

THE TAXONOMIST

The Facilitators

By Robert S. McIntyre

Do our big accounting firms deserve some of the blame for the demise of a free press, and even democracy itself, in Russia?

This thought first occurred to me when I stumbled on the fact that PricewaterhouseCoopers (PwC) is the accounting firm for Yukos, the huge, troubled Russian oil company. As has been widely reported, Yukos's billionaire principal owner is now in jail on massive tax-evasion charges, other corporate officers have fled the country to escape arrest, and the company's potential bankruptcy has helped push up the world price of oil to record highs. The plot thickened when I discovered that Yukos's ownership runs through a chain of tax havens, leading ultimately to a post office box in tiny Gibraltar. That shell company's auditors include not only PwC, but also KPMG and Ernst & Young—two other U.S. accounting firms neck-deep in helping American corporations use offshore tax shelters to hide their income from the IRS.

But let's back up a little.

After the Soviet Union collapsed in the early 1990s, American public-policy entrepreneurs flocked to eastern Europe to teach the former communists the virtues of the free market. In Russia, such tutoring eventually helped produce a flat-rate personal income tax, a national sales tax and a Russian corporate income tax so full of loopholes that you could drive a truck through it—or so its designers thought.

Even as these and other regressive tax laws were being debated and enacted, the vast business assets of the former Soviet state were grabbed by the greediest and most ruthless Russians, with the blessing of the government. One of the biggest prizes was Yukos, which fell into the hands of Mikhail Khodorkovsky and a few other well-placed Russians.

With the help of Western advisers, Khodorkovsky set up a new ownership structure for Yukos. He took the company public, but retained most of the stock for himself and a few close allies, using layers of shell corporations set up in tax havens such as Cyprus and the Isle of Man. At the top of the heap sits "Group Menatep," whose Gibraltar "office" is actually the P.O. box of a tax-shelter agent. KPMG has an office in the same building and PwC and Ernst & Young have ones nearby.

Beside owning most of Yukos, Menatep also owns a major Russian bank, among other Russian companies, and

engages in worldwide investment and hedging activities with the help of American firms like the Carlyle Group and the Blackstone Group.

Yukos's offshore companies were designed to help its owners avoid personal taxes and move money out of Russia. At the same time, Yukos arranged to avoid its corporate taxes by setting up shell companies inside Russia in regions of the country that supposedly could offer tax exemptions, then artificially shifting Yukos's profits into those shell companies. In effect, Yukos pretends to pump and refine oil in parts of Russia where that's as impossible as on the Rock of Gibraltar.

This is both sinister and sadly familiar. Not content with undermining the U.S. tax system, our accountants have exported their tax-sheltering skills so that even former godless communists can evade taxes just like church-going, red-blooded American corporate chiefs.

For a while, it all seemed so easy. As recently as May of 2003, Yukos's annual report bragged that PwC's "on-going review of tax strategy" would allow it to further cut Yukos's tax payments. But then the party ended.

Starting in the summer of 2003, Russian tax authorities, who had previously turned a blind eye to Yukos's tax evasion, began to crack down. So far, Yukos has been charged with evading \$1.6 billion in taxes just in 2000 and 2001, and experts think the total assessment may rise to as much as \$10 billion including penalties. Khodorkovsky now sits in jail awaiting trial.

There's no doubt that Yukos came under attack primarily for political reasons. Russian President (and former KGB head) Vladimir Putin has been on a mission to crush dissent in Russia and restore as much as possible the one-party state of the old Soviet Union. In Putin's eyes, Yukos's mortal sin wasn't tax evasion—after all, other Russian companies were just as crooked, if not worse—but Khodorkovsky's support for opposition candidates.

But that doesn't excuse our accounting firms from blame. Their nefarious facilitation of blatant tax evasion, not only by Yukos, but by Russian corporations generally, gave Putin a legally defensible way to achieve his even more nefarious ends.

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