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# NOMINATION OF PAMELA F. OLSON

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## HEARING

BEFORE THE

## COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

ON THE

NOMINATION OF

PAMELA F. OLSON, TO BE ASSISTANT SECRETARY OF THE TREASURY

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AUGUST 1, 2002

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**NOMINATION OF PAMELA F. OLSON, TO BE  
ASSISTANT SECRETARY OF THE TREASURY**

**THURSDAY, AUGUST 1, 2002**

U.S. SENATE,  
COMMITTEE ON FINANCE,  
*Washington, DC.*

The hearing was convened, pursuant to notice, at 11:10 a.m., in room 215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Also present: Senators Lincoln and Grassley.

**OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR  
FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. The committee will be in order.

Good morning, everybody. Today we consider the nomination of Pam Olson to be the next Secretary—actually, Assistant Secretary. [Laughter.] We have just promoted her. Nobody tell Paul O'Neill. The next Treasury Assistant Secretary for Tax Policy.

Pam, I wanted to begin today's hearing by congratulating you. It is an honor to be nominated by the President, clearly. It is nice to be nominated to positions of such trust as the one that you have been nominated for, and I just congratulate you for that.

I also want to welcome your family. Would you be kind enough to introduce your whole family, at least those that are here?

Ms. OLSON. Yes. Definitely.

First, my husband, Grant Aldonas, who I think needs no introduction.

The CHAIRMAN. Right. Grant.

Ms. OLSON. My daughters, Nicole and Kirsten, my mother, Inga Olson, and my son, Noah. Then in the row behind that, my brother-in-law and sister-in-law, Beth and John Aldonas, and their son, Michael.

The CHAIRMAN. Well, all of them also sacrifice, along with you, in giving public service to our country. So I would like all of them to stand, and we are all going to give them a round of applause. Everybody stand up.

[Applause.]

The CHAIRMAN. This is teamwork. We are in this together.

This is an historic event, certainly for you, Pam, and for your family. When confirmed by the Senate—and I definitely do plan to support your nomination—you will become the first woman to serve as Treasury's top tax policy advisor.

Over the years, I can think of many who have held your position before, all of your predecessors, and they have been very, very good

people. They are people whom I have relied on, and I know other members in the committee have relied on, to get sound, solid, professional advice: are we doing the right thing here or not, from the Treasury's perspective.

I must say, too, in past years it has been very objective. On occasion it may be slightly flavored by the administration, but it is my hope that when you do give us advice, as much as you possibly can, just give us the sound, solid advice from the U.S. Treasury perspective, irrespective of which administration might be in power. What is the U.S. Treasury's view on this, and what is best, what is right, what is not right?

You are obviously superbly qualified. You have excellent credentials. You also serve as, I think, a very wonderful, shining example to other young women across the country who are interested in public service. We are very fortunate that you are willing to serve in this capacity, and we wish you much success.

Pam has been Deputy Assistant Secretary for Policy since the President's inauguration. She has been Acting Assistant Secretary since spring, after the departure of Mark Weinberger. The confirmation of Pam Olson will make official the promotion she has been ably handling for the past several months.

Pam Olson brings a lot to the table. She has practiced as a tax lawyer for over 20 years, serving both in government and in the private sector. Earlier in her career she served as an advisor to the IRS Chief Counsel. Since 1986, she has enjoyed a successful career in private practice with one of the Nation's leading law firms. She has been a leader in the legal profession, serving in many capacities, including chairing the ABA Tax Section.

She is smart. She has the skills and the energy to handle the important tasks ahead. In short, she will make an excellent Assistant Secretary for Tax Policy.

Pam also is no stranger to the Finance Committee. She has worked with the committee on a number of legislative initiatives, including the development of the Tax Shelter Transparency Act. This legislation reinforces Treasury's tax shelter program by requiring greater disclosure of abusive transactions and increasing penalties for violators.

But her ties to the committee run far deeper than legislative matters. Her husband, Grant Aldonas, was a long-time trade counsel to former Chairman Bill Roth. The committee considered his nomination to be Under Secretary for International Trade at the Commerce Department in May of 2001.

Changing tenses here, Pam and Grant, I look forward to hosting family reunions up here as much as possible. [Laughter.] Maybe we could even include some more of your family here.

Seriously, we are all very fortunate that you both have accepted President Bush's invitation to serve our country. The committee expects to have a very active agenda during your tenure.

As you will probably agree, our Tax Code is too complicated. We need to move beyond talk and take action to simplify our tax laws. We look forward to working with you and your colleagues at Treasury to make tax simplification a reality.

There is a lot of talk there and I just very much hope that at least we can begin to simplify. Too many times we give with one

hand and we take away with the other, and it complicates the Code. People are frustrated, and in some sense a little bit irritated, and rightly so.

