STATEMENT OF SENATOR CARL LEVIN (D-MICH)
ON INTRODUCING
THE STOP TAX HAVEN ABUSE ACT

September 19, 2013

Mr. President, I am introducing today, along with my colleagues Senators Whitehouse, Begich and Shaheen, the Stop Tax Haven Abuse Act, legislation that is geared to stop the estimated $150 billion yearly drain on the U.S. treasury caused by offshore tax abuses. Offshore tax abuses are not only undermining public confidence in our tax system, but widening the deficit and increasing the tax burden for the rest of American families and businesses.

This bill eliminates incentives to send U.S. profits and jobs offshore, combats offshore tax abuses, and raises revenues needed to fund our national security and essential domestic programs. Its provisions could be part of an alternative deficit reduction package to substitute for sequestration this year, but should be adopted in any event because the loopholes we would close serve no economic purpose and shouldn't exist even if there were no deficit.

We should close these loopholes on principle. They are blatantly unfair, and we should end them, regardless of our deficit, regardless of whether sequestration is in effect. But surely, at a time when sequestration is harming families, national security, life-saving research, students and seniors, we should close these loopholes and dedicate the revenue to ending sequestration.

The bill is supported by a wide array of small business, labor and public interest groups, including the Financial Accountability and Corporate Transparency (FACT) Coalition, Americans for Tax Fairness, Tax Justice Network-USA, Citizens for Tax Justice, AFL-CIO, SEIU, American Sustainable Business Council, Business for Shared Prosperity, South Carolina Small Business Chamber of Commerce, Friends of the Earth, New Rules for Global Finance, U.S. Public Interest Research Group, Global Financial Integrity, Jubilee USA Network, and Public Citizen.

Frank Knapp, president and CEO of the South Carolina Small Business Chamber of Commerce, has explained small business support for the bill this way:

> "Small businesses are the lifeblood of local economies. We pay our fair share of taxes and generate most of the new jobs. Why should we be subsidizing U.S. multinationals that use offshore tax havens to avoid paying taxes? Big corporations benefit immensely from all the advantages of being headquartered in our country. It's time to end tax haven abuse and level the playing field."

The Stop Tax Haven Abuse Act is a product of the investigative work of the Permanent Subcommittee on Investigations which I chair. For more than 12 years, the Subcommittee has conducted inquiries into offshore tax avoidance abuses, including the use of offshore corporations and trusts to hide assets and shift income abroad, the use of tax haven banks to set up secret accounts, and the use of U.S. bankers, lawyers, accountants and other professionals to devise methods of taking advantage of tax loopholes that Congress never intended. Over the

years, my Subcommittee has learned a lot about these offshore tricks, and we have designed this bill to fight back by closing many of these tax loopholes and strengthening offshore tax enforcement.

The 113th Congress is the sixth Congress in which I've introduced a comprehensive bill to combat offshore and tax shelter abuses. A number of provisions from past bills have made it into law, such as measures to curb abusive foreign trusts, close offshore dividend tax loopholes, and strengthen penalties on tax shelter promoters.

In recent years, Congress has made a little progress in the offshore tax battle. In 2010, we enacted into law the economic substance doctrine, which up to then had been a judicially created policy. The law now authorizes courts to strike down phony business deals with no economic purpose other than to avoid the payment of tax. Getting the economic substance doctrine enacted was a victory many years in the making.

Also in 2010, Congress enacted the Baucus-Rangel Foreign Account Tax Compliance Act or FATCA, which is designed to flush out hidden offshore bank accounts. Foreign banks have engaged in a massive lobbying effort to weaken its disclosure requirements, but most U.S. banks have had it with foreign banks using secrecy to attract U.S. clients and want those foreign banks to have to meet the same disclosure requirements U.S. banks do. Starting next year, foreign financial institutions will have to agree to comply with FATCA's disclosure requirements, which include disclosing to the IRS all accounts held by U.S. persons, or else begin incurring a 30% withholding tax on all investment income received from the United States.

President Obama, who when in the Senate cosponsored the 2005 and 2007 versions of this bill we're introducing today, is a longtime opponent of offshore tax evasion. And just weeks ago, the G-20 leaders declared international tax avoidance by multinational corporations to be a global concern, and pledged to work cooperatively to end abuses.

The bottom line is that each of us has a legal and civil obligation to pay taxes, and most Americans fulfill that obligation. It is time to force the tax scofflaws, the tax dodgers, and the tax avoiders to do the same, and for us to take the steps needed to end their use of offshore tax havens. It is also time to recapture those unpaid taxes to pay for critical government services, including strengthening our education, health care, and defense to help replace the absurd sequestration approach with an alternative balanced deficit reduction package that includes revenues as one component.

The bill we are introducing today is a stronger, more streamlined version of the Stop Tax Haven Abuse Act introduced in the last Congress. This enhanced version includes key provisions from the last bill that have not yet been enacted into law, several provisions implementing the President's budget recommendations, and new provisions to stop the offshore tax haven abuses featured in hearings held and bipartisan reports filed during the last Congress by my Subcommittee.

The provisions retained from the prior version of the bill include, with some clarifying or strengthening language, special measures to deal with foreign jurisdictions and financial

institutions that significantly impede U.S. tax enforcement. They include tougher disclosure, evidentiary and enforcement provisions for accounts at foreign financial institutions that do not comply with FATCA; and the treatment of offshore corporations as domestic corporations for tax purposes when managed and controlled primarily from the United States. They also include stronger disclosure requirements for offshore accounts and offshore entities opening U.S. financial accounts, and closure of a tax loophole benefiting financial swaps that send money offshore. In addition, they mandate new disclosure requirements to stop multinational corporate tax evasion by requiring publicly traded corporations to disclose basic information about their employees, revenues and tax payments on a country-by-country basis.

The new provisions in this bill would eliminate tax provisions encouraging the offshoring of jobs and profits by deferring corporate tax deductions for expenses associated with moving and operating offshore unless and until the corporation repatriates the offshore profits produced by those operations and pays taxes on them. Another set of new provisions would end transfer pricing abuses by immediately taxing any excess income received by foreign affiliates to which U.S. intellectual property rights have been transferred, and limiting income shifting through U.S. property transfers offshore. Other new provisions would require foreign tax credits to be calculated on a pooled basis to stop the manipulation of those tax credits to dodge U.S. taxes. Still another new bill provision would end tax gimmicks involving the use of the so-called "check-the-box" and "CFC look-through" rules for offshore entities. Finally, a new bill provision would close the short-term loan loophole used by some corporations to avoid paying taxes on offshore income that is effectively repatriated.

Let me now go through each of the bill sections to explain the tax abuses they address and how they would work.

Title I — Deterring the Use of Tax Havens for Tax Evasion

The first title of the bill concentrates on combating tax havens and their financial institutions around the world that assist U.S. taxpayers in hiding their assets, avoiding U.S. tax enforcement efforts, and dodging U.S. taxes. It focuses on strengthening tools to stop tax haven jurisdictions and tax haven banks from facilitating U.S. tax evasion, to expose hidden offshore assets, and to eliminate incentives for U.S. persons to send funds offshore.

Section 101 - Special Measures Where U.S. Tax Enforcement Is Impeded

The first section of the bill, Section 101, which is carried over from the last Congress and which passed the Senate in 2012 as part of another bill but did not make it through conference, would allow the Treasury Secretary to apply an array of sanctions against any foreign jurisdiction or foreign financial institution that the Secretary determined was significantly impeding U.S. tax enforcement.

