

## Commissioner Doug Shulman's Remarks to the OECD, June 2, 2009

### Prepared Remarks of IRS Commissioner Doug Shulman Before the Organization For Economic Co-Operation And Development Washington, DC, June 2, 2009

Thank you for that gracious introduction and warm welcome. It is an honor to speak with you today about international tax issues, which are of utmost importance at this particular point in time.

First, let me recognize OECD Secretary-General Gurría for his leadership. He has strengthened the bonds of partnership between our member nations as we move forward together in a deeply intertwined global environment.

Indeed, the recent financial crisis has shown us in stark terms how interrelated we are as nations and how we truly operate in a global economy. Some of the trends that we have seen at the IRS further illustrate this point. For example, from 2000 to 2007, the volume of foreign tax credits claimed on tax returns by U.S. businesses increased by 71 percent.

At the same time, the volume of foreign tax credits claimed by individual Americans rose an eye-popping 133 percent. More businesses and individuals are using the global capital markets as a vehicle for investment, illustrating the opportunities presented by the development of capital markets, but also some of the challenges. Regulatory bodies and governments worldwide are wrestling with complex challenges without easy answers.

One broad question being asked is how do we enforce sovereign laws in a global environment? In the IRS' case, we are focused on international tax issues from two perspectives.

First, in the business context, how do we ensure that taxpayers do not use the complexities of international capital markets to push tax planning beyond acceptable bounds? Second, how can we better ensure that individuals who have assets overseas, but have a U.S. tax obligation pay what they owe?

There is no single silver bullet to solve this set of complex issues. It will take focus and a multi-year strategy to increase our capability to deal with sophisticated corporate and individual taxpayers who operate on a global basis. It will take new laws and regulations, enhanced tools and resources for the IRS, and deeper cooperation among nations.

However, we are at a critical juncture in our journey to step up our game in international tax issues. You can see and sense that real change and real progress have been taking place over the past year.

And it is taking place both at the corporate and individual level as we work to both eliminate the potential for corporations to exploit gray areas in the tax code, and to ensure U.S. individuals with assets overseas are paying their taxes.

In the U.S., international tax issues have moved to center stage. It is a major priority for President Obama, and last month he outlined a bold suite of international legislative proposals.

At the same time, the IRS has been stepping up enforcement measures in this area. We are aggressively tracking down tax evaders hiding their wealth overseas and the promoters who aid and abet these schemes. We are steadily increasing the pressure on offshore financial institutions that facilitate concealment of taxable income by U.S. citizens.

Indeed, I have made international issues a top priority since "Day One" of my tenure as IRS Commissioner and it's not just because we live in a global world.

In today's economic environment, it's more important than ever that the American people feel confident that everyone is playing by the rules and paying the taxes they owe.

On the world stage, the global economic downturn and recent tax evasion scandals have spurred urgent calls for fairness and transparency of the tax system. In April, the G-20 heads of state agreed in a show of unity to act against tax havens that impede legitimate tax enforcement.

The tide is indeed turning and I am proud to lead the IRS' renewed, refocused and reinvigorated enforcement efforts. All the right pieces are falling into place. And with the continued cooperation and commitment among nations and organizations, such as the OECD and JITSIC, we will create the right climate – an inhospitable climate for tax evasion and offshore secrecy.

And today, I would like to discuss in greater detail what the United States is doing to take us to that next level.

I believe we have a good foundation for the future of international tax administration. But more is required to get us on top of our international game. Let me sketch out some of the key points – what I call the “must haves.”

First, for too many years, the IRS was in the position of not having the resources to go toe-to-toe with taxpayers operating in the international markets. They had deep pockets and could hire a cadre of legal and tax experts. Some observers said, “We were outmanned and outgunned.”

To meet this challenge, we must keep existing personnel current on emerging techniques and hire top examiners, lawyers, economists, special agents and financial specialists who can unravel the sophisticated and complex world of international tax issues.

These enforcement resources can produce real victories, such as the recent Xilinx decision by the 9th Circuit Court of Appeals surrounding a transfer pricing issue. The IRS claimed that Xilinx was liable for taxes and penalties relating to transactions between the company and its Irish subsidiary.

