

S. 492

At the request of Mr. JOHNSON, the name of the Senator from Michigan (Mr. LEVIN) was added as a cosponsor of S. 492, a bill to amend the Social Security Act and the Internal Revenue Code of 1986 to exempt certain employment as a member of a local governing board, commission, or committee from Social Security tax coverage.

S. CON. RES. 4

At the request of Mr. NELSON of Florida, the names of the Senator from Connecticut (Mr. LIEBERMAN), the Senator from Pennsylvania (Mr. CASEY), the Senator from New Jersey (Mr. LAUTENBERG) and the Senator from Georgia (Mr. ISAKSON) were added as cosponsors of S. Con. Res. 4, a concurrent resolution calling on the President and the allies of the United States to raise the case of Robert Levinson with officials of the Government of Iran at every level and opportunity, and urging officials of the Government of Iran to fulfill their promises of assistance to the family of Robert Levinson and to share information on the investigation into the disappearance of Robert Levinson with the Federal Bureau of Investigation.

S. RES. 20

At the request of Mr. VOINOVICH, the name of the Senator from California (Mrs. FEINSTEIN) was added as a cosponsor of S. Res. 20, a resolution celebrating the 60th anniversary of the North Atlantic Treaty Organization.

STATEMENTS ON INTRODUCED BILLS AND JOINT RESOLUTIONS

By Mr. LEVIN (for himself, Mr. WHITEHOUSE, Mrs. MCCASKILL, and Mr. NELSON of Florida):

S. 506. A bill to restrict the use of offshore tax havens and abusive tax shelters to inappropriately avoid Federal taxation, and for other purposes; to the Committee on Finance.

Mr. LEVIN. Mr. President, America has been knocked flat on its back by the current financial crisis, but the American fighting spirit hasn't given up. We are battling back.

Congress recently passed an \$800 billion recovery bill to jumpstart the economy with new jobs and investments. That \$800 billion is on top of the \$700 billion we set aside earlier to revive the credit markets and recapitalize the financial institutions that got us into this mess. Those steps weren't easy to take and represent a lot of money going out the door.

That is why, today, I am introducing the Stop Tax Haven Abuse Act, along with Senators WHITEHOUSE, MCCASKILL and BILL NELSON, to stop tax cheats who drain our treasury of funds needed to pay for our recovery. The bill's target is offshore tax abuses that rob the U.S. Treasury of an estimated \$100 billion each year, reward tax dodgers using offshore secrecy laws to hide money from Uncle Sam, and offload the tax burden onto the backs of middle income families who play by the rules.

It is time for Congress and this administration to take a stand against offshore tax evasion. It is unfair; we can't afford it; and there is a whole lot more we can do to stop it.

The bill we are introducing today is an improved version of the Stop Tax Haven Abuse Act that I introduced in February 2007, with Senator Coleman and then Senator Obama, and that Congressmen LLOYD DOGGETT and Rahm Emanuel introduced in the House with the support of 47 cosponsors. No action was taken last Congress on either bill, even though evidence has continued to pour in about the extensive and serious nature of offshore tax dodging.

In July 2008, for example, the Senate Permanent Subcommittee on Investigations, which I chair, held two days of hearings and released a report that broke through the wall of secrecy that normally surrounds banks located in tax haven jurisdictions. The Subcommittee presented multiple case histories exposing how two such banks, UBS AG of Switzerland and LGT Bank of Liechtenstein, used an array of secrecy tricks to help U.S. clients hide assets and dodge U.S. taxes.

The hearing showed, for example, that UBS had opened Swiss accounts for an estimated 19,000 U.S. clients with nearly \$18 billion in assets, and did not report any of those accounts to the U.S. Internal Revenue Service. A UBS private banker based in Switzerland pled guilty to conspiring to helping a U.S. billionaire hide \$200 million and evade \$7.2 million in tax, and provided sworn deposition testimony to the Subcommittee about how UBS Swiss bankers sought and serviced clients right here in the United States. A more senior UBS official asserted his Fifth Amendment rights at the hearing rather than answer questions about UBS conduct.

The Subcommittee investigation also presented seven case histories of U.S. persons who had secretly stashed millions of dollars in accounts at LGT Bank, a private bank owned by the Liechtenstein royal family. These case histories unfolded like spy novels, with secret meetings, hidden funds, shell corporations, and complex offshore transactions spanning the globe from the United States to Liechtenstein, Switzerland, the British Virgin Islands, Australia, and Hong Kong. What the case histories had in common were officials from LGT Bank and its affiliates acting as willing partners to move a lot of money into LGT accounts, while obscuring the ownership and origin of the funds from tax authorities, creditors, and courts.

A former LGT employee, now in hiding for disclosing LGT client information, provided videotaped testimony during the hearing describing a long list of secrecy tricks and deceptive practices used by LGT to conceal client assets. They included using code names for LGT clients; requiring bankers to use outside pay phones to call clients

to prevent those calls from being traced back to the bank; establishing offshore shell corporations which clients could use to route money into and out of their LGT accounts without incriminating wire transfers; and creating elaborate offshore structures involving foundations, trusts, and corporations to conceal client ownership of assets. In addition, four U.S. persons asserted their Fifth Amendment rights at the hearing and declined to answer questions about their LGT accounts.

More than 150 U.S. taxpayers are now under investigation by the IRS for having undeclared Liechtenstein accounts. The IRS is not labouring alone. Nearly a dozen countries have investigations underway into possible tax evasion involving Liechtenstein accounts. Germany, for example, is working through a list of 600 to 700 German taxpayers with LGT accounts, including a prominent businessman who allegedly used LGT accounts to evade \$1.5 million in taxes.

LGT was invited to the July Subcommittee hearings to defend its actions, but chose not to appear. UBS, to its credit, appeared and announced at the hearings that it would take responsibility for its actions. It apologized for past compliance failures, promised to close all 19,000 Swiss accounts unless the U.S. accountholder agreed to disclose the account to the IRS, and announced it would no longer offer U.S. clients the option of opening Swiss accounts that are not disclosed to the IRS. A few months later, Liechtenstein signed its first tax information exchange agreement with the United States, and LGT announced its intention to change its business model and begin cooperating with foreign tax authorities.

The actions taken by UBS and LGT have reverberated around the tax haven world, raising questions about whether the game is finally up and the international community is ready to take action to put an end to offshore secrecy and tax abuses. Some banks, like Credit Suisse, Switzerland's largest bank after UBS, have decided to follow UBS' lead and stop offering hidden Swiss bank accounts to U.S. clients. But many other tax haven banks continue their secret ways and continue to engage in practices that facilitate tax evasion.

The United States Government is continuing its efforts to combat offshore secrecy. In November 2008, the U.S. Department of Justice, DOJ, indicted a senior UBS official, then head of the UBS private bank, for conspiring to help other U.S. clients dodge U.S. taxes. Because he has refused to face the charges, he remains a fugitive from justice in Switzerland. In February, DOJ indicted UBS itself, again for conspiring to help U.S. clients dodge U.S. taxes. That criminal prosecution was then deferred, because UBS admitted to the underlying facts, paid a \$780 million fine, turned over the names of at least 250 clients with Swiss accounts,

and promised to no longer open Swiss accounts for U.S. clients without notifying the IRS. A U.S. indictment of a major bank is rare; an indictment of a major bank for helping clients evade U.S. taxes may be unprecedented.

In addition to filing these criminal prosecutions, DOJ served UBS with a John Doe summons seeking the names of the other 19,000 U.S. clients with Swiss accounts hidden from the IRS. UBS said at the Subcommittee hearing in July that it was ready to cooperate, but virtually none of the information requested by the John Doe summons has been turned over, primarily because the Swiss Government has taken the position that turning over this client account information would violate Swiss secrecy laws. DOJ has asked the U.S. court that approved the summons to enforce it, and a trial to resolve the issue is now scheduled for July 2009, one year after the initial request for the information. The fact that the United States is having such a difficult time getting the client names, despite catching UBS red-handed and obtaining its admission of wrongdoing, shows how tough the offshore tax evasion problem is.

It is worth noting that Switzerland is refusing to allow UBS to provide the names of potential U.S. tax cheats, while at the same time attempting to claim it is not a tax haven and it is not a secrecy jurisdiction. It is also worth noting that top Swiss government officials have now formed a "strategic delegation" charged with defending Swiss bank secrecy against efforts by the United States, European Union, and other countries to change Swiss practices.

Right now, tax haven governments and tax haven banks often dress up their secrecy laws and banking practices with phrases like "financial privacy" and "wealth management." Some enter into tax treaties and tax information exchange agreements with the United States, while setting up procedures that deny or delay providing information essential for effective tax enforcement. They also use their secrecy laws and practices to hide, not only the wrongdoing of the taxpayers, but also the actions of the tax haven participants who aid and abet the wrongdoing.

Secrecy breeds tax evasion. Tax evasion eats at the fabric of society, not only by starving health care, education, and other needed government services of resources, but also by undermining trust—making honest folks feel like they are being taken advantage of when they pay their fair share.

We can fight back against offshore secrecy jurisdictions and offshore tax abuses if we summon the political will. Our bill offers powerful new tools to tear down the tax haven secrecy walls in favour of transparency, cooperation, and tax compliance. To tear down those secrecy walls, protect honest taxpayers, and obtain the revenues essential for critical needs, I hope my col-

leagues will act during this Congress to enact our legislation to shut down the \$100 billion in offshore tax abuses.

The Stop Tax Haven Abuse Act is the product of years of work. My Subcommittee, through reports and hearings, has exposed numerous abusive practices involving offshore tax havens as well as home-grown abusive tax shelters. In the 109th Congress, we confronted these twin threats to our treasury by introducing S. 1565, the Tax Shelter and Tax Haven Reform Act. In the 110th Congress, we introduced an improved version of that legislation, S. 681, reflecting not only the Subcommittee's additional investigative work but also innovative ideas to end the use of tax havens and to stop unethical tax advisers from aiding and abetting U.S. tax evasion.

Today's bill is very similar to S. 681, but with three new additions. A new Section 103 addresses the tax dodging that occurs when a business incorporates in a tax haven, pretending to be a foreign corporation for U.S. tax purposes, while, in reality, being managed and controlled from the United States. A new Section 108 seeks to put an end to financial gimmicks being used by offshore hedge funds and others to dodge payment of U.S. taxes on U.S. stock dividends. A new Section 109 expands reporting requirements for U.S. persons who benefit from a passive foreign investment corporation. These new sections offer powerful new tools to combat offshore tax abuse.

I will now describe some of the tax abuses that need to be addressed and explain what our bill would do to stop them. First, I will look at the offshore tax problem and then at some of our home-grown abusive tax shelters.

TAX HAVEN ABUSES

A tax haven is a foreign jurisdiction that maintains corporate, bank, and tax secrecy laws and industry practices that make it very difficult for other countries to find out whether their citizens are using the tax haven to cheat on their taxes. In effect, tax havens sell secrecy to attract clients to their shores. They peddle secrecy the way other countries advertise high quality services. That secrecy is used to cloak tax evasion and other misconduct, and it is that offshore secrecy that is targeted in our bill.

The Tax Justice Network, an international non-profit organization dedicated to fighting tax evasion, has estimated that wealthy individuals worldwide have stashed \$11.5 trillion of their assets in offshore tax havens. The IMF has estimated that, in 2000 alone, \$1.7 trillion in investments were sent through offshore tax havens. A series of 2007 Tax Notes articles estimated that over \$1.5 trillion in hidden assets were located in just four tax havens, Guernsey, Jersey, Isle of Man, and Switzerland, characterizing those assets as beneficially owned by non-resident individuals likely avoiding tax in their home jurisdictions. At one Subcommittee hearing, a former owner

of an offshore bank in the Cayman Islands testified that he believed 100 percent of his former bank clients were engaged in tax evasion. He said that almost all were from the United States and had taken elaborate measures to avoid IRS detection of their money transfers. He also expressed confidence that the offshore government that licensed his bank would vigorously defend client secrecy in order to continue attracting business.

In connection with a hearing held in August 2006, the Subcommittee released a staff report with six case studies describing how U.S. individuals use offshore tax havens to evade U.S. taxes. In one case, two brothers from Texas, Sam and Charles Wyls, established 58 offshore trusts and corporations, and operated them for more than 13 years without alerting U.S. authorities. To move funds abroad, the brothers transferred over \$190 million in stock option compensation they had received from U.S. publicly traded companies to the offshore corporations. They claimed that they did not have to pay tax on this compensation, because, in exchange, the offshore corporations provided them with private annuities which would not begin to make payments to them until years later. In the meantime, the brothers directed the offshore corporations to cash in the stock options and start investing the money. The brothers failed to disclose these offshore stock transactions to the SEC despite their position as directors and major shareholders in the relevant companies.

The Subcommittee was able to trace more than \$600 million in stock option proceeds that the brothers invested in various ventures they controlled, including two hedge funds, an energy company, and an offshore insurance firm. They also used the offshore funds to purchase real estate, jewelry, and artwork for themselves and their family members, claiming they could use these offshore dollars to advance their personal and business interests without having to pay any taxes on the offshore income. The Wyls were able to carry on these tax maneuvers in large part because all of their activities were shrouded in offshore secrecy.

In another of the case histories, six U.S. taxpayers relied on phantom stock trades between two offshore shell companies to generate fake stock losses which were then used to shelter billions in income. This offshore tax shelter scheme, known as the POINT Strategy, was devised by Quellos, a U.S. securities firm headquartered in Seattle; coordinated with a European financial firm known as Euram Advisers; and blessed by opinion letters issued by two prominent U.S. law firms, Cravath Swaine and Bryan Cave. The two offshore shell companies at the center of the strategy, known as Jackstones and Barneville, supposedly created a stock portfolio worth \$9.6 billion. However, no cash or stock transfers ever took place. Moreover, the shell companies

that conducted these phantom trades were so shrouded in offshore secrecy that no one would admit to knowing who owns them. One U.S. taxpayer used the scheme to shelter about \$1.5 billion from U.S. taxes. Another sought to shelter about \$145 million. Both have since agreed to settle with the IRS.

The persons examined by the Subcommittee are far from the only U.S. taxpayers engaging in these types of offshore tax abuses. Two experts, Joseph Guttentag and Professor Reuven Avi-Yonah, have estimated that U.S. individuals are using offshore tax schemes to avoid payment of \$40 to \$70 billion in taxes each year.

Corporations are also using tax havens to avoid payment of U.S. taxes. Data released by the Commerce Department indicates that, as of 2001, almost half of all foreign profits of U.S. corporations were in tax havens. A study released by the journal *Tax Notes* in September 2004 found that American companies were able to shift \$149 billion of profits to 18 tax haven countries in 2002, up 68 percent from \$88 billion in 1999. Professor Kimberly Clausing has estimated that corporate offshore abuses utilizing transfer pricing schemes resulted in \$60 billion in lost U.S. tax revenues in 2004, and other experts have estimated similar amounts.

Corporate use of tax haven jurisdictions is also widespread. In January 2009, Senator DORGAN and I released a report by the Government Accounting Office (GAO) which shows that out of the 100 largest U.S. publicly traded corporations, 83 have subsidiaries in tax havens. Of the 100 largest federal contractors, 63 have tax haven subsidiaries. Using data from their corporate filings with the Securities and Exchange Commission, GAO listed the number of tax haven subsidiaries for each of these corporations. GAO determined, for example, that Morgan Stanley has 273 tax haven subsidiaries, while Citigroup has 427, with 90 in the Cayman Islands alone. News Corp. has 152, while Procter and Gamble has 83, Pfizer has 80, Oracle has 77, and Marathon Oil has 76. My Subcommittee is currently engaged in an effort to understand why so many of these corporations have so many tax haven affiliates. To do that we are going to have to battle secrecy laws in 50 different jurisdictions.

