

STATEMENT OF SENATOR CARL LEVIN (D-MICH)
BEFORE
U.S. SENATE COMMITTEE ON FINANCE
ON
TAX SHELTERS: WHO'S BUYING, WHO'S SELLING,
AND WHAT'S THE GOVERNMENT DOING ABOUT IT?

October 21, 2003

Thank you inviting me here today to comment on the tax shelter promotion scandal that is corrupting too many of our U.S. tax professionals. The unethical, illegal, and, in some cases, criminal conduct involved in the peddling of abusive tax shelters needs to be exposed and stopped. We need to help honest taxpayers who are left holding the bag after tax cheats use improper tax shelters to avoid paying their fair share, and we need to help honest tax professionals who don't hawk abusive tax scams but must compete against those who do.

In some parts of the world, tax cheating is a way of life that governments do little to curb. But in this country, as taxpayers are asked to pay billions of dollars to strengthen homeland security, support our troops, care for the sick, improve our schools, rebuild Iraq, and more, the use of far-fetched and abusive schemes to avoid payment of tax needs to be exposed for what it really is -- unfair and, indeed, unpatriotic.

Last year, the Permanent Subcommittee on Investigations, of which I'm the Ranking Minority Member, opened an in-depth investigation into the development and marketing of abusive tax shelters by professional firms like accounting firms, banks, investment advisors, and law firms. I was then the Subcommittee chairman and initiated this effort in part due to our Enron investigation which, like yours, disclosed that company's use of elaborate tax dodges.

In December 2002, for example, the Subcommittee held a hearing which examined an abusive tax shelter known as Slapshot, which J.P. Morgan Chase had designed and sold to Enron for \$5 million. Enron had calculated Slapshot would produce tax benefits exceeding \$120 million. As detailed in a Subcommittee report, this tax shelter relied primarily on a sham \$1 billion loan that was arranged and financed by J.P. Morgan Chase, and concealed within a mind-boggling array of loans, stock swaps, and structured finance transactions, many of which occurred within minutes of each other. The shelter's complexity was designed in part to prevent tax authorities from finding out what really happened. We pierced the Slapshot veil only by subpoenaing hundreds of boxes of documents, reading thousands of emails, conducting numerous interviews, and spending months unraveling how that tax shelter worked.

We figured out Slapshot. But the larger issue, which we are now investigating with the support of our Subcommittee Chairman Norm Coleman, is how respected U.S. financial institutions end up hawking abusive tax shelters and enlisting the help of so many other respected U.S. professionals to make them work.

Our investigation has found, sadly, what could be called a target-rich environment – numerous respected accounting firms, investment advisors, banks, and law firms spending substantial resources, forming alliances, and developing the internal and external infrastructure necessary to aggressively design, market, and implement hundreds of complex tax shelters that U.S. taxpayers would otherwise be unable, unlikely, or unwilling to employ. And they are doing it in exchange for hundreds of millions of dollars in fees and other compensation, while denying the U.S. Treasury billions of dollars in revenues each year.

One common feature of the tax shelters we have examined during the past year is their reliance on highly skilled professionals. Many, for example, use layers of corporations, trusts, and special purpose entities that only a trained financial professional could devise and establish. Others rely on intricate financial transactions involving derivatives, warrants, and little known financial instruments that only a sophisticated investment professional could arrange. Still others utilize deceptive, multi-million-dollar loans that only our largest financial institutions could finance. And most rely on complex and novel interpretations of tax law, complete with obscure tax code references and convoluted tax opinions, that only a determined tax lawyer could construct and commit to paper.

Equally troubling is that, time and again, our investigation found that the professionals marketing highly questionable tax shelters were deliberately trading on their reputations as respected, big-name players in American business. Part of their sales pitch has been to assure potential clients that they can use complex financial transactions which those clients barely understand to eliminate their tax bills, and can rely on the firm's expertise, vast resources, and reputation to fend off IRS scrutiny and penalties. Some of the professionals peddling these tax dodges also have the audacity to claim that they are not tax shelter promoters subject to the IRS regulations requiring promoters to disclose their tax shelter activities.

Some people claim that the worst tax shelter abuses are already over, so there is no need for investigations, reforms, or stronger laws. But our investigation indicates that, while a few promoters are calling it quits, the tax shelter industry as a whole is still going strong, targeting new opportunities and market segments, hawking tax shelters like late-night cut-rate T.V. bargains, and victimizing honest taxpayers, communities, and tax professionals.

Next month, the Permanent Subcommittee on Investigations will hold the first in what we hope will be a series of hearings presenting detailed case histories demonstrating how respected U.S. tax and financial professionals develop, market, and implement abusive and highly questionable tax shelters. We plan to present an inside look at the attitudes and operations underlying these tax shelter activities, including documentary evidence illustrating the aggressive approach that some respected firms have taken in selling their tax shelters. For example, at one leading accounting firm that develops and markets tax shelters, but denies being a tax shelter promoter, a senior tax professional circulated to his team of professionals an internal email which states the following:

“I want to personally thank everyone for their efforts during the approval process of this strategy. It was completed very quickly and everyone demonstrated true teamwork. Thank you! Now let[‘]s SELL, SELL, SELL!!”

Our Subcommittee’s year-long investigation compliments the important work being done by the Finance Committee today. Our investigation also confirms that the tax shelter legislation already developed by this Committee is desperately needed. The Senate has twice followed this Committee’s leadership in approving tax shelter reforms which, among other measures, would strengthen the economic substance doctrine, tighten tax shelter prohibitions, and increase penalties on abusive tax shelter promoters. This Senate legislation has not yet been adopted by the House, but, hopefully, this hearing and our investigation will provide additional specific evidence and momentum for its enactment.

In addition, I am introducing today, with the cosponsorship of Senator Baucus and Senator McCain, a bill to end the conflicts of interest that now arise when an accounting firm sells an abusive tax shelter to an audit client and then audits that client’s financial statements -- in effect auditing its own work. The Auditor Independence and Tax Shelters Act would bar an accounting firm from auditing the books of any publicly traded company to which it has sold a tax shelter. The bill would also codify four auditor independence principles to guide publicly traded companies on how to avoid other auditor conflicts of interest. I ask unanimous consent to include in the hearing record a summary of our bill and a letter from five public interest organizations endorsing it. Your hearing will help show why this legislation is needed, and I hope additional Members of this Committee will join me, Senator McCain, and Senator Baucus in supporting it.

Thank you again for this opportunity.