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SENATE, HOUSE MEMBERS INTRODUCE STOP TAX HAVEN ABUSE ACT

Bill targets \$100 billion in lost tax revenue each year from offshore tax dodges

WASHINGTON – Stating that “tax havens are engaged in economic warfare against the United States, and honest, hardworking Americans,” Sen. Carl Levin, D-Mich., Sen. Sheldon Whitehouse, D-RI, Sen. Claire McCaskill, D-Mo. and Sen. Bill Nelson, D-Fla., today introduced comprehensive legislation to stop offshore tax haven and tax shelter abuses. A companion bill was introduced in the U.S. House of Representatives by over 40 Members led by Rep. Lloyd Doggett, D-Tex. and Rep. Rosa DeLauro, D-Conn.

Offshore tax abuses cost the U.S. Treasury an estimated \$100 billion each year in lost tax revenues, including \$40-\$70 billion from individuals and \$30-\$60 billion from corporations. Abusive domestic tax shelters cost tens of billions of dollars more.

“Offshore tax haven and tax shelter abuses are undermining the integrity of our tax system and increasing the tax burden on middle income families,” said Levin, chairman of the Permanent Subcommittee on Investigations which has conducted numerous inquiries into offshore abuses. “We cannot tolerate \$100 billion in offshore tax abuses burning a hole through our budget each year. We can fight back against secrecy jurisdictions and shut down offshore tax abuses if we have the political will. This bill provides a powerful set of new tools to clamp down on offshore tax and tax shelter abuses.”

“When over 80% of our largest companies have subsidiaries in tax havens, and one major recipient of taxpayer bailout monies achieves a 1% effective tax rate through ‘changes in geographic earnings mix,’ it is long past time to take effective action to stop offshore tax dodging.” said Congressman Doggett, a senior member of the House Ways and Means and Budget Committees, and a long-time foe of offshore tax havens. “These outrageous tax havens add to the soaring budget deficit and shift the tax burden to small businesses and families, who play by the rules.”

The Stop Tax Haven Abuse Act is an improved version of legislation introduced in the last Congress by Levin, Sen. Norm Coleman, R-Minn., then Sen. Barack Obama, and others in the Senate and by Doggett and 47 cosponsors in the House, including then Rep. Rahm Emanuel. The bill has been strengthened with the addition of three new provisions that would: (1) treat foreign corporations managed and controlled in the United States as domestic corporations for income tax purposes; (2) close an offshore tax dividend loophole that enables non-U.S. persons to dodge payment of U.S. taxes on U.S. stock dividends; and (3) expand the tax return reporting requirements for passive foreign investment corporations (PFICs) to include U.S. persons who don't own a PFIC, but have formed, sent assets to, received assets from, or benefitted from a PFIC.

The bill will be referred to the Finance Committee in the Senate and the Ways and Means Committee in the House.

Among other measures, the 84-page bill would:

- **ESTABLISH PRESUMPTIONS TO COMBAT OFFSHORE SECRECY (§101)** by allowing U.S. tax and securities law enforcement to treat for tax purposes non-publicly traded offshore entities as being controlled by the U.S. taxpayer who formed them, sent them assets, received assets from them, or benefitted from them, unless the taxpayer proves otherwise.
- **IMPOSE TOUGHER REQUIREMENTS ON U.S. TAXPAYERS USING OFFSHORE SECRECY JURISDICTIONS (§101)** by authorizing Treasury to develop a list of jurisdictions starting from an initial 34 jurisdictions identified in IRS court proceedings.
- **AUTHORIZE SPECIAL MEASURES TO STOP OFFSHORE TAX ABUSES (§102)** by giving Treasury authority to take special measures against foreign jurisdictions and financial institutions that impede U.S. tax enforcement.
- **CURE THE UGLAND HOUSE PROBLEM OF SHELL COMPANIES RUN FROM THE UNITED STATES CLAIMING FOREIGN STATUS (§103)** by treating foreign corporations that are publicly traded or have gross assets of \$50 million or more and whose management and control occurs primarily in the United States as U.S. domestic corporations for income tax purposes.
- **STRENGTHEN DETECTION OF OFFSHORE ACTIVITIES (§105)** by requiring U.S. financial institutions that open accounts for foreign entities controlled by U.S. clients, open accounts in offshore secrecy jurisdictions for U.S. clients, or establish entities in offshore secrecy jurisdictions for U.S. clients, to report such actions to the IRS.
- **CLOSE OFFSHORE TRUST LOOPHOLES (§106)** by taxing distributions, gifts and loans from foreign trusts of real estate, artwork, or jewelry to U.S. persons, and treating U.S. persons who receive offshore trust assets as trust beneficiaries.

