, please?
 23 **A. What we did -- what I did there was to visit**
 24 **with clients about, you know, estate planning strategies**
 25 **that were more sophisticated than, you know, just a**

Q. Effectively the entire thing?
A. Sure.
 Q. And do you recall what your initial investment
 in that entity was?
A. Probably \$750 to organize.
 Q. Were your duties any different in that entity
 as opposed to Krause & Associates?
A. No.
 Q. Prior to the formation of KAAS, was your
 ownership interest in Krause & Associates the only
 ownership interest you had in an entity at that time?
A. In my law firm?
 Q. Yeah.
A. Yeah.
 Q. You were the tax matters partner of KAAS; is
 that right?
A. Yes.
 Q. And going back to the settlement initiative,
 you received that as the tax matters partner of it?
A. Oh, yeah.
 Q. -- KAAS?
A. Uh-huh. I mean, if they sent one to me. I
mean, I was completely aware of it otherwise.
 Q. You were also aware of the two notices that
 came out, Notice 9959 and Notice 2000-44, when those came

1 out; is that right?

2 **A. I'm sure I was.**

3 Q. And you would presumably have advised your

4 clients about those notices?

5 **A. You know, in connection with the work that**

6 **Jenkins was doing, they provided advice on that.**

7 Q. But you would have become aware of those

8 notices prior to when you entered into this transaction;

9 is that correct?

10 **A. Yes.**

11 Q. In fact they came out several years before you

12 entered into this transaction?

13 **A. Yes.**

14 Q. And this transaction was one of the

15 transactions listed in Notice 9959 or 2000-44; is that

16 right?

17 **A. Well, Jenkins and Gilchrist' opinion**

18 **distinguishes their transaction from those notices.**

19 Q. But the notice had an offsetting options

20 transaction in there, did it not?

21 **A. You know, I don't recall. I mean, it's**

22 **entirely possible.**

23 Q. Okay. Krause Holdings, Inc.; can you tell me

24 what that entity was, please?

25 **A. Well, it's a corporation that serves as the**

Q. Now you're familiar with the offsetting foreign

currency digital option transaction called Son of Boss?

A. Yes.

Q. Is that the transaction that you entered

into?

A. Probably.

Q. Were you also involved in a Son of Boss shelter

called Curr-Spec?

A. Yes.

Q. What was that shelter?

A. That was as a -- a partnership that had some

transactions that -- and used -- used treasury short

sales.

Q. Now that's something that you entered into

yourself personally?

A. Yes.

Q. When was that loss -- that generated a loss; is

that right?

A. 1999.

Q. Did you take that loss on your return?

A. I did.

Q. And who was the promoter of that; do you

know?

A. There was no promoter.

Q. Was that a Jenkins & Gilchrist?

1 **general partner of limited partnerships, not that there**

2 **are many, but it's what it's doing right now.**

3 Q. Is that the only duty that it's conducting?

4 **A. Yes.**

5 Q. What about Krause Management, LC?

6 **A. Right now it's the general partner of Krause &**

7 **Associates, LP.**

8 Q. And that's the only thing it's doing?

9 **A. Yes.**

10 Q. And Krause & Associates, LP, is your law firm;

11 is that right?

12 **A. Yes, sir.**

13 Q. Krause Management, LC; what type of entity is

14 LC?

15 **A. Limited company.**

16 Q. And how is that different than a limited

17 partnership?

18 **A. It's a limited liability company.**

19 Q. So it's actually an LLC?

20 **A. It is, but those are some of the initials that**

21 **the statute authorizes; we try to have the fewest number**

22 **of keystrokes possible to make things simpler for the**

23 **clients.**

24 Q. But it is a limited liability company?

25 **A. Yes, sir.**

A. It was internally generated.

Q. You say -- did you do it yourself?

A. Yes.

Q. Where did you get the idea for that?

A. Well, I don't know, plagiarism.

Q. And do you recall whether that loss was

disallowed by the IRS?

A. Yes.

Q. Do you recall whether you paid penalties on

that tax shelter?

A. Not at this point.

Q. Not at this point you don't recall, or not at

this point --

A. Well, it's been in tax court now it's before

the 5th Circuit.

Q. Is there a recent ruling by the the 5th

Circuit?

A. There was.

Q. And as a result of that ruling, what -- what's

happening at this point?

A. Well, that ruling said that the -- the FPA was

not late and so there is no statute of limitation

defense.

Q. And so what will happen now; will you fight it

in tax court?

1 **A. Well, that -- that fight's already been fought.**
 2 **And so, you know, I guess the next step, just this last**
 3 **week we filed a petition for re-hearing --**
 4 Q. Assuming that it doesn't get granted, what
 5 happens then?
 6 **A. Then it's over with and I'm sure I'll get a --**
 7 **I'm sure I'll get a bill.**
 8 Q. Now will that bill include penalties?
 9 **A. It will.**
 10 Q. Do you remember if you filed a proceeding in
 11 tax court to challenge the FPAA?
 12 **A. In Curr-Spec?**
 13 Q. Yes.
 14 **A. Yes, absolutely.**
 15 Q. So within the 150-day period?
 16 **A. Yes.**
 17 Q. So that tax -- partnership level proceeding; is
 18 that right?
 19 **A. Right.**
 20 Q. Now you received the FPAA, the notice of final
 21 partnership administration, administrative --
 22 **A. -- adjustment.**
 23 Q. -- adjustment in this case; is that correct?
 24 **A. I'm sure I did.**
 25 Q. And you received it as the tax manager partner

about this transaction?

A. Paul Daugerdas probably did.

Q. Do you recall whether you made a profit on this transaction?

A. No, but I would be surprised if I did.

Q. Do you recall when you expected to make a profit on this transaction?

A. I think that there was -- the way it was described to me is that there was a reasonable likelihood that there could have been a profit.

Q. And who described that to you?

A. Paul Daugerdas.

Q. When you brought clients to -- I believe you testified you brought clients to Jenkins for purposes of entering into similar transactions; is that correct?

A. No, these were folks who had already heard about it and they asked me to help them with their transactions.

Q. Okay. Did you introduce them to Jenkins?

A. No. I don't think so. They knew about it -- a lot of people talk about it.

Q. So how did you help them with the transaction; is it what you described in terms of helping them complete documents?

A. Yes.

1 of KAAS?
 2 **A. Yes.**
 3 Q. And you did not file a petition in the tax
 4 court to challenge the FPAA?
 5 **A. Correct.**
 6 Q. And you also received a notice of deficiency
 7 from the IRS relating to this same adjustment, the tax
 8 adjustment?
 9 **A. Yes.**
 10 Q. And you're not challenging that?
 11 **A. Didn't challenge it at the time.**
 12 Q. Okay. And so it is my understanding that your
 13 only argument is that the penalties don't apply because
 14 of the 5th Circuit rulings in Heasley & Todd; is that a
 15 fair statement?
 16 **A. Yes.**
 17 Q. Now the loss you took in 2002 in this case was
 18 an ordinary loss; is that right?
 19 **A. Yes, sir.**
 20 Q. Do you recall when you first heard about this
 21 transaction, the offsetting foreign currency digital
 22 option transaction at issue in this lawsuit?
 23 **A. You know, there had been scuttlebutt about it**
 24 **for months.**
 25 Q. But you don't recall when -- or who told you

Q. Why did you engage in the digital option transaction in 2002?

A. Well, I believe that since the Sierra Microwave guys were doing it, it looked like a, you know, a good idea, so I said, Well, I'll jump on that bandwagon.

Q. But you advised them -- did you advise them to do it, the Sierra Microwave guys?

A. No.

Q. They had already decided to do it?

A. Yes. They knew about Jenkins. They wanted to talk to Jenkins, and so, you know, I let them talk to Jenkins and they said, We're going to go do this. And I said, All right.

Q. The primary purpose of executing this transaction for yourself, though, was to obtain a tax benefits; is that correct?

A. Well, the way it was described to me that there was also a reasonable opportunity to make a profit.

Q. How would you have made a profit on this transaction?

A. Because the offsetting digital options were created in a way so that if the currency moved within a certain range, then there could have been a pretty big profit.

Q. Do you know how big that range was there?

1 **A. I think it was pretty small.**
 2 Q. It was maybe two pips; are you familiar with
 3 what a pip is?
 4 **A. You know, now that you're mentioning it,**
 5 **I think I've heard about a pip before.**
 6 Q. Do you know what a pip is?
 7 **A. Not now. But back then I'm sure I knew what a**
 8 **pip was. It sounds really small.**
 9 Q. Do you know what the odds of the currency rate
 10 falling within the range that was given on your
 11 transaction?
 12 **A. I don't know now.**
 13 Q. Would you agree that the tax benefits played a
 14 substantial role in your deciding to invest in the
 15 transaction?
 16 **A. Yes.**
 17 Q. And you would not have entered into the
 18 transaction but for the tax benefits; is that right?
 19 **A. Well, the fact though that there was an**
 20 **opportunity to make a profit combined with were -- was**
 21 **the rationale.**
 22 Q. Have you done a digital option -- foreign
 23 currency option investment prior to the one in 2002?
 24 **A. No.**
 25 Q. What about after 2002?

A. Let's see. I think that what happened was is
that -- well, first of all, there was one option when it
expired, it created a loss and then there was another
option that created income and it was contributed to a
partnership. And then when the income was recognized,
that increased the basis in the partnership interest
because the income, you know, is reported to the
taxpayer. And so that created offsetting and so I'm not
sure how that there was another -- there was another loss
leg in there somewhere.
 Q. But legally can you tell me how -- what
 triggered the basis being increased; do you know the
 answer to that?
A. Yes. When a partnership has income, then the
partnership basis of the partner increased by the
proportionate share of the income.
 Q. You bought the options though personally; is
 that right?
A. I think that we bought the options personally
and at least one of them went into the partnership.
And the other one expired outside the partnership.
 Q. The one that expired outside the partnership
 that would have been income to you personally?
A. That created a loss. That was a loss
transaction.

1 **A. No.**
 2 Q. Okay. So this was the only foreign currency
 3 investment you've ever entered into?
 4 **A. Correct.**
 5 Q. Are you aware that certain people involved in
 6 the Son of Boss transactions have been indicted by the
 7 Southern District of New York?
 8 **A. You know, I guess that's news to me.**
 9 Q. What about the fact that certain members of --
 10 certain partners in the accounting firm of Ernst & Young
 11 have been convicted of a crime for --
 12 **A. No, I did not know about that.**
 13 Q. Give me your understanding of what the -- how
 14 the digital option, the offsetting option transaction
 15 worked, if you could, please?
 16 **A. Well, this is going to be really rudimentary**
 17 **and, you know -- digital option is apparently not a true**
 18 **option. It's described as synthetic, which I don't**
 19 **really quite understand what that means this time. But**
 20 **because the bets are placed, you know, in a certain way,**
 21 **then the risk of loss is contained but there is some**
 22 **opportunity to make money.**
 23 Q. Do you know how that translated -- how the
 24 transaction increased the basis in the partnership
 25 interest?

Q. Okay. So if the one that expired in the
 partnership created income --
A. -- then somewhere along the line, there was
some -- an additional loss leg.
 Q. And you increased your basis by the amount of
 the income generated; is that --
A. Yes.
 Q. And then what happened?
A. Well, then there was a loss -- another --
another loss leg that set off against that.
 Q. Do you know what that loss leg was?
A. I don't recall right now. I mean, it is
described in detail in the opinion.
 Q. Other than this transaction, do you have any
 experience in foreign currency investments?
A. No.
 Q. Do you understand the difference between a long
 and a short position in a digital option?
A. I understand the difference between a long and
a short position generally.
 Q. Describe that for me, please?
A. Well, a long position is where you own the --
you own the asset, you own the stock, you know, it's
yours, you own it, that's considered a long position. A
short position is where a person has borrowed, you know,

1 **an asset from another, and then sells it. And so they've**
2 **sold something that they don't own but they've borrowed.**

3 **That's a short position.**

4 Q. But as those relate to digital options
5 specifically you can't explain what the long and short
6 positions are?

7 **A. Well, when you add on the digital option piece,**
8 **then I don't know that it makes a difference, really,**
9 **because it's still being a long and a short.**

10 Q. You bought -- personally bought and sold the
11 options. There were two options in this transaction; is
12 that correct?

13 **A. Two or three because there was two loss legs**
14 **and one income leg.**

15 Q. We'll verify that in a little bit. But let's
16 assume that there were two options in this transaction.
17 You bought those personally; is that right?

18 **A. You know, I don't want to contradict what the**
19 **legal opinion says.**

20 Q. Do you recall contributing one or both of those
21 options to KAAS?

22 **A. The answer is is I don't really recall.**

23 Q. Okay. Do you recall why you may have done
24 that?

25 **A. On the -- I was advised to by Paul Daugerdas.**

other side of the transaction.

Q. So you would have bought the options and/or
sold the options from or to Gamma Trading Company?

A. If they were the counter-party, then the
answer, I suppose, would be yes.

Q. And how many meetings did you have with Jenkins
or Mr. Daugerdas about this transaction; do you recall?

A. No, but they would have been all by phone.

Q. Never met with him personally?

A. Never met the man -- oh, no, I never met him in
person.

Q. Have you met anyone from Jenkins & Gilchrist in
person?

A. Well, local lawyers here, but when I -- I did
go to Chicago one time on other business and, you know,
tried to meet Paul and some of his people and wasn't able
to get a meeting with them.

Q. Okay. About how many conversations did you
have with Mr. Daugerdas about your specific
transaction?

A. You know, it would be impossible to, you know,
without just speculating for me to say.

Q. Would you say more than five?

A. Sure.

Q. What about more than ten?

1 Q. But other than his advice, you don't have any
2 knowledge as to why that would have been done?

3 **A. Right. I'm sure at the time he explained it to**
4 **me and I understood it at that time.**

5 Q. And KAAS also bought \$20,000 worth of Canadian
6 dollars; do you recall that?

7 **A. No, not at this time.**

8 Q. Are you familiar with an entity called Gamma
9 Trading Partners, LLC, or limited liability company?

10 **A. Only in the respect that that's the company**
11 **that placed the trades on the digital options.**

12 Q. And how did you come about -- is that the only
13 time you've ever dealt with Gamma Trading Company is for
14 purposes of this transaction?

15 **A. Yes.**

16 Q. And do you recall how you came to know Gamma
17 Trading Company for purposes of this transaction?

18 **A. Through Paul Daugerdas.**

19 Q. What's your understanding -- do you understand
20 that Gamma Trading Partners was the counter-party in this
21 transaction?

22 **A. At the time I might have.**

23 Q. Do you know what counter-party means?

24 **A. Well, they're the party that you're either**
25 **borrowing from or selling to or buying from, they're the**

A. No, probably not.

Q. So between five and ten conversations?

A. Yes.

Q. And I'm talking about your specific shelter,
not other clients you may have had.

A. I'm sure I talked to him about, you know, the
transaction we were doing.

Q. Is there anyone else besides Mr. Daugerdas that
you talked with regarding this transaction?

A. Not that I recall.

Q. You don't recall ever paying a fee -- we talked
about this earlier but you don't recall ever paying a fee
to Jenkins for purposes of this transaction?

A. No, I don't recall doing that.

Q. Do you recall whether your other clients paid a
fee to Jenkins for entering into their transaction?

A. They paid big fees.

Q. Do you have any knowledge as to why you
wouldn't have paid a fee?

A. I think that -- I think that the reason for
that was because Paul was just adding me on to what he
was doing for them.

Q. Is it because you brought clients to Jenkins
that it was almost like a quid pro quo; is that fair to
say?

1 **A. No. Because, you know, I'm not the one that**
 2 **told the people to go up there. They were, you know, had**
 3 **already decided that they wanted to do those kinds of**
 4 **things and since I was being helpful, and I was**
 5 **interested, then Paul offered that and I said, Let's do**
 6 **it.**

7 Q. Do you recall ever signing a confidentiality
 8 agreement regarding your specific transaction?

9 **A. I'm pretty sure I did not.**

10 Q. And just to clarify, both the financial non-tax
 11 benefits as well as the tax benefits, you expected to
 12 receive from this transaction are the ones outlined in
 13 the Jenkins' legal opinion?

