

How I got involved in research About corporate tax fraud And what I learned

Jeffrey Gramlich

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University of Southern Maine

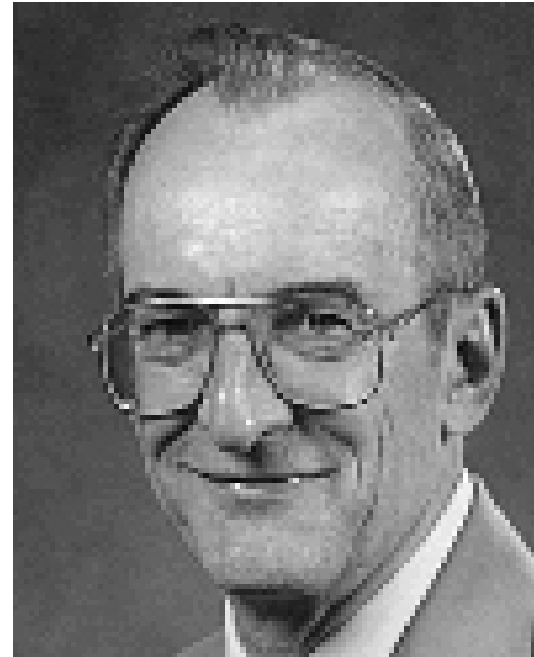
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UNIVERSITY OF
SOUTHERN MAINE



Jeffrey Gramlich



James Wheeler

Caltex Dividends Paid and Received per the Annual Reports

(in millions)

							Difference
	Net Income	Dividends	50% of	Caltex Div.	Caltex Div.	Caltex	Chevron >
	Reported	Paid by	Dividends	Received	Received	Minus	Texaco Div.
Year	by Caltex	Caltex	Paid	by Chevron	by Texaco	Chevron	Received
1976	653	527	263.5	262	265	265	(3)
1977	647	569	284.5	277	291	292	(14)
1978	616	469	234.5	239	230	230	9
1979	715	501	250.5	250	250	251	-
1980	959	841	420.5	421	420	420	1
1981	1,303	860	430.0	430	430	430	-
1982	922	649	324.5	332	318	317	14
1983	992	713	356.5	356	357	357	(1)
1984	928	921	460.5	507	414	414	93
1985	701	923	461.5	496	427	427	69
1986	428	595	297.5	305	290	290	15
1987	472	447	223.5	225	222	222	3
1988	471	391	195.5	196	195	195	1
	\$ 9,807	\$ 8,406	\$ 4,203	\$ 4,296	\$ 4,109	\$ 4,110	
	Chevron dividends greater than Texaco's						205
	Texaco dividends greater than Chevron's						18

Accounting Horizons
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How Chevron, Texaco, and the Indonesian Government Structured Transactions to Avoid Billions in U.S. Income Taxes