Here's just one simplified example of the gimmicks being used by corporations to transfer taxable income from the United States to tax havens to escape taxation. Suppose a profitable U.S. corporation establishes a shell corporation in a tax haven. The shell corporation has no office or employees, just a mailbox address. The U.S. parent transfers a valuable patent to the shell corporation. Then, the U.S. parent and all of its subsidiaries begin to pay a hefty fee to the shell corporation for use of the patent, reducing its U.S. income through deducting the patent

fees and thus shifting taxable income out of the United States to the shell corporation. The shell corporation declares a portion of the fees as profit, but pays no U.S. tax since it is a tax haven resident. The icing on the cake is that the shell corporation can then "lend" the income it has accumulated from the fees back to the U.S. parent for its use. The parent, in turn, pays "interest" on the "loans" to the shell corporation, shifting still more taxable income out of the United States to the tax haven. This example highlights just a few of the tax haven ploys being used by some U.S. corporations to escape paying their fair share of taxes here at home.

Our Subcommittee's 2008 investigation into tax haven banks and our 2006 investigation into offshore abuses also highlight the extent to which offshore secrecy rules make it possible for taxpayers to participate in illicit activity with little fear of getting caught. Through a series of case studies, the Subcommittee has shown how U.S. taxpayers, with the help of offshore financial institutions, service providers, legal counsel, and tax professionals, set up financial accounts and entities in secrecy jurisdictions to hide assets and dodge taxes. The case studies showed how some U.S. persons created complex offshore structures to hide their ownership of offshore bank accounts. Others formed offshore entities which they claimed were independent but, in fact, exercised control over them through compliant offshore trustees, officers, directors, and corporate administrators. Because of offshore secrecy laws and practices, offshore businesses could and did take steps to protect their U.S. clients' identities and financial information from U.S. tax and regulatory authorities, making it extremely difficult, if not impossible, for U.S. law enforcement authorities to get the information needed to enforce U.S. tax laws.

The extent of the offshore tax abuses documented by years of Subcommittee reports and hearings demonstrates the importance of obtaining new tools to combat offshore secrecy and restore the ability of U.S. tax enforcement to pursue offshore tax cheats. I'd now like to describe the key measures in the Stop Tax Havens Act providing those new enforcement tools. They include new legal presumptions to overcome offshore secrecy barriers, special measures to combat persons who impede U.S. tax enforcement, treatment of offshore corporations as domestic corporations when controlled by U.S. persons, elimination of the offshore dividend tax loophole, greater disclosure of offshore transactions, and more.

PRESUMPTIONS RELATED TO OFFSHORE SECRECY JURISDICTIONS

The 2006 Subcommittee staff report provided six case histories detailing how U.S. taxpayers are using offshore tax havens to avoid payment of the taxes they owe. These case histories examined an Internet based company

that helped persons obtain offshore entities and accounts; U.S. promoters that designed complex offshore structures to hide client assets, even providing clients with a how-to manual for going offshore; U.S. taxpayers who diverted business income offshore through phony loans and invoices; a one-time tax dodge that deducted phantom offshore stock losses from real U.S. stock income to shelter that income from U.S. taxes; and the 13-year offshore empire built by Sam and Charles Wyly. Each of these case histories presented the same fact pattern in which the U.S. taxpayer, through lawyers, banks, or other representatives, set up offshore trusts, corporations, or other entities which had all the trappings of independence but, in fact, were controlled by the U.S. taxpayer whose directives were implemented by compliant offshore personnel acting as the trustees, officers, directors or nominee owners of the offshore entities.

In the case of the Wyllys, the brothers and their representatives communicated Wyly directives to a so-called trust protector who then relayed the directives to the offshore trustees. In the 13 years examined by the Subcommittee, the offshore trustees never once rejected a Wyly request and never once initiated an action without Wyly approval. They simply did what they were told. A U.S. taxpayer in another case history told the Subcommittee that the offshore personnel who nominally owned and controlled his offshore entities, in fact, always followed his directions, describing himself as the "puppet master" in charge of his offshore holdings.

When the Subcommittee discussed these case histories with financial administrators from the Isle of Man, the regulators explained that none of the offshore personnel were engaged in any wrongdoing, because their laws permit foreign clients to transmit detailed, daily instructions to offshore service providers on how to handle offshore assets, so long as it is the offshore trustee or corporate officer who gives the final order to buy or sell the assets. They explained that, under their law, an offshore entity is considered legally independent from the person directing its activities so long as that person follows the form of transmitting "requests" to the offshore personnel who retain the formal right to make the decisions, even though the offshore personnel always do as they are asked.

The Subcommittee case histories illustrate what the tax literature and law enforcement experience have shown for years: that the business model followed in all offshore secrecy jurisdictions is for compliant trustees, corporate administrators, and financial institutions to provide a veneer of independence while ensuring that their U.S. clients retain complete and unfettered control over "their" offshore assets. That's the standard operating procedure offshore. Offshore service

providers pretend to own or control the offshore trusts, corporations, and accounts they help establish, but what they really do is whatever their clients tell them to do. In truth, the independence of offshore entities is a legal fiction, and it is past time to pull back the curtain on the reality hiding behind the legal formalities.

The reality behind these offshore practices makes a mockery of U.S. laws that normally view trusts and corporations as independent entities. They invite game-playing and tax evasion. To combat these offshore abuses, our bill takes them head on in a number of ways.

Section 101—Rebuttable evidentiary presumptions and initial list of offshore secrecy jurisdictions

The first section of our bill, Section 101, tackles this issue by creating several rebuttable evidentiary presumptions that would strip the veneer of independence from the U.S. person involved with offshore entities, transactions, and accounts, unless that U.S. person presents clear and convincing evidence to the contrary. These presumptions would apply only in civil judicial or administrative tax or securities enforcement proceedings examining transactions, entities, or accounts in offshore secrecy jurisdictions. These presumptions would put the burden of producing evidence from the offshore secrecy jurisdiction on the taxpayer who chose to do business there, and who has access to the information, rather than on the federal government which has little or no practical ability to get the information. The creation of these presumptions implements a bipartisan recommendation in the August 2006 Subcommittee staff report on tax haven abuses.

The bill would establish three evidentiary presumptions that could be used in a civil tax enforcement proceeding: (1) a presumption that a U.S. taxpayer who “formed, transferred assets to, was a beneficiary of, or received money or property” from an offshore entity, such as a trust or corporation, is in control of that entity; (2) a presumption that funds or other property received from offshore are taxable income, and that funds or other property transferred offshore have not yet been taxed; and (3) a presumption that a financial account controlled by a U.S. taxpayer in a foreign country contains enough money—\$10,000—to trigger an existing statutory reporting threshold and allow the IRS to assert the minimum penalty for nondisclosure of the account by the taxpayer.

In addition, the bill would establish two evidentiary presumptions applicable to civil proceedings to enforce U.S. securities laws. One would specify that if a director, officer, or major shareholder of a U.S. publicly traded corporation were associated with an offshore entity, that person would be presumed to control that offshore entity.

The second provides that securities nominally owned by an offshore entity are presumed to be beneficially owned by any U.S. person who controlled the offshore entity.

These presumptions are rebuttable, which means that the U.S. person who is the subject of the proceeding could provide clear and convincing evidence to show that the presumptions were factually inaccurate. To rebut the presumptions, a taxpayer could establish, for example, that an offshore corporation really was controlled by an independent third party, or that money sent from an offshore account really represented a nontaxable gift instead of taxable income. If the taxpayer wished to introduce evidence from a foreign person, such as an offshore banker, corporate officer, or trust administrator, to establish those facts, that foreign person would have to actually appear in the U.S. proceeding in a manner that would permit cross examination in order for the taxpayer to rebut the presumption. A simple affidavit from an offshore resident who refused to submit to cross examination in the United States would be insufficient.

There are several limitations on these presumptions to ensure their operation is fair and reasonable. First, the evidentiary rules in criminal cases would not be affected by this bill which would apply only to civil proceedings. Second, because the presumptions apply only in enforcement “proceedings,” they would not directly affect, for example, a person’s reporting obligations on a tax return or SEC filing. The presumptions would come into play only if the IRS or SEC were to challenge a matter in a formal proceeding. Third, the bill does not apply the presumptions to situations where either the U.S. person or the offshore entity is a publicly traded company, because in those situations, even if a transaction were abusive, IRS and SEC officials are generally able to obtain access to necessary information. Fourth, the bill recognizes that certain classes of offshore transactions, such as corporate reorganizations, may not present a potential for abuse, and accordingly authorizes Treasury and the Securities and Exchange Commission to issue regulations or guidance identifying such classes of transactions, to which the presumptions would then not apply.

An even more fundamental limitation on the presumptions is that they would apply only to transactions, accounts, or entities in offshore jurisdictions with secrecy laws or practices that unreasonably restrict the ability of the U.S. government to get needed information and which do not have effective information exchange programs with U.S. law enforcement. The bill requires the Secretary of the Treasury to identify those offshore secrecy jurisdictions, based upon the practical experience of the IRS in obtaining needed information from the relevant country.

To provide a starting point for Treasury, the bill presents an initial list of 34 offshore secrecy jurisdictions. This list is taken from actual IRS court filings in court proceedings in which the IRS sought permission to obtain information about U.S. taxpayers active in the named jurisdictions. The bill thus identifies the same jurisdictions that the IRS has already named publicly as probable locations for U.S. tax evasion. Federal courts all over the country have consistently found, when presented with the IRS list and supporting evidence, that the IRS had a reasonable basis for concluding that U.S. taxpayers with financial accounts in those countries presented a risk of tax non-compliance. In every case, the courts allowed the IRS to collect information about accounts and transactions in the listed offshore jurisdictions.

The bill also provides Treasury with the authority to add or remove jurisdictions from the initial list so that the list can change over time and reflect the actual record of experience of the United States in its dealings with specific jurisdictions around the world. The bill provides two tests for Treasury to use in determining whether a jurisdiction should be identified as an “offshore secrecy jurisdiction” triggering the evidentiary presumptions: (1) whether the jurisdiction’s secrecy laws and practices unreasonably restrict U.S. access to information, and (2) whether the jurisdiction maintains a tax information exchange process with the United States that is effective in practice.

If offshore jurisdictions make a decision to enact secrecy laws and support industry practices furthering corporate, financial, and tax secrecy, that’s their business. But when U.S. taxpayers start using those offshore secrecy laws and practices to evade U.S. taxes to the tune of \$100 billion per year, that’s our business. We have a right to enforce our tax laws and to expect that other countries will not help U.S. tax cheats achieve their ends.

The aim of the presumptions created by the bill is to eliminate the unfair advantage provided by offshore secrecy laws that for too long have enabled U.S. persons to conceal their misconduct offshore and game U.S. law enforcement. These presumptions would allow U.S. law enforcement to establish what we all know from experience is normally the case in an offshore jurisdiction—that a U.S. person associated with an offshore entity controls that entity; that money and property sent to or from an offshore entity involves taxable income; and that an offshore account that wasn’t disclosed to U.S. authorities should have been. U.S. law enforcement can establish these facts presumptively, without having to pierce the secrecy veil. At the same time, U.S. persons who chose to transact their affairs through an offshore secrecy jurisdiction are given the opportunity to lift the veil of secrecy and demonstrate that the presumptions are factually wrong.

We believe these evidentiary presumptions will provide U.S. tax and securities law enforcement with powerful new tools to shut down tax haven abuses.

Section 102—Special measures where U.S. tax enforcement is impeded

Section 102 of the bill is another innovative approach to combating tax haven abuses. This section would build upon existing Treasury authority to apply an array of sanctions to counter specific foreign money laundering threats by extending that same authority to counter specific foreign tax administration threats.

In 2001, the Patriot Act gave Treasury the authority under 31 U.S.C. 5318A to require domestic financial institutions and agencies to take special measures with respect to foreign jurisdictions, financial institutions, or transactions found to be of "primary money laundering concern." Once Treasury designates a foreign jurisdiction or financial institution to be of primary money laundering concern, Section 5318A allows Treasury to impose a range of requirements on U.S. financial institutions in their dealings with the designated entity—from requiring U.S. financial institutions, for example, to provide greater information than normal about transactions involving the designated entity, to prohibiting U.S. financial institutions from opening accounts for that foreign entity.

This Patriot Act authority has been used sparingly, but to telling effect. In some instances Treasury has employed special measures against an entire country, such as Burma, to stop its financial institutions from laundering funds through the U.S. financial system. More often, Treasury has used the authority surgically, against a single problem financial institution, to stop laundered funds from entering the United States. The provision has clearly succeeded in giving Treasury a powerful tool to protect the U.S. financial system from money laundering abuses.

The bill would authorize Treasury to use that same tool to require U.S. financial institutions to take the same special measures against foreign jurisdictions or financial institutions found by Treasury to be "impeding U.S. tax enforcement." Treasury could, for example, in consultation with the IRS, Secretary of State, and the Attorney General, require U.S. financial institutions that have correspondent accounts for a designated foreign bank to produce information on all of that foreign bank's customers. Alternatively, Treasury could prohibit U.S. financial institutions from opening accounts for a designated foreign bank, thereby cutting off that foreign bank's access to the U.S. financial system. These types of sanctions could be as effective in ending the worst tax haven abuses as they have been in curbing money laundering.

In addition to extending Treasury's ability to impose special measures

against foreign entities impeding U.S. tax enforcement, the bill would add one new measure to the list of possible sanctions that could be applied to foreign entities: it would allow Treasury to instruct U.S. financial institutions not to authorize or accept credit card transactions involving a designated foreign jurisdiction or financial institution. Denying tax haven banks the ability to issue credit cards for use in the United States, for example, would be a powerful new way to stop U.S. tax cheats from obtaining access to funds hidden offshore.

Section 103—Deny tax benefits for foreign corporations managed and controlled in the United States

In July 2008, the Senate Finance Committee held a hearing detailing findings made by GAO when it went to the Cayman Islands to look at the infamous Uglund House, a five-story building that is the official address for over 18,800 registered companies. GAO's review seems to indicate that the Cayman Islands has more registered businesses than residents, with a mutual fund or hedge fund for every five residents, and two registered companies for every resident.

GAO also determined that about half of the alleged Uglund House tenants—around 9,000 entities—have a billing address in the United States and were not actual occupants of the building. In fact, GAO determined that none of the nearly 19,000 companies registered at the Uglund House was an actual occupant. GAO found that the only true occupant of the building is a Cayman law firm, Maples and Calder. According to the GAO: "Very few Uglund House registered entities have a significant physical presence in the Cayman Islands or carry out business in the Cayman Islands. According to Maples and Calder partners, the persons establishing these entities are typically referred to Maples by counsel from outside the Cayman Islands, fund managers, and investment banks. As of March 2008 the Cayman Islands Registrar reported that 18,857 entities were registered at the Uglund House address. Approximately 96 percent of these entities were classified as exempted entities under Cayman Islands law, and were thus generally prohibited from carrying out domestic business within the Cayman Islands."