14 **A. Yes.**

15 Q. Are there any others outside of that opinion
 16 that you can tell me about?

17 **A. Not that I recall.**

18 Q. Did you get an opinion from anyone other than
 19 Jenkins & Gilchrist regarding this transaction?

20 **A. No.**

21 Q. Did you talk to anyone outside of Jenkins &
 22 Gilchrist about this transaction?

23 **A. You know, I may have, but I don't recall who I**
 24 **would have. It wasn't anything that I was trying to keep**
 25 **quiet.**

(marked for identification.)

Q. Turn to the next exhibit, and we'll call this
 Government Exhibit 2. And Winston, if you could, just to
 make it easier for the court reporter, can you just write
 in the exhibit number in there as we go along? I just
 want to make sure she's got those, because -- she's going
 to get that booklet.

A. Two.

Q. Yeah.

A. This is one.

Q. Yeah. And if you can, take a look at this
 exhibit and ask me -- or tell me if you recognize it.

A. I do now.

Q. Can you tell me what this letter -- this is a
 letter from you to Paul Daugerdas?

A. Yes.

Q. Dated March 29th of 1999; is that right?

A. Yes.

Q. And it discusses a basis enhancement securities
 transaction prospect. Can you tell me what that is?

A. Well, it says, "Is a transaction of only 4.25
million enough to go forward with a BEST?"

Q. Tell me what a BEST is.

A. Well, it's a basis enhancement securities
transaction.

1 Q. But did you go to anyone, another attorney,
 2 maybe informally and maybe ask them their opinion on --

3 **A. No.**

4 Q. So you don't recall getting any advice about
 5 this shelter outside of Jenkins & Gilchrist prior to when
 6 you entered into this transaction?

7 **A. The only advice that I got on this transaction**
 8 **was from Jenkins & Gilchrist.**

9 Q. And you stated you never met with Mr. Daugerdas
 10 personally, did you get any -- did you ever attend any
 11 presentations regarding this transaction whether it was
 12 for your own personal transaction or any of your other
 13 clients?

14 **A. No.**

15 Q. Do you recall giving your clients any advice
 16 regarding the digital option transaction?

17 **A. I'm not going to call it advice. They asked me**
 18 **if I understood it and I said, Yes.**

19 Q. Did you explain it to them?

20 **A. They seemed to understand it and we just talked**
 21 **about it.**

22 Q. Do you recall any PowerPoint presentations
 23 made?

24 **A. No.**

(Government Exhibit No. 2

Q. Right. And can you tell me what that
 transaction is?

A. I believe that's a treasury short.

Q. And you asked whether the 4.25 million is
 enough to go forward. What did you mean by that?

A. You know, I was probably wanting to know, you
know, what was the threshold for making it worthwhile.

Q. When you say "worthwhile," you're talking about
 in what context?

A. In context of whether or not, you know, Mr.
Daugerdas would consider doing it.

Q. Is that in relation to the fees that would be
 generated or the loss that would be generated, and
 what -- why wouldn't it be enough for Mr. Daugerdas to go
 forward?

A. Well, I -- whether or not it was a transaction
that was worth his while.

Q. Was it your understanding that transactions
 that were worth 4.25 million may not be worth his while
 to go forward?

A. Well, that's kind of why I was asking him.

Q. Do you know whether this was the Owens
 transaction that you were referring to?

A. It might have been. It might have been.

Q. And so you were having conversations with Mr.

1 Daugerdas as far as back as March of '99. As we talked
2 about, you were given that the notices from the IRS came
3 out, subsequent to that you were clearly familiar with
4 those two notices; is that right?

5 **A. Oh, yeah, I already testified about that.**

6 Q. Did you know that Jenkins was promoting the
7 basis enhancement securities transaction?

8 **A. That's why I wrote to them.**

9 Q. Do you remember getting a response from Mr.
10 Daugerdas?

11 **A. You know, I'm sure, I did.**

12 Q. And if this is the Owens transaction, it
13 actually did go forward; is that right?

14 **A. Yes.**

15 Q. Do you know whether Mr. Daugerdas was involved
16 personally in the Owens transaction?

17 **A. I would imagine.**

18 **(Government Exhibit No. 3**
19 **(marked for identification.**

20 Q. Turn to the next exhibit if you would please;
21 this is Exhibit 3. Do you recognize this document?

22 **A. No.**

23 Q. Do you know who Transtar Capital Corporation
24 is?

25 **A. Yeah, I recognize the name. But, you know, I'm**

delegating somebody else to get me some information.

Q. Okay. You had requested information on behalf
of the Owens -- behalf of Owens and Paul; is that
right?

A. Yes.

Q. And this fax appears to state -- or to request
Mr. Daugerdas to send information to you and this request
is coming from Mr. Klopfenstein; is that right?

**A. Let's see, fax cover sheet from Transtar to
Paul Klopfenstein. This is coming looks like from
Klopfenstein.**

Q. But you don't have any knowledge as to why Mr.
Klopfenstein would be asking Paul Daugerdas to send
information to you?

**A. No. When I first looked at this, I thought it
was the other way around, but obviously it can't be. So
what was the question again?**

Q. Well, my question is, Mr. Klopfenstein is
asking Mr. Daugerdas to send a BEST information package
to you on behalf of Mr. Owens and Mr. Paul, references to
the Harley Davidson dealership, but we know that that was
Mr. Owens and Mr. Paul?

A. Right.

Q. So my question is, do you have any knowledge as
to why Mr. Klopfenstein would be asking Mr. Daugerdas to

1 **not sure anymore what they do.**

2 Q. What about Mark Klopfenstein?

3 **A. Never met Mark Klopfenstein.**

4 Q. Do you know Mr. Klopfenstein?

5 **A. No.**

6 Q. Have you ever talked to him?

7 **A. I'm sure I've talked to him on the phone.**

8 Q. Do you recall what you would have talked to him
9 about?

10 **A. It would have been about whatever Paul
11 Daugerdas was faxing him about.**

12 Q. And this says, "Please send a BEST information
13 package to" you -- BEST would have been Basis Enhancement
14 Securities Transaction?

15 **A. Yes.**

16 Q. And you reference at the bottom, or it's
17 referenced at the bottom, excuse me, a \$9 million gain
18 from the sale of assets of a Harley Davidson dealership;
19 that was the Owens transaction?

20 **A. Yes.**

21 Q. So were you asking for a BEST package to be
22 sent to you to give to Mr. Owens and Mr. Paul? Is that
23 what was going on here?

24 **A. Well, I don't know if I was asking or pursuant
25 to my letter in Exhibit 2, that this is how Paul was**

send information to you?

**A. You know, it may be that I talked to
Mr. Klopfenstein first.**

Q. But what was his role in this transaction?

A. You know, I don't recall at this time.

Q. Do you know whether he was somehow -- had a
relationship with Mr. Owens or Mr. Paul?

A. I doubt that he did.

Q. Did he have a relationship with you outside of
this transaction?

**A. No. I mean, I may have spoken to him on the
phone, you know, prior to this.**

(Government Exhibit No. 4
(marked for identification.

Q. Turn to the next exhibit, please.

A. Four?

Q. Yes. Do you recognize this document?

**A. Well, this appears to be a confidentiality and
nondisclosure agreement that is signed by Transtar
Capital Corporation and me on behalf of the
undersigned.**

Q. That's your signature; is that correct?

A. It sure is.

Q. And what kind of entity is Krause & Associates,
LC?

1 **A. That is Krause and -- well, that's actually a**
 2 **predecessor to Krause & Associates, LP.**
 3 Q. So was Krause & Associates a limited liability
 4 company prior to when it became a limited partnership?
 5 **A. Yes. I think that it became, you know, Krause**
 6 **Management, LC and --**
 7 Q. But this is different than Krause & Associates,
 8 LP?
 9 **A. Yes.**
 10 Q. This entity?
 11 **A. You know, I think so. It's a predecessor to**
 12 **it.**
 13 Q. Why did you sign this confidentiality
 14 agreement; do you remember?
 15 **A. Well, I'm sure I signed it, speculating about**
 16 **it, because I don't remember specifically, is because**
 17 **Transtar Capital Corporation requested it.**
 18 Q. And the -- the confidentiality agreement
 19 discusses various tax recommendations. Do you see that,
 20 the first paragraph under the first "where as"
 21 paragraph?
 22 **A. (Reading from Exhibit No. 4.) "... -- entering**
 23 **into various arrangements to implement various tax**
 24 **recommendations for themselves, or for their affiliates,**
 25 **customers or clients." Yes.**

A. Well, Curr-Spec partners was a partnership.
 Q. Okay. Do you remember whether there was a
 basis increase --
A. Yes.
 Q. -- that then generated a loss?
A. Yes.
(Government Exhibit No. 5
(marked for identification.
 Q. Turn to the next exhibit if you would, please.
 We'll call this Exhibit 5. I'll ask if you recognize
 this document?
A. I recognize it as an account statement.
 Q. This is an account statement from RBC Dain
 Rauscher; is that correct?
A. Yes, sir.
 Q. This account statement is related to the
 transaction at issue in this matter; is it not?
A. The dates indicate that it sure might be.
 Q. If you go to the very last, the reason I'm
 asking is, if you go to the very last account statement,
 looking at D.O.J. 585, the bottom, base number. For the
 month of December in 2002, which I believe is when your
 transaction transpired; is that right? December of
 2002?
A. Yes.

1 Q. And do you know what tax recommendations are
 2 being referenced here?
 3 **A. Well, the document itself doesn't indicate, but**
 4 **one of the prior exhibits indicates that it might be**
 5 **a BEST transaction.**
 6 Q. Now you're signing a confidentiality agreement,
 7 did they then provide you with the details of the BEST
 8 transaction?
 9 **A. I'm assuming that they did.**
 10 Q. And then did you take that to Mr. Owens and
 11 Mr. Paul and explain to them what the BEST transaction
 12 was?
 13 **A. We -- I'm sure we discussed it.**
 14 Q. And did you advise them to enter into the BEST
 15 transaction?
 16 **A. You know, I don't know if I told them that they**
 17 **should or if, you know, once I explained it, they decided**
 18 **that they -- it was something that they could do.**
 19 Q. Was the Curr-Spec transaction we discussed
 20 earlier, was that a BEST transaction?
 21 **A. I don't know if a BEST is different from a**
 22 **treasury short or not.**
 23 Q. But in that transaction, do you recall whether
 24 there was a partnership involved; I'm talking about the
 25 Curr-Spec?

Q. It says here that this account at one point
 owned roughly 20,000 of Canadian currency; is that
 correct?
A. 19,528 Canadian dollars and 92 cents, that's
the amount, but the quantity looks like 30 million or
something.
 Q. The Canadian currency was part of the
 transaction at issue in this matter; is that correct?
A. I -- I don't dispute that; I don't recall.
 Q. Do you know Donna Guerin; does that name ring a
 bell?
A. No.
 Q. What about John Beery?
A. I recognize that name, I'm just not sure where
from.
 Q. Do you know whether Mr. Beery worked for
 Jenkins & Gilchrist?
A. He might have been an associate.
 Q. Do you know whether you worked with him on your
 transaction?
A. You know, I don't recall.
 Q. Were you aware at the time you entered into
 this transaction that Jenkins & Gilchrist was actively
 promoting tax shelters?
A. Well, I knew that they were giving tax advice

1 **to people.**
 2 Q. And they were preparing opinions, tax
 3 opinions?
 4 **A. Yes.**
 5 Q. Do you recall whether you took any notes from
 6 the telephone conversations you might have had with
 7 Jenkins & Gilchrist?
 8 **A. Highly likely.**
 9 Q. Do you know if you still have those notes?
 10 **A. Definitely not.**
 11 Q. You don't know or you don't have them?
 12 **A. No, I -- the only thing I kept on this**
 13 **transaction was the opinion and then the backup**
 14 **documents.**
 15 Q. Okay. Have you provided those to the
 16 government?
 17 **A. Yes.**
 18 Q. And you mentioned you didn't have an outside
 19 attorney review this transaction; is that correct?
 20 **A. Correct.**
 21 Q. And why not?
 22 **A. Because I felt like I was competent to**
 23 **understand what the rationale was.**
 24 Q. Even though you had never entered into a
 25 foreign currency transaction before entering into this

was a -- it was a government victory and basically what
it said was that an option, delivery obligation under an
option is not considered a liability for tax purposes.
 Q. And that would have allowed you to include the
 long position in the basis without having to account for
 the short position; is that right?
A. Yes.
 Q. So you could account for the fact that you --
 you didn't have to account for the fact that you were on
 the hook for one of the options in your partnership
 basis; is that a fair statement?
A. What it was, it was authority for the fact that
a delivery obligation didn't have tax consequences.
 Q. You didn't have the Jenkins' opinion though
 when you entered into this transaction; is that right?
A. Right.
 Q. So you didn't -- what information did you rely
 on when making the decision to enter into --
A. Visiting with Paul. He explained it -- that
this is different.
 Q. And how did he explain that this was different;
 just what we talked about?
A. You know, I'm not sure we actually talked about
it, but, you know, he made me feel comfortable enough
that, you know, I mean, first of all, he was willing to

1 one?
 2 **A. You know, I relied on Jenkins to explain the**
 3 **substance of the economics of the transaction but the tax**
 4 **analysis looked good to me.**
 5 Q. Did you have any concern about the fact that
 6 the IRS has come out in their two notices and listed
 7 transactions similar to this one as being covered under
 8 their tax shelter rules?
 9 **A. You know, Jenkins in my mind successfully**
 10 **distinguished these transactions from those.**
 11 Q. But did you have any concern about that or were
 12 you just completely relying on what Jenkins had said?
 13 **A. You know, I looked at their rationale for the**
 14 **distinction and I thought it was solid.**
 15 Q. Did you do any research on short sales prior to
 16 entering into this transaction?
 17 **A. Sure.**
 18 Q. What type of research did you do?
 19 **A. Well, I read the Hellmer case and, you know,**
 20 **thought that that -- you know, I mean that's, you know,**
 21 **pretty muchly the -- part of the reason for the rationale**
 22 **for the short sale.**
 23 Q. And tell me what your understanding of the
 24 Hellmer case is, if you wouldn't mind?
 25 **A. Well, my understanding of it is that -- it**

go forward with it, okay? He felt like it was
distinguished enough. And then, second of all, he -- you
know, I feel like he explained it to me, I don't have a
specific recollection about it, but if -- I do know that
if he had said, Oh, well, you know, we're just doing this
and this is -- you know, not any good, then I'm like, I
wouldn't have done it. Okay? So the fact that he was
willing to do it, you know, stake his reputation on it,
and he explained a rationale to me that made sense, then
based on that I decided it was fine to go forward.
 Q. You were aware at that time though that Jenkins
 was getting fees related to this shelter transaction; is
 that right?
A. Well, he was getting fees for his legal work,
yes.
 Q. And those fees were triggered off the amount of
 the tax loss that a client wanted to shelter -- I'm
 sorry, the amount of tax loss that a client wanted to
 generate as a result of the transaction; did you
 understand that?
A. Well, I understood that they were getting a fee
based on the value of the transaction of the client.
 Q. Okay. And so you were aware that the promoter
 of the transaction, which was Jenkins was also writing
 the tax opinion; is that correct?

1 **A. Well, as a law firm, advising people on, you**
2 **know, transactions and their tax consequence, I didn't**
3 **find it unusual at all that they would be paid for their**
4 **services.**

5 Q. But if I come to you and say, I have a product
6 to sell you, which is what Jenkins was doing; do you
7 agree with that?

8 **A. They were offering legal services, yes.**

9 Q. They were setting up a transaction that was
10 used to shelter income from taxes, that was generating a
11 tax loss; is that a fair statement?