Jeffrey D. Gramlich and James E. Wheeler



HOW CHEVRON AND TEXACO
STRUCTURED TRANSACTIONS
TO AVOID BILLIONS IN U.S. TAXES

By Jeffrey D. Gramlich and
James E. Wheeler

The Parties

**Government of
Indonesia**

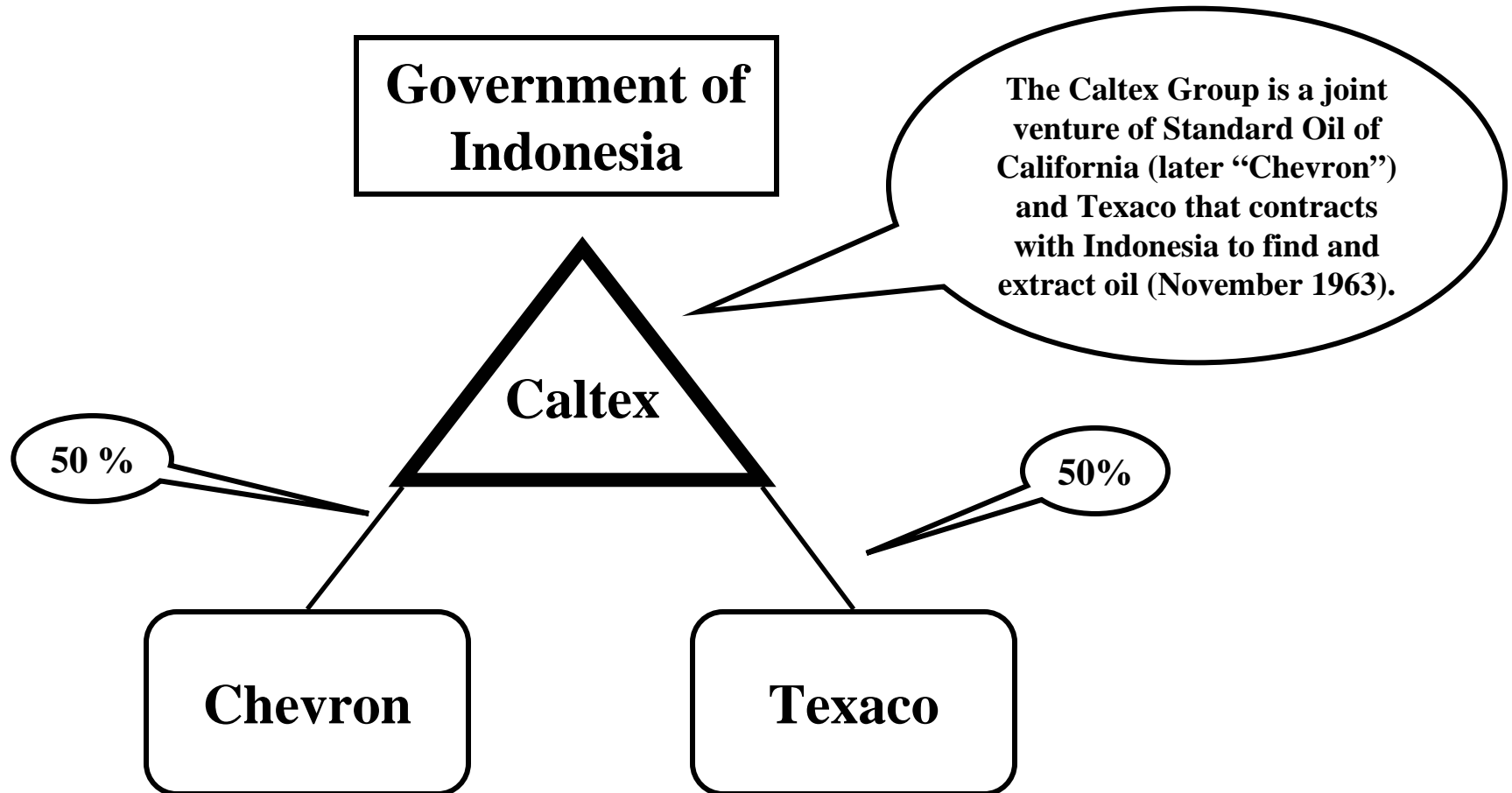
**Indonesia has oil
reserves.**

Chevron

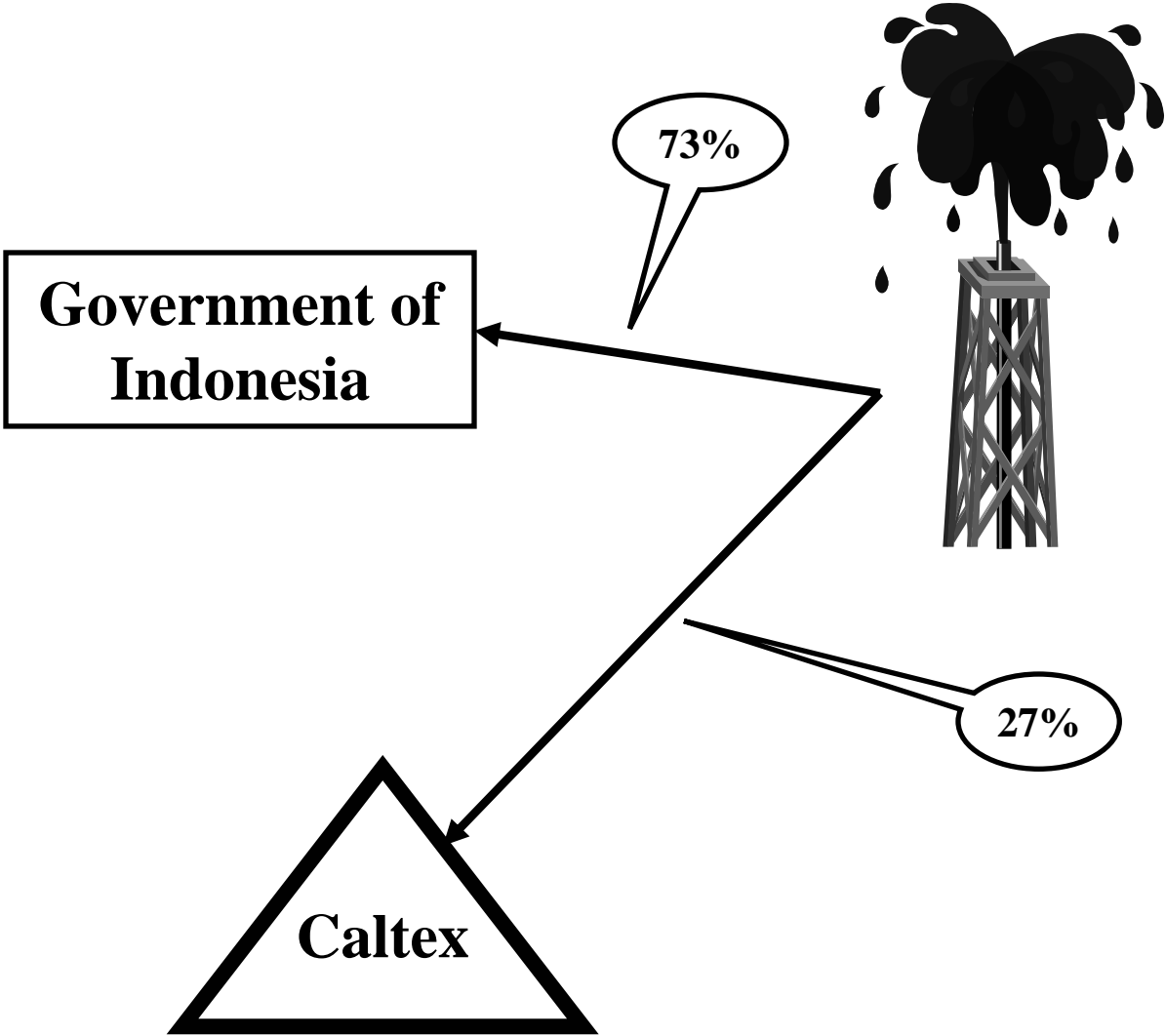
Texaco

**Chevron and Texaco have knowledge,
capital, and retail markets.**

Chevron and Texaco Team Up in Indonesia



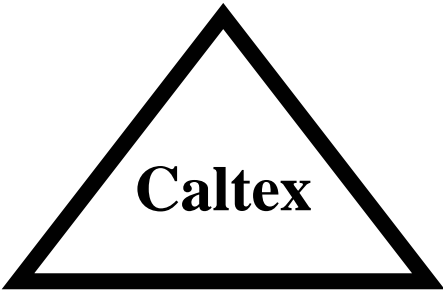
The Sharecropping Arrangement (before tax)



The Tax Jurisdictions

**Government of
Indonesia**

Caltex (a Delaware corporation) domiciled in Indonesia pays Indonesian taxes (approximately 56%).