Section 103 of the bill is a new addition to the Stop Tax Haven Abuse Act designed to address the Uglund House problem. It focuses on the situation where a corporation is incorporated in a tax haven as a mere shell operation with little or no physical presence or employees in the jurisdiction. The shell entity pretends it is operating in the tax haven, even though its key personnel and decisionmakers are in the United States. The objective of this set up is to enable the owners of the shell entity to take advantage of all of the benefits provided by U.S. legal, educational, financial, and commercial

systems, and at the same time avoid paying U.S. taxes.

My Subcommittee has seen numerous companies exploit this situation, declaring themselves to be foreign corporations, even though they really operate out of the United States. For example, thousands of hedge funds whose financial experts live in Connecticut, New York, Texas, or California play this game to escape taxes and avoid regulation. In an October 2008 Subcommittee hearing, three sizeable hedge funds, Angelo Gordon, Highbridge Capital, and Maverick Capital, admitted that, although all they claimed to be based in the Cayman Islands, none had an office or a single full time employee in that jurisdiction. Instead, their offices and key decisionmakers were located and did business right here in the United States.

Section 103 will put an end to such corporate fictions and offshore tax dodging. It states that if a corporation is publicly traded or has aggregate gross assets of \$50 million or more, and its management and control occurs primarily in the United States, that corporation will be treated as a U.S. domestic corporation for income tax purposes.

To implement this provision, Treasury is directed to issue regulations to guide the determination of when management and control occur primarily in the United States, looking at whether "substantially all of the executive officers and senior management of the corporation who exercise day-to-day responsibility for making decisions involving strategic, financial, and operational policies of the corporation are located primarily within the United States."

This new section relies on the same principles regarding the true location of ownership and control of a company that underlie the corporate inversion rules adopted in the American Jobs Creation Act of 2005. Those inversion rules, however, do not address the fact that some entities directly incorporate in foreign countries and manage their businesses activities from the United States. Section 103 seeks to level the playing field and ensure that entities which incorporate directly in another country are subject to a similar management and control test. Section 103 is also similar in concept to the substantial presence test in the income tax treaty between the United States and the Netherlands, which looks to the primary place of management and control to determine corporate residency.

Section 103 also provides an exception for foreign corporations with U.S. parents. This exception from the \$50 million gross assets test recognizes that, within a multinational operation, strategic, financial, and operational decisions are often made from a global or regional headquarters location and then implemented by affiliated foreign corporations. Where such decisions are undertaken by a parent corporation

that is actively engaged in a U.S. trade or business and is organized in the United States—and is, therefore, already a domestic corporation—the bill generally will not override existing U.S. taxation of international operations. At the same time, this exception makes it clear that the mere existence of a U.S. parent corporation is not sufficient to shield a foreign corporation from also being treated as a domestic corporation under this section. The section also creates an exception for private companies that once met the section's test for treatment as a domestic corporation but, during a later tax year, fell below the \$50 million gross assets test, do not expect to exceed that threshold again, and are granted a waiver by the Treasury Secretary.

Section 103 is intended to stop, in particular, the outrageous tax dodging that now goes on by too many hedge funds and investment management businesses that structure themselves to appear to be foreign entities, even though their key decisionmakers—the folks who exercise control of the company, its assets, and investment decisions—live and work right here in the United States. Too many hedge funds establish a structure of offshore entities, often including master and feeder funds, that make it appear as if the hedge fund's assets and investment decisions are offshore, when, in fact, the funds are being managed and controlled by investment experts located in the United States. It is unacceptable that such companies utilize U.S. offices, personnel, laws, and markets to make their money, but then stiff Uncle Sam and offload their tax burden onto competitors who play by the rules.

To put an end to this charade, Section 103 specifically directs Treasury regulations to specify that, when corporate assets are being managed primarily on behalf of investors and the investment decisions are being made in the United States, the management and control of that corporation shall be treated as occurring primarily in the United States, and that corporation shall be subject to U.S. taxes in the same manner as any other U.S. corporation.

If enacted into law, Section 103, the Ugland House provision, would put an end to the unfair situation where some U.S.-based companies pay their fair share of taxes, while others who set up a shell corporation in a tax haven are able to defer or escape taxation, despite the fact that their foreign status is nothing more than a paper fiction.

Section 104—Extension of time for offshore audits

Section 104 of the bill addresses a key problem faced by the IRS in cases involving offshore jurisdictions—completing audits in a timely fashion when the evidence needed is located in a jurisdiction with secrecy laws. Currently, in the absence of fraud or some other exception, the IRS has three years

from the date a tax return is filed to complete an audit and assess any additional tax. Because offshore secrecy laws slow down, and sometimes impede, efforts by the United States to obtain offshore financial and beneficial ownership information, the bill gives the IRS an extra three years to complete an audit and assess a tax on transactions involving an offshore secrecy jurisdiction. Of course, in the event that a case turns out to involve actual fraud, this provision of the bill is not intended to limit the rule giving the IRS unlimited time to assess tax in such cases.

Section 105—Increased disclosure of offshore accounts and entities

Offshore tax abuses thrive in secrecy. Section 105 attempts to pierce that secrecy by creating two new disclosure mechanisms requiring third parties to report on offshore transactions undertaken by U.S. persons.

The first disclosure mechanism focuses on U.S. financial institutions that open a U.S. account in the name of an offshore entity, such as an offshore trust or corporation, and learn from an anti-money laundering due diligence review, that a U.S. person is the beneficial owner behind that offshore entity. In the Wyly case history examined by the Subcommittee, for example, three major U.S. financial institutions opened dozens of accounts for offshore trusts and corporations which they knew were associated with the Wyly family.

Under current anti-money laundering law, all U.S. financial institutions are supposed to know who is behind an account opened in the name of, for example, an offshore shell corporation or trust. They are supposed to obtain this information to safeguard the U.S. financial system against misuse by terrorists, money launderers, and other criminals.

Under current tax law, a bank or securities broker that opens an account for a U.S. person is also required to give the IRS a 1099 form reporting any capital gains or other reportable income earned on the account. However, the bank or securities broker need not file a 1099 form if the account is owned by a foreign entity not subject to U.S. tax law. Problems arise when an account is opened in the name of an offshore entity that is nominally not subject to tax, but which the bank or broker knows, from its anti-money laundering review, is owned or controlled by a U.S. person who is subject to tax. The U.S. person should be filing a tax return with the IRS reporting the income of the “controlled foreign corporation.” However, since he or she knows it is difficult for the IRS to connect an offshore account holder to a particular taxpayer, he or she may feel safe in not reporting that income. That complacency might change, however, if the U.S. person knew that the bank or broker who opened the account and learned of the connection had a legal

obligation to report any account income to the IRS.

Under current law, the way the regulations are written and typically interpreted, the bank or broker can treat an account opened in the name of a foreign corporation as an account that is held by an independent entity that is separate from the U.S. person, even if it knows that the foreign corporation is merely holding title to the account for the U.S. person, who exercises complete authority over the corporation and benefits from any income earned on the account. Many banks and brokers contend that the current regulations impose no duty on them to file a 1099 or other form disclosing that type of account to the IRS.

The bill would strengthen current law by expressly requiring a bank or broker that knows, as a result of its anti-money laundering due diligence or otherwise, that a U.S. person is the beneficial owner of a foreign entity that opened an account, to disclose that account to the IRS by filing a 1099 or equivalent form reporting the account income. This reporting obligation would not require banks or brokers to gather any new information—financial institutions are already required to perform anti-money laundering due diligence for accounts opened by offshore shell entities. The bill would instead require U.S. financial institutions to act on what they already know by filing the relevant form with the IRS.

This section would require such reports to the IRS from two sets of financial institutions. The first set are financial institutions which are located and do business in the United States, supply 1099 and other forms to the IRS, and open U.S. accounts for foreign entities which the financial institution knows are beneficially owned by U.S. persons. The second set are foreign financial institutions which are located and do business outside of the United States, but are voluntary participants in the Qualified Intermediary Program, and have agreed to provide information to the IRS about certain accounts. Under this section, if a foreign financial institution has an account under the QI Program, and the account holder is a non-U.S. entity that is controlled or beneficially owned by a U.S. person, then that foreign financial institution would have to report to the IRS any U.S. securities or other reportable assets or income in that account.

The second disclosure mechanism created by Section 105 targets U.S. financial institutions that open foreign bank accounts or set up offshore corporations, trusts, or other entities for their U.S. clients. Our investigations have shown that it is common for private bankers and brokers in the United States to provide these services to their wealthy clients, so that the clients do not even need to leave home to set up an offshore structure. The offshore entities can then open both offshore and U.S. accounts and supposedly

be treated as foreign account holders for tax purposes.

A Subcommittee investigation learned, for example, that Citibank Private Bank routinely offered to its clients private banking services which included establishing one or more offshore shell corporations—which it called Private Investment Corporations or PICs—in jurisdictions like the Cayman Islands. The paperwork to form the PIC was typically completed by a Citibank affiliate located in the jurisdiction, such as Cititrust, which is a Cayman trust company. Cititrust could then help the PIC open offshore accounts, while Citibank could help the PIC open U.S. accounts.

Section 105 would require any U.S. financial institution that directly or indirectly opens a foreign account or establishes a foreign corporation or other entity for a U.S. customer to report that action to the IRS. The bill authorizes the regulators of banks and securities firms, as well as the IRS, to enforce this filing requirement. Existing tax law already requires U.S. taxpayers that take such actions to report them to the IRS, but many fail to do so, secure in the knowledge that offshore secrecy laws limit the ability of the IRS to find out about the establishment of new offshore accounts and entities. That's why our bill turns to a third party—the financial institution—to disclose the information. Placing this third party reporting requirement on the private banks and brokers will make it more difficult for U.S. clients to hide their offshore transactions.

Section 106—Closing foreign trust loopholes

Section 106 of our bill strengthens the ability of the IRS to stop offshore trust abuses by making narrow but important changes to the Revenue Code provisions dealing with taxation of foreign trusts. The rules on foreign trust taxation have been significantly strengthened over the past 30 years to the point where they now appear adequate to prevent or punish many of the more serious abuses. However, the Subcommittee's 2006 investigation found a few loopholes that are still being exploited by tax cheats and that need to be shut down.

The bill would make several changes to close these loopholes. First, our investigation showed that U.S. taxpayers exercising control over a supposedly independent foreign trust commonly used the services of a liaison, called a trust "protector" or "enforcer," to convey their directives to the supposedly independent offshore trustees. A trust protector is typically authorized to replace a foreign trustee at will and to advise the trustees on a wide range of trust matters, including the handling of trust assets and the naming of trust beneficiaries. In cases examined by the Subcommittee, the trust protector was often a friend, business associate, or employee of the U.S. person exercising control over the foreign trust. Section 105 provides that, for tax purposes, any powers held by a trust

protector shall be attributed to the trust grantor.

A second problem addressed by our bill involves U.S. taxpayers who establish foreign trusts for the benefit of their families in an effort to escape U.S. tax on the accumulation of trust income. Foreign trusts can accumulate income tax free for many years. Previous amendments to the foreign trust rules have addressed the taxation problem by basically disregarding such trusts and taxing the trust income to the grantors as it is earned. However, as currently written, this taxation rule applies only to years in which the foreign trust has a named "U.S. beneficiary." In response, to avoid the reach of the rule, some taxpayers have begun structuring their foreign trusts so that they operate with no named U.S. beneficiaries.

For example, the Subcommittee's investigation into the Wyly trusts discovered that the foreign trust agreements had only two named beneficiaries, both of which were foreign charities, but also gave the offshore trustees "discretion" to name beneficiaries in the future. The offshore trustees had been informed in a letter of wishes from the Wyly brothers that the trust assets were to go to their children after death. The trustees also knew that the trust protector selected by the Wyllys had the power to replace them if they did not comply with the Wyllys' instructions. In addition, during the life of the Wyly brothers, and in accordance with instructions supplied by the trust protector, the offshore trustees authorized millions of dollars in trust income to be invested in Wyly business ventures and spent on real estate, jewelry, artwork, and other goods and services used by the Wyllys and their families. The Wyllys plainly thought they had found a legal loophole that would let them enjoy and direct the foreign trust assets without any obligation to pay taxes on the money they used.

To stop such foreign trust abuses, the bill would make it impossible to pretend that this type of foreign trust has no U.S. beneficiaries. The bill would shut down the loophole by providing that: (1) any U.S. person actually benefiting from a foreign trust is treated as a trust beneficiary, even if they are not named in the trust instrument; (2) future or contingent U.S. beneficiaries are treated the same as current beneficiaries; and (3) loans of foreign trust assets or property such as real estate, jewelry and artwork (in addition to loans of cash or securities already covered by current law) are treated as trust distributions for tax purposes.

Section 10—Legal opinion protection from penalties

Section 107 of the bill takes aim at legal opinions that are used to try to immunize taxpayers against penalties for tax shelter transactions with offshore elements. The Subcommittee investigations have found that tax prac-

tioners sometimes tell potential clients that they can invest in an offshore tax scheme without fear of penalty, because they will be given a legal opinion that will shield the taxpayer from any imposition of the 20 percent accuracy related penalties in the tax code. Current law does, in fact, allow taxpayers to escape these penalties if they can produce a legal opinion letter stating that the tax arrangement in question is "more likely than not" to survive challenge by the IRS. The problem with such opinions where part of the transaction occurs in an offshore secrecy jurisdiction is that critical assumptions of the opinions are often based on offshore events, transactions and facts that are hidden and cannot be easily ascertained by the IRS. Legal opinions based on such assumptions should be understood by any reasonable person to be inherently unreliable.

The bill therefore provides that, for any transaction involving an offshore secrecy jurisdiction, the taxpayer would need to have some other basis, independent of the legal opinion, to show that there was reasonable cause to claim the tax benefit. The "more likely than not" opinion would no longer be sufficient in and of itself to shield a taxpayer from all penalties if an offshore secrecy jurisdiction is involved. This provision, which is based upon a suggestion made by IRS Commissioner Mark Everson at our August 2006 hearing, is intended to force taxpayers to think twice about entering into an offshore scheme and to stop thinking that an opinion by a lawyer is all they need to escape any penalty for nonpayment of taxes owed. By making this change, we would also provide an incentive for taxpayers to understand and document the complete facts of the offshore aspects of a transaction before claiming favorable tax treatment.

To ensure that this section does not impede legitimate business arrangements in offshore secrecy jurisdictions, the bill authorizes the Treasury Secretary to issue regulations exempting two types of legal opinions from the application of this section. First, the Treasury Secretary could exempt all legal opinions that have a confidence level substantially above the more-likely-than-not level, such as opinions which express confidence that a proposed tax arrangement "should" withstand an IRS challenge. "More-likely-than-not" opinion letters are normally viewed as expressing confidence that a tax arrangement has at least a 50 percent chance of surviving IRS review, while a "should" opinion is normally viewed as expressing a confidence level of 70 to 75 percent. This first exemption is intended to ensure that legal opinions on arrangements that are highly likely to survive IRS review would continue to shield taxpayers from the 20 percent penalty.

Second, the Treasury Secretary could exempt legal opinions addressing classes of transactions, such as corporate reorganizations, that do not present

the potential for abuse. These exemptions would ensure that taxpayers who obtain legal opinions for these classes of transactions would also be protected from tax code penalties.

Finally, in drafting such regulations, it is intended that the Secretary of the Treasury take into account the function of the “more likely than not” standard in the context of corporations that are independently audited and subject to accounting rules requiring disclosure of uncertain tax positions. It is intended that the regulations issued under this bill provision be coordinated with the objectives of those accounting rules to ensure consistent guidance for detecting and stopping abusive transactions without disrupting the financial accounting of legitimate transactions.