We have all seen the press reports about tax haven banks that have deliberately helped U.S. clients evade U.S. taxes. In 2008, UBS, Switzerland's largest bank, admitted doing just that, paid a $780 million fine, and promised to stop opening accounts for U.S. persons without reporting them to the IRS. Earlier this year, Switzerland's oldest bank, Wegelin & Co., pleaded

guilty to conspiring with U.S. taxpayers to hide more than $1.2 billion in secret Swiss bank accounts and closed its doors. These are just a few examples of how some foreign banks knowingly impede U.S. tax enforcement efforts, and why the United States needs to be better armed with the tools needed to deal with them.

This bill section also has added significance now that Congress has enacted the Foreign Account Tax Compliance Act or FATCA requiring foreign financial institutions with U.S. investments to disclose all accounts opened by U.S. persons or pay a hefty withholding tax on all of the U.S. investment income they receive. FATCA has begun to go into effect, but some foreign financial institutions are saying that they will refuse to adopt FATCA's approach and will instead stop holding any U.S. investments. While that is their right, the question being raised by some foreign banks planning to comply with FATCA is what happens to the non-FATCA institutions that take on U.S. clients and don't report the accounts to the United States. Right now, the U.S. government has limited ways to take effective action against foreign financial institutions that open secret accounts for U.S. tax evaders. Section 101 of our bill would change that by providing a powerful new tool to deter and stop non-FATCA-compliant institutions from facilitating U.S. tax evasion.

Section 101 is designed to build upon existing Treasury authority to take action against foreign financial institutions that engage in money laundering by extending that same authority to the tax area. 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 – all the way 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 narrowly against a single problem financial institution, such as a bank in Syria, 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 against foreign jurisdictions or financial institutions found by Treasury to be "significantly impeding U.S. tax enforcement." Treasury could, for example, require U.S. financial institutions that have correspondent accounts for a designated foreign bank to produce information on all transactions by that foreign bank executed through a U.S. correspondent bank. 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. Those types of sanctions could be as effective in ending tax haven abuses as they have been in curbing money laundering.

In addition to extending Treasury's ability to impose special measures against foreign jurisdictions or financial institutions impeding U.S. tax enforcement, the bill would add a new measure to the list of possible sanctions that could be applied: it would allow Treasury to instruct U.S. financial institutions not to authorize or accept credit or debit card transactions involving a designated foreign jurisdiction or financial institution. Denying tax haven banks the ability to issue credit or debit cards for use in the United States, for example, offers an effective new way to stop U.S. tax avoiders from obtaining access to funds hidden offshore.

This provision is estimated by the Joint Committee on Taxation to raise $880 million over ten years. It was passed by the Senate last year as an amendment to help pay for the transportation bill, but, ultimately, did not make it into law. This non-controversial, completely discretionary power aimed at foreign facilitators of U.S. tax evasion should be enacted into law without further delay.

Section 102 – Strengthening FATCA

Section 102 of the bill is a new section that seeks to clarify, build upon, and strengthen the Foreign Account Tax Compliance Act, or FATCA, to flush out hidden foreign accounts and assets used by U.S. taxpayers to evade paying U.S. taxes. The law is currently designed to become effective in stages, beginning in 2013, and will eventually require disclosure of accounts held by U.S. persons at foreign banks, broker-dealers, investment advisers, hedge funds, private equity funds and other financial firms.

Some foreign financial institutions are likely to choose to forego maintaining accounts for U.S. persons rather than comply with FATCA's disclosure rules. If some foreign financial institutions decide not to participate in the FATCA system, that's their business. But if U.S. taxpayers start using those same foreign financial institutions to hide assets and evade U.S. taxes to the tune of $100 billion per year, that's our business. The United States has a right to enforce our tax laws and to expect that financial institutions will not assist U.S. tax cheats.

Section 101 of the bill would provide U.S. authorities with the means to take direct action against foreign financial institutions that decide to operate outside of the FATCA system and allow U.S. clients to open hidden accounts. If the U.S. Treasury determines that such a foreign financial institution is significantly impeding U.S. tax enforcement, Section 101 would give U.S. authorities a menu of special measures that could be taken in response, including prohibiting U.S. banks from doing business with that institution.

Section 102, in contrast, does not seek to take action against a non-FATCA institution, but instead seeks to strengthen U.S. tax enforcement tools with respect to U.S. persons opening accounts at those institutions. Section 102 would also help clarify when foreign financial institutions are obligated to disclose certain accounts to the United States under FATCA.

Background. In 2006, the Permanent Subcommittee on Investigations released a report with six case histories detailing how U.S. taxpayers were using offshore tax havens to avoid payment of the taxes they owed. 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 and even providing clients with a how-to manual for going offshore. They also examined 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 a 13-year offshore network of 58 offshore trusts and corporations built by American brothers 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 Wylys, the brothers and their representatives communicated Wyly directives to a so-called trust protector who then relayed the directives to the offshore trustees and corporate officers. In the 13 years examined by the Subcommittee, the offshore trustees and corporate officers never once rejected a Wyly request and never once initiated an action without Wyly approval. They simply did what they were told, and directed the so-called independent offshore trusts and corporations to do what the Wylys wanted. 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 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.

Rebuttable Evidentiary Presumptions. The reality behind these offshore practices makes a mockery of U.S. laws that normally view trusts and corporations as independent actors. They invite tax avoidance and tax evasion. To combat these abusive offshore practices, Section 102(g) of the bill would implement a bipartisan recommendation in the Levin-Coleman 2006 report by establishing several rebuttable evidentiary presumptions that would presume a U.S. taxpayer controls offshore entities that they create, finance, or from which they benefit, unless the U.S. taxpayer presents clear and convincing evidence to the contrary.

The presumptions would apply only in civil judicial or administrative tax or securities enforcement proceedings examining offshore entities or transactions. They would place the burden of producing evidence from offshore jurisdiction on the taxpayer who chose to open an offshore account at a non-FATCA compliant financial institution and who has access to the information, rather than placing the burden on the federal government that has little practical ability to get the information.

Section 102(g)(1) would establish three evidentiary presumptions in civil tax enforcement efforts. First is a presumption that a U.S. taxpayer who "formed, transferred assets to, was a beneficiary of, had a beneficial interest in, or received money or property or the use thereof" from an offshore entity, such as a trust or corporation, controls that entity. Second is 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. Third is 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.

Section 102(g)(2) would establish two evidentiary presumptions applicable to civil proceedings to enforce U.S. securities laws. The first would specify that if a director, officer, or major shareholder of a U.S. publicly-traded corporation creates, finances, or benefits from an offshore entity, that U.S. corporation would be presumed to control that offshore entity. The second presumption would provide that securities nominally owned by an offshore entity are presumed to be beneficially owned by any U.S. person who controlled that offshore entity.

All of these presumptions are rebuttable, which means that the U.S. person who is the subject of the presumptions 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 appear in the U.S. proceeding in a manner that would permit cross examination.

The bill also includes several limitations on the presumptions to ensure their operation is fair and reasonable. First, criminal cases would not be affected by this bill, which would apply only to civil proceedings. Second, the presumptions would come into play only if the IRS or SEC were to challenge a matter in an enforcement proceeding. Third, 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 SEC to issue regulations or guidance identifying such classes of transactions to which the presumptions would not apply.

An even more fundamental limitation on the presumptions is that they would apply only to U.S. persons who directly or through an offshore entity choose to do business with a "non-FATCA institution," meaning a foreign financial institution that has not adopted the FATCA disclosure requirements and instead takes advantage of banking, corporate, and tax secrecy laws

and practices that make it very difficult for U.S. tax authorities to detect financial accounts benefiting U.S. persons.