12 **A. They were offering tax advice and advising**
13 **people on how to enter into transactions that would have**
14 **the consequences that they believed were appropriate.**

15 Q. But even beyond that though, Jenkins was
16 preparing documentation for clients to execute the
17 transaction, not just providing tax advice; is that
18 right?

19 **A. That sounds perfectly consistent to me with**
20 **what a lawyer would do.**

21 Q. So if I come to you as a lawyer and I say, I've
22 got this transaction that I think will work, and you're
23 going to pay me a fee, I'm going execute the transaction,
24 I'm also going to write you an opinion that says the
25 transaction will work for tax purposes; do you see a

as you call it; is that right?

A. Yes.

Q. Jenkins also wrote the opinion that said this
will work; is that right?

A. Yes.

Q. And you don't see a conflict of interest
anywhere in there?

A. I think that's what lawyers do.

Q. The opinion writer is supposed to be objective;
is that correct? The tax opinion; you would agree with
that statement?

A. Yes, absolutely.

Q. If I'm saying I wrote the opinion, if I'm
selling you the transaction and I'm also writing the
opinion saying it will work, do you believe that that's
an objective opinion?

A. Sure.

Q. And why do you believe that?

A. Well, let's move it to a different context. If
I'm a lawyer for a client that's borrowing \$30 million
from a bank and the bank asks me to write a legal opinion
saying that, you know, the documents that I've reviewed
that their lawyer wrote is going to validly put my client
on the hook, I'm going to get paid a fee for that, okay?
And I'm involved in the transaction because I helped to

1 conflict of interest anywhere in there?

2 **A. Well, the only thing I want to distinguish with**
3 **what you have said is that Gamma Trading was executing**
4 **the transaction and Jenkins & Gilchrist was advising how**
5 **the transaction should be structured.**

6 Q. And I'm not talking about your situation
7 specifically. Let's talk about one of your other clients
8 who may have entered into this transaction. Jenkins,
9 they were aware that Jenkins was selling a transaction
10 that could generate a tax loss; is that right?

11 **A. Well, I mean, Jenkins was well-known at the**
12 **time as being a very sophisticated firm that provided**
13 **some services that were highly valuable to clients.**

14 Q. Okay, but my question was, your clients -- you
15 testified, came to you because they heard about a
16 transaction Jenkins was promoting that could generate a
17 tax loss; is that correct?

18 **A. They had heard that Jenkins & Gilchrist was**
19 **offering services that they were interested in.**

20 Q. And those services involved transactions such
21 as a basis enhancement securities transaction or a
22 digital option transaction that could generate a tax
23 loss; is that a fair statement?

24 **A. Absolutely.**

25 Q. Okay. Jenkins charged a fee for that service

negotiate the documents on all of that. So, you know,
that's -- I think that's what lawyers do.

Q. Okay. But going back to my original question.
You were aware that Jenkins was selling a transaction
that could generate a tax loss and also writing an
opinion that covered that transaction; is that correct?

A. They had -- they had opinions about, you know,
the consequences of certain kinds of transaction and they
were happy to advise people about that. And so they
would advise people on how to do the transaction, there
was always a securities firm that executed the
transaction, and then they stepped up to the plate and
wrote a legal opinion that they were ready to stand
behind that said what the consequences were.

Q. Okay. And you were aware that this was going
on prior to the time that you entered into your
transaction?

A. Yes.

Q. Now for your transaction, you're not relying on
the Jenkins' opinion for purposes of arguing that
penalties are not applicable?

A. That's right.

Q. Your sole argument is that cases of Heasley and
Todd prevent the imposition of the penalties in this
matter?

1 **A. The answer to that is yes except that I've got**
 2 **other cases that support the same thing; I've got tax**
 3 **court cases and I've got a court claims case in there**
 4 **also. I've got three independent bases for it.**

5 Q. And you're absolutely right. But I'm going
 6 back to the Jenkins' legal opinion; you're not relying on
 7 the Jenkins' legal opinion for purposes of your position
 8 in this lawsuit?

9 **A. You're right.**

10 Q. You're not saying you had substantial authority
 11 for the position that you took?

12 **A. Correct. Not claiming that at all.**

13 Q. Your sole position is that the cases whether
 14 it's Heasley and Todd or --

15 **A. The other cases cited in our motion for summary**
 16 **judgment.**

17 Q. Right. The Weiner case and I think you might
 18 have cited a 9th Circuit case as well, prevent the
 19 imposition of the penalties; is that correct?

20 **A. Yes.**

21 Q. And you're not making any sort of reasonable
 22 cause argument as well?

23 **A. No, I'm not.**

24 Q. Okay. How did you decide what currencies to
 25 invest in?

to.

Q. Anyone advise you to do that?

A. No.

Q. If you could explain to me in a little more
 detail the basis of your position that the cases you
 mentioned prevent the imposition of the penalties in this
 matter?

A. Are you asking me for a legal opinion?

Q. Well, I'm not asking for a legal opinion, I'm
 asking for your opinion as a party in this case as to
 what your basis of the argument that the penalties should
 not be applied, whether it's factual or legal or --

A. Oh, shoot. You know, I have got that I think
pretty well explained in my motion or my brief, you know,
and I'm just concerned that if I testify about it, I
might contradict that, and I would really rather not.

Q. So are you then just standing on what you've
 stated in your motion for summary judgment as your
 position?

A. There's a lot of thought that went into that.

Q. What is your understanding of the gross
 evaluation of the statement penalty?

A. My understanding of the penalty is that it has
to relate to some kind of evaluation, you know,
misstatement, and I don't think that there was any

1 **A. I'm not sure that I did.**

2 Q. What's your understanding of how the penalties
 3 were calculated in this matter?

4 **A. The service took 40 percent of the increase in**
 5 **tax and applied the penalty.**

6 Q. And you're also arguing that the 20 percent
 7 penalty doesn't apply; is that correct?

8 **A. Right.**

9 Q. And your argument on that, if my understanding
 10 is correct, is that the IRS never assessed that specific
 11 penalty?

12 **A. That's right.**

13 Q. You're aware though that those penalties are
 14 listed in both the FPAA, the notice of final partnership
 15 of administrative adjustment as well as the statutory
 16 notice of deficiency; is that right?

17 **A. Absolutely.**

18 Q. Now you amended your 2003 return; is that
 19 right?

20 **A. Yes.**

21 Q. Why did you do that?

22 **A. To report the income without the loss**
 23 **carryover.**

24 Q. Why did you decide to do that?

25 **A. I just thought it would be in my best interest**

valuation, you know, in any of this transaction
whatsoever.

Q. You don't think the fact that the basis was
 overstated represents a valuation misstatement?

A. Has nothing to do with valuation.

Q. And where does that understanding come from?

A. Well, it comes from my understanding and, of
course, you know, now we're getting into, you know, legal
opinion here, but it's my understanding that those are
just a consequence of partnership tax accounting rules.

Q. Are you challenging the penalties in the
 Curr-Spec case?

A. I haven't paid any penalties in Curr-Spec.

Q. Are you planning on challenging the penalties
 in the Curr-Spec case?

A. Yes.

Q. Are you going to file a refund suit in that
 case? Or are you going to go to tax court --

A. Well, I've already been to tax court.

Q. Okay.

A. Well, that's -- that's just a partnership level
proceeding -- yeah, I sure might.

Q. When you say -- you amended your 2003 return
 and you took off the loss that had carried over from 2002
 you were backing out the tax benefit you received from

1 any of those transactions; is that right?

2 **A. Correct.**

3 Q. Now that tax benefit arose due to the increased

4 basis; is that right, in the partnership?

5 **A. Well, it carry -- it was a loss carryover from**

6 **the prior year.**

7 Q. But in 2002, which generated the loss

8 carryover, that tax benefit arose due to the increased

9 basis in KAAS; is that right?

10 **A. Well, remember there was a loss leg and then**

11 **end of the partnership went -- I think, and the income**

12 **leg and the loss leg that set off, okay? So what**

13 **happened was that that all set off and it left the loss**

14 **leg outside. So I think the loss came from, you know,**

15 **entering into a digital option. And that's going to be**

16 **subject to whatever the opinion describes, you know, as**

17 **the transaction.**

18 MR. BLACKER: I need to take a quick break.

19 (Short recess.)

20 MR. BLACKER CONTINUES:

21 (Government Exhibit No. 6

22 (marked for identification.

23 Q. I think we are on Exhibit 6. And I'll ask if

24 you recognize this document?

25 **A. I do.**

A. Yes. Well, it's related to the transactions

that Jenkins & Gilchrist wrote an opinion about.

Q. So this generated -- the expiration of that

option generated a \$2.7 million ordinary loss; is that

right?

A. According to Jenkins, yes.

Q. How does the expiration of an option generate a

loss?

A. You know, Jenkins explained it very succinctly

in the opinion.

Q. Do you recall just as you sit here how that --

A. I haven't looked at that opinion in a long

time.

Q. Turn to Schedule E on this return, the second

page of Schedule E, you've got a \$2.377 million

nonpassive loss from Krause & Associates, LC; do you see

that?

A. 2.7?

Q. 2.377, under A?

A. Oh, yes, Krause & Associates, yes.

Q. Two questions, a few questions, should that

have been Krause & Associates, LP?

A. It might have been. Might should have been. I

mean, that's my -- you know, that's my law firm.

Q. So Krause & Associates, LP, is your law firm,

1 Q. And on the signature page is that your

2 signature?

3 **A. Absolutely.**

4 Q. And that's your wife's signature?

5 **A. It sure is.**

6 Q. And it says it was self-prepared; does that

7 mean you prepared it?

8 **A. I used TurboTax, yes.**

9 Q. And you describe your profession as attorney

10 and your wife as development director; what does that

11 mean?

12 **A. She helps charities raise money.**

13 Q. And do you ordinarily prepare your own

14 returns?

15 **A. I do.**

16 Q. On Line 14 you report a \$2,791,250 loss.

17 **A. Isn't that a beautiful thing?**

18 Q. And then you point to Schedule 4797 or -- it

19 says to attach 4797 as the supporting schedule. Can you

20 explain how that loss was generated?

21 **A. Let's see, 4797. Expired option.**

22 Q. And which option is that; do you know?

23 **A. I do not.**

24 Q. But that was related to the shelter transaction

25 at issue in this matter?

right?

A. Yes.

Q. And do you know how that loss was generated?

A. Well, I'm sure if -- it flowed through from

Krause & Associates Advance Strategies to Krause &

Associates and then onto here.

Q. So loss generated by KAAS which then flowed

through to --

A. KA --

Q. Krause & Associates, LP?

A. Yes.

Q. Which then flowed through to you on your

individual return?

A. Yes.

Q. That's a result of the transaction at issue in

this matter; is that right?

A. Yes.

Q. But do you know how that loss was generated?

A. I'm sure it was expiration of an option.

Q. You also have income of 2.791250, \$2,791,250

from KAAS. Do you see that?

A. Yes.

Q. How is that income generated?

A. Well, that must have been an option that --

when it expired, it generated income.

1 Q. Okay. So are you saying that there were three
2 options involved?

3 **A. Three legs, three legs.**

4 Q. Do you remember there being a debt instrument
5 mixed in here?

6 **A. Entirely possible.**

7 Q. And were you just trying to -- you were
8 generating -- you were trying to generate an ordinary
9 loss to offset income from your law partnership; is that
10 a fair statement?

11 **A. Well, what I was trying to do is to engage in a
12 transaction that might make some money and it apparently
13 did not.**

14 Q. Ultimately -- it offset income you generated
15 from your law partnership?

16 **A. The unfortunate consequence is that the loss
17 was greater than all the other income.**

18 Q. What income did you have during 2002 that would
19 have been offset by this loss?

20 **A. Wages, interest, dividends, a small capital
21 gain, and then other income from other partnerships.**

22 Q. The wages that would have been from your wife;
23 is that right?

24 **A. Right, uh-huh.**

25 Q. And the other income on line -- I'm sorry, the

**and now I just keep it around because, you know, it
contains the minute amount of separate property that I
own. It's just a little partnership that keeps that
separate from everything else.**

Q. Are you getting royalties out of that
partnership?

A. Huh-uh, it makes nothing.

Q. Does it own oil and gas leases?

A. Not any longer.

Q. What does it own today?

**A. A little bit of money that earn practically no
interest.**

Q. And what is Interface -- Interfase Capital
Managers, LLC?

**A. That is the general partner entity of two
partnerships that own some stock in an animation studio
out in San Diego. And what that is, just real quickly
is -- there was a promoter fellow here in town that
organized a series of partnerships named Interfase and
raised about \$40 million, and then he got sued and he had
to resign as the manager. And I was hired by the other
general partners to manage these two partnerships and
protect the interest of the investors.**

Q. Is that still going on today?

A. Yes.

1 income from partnerships on Line 17, that would have been
2 from your partnership, the law partnership?

3 **A. Well, there are four partnerships down there.
4 It looks like the 2.3, it looks like it's -- well, let's
5 see -- four, five, six -- 400,000 here. Yeah, okay.
6 The -- I'm sorry, I forgot the question.**

7 Q. Well, you were talking about that there were
8 four partnerships; I was asking what the \$456,000 number
9 on Line 17, where that --

10 **A. Well, it's the sum of Line 26 on Page 1 of
11 Schedule E and Line 31 on Page 2 of Schedule E.**

12 Q. And line --

13 **A. And then go down to the summary, Line 40 on
14 Page 2 of Schedule E. Right.**

15 Q. So that Line 40 flowed into Line 17 on the
16 1040?

17 **A. It did.**

18 Q. Okay. And that would have included some rental
19 income?

20 **A. Yes. The 456,000 includes everything from all
21 the partnerships plus the little bit of rents.**

22 Q. What's Boulevard Oaks?

23 **A. That's a company that I organized. Well, it's
24 a company that I had -- I've had for many, many years
25 that originally had some oil and gas properties in it,**

Q. And do you make any money from that?

A. No.

Q. The 2,791,250 that you report as income on
Schedule E, that amount offsets the 2,791,250 loss
reported on Form 4797 due to the expired option; is that
right?

A. If that's what the return says, then yes.

Q. That's what the return says.

A. Okay.

Q. So those two amounts offset each other. Then
you had a \$2.3 million loss that came from Krause &
Associates, your law firm; is that correct?

**A. I -- my testimony is going to be that if that's
what the return says, then it's written right there.**

**(Government Exhibit No. 7
marked for identification.)**

Q. Turn to the next exhibit; I believe we're on 7.
I'll ask if you recognize this document?

A. I do.

Q. Can you tell me what it is, please?

**A. It is a -- it's the 2001 partnership tax return
for Krause -- for KAAS.**

Q. Is that your signature?

A. It sure is.

Q. You prepared this return; is that right?

1 **A. I did.**
 2 Q. This partnership KAAS during 2001 generated
 3 income of two hundred ninety eight five -- about
 4 \$298,500; is that correct?
 5 **A. Yes.**
 6 Q. What was that income from?
 7 **A. That was income from, you know, legal services**
 8 **connected with what I consider to be extra high value**
 9 **services.**
 10 Q. What types of services were those?
 11 **A. Typically tax -- tax planning, estate planning,**
 12 **you know, some type of corporate transactions.**
 13 Q. Any of the fees that were generated as a result
 14 of your work on Jenkins' transactions reported in this
 15 income?
 16 **A. You know, I don't recall. I don't know that**
 17 **there were any clients that, you know, engaged in**
 18 **Jenkins' transactions in 2001.**
 19 Q. Any fees that you would have generated for
 20 advising clients related to a Jenkins' shelter
 21 transaction; would those fees have been reported in
 22 KAAS?
 23 **A. Entirely possible.**
 24 Q. Do you recall generating any types of those
 25 fees; in any year?