Section 108—Closing the dividend tax loophole

Section 108 of this bill is the second new addition to the Stop Tax Haven Abuse Act. It is aimed at closing down a tax loophole that has enabled offshore hedge funds and others to use complex financial gimmicks, including transactions involving equity swaps and offshore stock loans, to dodge billions of dollars in U.S. taxes over the last ten years. This loophole contributes to the estimated \$100 billion in unpaid taxes that Uncle Sam loses each year from offshore tax abuses. With financial disasters hitting this country from every direction, we can no longer afford to ignore this offshore tax dodge. It is time to shut it down.

The section is straightforward. It amends the Internal Revenue Code to make it clear that non-U.S. persons cannot escape payment of U.S. taxes on U.S. stock dividends by participating in structured financial transactions that recast taxable stock dividend payments as allegedly tax-free “dividend equivalent” or “substitute dividend” payments. The bill eliminates this offshore tax dodge by requiring that dividend, dividend equivalent, and substitute dividend payments made to non-U.S. persons all receive the same tax treatment—as taxable income subject to withholding.

Right now, foreigners who invest in the United States enjoy a minimal tax burden. For example, non-U.S. persons who deposit money with a U.S. bank or securities firm pay no U.S. taxes on the interest earned. They pay no U.S. taxes on capital gains. U.S. citizens do pay taxes on that income, but the tax code lets foreign investors operate without tax in an effort to attract foreign investment.

But there is one tax on the books that even foreign investors are supposed to pay. If they buy stock in a U.S. company, and that stock pays a dividend, the non-U.S. stockholder is supposed to pay a tax on the dividend. The general tax rate is 30%, unless their country of residence has negotiated a lower rate with the United States, typically 15%.

In addition, to make sure those dividend taxes are paid, U.S. law requires the person or entity paying a stock dividend to a non-U.S. person to withhold the tax owed Uncle Sam before any part of the dividend leaves the United States. If the “withholding agent” fails to retain and remit the dividend tax to the IRS, and the tax is not paid by the dividend recipient, the tax code makes the withholding agent equally liable for the unpaid taxes. That’s the law. But the reality is that many non-U.S. stockholders never pay the dividend taxes they owe.

An investigation conducted by the Permanent Subcommittee on Investigations, which I chair, resulted in a staff report and hearing in September 2008, which showed that foreign entities, primarily offshore hedge funds and foreign financial institutions, use two common schemes to dodge their dividend tax obligations to the U.S. government—equity swaps and stock loans.

Swaps sound complicated, but they are essentially a financial bet—in the case of equity swaps a bet on the future of a stock price. Under the swap, a financial institution promises to pay, say, a hedge fund an amount equal to any price appreciation in the stock price and the amount of any dividend paid during the term of the swap. The payment reflecting the dividend is referred to as a “dividend equivalent.” In return, the hedge fund agrees to pay the financial institution an amount equal to any price depreciation in the stock price. The financial institution hedges its risk by holding the physical shares of stock that were “sold” to it by the hedge fund. It also charges a fee, which usually includes a portion of the tax savings that the hedge fund will obtain by dodging the withholding tax.

The swap gives the hedge fund the same economic risks and rewards that it had when it owned the physical shares of the stock. So why hold a swap instead of the stock itself? Because under the tax code, dividend payments are taxed, but dividend equivalent payments made under a swap are not.

Dividend equivalent payments made under a swap are tax free, because, in 1991, the IRS issued a series of regulations to determine what types of income will be treated as coming from the United States and therefore taxable. These so-called “source” rules treat U.S. stock dividends as U.S. source income, because the money comes from a U.S. corporation. But the 1991 regulation takes the opposite approach with respect to swaps. It deems swap agreements to be “notional principal contracts” and says that the “source” of any payment made under that contract is to be determined, not by where the money came from, but by where it ends up. In other words, the payment’s source is the country where the payment recipient resides.

That approach turns the usual meaning of the word, “source,” on its head. Instead of looking to the origin of the

payment to determine its “source,” the IRS swap rule looks to its end point—who receives it. That “source” is not really a “source” by any known definition of the word. It is the opposite—not the point of origin but the end point.

The result is that when a financial institution makes a dividend equivalent payment to an offshore client under a swap agreement, the tax code provides that the payment is from an offshore “source.” So the swap payment is free of any U.S. tax. In our example, the U.S. financial institution makes the swap payment to the offshore hedge fund, minus its fee, and stiffes Uncle Sam for the amount of taxes that should have been sent to the IRS. The swap is then terminated, and the stock is “sold” back to the hedge fund. Under this gimmick, the hedge fund ends up in the same position as before the swap, as a stockholder, except it has pocketed a dividend payment without paying any U.S. tax.

Stock loans are also used to dodge dividend taxes. These transactions pile a stock loan on top of a swap to achieve the same allegedly tax-free result.

The first step is that the client with an upcoming dividend lends its stock to an offshore corporation controlled by the financial institution. This offshore corporation promises, as part of the loan agreement, to forward any dividend payments back to the client.

The next step is that offshore corporation enters into a swap with the financial institution that controls it, referencing the same type of stock and number of shares that is the subject of the stock loan. Essentially, two related parties are placing a bet on the stock, which makes no economic sense except, once that stock pays the dividend, the swap arrangement allows the financial institution to send it as an allegedly tax-free dividend equivalent payment to the offshore corporation it controls. The offshore corporation then forwards the same amount to the client. Because the payment is sent to the client as part of a stock loan agreement, it is called a “substitute dividend.” The tax code treats substitute dividends in the same way as the underlying dividend. So if the underlying dividend came from a U.S. corporation, the substitute dividend would normally be taxed as U.S. source income.

But in this transaction, the parties claim the substitute dividend is tax-free by invoking the wording of an obscure IRS Notice 97-66 never intended to be applied to this situation. That notice says that when two parties in a stock loan are outside of the United States and subject to the same dividend tax rate, they don’t have to pay the dividend tax when passing on a substitute dividend. The assumption is that the tax was already paid by another party in the lending transaction. Some tax lawyers have seized on the wording to claim that this IRS Notice, which was intended to prevent over-withholding, could be used to eliminate

dividend withholding entirely, so long as one offshore party passes on a substitute dividend to another offshore party subject to the same dividend tax rate. The IRS testified at the Subcommittee hearing that Notice 97-66 was never intended to be interpreted that way, but in the ten years since it was issued and abusive stock loans have exploded, the IRS has never put that in writing.

The end result in our example is that the client pockets a substitute dividend payment—minus the financial institution's fee—without paying any tax. The stock loan is terminated, and the stock is returned to the client. The big advantage of this approach over a swap is that the client doesn't have to explain why he got his stock back after the transaction. The stock was, after all, only on loan.

Tax dodging was clearly the economic purpose of the two transactions just described. While there are many types of legitimate swap and stock loan transactions, the Subcommittee investigation found that in these cases, such transactions were conducted primarily to dodge U.S. taxes and not for legitimate business purposes. In some of the most extreme examples, the client owned U.S. stock both before and after each transaction. Neither the swap nor the stock loan altered the client's market risk. The only risk involved in either transaction was that Uncle Sam would catch on and assess the dividend taxes that should have been paid but weren't.

To make it harder for Uncle Sam to catch on and prove what is going on, financial institutions have added more complexity, more bells and whistles, to these so-called "dividend enhancement" transactions. But the purpose of the transactions remains the same—to enable clients to escape paying the taxes they owe.

In the September 2008 hearing and report released by the Subcommittee, we described how specific financial institutions and hedge funds used swaps and stock loans to duck U.S. stock dividend taxes. We disclosed, for example, that Morgan Stanley helped clients, from 2000 to 2007, dodge payment of U.S. dividend taxes of over \$300 million. Lehman Brothers estimated that in one year alone, 2004, it helped clients dodge U.S. dividend taxes amounting to perhaps \$115 million. UBS enabled clients, from 2004 to 2007, dodge \$62 million in dividend taxes, but last year stopped offering the Cayman stock loans that produced that figure. Maverick Capital, which runs several offshore hedge funds, disclosed that its offshore hedge funds used dividend enhancement products sold by multiple firms to escape dividend taxes from 2000 to 2007, totaling nearly \$95 million. Citigroup even admitted to the IRS that it had failed to withhold dividend taxes on certain swap transactions from 2003 to 2005, and voluntarily paid missing taxes totaling \$24 million. The Subcommittee investigation documented, in short, a

whole swath of unpaid dividend taxes from just a handful of firms.

Section 108, if enacted into law, would prevent non-U.S. persons from avoiding their U.S. dividend tax obligations by recasting dividend payments as allegedly tax-free dividend equivalent or substitute dividend payments. Instead, all payments of dividend-based amounts would be treated consistently.

The section also authorizes the Treasury Secretary to issue regulations addressing several related issues. Treasury is directed, for example, to issue regulations to reduce possible over-withholding on dividend equivalents or substitute dividends, but only where the taxpayer can establish that the tax was previously withheld from an earlier payment. Treasury is also directed to issue regulations to impose withholding when dividend equivalent payments are netted with other payments under a swap contract, when dividend equivalent payments are made under other financial instruments, such as an option or forward contract, or when a substitute dividend is netted with fees and other payments. Finally, the section makes it clear that nothing in the legislation should be construed to limit the authority of the IRS Commissioner to collect taxes, interest, and penalties on dividend equivalent or substitute dividend payments made prior to the date of enactment of the bill.

Let me be clear. I do not oppose structured finance transactions used for legitimate purposes, including swaps and stock loans that facilitate capital flows, reduce capital needs, or spread risk. What I oppose, and what Section 108 would stop is the misuse of financial transactions to undermine the tax code, rob the U.S. treasury, and force honest Americans who play by the rules to shoulder the country's tax burden. What this section is intended to stop are dividend-based transactions whose economic purpose is nothing more than tax dodging.

Section 109—PFIC Reporting Requirement

Section 109 is the third and final new addition to the Stop Tax Haven Abuse Act. The purpose of this provision is to strengthen disclosure requirements for foreign corporations used as the personal investment vehicles of U.S. individuals. These corporations are sometimes established in offshore secrecy jurisdictions, making it particularly difficult for the IRS to detect them and establish links to the U.S. beneficiaries.

The tax obligations of these corporations, known as passive foreign investment corporations or PFICs, are set out in Sections 1291-1298 of the tax code. U.S. persons who are direct or indirect shareholders of a PFIC are currently required to complete a Form 8621 providing certain information about the PFIC to the IRS. While the IRS has issued proposed regulations governing PFIC reporting, they have not yet been finalized.

Section 109 of the bill would codify the PFIC reporting requirements set out in the proposed regulations, with one additional requirement. Specifically, PFIC reporting would be required not only by U.S. persons who have an ownership interest in a PFIC, but also by any U.S. person who, directly or indirectly, causes the PFIC to be formed, or who sent assets to or received assets from the PFIC during the relevant tax year.

The need for expanded reporting obligations was highlighted during the Subcommittee's investigative work which showed that, in too many cases, ownership requirements were not enough to trigger reporting obligations for offshore corporations. For example, the Subcommittee found numerous instances in which a U.S. person asked an offshore service provider to form an offshore corporation, lodge ownership of the new corporation in one or more offshore shell companies under the provider's control, and then operate the new corporation as the U.S. person directed, despite the absence of any direct ownership interest. This arrangement, which may have been designed to evade tax or other legal obligations that attach to corporations directly or indirectly owned by a U.S. person, nevertheless provided U.S. persons with beneficial interests in offshore corporations that effectively operated at their discretion.

To ensure that such offshore corporations are subject to the same reporting requirements as PFICs in which a U.S. person is a direct or indirect shareholder, the new Section 109 would require Forms 8621 to be filed by any U.S. person who formed a PFIC, sent assets to it, received assets from it, was a beneficial owner of it, or had beneficial interests in it. This expanded reporting requirement is intended to prevent any U.S. person who established, capitalized, or profited from a beneficial interest in a PFIC—whether or not that beneficial interest was evidenced by legal documentation—from arguing that they had no reporting obligation for that PFIC, because they lacked a formal ownership interest in it.

Finally, Section 109 is intended to require reporting by U.S. persons who have a beneficial interest in a PFIC; it is not intended to impose reporting requirements on persons who perform ministerial tasks associated with a PFIC, including tasks associated with a PFIC's formation, management, contributions or distributions.

Section 201—Stronger penalty for failure to make required securities disclosures

In addition to tax abuses, the 2006 Subcommittee investigation into the Wyly case history uncovered a host of troubling transactions involving U.S. securities held by the 58 offshore trusts and corporations associated with the two Wyly brothers. Over the course of a number of years, the Wyllys had obtained about \$190 million in stock options as compensation from three U.S. publicly traded corporations at which

they were directors and major shareholders. Over time, the Wyls transferred these stock options to the network of offshore entities they had established.

The investigation found that, for years, the Wyls had generally failed to report the offshore entities' stock holdings or transactions in their filings with the Securities and Exchange Commission (SEC). They did not report these stock holdings on the ground that the 58 offshore trusts and corporations functioned as independent entities, even though the Wyls continued to direct the entities' investment activities. The public companies where the Wyls were corporate insiders also failed to include in their SEC filings information about the company shares held by the offshore entities, even though the companies knew of their close relationship to the Wyls, that the Wyls had provided the offshore entities with significant stock options, and that the offshore entities held large blocks of the company stock. On other occasions, the public companies and various financial institutions failed to treat the shares held by the offshore entities as affiliated stock, even though they were aware of the offshore entities' close association with the Wyls. The investigation found that, because both the Wyls and the public companies had failed to disclose the holdings of the offshore entities, for 13 years federal regulators had been unaware of those stock holdings and the relationships between the offshore entities and the Wyly brothers.

Corporate insiders and public companies are already obligated by current law to disclose stock holdings and transactions of offshore entities affiliated with a company director, officer, or major shareholder. Current penalties, however, appear insufficient to ensure compliance in light of the low likelihood that U.S. authorities will learn of transactions that take place in an offshore jurisdiction. To address this problem, Section 201 of our bill would establish a new monetary penalty of up to \$1 million for persons who knowingly fail to disclose offshore stock holdings and transactions in violation of U.S. securities laws.

Sections 202 and 203—Anti-money laundering programs for hedge funds and company formation agents

The Subcommittee's August 2006 investigation showed that the Wyly brothers used two hedge funds and a private equity fund controlled by them to funnel millions of untaxed offshore dollars into U.S. investments. In addition, multiple Subcommittee investigations provide extensive evidence on the role played by U.S. company formation agents in assisting U.S. persons to set up offshore structures. Moreover, a Subcommittee hearing in November 2006 disclosed that U.S. company formation agents are forming U.S. shell companies for numerous unidentified foreign clients. Some of those U.S.

shell companies were later used in illicit activities, including money laundering, terrorist financing, drug crimes, tax evasion, and other misconduct. Because hedge funds, private equity funds, and company formation agents are as vulnerable as other financial institutions to money launderers seeking entry into the U.S. financial system, the bill contains two provisions aimed at ensuring that these groups know their clients and do not accept or transmit suspect funds into the U.S. financial system.

Currently, unregistered investment companies, such as hedge funds and private equity funds, are the only class of financial institutions under the Bank Secrecy Act that transmit substantial offshore funds into the United States, yet are not required by law to have anti-money laundering programs, including Know Your Customer, due diligence procedures, and procedures to file suspicious activity reports. There is no reason why this sector of our financial services industry should continue to serve as a gateway into the U.S. financial system for substantial funds of unknown origin.

