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FILE ONLY

CIA Director Disputes IRS Claim to \$100,000 in Back Taxes

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CIA Director William J. Casey is disputing an Internal Revenue Service claim that he owes at least \$100,000 in back taxes, plus interest, for deductions he took on two 1970s partnership ventures.

The precise amount in dispute cannot be determined from public records. However, some of Casey's partners are challenging the IRS in the U.S. Tax Court, and records in those cases list his investment and share of the write-offs.

In an interview last week, Casey did not dispute calculations made from the court records, but he refused to disclose the specific figures.

"My tax returns are confidential documents and I'm not going to talk about them," he said. He also said, in reference to the joint returns he and his wife Sophia file: "If we have to pay more taxes, we will."

In one case, the records show that Casey invested \$95 for a 1 percent share in PenVerter Partners, a group formed in late 1976 to develop a pen that transfers data directly to a computer from hand-printed writing. From 1977 to 1980 Casey took tax deductions of about \$60,000, a write-off 600 times his initial cash investment, according to the records. The IRS has disallowed the deductions.

The IRS also has disallowed from \$115,000 to \$150,000 in deductions that Casey and his wife took over the same period for her investment in a waste-recycling venture in Rhode Island. In each case, the Caseys were limited partners who made investments, but had no role in the operation of the ventures.

In another case, the IRS claims that a \$5 million price tag Casey set on patent rights for an automobile engine "unreasonably exceeded" the fair market value. Casey owns a 30 percent interest in the engine patent, according to records, and paid \$10,400 for his share a few months before he negotiated the \$5 million sale price in 1976. Casey was not a member of the partnership that claimed IRS-disputed deductions in this case. He would benefit only if the partners—who acquired the patent rights through notes—paid off the \$5 million to Casey and two other patent owners.

All the activities being challenged by the IRS took place before Casey assumed his sensitive role as head of the CIA. The IRS has made no charge of wrongdoing by Casey or the other partners in the ventures, and the matters are in civil Tax Court.

The IRS last year recovered 35 percent of the taxes being contested in Tax Court. There are now nearly 20,000 tax-shelter cases in Tax Court and more than 350,000 undergoing IRS audit, according to IRS spokesmen.

Casey, 71, is a millionaire former tax lawyer and publisher of tax manuals and books, including the 1952 "Tax Sheltered Investments," who has made a practice of investing in high-risk ventures. A dispute with the IRS, which might lead to payment of between \$100,000 and \$200,000 in back taxes and interest, is not unusual for a wealthy man who has a reputation for many decades of aggressive, and at times adventurous, investing.

Casey's personal investments have been an issue ever since he was nominated by President Richard M. Nixon to be chairman of the Securities and Exchange Commission in 1971. At that time he told the Senate Banking Committee that he had made 17 venture-capital investments in small corporations and had been sued for his activities in three of them.

If he limited his holdings to larger corporations he might have avoided litigation and made more money, he said. "But I would not have had the interest, satisfaction or experience that comes from investment and active participation in new enterprises concerned with development and change in our society."

He declared, "It is this activity, as much as anything else, that has given me an understanding of the way the capitalist system operates in America"

After Casey left the government in 1975, limited partnerships for research and development were becoming popular investment vehicles for venture capitalists.

The Senate Select Committee on Intelligence knew of Casey's PenVerter write-offs in 1981 when it investigated his finances. But the IRS had not completed the audit that led to disallowing the deductions.

Records in Tax Court show the IRS disallowed \$6 million that the PenVerter partners declared as losses between 1977 and 1980. During that period Casey was entitled to 1 percent of PenVerter's profits and losses, the records show.

PenVerter, the automobile-engine partnership and the waste-recycling venture were organized by Carl G. Paffendorf, a longtime friend and business associate of Casey. They are among several Paffendorf-related partnerships whose deductions have been disallowed by the IRS in recent years.

