



U.S. SENATE COMMITTEE ON

# Finance

SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

<http://finance.senate.gov>

For Immediate Release

Friday, August 15, 2008

Grassley says taxpayers should not be left to pay SEC penalties aimed at financial institutions

WASHINGTON — Senator Chuck Grassley today said the Securities and Exchange Commission needs to protect taxpayers by considering increasing any payments it may require of financial institutions for misleading investors about the safety and liquidity of auction-rate securities. Reports indicate the SEC is currently investigating such activity.

Grassley said “if these financial institutions are allowed to deduct these payments from their taxable income, that would amount to a tax windfall for these financial institutions that is paid for by U.S. taxpayers.”

The issue of the tax deductibility of certain payments by financial institutions arose in 2003 in connection with a \$1.4 billion global settlement between the SEC and 10 financial institutions over allegations that the institutions misled investors regarding certain corporations to attract business from corporations underwriting these corporations’ securities.

That year, Grassley and Senators Max Baucus and John McCain introduced the Government Settlement Transparency Act, which would have made clear that payments made to acknowledge actual or potential violations of any law would not be tax-deductible. The legislation was never passed by Congress.

Grassley said that until such a common sense proposal becomes law, “the SEC needs to do what it can to make sure that the after-tax amount of the payment reflects the amount that the SEC actually intends to be paid by the financial institution.”

The text of the letter Grassley sent today to the SEC Chairman follows here, along with news releases, letters and statements issued by Grassley, Baucus and McCain in 2003.

August 15, 2008

The Honorable Christopher Cox  
Chairman  
U.S. Securities and Exchange Commission  
100 F Street, NW  
Washington, DC 20549

Dear Chairman Cox:

I understand that the Securities and Exchange Commission (SEC) is investigating whether Citigroup and other financial institutions misled investors regarding the safety and liquidity of auction-rate securities. If the SEC determines that monies should be paid by Citigroup or other financial institutions as a result of these allegations, the SEC should consider the potential tax deductibility of these payments by Citigroup or other financial institutions when determining the appropriate amount of such payments.

For example, if the SEC decides that Citigroup should pay \$600 million in connection with Citigroup's representations regarding auction-rate securities, Citigroup may be allowed to deduct this \$600 million payment from its taxable income, resulting in a tax benefit to Citigroup of \$210 million, which is equal to the \$600 million payment multiplied by the corporate tax rate of 35 percent. To prevent Citigroup from receiving this potential tax windfall at the expense of American taxpayers, the SEC should consider "grossing-up" the payment by Citigroup to an amount of \$923 million. This way, Citigroup may be able to deduct the \$923 million payment at the 35 percent corporate tax rate, which is worth \$323 million in tax benefits to Citigroup, resulting in an after-tax payment of \$600 million (the \$923 million net payment minus the \$323 million in tax benefits received by Citigroup). Therefore, the after-tax amount of \$600 million would actually be paid by Citigroup, rather than a large portion of this amount being paid by American taxpayers.

As you know, the issue of the tax deductibility of certain payments by financial institutions arose in 2003 in connection with a \$1.4 billion global settlement between the SEC and ten financial institutions regarding allegations that these institutions misled investors to attract business from corporations to underwrite these corporations' securities. Yet again, Citigroup was involved, with Citigroup's Salomon Smith Barney owing the largest payment of \$400 million.

On April 29, 2003, Chairman Baucus, myself, and Senator McCain introduced the Government Settlement Transparency Act of 2003 regarding any settlement with any level of government, state or federal, of a violation or potential violation of the law involving penalty payments. Generally, the bill made clear that payments made to acknowledge actual or potential violations of any law would not be tax-deductible. The bill, if enacted, would have denied a deduction for any such payment, including those where there is no admission of guilt or liability and those made to avoid further investigation or litigation. Payments for real restitution to people that were harmed would have remained tax-deductible.

This common-sense revenue-raising legislation has not been enacted into law, due in part to opposition from financial institutions including Citigroup. As my colleagues on the other side of the aisle continue to insist on paying for tax relief such as the active-financing exception provision in the tax-extenders legislation by enacting other revenue-raising proposals, I will continue to attempt to enact such common-sense revenue-raising proposals as this one, which prohibits financial institutions from shifting the burden of its obligations to the American taxpayer. Until such a proposal becomes law, please consider grossing-up any payment amount

by any financial institution in connection with auction-rate securities so that the after-tax amount of the payment reflects the amount that the SEC actually intends to be paid by the financial institution.

