OPENING STATEMENT

SENATOR NORM COLEMAN
RANKING MEMBER
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING
"Dividend Tax Abuse: How Offshore Entities Dodge Taxes On U.S. Stock Dividends"
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AS PREPARED
Thank you all for attending today's hearing. I want to begin by thanking Chairman Levin for initiating this investigation, and I want to commend his long-standing commitment to identifying institutions and individuals who facilitate the inappropriate avoidance of legitimate taxes through complex offshore schemes.

Today, we turn our attention to the findings of another bipartisan inquiry, which the Chairman just described: That some U.S. financial institutions have been structuring equity swap and loan transactions to assist their offshore clients in avoiding U.S. taxes on stock dividends. The factual findings at issue today and identified in this Subcommittee's bipartisan Staff Report are compelling. They raise valid concerns that demonstrate the need to reevaluate the wisdom and effectiveness of tax laws and policies respecting the treatment of specific equity swap and loan transactions.

For a foreign investor, there is a significant difference in the U.S. withholding tax consequences between investing synthetically through an equity swap versus investing directly in physical, U.S. equities. This difference in treatment has led to certain abuses. While the activities may not rise to the level of criminal tax evasion, there is no doubt that some institutions have taken advantage of ambiguities in U.S. tax law and pushed the tax-avoidance envelope too aggressively.

I want to be clear: our target here today is neither derivatives generally nor equity swaps specifically. Derivatives serve many purposes critical to the health and dynamism of American markets, as well as the U.S. economy writ large. Swaps, in particular, often offer superior leverage, accounting treatment, market access, and transactional efficiency, all of which – *including* the preferential tax treatment afforded to swaps under current law – are *legitimate* factors that may influence the decision to trade in swap form.

That said, a swaps transaction with no business purpose *other than* the avoidance of withhold tax is a bridge too far. For the most part, I'm talking about a subset of aggressively-structured dividend enhancement trades that are short-lived; clustered around dividend record dates; involve so-called "crossing in" just prior to the dividend date; and feature the reacquisition of the physical shares after completion of the synthetic transaction.

During the course of our bipartisan investigation, we have seen these aggressive schemes executed far too often, and, frankly, some of the more egregious fact patterns that we have examined reflect a shameless and cynical abuse of U.S. tax policy.

While there is no doubt that certain financial institutions and hedge funds have crossed the line, the conditions for these abuses were largely created by Treasury and the IRS. The reality is that the state of the tax law here is muddled; the Treasury and the IRS have known about these ambiguities and have done woefully little to clarify the situation, failing to offer taxpayers clear guidance and direction. Therefore, while some financial institutions undoubtedly raced to the bottom, Treasury and the IRS bear some responsibility as well.

We're not in the blame business, however – we're in the problem-solving business. So, the question is: how do we fix this problem?

In light of the Subcommittee's findings, we need a comprehensive and in-depth analysis of the potential legislative or regulatory responses to these abuses. The relevant executive branch agencies, the Congressional committees of jurisdiction, and experts on tax law and policy should engage in a deliberative process to evaluate the various possible responses and determine the most appropriate path.

I strongly urge, however, that any response to these abuses be clearly defined and carefully targeted to preserve the integrity and efficiency of our capital markets and avoid unintended consequences. In particular, any response should avoid negatively impacting foreign investment in the United States. Such investments are critical to job growth and opportunity expansion and are undeniably necessary for the economic well-being of our citizens.

Which brings me to perhaps the most important issue: As I have said many times before – most recently in the Subcommittee's hearings on tax-cheats and tax-shelters – inappropriate tax avoidance by a privileged few forces millions of honest American taxpayers to shoulder a disproportionate share of the tax base, to dig deeper to maintain investment in crucial areas like healthcare, homeland security, and education. That tax loss sits like a millstone around the neck of honest American taxpayers, who are struggling with high taxes, ever-increasing gas prices, and rising healthcare costs. Those honest taxpayers are the real victims here.