Paffendorf is president of COAP Systems Inc., which he and Casey co-founded 20 years ago, according to documents on file at the SEC. Casey also has been a stockholder in the company, and bought one of its subsidiaries in 1979 for \$250,000. Paffendorf, who has been described as a Casey protégé, did not return calls for comment.

All three cases in Tax Court involve the sale of patent or licensing rights at prices that the IRS has challenged because the investors put up little cash and signed large "non-recourse" notes for loans. Investors are not personally liable for such loans if the venture fails. The partnerships also wrote off millions of dollars in research and development fees they owed to Hi-Tech Research Inc., a subsidiary of COAP Systems. SEC records show that COAP Systems has not collected any of the interest or principal owed it by the partnerships.

PenVerter

Soon after Paffendorf formed the PenVerter partnership in November, 1976, Casey replaced him as the "original limited partner" with an investment of \$95. The same month, the PenVerter partnership obtained "rights to certain confidential information and technology" relating to computers from COAP Systems for \$4 million. Of that, \$100,000 was paid in cash; the remaining \$3.9 million was in non-recourse notes.

Court records show that PenVerter then paid another \$1.4 million—all but \$50,000 of it in non-recourse notes—to a group of engineers from the Massachusetts Institute of Technology to develop a laboratory model of the computer pen device. In their work, the

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engineers were to use the "information and technology" that the partners had bought from COAP Systems. The three engineers involved said in recent interviews that they did not receive anything from PenVerter that they would describe as "technology."

"Carl Paffendorf came up with the idea of having accountants write on tablets that got right into a computer," Barry Blesser, one of the engineers, recalled.

"He conceived the idea. He had sketches He owned the concept. He hired us to implement it There was nothing substantial I would call technology."

PenVerter also hired Hi-Tech Research, the COAP Systems subsidiary, for \$1.5 million—including \$1 million in non-recourse notes—to develop a production model of the device in 1977. The MIT engineers said they were not aware of what Hi-Tech did for the money.

In early 1980, the PenVerter partners sold their interest to a new company called Pencept, which was backed by J.H. Whitney and Co., a New York investment banking firm. Don Ackerman, a Whitney partner and director of Pencept, said the new company has invested several million dollars in the technology, which is being marketed under the name Penpad. He said he told the Senate intelligence committee in 1981 that he thought the \$4 million value placed on the PenVerter technology was "suspect."

Recycling Venture

The waste-recycling venture, Recycle and Energy Associates/Little Compton (Realco), was set up in 1974 by Paffendorf and an associate. Its purpose was to "acquire, lease, and/or operate" a system for disposal and recycling of solid waste in Little Compton, R.I. In early 1975 it had five limited partners, including Sophia Casey. By 1978 her investment totaled \$40,000 in cash and another \$40,000 in notes—20 percent of the group's capital.

The Tax Court case covers nearly \$800,000 the partnership claimed as losses between 1977 and 1980. The limited partners were entitled to split 95 percent of the write-off, according to partnership papers. Thus the Caseys apparently deducted between \$115,000 and \$150,000 on their joint returns over that four-year period.

The recycling facility is not currently being used. Jane Cabot, president of the Little Compton town council at the time, said, "It didn't pass state pollution tests and it sounded like a jet engine when it was running. We got a lot of complaints."

Engine Partnership

In the Tri-Rotor Motor Co. partnership case, in which Casey has no personal investment, the IRS disallowed all \$5.5 million in losses claimed by the partnership from 1977 to 1980. The tax agency also is questioning the group's payment of \$5 million for the rights to the engine patent owned by Casey and two brothers, George J. and Helias Doundoulakis.

In papers filed in Tax Court, the IRS said that only \$50,000 of the \$5 million purchase price was cash. The remaining \$4.95 million was in the form of "non-recourse" notes.

"Both the alleged purchase price of the patent and the principal amount of the alleged non-recourse note unreasonably exceeded the fair market value of the patents at the time of the purchase," IRS lawyers said in papers filed Feb. 23. They added:

"The acquisition of the patents and the claimed research and experimental expenditures were not activities entered into for profit. On the contrary, the transactions entered into by Tri-Rotor and the activities undertaken by it were solely or primarily to reduce the income taxes of the partners."

