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Tax Moves by Enron Said to Mystify the I.R.S.

By DAVID CAY JOHNSTON

Enron and other big companies have escaped taxes in recent years through financial maneuvers so complex that the Internal Revenue Service has been unable to understand them, the Senate Finance Committee will be told this morning by Congressional tax experts who spent nearly a year going over Enron's tax returns.

In a report to the committee, the experts will explain that companies can avoid taxes by exploiting differences in the rules governing the two sets of books that all companies must keep, one for shareholders and the other for the I.R.S., according to people who have seen the report.

These differences between what are known as book accounting and tax accounting can be used to make taxes disappear, but only through costly transactions that create risks for shareholders that are not disclosed.

Current laws are ineffective at stopping the use of such transactions, whose only purpose is to avoid taxes, according to four people who had access to the report's findings.

Enron, the Houston-based energy trading company, was one of the most politically connected businesses in the country, with ties to President Bush and many other federal officials. Its name became synonymous with corporate scandal when its stock price collapsed and it sought bankruptcy protection in December 2001. Enron's chief financial officer is awaiting trial on fraud and other charges.

The report's disclosures on corporate tax avoidance, and its details on executive compensation, "are eye-popping," said Senator Max Baucus, Democrat of Montana, the ranking minority member of the Senate Finance Committee and one of only two people who would speak publicly yesterday about its contents.

"The report paints quite a shocking picture of Enron's tax gimmicks and structured transactions and executive compensation," Mr. Baucus said. "Bad as Enron is going to come out, the deeper concern is this is just not Enron alone. It involves lots of other companies and how they inundated the I.R.S., out-complexed the I.R.S. The I.R.S. just cannot handle the complexity of some of these transactions."

Enron created 881 offshore subsidiaries, 692 of them in the Cayman Islands, as part of its strategy to avoid taxes.

The committee chairman, Senator Charles E. Grassley, Republican of Iowa, called the report "an absolute barn-burner."

At a confirmation hearing for new Tax Court judges yesterday, Senator Grassley said the report "provides for the first time the complete story of Enron's efforts to manipulate its taxes and accounting."

"The report is very disturbing in its findings," he added. "From this report, I'm worried about the Tax Court blessing highly artful interpretations of the code."

Legislation sponsored by the two senators that would curb tax shelters, which the Finance Committee approved last week, would not stop many of the practices described in the report, Senator Baucus said.

Mr. Grassley said the report would "help Congress know what needs fixing."

It was prepared by the staff of the Joint Committee on Taxation. Enron cooperated with the study, turning over documents and helping tax lawyers, accountants and economists on the joint committee staff understand the transactions. The report has four volumes, each as thick as a phone book for a large city, according to two people who have read parts of it.

Mark Palmer, an Enron spokesman, said last night that "we have and will continue to cooperate with investigations into Enron's past." He said the chief concern now was "on the future and on maximizing value and in enhancing our creditors' position" so that the company can emerge from bankruptcy. Enron continues to operate, with about 11,000 employees, down from about 25,000, not counting short-term construction and contract workers.

Enron did not pay taxes in four of the five years before its collapse, according to the financial statements it sent to shareholders. The company has hinted in the past that it may have actually paid some tax during those four years because of the corporate alternative minimum tax. If Enron did pay some alternative tax in those four years, it would raise fresh questions about the reliability of reports to shareholders and whether the Securities and Exchange Commission is adequately policing rules on the disclosure of material information about corporate finances.

The report is also likely to influence the debate over corporate governance because the devices that enable taxes to disappear also tie up cash, making it difficult to pay dividends. President Bush has proposed making dividends tax-free to individuals, provided they are paid by corporations that paid taxes.

Tax shelters are sold primarily to the very biggest companies because they can pay the largest fees to the accounting and law firms and investment houses that design them and sell them on the condition of confidentiality. The I.R.S. has stepped up efforts to find tax shelters, but the agency lacks the resources to address the problem fully, Charles O. Rossotti, the former I.R.S. commissioner, warned last fall in his final report to his oversight board.

Corporate profits reported to the I.R.S. in 1998 were $155 billion less than those reported to shareholders, according to Mihir A. Desai, a Harvard economist. His study and others suggest that tax shelters may be the primary reason for this difference, which is costing the government as much as $54 billion in taxes each year.

The 10,000 or so largest companies paid 20.3 percent of their 1999 profits in federal income taxes, while the next tier of companies paid at a 30.9 percent rate, according to an I.R.S. analysis of corporate tax returns for the year. The largest companies had 26 times the profits of the second tier of companies, which paid income taxes at a rate 50 percent higher than the largest companies, the I.R.S. data shows.