- **CLOSE THE OFFSHORE TAX DIVIDEND LOOPHOLE (§108)** by treating all U.S. corporate dividend-based payments to non-U.S. persons as taxable income subject to withholding.
- **EXPAND IRS REPORTING REQUIREMENTS (§109)** for passive foreign investment companies (PFICs) to include not only U.S. persons who own a PFIC but also those who have formed, sent assets to, received assets from, or benefitted from a PFIC.
- **REQUIRE ANTI-MONEY LAUNDERING PROGRAMS (§203)** for hedge funds and company formation agents to ensure they screen their clients and any offshore funds.
- **STRENGTHEN PENALTIES (§§301-302)** on tax shelter promoters by increasing the maximum fine to 150% of their ill-gotten gains, and on corporate insiders who hide offshore stock holdings by increasing the maximum fine to \$1 million per violation of U.S. securities laws.
- **BAN TAX SHELTER PATENTS (§303)** by prohibiting the U.S. patent office from issuing patents for “inventions” designed to minimize, avoid, or defer taxes.

A more detailed summary of the Stop Tax Haven Abuse Act, the bill text, and a floor statement by Levin explaining its provisions in more detail are available at levin.senate.gov.

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SUMMARY OF STOP TAX HAVEN ABUSE ACT

February 26, 2009

TITLE I – Deterring the Use of Offshore Secrecy Jurisdictions for Tax Evasion

Establish presumptions for entities and transactions in Offshore Secrecy Jurisdictions. (§101)

- Establishes rebuttable evidentiary presumptions in tax and securities legal proceedings for non publicly-traded entities located in Offshore Secrecy Jurisdictions. The presumptions are as follows:
 - **Control** – In a tax proceeding, if a U.S. person (other than a publicly-traded corporation) directly or indirectly formed, transferred assets to, was a beneficiary of, had a beneficial interest in, or received assets from an Offshore Secrecy Jurisdiction entity (other than a publicly-traded corporation), it will be presumed that the person exercised control over the entity.
 - **Transfers of income** – In a tax proceeding, any amount or thing of value –
 - a) transferred to a U.S. person (other than a publicly-traded corporation) directly or indirectly from an account or entity in an Offshore Secrecy Jurisdiction, or
 - b) transferred from such a U.S. person directly or indirectly to an account or entity in an Offshore Secrecy Jurisdiction,will be presumed to represent previously unreported income to the U.S. person in the year of transfer.
 - **Beneficial ownership** – In a proceeding to enforce securities law, if a U.S. person (other than a publicly-traded corporation) formed, transferred assets to, was a beneficiary of, had a beneficiary interest in, or received assets from an Offshore Secrecy Jurisdiction entity (other than a publicly-traded corporation), it will be presumed that the person beneficially owned and exercised control over such entity, regardless of the nominal ownership.
 - **Foreign financial accounts** – Current law requires that U.S. taxpayers report to the IRS any foreign financial accounts containing at least \$10,000 (known as an FBAR filing). Presumption is that any account in an Offshore Secrecy Jurisdiction contains funds sufficient to trigger this reporting requirement.
- These presumptions are needed in civil judicial and administrative proceedings, because the tax, corporate, or bank secrecy laws and practices of these jurisdictions make it nearly impossible for U.S. authorities to gain access to needed information. Presumptions may be rebutted by clear and convincing evidence. No evidence may be accepted from a non-U.S. person unless the person appears to testify in the proceedings.

- Treasury and SEC are authorized to issue regulations or guidance to implement this section, and exempt classes of transactions, such as corporate reorganizations, that do not present the potential for abuse.

Determine “Offshore Secrecy Jurisdictions.” (§101)

- Provides initial list of 34 Offshore Secrecy Jurisdictions, while giving Treasury Secretary discretion to add or subtract from the list using certain criteria. Initial list of jurisdictions was taken from IRS court filings identifying them as probable locations for U.S. tax evasion:

Anguilla	Cook Islands	Jersey	St. Kitts and Nevis
Antigua and Barbuda	Costa Rica	Latvia	St. Lucia
Aruba	Cyprus	Liechtenstein	St. Vincent & the Grenadines
Bahamas	Dominica	Luxembourg	Singapore
Barbados	Gibraltar	Malta	Switzerland
Belize	Grenada	Nauru	Turks and Caicos
Bermuda	Guernsey/Sark/Alderney	Netherlands Antilles	Vanuatu
British Virgin Islands	Hong Kong	Panama	
Cayman Islands	Isle of Man	Samoa	

- Directs Treasury Secretary to list jurisdictions with secrecy laws or practices that unreasonably restrict U.S. tax authorities from obtaining needed information, unless the jurisdiction has information exchange practices that effectively overcome those secrecy barriers.