FATCA's disclosure requirements were designed to combat offshore secrecy and flush out hidden accounts being used by U.S. persons to evade U.S. taxes. Section 102(g) would continue the fight by allowing federal authorities to benefit from rebuttable presumptions regarding the control, ownership and assets of offshore entities that open accounts at financial institutions outside the FATCA disclosure system. 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 who creates, finances, or benefits from 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 has not been disclosed to U.S. authorities should become subject to inspection. U.S. law enforcement needs to establish those facts presumptively, without having to pierce the secrecy veil, because of the difficulty of getting access to the relevant information. At the same time, U.S. persons who chose to transact their affairs through accounts at a non-FACTA institution are given the opportunity to lift the veil of secrecy and demonstrate that the presumptions are factually incorrect. These rebuttable evidentiary presumptions would provide U.S. tax and securities law enforcement with powerful new tools to end tax haven abuses.

FATCA Disclosure Obligations. In addition to establishing presumptions, Section 102 would make several changes to clarify and strengthen FATCA's disclosure obligations.

Section 102(b) would amend 26 U.S.C. Section 1471 to make it clear that the types of financial accounts that must be disclosed by foreign financial institutions under FATCA include not just savings, money market or securities accounts, but also transaction accounts, such as checking accounts, that some banks might claim are not depository accounts. This section would also make it clear that financial institutions may not omit from their disclosures client assets in the form of derivatives, including swap agreements.

Section 102(c) would amend 26 U.S.C. 1472 to clarify when a withholding agent "knows or has reason to know" that an account is directly or indirectly owned by a U.S. person and must be disclosed to the United States. The bill provision would make it clear that the withholding agent would have to take into account information obtained as the result of "any customer identification, anti-money laundering, anti-corruption, or similar obligation to identify accountholders." In other words, if a foreign bank knows, as a result of due diligence inquiries made under its anti-money laundering program, that a non-U.S. corporation was beneficially owned by a U.S. person, the foreign bank would have to report that account to the IRS – it could not treat the offshore corporation as a non-U.S. customer. That approach is already implied in the existing statutory language and is part of the regulations that have been issued to implement FATCA, but this amendment would make it crystal clear.

Section 102(c) would also amend the law to make it clear that the Treasury Secretary, when exercising authority under FATCA to waive disclosure or withholding requirements for non-financial foreign entities, can waive those requirements only for a class of entities that the Secretary identifies as "posing a low risk of tax evasion." A variety of foreign financial

institutions have pressed Treasury to issue waivers under Section 1472, and this amendment would make it clear that such waivers are possible only when the risk of tax evasion is minimal.

Section 102(d) would amend 26 U.S. C. 1473 to clarify that the definition of "substantial United States owner" includes U.S. persons who are beneficial owners of corporations or the beneficial owner of an entity that is one of the partners in a partnership. While the current statutory language already implies that beneficial owners are included, this amendment would leave no doubt.

Section 102(e) would amend 26 U.S.C. 1474 to make two exceptions to the statutory provision which makes account information disclosed to the IRS by foreign financial institutions under FATCA confidential tax return information. The first exception would allow the IRS to disclose the account information to federal law enforcement agencies, including the SEC and bank regulators, investigating possible violations of U.S. law. The second would allow the IRS to disclose the name of any foreign financial institution whose disclosure agreement under FATCA was terminated, either by the institution, its government, or the IRS. Financial institutions should not be able to portray themselves as FATCA institutions if, in fact, they are not.

Section 102(f) would amend 26 U.S.C. 6038D, which creates a new tax return disclosure obligation for U.S. taxpayers with interests in "specified foreign financial assets," to clarify that the disclosure requirement applies not only to persons who have a direct or nominal ownership interest in those foreign financial assets, but also to persons who have a beneficial ownership interest in them. While the existing statutory language implies this broad reporting obligation, the amendment would make it clear.

Finally, Section 102(a) would amend a new annual tax return obligation established in 26 U.S.C. 1298(f) for passive foreign investment companies (PFICs). PFICs are typically used as holding companies for foreign assets held by U.S. persons, and the intent of the new Section 1298(f) is to require all PFICs to begin filing annual informational tax returns with the IRS. The current statutory language, however, limits the disclosure obligation to any U.S. person who is a "shareholder" in a PFIC, and does not cover PFICs whose shares may be nominally held by an offshore corporation or trust, but beneficially owned by a U.S. person. The bill provision would broaden the PFIC reporting requirement to apply to any U.S. person who "directly or indirectly, forms, transfers assets to, is a beneficiary of, has a beneficial interest in, or receives money or property or the use thereof" from a PFIC. That broader formulation of who should file the new PFIC annual tax return would ensure that virtually all PFICs formed by, financed by, or benefiting U.S. persons are required to file informational returns with the IRS.

Section 103 – Corporations Managed and Controlled in the United States

Section 103 of the bill focuses on corporations which claim foreign status – often in a tax haven jurisdiction – in order to avoid payment of U.S. taxes, but then operate right here in the United States in direct competition with domestic corporations that are paying their fair share.

This offshore game is all too common. In 2008, the Senate Finance Committee held a hearing describing a trip made by GAO to the Cayman Islands to look at the infamous Ugland House, a five-story building that is the official address for over 18,800 registered companies. GAO found that about half of the alleged Ugland House tenants — around 9,000 entities — had a billing address in the United States and were not actual occupants of the building. In fact, GAO determined that none of the companies registered at the Ugland House had office space or actual employees there. GAO found that the only true occupant of the building was a Cayman law firm, Maples and Calder.

Here's what the GAO wrote:

> "Very few Ugland 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 Ugland 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 designed to address the Ugland 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. This set up allows 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 managers live and work in the United States play this game to escape taxes and avoid regulation. In an October 2008 Subcommittee hearing, three sizeable hedge funds, Highbridge Capital which is associated with JPMorgan Chase, Angelo Gordon, and Maverick Capital, acknowledged that, although all claimed to be Cayman Island corporations, 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.

According to a Wall Street Journal article, over 20 percent of the corporations that made initial public offerings or IPOs in the United States in 2010, were incorporated in Bermuda or the Cayman Islands, but also described themselves to investors as based in another country, such as the United States. The article also described how Samsonite, a Denver-based company, reincorporated in Luxembourg before going public. Too many of these tax-haven incorporations appear to have no purpose other than having the advantage of operating in the United States while avoiding U.S. taxation and undercutting U.S. competitors who pay their taxes.

Still another illustration of the problem came to light earlier this year, in a Subcommittee hearing which disclosed that Apple, a prominent U.S. corporation, had established three wholly-

owned subsidiaries in Ireland that claimed the bulk of Apple's foreign sales income, while also claiming not to be tax resident in any country. All three of Apple's Irish subsidiaries were run by personnel located primarily in the United States. Under Irish law, because the management of the corporations was not in Ireland, they were not considered tax residents of Ireland. Under U.S. law, because the corporations were formed in Ireland, they were not considered tax residents of the United States. They were neither here nor there, and paid no corporate income taxes anywhere.

Section 103 would put an end to such corporate fictions and unjustified tax avoidance by profitable multinational corporations through offshore loopholes. It provides 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, then 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 would 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 that looks to the primary place of management and control to determine corporate residency.

To address, in particular, the many investment companies that incorporate in tax havens but operate with investment managers who live and work in the United States, Section 103 specifically directs Treasury to issue regulations to specify that, when 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.

The section would provide exceptions 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.

If enacted into law, Section 103 would put an end to the unfair situation where some U.S.-based companies pay U.S. taxes, while their competitors set up a shell corporation in a tax haven and are able to defer or escape taxation, despite the fact that their foreign status is nothing more than a paper fiction. This provision has been estimated by the Joint Committee on Taxation to raise $6.6 billion in tax revenues over ten years.