The global nature of our economy also requires us to rethink our international tax regime. Again, this will not be easy. But we must take a fresh look at our tax laws and the extent to which they hinder the ability of United States businesses to compete. This will take time, require input from all interested parties, and in particular will require leadership from Treasury.

The committee is concerned with the real danger that tax scams pose to the integrity of our voluntary tax system. The government's response must be commensurate to the threat. I will be interested to hear what specific steps Treasury and the IRS are taking to crack down on these abuses.

A very important point. I am very concerned that the volunteerism of our tax structure is being tested, with more and more articles in the papers of abuse overseas. And, gee, they are not paying, why should I, and so forth. It is very important that the abuses be stopped, domestic and overseas.

So, Ms. Olson, I am very proud that you are here and wish you the very best. I am interested in hearing your priorities as the about-to-be new Assistant Secretary for Tax Policy. Welcome.

**STATEMENT OF PAMELA F. OLSON, NOMINEE TO BE ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY, DEPARTMENT OF THE TREASURY**

Ms. OLSON. Thank you, Mr. Chairman. I appreciate the introduction.

I am honored to appear before this committee as President Bush's nominee to serve as Assistant Secretary of the Treasury for Tax Policy. I am humbled by the confidence that the President and Secretary O'Neill have placed in me by giving me the opportunity to serve my country in this capacity.

I am especially grateful for the courtesy extended to me by this committee in moving my nomination forward so quickly. Let me say that I would be happy to meet individually with any member who would like to do so.

The committee holds a special place for me because of Grant's service as the committee's chief trade counsel. As you know, familiarity can breed a lot of things, and not all of them are good. But in this case, familiarity bred increased admiration and respect for the members of this committee as he observed firsthand the workings of the committee.

The committee has always worked in a cooperative and bipartisan manner, trying to get to the right answer. If I am confirmed, I pledge to work with the committee in that same cooperative spirit.

The tax system faces a number of critical issues in the coming years, and you have already identified most of them. Addressing them presents serious challenges. I want to mention just two on which I hope to work with the committee, tax complexity and tax compliance.

Computation of tax liability is simply too complicated today for ordinary folks and sophisticated taxpayers alike. Complexity is par-

tially caused by the complicated world in which we live. It is partially caused by calculating tax on the basis of income because satisfactorily defining and measuring income is difficult.

Complexity burdens the economy, it hinders tax administration, it leads to unintended results, it fees the proliferation of tax shelters, and it weakens our self-assessment system. I know complexity is a concern of this committee, and if I am confirmed I pledge to make it a high priority during my tenure.

On the compliance front, there is much to be done. This committee has shown thoughtful leadership by focusing on compliance issues. Mr. Chairman, you were among the first to highlight concerns about tax shelters, tax scams, and schemes.

I have been pleased to work with committee staff in considering many difficult compliance questions, particularly questions related to abusive tax avoidance transactions and the most effective ways of addressing them.

Working with your staff, I believe we have crafted legislation that will materially aid in the IRS's efforts to detect, audit, and penalize abusive tax avoidance activity, and even more important, that will deter future abusive tax avoidance activity.

Complexity and compliance concerns are closely related. I believe our self-assessment system is strong, but keeping it strong requires the confidence of the citizenry. Research by social scientists suggest that when it comes to complying with the law, the belief that the laws are legitimate and should be obeyed has a stronger motivating effect than the fear of being caught.

Complexity in our tax laws undermines legitimacy because it creates crevices and shadows where those who would cut corners can hide. Moreover, complexity also gives rise to the belief that the laws bestow on certain taxpayers, and not others, opportunities to minimize their taxes. This has a corrosive effect on our tax system, leading taxpayers to question its fairness. This should concern us all.

I hope to have the opportunity to continue to work with the committee on both of these important issues and the many others that may confront the tax system.

Finally, I would like to recognize my family again. My husband Grant has been my compass, my best friend, and my partner in all for nearly 25 years. There is no one whose judgment I would rather have on any difficult issue.

My daughters Nicole and Kirsten, and my son Noah have put up with long hours, interrupted vacations, and missed dinners. I am grateful for their love and support, and the rarity of their complaints.

I also want to recognize my mother, Inga Olson. She is a farmer's wife, but I do not think she will be able to trade crop prices with Senator Grassley because she left the farm a number of years ago.

She taught me life's most important lesson, the difference between right and wrong and the importance of always doing what is right.

I would be pleased to answer any questions you might have.

[The prepared statement of Ms. Olson appears in the appendix.]  
The CHAIRMAN. Thank you very much, Ms. Olson.

I will start out with three standard questions we ask every nominee.