Authorize special measures against foreign jurisdictions, financial institutions, and others that impede U.S. tax enforcement. (§102)

- Currently, Treasury has the authority under §311 of the Patriot Act (31 U.S.C. 5318(a)) to impose financial sanctions on foreign jurisdictions, financial institutions, or transactions found to be of “primary money laundering concern.” Bill would authorize Treasury to impose the same sanctions on the same types of entities if Treasury finds them to be “impeding U.S. tax enforcement.” In addition, the bill would add to the list of possible sanctions the ability to prohibit the use of credit cards issued by a foreign bank in the United States.

Treat foreign corporations managed and controlled in the United States as domestic corporations for income tax purposes. (§103)

- Treats a corporation that is publicly traded or has aggregate gross assets of \$50 million or more during the tax year or the preceding tax year as a domestic corporation for income tax purposes if substantially all of the executive officers and senior management who exercise day-to-day responsibility for making decisions involving strategic, financial, and operational policies of the corporation are located primarily in the United States.

- Provides exceptions for foreign corporations that are subsidiaries of active U.S. parent corporations and for foreign corporations that are granted a waiver by the Treasury Secretary because the corporation no longer meets and no longer expects to meet the criteria established in this section.

Allow more time for investigations involving Offshore Secrecy Jurisdictions. (§104)

- Extends from three years to six years the amount of time IRS has after a return is filed to investigate and propose an assessment of additional tax if the case involves an Offshore Secrecy Jurisdiction.

Increase disclosure of offshore accounts, transactions, and entities. (§105)

- Requires any bank or securities firm that knows from its anti-money laundering due diligence that the beneficial owner of one of its foreign-owned financial accounts is a U.S. taxpayer, to file, in its role as withholding agent, a 1099 form reporting account income of that beneficial owner to the IRS.
- Requires any financial institution directly or indirectly opening a financial account or creating an entity in an Offshore Secrecy Jurisdiction for a U.S. client to report the transaction to the IRS.
- These filing requirements would be subject to the same penalties under Title 26 presently applicable to forms 1099 and W-2, and bank and securities regulators are given express authority to use their existing enforcement authority to address failures to report

Prevent misuse of foreign trusts for tax evasion. (§106)

- Attributes all powers and interests held by a trust protector of a foreign trust to the U.S. trust grantor.
- Treats a U.S. person who receives or uses cash or other property from a foreign trust as a beneficiary of that trust, unless the exchange was for fair market value.
- Expands the list of taxable trust distributions to include loans of real estate, marketable securities, and personal property of any kind, including artwork, furnishings and jewelry.
- Amends tax code to treat foreign trusts with current or future U.S. beneficiaries, including contingent U.S. beneficiaries, as taxable “grantor” trusts, rather than limiting that treatment to trusts with current U.S. beneficiaries.

Limit legal opinion protection from penalties with respect to transactions involving Offshore Secrecy Jurisdictions. (§107)

- Denies the penalty protections afforded by a legal opinion if the transaction involves an Offshore Secrecy Jurisdiction. Treasury is also authorized to exempt opinions that express a high confidence level regarding the tax treatment of the transaction and opinions on certain classes of transactions that are determined not to present the potential for abuse.

Close the offshore dividend tax loophole. (§108)

- Ensures non-U.S. persons pay U.S. taxes on U.S. stock dividends by ending the practice of using complex financial transactions to recast taxable dividend payments as allegedly tax free dividend equivalent or substitute dividend payments.
- Ensures consistent tax treatment of dividend, dividend equivalent, and substitute dividend payments by defining "dividend" to include dividend equivalent and substitute dividend payments under Sections 871 and 881 of the tax code.
- Authorizes the Treasury Secretary to issue regulations to prevent possible over-withholding of taxes on dividend equivalent or substitute dividend payments, and to address other issues, including the netting of payments and other transactions involving options, forward contracts, or similar arrangements with similar economic results as covered transactions.

Expand reporting requirements for PFICs. (§109)

- Expands tax return reporting requirements for passive foreign investment corporations (PFICs) to include not only U.S. persons who are shareholders in a PFIC, but also U.S. persons who directly or indirectly form, transfer assets to, are a beneficiary of, have a beneficiary interest in, or receive assets from a PFIC.