Section 104 - Increased Disclosure of Offshore Accounts and Entities

Offshore tax abuses thrive in secrecy. Section 104(a) attempts to overcome offshore secrecy practices by creating two new disclosure mechanisms requiring third parties to report 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 that 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 that 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 accountholder to a particular taxpayer, the U.S. person 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 acting merely as a screen to hide the identity of 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 form 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 is financial institutions that are located and do business in the United States. The second set is foreign financial institutions which are located and do business outside of the United States, but are voluntary participants in either the FATCA or 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 FATCA or QI program, and the accountholder 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 any reportable assets or income in that account to the IRS. While foreign financial institutions are already required to report such accounts under FATCA regulations, Section 104(a) would provide a clear statutory foundation for those regulatory provisions and extend them to U.S. financial institutions as well.

The second disclosure mechanism created by Section 104(a) targets U.S. financial institutions that open foreign bank accounts for U.S. clients at non-FATCA institutions, meaning foreign financial institutions that have not agreed under FATCA to disclose to the IRS the accounts they open for U.S. persons. Past Subcommittee investigations have found that some U.S. financial institutions help their U.S. clients both to form offshore entities and to open foreign bank accounts for those entities, so that their clients do not even need to leave home to set up an offshore structure. Since non-FATCA institutions, by definition, have no obligation to disclose the accounts to U.S. authorities, Section 104(a) would instead impose that disclosure obligation on the U.S. financial institution that helped set up the account for its U.S. client.

Section 104(b) would impose the same penalties for the failure to report such accounts as apply to the failure to meet other reporting obligations of withholding agents.

Section 105 – Closing the Swaps Offshore Loophole

Section 105 of the bill targets a tax loophole benefiting swap dealers and other parties that enter into swap arrangements, which I call the swaps offshore loophole.

In simple terms, a swap is a financial contract in which two parties typically bet against each other on the performance of a referenced financial instrument or on the outcome of a referenced event over a specified period of time. The bet can be about whether a commodity price or stock value will go up or down over time, whether one foreign currency or interest rate will gain or lose value compared to another during the covered period, or whether a corporate bond or sovereign country will default before a specified date. Those swaps are generally referred to as commodity, equity, interest rate, foreign currency, or credit default swaps. Sometimes swaps are used, not to place bets, but to allocate revenue streams over time. For example, in a "total return swap," one party may promise to pay the other party all financial returns produced by a referenced financial instrument during the covered period. In many swaps, one party makes a series of payments to the other during the covered period to reflect the change in value of the swap over time.

Ten years ago, few people outside of financial circles had ever heard of a swap, but we all learned a great deal about them during the financial crisis. We watched AIG teeter on the brink of bankruptcy from issuing credit default swaps whose collateral calls it could not meet, needing a $182 billion rescue with taxpayer dollars. Since then, we have seen credit default

swaps play roles in financial crises around the world from Greece to Ireland to Portugal. We have also learned that virtually all major U.S. banks engage in interest rate and foreign currency swaps, and have seen U.S. cities like Detroit incur major losses from entering into complex interest rate swaps that went sour. We have also learned that global swap markets have grown so large that, by the end of 2012, according to the Bank for International Settlements, their dollar value topped $560 trillion.

Well it turns out that there's a tax angle that promotes not only swaps dealing, but also offshore finagling. That's because U.S. tax regulations currently allow swap payments that are sent from the United States to someone offshore to be treated as non-U.S. source income that may escape U.S. taxation. Let me repeat that. Under existing IRS regulations, swap payments sent from the United States are deemed to be non-U.S. source income to the recipient for U.S. tax purposes. That is because current IRS regulations deem the "source" of the swap payment to be where the payment ends up – the exact opposite of the normal meaning of the word "source."

You can imagine the use that some hedge funds that are managed here in the United States, but are incorporated offshore and maintain post office boxes and bank accounts in tax havens, may be making of that tax loophole. They can tell their swap counterparties in the United States to send any swap payments to their offshore post box or bank account, tell Uncle Sam that those payments are legally considered non-U.S. source income, and count the swap payments the receive as foreign income not subject to U.S. tax. Hedge funds are likely far from alone in sheltering their swap income from taxation by sending it offshore. Banks, securities firms, other financial firms and a lot of commercial firms may be doing the same thing.

Our bill would shut down that offshore game simply by recognizing reality – that swap payments sent from the United States are U.S. source income subject to taxation.

Title II — Other Measures to Combat Tax Haven Abuses

The second title of the bill concentrates on strengthening key domestic measures used to combat offshore tax abuse. Its provisions focus on strengthening corporate offshore disclosure requirements and nondisclosure penalties, anti-money laundering safeguards used to screen incoming offshore funds, procedures to authorize John Doe summonses used to uncover the identities of tax dodgers, and Foreign Bank Account Reports used to identify assets held offshore.

Section 201 - Country-By-Country Reporting

Section 201 of the bill would tackle the problem of offshore secrecy that currently surrounds most multinational corporations by requiring them to provide basic information on a country-by-country basis to the investing public and government authorities.

Many multinationals today are complex businesses with sprawling operations that cross multiple international boundaries. In many cases, no one outside of the corporations themselves knows much about what a particular corporation is doing on a per country basis or how its

country-specific activities fit into the corporation's overall performance, planning, and operations.

The lack of country-specific information deprives investors of key data to analyze a multinational's financial health, exposure to individual countries' problems, and worldwide operations. There is also a lack of information to evaluate tax revenues on a country-specific basis to combat tax evasion, financial fraud, and corruption by government officials.

The lack of country-specific information impedes efficient tax administration and leaves tax authorities unable to effectively analyze transfer pricing arrangements, foreign tax credits, business arrangements that attempt to play one country off another to avoid taxation, and illicit tactics to move profits to tax havens.

For example, earlier this year, the Subcommittee hearing on Apple disclosed for the first time that it had three wholly owned subsidiaries in Ireland which claimed the bulk of Apple's sales income, but also claimed not to be tax resident in any country. One of those subsidiaries, Apple Operations International, had no physical presence at any address and, in thirty years of existence, no employees. It was run entirely from the United States, but claimed it was not a U.S. tax resident. Over a four year period from 2009 to 2012, it declared $30 billion in revenues, but paid no corporate income tax in the United States, Ireland, or any other jurisdiction. Apple Sales International, a second Irish subsidiary, received sales revenue over a three-year period, from 2009 to 2011, totaling $74 billion, but did not declare any of that income in the United States and apparently only a tiny fraction in Ireland. In 2011, for example, it paid no corporate income taxes at all in the United States and only $10 million in taxes in Ireland on $22 billion in income, producing an overall tax rate of five-hundreds of one percent. It is far from clear that either U.S. or Irish tax authorities were fully aware of the actions taken by Apple to avoid taxation in both countries.

Apple is far from alone. Over the last two years, other multinational corporations, including Starbucks, Amazon, Google, and others, have been excoriated for failing to pay taxes in countries where they have massive sales. Earlier this month, leaders of the G-20 countries declared aggressive multinational corporate tax avoidance through profit shifting was a global problem, and called for profits to be taxed where economic activities added value or produced profits. The G-20 leaders, including President Obama, committed their countries to engaging in automatic information sharing to stop tax evasion and to support an ongoing effort by the Organization for Cooperation and Economic Development – the OECD – to develop global tax principles aimed at ending corporate profit shifting and tax avoidance. They also endorsed an ongoing OECD effort to develop a standard template for multinational corporations to disclose their income and taxes on a per country basis.