A. Well, up at the top it says "Termination due to
Section 70 -- 708-1B4," which probably refers to a
technical partnership termination.
 Q. And is that your signature?
A. Yes.
 Q. And you prepared this return; is that right?
A. With the aid of TurboTax, yes.
 Q. Do you recall whether Jenkins had accounting
 firms preparing tax returns as part of their
 transaction?
A. I don't recall at all.
 Q. You were the tax manager partner for this
 entity?
A. Yes.
 Q. And again --
A. Well, let's see -- that's not designated.
Well, I wasn't a partner; I think Krause Holdings might
have been.
 Q. But you were the sole owner of Krause
 Holdings?
A. Yeah.
 Q. Partners of this were Krause Holdings and your
 law firm, Krause & Associates, LP?
A. Yes.
 Q. And this partnership generated a 2.7 --

1 **A. Well, 300,000 in 2001.**
 2 Q. And the partner in KAAS are listed as Krause &
 3 Associates, LP, which is a 99.99 percent limited partner;
 4 is that right?
 5 **A. Yes, sir.**
 6 Q. And that's your law firm?
 7 **A. Yes, sir.**
 8 Q. And then the other partner is Krause Holdings,
 9 Inc., as a .01 percent general partner; is that
 10 correct?
 11 **A. Yes, sir.**
 12 **(Government Exhibit No. 8**
 13 **(marked for identification.**
 14 Q. You can turn to the next form, this is
 15 Exhibit 8. And I'll ask if you recognize this
 16 document?
 17 **A. I do.**
 18 Q. Can you tell me what it is, please?
 19 **A. 2002 US return of partnership income for**
 20 **KAAS.**
 21 Q. And this is a return for the year January 1 to
 22 December 26th; is that right?
 23 **A. Yes.**
 24 Q. Do you recall why the year would have ended on
 25 December 26th?

\$2,791,250 gain during this year; is that right?
A. Where does it say that?
 Q. If you look at Line 6?
A. Oh, okay. That's a gain and not a loss.
 Q. Do you know where that came from?
A. 4797.
 Q. I didn't see a 4797 attached to this return.
A. Maybe that got detached somewhere. Well, this
is not a completed copy of the return because it doesn't
have the K1s either, not that that matters.
 Q. But sitting here, can you tell me what that
 gain represents?
A. Well, sure, that that was, you know, the result
of an expired option.
 Q. Is it possible for an expired option to
 generate both a loss and a gain?
A. I don't think so. They would have to be
different options.
 Q. How would an option generate a gain -- an
 expired option; do you know?
A. I'd have to go refresh my recollection on how
that worked in this particular transaction.
 Q. KAAS for most of 2002 reported \$167,000 of
 income. Where did that money come from?
A. From other transactions with clients.

1 Q. Would those transactions include clients who
2 entered into Jenkins' shelter transactions?

3 **A. You know, I just can't recall. You know, the
4 thing is is that, you know, there was some, I guess, in
5 2000 and then the next batch was in 2002. So that would
6 have been later.**

7 Q. We know -- we saw in 2001 too, KAAS had
8 generated fees as well?

9 **A. Uh-huh.**

10 Q. You were receiving fees from clients for your
11 advising them on Jenkins' transactions; is that right?

12 **A. Right.**

13 Q. This return also states that there was capital
14 contributed during the year, and I'm looking at the M2 of
15 this same No. 2791-250. Do you know where that came
16 from?

17 **A. That might have been a contribution to one of
18 option legs.**

19 Q. And do you know why the option leg would have
20 been contributed to KAAS?

21 **A. I don't recall at this time, but I'm sure it's
22 explained in detail in the opinion.**

23 Q. KAAS, this year was closed on December 26th
24 because you contributed your interest in this partnership
25 to your law firm; is that right?

signature?

A. Sure is.

Q. And you prepared this return; is that right?

A. Self-prepared with TurboTax help.

Q. I'll stipulate that anytime you prepared the
return that it was with TurboTax's help.

A. Back in the day we did this by hand.

Q. This partnership for -- what appears to be five
days at the end of 2002, December 26th through December
31st reported a loss of \$2,791,708; is that right?

A. Yes, sir.

Q. Now on the form 4797, that talks about a sale
of Canadian currency?

A. Exhibit 9.

Q. Seven pages.

A. Oh, here we go, Canadian currency, yes.

Q. So is this the -- is this the other loss leg
you were talking about?

**A. It must be. This is obviously partnership
assets that acquired the basis of the partnership
interest on the termination.**

Q. So the basis of the partnership interest --
well, let me back up. KAAS on your instructions bought
20,000 of Canadian currency; is that right?

A. It appears so.

1 **A. You know, I don't recall that, but --**

2 Q. That's what would have caused the technical
3 termination, because it only had one partner?

4 **A. Well, let's take a look at 9 and see who the
5 partners are there. Krause Holdings. This doesn't
6 appear to be a complete return either. Well, let's see.
7 Yes, it looks like it because there is -- Krause &
8 Associates, LP, is a partner from December 26th through
9 December 31.**

10 Q. So you contributed your interest in KAAS to
11 Krause & Associates, LP, and then --

12 **A. Apparently, yes.**

13 Q. -- and then a new Krause & Associates --

14 **A. -- KAAS --**

15 Q. -- was formed?

16 **A. Yes.**

17 **(Government Exhibit No. 9
18 (marked for identification.)**

19 Q. Now moving on to what we've marked as
20 Government Exhibit 9; can you tell me what that is,
21 please?

22 **A. This is the KAAS return for 2002 from December
23 26, 2002 to December 31, 2002.**

24 Q. And on this return you report a loss-- or KAAS
25 reports a loss -- I'm sorry, strike that. Is that your

Q. Okay. They sold that Canadian currency for
\$19,542?

A. That's what this return says.

Q. Okay. You bought it for 20 -- you -- KAAS
bought it for 20, sold it for 19,542, but you report a 2
million -- close to a \$2.8 million loss on that; is that
right?

A. That's what this form says, yes.

Q. And can you explain how that -- how the basis
of the Canadian currency became -- well, according to the
form \$2.8 million?

**A. Well, according to partnership tax accounting
rules, whenever there is a partnership termination, then
it's treated as if the assets were distributed out and
then recontributed. And so when the assets were
distributed out, then, you know, the basis of the
partnership interest is attached to the -- and allocated
among the assets.**

Q. And the assets were the Canadian currency?

A. Yes.

Q. And the basis of the partnership interest arose
due to the fact that you treated the option -- you took
the basis of one of the options and ignored the other
option; is that a fair statement?

A. No, I think that what happened was is that

1 there was an option that was contributed, you know, into
2 the partnership. And then when it expired, it generated
3 all this income, And then that increased the basis of the
4 partnership interest and the termination took that
5 increased basis of partnership interest and that became
6 the basis of the inside assets. And then that, you know,
7 with the rules that say on a technical termination, that
8 it's a recontribution, well, the inside assets now have
9 the basis that it had because of the rules and when it
10 sold, then that generates a loss.

11 Q. And you didn't have to recognize income on the
12 expiration of an option because you had another option
13 that expired that offset that income; is that right?
14 That's how the transaction worked; is that correct?

15 A. Well, let's see, there was one option that was
16 on the outside and that always was on the outside and
17 that produced a loss. There was another option that was
18 contributed to the partnership and it produced a gain.
19 That gain flowed through and caused the basis in the
20 partnership interest to be increased, then the
21 termination took that partnership basis and put it on the
22 partnership assets that remained at the time, which is
23 the Canadian currency, and then this Canadian currency
24 with the -- with the new basis is then recontributed to
25 the partnership and when sold, it realizes a loss. So it

income of 2.791,250?

A. That's right.

Q. Now go back to your 1040, which is Government Exhibit 6.

A. Let's see here. I want to look at 6. Let's look at six.

Q. And there's the 2,791,250 loss that you're -- that's the outside option, and that's what you reported on 4797?

A. Right, right. And then that's also the same as on Page 2 Schedule E, 2,791,250.

Q. Absolutely, and that's the -- that's the gain that we just looked at on Exhibit 8?

A. That's the gain. It sure is.

Q. That flowed through down from KAAS; is that right?

A. Right.

Q. So those two offset, then it's the sale of the Canadian currency that generates the actual monetary loss.

A. Oh, okay.

Q. Is that a fair statement?

A. Yeah, it's coming back to me now.

Q. Okay. So you have this sale of Canadian currency, which would you agree that economically your

1 sounds -- after we've been through this whole thing, that
2 there was really just two option legs.

3 Q. There were two options legs?

4 A. One that always was outside and the other one
5 that was transferred in.

6 Q. Right. And the one that was outside generated
7 a loss for you individually?

8 A. Uh-huh.

9 Q. And you reported that on your individual 1040.
10 The one on the inside generated income that eventually
11 flowed up to you on your individual return; those two
12 offset, correct?

13 A. Well, I'm actually thinking that what offset --
14 and of course they all offset, you know, but I'm not sure
15 which offset, because there is -- one large loss and then
16 one large piece of income realized, then one large loss.
17 So I've got two losses and one income, so they set off to
18 whatever they set off to.

19 Q. Right. And the -- the loss on the outside
20 exactly matched the option loss on the inside, so those
21 two would offset, dollar for dollar?

22 A. Well, maybe.

23 Q. Well, let's look. Go back to the Exhibit 8.

24 A. 8.

25 Q. On the first page of Exhibit 8, you report

loss was less than \$1,000; is that a fair statement?

A. Closer to 500.

Q. Out of pocket, cash out of pocket?

A. Yes.

Q. You bought it for 20,000, you sold it for 19,500 so it's about a \$500 economic loss; is that a fair statement?

A. Would appear to be so.

Q. You took \$2.7 million ordinary loss as a result of the transaction you entered into with Jenkins. That was part of that; is that right? Is that a fair statement?

A. You know, I am not running away from what these things say.

Q. And I'm not -- I'm not trying to trick you, I'm just trying to -- I need to get an understanding of how the transaction worked. This 2 million, \$2.7 million, close to \$2.8 million loss that KAAS reported for its year December 26 through December 31; that loss -- a portion of that loss then flowed through to Krause & Associates, LP?

A. It appears so.

Q. On the K1, for Government Exhibit 9, you've got 2.791,429 flowing through to KALP, Krause & Associates, LP.

1 **A. Apparently.**
 2 **(Government Exhibit No. 10**
 3 **(marked for identification.**
 4 Q. Then if you take look at the one, which is,
 5 we'll call 10, this is the Krause & Associates 1065 for
 6 the tax year 2002, correct?
 7 **A. Yes, sir.**
 8 Q. And that's your signature?
 9 **A. It is.**
 10 Q. And you prepared this return as well?
 11 **A. I did.**
 12 Q. And we can see where that 2,791,429 flowed
 13 through if you turn to 5th page; one of the supplemental
 14 schedules?
 15 **A. There it is.**
 16 Q. Right. So that came from Krause & Associates
 17 Advanced Strategies and Krause & Associates, LP, for 2002
 18 ended up reporting about a \$2.3 million net loss?
 19 **A. Correct.**
 20 Q. That loss would have then flowed through to
 21 your individual return?
 22 **A. Yes.**
 23 Q. And that's the \$2.377 million loss we see on
 24 Schedule E from Krause & Associates, says LC, but it
 25 should have been LP; is that right?

through from KAAS helped offset some of that income; is
 that right?
A. Yes.
 Q. Turn to the next exhibit, if you would, please.
 I'm sorry, actually go back to Government Exhibit 10 real
 quick. And look at the K1 for you and your wife. You
 allocated 2,377,276 of the loss that was generated by
 Krause & Associates, LP, or the loss that flowed through
 to Krause & Associates LP, correct?
A. Yes, sir.
 Q. And then that loss would have then been
 reported on your 1040?
A. Yes.
 Q. Okay. And your 1040, you report 2,377,279, and
 for us here it's 276, was that just a typo?
A. Might have been.
(Government Exhibit No. 11
(marked for identification.
 Q. Turn to Government 11, if you would, please.
 And this is the KAAS return for 2003; is that right?
A. Yes, sir.
 Q. And it states that this is the final return for
 this entity; is that your understanding?
A. Apparently so.
 Q. So KAAS would have been terminated in 2003; is

1 **A. Yep.**
 2 Q. Now the IRS disallowed on the KAAS partnership
 3 return for the 2002 -- the short year, they disallowed
 4 that 2,791,708 loss; is that correct?
 5 **A. Yes.**
 6 Q. They gave you some basis in the Canadian
 7 currency; that is right?
 8 **A. I don't recall.**
 9 Q. They could have disallowed the entire
 10 2,811,250; they could have allowed the entire sales
 11 price -- I mean, the entire basis?
 12 **A. Well, I don't know that they didn't.**
 13 Q. Well, if you take a look at the FPAA, which
 14 we'll look at, I believe it says that they disallowed the
 15 2,791,708; do you recall them giving you any basis in the
 16 currency?
 17 **A. No, I thought, my impression, of course, you**
 18 **know, we'll refresh the recollection when we get there,**
 19 **but it looked to me that they just kind of reversed out**
 20 **everything that was on the partnership returns.**
 21 Q. On Exhibit 10 for 2002, your law practice
 22 generated about a half a million dollars -- over half a
 23 million dollars worth of income?
 24 **A. Of gross income.**
 25 Q. And of course the loss that would have flowed

that your signature --
A. I --
 Q. Sorry, go ahead?
A. Yes, that's my signature.
 Q. And to your knowledge KAAS has not been
 reformed; is that right?
A. It has not.
 Q. Okay. And you didn't generate any income in
 KAAS for 2003; is that right?
A. Correct.
(Government Exhibit No. 12
(marked for identification.
 Q. Now if you can turn to Government Exhibit 12;
 do you recognize this document? It's not a complete
 return, this is all we got.
A. It's okay.
 Q. Do you recognize this document?
A. I do.
 Q. This is your 2003 individual 1040?
A. Yes, sir.
 Q. And that's your signature and your wife's
 signature?
A. Absolutely.
 Q. Now here you report an adjusted gross income of
 one point -- over 1.8 -- a \$1.8 million dollar loss,

1 correct?

2 **A. Yes.**

3 Q. That would have been the result of the

4 operating loss --

5 **A. -- carried forward.**

6 Q. -- carried forward from 2002, correct?

7 **A. Yes.**

8 **(Government Exhibit No. 13**

9 **(marked for identification.**

10 Q. And then if you turn to Government 13, this is

11 your amended return for 2003; is that right?

12 **A. Yes.**

13 Q. Here you're backing out the net operating loss

14 that carried forward from '02, correct?

15 **A. Yes. The return is filed "reflecting ... and**

16 **in a -- that taxpayers now wish to disregard in**

17 **determining their income tax."**

18 Q. Your AIG went from -- I'm sorry, your adjusted

19 gross income went from a loss of 1.8 million to income of

20 a little over 400,000; is that right?

21 **A. It appears that that's what it says.**

22 Q. And that's your signature and your wife's

23 signature?

24 **A. Yes.**

25 Q. And why did you decide to amend your return? I

A. Sure.

Q. This is your claim for refund filed in this case; is that right?

A. Yes.

Q. And in this, your position -- the position you take in this claim for refund is that the IRS can't assert a valuation misstatement penalty due to a disallowed deduction; is that right?

A. Right.

Q. And that would have come from, among other cases, Heasley and Todd; correct?

A. Yes, uh-huh.

Q. And there is no substantial authority, no reasonable cause, argument outlined in here; is that correct?

A. Right.

Q. Is it your position that what the IRS did in disallowing the losses represented the disallowance of a deduction as opposed to a basis adjustment?

A. You know, it may just disallow a loss.

Q. Wasn't that disallowance though as a result of a basis adjustment?

A. You know, I think the FPAA -- between the FPAA and the stat notice there were something on the order of about 20 different rationales for it, so it's hard to

1 mean, you know, you said you thought it was --

2 **A. -- best thing to do, you know, I think the**

3 **settlement issue was coming out and so I think I -- it's**

4 **the best thing to do.**

5 **(Government Exhibit No. 14**

6 **(marked for identification.**

7 Q. I'm going to mark this as Exhibit 14. I'm

8 going to hand you that. This is your amended complaint

9 filed in this case; is that right?