First, is there anything you are aware of in your background that might present a conflict of interest with the duties of the office to which you have been nominated?

Ms. OLSON. No, sir.

The CHAIRMAN. Do you know of any reason, personal or otherwise, that would in any way prevent you from fully and honorably discharging the responsibilities of the office to which you have been nominated?

Ms. OLSON. No.

The CHAIRMAN. Third, do you agree without reservation to respond to any reasonable summons to appear and testify before any duly-constituted committee of Congress, if you are confirmed?

Ms. OLSON. Yes, I do.

The CHAIRMAN. Thank you.

Senator Grassley, do you have a statement?

Senator GRASSLEY. No statement. I do have one. I will put it in the record. I would like to ask a few questions. But you go ahead.

The CHAIRMAN. All right.

Ms. Olson, on July 8, in Fortune magazine, you were quoted as saying, with respect to simplification, "Nothing is off limits, including an entirely new revenue collecting system that would tax consumption rather than income. Both corporate and individual taxes are also under the microscope."

It says, "Olson describes three basic options for reform: (1) radical simplification of the income tax; (2) either a value added tax or an income tax with consumption tax underpinnings; (3) a system with both a consumption and income tax in it."

All of those points have been discussed over the years. I am curious what your more precise view is.

Ms. OLSON. We have under way at the Treasury Department right now a project to study tax reform and the various options that might be considered. I think those three that are outlined in that article are the three most important ones to look at.

We, of course, also have under way a significant tax simplification project, and the tax simplification project could well feed into the tax reform project if it goes in the direction of radical reform, radical simplification of the income tax.

I think, as we look at what our tax system ought to look like for the future, we can look at small changes, we can look at large changes, but as we look at changes we need to do a better job than we have perhaps in the past of looking at what goes on in other countries around the globe in terms of how they structure their tax systems, because as we move into an increasingly global economy, what other countries do with respect to the tax systems has to affect what we do as well.

The CHAIRMAN. But given all that, what is your inclination? What direction?

Ms. OLSON. Well, I think that radical simplification may be the first step. But I do think that we need to look at some of the issues related to our double taxation of savings, because we have too many disincentives built into the system right now with respect to

the taxation of savings. So, I think it is important for us to bear that in mind as we look at reform for the future.

The CHAIRMAN. And when you say "radical simplification," what do you have in mind?

Ms. OLSON. Well, one of the things you mentioned is the fact that we have a proposal out to unify the definition of "child." There are five different definitions of child in the code, five different reasons for which you need to know whether or not a child is a child for tax purposes.

Unifying the definition is one step, but you still have five different reasons in the Code to know whether or not the child is a child. We need to look at things that would, for example, combine all of those reasons for knowing whether or not your child is a child into a single provision. That kind of thinking would go, I think, a long ways towards materially simplifying the Tax Code.

The CHAIRMAN. Shifting gears, what about this big, absent surplus we are now faced with? Just the degree to which you think tax policy should address the rising potential deficit, at least in the short term, but generally on a macro level? What is the degree to which you think tax policy should address the surplus or a deficit situation?

Ms. OLSON. Well, I think it is important for us right now to stay the course. As we see the numbers from the economy not perking along quite as well as we had hoped that they would be, it is important for us to give people confidence that we are not going to make any significant changes in the system in terms of increasing tax levels, I think, to cover the deficit. I think that could have a very adverse effect on the economy.

The CHAIRMAN. I am glad you said that. I think, generally, we serve our country better the more investors, consumers, and business people in and around America have an idea of what our Tax Code is and know that it is not going to change radically, or quite significantly, say, year-to-year, or every 2 years. That is, people want predictability. They do care what it is, but they also care, sometimes more, that it is changing all the time. If it is not changing all the time, I think that performs a good service to our people.

So, I urge you at Treasury not to succumb to the siren song of just radically changing taxes for short-term reasons, whereas the long-term, sometimes pretty soon, helps the short term. I think that is a very important principle.

Ms. OLSON. I agree.

The CHAIRMAN. You were part of a FSC/ETI working group, as I understand it. That is, with the DISC/FSC problems we were facing in our country, there was a working group put together to try to find a replacement mechanism, known as the ETI, and various people were working on it.

That is, Joint Tax, Finance Committee staff, Ways and Means staff, Treasury, the private sector, and so forth. I would just like your views on that, because today, as we try to find a replacement for the ETI provisions that the WTO has struck down, and as the United States tries to come up with a solution, at this point there are lots of disparate views.

Some suggest a straight tax solution, others go back to WTO, some say do both. It is kind of confusing, frankly. As I said at a

hearing not long ago, two things are clear. Number one, we have got a problem, and number two, we do not have a solution. The working group you were a part of, I think, was a pretty good process of developing a solution at that time.