Second, the IRS is an information intensive organization. Data is our lifeblood. It informs all of our activities – from service to enforcement. But it's not just about getting the data, but rather analyzing and making the best use of it.

For example, we know that those taxpayers who have their taxes withheld and reported to the IRS through third parties are the most compliant. On the other end of the scale, those operating without withholding and reporting are the least compliant.

What's the lesson here? Simple – better information reporting can boost compliance and we need more of it from foreign countries and foreign financial institutions.

Third, regulatory and legislative changes and enhancements are needed. For example, the Qualified Intermediary program gives the IRS an important line of sight into the activities of U.S. taxpayers at foreign banks and financial institutions. But it's not problem-free.

We need to shore up the QI program and enhance, improve and strengthen it. Last fall, and in the President's 2010 fiscal year budget, we issued a set of proposed changes to the QI program which we believe will give us a clearer line of vision and transparency that we need in tax administration.

QI is not the only way to gain transparency. The President's 2010 budget also calls for additional information reporting on cross-border wire transfers, which will allow the IRS to focus examination resources on the areas of highest risk.

Time is also one of our greatest enemies. Cases involving offshore bank and investment accounts located in bank secrecy jurisdictions take additional time to complete. These cases often present challenges for the IRS in obtaining information from a financial institution that is not subject to U.S. jurisdiction.

Extending the statute of limitations would be an important asset to our efforts, and we hope Congress will pass legislation giving us the time we need to pursue our investigations and other enforcement activities.

These are our challenges. Let me now talk about the solutions, including the proposed set of international measures that President Obama announced.

And before discussing them, I want to again make the distinction between corporations and individuals in the international tax compliance context.

International business transactions can be complex for many reasons, but it's no secret that multinational corporations engage in sophisticated tax planning. Let me be clear. There are plenty of international tax strategies that are perfectly legal. And many corporations and their legal and tax advisors are genuinely trying to comply with the myriad of international tax laws.

While we won't always agree about what the law is, or how it applies in particular cases, we recognize that many businesses are trying to get it right. However, we also know that some businesses use the complexity of the tax code and the international capital markets to push the envelope too far.

That is where we have issues, and where we will continue to focus. I have highlighted in the past some of the areas where we have particular interest and these include: transfer pricing, financial instruments, hybrid structures, and withholding taxes.

For individuals with overseas income and assets, it's much more straightforward. If you are a U.S. taxpayer holding overseas assets, you must pay your taxes or we will be very focused on finding you. It's as simple as that.

Now, let's get into the meat of the Administration's proposals.

As I just noted, some of these proposals deal with techniques used by U.S.-based multinational corporations to reduce their U.S. tax liability. I won't dwell on these, except to give you a few highlights.

For example, U.S. multinational corporations that invest overseas can take immediate deductions on their U.S. tax returns for certain expenses but defer paying U.S. taxes on the income. The Administration proposes to reform these rules so that companies cannot take the deductions on their U.S. tax returns until they repatriate these offshore profits – with the exception of research and experimentation expenses.

And let me be clear here too. The President is not repealing deferral. The Administration is simply proposing that deductions for expenses should match the deferred income.

Another example of a corporate tax reform proposal is to change the "check-the-box" rules that can make foreign subsidiaries "disappear" for U.S. tax purposes. The Administration's proposals restrict the use of the check-the-box rules for certain foreign entities. The proposals also would restrict the ability to use foreign tax credits in certain situations. The goal of these proposals is to ensure a level playing field and fairness in the tax code. This Administration is also committed to ensuring U.S. businesses remain competitive globally.

Now, I would like to focus on the President's proposals aimed at individuals avoiding tax by hiding income in offshore accounts. These proposals will enhance information reporting, increase tax withholding in certain situations, strengthen penalties, and shift the burden of proof to make it harder for offshore account-holders to evade U.S. taxes. They will also provide the enforcement tools we need to crack down on offshore tax abuse.