Section 201 of our bill would help the United States carry out its G-20 commitment to combat multinational tax avoidance while also assisting U.S. investors and tax administrators to identify U.S. corporations engaged in profit shifting and tax avoidance. The bill would accomplish those objectives by requiring corporations that are registered with the Securities and Exchange Commission to provide an annual report with basic information about their operations on a country-by-country basis. Three types of information would have to be provided: the

approximate number of corporate employees per country; the total amount of pre-tax gross revenues assigned by the corporation to each country; and the total amount of tax obligations and actual tax payments made by the corporation in each jurisdiction. This information would have to be provided by the corporation in a publicly available annual report filed with the SEC.

The bill requires disclosure of basic data that multinational corporations should already have. The data would not be burdensome to collect. It's just information that is not routinely released by many multinationals. It is time to end the secrecy that now enables too many multinationals to run circles around tax administrators.

In the case of the United States, the value of country-by-country data would provide critical information in the fight against rampant corporate tax evasion. An article by Professor Kimberly Clausing estimated that, in 2008 alone, "the income shifting of multinational firms reduced U.S. government corporate tax revenue by about $90 billion," which was "approximately 30 percent of corporate tax revenues." Think about that. Profit shifting – in which multinationals use various tactics to shift income to tax havens to escape U.S. taxes – is responsible for $90 billion in unpaid taxes in a single year. Over ten years, that translates into $900 billion – nearly a trillion dollars. It is unacceptable to allow that magnitude of nonpayment of corporate taxes to continue year after year in light of the mounting deficits facing this country and the sequestration that has been imposed.

Treasury data shows that the overall share of federal taxes paid by U.S. corporations has fallen dramatically, from 32% in 1952, to about 9% last year. A 2008 report by the Government Accountability Office found that, over an eight-year period, about 1.2 million U.S. controlled corporations, or 67% of the corporate tax returns filed, paid no federal corporate income tax at all, despite total gross receipts of $2.1 trillion. A more recent study found that, over a recent three year period, 30 of the largest U.S. multinationals, with more than $160 billion in profits, paid no federal income taxes at all. A 2013 GAO report found that, contrary to the statutory corporate income tax rate of up to 35%, in 2010, overall, large profitable corporations actually paid an effective tax rate of just 12.6%. At the same time that corporations are dodging payment of U.S. taxes, corporate misconduct is continuing to drain the U.S. treasury of billions upon billions of taxpayer dollars to combat mortgage fraud, oil spills, bank bailouts, and more.

Corporate nonpayment of tax involves a host of issues, but transfer pricing and offshore tax dodging by multinationals is a big part of the problem. Section 201 of the bill would take the necessary first step to stop transfer pricing abuses by requiring clear disclosures of basic corporate data on a country-by-country basis.

Section 202 - $1 Million Penalty for Hiding Offshore Stock Holdings

Section 202 of the bill addresses a different offshore abuse. 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 Wylys 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 Wylys transferred those stock options to the network of offshore entities they had established.

The investigation found that, for years, the Wylys 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 those stock holdings on the ground that the 58 offshore trusts and corporations functioned as independent entities, even though the Wylys continued to direct the entities' investment and other activities. The public companies where the Wylys 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 Wylys, that the Wylys 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 Wylys. The investigation found that, because both the Wylys 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. In fact, in 2010, the SEC filed a civil complaint against the Wylys in connection with their hidden offshore holdings and alleged insider trading. 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 202 of the 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 203 and 204 - Anti-Money Laundering Programs

The next two sections of the bill seek to establish preventative programs to screen offshore money being sent into the United States through private investment funds.

The Subcommittee's 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. Other Subcommittee investigations provide extensive evidence of the role played by U.S. formation agents in assisting U.S. persons to set up offshore structures as well as U.S. shell companies later used in illicit activities, including tax evasion, money laundering, and other misconduct. Because hedge funds, private equity funds, and 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 who their clients are and do not transmit suspect funds into the U.S. financial system.

Currently, hedge funds and private equity funds are free to transmit substantial offshore funds into the United States without the same safeguards that apply to other financial institutions -- anti-money laundering programs that require them to know their customers, understand where substantial funds are coming from, and report suspicious activity. There is no reason why this

sector of our financial services industry should continue to serve as an unfettered gateway into the U.S. financial system for substantial funds that could be connected to tax evasion, money laundering, terrorism, drug trafficking, or other misconduct.

In 2001, after the 9-11 terrorist attack, the Patriot Act required all U.S. financial institutions to put anti-money laundering programs in place. Eleven years ago, in 2002, in compliance with the Patriot Act, the Treasury Department proposed anti-money laundering regulations for hedge funds and private equity companies, but never finalized them. In 2008, the Department withdrew them with no explanation. Section 203 of the bill would require Treasury to get back on track and issue final anti-money laundering regulations for investment advisors to hedge funds and private equity companies registered with the SEC. Treasury would be free to draw upon its 2002 proposal, and would have 180 days after enactment of the bill to propose a rule and another 270 days to finalize it and put in place the same types of safeguards that now apply to all other financial firms.

In addition, Section 204 of the bill would add formation agents to the list of persons with anti-money laundering obligations. For the first time, those engaged in the business of forming corporations, trusts, and other entities, both offshore and in the 50 States, would be responsible for knowing who their clients are and avoiding suspect funds. The bill directs Treasury to develop anti-money laundering regulations for this group in a little over a year. 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 seven years later has yet to do so. Section 204 also creates an exemption for government personnel and for attorneys who use paid formation agents when forming entities for their clients. Because paid formation agents would already be subject to anti-money laundering obligations under the bill, there would be no reason to simultaneously subject attorneys using their services to the same anti-money laundering requirements.

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 formation agents to adopt risk-based procedures that would concentrate their due diligence efforts on clients and funds that pose the highest risks of injecting suspect funds into the United States.

Section 205 - IRS John Doe Summons

Section 205 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 a John Doe summons. Section 205 would make three technical changes to make the use of a 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 that 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, the 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 obtain information about taxpayers operating in offshore secrecy jurisdictions. For example, the IRS obtained court approval to serve a John Doe summons on a Swiss bank, UBS AG, to obtain the names of thousands of U.S. clients who opened UBS accounts in Switzerland without disclosing those accounts to the IRS. That landmark effort to overcome Swiss secrecy laws led to the bank's turning over thousands of U.S. client names to the United States and to the Swiss government's announcing it would no longer use its secrecy laws to protect U.S. tax evaders. 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 has 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 that offshore secrecy jurisdiction meant that 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 a correspondent or payable-through account involving a non-FATCA institution, 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 at non-FATCA institutions raise tax compliance issues.

In addition, Section 205 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.

Section 206 - FBAR Investigations and Suspicious Activity Reports

Section 206 of the bill contains several provisions to strengthen the ability of the IRS to enforce the Foreign Bank Account Report (FBAR) requirements and clarify the right of access by IRS civil enforcement authorities to Suspicious Activity Reports.

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 has delegated to the IRS responsibility for investigating FBAR violations and assessing FBAR penalties. Because the FBAR enforcement jurisdiction derives from Title 31, however, the IRS has set up a complex process for when its personnel may use tax return information when acting in its role as FBAR enforcer. The tax disclosure law, in Section 6103(b)(4) of the tax code, permits the use of tax information only for the administration of the internal revenue laws or "related statutes." To implement this statutory requirement, the IRS currently requires its personnel 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 a repetitive determination in every FBAR case before an IRS agent can look at the potential non-filer's income tax return to determine if such filer checked the FBAR box, but it also prevents the IRS from comparing FBAR filing records to bulk data on foreign accounts received from tax treaty partners 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 the IRS has been charged with FBAR enforcement because of the FBARs' close connection to tax administration, common sense dictates that the FBAR statute should be viewed as a "related statute" for tax disclosure purposes. Section 206(a) of the bill would make that clear by adding a provision to Section 6103(b) of the tax code deeming FBAR-related statutes to be "related statutes," thereby allowing IRS personnel to make routine use of tax return information when working on FBAR matters.