Sincerely,

Chuck Grassley  
United States Senator  
Ranking Member of the Committee on Finance

CC: Vikram S. Pandit  
Chief Executive Officer  
Citigroup Inc.

Robert Wolf  
Chairman and Chief Executive Officer, Americas  
UBS AG

Robert E. Rubin  
Chairman of the Executive Committee  
Citigroup Inc.

Jeffrey Levey  
Vice President, Global Government Affairs  
Citigroup Inc.

#### MEMORANDUM

To: Reporters and Editors  
Re: Global settlement  
Da: Thursday, April 24, 2003

Sen. Chuck Grassley, chairman of the Committee on Finance, made the following comment on reports that the Securities and Exchange Commission might recommend that the 10 Wall Street firms in a \$1.4 billion conflict-of-interest settlement be barred from deducting the cost from taxes or seeking insurance reimbursement.

“I welcome this apparent acknowledgement of the SEC’s responsibility in this area. I hope any SEC language on deductibility and insurance coverage will be as strong as possible under the agency’s authority, and that it’ll reflect consultation with the Internal Revenue Service, which enforces tax deductibility laws. I’ll reserve judgment on whether this action will be adequate until I see the language. My interest is in making sure that the firms are paying their fair share and not shifting any of their burden to the taxpayers or insurers.”

## MEMORANDUM

To: Reporters and Editors  
Re: SEC "global settlement" case  
Da: Monday, April 21, 2003

Sen. Chuck Grassley, chairman of the Committee on Finance, along with key colleagues, has been corresponding with the Securities and Exchange Commission (SEC) over the \$1.4 billion global settlement the SEC has reached in principle with Wall Street's largest firms over allegations of conflicted stock research. Grassley's concerns are twofold: whether the SEC is taking into account that the firms might be able to deduct part of the settlement's cost from their taxes, at the cost of other taxpayers, or have insurers pick up the tab; and whether the SEC will disclose the terms of the settlement to the public before voting to approve the settlement. Grassley's staff learned today that the SEC has no plans to release the settlement details to senators or the public prior to the vote, which could come as early as this week. Grassley made the following comment on that development.

"I'm worried that the SEC is deciding to operate in the shadows instead of the sunlight. The SEC appears set to ignore the bipartisan request for full disclosure of the \$1.4 billion agreement with Wall Street prior to the SEC vote. If it's a good deal for taxpayers and investors, then it should be able to withstand public scrutiny prior to the vote. We should all know the tax and insurance consequences of this proposal. Operating in the dark only heightens my concerns that Wall Street may be getting just a slap on the wrist."

The original letter Grassley co-wrote to the SEC follows.

February 28, 2003

The Honorable William H. Donaldson  
Chairman  
Securities and Exchange Commission  
450 5<sup>th</sup> St. NW  
Washington, D.C. 20549

Dear Chairman Donaldson:

We are writing to you regarding the Securities and Exchange Commission's (SEC) review and approval of the settlement of lawsuits against certain Wall Street firms. These settlements resolve claims of stock research abuses.

We are very concerned about press reports that these settlements are being structured to maximize the amount of the payments that are tax deductible, thereby leaving the American taxpayer to pick up much of the tab. In addition, we question the wisdom of settlements that have been carefully structured to allow investment bankers and Wall Street firms to pass the bill on to their insurers.

This is unacceptable. Congress has pressed hard for real change at the SEC and in the boardroom. We are not interested in settlements that look good in the newspaper headlines but fail to bring real accountability. It is disingenuous to hold press conferences highlighting settlements which fail to mention that a significant portion of the payments may be deductible and are covered by insurance.

It is particularly galling that as American families sit at the kitchen table filling out their tax return and pay their fair share to the U.S. Treasury, SEC spokeswoman Christi Harlan stated in response to concerns about the tax treatment of the settlements with Wall Street: "The SEC enforcement staff looks at violations of securities law; we don't take other factors into consideration."

The SEC may not take into consideration the tax treatment of settlement payments or who ultimately makes such payments. Let us assure you, though, that we are concerned and we expect the SEC to reconsider its apparent apathy about the tax treatment of settlements and who is liable for making such payments. Accordingly, we request that as part of the SEC's consideration of these settlements that all Commissioners are provided a general analysis of the tax treatment of these settlements – specifically, what portion will be deductible and what deductibility will mean generally for the firm in regards to tax savings as well as in terms of potential loss of revenue to the Treasury. In addition, we request that the Commissioners be advised as to what portion of the settlements will be payable by the settling firms' insurers and what such payments will mean for each settling firm.