Seven years ago, in 2002, the Treasury Department proposed anti-money laundering regulations for these companies, but never finalized them. In 2008, the Department withdrew them with no explanation. Section 202 of the bill would require Treasury to issue final anti-money laundering regulations for unregistered investment companies within 180 days of the enactment of the bill. Treasury would be free to draw upon its 2002 proposal, but the bill would also require the final regulations to direct hedge funds and private equity funds to exercise due diligence before accepting offshore funds and to comply with the same procedures as other financial institutions if asked by federal regulators to produce records kept offshore.

In addition, Section 203 of the bill would add company formation agents to the list of persons subject to anti-money laundering obligations. For the first time, those engaged in the business of forming corporations and other entities, both offshore and in the 50 States, would be responsible for knowing the identity of the person for whom they are forming the entity. The bill also directs Treasury to develop anti-money laundering regulations for this group. Treasury's key anti-money laundering agency, the Financial Crimes Enforcement Network, testified before the Subcommittee in 2006, that it was considering drafting such regulations but has yet to do so.

We expect and intend that, as in the case of all other entities required to institute anti-money laundering programs, the regulations issued in response to this bill would instruct hedge funds, private equity funds, and company formation agents to adopt risk-based procedures that would concentrate their due diligence efforts on clients that pose the highest risk of money laundering.

Section 204—IRS John Doe summons

Section 204 of the bill focuses on an important tool used by the IRS in recent years to uncover taxpayers involved in offshore tax schemes, known as the John Doe summons. Section 204 would make three technical changes to make the use of John Doe summons more effective in offshore and other complex investigations.

A John Doe summons is an administrative IRS summons used to request information in cases where the identity of a taxpayer is unknown. In cases involving a known taxpayer, the IRS may issue a summons to a third party to obtain information about the U.S. taxpayer, but must also notify the taxpayer who then has 20 days to petition a court to quash the summons to the third party. With a John Doe summons, however, IRS does not have the taxpayer's name and does not know where to send the taxpayer notice, so the statute substitutes a procedure in which the IRS must instead apply to a court for advance permission to serve the summons on the third party. To obtain approval of the summons, the IRS must show the court, in public filings to be resolved in open court, that: (1) the summons relates to a particular person or ascertainable class of persons, (2) there is a reasonable basis for concluding that there is a tax compliance issue involving that person or class of persons, and (3) the information sought is not readily available from other sources.

In recent years, the IRS has used John Doe summonses to try to obtain information about taxpayers operating in offshore secrecy jurisdictions. For example, as indicated earlier, the IRS obtained court approval to serve a John Doe summons on the Swiss bank, UBS, to obtain the names of an estimated 19,000 U.S. clients who opened UBS accounts in Switzerland without disclosing those accounts to the IRS. This is a landmark effort to try to overcome Swiss secrecy laws. In earlier years, the IRS obtained court approval to issue John Doe summonses to credit card associations, credit card processors, and credit card merchants, to collect information about taxpayers using credit cards issued by offshore banks. This information has led to many successful cases in which the IRS identified funds hidden offshore and recovered unpaid taxes.

Currently, however, use of the John Doe summons process is time consuming and expensive. For each John Doe summons involving an offshore secrecy jurisdiction, the IRS has had to establish in court that the involvement of accounts and transactions in offshore secrecy jurisdictions meant there was a significant likelihood of tax compliance problems. To relieve the IRS of the need to make this same proof over and over in court after court, the bill would provide that, in any John Doe summons proceeding involving a class defined in terms of accounts or transactions in an offshore secrecy jurisdiction, the court may presume that the

case raises tax compliance issues. This presumption would then eliminate the need for the IRS to repeatedly establish in court the obvious fact that accounts, entities, and transactions involving offshore secrecy jurisdictions raise tax compliance issues.

Second, for a smaller subset of John Doe cases, where the only records sought by the IRS are offshore bank account records held by a U.S. financial institution where that offshore bank has an account, the bill would relieve the IRS of the obligation to get prior court approval to serve the summons. Again, the justification is that offshore bank records are highly likely to involve accounts that raise tax compliance issues so no prior court approval should be required. Even in this instance, however, if a U.S. financial institution were to decline to produce the requested records, the IRS would have to obtain a court order to enforce the summons.

Finally, the bill would streamline the John Doe summons approval process in large "project" investigations where the IRS anticipates issuing multiple summonses to definable classes of third parties, such as banks or credit card associations, to obtain information related to particular taxpayers. Right now, for each summons issued in connection with a project, the IRS has to obtain the approval of a court, often having to repeatedly establish the same facts before multiple judges in multiple courts. This repetitive exercise wastes IRS, Justice Department, and court resources, and fragments oversight of the overall IRS investigative effort.

To streamline this process and strengthen court oversight of IRS use of John Doe summons, the bill would authorize the IRS to present an investigative project, as a whole, to a single judge to obtain approval for issuing multiple summonses related to that project. In such cases, the court would retain jurisdiction over the case after approval is granted, to exercise ongoing oversight of IRS issuance of summonses under the project. To further strengthen court oversight, the IRS would be required to file a publicly available report with the court on at least an annual basis describing the summonses issued under the project. The court would retain authority to restrict the use of further summonses at any point during the project. To evaluate the effectiveness of this approach, the bill would also direct the Government Accountability Office to report on the use of the provision after five years.

Section 205—FBAR investigations and suspicious activity reports

Section 205 of the bill would make several changes to Title 31 of the U.S. Code needed to reflect the IRS' new responsibility for enforcing the Foreign Bank Account Report (FBAR) requirements and to clarify the right of access to Suspicious Activity Reports by IRS civil enforcement authorities.

Under present law, a person controlling a foreign financial account with over \$10,000 is required to check a box on his or her income tax return and, under Title 31, also file an FBAR form with the IRS. Treasury's Financial Crimes Enforcement Network (FinCEN), which normally enforces Title 31 provisions, recently delegated to the IRS the responsibility for investigating FBAR violations and assessing FBAR penalties. Because the FBAR enforcement jurisdiction derives from Title 31, however, and most of the information available to the IRS is tax return information, IRS routinely encounters difficulties in using available tax information to fulfill its new role as FBAR enforcer. The tax disclosure law permits the use of tax information only for the administration of the internal revenue laws or "related statutes." This rule is presently understood to require the IRS to determine, at a managerial level and on a case by case basis, that the Title 31 FBAR law is a "related statute." Not only does this necessitate repetitive determinations in every FBAR case investigated by the IRS before each agent can look at the potential non-filer's income tax return, but it prevents the use by IRS of bulk data on foreign accounts received from tax treaty partners to compare to FBAR filing records to find non-filers.

One of the stated purposes for the FBAR filing requirement is that such reports "have a high degree of usefulness in . . . tax . . . investigations or proceedings." 31 U.S.C 5311. If one of the reasons for requiring taxpayers to file FBARs is to use the information for tax purposes, and if IRS is to be charged with FBAR enforcement because of the FBARs' connection to taxes, common sense dictates that the FBAR statute should be considered a related statute for tax disclosure purposes, and the bill changes the related statute rule to say that.

The second change made by Section 205 is a technical amendment to the wording of the penalty provision. Currently the penalty is determined in part by the balance in the foreign bank account at the time of the "violation." The violation is interpreted to have occurred on the due date of the FBAR return, which is June 30 of the year following the year to which the report relates. The statute's use of this specific June 30th date can lead to strange results if money is withdrawn from the foreign account after the reporting period closed but before the return due date. To eliminate this unintended problem, the bill would instead gauge the penalty by using the highest balance in the account during the reporting period.

The third part of section 205 relates to Suspicious Activity Reports, which financial institutions are required to file with FinCEN whenever they encounter suspicious transactions. FinCEN is required to share this information with law enforcement, but cur-

rently does not permit IRS civil investigators access to the information. However, if the information that is gathered and transmitted to Treasury by the financial institutions at great expense is to be effectively utilized, its use should not be limited to the relatively small number of criminal investigators, who can barely scratch the surface of the large number of reports. In addition, sharing the information with civil tax investigators would not increase the risk of disclosure, because they operate under the same tough disclosure rules as the criminal investigators. In some cases, IRS civil agents are now issuing an IRS summons to a financial institution to get access, for a production fee, to the very same information the financial institution has already filed with Treasury in a SAR. The bill changes those anomalous results by making it clear that "law enforcement" includes civil tax law enforcement.

Overall, Titles I and II of our bill include a host of innovative measures to strengthen the ability of federal regulators to combat offshore tax haven abuses. We believe these new tools merit Congressional attention and enactment this year if we are going to begin to make a serious dent in the \$100 billion in annual lost tax revenue from offshore tax abuses that forces honest taxpayers to shoulder a greater tax burden than they would otherwise have to bear.

Until now, I've been talking about what the bill would do combat offshore tax abuses. Now I want to turn to what the bill would do to combat abusive tax shelters and their promoters who use both domestic and offshore means to achieve their ends.

ABUSIVE TAX SHELTERS

Abusive tax shelters are complicated transactions promoted to provide tax benefits unintended by the tax code. They are very different from legitimate tax shelters, such as deducting the interest paid on a home mortgage or Congressionally approved tax deductions for building affordable housing. Some abusive tax shelters involve complicated domestic transactions; others make use of offshore shenanigans. All abusive tax shelters are marked by one characteristic: there is no real economic or business rationale other than tax avoidance. As Judge Learned Hand wrote in *Gregory v. Helvering*, they are "entered upon for no other motive but to escape taxation."

Abusive tax shelters are usually tough to prosecute. Crimes such as terrorism, murder, and fraud produce instant recognition of the immorality involved. Abusive tax shelters, by contrast, are often "MEGOs," meaning "My Eyes Glaze Over." Those who cook up these concoctions count on their complexity to escape scrutiny and public ire. But regardless of how complicated or eye-glazing, the hawking of abusive tax shelters by tax professionals like accountants, bankers, investment advisers, and lawyers to

thousands of people like late-night, cut-rate T.V. bargains is scandalous, and we need to stop it.

My Subcommittee has spent years examining the design, sale, and implementation of abusive tax shelters. Our first hearing on this topic in recent years was held in January 2002, when the Subcommittee examined an abusive tax shelter purchased by Enron. In November 2003, the Subcommittee held two days of hearings and released a staff report that pulled back the curtain on how even some respected accounting firms, banks, investment advisors, and law firms had become engines pushing the design and sale of abusive tax shelters to corporations and individuals across this country. In February 2005, the Subcommittee issued a bipartisan report that provided further details on the role these professional firms played in the proliferation of these abusive shelters. Our Subcommittee report was endorsed by the full Committee on Homeland Security and Governmental Affairs in April 2005.

In 2006, the Subcommittee released a staff report entitled, "Tax Haven Abuses: The Enablers, the Tools, and Secrecy," which disclosed how financial and legal professionals designed and sold yet another abusive tax shelter known as the POINT Strategy, which depended on secrecy laws and practices in the Isle of Man to conceal the phantom nature of securities trades that lay at the center of this tax shelter transaction. Most recently, in 2008, the Subcommittee released a staff report and held a hearing on how financial firms have designed and sold complex financial transactions, referred to as dividend enhancement transactions, to help offshore hedge funds and others escape payment of U.S. taxes on U.S. stock dividends.

The Subcommittee investigations have found that many abusive tax shelters are not dreamed up by the taxpayers who use them. Instead, most are devised by tax professionals, such as accountants, bankers, investment advisors, and lawyers, who then sell the tax shelter to clients for a fee. In fact, as our 2003 investigation widened, we found a large number of tax advisors cooking up one complex scheme after another, packaging them up as generic "tax products" with boiler-plate legal and tax opinion letters, and then undertaking elaborate marketing schemes to peddle these products to literally thousands of persons across the country. In return, these tax shelter promoters were getting hundreds of millions of dollars in fees, while diverting billions of dollars in tax revenues from the U.S. Treasury each year.

For example, one shelter investigated by the Subcommittee and featured in the 2003 hearings has since become part of an IRS effort to settle cases involving a set of abusive tax shelters known as "Son of Boss." Following our hearing, more than 1,200 taxpayers admitted wrongdoing and

agreed to pay back taxes, interest and penalties totaling more than \$3.7 billion. That's billions of dollars the IRS has collected on just one type of tax shelter, demonstrating both the depth of the problem and the potential for progress. The POINT shelter featured in our 2006 hearing involved another \$300 million in tax loss on transactions conducted by just six taxpayers. The offshore dividend tax scams we examined in 2008 meant additional billions of dollars in unpaid taxes over a ten year period.

Titles III and IV of the bill we are introducing today contain a number of measures to curb abusive tax shelters. First, they would strengthen the penalties imposed on those who aid or abet tax evasion. Second, they would prohibit the issuance of tax shelter patents. Several provisions would deter bank participation in abusive tax shelter activities by requiring regulators to develop new examination procedures to detect and stop such activities. Others would end outdated communication barriers between the IRS and other enforcement agencies such as the SEC, bank regulators, and the Public Company Accounting Oversight Board, to allow the exchange of information relating to tax evasion cases. The bill also provides for increased disclosure of tax shelter information to Congress.

In addition, the bill would simplify and clarify an existing prohibition on the payment of fees linked to tax benefits; and authorize Treasury to issue tougher standards for tax shelter opinion letters. Finally, the bill would codify and strengthen the economic substance doctrine, which eliminates tax benefits for transactions that have no real business purpose apart from avoiding taxes.

Let me be more specific about these key provisions to curb abusive tax shelters.

Sections 301 and 302—Strengthening tax shelter penalties

Title III of the bill strengthens two very important penalties that the IRS can use in its fight against the professionals who make complex abusive shelters possible. Three years ago, the penalty for promoting an abusive tax shelter, as set forth in Section 6700 of the tax code, was the lesser of \$1,000 or 100 percent of the promoter's gross income derived from the prohibited activity. That meant in most cases the maximum fine was just \$1,000.

Many abusive tax shelters sell for \$100,000 or \$250,000 apiece. Our investigation uncovered some tax shelters that were sold for as much as \$2 million or even \$5 million apiece, as well as instances in which the same cookie-cutter tax opinion letter was sold to 100 or even 200 clients. There are huge profits to be made in this business, and a \$1,000 fine is laughable.

The Senate acknowledged that in 2004, when it adopted the Levin-Coleman amendment to the JOBS Act, S. 1637, raising the Section 6700 penalty

on abusive tax shelter promoters to 100 percent of the fees earned by the promoter from the abusive shelter. A 100 percent penalty would have ensured that the abusive tax shelter hucksters would not get to keep a single penny of their ill-gotten gains. That figure, however, was cut in half in the conference report, setting the penalty at 50 percent of the fees earned and allowing the promoters of abusive shelters to keep half of their illicit profits.

While a 50 percent penalty is an obvious improvement over \$1,000, this penalty still is inadequate and makes no sense. Why should anyone who pushes an illegal tax shelter that robs our Treasury of needed revenues get to keep half of their ill-gotten gains? What deterrent effect is created by a penalty that allows promoters to keep half of their fees if caught, and of course, all of their fees if they are not caught?

Effective penalties should make sure that the peddler of an abusive tax shelter is deprived of every penny of profit earned from selling or implementing the shelter and then is fined on top of that. Section 301 of this bill would do just that by increasing the penalty on tax shelter promoters to an amount equal to up to 150 percent of the promoters' gross income from the prohibited activity.