The second change that would be made by Section 206 is an amendment to simplify the calculation of FBAR penalties. Currently the penalty is determined in part by the balance in the foreign bank account at the time of the "violation." The violation has been 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, Section 206(b) of the bill would instead calculate the penalty using the highest balance in the account during the covered reporting period.

The third part of Section 206 relates to Suspicious Activity Reports or SARs, which financial institutions are required to file with the Financial Crimes Enforcement Center (FinCEN) of the Treasury Department when they encounter suspicious transactions. FinCEN is required to share this information with law enforcement, but currently does not permit IRS civil investigators access to the information, even though IRS civil investigators are federal law enforcement officials. Sharing SAR information with civil IRS investigators would likely prove very useful in tax investigations and would not increase the risk of disclosure of SAR

information, because IRS civil personnel operate under the same tough confidentiality rules as IRS 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. Section 206(c) of the bill would end that inefficient and costly practice by making it clear that "law enforcement" includes civil tax law enforcement.

Title III -- Ending Corporate Offshore Tax Avoidance

The first two titles of the bill focus primarily on strengthening tools needed to identify, stop, and punish offshore tax evasion, concentrating on activities that, for the most part, are already illegal. Another problem, however, are actions taken by multinational corporations to exploit loopholes in our tax code. Title III of the bill seeks to close loopholes that contribute to offshore tax abuse and create incentives for U.S. corporations to send jobs and operations offshore. Most of these provisions are modeled after recommendations made by the President in his budget proposals.

Earlier this month, the G-20 leaders endorsed efforts to prevent tax avoidance and tax evasion through offshore structures. They stated that "international tax rules, which date back to the 1920's, have not kept pace with the changing business environment, including the growing importance of intangibles and the digital economy." They agreed that base erosion and profit shifting (BEPS) deprives countries across the world of the funds needed to finance their governments, and results in an unfair burden on the citizens who must make up the lost revenues through increased taxes. The G-20 leaders issued a declaration that "we must move forward in fighting BEPS practices so that we ensure a fair contribution of all productive sectors to the financing of public spending in our countries."

The provisions we are offering today would help do just that.

Section 301 – Allocation of Expenses and Taxes on the Basis of Repatriation of Foreign Income

Section 301 addresses two key loopholes in the taxation of multinational corporations. First, it would stop corporations from taking current deductions for expenses arising from moving assets and operations abroad while being able to still defer paying U.S. income taxes on the income generated from those assets and operations.

Offshore Expenses. Under current law, a multinational corporation can lower its U.S. taxes by taking deductions for offshore expenses currently, while deferring paying taxes on its related income. For example, if a U.S.-based company borrows money in the United States to build a factory offshore, then it can deduct currently the interest expense it pays on the loan from its U.S. taxes. It can also deduct currently the expenses of moving materials to the offshore factory and for operating the offshore factory on an ongoing basis. But the company doesn't have to pay U.S. taxes on any of the income arising from its offshore factory operations until it chooses to return that income to the United States. The end result is that the multinational corporation currently deducts the offshore expenses from its taxable income, while deferring taxes on the offshore income related to those expenses. That deduction-income mismatch creates a tax incentive for corporations to move their operations, jobs, and profits offshore.

Section 301 of the bill would eliminate that offshore incentive by allowing multinationals to claim deductions only for the expenses of producing foreign income when they have repatriated the income back to the U.S. parent corporation and paid taxes on it. For corporations that choose to immediately repatriate, and thus pay taxes on, their foreign earnings, the bill would present no change from current tax policy. But for multinational corporations that park their overseas earnings outside the United States, and defer paying any taxes on those earnings, the bill would no longer allow them to claim U.S. tax deductions for expenses associated with those same overseas operations, again, unless and until they return the profits to the United States and pay taxes on them.

It simply does not make sense for American taxpayers to subsidize the offshoring of American jobs and operations — but that is exactly what the current tax code is doing. The bill being introduced today would stop that unjustified tax subsidy.

This provision has been proposed in various forms in the President's budget proposals, and is estimated by the Joint Committee on Taxation to raise $60 billion over ten years.

Foreign Tax Credits. The second loophole addressed by Section 301 would fix a complex mathematical game played by multinational corporations with how they calculate their foreign tax credits. Our proposal, which the President has included in his budget proposals, would close the loophole that allows multinationals to use excess foreign tax credits from higher tax jurisdictions to shelter income run through lower tax jurisdictions from U.S. taxes. There is bipartisan agreement that this issue needs to be addressed.

The first part of this mathematical game is straightforward. Under current law, the tax code protects U.S. taxpayers from double taxation of foreign income by allowing them to claim a foreign tax credit for taxes paid to a foreign jurisdiction. Those foreign tax credits can be used to offset U.S. income taxes owed by the corporation.

Here is an example. Suppose ABC Corporation, a U.S. multinational corporation, has $100 in income in Higher Tax Country where it is taxed at 40 percent, and another $100 in income in Lower Tax Country where it is taxed at 0 percent. Because ABC Corp. paid $40 in taxes to Higher Tax Country, it would generate a $40 foreign tax credit which it could immediately use to lower its U.S. taxes when it repatriates the foreign income.

Now here is where it gets a bit more complex. Under current law, the corporation can use some of the foreign tax credits generated from paying taxes in one country to shield from U.S. taxes foreign income attributed to another country, including a tax haven.

Right now, if a corporation earns foreign tax credits from a higher tax jurisdiction and those tax credits exceed the amount used to offset the corporation's U.S. tax liability upon repatriation, current law allows those excess credits to be applied to offset U.S tax on income repatriated from a lower-tax jurisdiction, typically a tax haven.

Let's go back to our example, using the current maximum U.S. corporate tax rate of 35%. ABC Corp. has generated a $40 foreign tax credit from the taxes it paid to Higher Tax Country. The $40 foreign tax credit allows ABC Corp. to repatriate all $100 of its income from Higher

Tax Country free of U.S. tax. Since that income had already been taxed by Higher Tax Country, it is reasonable under the principle of avoiding double taxation that the corporation should not have to pay any further U.S. tax on that income.

But repatriating that $100 would use up only $35 of the corporation's $40 foreign tax credit, with a $5 foreign tax credit left over. Under current law, the corporation could then repatriate another $14 of offshore income from Lower Tax Country, and use its left over $5 foreign tax credit to shelter that income from U.S. taxes. But foreign tax credits are supposed to prevent double taxation of the same income, not shield foreign income from any taxation at all. By allowing that use of excess foreign tax credits, the tax code encourages multinationals to run income through tax havens.

To change that outcome, the bill would require corporations to pool their foreign tax credits. The bill would then limit the amount of tax credits that could be used, by allowing only that percent of its foreign tax credits equal to the percent of foreign income that the corporation has repatriated that year. For example, if the corporation repatriated only 10% of its foreign income, it could use only 10% of its foreign tax credits.

By aggregating the foreign tax credits of multinational corporations, the bill would remove the tax incentive for locating offshore income in low-tax jurisdictions, while leveling the global playing field for multinationals operating in multiple countries. The Joint Committee on Taxation has estimated that this provision would raise $55 billion over 10 years.

Section 302 – Excess Income from Transfers of Intangibles to Low-taxed Affiliates

Section 302 of the bill addresses the problem of corporate transfers of intangible property offshore, an area rampant with tax abuse.

Intangible property includes such valuable items as patents, trademarks, and marketing and distribution rights. Under U.S. tax law, if a multinational corporation has valuable intellectual property, it can sell that property to its wholly-owned offshore subsidiary. So long as the corporation complies with a set of complicated "transfer pricing" rules, the corporation can then treat any income generated from that intellectual property as offshore income, and defer paying U.S. taxes on it.