10 **A. Yes, sir.**

11 Q. Now if you turn to your Exhibit A in that

12 amended complaint --

13 **A. Well, this is part of it. It doesn't have all**

14 **the exhibits.**

15 Q. Does yours go to Page 45?

16 **A. This one right here?**

17 Q. Yes.

18 **A. No. It goes to -- the only exhibit that this**

19 **particular copy has is Exhibit A.**

20 Q. Okay.

21 **A. So there is Exhibit B, Exhibit C, Exhibit D,**

22 **you know, and here Government Exhibit 14; well, this is a**

23 **copy of my Exhibit D to this, so --**

24 Q. And I -- what I really want to talk about was

25 Exhibit A?

say. I think there was like 14 in the FPAA and eight of

them in the stat notice so --

(Government Exhibit No. 15

(marked for identification.

Q. Let's look at the FPAA, which I think I'll mark as 15 --

A. Oh, shoot.

Q. That's all right. I forgot to put --

A. I got a little ahead of you here. I've got

this one marked as 15 now; I'll just make that a six.

Not very artful.

Q. This is a copy of the FPAA you received, or Krause Holdings, Inc., received related to this transaction, correct?

A. It's related to the partnership tax return for KAAS for 2002.

Q. It would have been addressing the Jenkins' transaction that is the subject of this lawsuit; is that right?

A. I'll tell you what it addressed; it addressed every single thing that was on the return. It just simply reversed out every -- every entry on the form.

Q. And I believe the page you're looking at, it's got the -- it reverses out the gain that was reported for the year ending 12/26/02, reverses out the income

1 reported and reverses out the loss reported; is that
2 right?

3 **A. Yes.**

4 Q. Of 2,791,708?

5 **A. Yes, that would have been the income.**

6 Q. Well, the partnership reported a loss at the
7 end of 2002?

8 **A. Uh-huh.**

9 Q. And so in reversing it, it would have reversed
10 that loss and treated it as income; is that right?

11 **A. Yes. This adjustment -- if this is a negative
12 number, that means that it was taking away income, that's
13 in this one column ending December 26. And in the other
14 column, if it's a positive number, then it's reversing a
15 loss.**

16 Q. Right. And we've gone through and talked about
17 those -- that loss and that income; is that correct?

18 **A. Sure.**

19 Q. And you never challenged this FPAA?

20 **A. No, I didn't file anything in tax court, claims
21 court, anything.**

22 Q. What is your understanding of what happens when
23 an FPAA is not challenged?

24 **A. That the partnership items that were changed as
25 a result of the FPAA are changed for all the partners.**

**a jurisdictional challenge I think by the government, to
the -- and that was a partnership proceeding. And so
I think the government challenged the Court's
jurisdiction in the Eastern District of Texas to be able
to hear evidence having to do with the partnerships
evaluation, you know, of the transactions. And the Court
said, Well, we sure can hear that. And it seemed like
the 5th Circuit came long and said that even though
penalties are assessed at partner level, that some aspect
of it is determined at the partnership level.**

Q. Of course Klamath was a partnership level
case?

A. Right.

Q. So the determinations in the FPAA had not been
made prior to when Klamath was decided, I mean, that's
what the whole case was about, correct?

A. Sure.

Q. In this case --

**A. But, but, the FPAA, I'm sure like this one, you
know, listed all these penalties and so the partnership
in that case wanted to put on some evidence.**

Q. Right.

**A. And of course the government contested that
saying no jurisdiction.**

Q. But aren't we past that point in this case?

1 Q. And that would have included penalties; is that
2 right?

3 **A. Well, there's been recent case law that says
4 that -- it only addresses the partnership level aspects
5 of it.**

6 Q. Do you know whether penalties are considered
7 partnership level items?

8 **A. They can be. I mean, I think it's a little bit
9 of an open item at this point.**

10 Q. The FPAA lists the 40 percent penalty as well
11 as several 20 percent penalties; is that right?

12 **A. It's got four of them in there.**

13 Q. And your position is that the IRS never
14 assessed the 20 percent penalty, they only assessed the
15 40 percent penalty and therefore the 20 percent penalty
16 is not applicable; is that right?

17 **A. That's right.**

18 Q. And when you talk about recent cases, can you
19 give me the names of those cases?

20 **A. I think Klamath is one.**

21 Q. Klamath?

22 **A. Klamath, yeah.**

23 Q. And what's your understanding of Klamath's view
24 on penalties?

25 **A. Well, I think that what Klamath says, there was**

A. Oh, yeah.

Q. So the determinations outlined in the FPAA have
been upheld because you did not challenge them; is that
correct?

A. Didn't challenge the FPAA.

Q. Or the Notice of Deficiency?

A. Correct.

Q. And what is your basis for your position that
20 percent penalty doesn't apply?

A. My legal basis?

Q. We're kind of in a gray area here because
you're both the attorney and the party. Let me ask you,
do you have a factual basis for your position that the 20
percent penalty does not apply?

**A. Well, the factual basis is is that if there
were other penalties that applied, you know -- well,
first of all, a claim for refund is only a claim for the
taxes that were assessed and paid. And so the IRS chose
the higher one and picked that and assessed it and it was
paid and that's what the claim is about. It's not about
other penalties that could have been assessed but were
not, and therefore were not paid and therefore are not
part of the claim for refund.**

Q. It's your position then that the IRS could have
assessed --

1 **A. -- any one of these.**
 2 Q. Or all of them, correct?
 3 **A. No. They have to pick one.**
 4 Q. Exactly. They have to pick one. They can't
 5 assess 40 and then four 20s; is that right?
 6 **A. That's right. They have to pick.**
 7 Q. Okay. So what is your -- your position is that
 8 because they chose the 40, the 20 is completely
 9 inapplicable; is that right?
 10 **A. Correct.**
 11 Q. Where does that come from?
 12 **A. Well, it comes from the fact that they have to**
 13 **decide. They just can't say it's all.**
 14 Q. Is there a statute that says that?
 15 **A. Well, there's the anti-stacking regulation, you**
 16 **know, that you pointed to.**
 17 Q. Right. And what's your understanding of that
 18 regulation?
 19 **A. That they have to decide.**
 20 Q. Okay.
 21 **A. They have to choose.**
 22 Q. Are you aware of any court deciding that the 40
 23 percent penalty is inapplicable but the 20 percent
 24 penalty is applicable?
 25 **A. No.**

A. 2.5, yeah. Are these not the same?
 Q. Well, let's take a look. Look at the -- where
 it says, about midway down, amount of transaction. Do
 you see that?
A. 2.5 -- got you. Okay.
 Q. Do you see where I'm looking at?
A. Yeah, this one says 2 million.
 Q. And right underneath that, it says ordinary 2
 million?
A. Yeah. Okay.
 Q. That's the amount of tax loss to be generated
 from this transaction; is that correct?
A. You know, that's probably the amount of the
digital option.
 Q. And that roughly coincides with the amount of
 loss reported on the return; is that right?
A. Well --
 Q. Actually less.
A. It seems like it was a lot less.
 Q. Well, then we turn to page --
A. This is a lot less.
 Q. -- to the next one. We have got a transaction,
 750,000?
A. Yes.
 Q. Ordinary 750,000. Do you see that?

1 Q. So you're not aware of any case law that says
 2 that?
 3 **A. No.**
 4 **(Government Exhibit No. 16**
 5 **(marked for identification.**
 6 Q. Turn to the next one. I think we're on 16?
 7 **A. 16.**
 8 Q. Do you recognize this document?
 9 **A. This is an information questionnaire from**
 10 **Jenkins & Gilchrist.**
 11 Q. Do you recall seeing this?
 12 **A. Well, it's addressed to me.**
 13 Q. There is actually two here, right?
 14 **A. Oh, okay. They're both addressed to me.**
 15 Q. And one of them, you've got an amount of the
 16 transaction -- well, let me ask, do you recognize this
 17 document?
 18 **A. Well, I recognize it as something that, you**
 19 **know, very easily could have come into the office.**
 20 Q. And you would have provided this information;
 21 is that correct?
 22 **A. That's the only way they could have gotten the**
 23 **information.**
 24 Q. Sure. So the amount of transaction at the
 25 first page is listed as 2 million. Do you see that?

A. I do.
 Q. Combine those two, you get about 2.7 million of
 ordinary loss; is that right?
A. Well, it's probably 2.7 million of digital
options.
 Q. Okay. Well, when you say amount of digital
 option, doesn't that coincide with the amount of loss to
 be recognized?
A. You know, I think that's the way it turned out.
 Q. And this amount was determined even prior to
 when the transaction was completed; is that right?
A. Got to start somewhere.
(Government Exhibit No. 17
(marked for identification.
 Q. All right. Turn to the next exhibit if you
 would, please?
A. And there is John Beery's name. Have you ever
met him?
 Q. Huh-uh, no. Does this help refresh your
 recollection as to who Mr. Beery is?
A. This looks like something I prepared.
 Q. Is this your understanding of the structure of
 the Jenkins transaction?
A. Well, this is the structure of my companies.
 Q. Why would you have been sending this to

1 Mr. Beery?

2 **A. To help them with their planning. It would be**

3 **important for them to understand what the setup was.**

4 Q. At the bottom of -- again, this was prepared

5 prior to when you entered into the transaction; is that

6 right?

7 **A. In November, yeah.**

8 Q. And these are entities that were involved in

9 the shelter transaction, correct?

10 **A. Well, these are the entities that were in**

11 **existence at the time that the transaction occurred and**

12 **both of them had been in existence for several years.**

13 Q. But they were involved in the shelter

14 transaction; is that right?

15 **A. Well, they were involved in the digital options**

16 **transactions that Gamma Trading executed.**

17 Q. And you state at the bottom that you may not

18 want to sell all the foreign currency immediately but

19 sell some in 2003; do you see that?

20 **A. I see where it says that.**

21 Q. How did you know back in November of 2002, you

22 might want to sell some in 2003?

23 **A. You know, those foreign currency values go up**

24 **and down. I might have wanted to sell some later.**

25 Q. Did you need a loss in 2003 as well?

within the bounds to have a discussion about and it

wasn't completely a one-way discussion.

(Government Exhibit No. 18

(marked for identification.

Q. Turn to the next one. I'll ask you if you

recognize this document?

A. I recognize it.

Q. Tell me what it is, please?

A. Although I haven't seen it in probably eight

years. This is an individual customer information form

from Gamma Trading Partners, and there is a couple of

them.

Q. And that -- let me ask my first question. Have

you ever done business with Gamma Trading Partners prior

to this transaction?

A. Never before and never since.

Q. Had you ever heard of Gamma Trading Partners

before this transaction?

A. No.

Q. It appears that you filled an information form

out individually; is that a fair statement?

A. Well, it's got my name up there.

Q. And then Krause & Associates also did one; is

that right? Or is that part of the --

A. That may just be -- it says current employer.

1 **A. I'm not sure I needed anything in 2003.**

2 Q. What was the structure intended to achieve; do

3 you know?

4 **A. The structure here on these pages?**

5 Q. Yes.

6 **A. Well, this is just how everything was set up.**

7 **I mean, Krause & Associates had been around for a long**

8 **time and KAAS had been around for two or three years.**

9 Q. Well, this is also talking about though how the

10 transaction is going to work, at least part it; is that

11 right?

12 **A. It addresses the, you know, the work that I was**

13 **doing with Jenkins & Gilchrist, yeah.**

14 Q. But you were actually telling Jenkins how the

15 transaction, at least a portion of it, was going to

16 work?

17 **A. Well, I was telling them, I mean, if you look**

18 **at what this really does, I was telling them what the**

19 **setup is and then -- let's see, "JWK contributes position**

20 **thus," and it looks like it's incomplete. It might have**

21 **been a proposal, you know, for -- maybe this is how it**

22 **could work.**

23 Q. Why were you telling Jenkins -- why were you

24 giving Jenkins a proposal as to how this might work?

25 **A. Well, I think it was, you know, perfectly**

Q. So this was just kind of part of the same

form?

A. Yeah, and it says Page 2 of 2 at the top of the

third page.

Q. Fair enough. Is that your signature?

A. It is.

Q. And it's dated November 25th of '02; is that

right?

A. Yes, sir.

(Government Exhibit No. 19

(marked for identification.

Q. Turn to the next page, please.

A. The next exhibit?

Q. Yeah, I'm sorry, the next exhibit. And I'll

ask if you recognize what I've marked as Government

Exhibit 19?

A. I do.

Q. Tell me what it is, please?

A. It is an account information non-entity form

for RBC Dain Rauscher.

Q. Had ever worked with RBC Dain Rauscher before

this transaction?

A. Well, I've never had an account with them, but

I've got relationships here in town with people that work

for Dain Rauscher and I've got clients that have, you

1 **know, accounts with Dain Rauscher.**
 2 Q. Okay. Before this transaction, had you ever
 3 had an account with Dain Rauscher?
 4 **A. I did not.**
 5 Q. What about since this transaction?
 6 **A. I have not -- oh, wait a minute. I do have an**
 7 **account at Dain Rauscher. That was just opened last**
 8 **year.**
 9 Q. On this -- let me ask, is that your signature
 10 at the bottom of that first page?
 11 **A. Yes, sir.**
 12 Q. And do you recall why Krause & Associates
 13 Advance Strategies needed to fill out this form?
 14 **A. You know, it looked like it needed to have an**
 15 **account at RBC Dain Rauscher.**
 16 Q. Was that for purposes of completing the
 17 Jenkins' transaction?
 18 **A. It sure might have been part of it. And the**
 19 **only reason why I know is because I see John Beery's name**
 20 **on here.**
 21 Q. Is he the one that told you to get an account
 22 at RBC Dain Rauscher?
 23 **A. He probably recommended it.**
 24 Q. This first page doesn't appear to be dated. Do
 25 you see that?

would be why.
 Q. And of course No. 20 is dated 12/18, I'm
 assuming that's an 18; is that an 18 or is that a two?
A. I don't know.
 Q. But it's dated in any event; is that right?
A. Yes.
 Q. And that's your signature?
A. It is.
 Q. And this one -- No. 20 appears to have been
 opened 12/5/02, while 19 appears to have been opened
 12/17/02.
A. It looks like there was some delay in them
taking this information and creating a new account.
 Q. On 19 you indicate that your investment
 experience was extensive; is that right?
A. Well, you know, it looks like that, but they
put down there, because if you see what I sent to them, I
just said securities.
 Q. Okay. What did you mean by securities?
A. That I'd owned some stocks and bonds.
 Q. And the investment objectives were different as
 well. They put down aggressive growth. You put down
 growth and value of income.
A. Does it surprise you that stockbrokers do that?
 Q. Well, that was part of my question. Were you

1 **A. Well, it's dated by the financial consult but**
 2 **it doesn't look like it's got my date on it. By my**
 3 **signature.**
 4 Q. And thank you very much for that clarification,
 5 actually.
 6 (Government Exhibit No. 20
 7 (marked for identification).
 8 Q. If you can turn to the next exhibit, what's
 9 marked as 20. This one is for the same entity; is that
 10 right? Krause & Associates Advanced Strategies?
 11 **A. Let's see. Yeah.**
 12 Q. It's got a different EIN. Do you have any idea
 13 why that would be different?
 14 **A. It looks like the next to last number was**
 15 **transposed.**
 16 Q. Okay. So --
 17 **A. It's -- instead of being an eight like it is --**
 18 **because this looks like something that, you know, we**
 19 **typed in our office and this looks like something that**
 20 **was produced in their office.**
 21 Q. Okay.
 22 **A. And see if I can say that a little bit better.**
 23 **20 looks like a form that I had typed in my office, and**
 24 **19 looks like they took that information and then they**
 25 **printed it out on their form in their office, and that**

looking for aggressive growth or were you looking for
 growth of value and income?
A. I'm sure it was probably all of the above.
 Q. Would you consider the foreign currency
 investment that you made fairly aggressive?
A. I don't know. It was a pretty small amount.
 Q. Do you consider foreign currency investments in
 general to be fairly risky?
A. No, not really, you know, I mean, you have to
own a lot to really make any money on a movement.
 Q. Do you know -- do you advise any individual
 clients about foreign currency investments?
A. Well, it's not my business to advise anybody on
investments.
 Q. Has anyone ever asked you about entering into a
 foreign currency investment, one of your clients; you've
 sent them to a financial advisor?
A. Well, I've got a client that likes to talk
about it a lot but, you know, I'm not giving him advice
on it.
 Q. Okay. And I'm not -- I'm not trying to get you
 in trouble as being a financial adviser, but my question
 is do you know of any of your clients who have invested
 in foreign currencies?
A. Yes, I do.