A second penalty provision in the bill addresses what our investigations have found to be a key problem: the knowing assistance of accounting firms, law firms, investment firms, banks, and others to help taxpayers understate their taxes. In addition to those who meet the definition of "promoters" of abusive shelters, there are many other types of professional firms that aid and abet the use of abusive tax shelters and enable taxpayers to carry out the abusive tax schemes. For example, law firms are often asked to write "opinion letters" to help taxpayers head off IRS questioning and fines that they might otherwise confront for using an abusive shelter. Currently, under Section 6701 of the tax code, these aiders and abettors face a maximum penalty of only \$1,000, or \$10,000 if the offender is a corporation. This penalty, too, is a joke. When law firms are getting \$50,000 for each of these cookie-cutter opinion letters, it provides no deterrent whatsoever. A \$1,000 fine is like a jaywalking ticket for robbing a bank.

Section 302 of the bill would strengthen Section 6701 of the tax code by subjecting aiders and abettors to a maximum fine up to 150 percent of the aider and abettor's gross income from the prohibited activity. This penalty would apply to all aiders and abettors, not just tax return preparers.

Again, the Senate has recognized the need to toughen this critical penalty. In the 2004 JOBS Act, Senator Coleman and I successfully increased this fine to 100 percent of the gross income derived from the prohibited activity. Unfortunately, the conference report completely omitted this change, allowing

many aiders and abettors to continue to profit without penalty from their wrongdoing.

If further justification for toughening these penalties is needed, one document uncovered by our investigation shows the cold calculation engaged in by a tax advisor facing low fines. A senior tax professional at accounting giant KPMG compared possible tax shelter fees with possible tax shelter penalties if the firm were caught promoting an illegal tax shelter. This senior tax professional wrote the following: “[O]ur average deal would result in KPMG fees of \$360,000 with a maximum penalty exposure of only \$31,000.” He then recommended the obvious: going forward with sales of the abusive tax shelter on a cost-benefit basis.

Section 303—Prohibition on tax shelter patents

Section 303 of our bill addresses the growing problem of tax shelter patents, which has the potential for significantly increasing abusive tax shelter activities.

In 1998, a federal appeals court ruled for the first time that business methods can be patented and, since then, various tax practitioners have filed applications to patent a variety of tax strategies. The U.S. Patent Office has apparently issued over 70 tax strategy patents to date, up from 49 in 2007, and with many more on the way. These patents were issued by patent officers who, by statute, have a background in science and technology, not tax law, and know little to nothing about abusive tax shelters.

Issuing these types of patents raises multiple public policy concerns. Patents issued for aggressive tax strategies, for example, may enable unscrupulous promoters to claim the patent represents an official endorsement of the strategy and evidence that it would withstand IRS challenge. Patents could be issued for blatantly illegal tax shelters, yet remain in place for years, producing revenue for the wrongdoers while the IRS battles the promoters in court. Patents for tax shelters found to be illegal by a court would nevertheless remain in place, creating confusion among users and possibly producing illicit income for the patent holder.

Another set of policy concerns relates to the patenting of more routine tax strategies. If a single tax practitioner is the first to discover an advantage granted by the law and secures a patent for it, that person could then effectively charge a toll for all other taxpayers to use the same strategy, even though as a matter of public policy all persons ought to be able to take advantage of the law to minimize their taxes. Companies could even patent a legal method to minimize their taxes and then refuse to license that patent to their competitors in order to prevent them from lowering their operating costs. Tax patents could be used to hinder productivity and competition rather than foster it.

The primary rationale for granting patents is to encourage innovation, which is normally perceived to be a sufficient public benefit to justify granting a temporary monopoly to the patent holder. In the tax arena, however, there has historically been ample incentive for innovation in the form of the tax savings alone. The last thing we need is a further incentive for aggressive tax shelters. That’s why Section 303 would prohibit the patenting of any “tax planning invention” that is “designed to reduce, minimize, determine, avoid or defer ? tax liability.” The wording of this section has been updated since the Stop Tax Haven Abuse Act of 2007, to reflect the bipartisan consensus that was reached on this provision in S. 2369, a Baucus-Grassley-Levin bill to bar tax patents, introduced but not acted upon in the 110th Congress.

Section 304—Fees contingent upon obtaining tax benefits

Another finding of the Subcommittee investigations is that some tax practitioners are circumventing current state and federal constraints on charging tax service fees that are dependent on the amount of promised tax benefits. Traditionally, accounting firms charged flat fees or hourly fees for their tax services. In the 1990s, however, they began charging “value added” fees based on, in the words of one accounting firm’s manual, “the value of the services provided, as opposed to the time required to perform the services.” In addition, some firms began charging “contingent fees” that were calculated according to the size of the paper “loss” that could be produced for a client and used to offset the client’s other taxable income—the greater the so-called loss, the greater the fee.

In response, many states prohibited accounting firms from charging contingent fees for tax work to avoid creating incentives for these firms to devise ways to shelter substantial sums. The SEC and the American Institute of Certified Public Accountants also issued rules restricting contingent fees, allowing them in only limited circumstances. Recently, the Public Company Accounting Oversight Board issued a similar rule prohibiting public accounting firms from charging contingent fees for tax services provided to the public companies they audit. Each of these federal, state, and professional ethics rules seeks to limit the use of contingent fees under certain, limited circumstances.

The Subcommittee investigation found that tax shelter fees, which are typically substantial and sometimes exceed \$1 million, are often linked to the amount of a taxpayer’s projected paper losses which can be used to shelter income from taxation. For example, in four tax shelters examined by the Subcommittee in 2003, documents show that the fees were equal to a percentage of the paper loss to be gen-

erated by the transaction. In one case, the fees were typically set at 7 percent of the transaction’s generated “tax loss” that clients could use to reduce other taxable income. In another, the fee was only 3.5 percent of the loss, but the losses were large enough to generate a fee of over \$53 million on a single transaction. In other words, the greater the loss that could be concocted for the taxpayer or “investor,” the greater the profit for the tax promoter. Think about that—greater the loss, the greater the profit. How’s that for turning capitalism on its head!

In addition, evidence indicated that, in at least one instance, a tax advisor was willing to deliberately manipulate the way it handled certain tax products to circumvent contingent fee prohibitions. An internal document at an accounting firm related to a specific tax shelter, for example, identified the states that prohibited contingent fees. Then, rather than prohibit the tax shelter transactions in those states or require an alternative fee structure, the memorandum directed the firm’s tax professionals to make sure the engagement letter was signed, the engagement was managed, and the bulk of services was performed “in a jurisdiction that does not prohibit contingency fees.”

Right now, the prohibitions on contingent fees are complex and must be evaluated in the context of a patchwork of federal, state, and professional ethics rules. Section 304 of the bill would establish a single enforceable rule, applicable nationwide, that would prohibit tax practitioners from charging fees calculated according to a projected or actual amount of tax savings or paper losses.

Section 305—Deterring financial institution participation in abusive tax shelter activities

The bill would also help fight abusive tax shelters that are disguised as complex investment opportunities and use financing or securities transactions provided by financial institutions. In reality, tax shelter schemes lack the economic risks and rewards associated with a true investment. These phony transactions instead often rely on the temporary use of significant amounts of money in low risk schemes mischaracterized as real investments. The financing or securities transactions called for by these schemes are often supplied by a bank, securities firm, or other financial institution.

Currently the tax code prohibits financial institutions from providing products or services that aid or abet tax evasion or that promote or implement abusive tax shelters. The agencies that oversee these financial institutions on a daily basis, however, are experts in banking and securities law and generally lack the expertise to spot tax issues. Section 305 would crack down on financial institutions’ illegal tax shelter activities by requiring federal bank regulators and the

SEC to work with the IRS to develop examination techniques to detect such abusive activities and put an end to them.

These examination techniques would be used regularly, preferably in combination with routine regulatory examinations, and the regulators would report potential violations to the IRS. The agencies would also be required to prepare joint reports to Congress in 2010 and 2013 on preventing the participation of financial institutions in tax evasion or tax shelter activities.

Section 306—Ending communication barriers between enforcement agencies

During hearings before the Permanent Subcommittee on Investigations on tax shelters in November 2003, IRS Commissioner Mark Everson testified that his agency was barred by Section 6103 of the tax code from communicating information to other federal agencies that would assist those agencies in their law enforcement duties. He pointed out that the IRS was barred from providing tax return information to the SEC, federal bank regulators, and the Public Company Accounting Oversight Board (PCAOB)—even, for example, when that information might assist the SEC in evaluating whether an abusive tax shelter resulted in deceptive accounting in a public company's financial statements, might help the Federal Reserve determine whether a bank selling tax products to its clients had violated the law against promoting abusive tax shelters, or help the PCAOB judge whether an accounting firm had impaired its independence by selling tax shelters to its audit clients.

Another example demonstrates how harmful these information barriers are to legitimate law enforcement efforts. In 2004, the IRS offered a settlement initiative to companies and corporate executives who participated in an abusive tax shelter involving the transfer of stock options to family-controlled entities. Over a hundred corporations and executives responded with admissions of wrongdoing. In addition to tax violations, their misconduct may be linked to securities law violations and improprieties by corporate auditors or banks, but the IRS has informed the Subcommittee that it is currently barred by law from sharing the names of the wrongdoers with the SEC, banking regulators, or PCAOB. The same is true for the offshore dividend tax shelters exposed in the Subcommittee's 2008 hearing. The IRS knows who the offending banks and investment firms are that designed and sold questionable dividend enhancement transactions to offshore hedge funds and others, but it is barred by Section 6103 of the tax code from providing detailed information or documents to the SEC or banking regulators who oversee the relevant financial institutions.

These communication barriers are outdated, inefficient, and ill-suited to stopping the torrent of tax shelter

abuses now affecting or being promoted by so many public companies, banks, investment firms, and accounting firms. To address this problem, Section 306 of this bill would authorize the Treasury Secretary, with appropriate privacy safeguards, to disclose to the SEC, federal banking agencies, and the PCAOB, upon request, tax return information related to abusive tax shelters, inappropriate tax avoidance, or tax evasion. The agencies could then use this information only for law enforcement purposes, such as preventing accounting firms, investment firms, or banks from promoting abusive tax shelters, or detecting accounting fraud in the financial statements of public companies.

Section 307—Increased disclosure of tax shelter information to Congress

The bill would also provide for increased disclosure of tax shelter information to Congress. Section 307 would make it clear that companies providing tax return preparation services to taxpayers cannot refuse to comply with a Congressional document subpoena by citing Section 7216, which prohibits tax return preparers from disclosing taxpayer information to third parties. Several accounting and law firms raised this claim in response to document subpoenas issued by the Permanent Subcommittee on Investigations, contending they were barred by the nondisclosure provision in Section 7216 from producing documents related to the sale of abusive tax shelters to clients for a fee.

The accounting and law firms maintained this position despite an analysis provided by the Senate legal counsel showing that the nondisclosure provision was never intended to create a privilege or to override a Senate subpoena, as demonstrated in federal regulations interpreting the provision. This bill would codify the existing regulations interpreting Section 7216 and make it clear that Congressional document subpoenas must be honored.

Section 307 would also ensure Congress has access to information about decisions by Treasury related to an organization's tax exempt status. A 2003 decision by the D.C. Circuit Court of Appeals, *Tax Analysts v. IRS*, struck down certain IRS regulations and held that the IRS must disclose letters denying or revoking an organization's tax exempt status. The IRS has been reluctant to disclose such information, not only to the public, but also to Congress, including in response to requests by the Subcommittee.

For example, in 2005, the IRS revoked the tax exempt status of four credit counseling firms, and, despite the Tax Analysts case, claimed that it could not disclose to the Subcommittee the names of the four firms or the reasons for revoking their tax exemption. Our bill would make it clear that, upon receipt of a request from a Congressional committee or subcommittee, the IRS must disclose documents, other than a

tax return, related to the agency's determination to grant, deny, revoke or restore an organization's exemption from taxation.

Section 308—Tax shelter opinion letters

As part of Circular 230, the Treasury Department has issued standards for tax practitioners who provide opinion letters on the tax implications of potential tax shelters. Section 308 of the bill would provide express statutory authority for these and even clearer regulations.

The public has traditionally relied on tax opinion letters to obtain informed and trustworthy advice about whether a tax-motivated transaction meets the requirements of the law. The Permanent Subcommittee on Investigations has found that, in too many cases, tax opinion letters no longer contain disinterested and reliable tax advice, even when issued by supposedly reputable accounting or law firms. Instead, some tax opinion letters have become marketing tools used by tax shelter promoters and their allies to sell clients on their latest tax products. In many of these cases, financial interests and biases were concealed, unreasonable factual assumptions were used to justify dubious legal conclusions, and taxpayers were misled about the risk that the proposed transaction would later be designated an illegal tax shelter. Reforms are essential to address these abuses and restore the integrity of tax opinion letters.

The Treasury Department recently adopted standards that address a number of the abuses affecting tax shelter opinion letters; however, the standards could be stronger yet. Our bill would authorize Treasury to issue standards addressing a wider spectrum of tax shelter opinion letter problems, including: preventing concealed collaboration among supposedly independent letter writers; avoiding conflicts of interest that would impair auditor independence; ensuring appropriate fee charges; preventing practitioners and firms from aiding and abetting the understatement of tax liability by clients; and banning the promotion of potentially abusive tax shelters. By addressing each of these areas, a beefed-up Circular 230 could help reduce the ongoing abusive practices related to tax shelter opinion letters.

TITLE IV—ECONOMIC SUBSTANCE

Finally, Title IV of the bill incorporates a Baucus-Grassley proposal which would strengthen legal prohibitions against abusive tax shelters by codifying in federal tax statutes for the first time what is known as the economic substance doctrine. This anti-tax abuse doctrine was fashioned by federal courts evaluating transactions that appeared to have little or no business purpose or economic substance apart from tax avoidance. It has become a powerful analytical tool used by courts to invalidate abusive tax shelters. At the same time, because there is no statute underlying this doctrine and the courts have developed

and applied it differently in different judicial districts, the existing case law has many ambiguities and conflicting interpretations.

This language was developed under the leadership of Senators BAUCUS and GRASSLEY, the Chairman and Ranking Member of the Finance Committee. The Senate has voted on multiple occasions to enact the economic substance doctrine into law, but House conferees have rejected it each time. Since no tax shelter legislation would be complete without addressing this issue, Title IV of this comprehensive bill proposes once more to include the economic substance doctrine in the tax code.

CONCLUSION

The eyes of some people may glaze over when tax shelters and tax havens are discussed, but unscrupulous taxpayers and tax professionals see illicit dollar signs. Our commitment to crack down on their tax abuses must be as strong as their determination to get away with ripping off America and American taxpayers.

Our bill provides powerful tools to end offshore tax haven and tax shelter abuses. Offshore tax abuses alone contribute nearly \$100 billion to the \$345 billion annual tax gap, which represents taxes owed but not paid. With the financial crisis facing our country today and the long list of expenses we're incurring to try to end that crisis, it is past time for taxes owing to the people's Treasury to be collected. And it is long past time for Congress to stop tax cheats from shifting their taxes onto the shoulders of honest Americans.

I am optimistic that under the leadership of the new Obama Administration and with the support of the Senate Finance Committee that we can finally tackle this massive problem.

By Mr. AKAKA (for himself, Ms. MURKOWSKI, Mr. INOUE, and Mr. BEGICH):

S. 507. A bill to provide for retirement equity for Federal employees in nonforeign areas outside the 48 contiguous States and the District of Columbia, and for other purposes; to the Committee on Homeland Security and Governmental Affairs.

