

Testimony of Mr. ABC - A Confidential Witness

Senate Finance Committee - July 21, 2004

Testimony of Mr. ABC:

Mr. Chairman and Members of the Committee. I want to thank you for giving me the opportunity to testify today.

I am speaking to you about my experience as an IRS “Confidential Informant” who provided original information concerning significant and ongoing tax fraud involving major Wall Street firms.

I speak from first-hand knowledge. I work for a Wall Street investment bank, and through my professional experience I am intimately aware of competitors’ fraudulent tax shelters. The schemes in some cases have been ongoing for more than a decade. A couple of the schemes involved Enron. The Wall Street fraud is complex and involves hundreds of millions, if not billion of dollars of US tax liabilities.

In a nutshell, I blew the whistle on three types of abusive tax shelters:

The first abuse concerns the fraudulent transfer of US tax liabilities to foreign entities not subject to US tax. There are various permutations to the scheme, but one essential component of this fraud is the creation of sham “domestic” partnerships to serve as fronts for foreign owners who acquire the US tax liabilities, but who have no intention of ever paying US tax.

The second abuse involves the transfer of US tax liabilities to the foreign branches of US taxpayers in order to artificially generate foreign source income and claim additional US tax credits.

The third abuse, which is generally performed in conjunction with the above two, concerns the artificial replication of tax basis solely for the purpose of creating false deductions to be sold to outside taxpayers. These duplicate deductions are then claimed by the unrelated taxpayers as an offset to their otherwise taxable income from other sources.

As a Wall Street insider I am very knowledgeable about these abuses. I can tell you from experience that about 75 percent of all of the transactions specific to my expertise ended up in abusive tax shelters. Because the IRS has moved too slowly, or not at all, the abuses are still ongoing. That has resulted in huge tax liabilities being avoided. I estimate that the US Treasury has lost at least \$400 million of tax revenues every year from these particular

schemes.

Another important consequence of this fraud is that US taxpayers who want to engage in transactions legally are being undercut by those engaging in the tax abuse. The transactions' true market value depends on compliance with applicable US tax laws. If the associated tax liability is simply ignored through sham domestic partnerships, or by the artificial generation of offsetting credits, then the market value of the transactions erodes significantly. As a result, my livelihood and the business interests of honest US taxpayers are being seriously harmed by the fraudulent practices of others.

In 1998, I decided to come forward and report a particularly abusive group of entities that I knew were engaged in this fraud. I contacted the IRS' Criminal Investigative Division, and through them was put in contact with an IRS Civil Examination agent who just happened to be auditing one of the partnerships that I was concerned about. That first contact concerned 3 particular entities, and then over the next few years I provided detailed information concerning more than a dozen other entities and related groups engaged in similar tax abuse.

From the time of that first contact until today, my efforts to correct the

abuses have resulted in a series of frustrating and often unproductive dealings with the IRS. Over the past 6 years, I have literally spent thousands of hours educating and prodding the IRS, urging them to take action. I have traveled across the country at my own expense to have face-to-face meetings with agents. I have provided the IRS with hundreds of pages of evidence, and submitted numerous writings and diagrams explaining the fraud and analyzing the abusive shelters in detail.

As I mentioned, when I first contacted the IRS they had one of the partnerships under audit. Not to fault that particular IRS audit team, but they truly did not know what they were looking at. These are sophisticated tax avoidance strategies concocted by Wall Street. As a general matter, I observe that the IRS is consistently outgunned and outmatched. From my vantage point, the IRS simply does not understand how the tax shelters work, or how the transactions and structures fit together.

When I first met with the IRS in 1998, I submitted an IRS Form 211 concerning the overall abuse. Later, I submitted detailed and separate Form 211s for each of the entities involved. Form 211 is the IRS form for confidential informants to supply information, and to apply for a reward under the IRS' whistleblower program.

Later in 1998, I provided information about 2 more entities engaged in significant partnership fraud. In 1999, I provided detailed information about 6 or 7 more entities involved in abusive basis replication schemes; and about 5 other entities involved in the fraudulent domestic partnerships. I also identified a major Wall Street bank that was involved in the foreign branch abuse. In 2000, I provided information about yet another Wall Street bank's foreign branch approach, as well as 2 other additional entities that were utilizing fraudulent domestic partnerships. In 2003, I provided information concerning 2 entities that were acting as "promoters" of various types of transaction scams. And, in 2004, I provided information to the IRS concerning 2 other entities conducting basis replication schemes.