Jerome Kamerman, an attorney for a Tri-Rotor partner fighting the IRS challenge to the deductions, said at a Tax Court hearing last month that he understood that Casey "set the price on the patent in question and he bargained very hard on that price and he thought it was valuable."

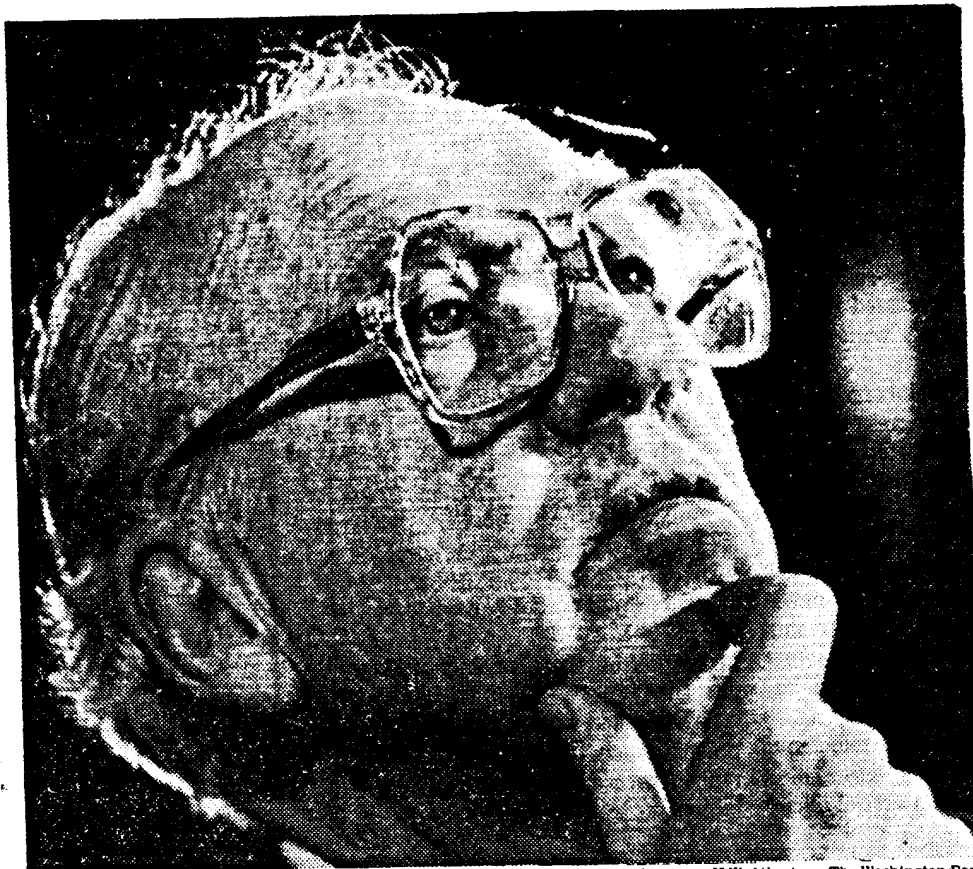
Casey said he is willing to testify.

Technical reviews of the engine in 1977, 1980 and 1982 commented on its unique and intriguing design, but also noted the partners' troubles in getting it to perform as hoped. Inventor George Doundoulakis, in a report he circulated earlier this year, said that it wasn't until April, 1983, that his engine "began starting at every try and continued to run with good consistency."

Doundoulakis said in a recent interview that he could not demonstrate the engine because it was taken apart after testing.

"We are confident our engine will become the engine of the future," he said. Asked about the IRS challenge, he said: "The IRS says everything is overvalued. That's their job They'll say it's worth nothing. We'll say it's worth a billion dollars. We'll let the judge decide."

Special correspondents John Kennedy and Anndee Hochman contributed to this report.



By James K.W. Atherton - The Washington Post

Venture capitalist Casey likes "participation in enterprises concerned with development and change."