Mr. AKAKA. Mr. President, today I join with my good friend from Hawaii, Senator DANIEL INOUE, and my friends from Alaska, Senators LISA MURKOWSKI and MARK BEGICH, to reintroduce legislation to ensure retirement equity for Federal workers in Hawaii, Alaska, and the U.S. Territories.

For years, Federal employees in my home State of Hawaii and in other nonforeign areas have been disadvantaged when it comes to their retirement due to a lack of locality pay. Federal workers in those areas may receive a nonforeign cost of living allowance, COLA, based on the difference in the cost of living between those areas and the District of Columbia. However, this pay adjustment does not count toward their retirement.

The inequity in retirement benefits for Federal workers in Hawaii, Alaska, and the U.S. Territories hinders efforts to recruit and retain Federal workers in these areas, and it has led to several lawsuits against the Federal government. Most recently, on January 30, 2008, Judge Phillip M. Pro in the U.S. District Court in Honolulu issued a decision on this in *Matsuo v. the Office of Personnel Management*. In his ruling, Judge Pro acknowledged the disparity saying that Congress discharged its legislative responsibilities imperfectly and recommended that Congress correct the incongruity made so evident by this case.

Under the Federal Employee Pay Comparability Act, FEPCA, of 1990, Federal employees in Alaska, Hawaii, and the Territories were excluded from receiving locality pay, which is adjusted for local labor markets across the country to help close the gap between private sector and public sector wages. The first year FEPCA was implemented, in 1994, Federal employees in Alaska, Hawaii, and the Territories were denied a pay raise so that Federal employees in the 48 contiguous States could receive their first locality pay allowance. Every year since 1994, Federal employees outside of the continental United States have been denied approximately one percent of the average annual pay raise, which goes toward locality pay rates.

As you can imagine, this issue has caused Federal employees in the nonforeign areas great concern for years, but there has never been enough support for any proposed solution. In the past two years, however, we have laid the groundwork for the solution represented by this bipartisan bill. The previous Administration submitted a legislative proposal to phase-out nonforeign COLA and phase-in locality pay. That proposal provided a good starting point, but did not address numerous important issues, including the impact such a change would have on postal employees, employees who receive special rates, members of the Senior Executive Service, and others who are in agency-specific personnel systems or those who do not receive locality pay, such as employees under the National Security Personnel System at the Department of Defense.

My Federal Workforce Subcommittee, in collaboration with Senators Stevens, INOUE, and MURKOWSKI, worked extensively with Federal employees in Hawaii, Alaska, and the Territories and with the Office of Personnel Management, OPM, and other Federal agencies to craft a comprehensive solution, which we introduced as the Non-Foreign Area Retirement Equity Assurance Act last year.

We also have worked with OPM to help ensure that affected Federal employees understand the proposal. After we introduced the bill, my Subcommittee held a series of meetings in Hawaii with representatives from OPM, the Postal Service, and DoD to educate

Federal employees on the impact of the legislation and listen to their concerns. I also chaired a field hearing in Honolulu, Hawaii, where the Administration presented its formal opinion on the legislation and Federal employee representatives from Hawaii, Alaska, Guam, and other Territories were invited to express their thoughts on the legislation. While there are still divergent views on this proposal, the vast majority of employees who I have heard from support it.

As the bill moved through the Senate, I agreed to a few modifications of the bill to address particular concerns. The Senate passed the amended version by unanimous consent in October 2008. Unfortunately, the 110th Congress adjourned before the House could take action on the bill.

Today, we are reintroducing a similar version of the Non-Foreign AREA Act that passed the Senate by unanimous consent only a few months ago in the hopes that we can move quickly to address this growing inequity. This bill is not a windfall or a pay raise for Federal employees. Since 1994, Federal employees in Alaska, Hawaii, and the Territories have been denied pay and retirement equity and this bill seeks to correct the long-time inequity, prevent further lawsuits, and protect employees take-home pay in the process.

As we all know, the declining economy is making it hard on working men and women to pay their bills and stay afloat. While locality rates have increased in recent years, nonforeign COLA rates have been gradually declining. COLA rates are expected to drop again this year in Alaska, Hawaii, and the Territories. Unless Congress acts soon, Federal employees in these areas will see their pay further adversely affected. In the current economic climate, we must be careful to do no harm.

I continue to encourage employees in Alaska, Hawaii, and in the Territories to write us with their questions and concerns on our legislation. My goal remains to ensure that Federal workers in the nonforeign areas are not disadvantaged when it comes to their pay and retirement.

Mr. President, I ask unanimous consent that the text of the bill be printed in the RECORD.

There being no objection, the text of the bill was ordered to be placed in the RECORD, as follows:

S. 507

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Non-Foreign Area Retirement Equity Assurance Act of 2009" or the "Non-Foreign AREA Act of 2009".

SEC. 2. EXTENSION OF LOCALITY PAY.

(a) LOCALITY-BASED COMPARABILITY PAYMENTS.—Section 5304 of title 5, United States Code, is amended—

(1) in subsection (f)(1), by striking subparagraph (A) and inserting the following:

“(A) each General Schedule position in the United States, as defined under section

5921(4), and its territories and possessions, including the Commonwealth of Puerto Rico and the Commonwealth of the Northern Mariana Islands, shall be included within a pay locality;"

(2) in subsection (g)—
(A) in paragraph (2)—
(i) in subparagraph (A), by striking "and" after the semicolon;

(ii) in subparagraph (B) by striking the period and inserting "; and"; and
(iii) by adding after subparagraph (B) the following:

"(C) positions under subsection (h)(1)(C) not covered by appraisal systems certified under section 5382; and"; and

(B) by adding at the end the following:
"(3) The applicable maximum under this subsection shall be level II of the Executive Schedule for positions under subsection (h)(1)(C) covered by appraisal systems certified under section 5307(d)."; and

(3) in subsection (h)(1)—
(A) in subparagraph (B) by striking "and" after the semicolon;

(B) by redesignating subparagraph (C) as subparagraph (D);

(C) by inserting after subparagraph (B) the following:

"(C) a Senior Executive Service position under section 3132 or 3151 stationed within the United States, but outside the 48 contiguous States and the District of Columbia in which the incumbent was an individual who on the day before the date of enactment of the Non-Foreign Area Retirement Equity Assurance Act of 2009 was eligible to receive a cost-of-living allowance under section 5941; and";

(D) in clause (iv) in the matter following subparagraph (D), by inserting ", except for members covered by subparagraph (C)" before the semicolon; and

(E) in clause (v) in the matter following subparagraph (D), by inserting ", except for members covered by subparagraph (C)" before the semicolon.

(b) ALLOWANCES BASED ON LIVING COSTS AND CONDITIONS OF ENVIRONMENT.—Section 5941 of title 5, United States Code, is amended—

(1) in subsection (a), by adding after the last sentence "Notwithstanding any preceding provision of this subsection, the cost-of-living allowance rate based on paragraph (1) shall be the cost-of-living allowance rate in effect on the date of enactment of the Non-Foreign Area Retirement Equity Assurance Act of 2009, except as adjusted under subsection (c).";

(2) by redesignating subsection (b) as subsection (d); and

(3) by inserting after subsection (a) the following:

"(b) This section shall apply only to areas that are designated as cost-of-living allowance areas as in effect on December 31, 2009.

"(c)(1) The cost-of-living allowance rate payable under this section shall be adjusted on the first day of the first applicable pay period beginning on or after—

"(A) January 1, 2010; and

"(B) January 1 of each calendar year in which a locality-based comparability adjustment takes effect under section 4 (2) and (3) of the Non-Foreign Area Retirement Equity Assurance Act of 2009.

"(2)(A) In this paragraph, the term 'applicable locality-based comparability pay percentage' means, with respect to calendar year 2010 and each calendar year thereafter, the applicable percentage under section 4 (1), (2), or (3) of Non-Foreign Area Retirement Equity Assurance Act of 2009.

"(B) Each adjusted cost-of-living allowance rate under paragraph (1) shall be computed by—

"(i) subtracting 65 percent of the applicable locality-based comparability pay percentage from the cost-of-living allowance percentage rate in effect on December 31, 2009; and

"(ii) dividing the resulting percentage determined under clause (i) by the sum of—

"(I) one; and

"(II) the applicable locality-based comparability payment percentage expressed as a numeral.

"(3) No allowance rate computed under paragraph (2) may be less than zero.

"(4) Each allowance rate computed under paragraph (2) shall be paid as a percentage of basic pay (including any applicable locality-based comparability payment under section 5304 or similar provision of law and any applicable special rate of pay under section 5305 or similar provision of law)."

SEC. 3. ADJUSTMENT OF SPECIAL RATES.

(a) IN GENERAL.—Each special rate of pay established under section 5305 of title 5, United States Code, and payable in an area designated as a cost-of-living allowance area under section 5941(a) of that title, shall be adjusted, on the dates prescribed by section 4 of this Act, in accordance with regulations prescribed by the Director of the Office of Personnel Management under section 8 of this Act.

(b) AGENCIES WITH STATUTORY AUTHORITY.—

(1) IN GENERAL.—Each special rate of pay established under an authority described under paragraph (2) and payable in a location designated as a cost-of-living allowance area under section 5941(a)(1) of title 5, United States Code, shall be adjusted in accordance with regulations prescribed by the applicable head of the agency that are consistent with the regulations issued by the Director of the Office of Personnel Management under subsection (a).

(2) STATUTORY AUTHORITY.—The authority referred to under paragraph (1), is any statutory authority that—

(A) is similar to the authority exercised under section 5305 of title 5, United States Code;

(B) is exercised by the head of an agency when the head of the agency determines it to be necessary in order to obtain or retain the services of persons specified by statute; and

(C) authorizes the head of the agency to increase the minimum, intermediate, or maximum rates of basic pay authorized under applicable statutes and regulations.

(c) TEMPORARY ADJUSTMENT.—Regulations issued under subsection (a) or (b) may provide that statutory limitations on the amount of such special rates may be temporarily raised to a higher level during the transition period described in section 4 ending on the first day of the first pay period beginning on or after January 1, 2012, at which time any special rate of pay in excess of the applicable limitation shall be converted to a retained rate under section 5363 of title 5, United States Code.

SEC. 4. TRANSITION SCHEDULE FOR LOCALITY-BASED COMPARABILITY PAYMENTS.

Notwithstanding any other provision of this Act or section 5304 or 5304a of title 5, United States Code, in implementing the amendments made by this Act, for each non-foreign area determined under section 5941(b) of that title, the applicable rate for the locality-based comparability adjustment that is used in the computation required under section 5941(c) of that title shall be adjusted effective on the first day of the first pay period beginning on or after January 1—

(1) in calendar year 2010, by using $\frac{1}{2}$ of the locality pay percentage for the rest of United States locality pay area;

(2) in calendar year 2011, by using $\frac{3}{4}$ of the otherwise applicable comparability payment

approved by the President for each non-foreign area; and

(3) in calendar year 2012 and each subsequent year, by using the full amount of the applicable comparability payment approved by the President for each non-foreign area.

SEC. 5. SAVINGS PROVISION.

(a) SENSE OF CONGRESS.—It is the sense of Congress that—

(1) the application of this Act to any employee should not result in a decrease in the take home pay of that employee;

(2) in calendar year 2012 and each subsequent year, no employee shall receive less than the Rest of the U.S. locality pay rate;

(3) concurrent with the surveys next conducted under the provisions of section 5304(d)(1)(A) of title 5, United States Code, beginning after the date of the enactment of this Act, the Bureau of Labor Statistics should conduct separate surveys to determine the extent of any pay disparity (as defined by section 5302 of that title) that may exist with respect to positions located in the State of Alaska, the State of Hawaii, and the United States' territories, including American Samoa, Guam, Commonwealth of the Northern Mariana Islands, Commonwealth of Puerto Rico, and the United States Virgin Islands;

(4) if the surveys under paragraph (3) indicate that the pay disparity determined for the State of Alaska, the State of Hawaii, or any 1 of the United States' territories including American Samoa, Guam, Commonwealth of the Northern Mariana Islands, Commonwealth of Puerto Rico, and the United States Virgin Islands exceeds the pay disparity determined for the locality which (for purposes of section 5304 of that title) is commonly known as the "Rest of the United States", the President's Pay Agent should take appropriate measures to provide that each such surveyed area be treated as a separate pay locality for purposes of that section; and

(5) the President's Pay Agent will establish 1 locality area for the entire State of Hawaii and 1 locality area for the entire State of Alaska.

(b) SAVINGS PROVISIONS.—

(1) IN GENERAL.—During the period described under section 4 of this Act, an employee paid a special rate under 5305 of title 5, United States Code, who the day before the date of enactment of this Act was eligible to receive a cost-of-living allowance under section 5941 of title 5, United States Code, and who continues to be officially stationed in an allowance area, shall receive an increase in the employee's special rate consistent with increases in the applicable special rate schedule. For employees in allowance areas, the minimum step rate for any grade of a special rate schedule shall be increased at the time of an increase in the applicable locality rate percentage for the allowance area by not less than the dollar increase in the locality-based comparability payment for a non-special rate employee at the same minimum step provided under section 4 of this Act, and corresponding increases shall be provided for all step rates of the given pay range.

(2) CONTINUATION OF COST OF LIVING ALLOWANCE RATE.—If an employee, who the day before the date of enactment of this Act was eligible to receive a cost-of-living allowance under section 5941 of title 5, United States Code, would receive a rate of basic pay and applicable locality-based comparability payment which is in excess of the maximum rate limitation set under section 5304(g) of title 5, United States Code, for his position (but for that maximum rate limitation) due to the operation of this Act, the employee shall

continue to receive the cost-of-living allowance rate in effect on December 31, 2009 without adjustment until—

(A) the employee leaves the allowance area or pay system; or

(B) the employee is entitled to receive basic pay (including any applicable locality-based comparability payment or similar supplement) at a higher rate, but, when any such position becomes vacant, the pay of any subsequent appointee thereto shall be fixed in the manner provided by applicable law and regulation.

(3) **LOCALITY-BASED COMPARABILITY PAYMENTS.**—Any employee covered under paragraph (2) shall receive any applicable locality-based comparability payment extended under section 4 of this Act which is not in excess of the maximum rate set under section 5304(g) of title 5, United States Code, for his position including any future increase to statutory pay limitations under 5318 of title 5, United States Code. Notwithstanding paragraph (2), to the extent that an employee covered under that paragraph receives any amount of locality-based comparability payment, the cost-of-living allowance rate under that paragraph shall be reduced accordingly, as provided under section 5941(c)(2)(B) of title 5, United States Code.

SEC. 6. APPLICATION TO OTHER ELIGIBLE EMPLOYEES.