1 Q. How many?
 2 **A. There is only one.**
 3 Q. So one of your clients has invested in foreign
 4 currencies?
 5 **A. Uh-huh.**
 6 Q. But beyond that you're not aware of any of your
 7 other clients doing that?
 8 **A. Correct.**
 9 Q. And prior to this transaction, you had never
 10 invested in a foreign currency and after this transaction
 11 you had never invested in a foreign currency?
 12 **A. Right, right.**
 13 **(Government Exhibit No. 21**
 14 **(marked for identification.**
 15 Q. Can you turn to the next exhibit for me,
 16 please? Do you recognize this document?
 17 **A. Only because it's got my signature on it.**
 18 Q. That is your signature?
 19 **A. It is.**
 20 Q. And you signed on behalf of both Krause &
 21 Associates, LP, and Krause Holdings, Inc.
 22 **A. Yes.**
 23 Q. And do you recall whether this was actually
 24 signed on March 26th, 2001 or is that a typo?
 25 **A. Well, that has to do with the execution of the**

income.
 Q. If the option hit, you would have made a lot of
 money?
A. Oh, yeah. Retirement money.
(Government Exhibit No. 22
(marked for identification.
 Q. All right. Go to the next exhibit, if you
 would, please. This is marked as 22. Do you recall this
 letter?
A. You know, not specifically, but, you know, I
don't have any qualms about it.
 Q. It's a letter to you from Mr. Beery at Jenkins
 & Gilchrist dated November 23rd, 2002; is that right?
A. It appears to be, yeah.
 Q. And in it Mr. Beery states that "Enclosed are
 various documents necessary to establish the entities and
 trading relationships you've requested." What entities
 and trading relationships did you request of Jenkins &
 Gilchrist; do you recall?
A. I don't.
 Q. Was it a transaction that we've been
 discussing?
A. I'm sure it had to do with KAAS and Krause &
Associates and all of those.
(Government Exhibit No. 23

partnership agreement for Advanced Strategies.
 2 Q. So is that one when Advanced Strategies came
 3 into existence?
 4 **A. You know, I don't recall, but they obviously**
 5 **got that off of the partnership term when I sent it to**
 6 **them.**
 7 Q. You sent RBC Dain Rauscher --
 8 **A. I must have because they, you know, have**
 9 **something down there about that.**
 10 Q. Was that consistent with your understanding
 11 about when KAAS was formed, March of 2001?
 12 **A. You know, I -- I thought it had been organized**
 13 **earlier than that.**
 14 Q. Do you have copies of any tax returns for KAAS
 15 earlier than 2001?
 16 **A. You know, I just don't recall. I would have to**
 17 **check it out.**
 18 Q. If you could check and if you have earlier
 19 returns, just please send them?
 20 **A. Sure.**
 21 Q. Going back to Exhibit 20 real quick, when you
 22 state your objective is growth and value with income. Do
 23 you have any knowledge as to how the option transaction
 24 would have generated growth and value with income?
 25 **A. Well, I know how it would have generated**

(marked for identification.
 Q. If you can, turn to the next one, please. I've
 marked this as Exhibit 23. This is a letter to you
 from -- I'm sorry, it's to Msrs. Rodriguez, Tsankov and
 Turpin from Mr. Daugerdas. Do you see that?
A. Yes, sir.
 Q. Now these are the guys that own Sierra
 Microwave Technologies; is that correct?
A. Correct.
 Q. And the letter states that, Pursuant to your
 request, Mr. Daugerdas is sending various documents to
 these three individuals; is that right?
A. That's what it says.
 Q. Okay, and this is dated November 20th of '01?
A. Absolutely.
 Q. Do you recall making that request?
A. You know, my job was to facilitate, you know,
the -- you know, representation of Jenkins with my
clients, and so I'm sure that I was doing what I was
asked to do.
 Q. So your clients wanted to enter into a
 Jenkins --
A. Oh, yeah.
 Q. -- tax transaction; is that right?
A. Yeah. They thought that Jenkins had a lot of

1 **good advice to give.**
 2 Q. Okay. And they asked you to request documents
 3 from Jenkins & Gilchrist?
 4 **A. Sure.**
 5 Q. And that's what this letter is referencing, is
 6 your request to Jenkins for them to send documents to the
 7 owners of Sierra Microwave Technologies?
 8 **A. That's correct.**
 9 Q. Do you know whether they were selling the
 10 company during 2001?
 11 **A. You know, I thought that they sold the company**
 12 **in 2002, but then, you know, that's just based on**
 13 **recollection.**
 14 Q. And the sale of that company would have
 15 generated a large gain; is that right as individuals?
 16 **A. Absolutely.**
 17 Q. Okay. And did you advise them on the Jenkins'
 18 transaction and receive a fee for that?
 19 **A. I did.**
 20 Q. Okay. Did you explain the transaction to
 21 them?
 22 **A. Absolutely.**
 23 Q. Do you recall being at a meeting where Jenkins
 24 may have explained the transaction to them?
 25 **A. No.**

Q. I'm sorry, I think I might have said Frank
 Henna; do you know whether there is a Frank Henna and a
 Louis Henna?
A. Well, Louis Henna is my client and Frank would
not be anybody.
 Q. There's no such thing has Frank Henna?
A. Not that I'm aware of.
 Q. So -- and you actually prepared some of the
 documents -- well, let me back up. Mr. Henna was also
 wanting to engage in Jenkins' tax transaction?
A. He did.
 Q. During 2001?
A. Yes, sir.
 Q. And you advised him regarding that
 transaction?
A. I helped him as much as I could.
 Q. Okay. And you actually helped prepare some of
 the documents that were used in that transaction?
A. I organized some of the companies. I did an
Articles of Conversion. I did a number of things.
 Q. Well, let's look at this Exhibit 24. There is
 an Articles of Organization for an entity LMHJ in 2001,
 I, LC; do you see that?
A. I do.
 Q. Is that your signature on the back page of that

1 Q. So you're the one who explained the tax
 2 consequences of entering into the transaction?
 3 **A. Well, I wasn't the only one. I mean, there was**
 4 **telephone conferences. I mean, nobody from Chicago came**
 5 **down so --**
 6 Q. But you met with them in person?
 7 **A. I met with my clients in person, yeah.**
 8 Q. And explained to them the transaction?
 9 **A. You know something, that Troy Rodriguez is a**
 10 **pretty smart guy; he was explaining it to me.**
 11 Q. And the fees that you would have received from
 12 your advising would have been reported in KAAS for this
 13 year; is that correct?
 14 **A. Yeah. I mean, if it got favor pay, then they'd**
 15 **be reported there.**
 16 **(Government Exhibit No. 24**
 17 **(marked for identification.**
 18 Q. Turn to the next exhibit if you would, please,
 19 24. And I'll ask if you have ever seen this document?
 20 **A. Henna Chevrolet is one of my clients, so more**
 21 **than likely, yes.**
 22 Q. And I had asked earlier if you knew anyone
 23 named Louis Henna?
 24 **A. Well, it was Frank Henna, and I wasn't sure**
 25 **that that was the same guy.**

document?
A. Article -- it sure is.
 Q. And there is also a -- in there, there is a
 document that is the Articles of Conversion?
A. Yes.
 Q. Do you recall preparing that?
A. I did prepare those.
 Q. Okay. And do you recall what type of tax
 transaction this was; do you know whether it was an
 option transaction or a treasury short sale?
A. No, I don't. And I'm not sure I've got the
opinion anymore.
 Q. Got the tax opinion?
A. Yeah. I'm not sure I do have it anymore.
 Q. Do you know who provided that? Was that
 Jenkins?
A. Jenkins & Gilchrist.
 Q. And do you recall receiving a fee relating to
 your advice on this transaction?
A. Sure. Uh-huh.
 Q. Do you recall about how much the loss was that
 Mr. Henna reported?
A. No.
 Q. Do you recall meeting with Mr. Henna and
 explaining to him the tax -- the tax consequences of

1 entering into this transaction?
 2 **A. Yes. Well, not specifically, but, you know,**
 3 **that would have been something I would have done.**
 4 Q. And this was back in 1999; is that right?
 5 **A. Well, these documents are all dated 2001,**
 6 **except the Articles of Conversion. The Articles of**
 7 **Conversion didn't have anything to do with**
 8 **anything Jenkins & Gilchrist did.**
 9 Q. Do you know why you would have converted it?
 10 **A. To avoid paying Texas franchise tax.**
 11 **(Government Exhibit No. 25**
 12 **(marked for identification.**
 13 Q. Turn to the next one, please. We're kind of
 14 moving through these at a fairly rapid pace, my
 15 preference would be to kind of finish this and maybe take
 16 a lunch break.
 17 **A. That would be great.**
 18 Q. Is that okay with everybody?
 19 **A. So the next one is 24.**
 20 **(Short recess.)**
 21 **MR. BLACKER CONTINUES:**
 22 Q. Let's turn to the next one. I've got it marked
 23 as 25? And this is a letter from Mr. Daugerdas to Louis
 24 Henna dated September 20 of 2000; is that right?
 25 **A. Yes, sir. 2000 -- 2000, September 20, 2000.**

of entering into a second shelter transaction; is that
 right?
A. Well, she's providing him these five documents
that are listed there.
 Q. Okay. And what was the purpose of these five
 documents?
A. These five documents, the purpose of these five
documents were to implement the transactions that Jenkins
was helping to implement.
 Q. This was the second of Mr. Henna's shelter
 transactions; is that right?
A. Well, the first one was in 2000 and the second
one was in 2001.
 Q. Is that your recollection as well?
A. Yes.
 Q. Did Mr. Henna do a third tax shelter?
A. I don't think so.
(Government Exhibit No. 27
(marked for identification.
 Q. If you turn to the next exhibit, I think I've
 got that labeled as 27. And at the bottom of this --
 there's two e-mails on this page, one of them is from you
 to Mr. Henna with a copy to Mr. Beery asking Mr. Henna to
 provide wiring instructions; do you recall the purpose of
 that?

1 Q. And you were copied on this letter; is that
 2 correct?
 3 **A. There is a CC down there with my name by it.**
 4 Q. And you were -- you had again requested that
 5 Jenkins provide documents to Mr. Henna for purposes of
 6 entering into the tax transaction?
 7 **A. Well, this letter just says that I requested**
 8 **that he send these items.**
 9 Q. Okay.
 10 Do you recall what the fee you received for
 11 this transaction was?
 12 **A. No, sir.**
 13 Q. And Mr. Henna did a shelter in both 2000 and
 14 2001; is that right? He did two shelters?
 15 **A. He had two year's worth.**
 16 **(Government Exhibit No. 26**
 17 **(marked for identification.**
 18 Q. And if you turn the page to the next document,
 19 which I've marked as 26, this is essentially the same
 20 letter from Mr. -- Ms. Guerin to Mr. Henna at your
 21 request sending various -- or requesting -- sending Mr.
 22 Henna various documents at your request; is that right?
 23 **A. Yes. This is a letter where Ms. Guerin is**
 24 **sending this letter to Mr. Henna.**
 25 Q. And she's providing him documents for purposes

A. Well, I'm sure the wiring instructions would
have been to -- for sending money.
 Q. Did that relate to Mr. Henna's tax shelter
 transaction?
A. Well, I'm sure it actually related to a request
by Jenkins & Gilchrist.
 Q. Okay. Were they trying to get their fees?
A. I don't know if it was their fees or if they
needed to have some money to make the transaction go or
whatever.
 Q. Well, this e-mail is dated December 16th of
 '02.
A. Okay.
 Q. And we've already talked about the fact that he
 did the shelters in 2000 and 2001. I'm just curious why
 there would have been a subsequent e-mail in 2002
 relating to -- do you have any recollection of that?
A. Maybe we don't -- maybe we're getting the years
wrong.
 Q. Well, I mean the letters clearly are dated 2000
 and 2001, and again I'm not trying to trick you, I'm just
 trying to ask if you know what -- if you have any idea
 what this was about in late 2002.
A. You know, I don't.
(Government Exhibit No. 28

1 (marked for identification.)
 2 Q. Turn the page, 28. This is a letter from
 3 Mr. Beery to Mr. Henna in December of '02 and it states
 4 that, the middle paragraph says, "Also enclosed is an
 5 invoice for our services. Pursuant to the transaction
 6 structure as set forth in our conversation with J.
 7 Winston Krause, I have also prepared a letter of
 8 authorization directing a payment of our fee from a
 9 partnership account you have established." Does that
 10 help refresh your recollection?

11 **A. Well, it -- it may be that his transactions**
 12 **that he undertook were in 2001 and 2002.**

13 Q. Okay. And what transaction structure is
 14 referenced in this letter; do you know?

15 **A. Well, it would be in connection with the**
 16 **partnerships and, you know, that he had going at the**
 17 **time.**

18 (Government Exhibit No. 29
 19 (marked for identification.)

20 Q. Would you turn to the next document? This is
 21 29. This is a package of documents related to JK
 22 Chevrolet, Inc.; are you familiar with that entity?

23 **A. Yes, sir.**

24 Q. Can you tell me what your understanding of that
 25 is?

Q. You prepared the Articles of Organization?
A. More than -- anything that would have been
filed in Texas, that would have been me.

Q. Okay. That's your signature as part of the
 Articles of Organization; is that right?

A. Articles of Organization of JK operating LC?

Q. Yes.

A. Absolutely. Proudly so.

Q. Do you recall whether you advised Mr. Keating
 regarding this transaction?

A. Well, I was actually helping him in connection
with the sale of his business. And so, you know, I'm
sure that since I was working with him on that it segued
into his work with Jenkins & Gilchrist.

Q. And do you recall how much -- he was going to
 recognize a gain on the sale of his business, is that
 right?

A. You know, I would hope so, but I don't have any
recollection about it.

(Government Exhibit No. 30
 (marked for identification.)

Q. If you can turn to the next document?

A. This is a fax cover sheet from Jenkins &
Gilchrist.

Q. Yes.

1 **A. JK Chevrolet, Inc. is an auto dealership over**
 2 **in Nederland, Texas.**

3 Q. Okay. You represent the dealership?

4 **A. I represent the owner.**

5 Q. That's John Keating?

6 **A. Yes.**

7 Q. And this was -- this was a package of documents
 8 that was provided for purposes of Mr. Keating to enter
 9 into a shelter transaction; is that right?

10 **A. Well, what this looks like is it looks like the**
 11 **group of documents that Jenkins & Gilchrist would have**
 12 **put together as part of their documentary basis for doing**
 13 **the work that they did.**

14 Q. Okay. This relates though to a -- to a tax
 15 shelter transaction; is that right?

16 **A. Well, it relates to the work that Jenkins &**
 17 **Gilchrist was hired for.**

18 Q. Other than the tax shelter work that they were
 19 hired for, do you know of any work that Jenkins &
 20 Gilchrist did for Mr. Keating?

21 **A. You know, I'm not going to say that there was**
 22 **any tax shelter involved.**

23 Q. And you prepared some of the documents that are
 24 in this package; is that right?

25 **A. Yes, sir.**

A. Number?

Q. I've got it as 30. This was to you and Mr.
 Keating. It looks like it was dated around October 10th
 of 2000; is that right?

