Phony Prices May Hide Import-Export Profits From IRS

By JONATHAN WEITMAN
Washington Post Staff Writer

RAZOR blades imported from Britain for $113 a piece. Tweezers from Japan for $4,896 each. Cut rubies from Burma for $38,182 per carat. And for U.S. trading partners, the deals of the century: car seats exported to Belgium for $1.96 each, microwave ovens exported to Brazil for $35.82, television sets exported to France for $2,464 a pop. Lurking in rows of 2001 government trade data are thousands of such wildly mispriced transactions, and those trades may have passed in corporate taxation and money laundering on a grand scale, according to academics with the Office of Public Affairs bureau that have been mining the data for more than a decade.

Simon J. Pak, a finance professor at Pennsylvania State University, Gary Meek, and John S. Zdanowicz, the director of the Center for Banking and Financial Institutions at Florida International University, plan today to release their latest analysis of overpriced U.S. imports and underpriced exports, estimating that corporations manipulated international trades last year to shave $53.1 billion from their tax bills.

That is a 10 percent increase from the tax cheating that Pak and Zdanowicz believe they uncovered in 2000, and an 8 percent increase from 1998.

For a decade, government officials and fellow academics have questioned such eye-popping numbers. One senior Treasury official bluntly dismissed the amounts as "much too large." Some of those outlandish prices were merely typographical or classification errors on customs forms, the Treasury official and other tax and trade experts say. But the IRS is the only government agency that has been seriously studying the pricing schemes to prevent money laundering and tax evasion. Customs uses its own research along with expert testimony from Pak and Zdanowicz.

But even skeptics are beginning to concede that although their numbers may be too high, the well-known "smoking guns" are real things: Overpricing imports or underpricing exports is a way of masking taxable income out of the United States, or ill-gotten gains into the country.

After the Sept. 11, 2001, attacks, the tech-nology industry has been redefined as a potential mechanism for terrorism financing.

"We do not think that the government is a major factor," said Customs Service spokesman Mike J. Atkinson of the analysis. "It is very serious, but we believe that you can do this with any commodity."

The Customs Service recently shifted millions of dollars into its own effort, the Internationally Integrated Pre-screening System, to expand its focus on terrorism financing.

See TAXES, E1, COL. 5

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Gone With the Invoice

A study due out today estimates that companies avoided $53.1 billion from their 2001 tax bills by inflating the costs of imports and undervaluing their exports. Here's how it works:

$100

1. Japanese automaker manufactures a car for $100.

2. A U.S. subsidiary purchases it for $199, then sells it for $200.

3. The company's bottom line hasn't changed, but the taxable profit in the United States is now $3 instead of $100. A tax bill that would have been $34 is reduced to 3 cents.

OR

1. American automaker manufactures a car for $100.

2. A U.S. subsidiary purchases it for $1, then sells it for $200.

3. Company reduces taxable income by $99 and records a $100 profit on global operations.

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2001 examples of abnormally high import prices:

<table>
<thead>
<tr>
<th>Product</th>
<th>Exporting country</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plastic buckets</td>
<td>Czech Republic</td>
<td>$972.78</td>
</tr>
<tr>
<td>Fence posts</td>
<td>Canada</td>
<td>$385.50</td>
</tr>
<tr>
<td>Toilet tissue</td>
<td>China</td>
<td>$1,241.81</td>
</tr>
<tr>
<td>Brooms and pianos</td>
<td>Hungary</td>
<td>$739.25</td>
</tr>
<tr>
<td>Dolls</td>
<td>Pakistan</td>
<td>$153.72</td>
</tr>
<tr>
<td>Lawnmower blades</td>
<td>Australia</td>
<td>$2,326.75</td>
</tr>
</tbody>
</table>

2001 examples of abnormally low export prices:

<table>
<thead>
<tr>
<th>Product</th>
<th>Importing country</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cows</td>
<td>Mexico</td>
<td>$20.65</td>
</tr>
<tr>
<td>Toilets</td>
<td>Hong Kong</td>
<td>$1.75</td>
</tr>
<tr>
<td>Forklifts</td>
<td>Jamaica</td>
<td>$94.14</td>
</tr>
<tr>
<td>Bulldozers</td>
<td>Colombia</td>
<td>$1,714.92</td>
</tr>
<tr>
<td>Color video monitors</td>
<td>Pakistan</td>
<td>$21.90</td>
</tr>
<tr>
<td>Semitrailer road tractors</td>
<td>Nigeria</td>
<td>$3,750</td>
</tr>
</tbody>
</table>

SOURCE: Simon J. Pak, Pennsylvania State University; and John S. Zdanowicz, Florida International University

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Mispricing Robs U.S. Of Billions, Study Says

TAXES, E1

General Accounting Office, which in 1965 drafted a generally disparaging report attributed with misleading fluctuations to recording errors, is examining the issue again, this time analyzing the misclassification of commodities as a means to mask money laundering and terrorism financing.