(a) **IN GENERAL.**—

(1) **DEFINITION.**—In this subsection, the term “covered employee” means—

(A) any employee who—

(i) on the day before the date of enactment of this Act—

(I) was eligible to be paid a cost-of-living allowance under 5941 of title 5, United States Code; and

(II) was not eligible to be paid locality-based comparability payments under 5304 or 5304a of that title; or

(ii) on or after the date of enactment of this Act becomes eligible to be paid a cost-of-living allowance under 5941 of title 5, United States Code; or

(B) any employee who—

(i) on the day before the date of enactment of this Act—

(I) was eligible to be paid an allowance under section 1603(b) of title 10, United States Code;

(II) was eligible to be paid an allowance under section 1005(b) of title 39, United States Code;

(III) was employed by the Transportation Security Administration of the Department of Homeland Security and was eligible to be paid an allowance based on section 5941 of title 5, United States Code; or

(IV) was eligible to be paid under any other authority a cost-of-living allowance that is equivalent to the cost-of-living allowance under section 5941 of title 5, United States Code; or

(ii) on or after the date of enactment of this Act—

(I) becomes eligible to be paid an allowance under section 1603(b) of title 10, United States Code;

(II) becomes eligible to be paid an allowance under section 1005(b) of title 39, United States Code;

(III) is employed by the Transportation Security Administration of the Department of Homeland Security and becomes eligible to be paid an allowance based on section 5941 of title 5, United States Code; or

(IV) is eligible to be paid under any other authority a cost-of-living allowance that is equivalent to the cost-of-living allowance under section 5941 of title 5, United States Code.

(2) **APPLICATION TO COVERED EMPLOYEES.**—

(A) **IN GENERAL.**—Notwithstanding any other provision of law, for purposes of this

Act (including the amendments made by this Act) any covered employee shall be treated as an employee to whom section 5941 of title 5, United States Code (as amended by section 2 of this Act), and section 4 of this Act apply.

(B) **PAY FIXED BY STATUTE.**—Pay to covered employees under section 5304 or 5304a of title 5, United States Code, as a result of the application of this Act shall be considered to be fixed by statute.

(C) **PERFORMANCE APPRAISAL SYSTEM.**—With respect to a covered employee who is subject to a performance appraisal system no part of pay attributable to locality-based comparability payments as a result of the application of this Act including section 5941 of title 5, United States Code (as amended by section 2 of this Act), may be reduced on the basis of the performance of that employee.

(b) **POSTAL EMPLOYEES IN NON-FOREIGN AREAS.**—

(1) **IN GENERAL.**—Section 1005(b) of title 39, United States Code, is amended—

(A) by inserting “(1)” after “(b)”;

(B) by striking “Section 5941,” and inserting “Except as provided under paragraph (2), section 5941”;

(C) by striking “For purposes of such section,” and inserting “Except as provided under paragraph (2), for purposes of section 5941 of that title,”; and

(D) by adding at the end the following:

“(2) On and after the date of enactment of the Non-Foreign Area Retirement Equity Assurance Act of 2009—

“(A) the provisions of that Act and section 5941 of title 5 shall apply to officers and employees covered by section 1003(b) and (c) whose duty station is in a nonforeign area; and

“(B) with respect to officers and employees of the Postal Service (other than those officers and employees described under subparagraph (A)) section 6(b)(2) of that Act shall apply.”

(2) **CONTINUATION OF COST OF LIVING ALLOWANCE.**—

(A) **IN GENERAL.**—Notwithstanding any other provision of this Act, any employee of the Postal Service (other than an employee covered by section 1003 (b) and (c) of title 39, United States Code, whose duty station is in a nonforeign area) who is paid an allowance under section 1005(b) of that title shall be treated for all purposes as if the provisions of this Act (including the amendments made by this Act) had not been enacted, except that the cost-of-living allowance rate paid to that employee—

(i) may result in the allowance exceeding 25 percent of the rate of basic pay of that employee; and

(ii) shall be the greater of—

(I) the cost-of-living allowance rate in effect on December 31, 2009 for the applicable area; or

(II) the applicable locality-based comparability pay percentage under section 4.

(B) **RULE OF CONSTRUCTION.**—Nothing in this Act shall be construed to—

(i) provide for an employee described under subparagraph (A) to be a covered employee as defined under subsection (a); or

(ii) authorize an employee described under subparagraph (A) to file an election under section 7 of this Act.

SEC. 7. ELECTION OF ADDITIONAL BASIC PAY FOR ANNUITY COMPUTATION BY EMPLOYEES.

(a) **DEFINITION.**—In this section the term “covered employee” means any employee—

(1) to whom section 4 applies;

(2) who is separated from service by reason of retirement under chapter 83 or 84 of title 5, United States Code, during the period of January 1, 2010, through December 31, 2012; and

(3) who files an election with the Office of Personnel Management under subsection (b).

(b) **ELECTION.**—

(1) **IN GENERAL.**—An employee described under subsection (a) (1) and (2) may file an election with the Office of Personnel Management to be covered under this section.

(2) **DEADLINE.**—An election under this subsection may be filed not later than December 31, 2012.

(c) **COMPUTATION OF ANNUITY.**—

(1) **IN GENERAL.**—Except as provided under paragraph (2), for purposes of the computation of an annuity of a covered employee any cost-of-living allowance under section 5941 of title 5, United States Code, paid to that employee during the first applicable pay period beginning on or after January 1, 2010 through the first applicable pay period ending on or after December 31, 2012, shall be considered basic pay as defined under section 8331(3) or 8401(4) of that title.

(2) **LIMITATION.**—The amount of the cost-of-living allowance which may be considered basic pay under paragraph (1) may not exceed the amount of the locality-based comparability payments the employee would have received during that period for the applicable pay area if the limitation under section 4 of this Act did not apply.

(d) **CIVIL SERVICE RETIREMENT AND DISABILITY RETIREMENT FUND.**—

(1) **EMPLOYEE CONTRIBUTIONS.**—A covered employee shall pay into the Civil Service Retirement and Disability Retirement Fund—

(A) an amount equal to the difference between—

(i) employee contributions that would have been deducted and withheld from pay under section 8334 or 8422 of title 5, United States Code, during the period described under subsection (c) of this section if the cost-of-living allowances described under that subsection had been treated as basic pay under section 8331(3) or 8401(4) of title 5, United States Code; and

(ii) employee contributions that were actually deducted and withheld from pay under section 8334 or 8422 of title 5, United States Code, during that period; and

(B) interest as prescribed under section 8334(e) of title 5, United States Code, based on the amount determined under subparagraph (A).

(2) **AGENCY CONTRIBUTIONS.**—

(A) **IN GENERAL.**—The employing agency of a covered employee shall pay into the Civil Service Retirement and Disability Retirement Fund an amount for applicable agency contributions based on payments made under paragraph (1).

(B) **SOURCE.**—Amounts paid under this paragraph shall be contributed from the appropriation or fund used to pay the employee.

(3) **REGULATIONS.**—The Office of Personnel Management may prescribe regulations to carry out this section.

SEC. 8. REGULATIONS.

(a) **IN GENERAL.**—The Director of the Office of Personnel Management shall prescribe regulations to carry out this Act, including—

(1) rules for special rate employees described under section 3;

(2) rules for adjusting rates of basic pay for employees in pay systems administered by the Office of Personnel Management when such employees are not entitled to locality-based comparability payments under section 5304 of title 5, United States Code, without regard to otherwise applicable statutory pay limitations during the transition period described in section 4 ending on the first day of the first pay period beginning on or after January 1, 2012; and

(3) rules governing establishment and adjustment of saved or retained rates for any

employee whose rate of pay exceeds applicable pay limitations on the first day of the first pay period beginning on or after January 1, 2012.

(b) OTHER PAY SYSTEMS.—With the concurrence of the Director of the Office of Personnel Management, the administrator of a pay system not administered by the Office of Personnel Management shall prescribe regulations to carry out this Act with respect to employees in such pay system, consistent with the regulations issued by the Office under subsection (a).

SEC. 9. EFFECTIVE DATES.

(a) IN GENERAL.—Except as provided by subsection (b), this Act (including the amendments made by this Act) shall take effect on the date of enactment of this Act.

(b) LOCALITY PAY AND SCHEDULE.—The amendments made by section 2 and the provisions of section 4 shall take effect on the first day of the first applicable pay period beginning on or after January 1, 2010.

SUBMITTED RESOLUTIONS

SENATE RESOLUTION 60—COMMEMORATING THE 10-YEAR ANNIVERSARY OF THE ACCESSION OF THE CZECH REPUBLIC, THE REPUBLIC OF HUNGARY, AND THE REPUBLIC OF POLAND AS MEMBERS OF THE NORTH ATLANTIC TREATY ORGANIZATION

Mrs. SHAHEEN (for herself and Mr. VOINOVICH) submitted the following resolution; which was referred to the Committee on Foreign Relations:

S. RES. 60

Whereas, on March 12, 1999, the Czech Republic, the Republic of Hungary, and the Republic of Poland formally joined the North Atlantic Treaty Organization (NATO);

Whereas, in March 2009, NATO will celebrate the 10-year anniversary of the accession of the Czech Republic, Hungary, and Poland as members of the alliance;

Whereas representatives of the governments of the Czech Republic, Hungary, and Poland will be in attendance as NATO celebrates its 60th anniversary at a summit to be held on April 4, 2009, in Germany and France;

Whereas the security of the United States and its NATO allies have been enhanced by the integration of the Czech Republic, Hungary, and Poland into the NATO alliance;

Whereas the Czech Republic, Hungary, and Poland have been integral to the NATO mission of promoting a Europe that is whole, undivided, free, and at peace;

Whereas the membership of the Czech Republic, Hungary, and Poland has strengthened the ability of NATO to perform a full range of missions throughout the world;

Whereas the Czech Republic, Hungary, and Poland continue to provide crucial support and participation in the NATO International Security Assistance Force in Afghanistan, as NATO struggles to help the people of Afghanistan create the conditions necessary for security and successful development and reconstruction;

Whereas the Czech Republic, Hungary, and Poland helped support NATO efforts to stabilize and secure the Balkans region by contributing to the NATO-led Kosovo Force;

Whereas the Czech Republic, Hungary, Poland, and all NATO members share a strong mutual commitment to defense, regional security, development, and human rights, throughout Europe and beyond; and

Whereas the Czech Republic, Hungary, and Poland have done much to help NATO meet

the global challenges of the 21st century, including the threat of terrorism, the spread of weapons of mass destruction, instability caused by failed states, and threats to global energy security: Now, therefore, be it

Resolved, That the Senate—

(1) celebrates the 10th anniversary of the accession of the Czech Republic, the Republic of Hungary, and the Republic of Poland as members of the North Atlantic Treaty Organization (NATO);

(2) congratulates the people of the Czech Republic, Hungary, and Poland on their accomplishments as members of free democracies and partners in European stability and security;

(3) expresses appreciation for the continuing and close partnership between the United States Government and the Governments of the Czech Republic, Hungary, and Poland; and

(4) urges the United States Government to continue to seek new ways to deepen and expand its important relationships with the Governments of the Czech Republic, Hungary, and Poland.

SENATE RESOLUTION 61—COMMEMORATING THE COLUMBUS CREW MAJOR LEAGUE SOCCER TEAM FOR WINNING THE 2008 MAJOR LEAGUE SOCCER CUP

Mr. VOINOVICH (for himself and Mr. BROWN) submitted the following resolution; which was referred to the Committee on the Judiciary:

S. RES. 61

Whereas, on Sunday, February 23, 2008, the Columbus Crew defeated the New York Red Bulls by a score of 3-1 to win the 2008 Major League Soccer (MLS) Cup;

Whereas the Columbus Crew led the league with a record of 17 wins, 7 losses, and 6 draws and scored 50 regular season goals and 8 playoff goals;

Whereas Columbus Crew head coach Sigi Schmid was named the 2008 MLS Coach of the Year and became the first MLS Coach to win an MLS Cup with two different teams;

Whereas Columbus Crew forward Guillermo Barros Schelotto was named the 2008 MLS Most Valuable Player and led the league with 19 regular season assists and 6 playoff assists;

Whereas Columbus Crew defender Chad Marshall was named the 2008 MLS Defender of the Year;

Whereas Columbus Crew forward Alejandro Moreno led the team in scoring with 9 regular season goals and 1 playoff goal;

Whereas Columbus Crew goalkeeper Will Hesmer had 17 wins, 97 saves, and 10 shutouts in 29 regular season games;

Whereas Alejandro Moreno, Chad Marshall, and Frankie Hejduk all scored goals in the MLS Cup Championship game;

Whereas the Columbus Crew was the winner of the 2008 MLS Supporters' Shield for being the team with the best regular season record;

Whereas Columbus Crew Captain Frankie Hejduk led the team to its first MLS Cup since the team's creation in 1994; and

Whereas the Columbus Crew, along with its supporters, has energized Columbus and brought great pride to the State of Ohio: Now, therefore, be it

Resolved, That the Senate—

(1) congratulates the Columbus Crew on winning the 2008 Major League Soccer Cup;

(2) recognizes the achievements of Sigi Schmid, Chad Marshall, Guillermo Barros Schelotto, and the other members of the Columbus Crew for their tireless work ethic and championship form;

(3) salutes the support of the Columbus Crew fan groups, including the Hudson Street Hooligans, the Crew Union, La Turbina Amarilla, and the rest of the Nordecke for unwavering dedication to the Columbus Crew; and

(4) expresses the hope that the Columbus Crew and Major League Soccer will continue to inspire soccer fans and players throughout Ohio, the United States, and the world.

SENATE CONCURRENT RESOLUTION 9—SUPPORTING THE GOALS AND IDEALS OF MULTIPLE SCLEROSIS AWARENESS WEEK

Mr. CASEY (for himself, Ms. SNOWE, Ms. LANDRIEU, Mr. PRYOR, Mr. LAUTENBERG, Mr. SANDERS, and Mr. DORGAN) submitted the following concurrent resolution; which was considered and agreed to:

S. CON. RES. 9

Whereas multiple sclerosis can impact men and women of all ages, races, and ethnicities; Whereas more than 400,000 people in the United States live with multiple sclerosis;

Whereas approximately 2,500,000 people worldwide have been diagnosed with multiple sclerosis;

Whereas it is estimated that between 8,000 and 10,000 children and adolescents are living with multiple sclerosis;

Whereas every hour of every day, someone is newly diagnosed with multiple sclerosis;

Whereas the exact cause of multiple sclerosis is still unknown;

Whereas the symptoms of multiple sclerosis are unpredictable and vary from person to person;

Whereas there is no laboratory test available for multiple sclerosis;

Whereas multiple sclerosis is not genetic, contagious, or directly inherited, but studies show that there are genetic factors that indicate that certain individuals are susceptible to the disease;

Whereas multiple sclerosis symptoms occur when an immune system attack affects the myelin in nerve fibers of the central nervous system, damaging or destroying it and replacing it with scar tissue, thereby interfering with, or preventing the transmission of, nerve signals;

Whereas in rare cases, multiple sclerosis is so progressive that it is fatal;

Whereas there is no known cure for multiple sclerosis;

Whereas the Multiple Sclerosis Coalition, an affiliation of multiple sclerosis organizations dedicated to the enhancement of the quality of life for all those affected by multiple sclerosis, recognizes and celebrates Multiple Sclerosis Awareness Week;

Whereas the Multiple Sclerosis Coalition's mission is to increase opportunities for cooperation and provide greater opportunity to leverage the effective use of resources for the benefit of the multiple sclerosis community;

Whereas the Multiple Sclerosis Coalition recognizes and celebrates Multiple Sclerosis Awareness Week during 1 week in March every calendar year;

Whereas the goals of Multiple Sclerosis Awareness Week are to invite people to join the movement to end multiple sclerosis, encourage everyone to do something to demonstrate a commitment to moving toward a world free of multiple sclerosis, and to acknowledge those who have dedicated their time and talent to help promote multiple sclerosis research and programs; and

Whereas in 2009, Multiple Sclerosis Awareness Week is recognized during the week of March 2nd through March 8th: Now, therefore, be it