That said, we recognize that payments of restitution are deductible and believe the tax code should not penalize efforts of direct restitution. However, we are concerned that payments may be presented as restitution for tax and other purposes but will not translate into real relief for those harmed.

For the SEC to be oblivious to the tax treatment and the ultimate payor of a settlement is to have the SEC working contrary to other functions and goals of the U.S. government. In addition, the SEC and states' attorneys general are naive if they do not believe that the tax treatment is of great importance to the Wall Street firms. As the Finance Committee continues its review of the tax treatment of fines and penalties it is with an eye toward the reality that lawyers with sharp pencils can always try to find a loophole. It is essential therefore that the SEC and states' attorneys general not act as an indifferent or unwitting partner in firms attempts to minimize their settlement costs through the tax code. While the SEC has its own resources, if you have any questions about possible tax treatment of a settlement, we encourage you to seek guidance from the Treasury Department.

We ask that you make available to us the same analyses provided to the Commissioners regarding the general tax treatment of the settlement and whether or not these costs will be borne by insurers of the firm at question. Bottom line: the Commissioners and the American taxpayer need to know how much each firm will pay that will not be deductible and will not be paid by an insurer or other third party.

There have been words about the need for change and reform both at the SEC and in Corporate America. Now is the opportunity to show the American people with action that makes

those responsible bear the full burden. However, artfully crafted settlements of corporate wrongdoing that have the taxpayers subsidize this wrongdoing or have the costs paid for by somebody else will only convince us that words are still all there is. We appreciate your prompt response to this matter by March 10, 2003.

Cordially yours,

Charles E. Grassley  
Chairman

John McCain  
Chairman

Max Baucus  
Ranking Member

#### MEMORANDUM

To: Reporters and Editors  
Re: IRS response to global settlement inquiry  
Da: Tuesday, April 8, 2003

In January, Sen. Chuck Grassley, chairman of the Committee on Finance, and Sen. Max Baucus, ranking member, sent a letter to the IRS chief counsel regarding the deductibility of payments made in connection with the settlement of government investigations into actual or potential violations of law. The senators have received a response from the IRS chief counsel, B. John Williams, Jr. For copies of Mr. Williams' response, please call or e-mail with your fax number.

Sens. Grassley and Baucus made the following comment on the response.

“We received the reply from the IRS Chief Counsel, B. John Williams, Jr., to our January 30, 2003, letter regarding the deductibility of payments made in connection with the settlement of government investigations into actual or potential violations of law.

“The letter was beneficial in providing the Finance Committee a detailed understanding of the IRS' views on the law regarding the deductibility of settlements with the federal government. The IRS' analysis will be useful as the Finance Committee continues to consider this matter.

“While the letter highlights the grey areas of the law, it makes clear that the government negotiators play a key role in determining whether or not a settlement payment is deductible. The IRS letter notes that generally agencies do not contact the IRS or Treasury about tax aspects of specific settlements. This is a very disturbing fact and suggests that taxpayers are not being well-served if government negotiators are blind to the tax consequences of settlement negotiations. We believe there needs to be a government-wide change in this regard.”

Grassley made the following additional comment:

“While government negotiators may be in the driver’s seat, it appears that they may not know where they’re going, or have a map. I look forward to working with Senator Baucus to determine what kind of government-wide change we need and whether that change requires legislation upon further analysis of the IRS letter and other aspects of this issue.”

For Immediate Release

Friday, February 28, 2003

Grassley, McCain, Baucus Question SEC Chairman

WASHINGTON – Key senators today raised concerns that the Securities and Exchange Commission may leave taxpayers bearing the burden for wrongdoing by Wall Street firms.

In a letter to the SEC Chairman, Sens. Chuck Grassley, John McCain and Max Baucus question the SEC's approval of settlement agreements in disputes over stock research abuses. Grassley is chairman of the Senate Committee on Finance. Baucus is ranking member. McCain is chairman of the Senate Commerce Committee.

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It is particularly galling that as American families sit at the kitchen table filling out their tax return and pay their fair share to the U.S. Treasury, SEC spokeswoman Christi Harlan stated in response to concerns about the tax treatment of the settlements with Wall Street: "The SEC enforcement staff looks at violations of securities law; we don't take other factors into consideration."

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