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THE GREAT AMERICAN TAX DODGE

BY HEDRICK SMITH

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Tax season, and as we begin the agony of filling out our IRS Form 1040s, the politicians are once again debating taxes. But there's a forgotten issue that hits every one of us in the pocketbook that isn't getting attention on the political stump or at the White House. Some big-time taxpayers are gaming the system and not honestly paying what they owe -- and sticking the rest of us with the bill.

According to [Charles O. Rossotti](#), the Republican businessman who recently spent five years as commissioner of Internal Revenue, roughly \$250-300 billion a year is owed but not being paid. "Which basically means everybody is paying 15 percent more," says Rossotti. "You could give everybody twice as big a refund, if they average it out, if you just collected all the taxes that are due."

That missing fortune includes outright tax cheats and frauds and a myriad of underpayments. The biggest single chunk, Mr. Rossotti says, is abusive tax shelters cooked up and marketed wholesale by the very people we trust to keep the system honest -- highly respected accounting firms and law firms. Their tax tricks have the veneer of legality but turn the tax code on its head because they generally lack authentic business purpose. "Sham transactions" is what John Chapoton, former assistant secretary of the treasury for tax policy in the Reagan administration, calls them.

The epidemic of illegitimate tax shelters has so seriously infected the tax system in recent years that [Larry Langdon](#), tax director at Hewlett Packard for 10 years, says he recalls "a number of CFOs, CEOs and others who realized it was going on and it was wrong. But frankly, a fair number, almost half of the major companies, were succumbing to that sort of pressure."

And while corporations and boom-time millionaires sought to cash in on dubious tax shelters, it was the tax-shelter promoters -- blue-ribbon accounting and law firms -- who were the heart of the problem. Pamela Olson, who knows the tax trade as a long-time tax attorney and until this month as assistant secretary of the treasury for tax policy in the Bush administration, was most troubled by "the callous disregard for the requirements of the law" among tax professionals "who were actively working to undermine the tax system."

It was the promoters, with their sophisticated tax tricks, who turned the tax line on corporate financial reports into a major profit center in corporate America's drive to impress Wall Street. Corporations competed to drive down their tax rate, by piling abusive tax shelters on top of legitimate deductions. The alarm bell went off for [Larry Summers](#), former secretary of the treasury in the Clinton administration, when in 2000 he saw overall corporate profits rise by 20 percent but corporate tax revenues fall by 2 percent.

As [Robert McIntyre](#), director of the Institute on Taxation and Public Policy, found in a study of 250 major corporations, it turned out that instead of paying the statutory 35 percent corporate tax rate, companies such as Texaco, PepsiCo, Pfizer, J.P. Morgan, General Motors and others were sometimes paying zero taxes or even getting refunds in the late 1990s.

As corporate tax payments plummeted, so did the corporate share of the total tax take: once 25 to 30 percent of the total, it fell last year to 7.7 percent, its second lowest level since the Great Depression. Individual taxpayers are making up the difference.

So let the politicians debate tax rates. What the rest of us need to know is who's going to stop "The Great American Tax Dodge," those bogus tax shelters. Since the mid-'90s, the Internal Revenue Service has tried shutting down abusive shelters, one by one. It has listed 28 types of shelters as unacceptable. It has even won a few court cases against major corporations. But once a shelter is banned, the promoters dream up a new version with a slightly different twist. It's like cat and mouse. The I.R.S., and the rest of us, are always a jump or two behind.

Republicans like Sen. Chuck Grassley of Iowa and Democrats such as [Rep. Lloyd Doggett](#) of Texas argue that what's needed is a broad rule banning tax tricks that have no real business purpose but are devised solely to reduce taxes. But broad shelter reform remains bottled up in the House Ways and Means Committee. Business

lobbyists contend no action is needed because the shelter wave has subsided. But tax specialists warn that as the economy recovers, a new avalanche of bogus shelters will come crashing down on us.

The Bush administration's answer is more loophole closing of specific shelters, plus stiff penalties for shelter promoters. But to a veteran of the tax-shelter wars like Charles Rossotti, that's not enough. "There have been specific patches that Congress has put in to patch this particular shelter or that particular shelter, but people just work around that," Mr. Rossotti observes. "Congress needs to act. They need to outlaw tax shelters, period."

And if ordinary, honest taxpayers catch on to the game that's been going on at their expense, that's what they're likely to demand as well.

Hedrick Smith is correspondent and senior producer of FRONTLINE's "Tax Me If You Can."

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