Indonesia



USA

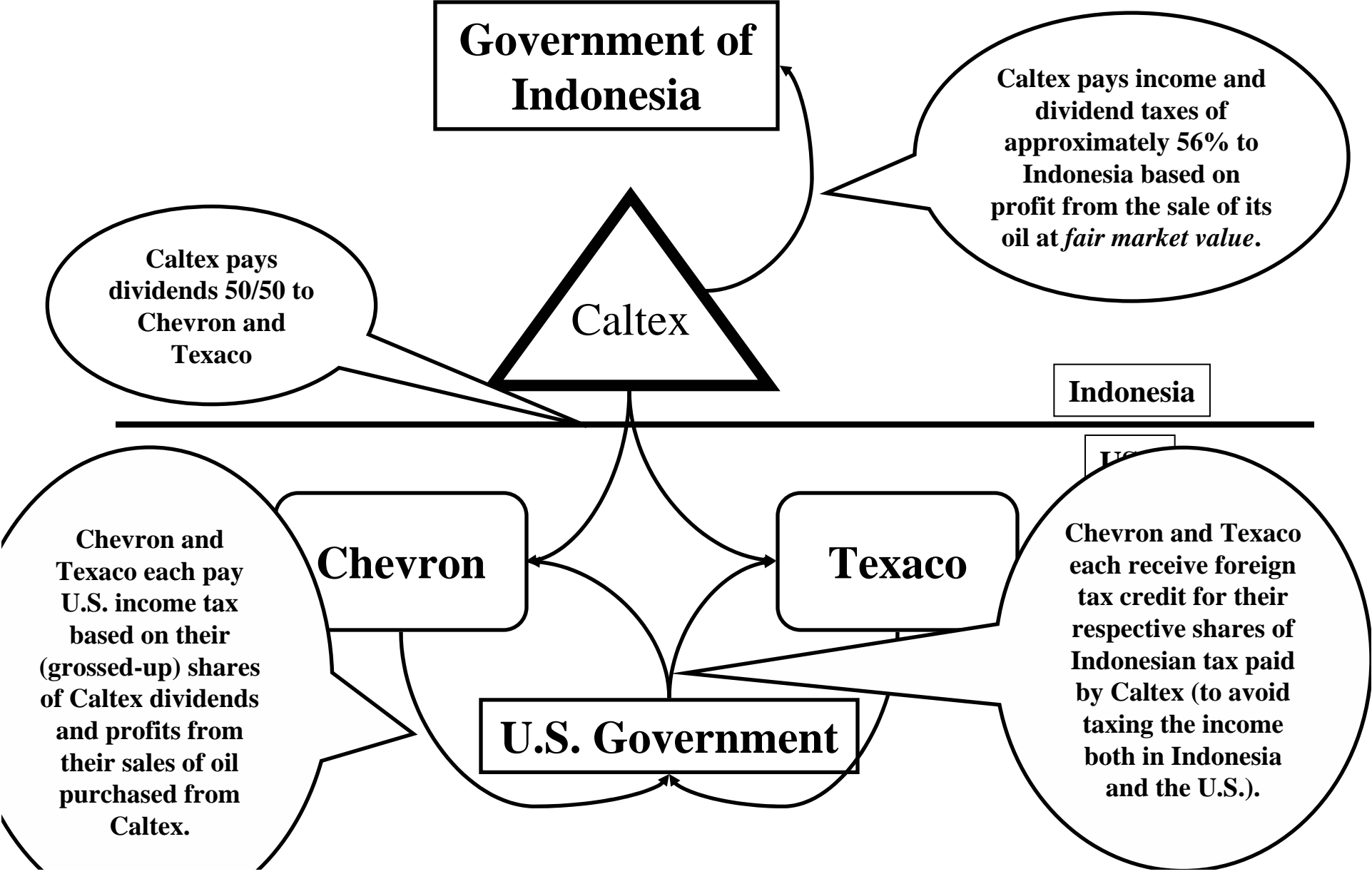
Chevron

Texaco

U.S. Government

Chevron and Texaco are domiciled in the U.S. and pay U.S. income tax.

How taxes should have been handled



Government of Indonesia

Caltex pays income and dividend taxes of approximately 56% to Indonesia based on profit from the sale of its oil at *fair market value*.

Caltex pays dividends 50/50 to Chevron and Texaco

Caltex

Indonesia

Chevron and Texaco each pay U.S. income tax based on their (grossed-up) shares of Caltex dividends and profits from their sales of oil purchased from Caltex.