At that rate, the honey exporter would have received $3,311,456 in excess proceeds just as the Sept. 11 hijackers took up residence in the United States. Where that money went is unknown.

Other cases are not so shrouded in mystery. In 1999, the owners of an Argentine export company pleaded guilty to U.S. charges connected to a modification of its sales to mask money laundering and terrorism financing.

The Treasury Department and the IRS, though still skeptical, are taking a second look at Pak and Zdanowicz's computer program and the validity of their findings, in part because the U.S. Department of Justice, as well as the IRS, have requested the researchers to force the government to take the work seriously.

Pak and Zdanowicz do not have access to the names of the companies that do the trading, but the IRS does.

"The IRS and the Treasury have been in a deep sleep on this subject," Dorgan said. "I want Treasury and the IRS to look at this, to say this is a big, serious problem."

Other academics are expressing more interest. Deborah L. Swenson, an economist at the University of California at Davis, combed through export data for a paper published last year and she, too, found that trade prices seemed to fluctuate not according to government market but according to tax-rate changes. In other words, U.S. companies appeared to be manipulating the prices of imports from their foreign subsidiaries to maximize tax advantages.

"The interest is definitely growing," said Mila M. Desai, an economist at Harvard Business School who is studying how corporations shift income to avoid taxation.

It is relatively simple. For example, an American automaker manufactures a car for $100, but its U.S. subsidiary buys it for $596 and then sells it for $500. The company's bottom line hasn't changed, but the taxable profit in the United States is now just $1 instead of $100. A tax bill that would have been $34 is reduced to 34 cents.

Conversely, if a U.S. manufacturer exports a bulldozer to its Colombian subsidiary for $1,742, the Colombian company sells it to a buyer for $20,000. The U.S. company's cost of producing the bulldozer can be written off its income taxes, but the profit from the sale would reside in Colombia. That profit would be subject to U.S. taxes only after it is "repatriated" across the border, presumably in a bad economic year when the company's taxable U.S. income is low or nonexistent.

The same kinds of schemes can move vast amounts of money around the globe virtually undetected.

After the Treasury Department linked three Yemeni honey companies to Osama bin Laden's terrorist financing operation, Pak and Zdanowicz examined the U.S.-Middle East honey trade. They found that in 2000, someone shipped 182,000 kilograms of honey from Yemen for $2.63 per kilogram, a price 38 percent higher than the average honey price of $1.91 a kilogram.

Argentine-export companies pleaded guilty to U.S. charges connected to a $130 million money-laundering scheme involving the illicit shipment of gold to the United States. In 1997, a Los Angeles-based food company was convicted of overpricing its shipments to Hong Kong by inflating the cost of imports by as much as 900 percent.

Those cases aside, Zdanowicz said the government is "shutting down the front door on the illegal movement of money, focusing on banks, insurance companies and other financial institutions."

The back door is a wide open, international trade.

In 1986, after Switzerland adopted one of the most stringent anti-money-laundering laws in the world for its banks, Zdanowicz and Pak examined the amount of money moving from Switzerland to the United States through trade before and after the law was enacted. The numbers had doubled.

Such transactions will not overcome all the skepticism. One Treasury official said dramatic examples of off-shore import or export prices may look interesting, but they are one of the most likely to be simple errors. In 1995, the GAO made the same point. GAO auditors found that 8% of 700 companies seemingly valued at more than 375 times its market price was less than 1.

Two factors, however, could be significant. First, the Internal Revenue Service has recovered a large amount of money back to the IRS.

In 2001, the Treasury Department maintained 16,350 import and export records, and for each category Pak and Zdanowicz determined a median price for all U.S. transactions. They then ran 54.9 million transactions through their computer program to find prices more than 25 percent lower or higher than the median.

They found that about 13% of the prices were systematically lower than the median, 9% were systematically higher than the median, and 79% were not.

"It is difficult to ascribe that to a recording error," he said.