$500 Million Frozen in I.R.S. Crackdown in Doctors' Tax Case

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A federal judge has temporarily frozen more than $500 million in assets owned by thousands of doctors and dentists who bought abusive tax shelters run by a San Diego investment company, the Justice Department announced yesterday.

The action, one of the largest of its kind, is rare and part of an effort by the Internal Revenue Service to clamp down on tax shelters it considers abusive.

About 4,000 doctors and dentists across the nation bought tax-reduction plans in recent years from the company, Xelan, evading $420 million in taxes, not including interest and penalties, a statement from the Justice Department asserted.

Yesterday, agents from the I.R.S. and the F.B.I. searched Xelan's headquarters in San Diego. The agency is auditing the returns of several hundred doctors and dentists who used the tax shelters.

Xelan had set up several types of plans aimed at helping doctors and dentists lower their tax bills. The government is focusing on two of them, one involving a charity administered by Xelan and the other, disability insurance, which the company said would allow investors to defer taxes on income for seven years.

The I.R.S. says that it found some two dozen instances of doctors using the charity to make "contributions" to their children's college tuition.

Xelan - whose full name is Xelan, the Economic Association of Health Professionals - is a privately owned group of about a dozen companies that sell financial planning, investment and insurance through a cross-country network of offices.

The group, founded and run by Dr. L. Donald Guess, a San Diego dentist turned financial adviser, is the subject of a criminal investigation by a federal grand jury in San Diego. Calls and e-mail messages to Xelan's headquarters were not returned yesterday.

Four units of the company filed for bankruptcy protection in July as the investigation intensified, and the entire company is in the hands of a court-appointed receiver.

Judge Thomas J. Whelan of Federal District Court in San Diego issued the order temporarily freezing the assets on Tuesday after the Justice Department asked him to do so. The order, which also directs Dr. Guess and six other Xelan executives to turn in their passports and not destroy any company records, is in effect through Nov. 18, when the judge will consider whether to extend it. The Justice Department hopes to have the temporary freeze made permanent, so that the assets will be available to cover tax bills.

A Justice Department lawyer said that about $50 million of the assets was in various bank accounts in San Diego, while about $505 million was in investment accounts at the Vanguard Group, the giant mutual fund firm based in Valley Forge, Pa. A Vanguard spokesman declined to comment on the matter yesterday.

Michael C. Durney, a tax lawyer in Washington who represents several hundred of the doctors and dentists, said yesterday that the I.R.S. was "incorrect" in considering the plans not legitimate for tax deduction.

A lawyer for Dr. Guess, Darrell D. Hallett of Seattle, said his client "firmly believes that the Xelan programs are legitimate and that the I.R.S. allegations will be proven incorrect."

One focus of Justice Department scrutiny is the Xelan Foundation, which was set up as a charity that allows the donors - and not the charity - to decide how their contributions are to be used. The government contends that the foundation, which is registered with the I.R.S., operated as an abusive tax shelter. The Justice Department said it found 29 instances of the foundation's accepting pretax contributions from doctors and dentists, who then used the money for their children's college tuition.

The other focus of the investigation is a Xelan insurance business, called the Doctors Benefit Insurance Company, that is based in Barbados. The company offered four types of coverage for doctors, with a supplemental disability plan as its core product.

Xelan told doctors that they could put up to 100 percent of their income tax-free into the supplemental disability plan. Legitimate payments for insurance are tax-deductible. Xelan told the doctors that their contributions were tax-free for seven years, after which they would owe taxes on the principal and gains.

The I.R.S. maintains that the plan was not insurance but a taxable deferred-compensation program. The $505 million in Vanguard accounts was from the insurance plan, a Justice Department lawyer said.

Xelan's Web site, www.xelan.com, provides insight into how it marketed the tax-reduction plans. It offers a relatively simple online "income-tax loss test" questionnaire, that it says is intended to "estimate potential losses due to unnecessary income tax."

Mr. Durney said "the foundation and the supplemental insurance programs offered through Xelan are legitimate operations," adding, "They are neither a scam nor an abusive tax shelter." He said his clients bought the programs believing that they were legitimate.

Mr. Durney was a deputy assistant attorney general in the Justice Department's tax division in the mid-to-late 1980's. The insurance company, he said, was rated by A. M. Best, a leading ratings agency, as C+, or marginal, until August, when it was downgraded four notches to D, or poor, amid the scrutiny of Xelan.

A Justice Department lawyer said investigators suspect that Xelan executives also dipped into some of the doctors' own money, both to buy out doctors who had second thoughts about the investment plans and for unauthorized personal expenses.

Department lawyers said the I.R.S. had issued 10 summons to Vanguard and a unit of SEI Investments, an investment and financial transaction processing company in Oaks, Pa., in connection with Xelan.