Current transfer pricing rules are intended to ensure that the U.S. parent receives fair compensation in return for the sale of its property rights to its offshore subsidiary, but these rules are not working.

Last year, the Subcommittee held a hearing exposing how the current system works in a case history involving Microsoft. The hearing showed how Microsoft sold key intellectual property rights to an Irish subsidiary it had established for $2.8 billion. That subsidiary then turned around and sold the rights to other Microsoft offshore subsidiaries for $9 billion, immediately shifting more than $6 billion in profits offshore, without paying any U.S. taxes.

But Microsoft did not stop there. The U.S. parent also sold the right to market its products in North and South America to another offshore subsidiary and then bought back from that same subsidiary the right to sell Microsoft products in the United States in exchange for payment of licensing fees. In 2011, its offshore licensing agreement translated into Microsoft sending 47 cents of every U.S. sales dollar to its offshore subsidiary, shifting even more U.S. source income offshore. In total, over a three-year period, Microsoft used its transfer pricing gimmick to avoid paying $4.5 billion in U.S. corporate income taxes, or $4 million in taxes per day. Think about that. Microsoft products are developed here. They are sold here, to customers here. And yet Microsoft paid no taxes here on nearly half of its U.S. sales income, because current U.S. tax law allowed Microsoft to send that money offshore and defer indefinitely paying U.S. taxes on it.

The code currently includes provisions, particularly Sections 367(d) and 482, designed to stop multinationals from improperly transferring property offshore to avoid U.S. taxes. Those provisions, and the corresponding regulations, require that transfers of property from a U.S. parent to a "controlled foreign corporation," or CFC, be conducted at an "arms-length" price. The problem, however, is that determining an arms-length price for an intellectual property transaction demands analysis of complex facts with no decisive evidence of the proper price. Every case requires expensive and time consuming analysis by the IRS as well as expensive and time consuming litigation if the IRS decides to try to overturn an abusive transaction.

Section 302 of the bill would help erect a backstop to prevent unfair valuations of intellectual property being used to send money offshore. Specifically, if evidence indicated that the transferred property's value exceeded 150% of the transfer price, and it was transferred to a tax haven, then all gross income attributed to the use of such transferred property over 150% of the costs allocated to such gross income would be treated as Subpart F income subject to U.S. taxation. In the case of Microsoft, for example, since the re-transfer of its intellectual property rights for $9 billion exceeded the original transfer price of $2.8 billion by more than 150%, it would have triggered taxation on the excess amount. While the Microsoft transactions may very well violate existing transfer pricing laws based on arms-length determinations, Section 302 would make explicit that when offshore transfers result in large profits being transferred to an offshore CFC, those excess profits are subject to immediate taxation by the United States, without mandating a complex arms-length evaluation.

Section 302 has been designed to avoid taxation of legitimate business transfers. For example, to avoid capturing income related to legitimate business operations by the foreign subsidiary using intangible property, income derived from such subsidiary's actual use in the country would be entirely excluded from any excess income calculation. Further, to avoid impacting legitimate operations that simply earn high rates of return due to a business success, the provision targets only profits that are not taxed by the foreign jurisdiction. To do so, this provision exempts income that is taxed by a foreign jurisdiction at a rate of more than 15%, with a phase out set for rates between 10% and 15%. In most cases, this exemption would limit the impact of the provision so that it would affect only subsidiaries located in tax haven jurisdictions, which, of course, are the most likely candidates for abuse.

We are not alone in targeting transfer pricing abuses involving intellectual and other intangible property. The international community has recognized the severity of these abuses

when the G-20 leaders recently called for "ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation." The leaders went on to endorse "developing transfer pricing rules or special measures for transfer of hard-to-value intangibles."

Section 302 does not change U.S. transfer pricing rules generally. Instead it simply creates a backstop to ensure that a corporation cannot avoid taxes by transferring its property to an offshore subsidiary in a tax haven, and then enjoy windfall profits far in excess of the transfer price without paying U.S. taxes. While the new transfer pricing provision would still depend upon strong enforcement by the IRS, it would put in place a new bright-line approach that would deter some of the worst offshore transfer pricing abuses now going on.

Section 302 has been estimated by the Joint Committee on Taxation to raise $21.5 billion over ten years.

Section 303 – Limitations on Income Shifting Through Intangible Property Transfers

As just noted, our current tax code makes it far too easy for U.S. multinational corporations to shift intangible property to tax havens through transfer pricing and other similar schemes. In addition, as noted earlier, tax enforcement authorities are faced with the difficulty of valuing each property involved in a questionable transfer pricing transaction.

Section 303 would address these problems by clarifying current law that the IRS is fully authorized to use certain common sense valuation methods for determining the proper valuation of intangible property transfers. Specifically, this section authorizes Treasury to promulgate rules regarding the valuation of transferred intangible property. In particular, if deemed the "most reliable means of valuation" by the Secretary, tax enforcement officials would be allowed to aggregate offshore transfers by a company for the purpose of valuation. And, under this provision, tax officials could consider realistic alternatives to the transfer in developing their valuations, if such alternatives would lead to the most reliable valuation.

By providing tax enforcement authorities with the flexibility needed to perform realistic and more accurate assessments of the value of transferred intangible property, we would improve both the accuracy of enforcement and the fairness of our tax code. The Joint Committee on Taxation has estimated that this provision would raise about $1.7 billion over ten years.

Section 304 – Repeal of "Check-the-Box" Rule for Foreign Entities and the CFC "Look-Through" Rule

Section 304 of the bill addresses another key offshore tax abuse: use of the so-called "check-the-box" and CFC "look-through" rules to avoid paying U.S. corporate income taxes on passive offshore income. Both provisions enable multinational corporations to avoid taxation of offshore passive income which, under Subpart F of the tax code, is supposed to be taxed. Both provisions discourage repatriation of offshore profits, discourage U.S. investment, and deprive the U.S. Treasury of tens of billions of dollars.

To better understand this Section, it may be helpful to examine some general tax principles and a little bit of history. The first principle is that, if a U.S. corporation earns income

from an active business activity offshore, the corporation generally owes no U.S. tax until the income is returned to the United States. This principle is known as deferral. It is meant to defer taxes on active businesses such as a U.S. parent's foreign subsidiary selling products in another country.

The deferral principle is also subject to a big exception in Subpart F of the tax code. Subpart F provides that deferral of taxes is not permitted for passive, inherently mobile income such as interest, dividend, or royalty income. The reason is that passive income can be earned anywhere – in the United States or outside of it – and, if taxes are deferred on offshore passive income, it would create an enormous incentive for U.S. corporations to send their funds offshore. To eliminate that incentive, Subpart F makes passive income immediately taxable, even when the income is offshore. Subpart F's effort to remove the incentive to send U.S. funds offshore, however, has been largely undermined by regulations, temporary statutory changes, and weak IRS enforcement, not to mention numerous tax gimmicks devised by multinational corporations.

One key problem is the 1997 so-called "check-the-box" regulation, which allows a business enterprise to declare what type of legal entity it wants to be considered for federal tax purposes by simply checking a box. This rule was issued by the IRS without any statutory direction. It was intended to stop expensive and unproductive litigation and confusion over whether to treat business entities as taxable entities or as flow-through entities whose taxes had to be paid by their owners. It was in response to many states creating new business forms in the years leading up to its adoption. Since different states used different names with slightly different characteristics, the regulation was intended to help provide relief for taxpayers who were having difficulty determining whether they should taxed at the entity level, or have the income pass through to its owners. It was almost exclusively viewed as a domestic tax law issue.

