

**Testimony**

**of**

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**Senior Tax Partner**

**PricewaterhouseCoopers LLP**

**Before the**

**Permanent Subcommittee on Investigations**

**of the**

**Senate Committee on Governmental Affairs**

**November 18, 2003**

Chairman Coleman, Ranking Member Levin, and Members of the Subcommittee:

My name is Rick Berry and I am the Senior Tax Partner of PricewaterhouseCoopers LLP.<sup>1</sup>

I am privileged to be entrusted by my partners with the leadership and direction of our Firm's Tax practice within the United States.

There has been a significant amount of concern expressed in recent years about tax shelters by tax administrators, regulators and legislators, including this Subcommittee. I welcome the opportunity to share with you the significant changes we at PricewaterhouseCoopers have made in our Tax practice to deal with these issues and better serve our clients.

Our Tax practice in the United States is comprised of over 6,500 professionals. Through their efforts, we assist our clients with a variety of complex tax issues. We provide a full array of federal, foreign, state and local tax services to large multi-national corporations, middle market companies and individuals. These services range from preparing individual tax returns to advising large multi-nationals on mergers and acquisitions. Our approach is to develop long-term relationships with our clients and to serve each of them as a trusted advisor, providing specific services to match their individual circumstances and needs.

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<sup>1</sup> "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. PricewaterhouseCoopers LLP refers to the member firm conducting business in the United States.

Our tax practice has evolved considerably over the past few years, especially in the area of interest to this Subcommittee, tax shelters. In the 1990's there was increasing pressure in the marketplace for firms to develop aggressive tax shelters that could be marketed to large numbers of taxpayers. This had not been a traditional part of our tax practice, but regrettably our firm became involved in three types of these transactions between 1997 and 1999. The individual transactions are described below. Although the total number of transactions that were done by our firm was limited to 76 over a three-year period, we acknowledge that we should not have done any. Since late 1999, we have taken strong action to prevent our involvement in transactions like these again.

Foreign Leveraged Investment Program (FLIP): This was a complicated structured transaction designed to take advantage of special attribution rules to shift basis from a tax indifferent party to a U.S. tax party, thereby enabling an investor to shelter income or claim a significant loss. In 1997 and 1998, we participated in 12 and 38 FLIP transactions, respectively. In 1999, we withdrew from the seven transactions then in progress and refunded our fees. Since then, we have not done any of these transactions.

Contingent Deferred Swap (CDS): This was another complicated structured transaction involving the use of debt instruments to generate interest deductions and create an opportunity to convert ordinary income into capital gains. In 1998 and 1999, we participated in 11 and 15 CDS transactions, respectively. Since then, we have not done any of these transactions.

Bond and Options Sales Strategy (BOSS): This was the largest of these three strategies. It was designed to shelter gains through a complex series of sale, loan and dividend arrangements. In 1999, there were approximately 120 of these in progress. In late 1999, our firm shut down all of these and refunded all of our fees. None of these transactions were ever completed. Since then, we have not done any of these transactions, nor any of its successors.

In late 1999, the firm decided to get out of this business. The factors leading to this decision included damage to our business reputation, embarrassment caused to our clients, people and firm, the changing regulatory environment, and a desire among our partners to focus on our core tax business. As a result, we disbanded the group of approximately ten professionals who were responsible for the development and marketing of these transactions.

A positive consequence of this experience was our development of a comprehensive quality review program and its implementation in 2000. The purpose of this program is to prevent our participation in abusive tax shelters and to ensure that we provide the highest quality advice to our clients. Significant resources have been committed to a quality and risk management group that is independent of any business unit and reports directly to the leader of the Tax practice. This group is tasked with developing quality and review procedures to ensure that we do not get involved in the types of transactions previously described.

This group is centralized with representatives embedded throughout our organizational levels (national, regional, and business unit). The function includes six full-time partners, supporting staff and an additional eight partners spending significant amounts of time in this activity. Under the procedures established by this group, all of our tax related services must go through a quality review.

The quality review process is comprehensive and has differing levels of review depending upon the complexity of the issues involved. Even the most routine of our tax services are reviewed, often by a second partner. In most instances, the second partner is required to be a technical expert in the subject matter in question. When multiple tax issues are involved, there will be participation by multiple subject matter experts in the technical and business analysis. If the advice to be rendered is considered a third party opinion, then an additional review is undertaken by a national quality and risk management partner.

If the strategy involves a tax planning idea with potential applicability to more than one client, the strategy will undergo a significant review under procedures in place since 2000. The procedures begin with a required description and technical analysis, review and support by appropriate specialists, and a qualification review by a quality and risk management partner and a member of the Tax leadership. If these conditions are satisfied, the idea must still be unanimously approved by a committee of experts. Finally, if the committee approves the strategy, it will be resubmitted to Tax leadership for a final assessment as to whether it should be disseminated to the practice.

Since 2000, we have also worked with the IRS to address issues relating to the registration and list maintenance requirements of the tax law. In June 2002, our firm entered into a closing agreement with the IRS and made a settlement payment. Additionally, we agreed

to an IRS review of all of the ideas we have broadly disseminated and the IRS has not found any of them to be subject to the registration and list maintenance rules. Moreover, we provided the IRS with our quality control procedures for their review and we were told by the IRS that our procedures were comprehensive, thorough, and effective. We continue to cooperate with the IRS and fully abide by the terms of our agreement.

Our experience almost four years ago served as a wake up call to the Tax practice. Our partners were adamant that we get out of this business immediately. We shut down the largest transaction and returned all of our fees. We settled with the IRS. We implemented comprehensive quality control procedures to ensure that the firm would never again be engaged in the marketing and development of potentially abusive tax products. As a firm, this was the best thing that could have happened to us. We acknowledge our actions and we have learned from this regrettable mistake.

Thank you for the opportunity to appear before you today and to share our experiences with you. I look forward to answering any questions.