Chevron

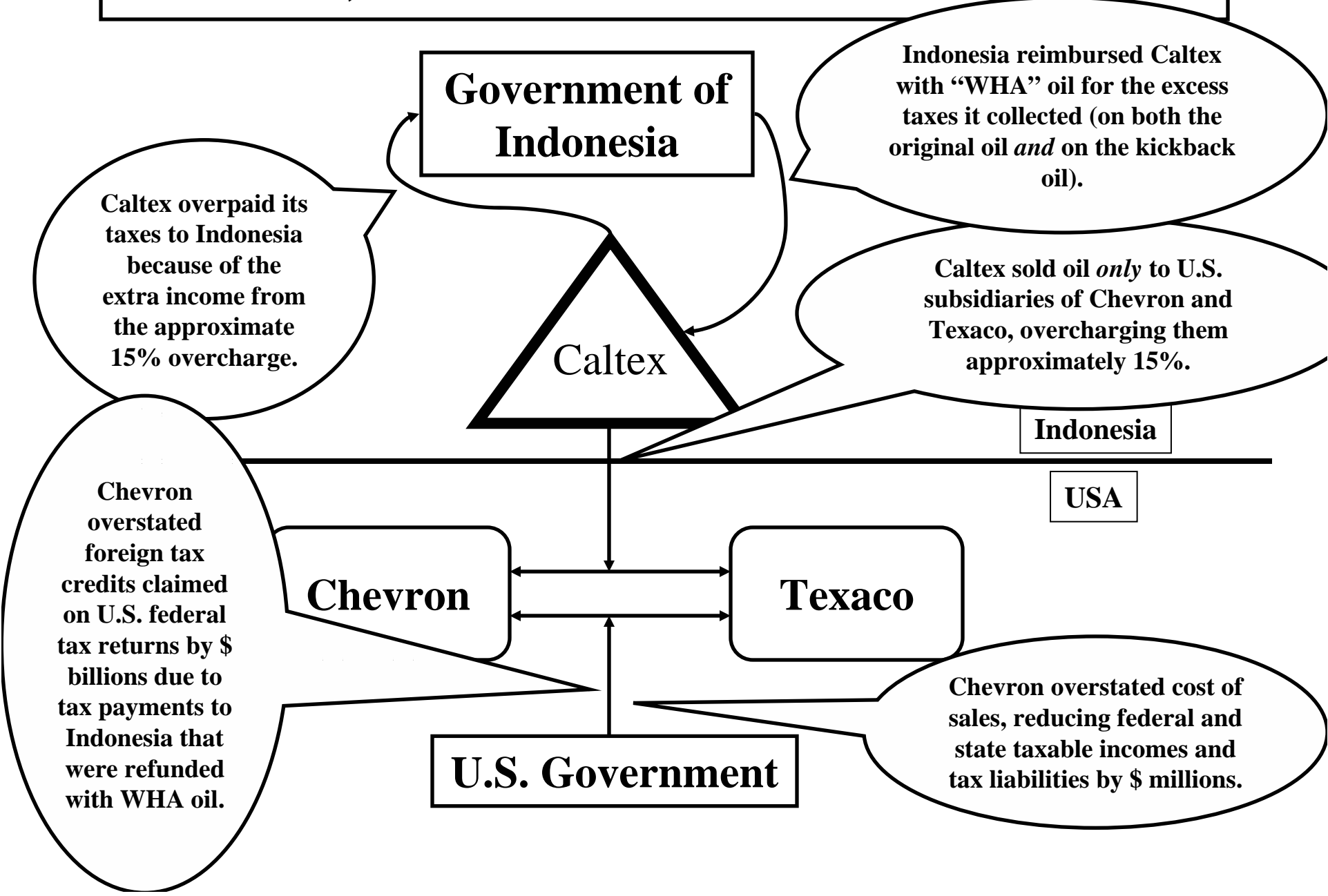
Texaco

U.S. Government

Chevron and Texaco each receive foreign tax credit for their respective shares of Indonesian tax paid by Caltex (to avoid taxing the income both in Indonesia and the U.S.).

U.S.

Chevron, Texaco and Indonesia Cooperate



Government of Indonesia

Indonesia reimbursed Caltex with "WHA" oil for the excess taxes it collected (on both the original oil and on the kickback oil).

Caltex overpaid its taxes to Indonesia because of the extra income from the approximate 15% overcharge.

Caltex

Caltex sold oil *only* to U.S. subsidiaries of Chevron and Texaco, overcharging them approximately 15%.