A. You're getting that from somewhere.

Q. From the top of the sheet.

A. Oh, oh, oh. October 10, 2000.

Q. And it states that attached, which I don't have
 the attachment, is a draft term sheet regarding the
 transaction, "Please note the term sheet is for 10.5
 million. We will be doing it with 8 million and two and
 a half million; do you know what that means?"

A. Well, it means that he's advising that the
transaction is going to occur in a certain way.

Q. Okay. And the 10.5 million represents what?

A. Well, it represents an amount that the term
sheet involves.

Q. Is that the amount of the transaction?

A. Well, I'm sure it is.

Q. That's the amount of tax that -- tax loss that
 was to be generated from the transaction?

A. Well, it's probably -- actually relates to
some digital option or some swap or something like that
that Jenkins was going have to place an order for.

Q. Mr. Keating actually did a swap transaction, is

1 that right, as opposed to a digital option transaction?

2 **A. Well, if you'll show me that something will**

3 **refresh my recollection, I'll be able to say yes or no.**

4 **(Government Exhibit No. 31**

5 **(marked for identification.**

6 Q. Okay. Take a look at the next page. I've got

7 this as 31.

8 Can you tell me what this document is, please?

9 **A. This is an executive summary of JK Chevrolet,**

10 **Inc. sale asset transaction.**

11 Q. Okay. And there's actually two documents here;

12 is that right?

13 **A. Yes.**

14 Q. And have you ever seen this before?

15 **A. Well, it looks like I wrote it.**

16 Q. Tell me what this is, please?

17 **A. Well, it's an executive summary illustrating**

18 **the method by which it sells its assets.**

19 Q. Okay. And this is also discussing the tax

20 loss, the generation of the tax loss; is it not?

21 **A. Well, it's a series of transactions where we --**

22 **there is already an -- already a limited partnership**

23 **that's organized. There is real property involved.**

24 **Let's see, general partnership, the sale of treasury**

25 **shorts, cash is contributed. There is 2.5 million of**

Q. The last bullet right before you get to

paragraph --

A. -- Okay. JK Chevrolet on its K1, JK, LP,

offsets the ordinary loss from the foreign currency loss.

Q. And they were also using -- this executive

summary describes using foreign currency to generate

ordinary tax loss; is that right?

A. Well, it's -- it says what it says.

Q. And you prepared both of these?

A. I did.

Q. Do you recall getting fees for preparing

these?

A. I was billing hourly so I'm sure I did.

(Government Exhibit No. 32

(marked for identification.

Q. Turn to the next document, 32. This is one of

the standard letters that we've seen from Mr. Daugerdas.

This one is to John Keating and you're copied on this; is

that right?

A. There is a CC with my name on it on there.

Q. Do you have any reason to believe you wouldn't

have received this?

A. No.

Q. And it's dated October 3rd of 2000, correct?

A. I confirm that.

1 **cash. And there is a purchase of foreign currency.**

2 **Contribution of partnership interest. One partner**

3 **liquidating, stepped up foreign currency generating**

4 **ordinary loss.**

5 Q. And that ordinary loss would have been --

6 ordinary tax loss; is that right?

7 **A. Yes.**

8 Q. So this outlines the treasury short sale

9 transaction that Mr. Keating entered into to generate an

10 ordinary tax loss?

11 **A. Well, this -- what this is, is this is an**

12 **executive summary to help him understand what Jenkins &**

13 **Gilchrist was proposing.**

14 Q. And what's the second page; is it kind of the

15 same thing but with a little more detail?

16 **A. It probably is. Another executive summary.**

17 Q. The dates seem to be a little bit different but

18 they're both 2000. The second one also talks about

19 generating an ordinary loss of foreign currency

20 transaction, correct?

21 **A. Okay.**

22 Q. Is that right?

23 **A. Well, let's see, where does it say that?**

24 Q. Right -- the last sentence under the 2.

25 **A. The last bullet.**

Q. And again you're requesting Jenkins send

documents to Mr. Keating; is that right?

A. Well, what this letter is it's a cover letter

for where they're sending these things.

Q. I'm sorry, you're right. You had requested

Jenkins send these documents to Mr. Keating?

A. You know, all these letters say that and so

whether I made a request or not, that's what these

letters say.

(Government Exhibit No. 33

(marked for identification.

Q. Turn to the next exhibit, if you would, please?

And this is a letter from you to Mr. Daugerdas.

A. Yes, sir.

Q. Dated July 27th of 2000; this also relates to

Mr. Keating's transaction; is that correct?

A. It does.

Q. That's not your signature; is that right?

A. That's probably my secretary.

Q. Okay. Did she sign documents on your behalf?

A. You know, if it was a cover letter like this

and something needed to go out, I would ask her to.

Q. Okay. Do you recall receiving these documents

from Mr. Daugerdas?

A. I don't have a specific recollection about it.

1 **(Government Exhibit No. 34**
 2 **(marked for identification.**
 3 Q. If you would turn to the next one, please?
 4 **A. And that number is?**
 5 Q. 34. This is a fax to Mr. Daugerdas from you
 6 dated May 5th of 2000, correct?
 7 **A. Yes, sir.**
 8 Q. And you're asking in the attached letter --
 9 that's your signature, right?
 10 **A. Yes.**
 11 Q. You're asking Mr. Daugerdas for any comments he
 12 may have on the JK Chevrolet proposed transaction; is
 13 that right?
 14 **A. Yes. That -- yes.**
 15 Q. Now that's the executive summary that we just
 16 discussed?
 17 **A. No. You know, maybe, maybe not. I mean, this**
 18 **says October. I'm sorry, August, and this letter is**
 19 **dated in May, so --**
 20 Q. Was there another proposed transaction for
 21 Mr. Keating, other than the one outlined in the executive
 22 summary?
 23 **A. You know, I can't say. I just -- I'm just**
 24 **noticing the difference in dates.**
 25 Q. Well, do you know whether there was another

you wrote this?
A. Well, at the time I'm pretty sure I had a
pretty good idea what I was talking about.
 Q. Is that one of the IRS notices that may have
 come out, around that time?
A. I don't know, you know, I describe it as
legislative and so that was obviously something that, you
know, he heard was being discussed in Congress.
 Q. Do you recall advising Mr. Keating about the
 IRS notices?
A. No, I don't have any recollection about that.
 Q. What about Mr. -- the gentlemen from Sierra
 Microwave Technologies, or Mr. Henna?
A. Well, it would make a difference, you know,
when the notices came out and when we were working
together. And for the most part, what I did is I -- you
know, since Paul was the one who, you know, knew about
all that, I always deferred to him to give that advice to
them.
 Q. But you would have advised your clients that
 there were IRS notices out that -- related to these
 shelter transactions?
A. Well, you know, I think that I probably would
have talked to them about the fact that the IRS, you
know, had qualms about certain kinds of transactions and

1 proposed transaction though besides the one that was
 2 outlined in the executive summary, that Mr. Keating was
 3 looking at?
 4 **A. I don't recall. You know, I mean there was,**
 5 **you know, work done continuously on it so there could**
 6 **have been earlier -- earlier versions.**
 7 **(Government Exhibit No. 35**
 8 **(marked for identification.**
 9 Q. Turn to the next one, if you would, please, 35?
 10 This is a fax from you to Mr. Daugerdas dated November
 11 30th regarding Mr. Keating, correct?
 12 **A. Yes.**
 13 Q. And in a letter, the attached letter, which is
 14 of the same date, November 30th, this is -- that's not
 15 your signature, right?
 16 **A. That's my secretary.**
 17 Q. Okay. Now in this letter, the letter states
 18 that Mr. Keating is expressing some concerns about
 19 legislative state -- or changes that may impact his tax
 20 planning?
 21 **A. Uh-huh.**
 22 Q. Do you know what legislative changes are talked
 23 about there?
 24 **A. No.**
 25 Q. You don't know what you were talking about when

that it would be important to understand what that was
about and why that was different from what we were
doing.
 Q. You were aware of the notices, though, right
 after they came out?
A. Contemporaneously.
 Q. So in '99 and in 2000?
A. Sure.
(Government Exhibit No. 36
(marked for identification.
 Q. Turn to the next one, if you would, please?
 This is 36. Do you recognize this package?
A. Yes. This is another of the, I guess,
documentation booklets that Jenkins would have put
together in connection with their tax opinions.
 Q. And this was the Sierra Microwave Technology
 group; is that right?
A. Yes, sir.
 Q. And you prepared the -- some of the documents
 that are in here; is that correct?
A. I did. And the things that were entity
organization documents that are filed in Texas would be
things that I would have organized.
 Q. For example, the Articles of Organization?
A. Of TJR Holdings, LC, yes.

1 Q. And there's other ones as well, SAT Holdings?

2 **A. Probably one for each of the individuals.**

3 Q. You would have prepared those?

4 **A. (Witness nods head affirmatively.) Well, let's**
5 **see, it looks like Jenkins prepared SMT Partners. It's**
6 **got Chicago on there.**

7 Q. That's the partnership agreement, though, isn't
8 it?

9 **A. Right, SMT Partners, agreement of limited**
10 **partnership -- agreement of general partnership.**

11 Q. And do you recall advising the owners of Sierra
12 Microwave Technologies about the tax consequences of this
13 transaction?

14 **A. You know, I'm sure that we discussed it. But,**
15 **you know, they didn't look -- look to me as the authority**
16 **on this.**

17 Q. But you talked to them about it?

18 **A. Oh, yeah.**

19 Q. Do you remember having meetings in person about
20 it?

21 **A. Yes.**

22 Q. Do you recall being in meetings with Jenkins &
23 Gilchrist?

24 **A. You know, again, nobody from Chicago came down.**
25 **And so I'll bet you that what happened most of the time**

1 **is that Troy Rodriguez would have been the one who -- he**
2 **would have been talking probably to Paul, you know, and I**
3 **don't recall ever like going to Troy's office and getting**
4 **on the phone with him and Paul. I know I had some**
5 **conversations with Daugerdas in my office -- when I was**
6 **in my office calling him, but, you know, I don't have any**
7 **specific recollection about being on the phone with my**
8 **client and calling and talking to Paul Daugerdas.**

9 Q. Was it you who advised the clients regarding
10 the settlement initiative or was that Jenkins &
11 Gilchrist?

12 **A. That would have been me.**

13 Q. Did you -- go ahead?

14 **A. Oh, oh, I've already put No. 36 was the Table**
15 **of Contents, okay. And so -- are we ready to go?**

16 **(Government Exhibit No. 37**
17 **(marked for identification.**

18 Q. Yeah, 37.

19 **A. 37.**

20 Q. Now this is your package of documents; is that
21 right?

22 **A. Yes, sir.**

23 Q. You've seen this before, correct?

24 **A. I have.**

25 **(Discussion off the record.)**

MR. BLACKER CONTINUES:

Q. We just went off the record and you -- looking
at Government Exhibit 37, this is the package of
documents that were used to implement your tax
transaction; is that correct?

A. Yes. Well, this is the -- these are the
documents that, for the most part, were generated either
by Gamma Trading or Jenkins & Gilchrist in connection
with the work that they did for me.

Q. Okay. And these documents relate to the losses
that were reported on your 1040, the 1065 for KAAS and
the 1065 for Krause & Associates, LP, for the tax years
2002 and 2003, correct?

A. Yes.

Q. And you've gone through here and verified that
the signatures -- your signature is on all of these
documents?

A. Well, all that purport to be my signatures are
mine, that is my signature.

Q. Okay. Well stated. Thank you. Do you know
who Somyat Vera?

A. No.

Q. Had you ever talked to this person?

A. Never.

Q. Did you ever talk to this person?

A. Never.

Q. Did you ever talk to anyone at Gamma Trading?

A. Never.

Q. If you can turn to No. 2, the second document
in there?

A. Well, we're back on -- let's see, still on 37?

Q. Yeah.

A. Okay.

Q. It's Bates No. 406 at the end, if that helps.

The last three --

A. It does.

Q. Yeah. Do you recognize this document?

A. Yes, I do.

Q. Can you tell me what it is, please?

A. This is a letter to me from Gamma Trading.

Q. And this is one of the trade confirmations; is
that right?

A. It is a confirmation to confirm terms and
conditions of a transaction.

Q. And this is one of the options that you entered
into for purposes of your transaction; is that right?

A. Yes. Uh-huh.

Q. Do you recall receiving this document?

A. Not specifically but it's got my signature on
it, so I admit that I do -- did.

1 Q. And turning to the next document, No. 3,
2 this is is also a trade confirmation; is that right?
3 This is the second option?
4 **A. Confirmed.**
5 Q. And that's your signature?
6 **A. My signature is on the third page of that.**
7 Q. Okay. So these are the two options
8 confirmations that were done with the counter-parties; is
9 that right?
10 **A. Yes, sir.**
11 Q. And if you turn to the fourth document, this is
12 a confirmation, but this actually relates to a debt
13 instrument; is that right?
14 **A. Well, I don't know. It says instrument seller**
15 **and instrument buyer. It looks like a sale.**
16 Q. There is no -- this is not an option
17 confirmation, is it?
18 **A. Well, it's a confirmation of a transaction**
19 **subject to an ISDA master agreement. There is a trade**
20 **date, payment date, settlement date. I don't recall at**
21 **this point exactly what this is.**
22 Q. Okay. That is your signature though?
23 **A. Sure is, yes.**
24 Q. And if you could turn to No. 6, I'm sorry,
25 No. 5. And do you know what this document is?

right?

A. Yes. All the signatures are mine that -- where it looks like mine.

Q. Okay. Turn to No. 7 if you would, please?
This is a letter from you or from KAAS requesting that RBC purchase the \$20,000 of Canadian dollars, correct?

A. It sure says that.

Q. And then the next document is an assignment agreement; do you know what this was?

A. Well, it looks like I am assigning a position from -- by -- I'm assigning a position to KAAS.

Q. Okay. And then No. 9, the next one, here you are assigning your partnership interest in KAAS to Krause & Associates, LP; is that right?

A. Yes, sir.

Q. And this causes the technical termination --

A. It does.

Q. -- and that's what gave rise to the short tax year return and the other tax year return for 2002?

A. Yes.

Q. And then finally here is where, on No. 10, you're selling the Canadian -- or authorizing RBC to sell the Canadian currency; is that right?

A. "Sell the positions listed on Schedule A." And it says all positions.

1 **A. It's another confirmation of a transaction.**
2 Q. Do you know what the transaction was?
3 **A. Well, it's a -- we've got buyers and sellers in**
4 **there, rather than debtors and, you know, borrowers and**
5 **all.**
6 Q. Now those -- those first group we looked at
7 were sent to you individually.
8 **A. Okay.**
9 Q. Is that right?
10 **A. Well, this one is Krause & Associates Advanced**
11 **Strategy. This one is me individually.**
12 Q. Do you know why this one -- this last one would
13 have been between Krause & Associates Advanced -- KAAS
14 and the others were you individually?
15 **A. Well, I'm wondering if this is where we settled**
16 **the option contracts. Well, you know, we assumed that**
17 **these earlier ones were the actual options. Yeah, I**
18 **guess they are because, look, they've got spot rates.**
19 Q. Well, and you can see the currencies in there,
20 too, you've got US dollar and Japanese yen and you've got
21 US dollar and Hong Kong, Japanese yen, Hong Kong dollar
22 so --
23 **A. Uh-huh. You know, I'm not sure exactly what**
24 **this does.**
25 Q. Turn to -- that's your signature there; is that

Q. This would have been the sale of the Canadian currency; is that right?

A. Well, let's see. Well, it's -- at the risk of anything, it's -- you know, it's a sale of everything that I've got there in their accounts.

Q. Well, do you recall that RBC Dain Rauscher was the brokerage firm?

A. Yeah. And, you know, and I don't recall exactly what was in there at that time, but -- you know, this just says sell it all.

Q. But you recall that Canadian currency was sold and that's what generated the loss?

A. Sure. It was sold at some point.

Q. And is that -- do you recall whether this is the letter that authorized the sale of that Canadian currency?

A. Not specifically, but if there was Canadian currency in there and this says sell all positions then that would have been an instruction to sell that, if that was owned then.

