CAPITAL
By DAVID WESSEL

It's Time to Pull the Plug On Corporate-Tax Games

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Congress has created an oversight board to look over accountants' shoulders to be sure they keep corporate books properly. Big companies have decided that paying executives in stock options is an expense and should be counted as such. John F. Welch Jr., the retired General Electric Co. chairman, will pay for his own flowers from now on.

Next on the to-do list: Get companies -- and lawyers, accountants and investment bankers -- to stop treating taxes like a videogame in which the prize goes to the player who most cleverly avoids paying the government.

Corporations always have labored to pay as little in taxes as the law allows. So have the rest of us. But the scale and audacity of corporate tax maneuvering have grown in the past couple of decades. Just as too many companies bent accounting standards in the 1990s -- so far that they were lying to their shareholders -- too many companies bent the tax rules to lie to the government.

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Oh, there's always a convoluted justification why a complex financial transaction is kosher; why something that looks like a loan is actually a lease; why a deal that is clearly crafted only to cut taxes actually has some connection to ordinary business.

But everyone playing the game understands it. Smart, well-paid financial engineers devise new ways for companies to dodge taxes faster than the tax cops can figure them out. By the time the government pounces, the engineers are marketing a new product. Three developments in the past decade, each of which brought economic benefits, contributed to the changing business behavior.

One, the 1990s boom created plenty of profits to be sheltered. Financial innovation, which created new tools for companies to lay off risks, also created tools to shift profits reported to the government onto the books of entities that didn't pay U.S. taxes, such as foreign partnerships, tax-exempt pension funds or even Native American tribes.

Two, U.S. companies grew less complacent about everything. "They are not just doing things the way they always have," says Daniel Shaviro, a New York University tax-law professor. "They're saying, 'We aren't doing inventory management the same way we did. We're going to do it better.' And they are bringing the same attitude to taxes." And this wasn't just the very biggest companies.

Three, accountants, lawyers and investment bankers began competing with each other, and discovered how much money was to be made selling or certifying tax shelters -- if they didn't mind holding their noses to hide the smell. Accountants and lawyers, some of whom consider professional ethics to be passe, emulated investment bankers. They stopped charging by the hour, and started charging a flat fee or even a fee linked to taxes saved. With that shift, their role changed. They stopped being obstacles to the most outrageous tax shelters and became salesmen.

Even before Enron Corp.'s scandal, some corporations were beginning to see risks in succumbing to the enticements of tax-shelter promoters. After Colgate-Palmolive Co. found its dispute with the Internal Revenue Service over a Merrill Lynch & Co.-designed offshore partnership dissected on the front page of this newspaper in 1996 (see article), big companies began worrying about bad publicity.

Public disgust has grown since. Former Treasury Secretary Lawrence Summers railed against corporate tax cheats. His successor, Paul O'Neill, is shifting IRS agents to scrutinize tax shelters and demanding more information from promoters -- and they are getting more tips about egregious shelters. Now, the top two Republican tax writers in Congress, Rep. Bill Thomas of California and Sen. Charles Grassley of Iowa, are pushing bills aimed at strengthening the government's hand. Some big financial houses see a lessening of demand for tax shelters, though that's partly because there are fewer profits to shelter.

That's heartening. But it's not enough. The gap between the profits companies report to shareholders and the profits they report to the government has grown too wide and needs narrowing. If the companies torturing their books to reduce profits they report to the tax man had to do the same with profits reported to shareholders, they'd be less tempted to dodge taxes. The most peculiar tax-code provisions, the ones that treat certain income for tax purposes in ways radically different than business executives view profits, need changing.

Some companies will still stretch the law, though. So the government needs to be smarter and swifter. Going after companies that have benefited from abusive tax shelters is important, because it raises the risks to companies that are tempted. Squashing the latest abusive innovation before it spreads is even more important. And some judge needs to tell a company seeking to avoid penalties for using an improper tax shelter that it's absurd to hide behind a favorable opinion written by a lawyer who was paid by how much he could reduce the company's tax bill.

And, just once in a while, some CEO or board of directors needs to loudly tell the company's tax wizards that they simply are going too far.

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