Indonesia

USA

Chevron

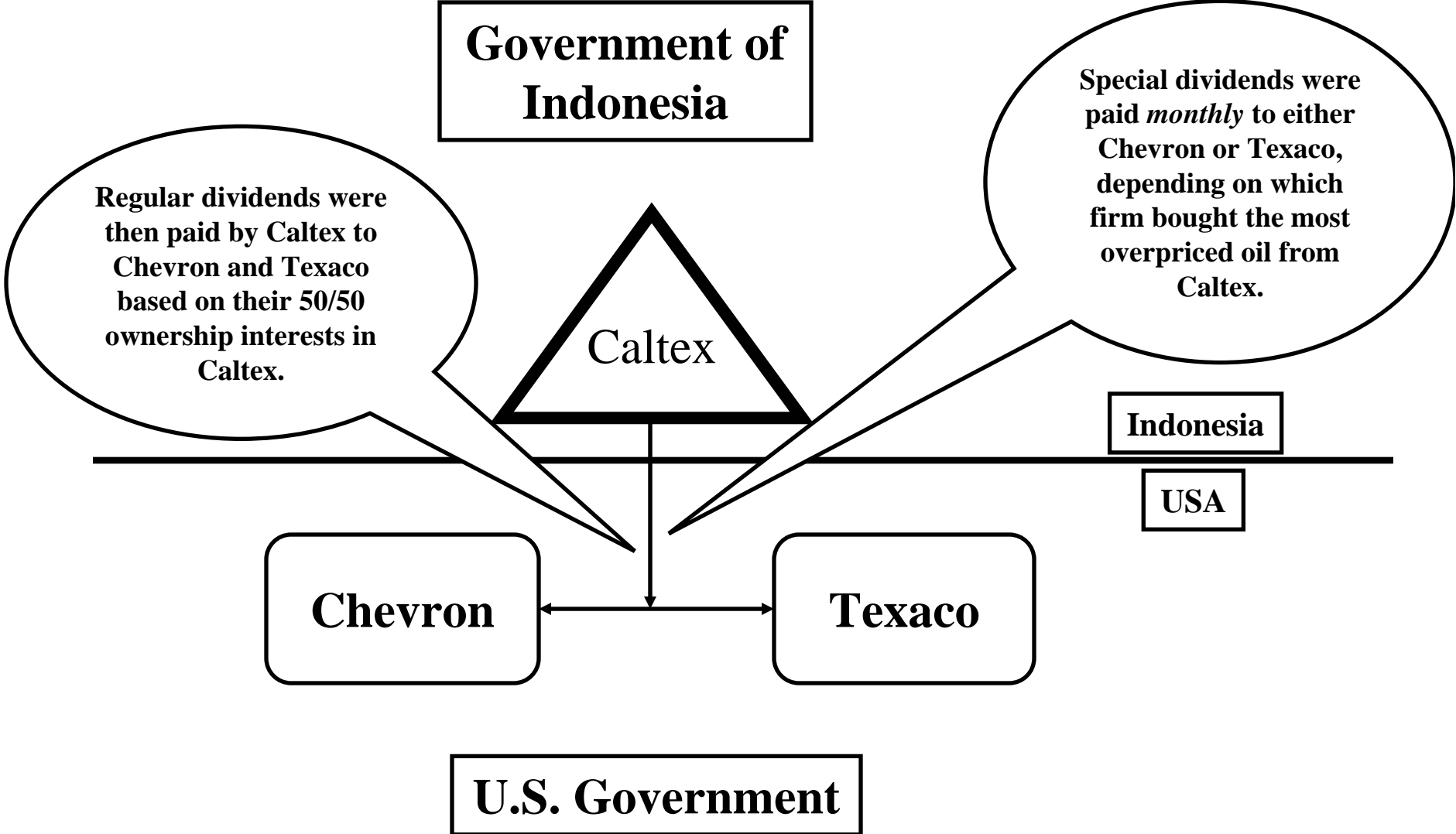
Texaco

Chevron overstated foreign tax credits claimed on U.S. federal tax returns by \$ billions due to tax payments to Indonesia that were refunded with WHA oil.

U.S. Government

Chevron overstated cost of sales, reducing federal and state taxable incomes and tax liabilities by \$ millions.

Full Circle—How Dividends Worked



Some Interesting Documents We Found

The court concludes that the proffer, along with the documents themselves, adequately supports a finding of probable cause to believe that one or more crimes or frauds have been committed or attempted and that the attorney-client communications at issue were created in furtherance of those crimes or frauds, including a showing of the client's intent.

The court finds that some or all of these factors are present in a substantial number of documents. The court finds sufficient evidence to support its conclusion that the Government has established probable cause by its proffer and by the documents themselves that they were prepared in furtherance of the crimes or frauds at issue and that therefore the crime-fraud exception applies. The attorney-client privilege is therefore breached, and the documents should be produced.

Federal Judge Magistrate's decision, 1/25/96

Some Interesting Documents We Found

Let:

- GSP = Government selling price - \$/bbl
- MP = Market price for crude in market where crude is overpriced - \$/bbl
- E_g = CPI gross earnings at GSP - \$
- E_m = CPI gross earnings at MP - \$
- T = Tax rate in market where crude is overpriced - expressed as a decimal
- SA = Market oriented A/T Special Allowance - \$/bbl
- B = Production - bbls

Then:

$$SA = \left[(1 - T) - \frac{(E_g - E_m)}{(B)(GSP - MP)} \right] (GSP - MP)$$

From Chevron's *The Economics of Lifting Sumatran Crude*

Some Interesting Documents We Found

January 28, 1986

INDONESIA Alternatives to the WHA

Mr. P. E. Baker, Jr.
2000 Westchester Avenue
White Plains, NY 10650

Mr. R. H. Matzke
225 Bush Street
San Francisco, CA 94104

Gentlemen:

As we have discussed the past few days, the drastic decline in crude oil prices has resulted in the calculated WHA approaching a level so high that there is not enough $\$L$ production available for CandT to lift to fully cover the WHA. And even if there were enough crude available, it is far more than the shareholders can utilize in their refining systems.

Caltex correspondence to Chevron & Texaco, January 1986

Federal Tax Status

1. In 1994 Chevron and the IRS settled all issues other than whether Chevron should be allowed foreign tax credit for taxes paid to Indonesia but refunded in oil.
2. In 1994 Chevron paid \$675 million but brought \$344 million back into income.
3. In 1994 the IRS District Office requested a TAM from the National Office.

Federal Tax Status

4. Texaco settled with the IRS in 1997, bringing \$488 million into income.
5. In 1996, federal judges Steele and Armstrong found evidence of “crimes or frauds” that overrides attorney-client privilege. The documents were then provided to the IRS.

Federal Tax Status

6. In 1998 the National Office of the IRS released the Technical Advice Memorandum that awarded the foreign tax credit to Chevron.

The documents containing evidence of “crimes or frauds” were not considered in either the 1994 settlement or the 1998 TAM.

The first draft of our paper
circulates in August 2002.

How Big Oil Companies Evade Taxes
With Transfer Prices, Kickbacks and Special Dividends

Jeffrey D. Gramlich[✓] and James E. Wheeler^{*}

New York Times, September 13, 2002

Study Says ChevronTexaco Evaded Taxes in Price Scheme

By NEELA BANERJEE and DAVID CAY JOHNSTON

ChevronTexaco, the world's fourth-largest oil company, evaded \$3.25 billion in federal and state taxes from 1970 to 2000 through a complex petroleum pricing scheme involving a project in Indonesia, according to a new research paper by two accounting professors.

Mr. Gramlich contended that the oil companies "like paying taxes in Indonesia, because they get their tax money back twice."

"They pay taxes in Indonesia and get it back in oil, and they get a foreign tax credit from the U.S. government."

San Francisco Chronicle, September 13, 2002

Report: Chevron avoided billions Oil giant denies new charges of abusing foreign tax credits

Matthew Yi, Chronicle Staff Writer

Chevron Corp. may have avoided paying billions of dollars in U.S. income taxes over a period of 30 years by claiming questionable foreign tax credits, according to a new research report released by two University of Michigan professors.