(Government Exhibit No. 38

(marked for identification.

Q. Turn to the next document, if you would, please? I think I've got it as 38. And tell me what this opinion is, please, or tell me what this document

1 is?

2 **A. This is Jenkins & Gilchrist's tax opinion**

3 **addressed to me.**

4 Q. Okay. And this is the opinion that you're

5 relying on?

6 **A. Absolutely.**

7 Q. Okay. And you received this opinion when?

8 **A. Well, probably sometime around -- sometime**

9 **during April of 2003.**

10 Q. Would have been about four months after you

11 completed the transaction; is that right?

12 **A. Yes.**

13 Q. Now in here there are facts that were outlined

14 beginning on Page 2. Do you see that?

15 **A. Yes.**

16 Q. Do you know where those facts came from?

17 **A. Well, I'm sure this is a description of facts**

18 **that are embodied in the documents that are part of**

19 **Exhibit 37.**

20 Q. So they've taken the documents in Exhibit 37

21 and incorporated them into this opinion; is that your

22 understanding?

23 **A. Yes.**

24 Q. And do you know who prepared this opinion?

25 **A. Well, besides Jenkins and Gilchrist?**

states that you have made certain representations to
Jenkins. Do you see that?

A. Yes.

Q. The first one is that you and/or the
partnership entered into the options and the debts for
substantial non-tax business reasons?

A. It says that.

Q. Okay. Can you tell me every substantial
non-tax reason you have for entering into this digital
option transaction?

A. You know, this occurred a long time ago and so
the best I'm going to be able to do at this point is that
it looked like that if -- you know, the values had fallen
within a certain range, then I would have made a bunch of
money. It would have been like hitting the lottery.

Q. What was your knowledge of whether the currency
prices or how the currency prices were going to move at
the end of 2002?

A. Well, you know, right now, I don't recall but,
you know, I take The Wall Street Journal every day and,
you know, I'm always taking a look at it to see where
they were going and I was interested in following that.

Q. Would you know how specifically you were going
to recognize income from the changes in the currency
prices?

1 Q. Yes. Anybody specifically within Jenkins &

2 Gilchrist?

3 **A. You know, it's signed by Paul Dagerdas, but I**

4 **bet you he had a whole staff of people working on it.**

5 Q. It's actually signed by Jenkins & Gilchrist,

6 correct? If you look at Page 93 at the bottom, Bates

7 No.?

8 **A. '93. That dumb dog. Jenkins & Gilchrist.**

9 Q. Have you read this entire opinion?

10 **A. I have, but not lately.**

11 Q. When was the last time you read it?

12 **A. Oh, I'm sure the last time I read it was**

13 **probably in October of 2003, because that would have been**

14 **when I was preparing the KAAS tax return and the Krause &**

15 **Associates tax return and my tax return.**

16 Q. But you didn't rely specifically on this

17 opinion to enter into the transaction?

18 **A. Well --**

19 Q. Because you didn't have this opinion at the

20 time you entered into your transaction; is that a fair

21 statement?

22 **A. Yeah, that's a -- absolutely accurate**

23 **statement.**

24 Q. The opinion states on Page -- beginning on Page

25 91, Page 12 of the opinion, the upper lefthand corner --

A. Say that again?

Q. How were you going to recognize income due to
the change in the currency prices at the end of 2002?

A. Well, you know, again, you know, this is eight
years later. Now it's six years later, seven years
later, and it -- it seemed like though that they either
had to fall or rise or stay in, you know, a -- a gap, and
that would be the winner.

Q. How much research did you do regarding the
Japanese yen and Hong Kong dollar at the end of 2002?

A. I don't know. It didn't take a lot of research
to see what a graph looked like going up and down. It
kind of always depended on what it was going to do that
day.

Q. Did you actually research the Hong Kong dollar
and Japanese yen before you entered into the
transaction?

A. You know, I think I researched it about the
time I was entering into the transaction.

Q. But you actually didn't decide on the Japanese
yen and the Hong Kong dollar, Jenkins decided on that?

A. Well, or Gamma Trading did.

Q. Gamma Trading decided?

A. Somebody -- somebody made the recommendation.

Q. And you just took the recommendation?

1 **A. Sure.**
 2 Q. You didn't decide to invest in the Hong Kong
 3 dollar and the Japanese yen; is that correct?
 4 **A. Right.**
 5 Q. Also states on No. 2, under a non-tax business
 6 reason, you believe "The most direct way with the most
 7 leverage to realize gain from expected changes in
 8 currency prices was the options." Can you explain that
 9 statement?
 10 **A. That's B here on --**
 11 Q. That's A2, see there is A2, little i?
 12 **A. Oh, oh, oh. "My belief that the most direct**
 13 **way with the most leverage." Okay. Can you ask me that**
 14 **again?**
 15 Q. Can you just explain that statement?
 16 **A. Oh, my belief that the most direct way to make**
 17 **the most amount of money from currency prices was the**
 18 **options. Basically what that's saying is that I thought**
 19 **that this was a really quick way to make money.**
 20 Q. And actually the transaction lasted less than a
 21 month; is that right? From inception to --
 22 **A. It may have lasted less time than that.**
 23 Q. Two weeks?
 24 **A. You know, you can make a lot of money on the**
 25 **roll of the dice. That only takes a second.**

contributed the option to KAAS?
A. You know, I'm sure at the time that I had
substantial non-tax business reasons, but I don't recall
at this time.
 Q. Okay. C was your contribution of your interest
 in the partnership KAAS to KALP, which was your law
 practice, was made for substantial non-tax business
 reasons. Can you tell me every non-tax business reason
 for doing that?
A. You know, it's probably a good time to collapse
them, it didn't make any sense to have them, you know,
separate anymore. It would be a good non-tax business
reason and -- and at the time I probably had that thought
in mind and others, but I don't recall beyond that.
 Q. But we know right after you contributed your
 interest in KAAS that caused the technical termination, a
 new KAAS was formed; is that right?
A. Well, it stayed in existence.
 Q. Okay. So you say it collapsed the entities, it
 really didn't do that, because there was still a KAAS in
 existence?
A. Well, then all that shows is that my
recollection today is not accurate as to what my thinking
was at the time.
 Q. Is there any reason outside this representation

1 Q. Three, little i, your belief that -- or reason
 2 was "To facilitate the options investments by providing
 3 adequate collateral to secure possible obligations on the
 4 options." What does that mean?
 5 **A. Well, what that -- I guess what that is that's**
 6 **an acknowledgment that there is a downside.**
 7 Q. What do you mean by that?
 8 **A. Well, there is always a risk of losing.**
 9 Q. Well, when it says "By providing adequate
 10 collateral to secure possible obligations"; what does
 11 that mean?
 12 **A. Well, it means backing up the obligations.**
 13 Q. What collateral were you providing to backup
 14 the obligations?
 15 **A. You know, I don't recall. But I did send money**
 16 **and I think I had some stock up somewhere.**
 17 Q. Do you know whether those secured the option
 18 transactions?
 19 **A. You know, I -- those are technical parts of the**
 20 **transaction that I just don't have any current**
 21 **recollection about.**
 22 Q. No. B states you contributed your interest in
 23 option B to the partnership, which is KAAS, for
 24 substantial non-tax business reasons. Can you tell me
 25 the non-tax business reasons why you would have

listed in the opinion that you can give me?
A. Not now, not at this point.
 Q. Do you have any documentation supporting that
 you provided these representations to Jenkins &
 Gilchrist?
A. No, all I retained is the actual opinion
booklet and then the supporting documents and, you know,
which those two things are Exhibit 37 and 38.
 Q. That's all you've got relating to this
 transaction?
A. Right.
 Q. Representation also states you provided all the
 facts and circumstances necessary to allow Jenkins to
 form the opinion, that's No. I, Representation I.
A. Yes, it does say that.
 Q. How did you provide these representations?
A. Well, most likely I would have talked to them
on the phone and then, you know, obviously I sent stuff
up by fax and probably Fed Ex.
 Q. And, again, there's no documents in existence
 that would verify that?
A. You know, looking at this thoroughly organized
booklet, you've got a lot more on it than I do.
 Q. I don't have that document though; do you know
 whether that document is in existence?

1 **A. No.**
 2 Q. Do you know when the representations would have
 3 been made?
 4 **A. Those representations probably would have been**
 5 **made in December of 2002.**
 6 Q. Did it ever occur to you to get an opinion from
 7 someone other than Jenkins & Gilchrist?
 8 **A. No, I thought that they had all the expertise**
 9 **necessary to get this done.**
 10 Q. Even though you knew they were the entity, or
 11 one of the entities that came up with this transaction
 12 and were receiving fees related to this transaction; is
 13 that right?
 14 **A. To me that's the normal way things work.**
 15 Q. And you sent other clients to Jenkins for
 16 purposes of entering into similar transactions?
 17 **A. I facilitated clients who had heard about their**
 18 **expertise and wanted to hire them, yeah. I wasn't going**
 19 **to stand in the way of that. That would be me losing**
 20 **business so --**
 21 Q. And did you ever wonder why if the transaction
 22 was valid, it took such a long opinion letter to defend
 23 it?
 24 **A. Well, you know, a lot of those are some pretty**
 25 **mundane issues that they're required to cover, you know,**

A. -- Keating, yes.
 Q. And it states \$10.5 million swap; is that your
 understanding?
A. If it was a swap, then it was a swap.
 Q. But you represented Mr. Keating in those
 entities with respect to the Jenkins' tax transaction?
A. Oh, yeah.
 Q. The next one on the next page is somebody named
 Barshop?
A. That is not me.
 Q. What is that?
A. Well, Barshop Olds is a -- you know, I know,
you know, Pat Olds, I don't know Mr. Barshop. But you
know, that's not anybody that I've ever worked with.
 Q. You don't recall bringing anybody from the
 Barshop family to Jenkins & Gilchrist?
A. Huh-uh.
 Q. Do you know why they would have your name next
 to it?
A. I do not.
 Q. If you go to Page 15, you're listed --
A. You said 19?
 Q. 15.
A. 15, okay.
 Q. You're listed next to somebody named Tim

1 **like what's a technical termination, and was it a**
 2 **technical termination. I mean, you know, I don't know --**
 3 **we can go through and look at them because it seemed like**
 4 **not that much of this is actually really very**
 5 **controversial. It's just only certain -- certain**
 6 **exhibits that, you know, contain -- I bet you that**
 7 **there's probably only about three or four parts of this**
 8 **that you disagree with.**
 9 **(Government Exhibit No. 39**
 10 **(marked for identification.**
 11 Q. Let's turn to the next exhibit. Do you recall
 12 ever seeing this document?
 13 **A. No, sir.**
 14 Q. I'm sorry, this is 39.
 15 **A. Never seen this before.**
 16 Q. This is a document that we received as part of
 17 the package of documents from Jenkins & Gilchrist and
 18 you're listed as the source for several of these clients
 19 in here.
 20 **A. Okay.**
 21 Q. The first one -- if you look at the bottom, I'm
 22 going to refer to the Bates Number, the last two digits,
 23 No. 10 -- do you see what I'm talking about? At the
 24 very bottom of that page you're listed next to John
 25 Keating --

Timmerman?
A. Yes.
 Q. And who is Mr. Timmerman?
A. He's a friend of mine and a client.
 Q. Did you bring him to Jenkins for purposes of
 entering into a transaction?
A. You know, he was interested in learning a
little bit about it, but he didn't ever do any
transaction.
(Government Exhibit No. 40
(marked for identification.
 Q. Turn to the next one, I believe we're at 40.
 This is another one of these letters from Mr. Daugerdas
 to you related to Tack Development, Limited?
A. Yeah. Well, this is a letter to me --
 Q. I'm sorry --
A. -- from me, from me, and this 40 or 41?
 Q. I've got 40.
A. Okay. Yes.
 Q. What is Tack Development? You're right, that
 is your signature?
A. You know, this has to do with the Timmermans
and, you know, we were just getting a conversation
started.
 Q. About doing a tax transaction?

1 **A. Yeah, about them hiring Jenkins & Gilchrist.**
 2 Q. I'm sorry, that is your signature at the
 3 bottom?
 4 **A. Oh, yeah.**
 5 **(Government Exhibit No. 41**
 6 **(marked for identification.**
 7 Q. Turn to the next document. This is another one
 8 of those letters from -- from Jenkins. This is from --
 9 Ms. Guerin, excuse me, to Mr. Timmerman. And you're
 10 copied on it; is that correct?
 11 **A. I am.**
 12 Q. And Ms. Guerin states that at your request
 13 she's sending kind of the same package of documents we've
 14 seen before; is that right?
 15 **A. Right.**
 16 Q. Does this refresh your recollection as to
 17 whether Mr. Timmerman actually did a transaction?
 18 **A. I can state categorically, he did not.**
 19 Q. Do you know why he didn't?
 20 **A. You know, I think that he just wasn't that**
 21 **interested in it.**
 22 Q. But he went down the road of actually getting
 23 documents, preparing them and signing them and --
 24 **A. You know, I don't think that you -- I think**
 25 **that it can't be overstated that a lot of this just got**

(marked for identification.
 Q. You're submitting a -- you're providing Jenkins
 with a --
A. -- information questionnaire.
 Q. Mr. Timmerman's questionnaire. Was one of your
 duties to get this information and relay it to Jenkins
 for your various clients?
A. Oh, yeah.
 Q. And it looks like -- at some point
 Mr. Timmerman was considering doing a \$6.5 million
 capital gain transaction; is that right?
A. Well, let's see. Yes.
 Q. So he had a large capital gain in 2000 that he
 was looking at trying to offset?
A. You know, that's a distinct possibility.
 Q. But he never did?
A. He never did.
(Government Exhibit No. 44
(marked for identification.
 Q. Okay. Go to the next document if you would,
 please? This is --
A. -- more about the Timmermans?
 Q. Well, this one is actually --
A. What's the number on this?
 Q. 44. This is a letter from you to -- a fax

1 **kind of spit out automatically out of Chicago. You know,**
 2 **because -- you know, they never had any intention of**
 3 **opening up accounts at Deutsche Bank.**
 4 **(Government Exhibit No. 42**
 5 **(marked for identification.**
 6 Q. Okay, well, let's turn to the next one, 42.
 7 That is your signature?
 8 **A. Yes.**
 9 Q. This is to Donna Guerin again relating to Mr.
 10 Timmerman and you're sending documents back to her. I
 11 assume these were executed documents?
 12 **A. You know, these were documents that were in**
 13 **existence already. Well, I'm sorry, Tack Development and**
 14 **Commerce Properties were already in existence. You know,**
 15 **and so it looks like, you know, things started to happen**
 16 **but they did not do one of these transactions.**
 17 Q. Well, at the bottom you talk about the basis
 18 enhancement and how that would likely be 15 million?
 19 **A. That's right.**
 20 Q. But you're saying he never did a transaction?
 21 **A. Never did.**
 22 Q. Okay.
 23 **A. And what number is this?**
 24 Q. 42. The next one is 43.
 25 (Government Exhibit No. 43

containing a letter from you to Mr. Daugerdas stating
 that you're submitting the questionnaires for
 Mr. Keating, Mr. Henna and Mr. Timmerman; I only have
 Mr. Henna attached. Mr. Henna was looking at doing a \$6
 million ordinary income transaction; is that right?
A. According to this information questionnaire.
 Q. You would have have gotten this information
 from Mr. Henna and turned around and provided it to
 Jenkins?
A. Yes. It looks like this is my typewriter.
 Q. And you would have gotten paid for doing this
 work; is that correct?
A. If this transaction -- you know, occurred, then
I would have been involved with it.
 Q. And you would have received a fee for this?
A. Absolutely.
 Q. We know Mr. Henna did a transaction; is that
 right?
A. Oh, yeah.
 Q. He did two of them?
A. That's right.
 Q. So you did in fact receive a fee for your work
 in this transaction?
A. Yes, if this is one of the ones that actually
closed, because remember, didn't really know if it was