The core of the Administration's proposals is to strengthen and expand the Qualified Intermediary system. The overall goal is to make it easy for individuals to comply with U.S. tax law, and make the intermediaries who facilitate the flow of funds across borders our partners in ensuring people pay the right amount of tax. The other part of the proposal is to create disincentives for those U.S. taxpayers who chose to do business with a financial institution that has chosen not to be a QI.

I should note the OECD has also been studying best practices, data templates, outside auditor requirements, and other guidelines for building QI-type networks. We believe the enhanced QI system proposed by the President is a good starting point eventually for a multilateral QI system.

The President's proposed enhancements to the QI program remind me of what someone once said. "Good laws make it easier to do right and harder to do wrong."

Although the multi-faceted proposal is complicated, I would summarize it into five key components. First, U.S. financial institutions and QIs will be required to determine the true beneficial owner of a particular account. Similar to the issues the EU has had with enforcing its Savings Directive, we have found that many U.S. taxpayers have formed shell entities to hold offshore accounts.

Second, we want to encourage Non-QIs to become QIs. Thus, the Administration proposes to impose significant withholding tax on transactions involving non-Qualifying Intermediaries. Specifically, it would require U.S. financial institutions and QIs to withhold 20 percent to 30 percent of U.S. payments to individuals or businesses who use non-QIs. To get a refund for the amount withheld, investors must disclose their identities and demonstrate that they're obeying the law.

In addition, the President's plan would create a legal presumption against users of non-Qualifying Intermediaries. This is a real game changer. U.S. citizens who send money to foreign banks that don't cooperate with us will have to provide convincing evidence to prove they're not breaking U.S. tax laws. Moreover, these presumptions will make it easier for the IRS to demand information and pursue cases against international tax evaders.

Third, the Administration's plan would increase various reporting requirements. For example, QIs would be required to report worldwide information on their U.S. customers to the same extent that U.S. financial intermediaries do. In addition, U.S. persons, U.S. financial institutions, and QIs will be required to report cross-border transfers to Non-QIs.

On all of the QI issues, let me note that we understand that these changes will require a commitment and resources by financial institutions in the QI program, and we look forward to discussing the proposals with them and ensuring a smooth and orderly implementation.

The fourth component of our plan is to improve the ability of the IRS to successfully prosecute international tax evasion. For example, the proposals would double certain penalties when a taxpayer fails to make a required disclosure of foreign financial accounts.

Fifth, the Administration also asks Congress to extend the current statute of limitations on international tax enforcement from three to six years after the taxpayer submits required information. As discussed earlier, these cases are often highly complex and require additional time to resolve beyond the current three-year statute.

The President is also putting resources behind his plan. The Administration's proposed FY 2010 budget for the IRS will allow us to make unprecedented investments in the people, tools, and overall coverage in the international arena.

As part of the President's budget, the IRS would be funded to hire nearly 800 new employees devoted specifically to international enforcement, such as agents, economists, lawyers and specialists.

This would increase the IRS' ability to crack down on offshore tax avoidance and evasion. It would also give us more resources to devote to complex international corporate tax issues such as transfer pricing and financial products.

Lastly, we have begun a dialogue to take international cooperation to the next level. I believe this should include joint examinations with other nations and working towards joint definitions around information reporting requirements.

Such new cooperation and coordination would, if done right, decrease burden on businesses and individuals trying to comply with the law, and help tax authorities consistently enforce the tax law on a global basis.

In conclusion, let me end where I started. The complexity of global capital markets and global capital flows presents new challenges to regulators worldwide. This is true of financial markets regulators, and also for tax authorities.

There are no simple answers, but there is clearly a desire among policymakers to ensure that businesses and individuals are playing by the rules and paying their fair share of taxes.

At the IRS, we are very committed to adapting and evolving as circumstances evolve. We have a multi-year, highly focused international strategy. The President and Secretary Geithner have given us the tools needed to pursue that strategy, and we have asked Congress for new authorities and laws to make it possible for us to succeed.

And our efforts will depend on a closely coordinated strategy among nations, because this is a challenge that all countries are confronting. We are committed to get it right, and it will remain a top agenda item for us.

Thank you for the opportunity to speak here today. I hope you enjoy the rest of the conference.

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