Almost as soon as it was issued, however, multinational corporations began to use the rule, not as a way of determining who should be taxed, but as a way to get around paying any taxes at all on passive offshore income under Subpart F.

A little over a year after its adoption, after it became clear that the rule would be abused to circumvent Subpart F taxation of passive income, Treasury attempted to revoke the check the box option. That effort was met with such opposition from industry groups, however, that it was abandoned. In 2006, in response to corporate pressure to provide a statutory basis for the check-the-box rule, Congress enacted Section 954(c)(6), the so-called CFC look-through rule, which excludes certain passive income transferred between related offshore entities from Subpart F taxation. That provision was so costly, however, that it was enacted for only a three-year period. After it expired in 2009, the provision was revived and has been twice extended, both times on a temporary basis. It is currently in effect, but will expire at the end of this year unless extended again.

Using the check-the-box and CFC look-through rules to avoid Subpart F taxation requires planning and multiple offshore subsidiaries, which is why it benefits large multinational corporations, giving them an advantage over their domestic competitors. One common tactic has been for a U.S. parent corporation to establish an offshore subsidiary that earns active sales

income whose taxes can be deferred indefinitely. The U.S. parent also establishes other subsidiaries in tax havens and typically drains money from the active business by requiring it to pay dividends, interest on intercompany loans, royalty income, or licensing fees to the tax haven subsidiaries. Then, instead of paying taxes on that passive income under Subpart F, the U.S. parent uses the check-the-box rule to treat its tax haven subsidiaries as "disregarded entities," making them invisible for U.S. tax purposes and leaving only the active business whose taxes can be deferred indefinitely.

The 2012 Apple hearing held by my Subcommittee provided a real life example. That hearing disclosed that Apple Inc., the U.S. parent, formed three wholly owned subsidiaries in Ireland, as well as subsidiaries in other countries that actually sold Apple products in Europe, Asia and Africa. Apple required the sales businesses to transfer most of their profits to one of the Irish subsidiaries, Apple Sales International, through licensing and other fees. In three years, those businesses sent sales revenues to Apple Sales International totaling $74 billion. Apple Sales International did not keep all of those funds; it issued dividends totaling $30 billion to another Apple Irish subsidiary, Apple Operations International. Under Subpart F, both Apple Sales International and Apple Operations International should have paid U.S. taxes on the passive income they received, but neither did. Instead, Apple Inc. used check-the-box to treat its Irish subsidiaries as disregarded entities for tax purposes and then deferred taxes on the sales income of their active business subsidiaries, even though those businesses did not actually retain most of the sales income. The end result was that check-the-box enabled Apple to circumvent Subpart F's immediate taxation of its offshore passive income.

The loss to the U.S. Treasury from these types of offshore check-the-box arrangements is enormous. Investigations conducted by my Subcommittee have found, for example, that for fiscal years 2009, 2010 and 2011, Google used check-the-box to defer taxes on over $24.2 billion in offshore passive income covered by Subpart F. Microsoft deferred $21 billion in the same period.

Section 304 would put an end to this type of tax avoidance and revitalize Subpart F by prohibiting the application of the check-the-box rule to offshore entities and by eliminating the CFC look-through rule altogether. The Joint Committee on Taxation has estimated that this provision would raise $78 billion over ten years.

Section 305– Prohibition on Offshore Loan Abuse

The final provision in the bill, Section 305, addresses another offshore abuse uncovered by my Subcommittee: the misuse of tax provisions that allow offshore funds to be repatriated tax free to the United States when provided as short term loans.

To understand this Section, it is again important to examine some general tax principles. One of those principles is that a U.S. parent corporation is supposed to be taxed on any profits sent to it by an offshore subsidiary, which is often called "repatriation." If an offshore subsidiary loans money to its U.S. parent, that is also subject to U.S. taxes. In both cases, the funds sent to the United States are to be treated as taxable dividends.

Once again, however, those simple tax principles have been subverted in practice by complex exclusions and limitations. Section 956 of the tax code is the provision that makes a loan from an offshore affiliate to a U.S. parent subject to U.S. tax. Although the law contains no exceptions or limits on the loans covered, the IRS has issued regulations that create exceptions for certain types of short term loans. The IRS regulations provide, for example, that offshore loans may be excluded from taxation if they are repaid within 30 days, as are all loans made over the course of a year if they are outstanding for less than 60 days in total. In addition, the IRS permits a controlled foreign corporation – a CFC – to loan offshore funds to a related U.S. entity to escape U.S. taxation, if the loan is initiated and concluded before the end of the CFC's calendar quarter. Those loans are not subject to the 30 day limit, and don't count against the aggregate 60 day limit for the fiscal year. The IRS has also declared that the limitations on the length of loans apply separately to each CFC of a U.S. corporation. So when aggregated, all loans for all CFCs could be outstanding for more than 60 days in total.

An investigation conducted by my Subcommittee found that U.S. multinationals have used the IRS' convoluted short term loan provisions to orchestrate a constant stream of offshore loans from their foreign subsidiaries without ever exceeding the 30 or 60 day limits or extending over the end of a CFC's quarter. Instead of ensuring that taxes are paid on offshore funds returned to the United States, Section 956 has been converted by the IRS regulations into a mechanism used to get billions of dollars back into the United States tax free.

This offshore tax scheme was illustrated in a 2012 Subcommittee hearing that showed how Hewlett-Packard has, for years, used a short term loan program to avoid paying U.S. taxes on billions of dollars in offshore income used to run its U.S. operations. Hewlett-Packard obtained the offshore cash by directing two of its controlled foreign corporations in Belgium and the Cayman Islands to provide serial, alternating loans to its U.S. operations. For a four year period, from March 2008 to September 2012, Hewlett-Packard used those intercompany loans to seamlessly provide an average of about $3.6 billion per day for use in its U.S. operations, claiming the funds were tax-free, short term loans of less than 30 days duration under Section 956.

Section 305 would put an end to this repatriation sleight of hand by eliminating the provision allowing offshore funds returned to the United States under the guise of short term loans to escape U.S. taxation. Instead, it would reaffirm the general principle that offshore funds returned to the United States are subject to U.S. taxes.

Conclusion. Offshore tax abuses eat at the fabric of society, not only by widening deficits and robbing health care, education, and other needed government services of resources, but also by undermining public trust – making law-abiding taxpayers feel like they are being taken advantage of when they pay their fair share. Tax law is complicated, and where most Americans see an inscrutable maze, too many profitable companies and wealthy individuals see an opportunity to avoid paying taxes. Our commitment to crack down on their tax-avoidance schemes must be as strong as their determination to get away with ripping off Uncle Sam and moving their tax burden onto the backs of the rest of American taxpayers.

Our nation is suffering greatly from the effects of sequestration, which were brought on by our failure to reach an agreement on a balanced mix of spending cuts and revenue increases. If we are serious about finding a solution to mindless sequestration cuts and our nation's

repeated budget battles, we must look at the offshore tax avoidance abuses that rob our Treasury of the funds needed to pay our soldiers, help the sick, research cures for diseases, educate students, and invest in our future. Putting the burden of funding our government on the backs of hardworking American families and domestic businesses, while letting a sophisticated minority of multinational corporations get away with these types of offshore gimmicks, is grossly unfair.

We can fight back against offshore tax abuses if we summon the political will. The Stop Tax Haven Abuse Act, which is the product of years of work, including hearings and reports of the Permanent Subcommittee on Investigations, offers the tools needed to close the tax haven loopholes and use the hundreds of billions of dollars which will come to our Treasury as part of a sensible balanced deficit reduction substitute for the damaging irrationality of sequestration.

I ask unanimous consent my entire statement be printed in the record and a summary of the bill be printed in the record following my remarks.

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