Friday, September 13, 2002

San Francisco Chronicle

CHRONICLE SECTIONS

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**Business
& Finance**

In a declaration signed in 1994, Brian Hom, an IRS official in San Francisco, wrote that the tax credits were "nothing but a sham, and that the alleged Indonesian 'taxes' were never intended to be anything but window-dressing for the IRS and therefore not creditable taxes under (the Internal Revenue Code)."

Wednesday, September 18, 2002

Taxing report

A study written by 2 Hawaii professors says ChevronTexaco evaded billions in taxes

State should investigate ChevronTexaco, authors say

How it worked

By Tim Ruel
truel@starbulletin.com

The authors of a new report that says ChevronTexaco avoided more than \$3 billion in state and federal taxes want the state of Hawaii to help expand their investigation of the company.

"We're only seeing part of it," said James Wheeler, a Lanikai resident who co-wrote the report and who has taught accounting at the University of Hawaii.

Wheeler and colleague Jeffrey Gramlich went public with their report last week in the New York Times and the San Francisco Chronicle. Gramlich is a University of Hawaii

accounting professor who is currently a visiting professor at the University of Michigan Business School.



Starbulletin.com

Sunday, September 22, 2002

**Chevron
owes Hawaii
\$563 million,
study says**

**Two professors say the oil giant
fraudulently evaded taxes in an
Indonesian joint venture**

[How it worked](#)

Starbulletin.com

Editorials

Tuesday, September 24, 2002

[OUR OPINION]

State probe justified in Chevron case

THE ISSUE

A study alleges that the oil company fraudulently evaded \$563 million in Hawaii taxes in a pricing scheme.

News Releases

News Release No. 2002-53 October 13, 2002

ATTORNEY GENERAL SEEKS LAWYERS FOR CHEVRON-TEXACO CASE

Attorney General Earl Anzai announced today that based on preliminary investigation and serious expressions of interest by numerous national law firms he will be selecting lawyers to assist and advise the State regarding the States' potential claims against Chevron/Texaco. The claims arise out of the September 12, 2002 report authored by University of Michigan Professor Emeritus James E. Wheeler and University of Hawaii Professor Jeffrey Gramlich entitled, "How Chevron, Texaco, and the Government of Indonesia Structured Transactions and Agreements to Save Billions in U.S. Income Taxes" (the "Chevron Report"). Among the professors' claims is that Chevron owes the State of Hawaii \$563 million in unpaid taxes.

Tuesday, October 22, 2002

13 law firms interested in state Chevron lawsuit

By Tim Ruel
truel@starbulletin.com

Thirteen law firms around the country have told the Attorney General's Office they are interested in helping the state make a case against ChevronTexaco Corp., which allegedly owes an estimated \$563 million in Hawaii back taxes.

"All of this is going to be looked at by some very high-powered people who are willing to risk their time and their money," Anzai said.

Tuesday, January 28, 2003

Senators seek oil suit

**Members of a state Senate panel
are pressing Gov. Lingle to seek
back taxes from ChevronTexaco**

Attorney General Earl Anzai hired a Chicago law firm on a contingency-fee basis to represent the state in investigating a lawsuit against ChevronTexaco. The firm, **Winston & Strawn**, would pay for all the costs of litigation, and would receive a chunk of any settlement.

Tuesday, April 1, 2003

Lingle searches for proof of ChevronTexaco tax fraud

By Richard Borreca
rborreca@starbulletin.com

Gov. Linda Lingle says her administration is continuing to research allegations that ChevronTexaco may have bilked Hawaii out of more than \$563 million in taxes in a complex oil pricing scheme.

Her statements came yesterday as the Senate, in a 20-4 vote, passed a resolution urging the administration to sue the oil giant. Lingle, however, said her administration does not have enough information yet to start a legal challenge. She promised to have a decision within a month.





HonoluluAdvertiser.com

Posted on: Tuesday, July 22, 2003

State won't sue oil firm

By Sean Hao and Gordon Y.K. Pang
Advertiser Staff Writers

The state won't sue ChevronTexaco Corp. for alleged tax evasion, saying there is no evidence the company avoided paying state income taxes or paid inflated prices for oil possibly leading to Hawai'i's high gas prices.

Yesterday's announcement came after an investigation of tax fraud charges made by two Michigan professors last fall. The professors alleged Chevron and Texaco funneled profits through an offshore joint venture to avoid taxes and paid inflated prices for crude oil that could have led to higher prices at the pump.