Finally, over all of these years I provided detailed documentation and analysis of the abuses to the IRS through meetings, phone calls, emails and faxes. I hope that you now have a sense of the quantity of information and assistance that I have provided, as well as the pervasiveness and persistence of the tax shelters themselves.

Together, I estimate that the numerous fraudulent schemes on which I provided original information involved over \$10 billion of taxable income. Obviously, there are very serious US tax liabilities associated with this

income that are being avoided. The combined loss to the US Treasury is immense.

In providing all this information, my experience with the IRS has been extremely frustrating and discouraging. What I have encountered is an agency that is resistant to and suspicious of confidential informants...that is, private citizens who are trying to do the right thing by coming forward and blowing the whistle on significant tax fraud. I have also encountered an agency that is disorganized, and that is generally not equipped to deal with complex and sophisticated tax shelters in an effective fashion.

Let me give you some examples. At the same time that I was actively supplying vast quantities of quality information to the agency, the IRS Service Center that was processing my Form 211s simply rejected them out of hand in 2003. There was no valid reason to reject them. It is just that the IRS Center had no idea what was going on, but chose to act anyway - probably just to get the paper off their desk. It then took months to get the Form 211 claims reinstated.

The IRS is also resistant to outside information - even when it comes from a knowledgeable insider like myself. I have often been treated suspiciously, as if I were the "bad guy." There appears to be more of a

willingness at the IRS to believe the taxpayer perpetrating the scheme than the informant justly questioning the fraud. I have never understood this attitude because I am putting myself at great personal risk by coming forward. I stand to lose my career if my identity is discovered, since employers are uniformly hostile to employees who interact with regulators. I just do not understand why the IRS has not welcomed the help and information.

In addition, from my perspective, the IRS lacks the staff and resources to take on serious enforcement against Wall Street. Since 1998, I have provided detailed information on over 20 entities and related groups that have engaged in complex and material tax abuse through numerous tax shelters. To date, action has been taken against only a couple of the entities. I have yet to receive any reward for my efforts as a confidential informant.

In many cases, the information I provided was simply ignored. One example that I find particularly troubling involves Enron prior to its collapse in 2001. In particular, in 1999 I provided detailed information about a series of fraudulent tax shelters involving a major Wall Street firm and Enron. The shelters involved the artificial duplication of tax deductions, for the sole purpose of generating fictitious book income. Approximately half a billion

dollars of taxable income was evaded a result of Enron's fraudulent tax schemes. And, conversely, hundreds of millions of dollars of fictitious book income appeared on Enron's financial statements.

Not only did I provide drafts of a suspect Arthur Anderson "opinion letter" comforting the shelter, but I also supplied a copy of the investment bank's "pitch book" to the IRS. The pitch book specifically outlined the questionable structure and its purported "benefits" - which included the almost too-good-to-be-true effect on Enron's GAAP financial statements. So, although these were tax abuses that Enron and Wall Street were engaged in, at the end of the day the tax shelters permitted Enron to inflate its book earnings. Obviously, if IRS authorities had pursued the information back in 1999, the federal government might have seen what was happening at Enron (and Arthur Anderson) long before there was a total melt down.

Remarkably, no one at IRS inquired about the information or pursued it. The one agent that I have worked most with questioned the lack of follow-up internally with the resident Enron IRS audit team and was rebuffed for raising the issues.

Part of the problem is that the regional organization of IRS audit teams has generated regional in-fighting, so that inquiries from one region are often

treated dismissively by another region. Part of the problem also is that on-site IRS audit staff seem to have divided loyalties, since they work on a daily basis with the entities they audit (and often go to work for them after completing government service). At other times, audit staff can be very protective and rigid because they do not want to reopen audit periods that are formally “complete.” And, the lack of staffing and high turnover generally also take their toll. For example, I often had to resubmit the same information multiple times because it would get lost, and the high staff turnover meant that I repeatedly had to bring new people up to speed.

I think that the greatest problem, however, is the agency’s resistance to take seriously outside information from knowledgeable insiders. If I hadn’t persisted, all of my claims would have been rejected and my information would have been lost. Actually, the biggest loser in this is the US Treasury since Confidential Informants can help the IRS recover hundreds of millions, if not billions of dollars of lost tax revenues.

Let me end by saying that if the IRS ever wants to put an end to Wall Street tax shelter schemes, they are going to need the help of Wall Street insiders to get the information and the expertise that it will take. Right now the IRS does not have such resources or expertise - and they should welcome

the assistance from knowledgeable insiders.

Thank you Mr. Chairman and Members.