

The logo for FRONTLINE, featuring the word "FRONTLINE" in white, bold, sans-serif capital letters on a red rectangular background.

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TAX ME IF YOU CAN

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It was one of corporate America's biggest hidden profit centers in the past decade—the tax shelter—and it became so lucrative that last year it helped major U.S. companies cut their tax rate to just half of what they had historically paid, leaving individual taxpayers to make up the difference.

The General Accounting Office estimates that illegitimate tax shelters cost the government more than \$85 billion in recent years.

“Anything that's not being paid that should be paid, that's basically what the honest taxpayer is making up,” asserts Charles Rossotti, a Republican businessman who became commissioner of Internal Revenue in 1997 and spent five years battling bogus shelters. Rossotti estimates that because the government is not collecting all that is owed—the biggest piece of which is illegitimate tax shelters—everyone else is paying 15 percent more than they should.

In “Tax Me If You Can,” airing Thursday, February 19, at 9 P.M. on PBS (check local listings), FRONTLINE® correspondent Hedrick Smith investigates the rampant abuse of tax shelters since the late 1990s. Through interviews with government officials, tax experts, and industry insiders, Smith uncovers an avalanche of bogus transactions created by some of America's biggest and most-respected accounting firms, law firms, and investment banks that were then aggressively marketed to big corporations and wealthy individuals.

“These were close to sham transactions—some were clearly sham transactions, [that] had nothing to do with investment,” says John “Buck” Chapoton, former treasury department policymaker in the Reagan administration. “They simply were financial mechanisms for creating losses—tax losses, not economic losses.”

FRONTLINE's Smith notes, “Chasing bogus tax shelters for the IRS was like a game of cat and mouse. The IRS had a terrible time finding them because they were hidden deep in tax returns. Once the IRS spotted one type of shelter and issued a regulation to block it, the shelter promoters had designed a new one. The IRS was forever playing catch-up.”

To overcome this problem, Rossotti asserts that Congress must now enact sweeping legislation to ban any tax shelters that do not have legitimate business purpose, and he warns of the danger of inaction.

“I think this thing is going to rebound in a serious way as the economy improves,” Rossotti tells FRONTLINE. “The fundamental drivers of this are still there. It’s still a very profitable business for the promoters. The law is still way too weak and too murky.”

In “Tax Me If You Can,” Smith follows the tax shelter trail to some surprising places. Smith discovers that sewer pipes in the city of Bochum, Germany, for example, have offered a huge tax write-off to the major American bank, Wachovia, of Charlotte, NC.

It was a deal that Bochum city officials couldn’t refuse: Through a complex, long-term lease-and-service transaction, the city would lease out its underground sewer pipes to Wachovia for \$500 million. The city would then immediately lease the pipes back, thus retaining use of its sewer system, and repay the lease over a period of many years. In return, Bochum was immediately paid a \$20 million fee. Wachovia would eventually get its money back—plus a fast, multi-million-dollar tax write-off.

Wachovia declined to be interviewed by FRONTLINE. But working with Wachovia’s annual reports, Robert McIntyre, director of the Institute for Taxation and Finance, details the payoff to Wachovia’s bottom line from many leasing deals similar to the Bochum transaction.

“Amazingly, in 2002—even though it reported \$4 billion in profits—[Wachovia] reported that it didn’t pay any taxes,” McIntyre tells FRONTLINE. “They worked it by sheltering all of their income. They said they saved \$3 billion in taxes over the last three years from leasing—huge write-offs.”

“Tax Me If You Can” also reveals how some of America’s most respected accounting firms drove the tax shelter wave, generating dozens of shelters that were mass marketed and then found to be illegitimate by the IRS and the courts. In the documentary, Smith speaks with a former tax attorney for KPMG, who describes how the firm’s accountants and attorneys were ordered by KPMG tax executives to design—and market aggressively—as many tax shelters as possible, since the firm made a profit based on how much it saved its clients in taxes.

KPMG declined to speak to FRONTLINE. But recently the firm fired and/or retired several of its leading tax partners who had overseen KPMG’s tax shelter operation, after they had been called to testify in a congressional investigation.

“Tax Me If You Can” concludes by reporting that while the Republican-controlled U.S. Senate has passed broad tax shelter reform legislation, both the Bush administration and private sector companies, such as accounting and leasing firms, oppose a Senate-backed provision requiring that shelters have economic substance and genuine business purpose to be legal. The House of Representatives has so far declined to pass such legislation, which remains bottled up in the Ways and Means Committee.

“You’re talking about powerful accounting firms, powerful legal firms, powerful investment bankers in a conspiracy to promote these tax shelters,” declares Senator Chuck Grassley (R-Iowa), chairman of the Senate Finance Committee, who sponsored the Senate bill. “They also have a fourth arm. They hire some of the most powerful lobbyists in town to work against this legislation.”

“Tax Me If You Can” is a FRONTLINE co-production with Hedrick Smith Productions. Hedrick Smith is senior producer and correspondent. Rick Young is producer and director.

In conjunction with the television broadcast, FRONTLINE and *Marketplace* will produce a two-part series based upon Hedrick Smith’s investigation. The public radio series airs Wednesday and Thursday, February 18 and 19, on *Marketplace*. The series is produced by Rick Young for FRONTLINE and by *Marketplace*’s Stephen Henn for American RadioWorks.

FRONTLINE is produced by WGBH Boston and is broadcast nationwide on PBS.

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FRONTLINE is closed-captioned for deaf and hard-of-hearing viewers.

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