TITLE II – Other Measures to Combat Tax Haven and Tax Shelter Abuses

Increase penalty for failing to disclose offshore holdings. (§201)

- Imposes penalty of up to \$1 million per violation of U.S. securities law on public companies or their officers, directors, or major shareholders who knowingly fail to disclose offshore holdings that should have been reported to the Securities and Exchange Commission.

Require anti-money laundering rule for hedge funds. (§202)

- Requires Treasury to issue a rule requiring unregistered investment companies, such as hedge funds and private equity funds, to establish anti-money laundering programs and submit suspicious activity reports. Rule must require such unregistered investment companies to use due diligence to evaluate investors supplying offshore funds and comply with same anti-money laundering rules as other financial institutions when asked for records by a federal regulator.

Apply anti-money laundering obligations to company formation agents. (§203)

- Adds company formation agents to current list of those who must comply with anti-money laundering obligations.
- Requires Treasury to issue a rule applying anti-money laundering obligations to company formation agents.

Strengthen John Doe summons use in offshore tax cases. (§204)

- Strengthens John Doe summonses in cases involving Offshore Secrecy Jurisdictions by:
 - allowing immediate summonses for U.S. correspondent account records of financial institutions located in an Offshore Secrecy Jurisdiction;
 - authorizing courts to presume for any summons relating to transactions in Offshore Secrecy Jurisdictions that there is a reasonable basis for believing the case involves non-compliance with tax laws; and
 - permitting a court to authorize John Doe summonses on an open-ended basis for three-year periods for project investigations, provided that the court exercises ongoing oversight of the IRS summonses.
- Requires GAO evaluation of this provision after five years.

Strengthen foreign financial account reporting requirements. (§205)

- Clarifies the authority of IRS agents investigating Foreign Bank Account Report (FBAR) violations to use tax information in those investigations; simplifies the calculation of FBAR penalties by tying the penalty to the highest balance in the account during the reporting period; and clarifies that Suspicious Activity Reports may be used for civil, and not just criminal, tax law enforcement.

TITLE III – Preventing Abusive Tax Shelter Transactions

Strengthen tax shelter penalties. (§§301-302)

- Strengthens penalties for promoting abusive tax shelters (§301) and knowingly aiding or abetting a taxpayer in understating tax liability (§302).

Violation	Current Law	Bill
Promotion of abusive tax shelters. IRC § 6700	50% of the promoters’ gross income from the activity.	Not to exceed 150% of the promoters’ gross income from the prohibited activity. (§301)
Knowingly aiding and abetting understatement of tax liability. IRC § 6701	Maximum of \$1,000 (\$10,000 for a corporation). Penalty applies only to tax return preparers.	Not to exceed 150% of the aider-abettor’s gross income from the prohibited activity. Penalty applies to all aiders-abettors, not just tax return preparers. (§302)

Prohibit tax shelter patents. (§303)

- Prohibits the issuance of any patent on a strategy, process, or system designed to reduce, minimize, determine, avoid, or defer the liability for tax.

Prohibit tax service fees contingent upon specific tax savings. (§304)

- Prohibits charging a fee for tax services in an amount that is calculated according to or dependant upon a projected or actual amount of tax savings or losses offsetting taxable income.

Deter financial institution participation in abusive tax shelter activities. (§305)

- Requires federal bank regulators and the SEC to develop and utilize examination techniques to detect violations by financial institutions of the prohibition against providing products or services that aid or abet tax evasion or that promote or implement abusive tax shelters, and report potential violations to the IRS.

Strengthen law enforcement through information sharing. (§§306-307)

- Authorizes Treasury to share certain tax return information with the SEC, federal bank regulators, or PCAOB, under certain circumstances, to enhance tax shelter enforcement or combat financial accounting fraud. Clarifies Congressional subpoena authority to obtain information (but not a taxpayer return) from tax return preparers. Clarifies Congressional authority to obtain certain tax information (but not a taxpayer return) from Treasury related to an IRS decision to grant, deny, revoke, or restore an organization's tax exempt status.

Require tougher tax shelter opinion standards for tax practitioners. (§308)

- Codifies and expands Treasury's authority to issue Circular 230 standards for tax practitioners providing "opinion letters" on specific tax shelter transactions.

TITLE IV – Requiring Economic Substance

Codify and strengthen the economic substance doctrine. (§§401-403)

- Codifies and strengthens the economic substance doctrine to invalidate transactions that have no meaningful economic substance or business purpose apart from tax avoidance or evasion. Also increases penalties for understatements attributable to a transaction lacking in economic substance.