November 18, 2003

Ex-Governor Did Not Know of Law Firm's Oil Giant Ties

By LYNNLEY BROWNING and DAVID CAY JOHNSTON

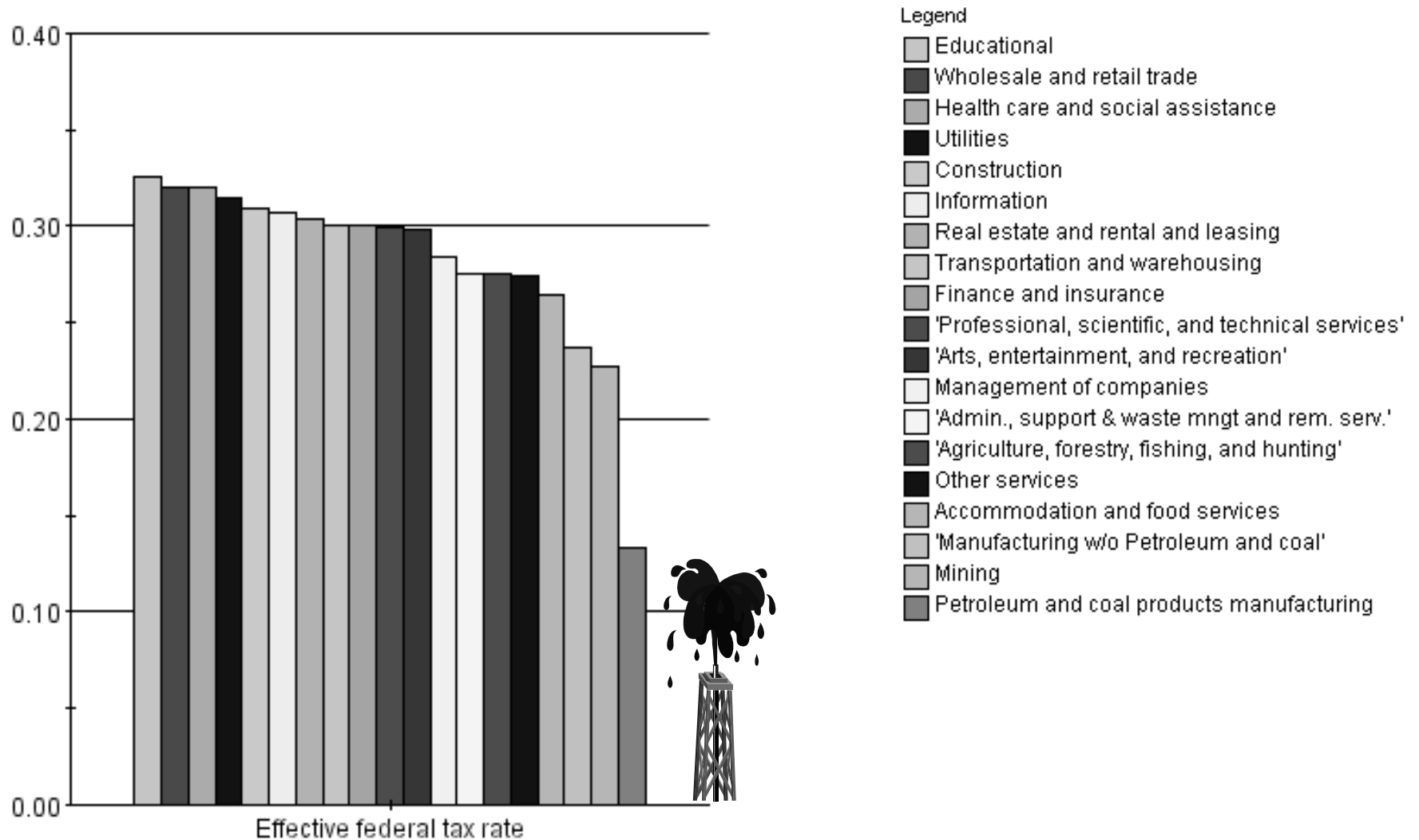
A former governor of Hawaii who ordered an investigation into accusations of tax fraud by ChevronTexaco says he was unaware that the law firm hired to investigate had worked for the predecessors of the company, which the firm eventually cleared of wrongdoing.

The former governor, Benjamin J. Cayetano, said last week that the state should not have selected the law firm, Winston & Strawn of Chicago, because of what he termed a conflict of interest.

But Jeffrey Gramlich, an accounting professor at the University of Southern Maine in Portland, and one of the two academics who asserted tax fraud by ChevronTexaco from 1970 to 2000, said Winston & Strawn had also represented Texaco on at least three cases, in the early to mid-1980's. Winston & Strawn did not mention those specific cases to the State of Hawaii.

Tax Year 2000 Effective Tax Rates by Industry

(from <http://www.irs.gov/pub/irs-soi/00co06nr.xls>)



And that's



UNIVERSITY OF
SOUTHERN MAINE

**How I got involved in research
About corporate tax fraud
And what I learned**

<http://www.usm.maine.edu/~gramlich>