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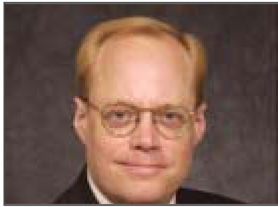

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Dow Chemical's $1 Billion Tax Shelter Stinks, Says Court

Dow Chemical has a very bad taste in its mouth. You would too if a federal judge had just slapped down your $1 ***billion*** in tax deductions and imposed a 20% penalty to boot. The penalty was basically for not being reasonable, for snapping up a deal that was plainly "too good to be true." Sure, there were big time tax advisers here and fancy documents.

(Image credit: AFP/Getty Images via @daylife)

But the court said these investment partnerships were shams just designed to artificially create tax losses. One deal (Chemtech I) was marketed by Goldman Sachs under the trade name SLIPS, for Special Limited Investment Partnership. Tax deals, it should be noted, often come in branded offerings with acronyms. The other (Chemtech II) was designed by top law firm King & Spalding.

Both were highly complex transactions involving byzantine partnership tax rules. Often, tax shelters involve cobbling together parts of the tax code that were probably never meant to be combined. When combined, they can yield—at least on paper—losses many times the size of the real dollars at stake. Few

deals are as big as Dow Chemical's, which handily shielded a whopping $1 billion in tax deductions.

At least that's how Dow's tax returns were filed. And with illustrious firms like Goldman Sachs and King & Spalding behind the wizardry, it may have seemed too good to be true. It turns out it was. A federal court in Louisiana rejected the deals by Dow Chemical that purported to create approximately $1 billion in tax deductions.

In a statement, Dow noted that it has "paid all taxes plus interest with respect to tax years 1993-2003 that were involved in this case, but sought a determination by the U.S. District Court that the taxes at issue were wrongly assessed by the IRS." It added: "Dow is disappointed by the trial court's decision in this case, and we believe the opinion is not supported by the facts and applicable law. Dow is exploring all of its options, including appeal."

Dow operated the structure out of its European headquarters in Switzerland. Chief Judge Jackson wrote in his opinion that the government was correct to reject the artificial tax benefits. There were schemes designed to exploit weaknesses in the tax code. They were not designed for legitimate business reasons. Slicing through the complexity, the Judge made it simple, noting that "tax law deals in economic realities, not legal abstractions."

Judge Jackson upheld penalties—and 20% here is a lot of money—because of common sense. Any reasonable and prudent person should have known that the artificial tax benefits created by the scheme were "too good to be true.," he said. Judge Jackson noted that "Dow viewed its tax department as a profit center," and had at its disposal "numerous lawyers and tax professionals."

Tax shelters don't always involve rich individuals trying to concoct something to shelter income from a company sale or IPO. Sometimes they involve companies with big and diverse operations that make money and that, without some fancy footwork, would pay big taxes. And while tax law is famously complex, it is even more complex when you look at the nuances of businesses and business entities that already file big and opaque tax returns. In Dow's case, the claimed tax deductions were spread across 1993 to 2003, plus penalties for 1997 to 2003. Just think of the interest on all that money.

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