U.S. SENATE COMMITTEE ON

Finance

SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

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Grassley Highlights Corporate Loophole Closers in New Tax Bill

WASHINGTON – Sen. Chuck Grassley, chairman of the Committee on Finance, today said the newly passed business tax bill contains the most significant crackdown on corporate abuses and tax dodges in a generation and will lead to many more companies paying their fair share of taxes – tens of billions of dollars more over the next decade.

"This legislation gives tax relief to businesses to encourage job creation," Grassley said. "At the same time, it closes a lot of the loopholes that allow companies to escape their fair share of U.S. taxes. The message is, if you play by the rules, you'll get a tax break. If you don't play by the rules, you'll be caught and pay a heavy price.

"Just this week, Securities and Exchange Commission Chairman William Donaldson said public mistrust of corporate America remains high, even though doubts have been eased somewhat by enforcement actions against hundreds of companies and corporate improvements. Trust won't be restored overnight, but every step helps. Like the Sarbanes-Oxley reforms, these new tax loophole closers should help to restore public confidence in corporate America. Under the new tax bill, penalties for failing to report a tax shelter now have to be disclosed in a company's SEC filing. Potential investors will know whether a company is violating our tax shelter laws, so they can decide whether they want to invest in a company with clouded business ethics."

The *American Jobs Creation Act of 2004* is designed to settle a tax dispute with the European Union. The bill repeals a tax break for U.S. exporters and replaces it with a tax benefit that effectively reduces domestic manufacturers' corporate tax rate. The legislation also contains tax reforms to make U.S. companies more competitive. The bill provides all of these benefits, nearly $140 billion worth over 10 years, but does not add one dime to the federal deficit. It is all paid for by shutting down corporate expatriations to Bermuda, tax shelter leasing abuses, and ending all the Enron tax shelter deals. The bill received final approval on Monday, with a bipartisan Senate vote of 69 to 17 and one senator voting present, and is headed to the President for his expected signature.

"This is the strongest anti-tax shelter measure since 1986," Grassley said. "These measures have been four years in the making." Grassley worked to include multiple provisions to curb corporate abuses:

Leasing tax shelters. This provision denies the tax benefits of leasing tax shelters, known the "Service-In, Lease-Out" or SILO, tax shelter. "In these scams, companies pretend to lease taxpayer-funded public works systems, like subways and sewers, and then lease them back to the cities," Grassley said. "The companies claim depreciation on these taxpayer-funded assets, while the cities get up-front money from the shelter promoter that's just chump change, compared to what the companies get." This measure raises $26.6 billion in revenues over the next 10 years.

General tax shelters. The bill has 21 provisions cracking down on tax shelters, including a measure that denies a deduction of interest on certain convertible debt transactions. It generally expands a provision in current law involving "disallowance of interest deductions" on debt that can be converted into equity.

The bill also requires companies and individuals to disclose to the Internal Revenue Service more details about tax shelters and boosts penalties for failing to do so. Penalties range up to $200,000 for failing to disclose a tax shelter the IRS has identified as an abusive transaction. Also, penalties for failing to report a tax shelter now have to be disclosed in a company's SEC filing so potential investors will know whether a company is violating tax shelter laws.

Tax shelter promoters are penalized more heavily. A promoter providing a false statement about tax benefits of a transaction will see a $1,000 penalty rise to 50 percent of the gross income from the transaction. Given the millions of dollars involved in such tax shelters, this new penalty could be very large.

Corporate inversions or expatriation. The bill raises $830 million in revenue over 10 years by taking aim at companies conducting "corporate inversions," which involve a company switching its headquarters in name only to an overseas tax haven – such as Bermuda – to lower or eliminate U.S. taxes. "This will hit the unpatriotic companies that dash and stash their cash," Grassley said. The crackdown applies to individuals as well; that will raise $377 million over 10 years.

Grassley and Sen. Max Baucus, ranking member, fought unsuccessfully to make the inversion crackdown effective date retroactive to March 21, 2002. That's when they expressed disgust over companies inverting to exploit the Sept. 11, 2001, tragedy and warned companies to do so at their own risk.

"I still remember my disgust when I watched a video of an accounting firm partner hawking corporate expatriation as a 'mega trend hot topic' because of depressed stock prices," Grassley said. "The video was taped on November 30, 2001 – less than 80 days after September 11. This accounting firm said corporations were hesitant to invert because of a sense of patriotism, but they assured the viewers that, and I quote, 'the improvement on earnings is powerful enough to say that maybe the patriotism issue needs to take a back seat.'

"In the halls of Congress, patriotism never takes a back seat. The companies that inverted in wake of September 11 leveraged that national tragedy to line their own pockets with illicit tax savings that are little more than blood money. I'm unhappy that House members rejected the March 2002 effective date. They let the companies that exploited September 11 get off scot-free. But I'll fight this fight again next year."

Nonqualified deferred compensation. In response to the Enron Corp. and WorldCom scandals, the bill significantly restricts the flexibility executives have in controlling distributions from deferred compensation plans and restricts nonqualified deferred compensation plans. One item will effectively shut down the use of offshore trusts to protect deferred compensation from creditors in the event of a corporate bankruptcy.

"This is a matter of fairness," Grassley said. "Executives shouldn't get to hide compensation from creditors while rank-and-file employees lose their shirts. It's also a matter of maintaining pension coverage for rank-and-file employees. If executives have their own rules for squirreling away money, they have less incentive to maintain nest eggs for their employees. This will be the most significant tightening of the tax treatment of deferred compensation ever enacted."

The Joint Committee on Taxation recommended reforms of nonqualified deferred compensation in its lengthy investigative report of the Enron Corp., released in February 2003 at a Finance Committee hearing.

Personal use of company aircraft. The legislation puts significant limitations on companies' ability to take significant tax deductions for the cost of executives' personal use of company aircraft. For example, under current rules, an executive who uses a company aircraft for a personal flight may report significantly less in income for the use of the flight than the company is allowed to deduct. The new legislation will restrict the company's deduction to the same value reported by the employee. This provision will bring in an estimated $2.3 billion over 10 years. "We'll be able to ground a good number of these high-flying corporate executives," Grassley said.

Fuel fraud. In July 2001, Grassley's staff discovered what's become known as a huge fraud upon the taxpayer – fuel tax evasion. This fraud is costing the taxpayers $1 billion a year. The Finance Committee had a very important hearing exposing this growing tax scam, Grassley said. The problem has come to light in more recent prosecutions. One involved an alleged terrorist cell that was skimming off fuel tax-free and selling it, using the money for unknown purposes. In another case, in July, prosecutors charged 19 workers at Miami International Airport with falsely classifying jet fuel as contaminated, and then selling it on the sly, stealing 2.7 million gallons of fuel. The legislation contains a series of reforms cracking down on fuel fraud.

Donations of intellectual property and cars. Grassley said corporations have been reducing their tax bill by hundreds of millions of dollars each year by taking intellectual property of little to no value and donating it to a charity. The legislation ends this abuse by corporations while still encouraging the donation of legitimate intellectual property that has real value for actual development.

In addition to the corporate reforms, the bill contains several crackdowns on individual tax abuse:

Car donations. The bill ends the shady practice of a donor giving a junker car to charity and claiming thousands of dollars for it as a deduction on his income tax. "The reforms will place no additional burden on the donor, will not reduce the amount going to charities from a donated car by a dime and will benefit all taxpayers by ending this abuse," Grassley said.

Virgin Islands tax scams. "There are many, many people going down to the Virgin Islands to not only get a tan but also to avoid the tax man," Grassley said. "I'm pleased that we're cracking down on this problem." The bill makes it harder for someone to qualify as a resident of the U.S. Virgin Islands or Puerto Rico in order to qualify for special income tax benefits for those island residents.

SUV loophole. The bill closes this loophole in which small businesses, doctors and lawyers are able to write off up to $100,000 the cost of a large sports utility vehicle or truck weighing more than 6,000 pounds. It returns the maximum expensing to $25,000 for a vehicle used for business. It applies only to cars purchased after the date of enactment. "Senator Nickles was right when he said it would be an embarrassment if we couldn't deal with this abuse. Well, we did," Grassley said.

"It's very uncommon for Congress to have a legislative opportunity to address tax shelters and tax abuse," Grassley said. "This bill provides the most sweeping attack on shelters and abuse in a generation. I'm glad we seized the opportunity to address these abuses. It could be years before another opportunity presents itself.

"This doesn't mean we'll rest on our laurels and ignore tax scams for a while. For example, I anticipate addressing other areas in the near future, such as land donation and façade donations based on our investigation of the Nature Conservancy and other land donation organizations. In general, because the Finance Committee has been so successful in rooting out tax fraud, we have more and more information coming to us over the transom about newer, more crooked and creative scams being cooked up out there in the underworld of tax shelters. All I can say is watch out, because we're coming after you."

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