I wonder if you could just give us some advice as to how we as a country, that is both Houses of Congress, the White House, and the private sector, can come together with a solution.

Ms. OLSON. I actually was not part of that working group. I was chair of the Tax Section at the time, and as chair of the Tax Section was involved in a number of discussions about it and did sponsor probably three or four programs on the WTO decision, as well as what we ought to do for the future with the increasingly globalization of the economy. I felt like a participant because Grant was a participant, and I heard about it on a regular basis from him.

I do think that the working group was effective in putting together an answer to the WTO. Unfortunately, it did not meet with much success. I think, as we go forward, a working group would be a good idea, again. But I think we would probably have to go into it with a little bit firmer mind-set about the fact that we probably are not going to be able to come up with another system that simply replicates the benefits of the current system, and we are going to have to look at some more serious changes to the Tax Code.

The CHAIRMAN. I think that also includes going back to the WTO regime because we have a direct tax system versus the indirect system of many other countries. We have to figure out a way where we do have a level playing field. So it is not just changing our Code, but also working with the rules of the game with other countries so that Americans get a fair deal.

Ms. OLSON. There is a lot we need to do to level the playing field.

The CHAIRMAN. Yes. And I just urge you to work on that side, too. It is not just the tax side, but also on the other. I see your husband nodding his head up and down.

Ms. OLSON. We are in agreement on this one.

The CHAIRMAN. That is right. Thank you.

Senator Grassley?

Senator GRASSLEY. Thank you very much. I am obviously pleased to have worked with you a little bit already, and that the president appointed you. If you are half as good as your predecessor bragged to me about you, you will do a very good job.

Ms. OLSON. I have been trying to get him to come back, but he will not listen to me. [Laughter.]

Senator GRASSLEY. Could I deal with a few issues, like inversion shelters, tax return data, and simplification? I would like to talk about corporate expatriation. I am glad that in various statements you have recognized the problem of these inversions.

I would like you to focus on what we should do about the problem short-term if we cannot address the so-called big-picture problems with our international tax system.

Ms. OLSON. Well, it is definitely something we need to address. I think that the study that the Treasury put out in May said that there is an urgent need to address the issue, and the testimony

that we have delivered on it says there is an urgent need to address the issue.

So, I think we have a clear agreement across the board that this is an issue that we have to address, and the question is figuring out the best way to do so. We believe very firmly that we need to take away what we refer to as “juice” in the transactions, remove the kinds of tax minimization opportunities that the Code presents for companies undertaking an inversion transaction. So we think if we can eliminate the reasons for undertaking the transactions, the transactions will not occur.

I think we do need to move forward on this. We need to move forward on it as quickly as we can. I think the corporate community is on notice at this point that we are all concerned about it and that we are all willing to address it, and address it currently. We need to move forward on that basis.

Senator GRASSLEY. And what you just said would include even if we passed something on a short-term, temporary basis to retard this movement?

Ms. OLSON. Yes, that is correct.

Senator GRASSLEY. All right. Thank you.

Now, if we were to go with enacting legislation, and even temporary legislation, we are at the end of the session, so that is kind of problematic. I do intend to push full force ahead in the efforts to get an anti-inversion bill passed.

If we fail to enact anti-inversion legislation, I would reiterate my warning to corporations that I made earlier this year, that if they are thinking about inverting, that we have this March 22 deadline. If you invert, you proceed at your own peril. I think at the time Chairman Baucus said that he agreed with me on that.

Would the Treasury join us in that sort of notice to corporations that might invert?

Ms. OLSON. Well, as I said, we have gone on record as this being an issue that needs to be addressed, and needs to be addressed urgently. There is no doubt that people are on notice that we all agree that we need to address this issue. So, I think that we should move forward on that basis.

Senator GRASSLEY. Let us go back to this committee’s effort to crack down on tax shelters. Obviously, Treasury is doing things in that direction as well. I want to thank you and your staff for your assistance in helping us craft legislation.

The Ways and Means Committee tax shelter legislation codified the Economic Substance Doctrine. The Finance Committee proposal does not include that cooperation or that codification.

Do you believe that codification of the Economic Substance Doctrine will help or hinder our goal of combatting tax shelters?

Ms. OLSON. I do not think that codification of the Economic Substance Doctrine will help. I do not think it will help for several reasons, but I would like to maybe mention a couple of them.

One, is that the doctrine right now is a very flexible doctrine that is applied by the courts as needed. I think any codification of it, even if in codifying it we say that we do not intend to override any other doctrines, I think it is going to make it more wooden and less flexible than it currently is. If that happens, then it has the poten-

tial for being both too broad and too narrow. So, that is a real danger.

A more serious danger I see with it, is I think it adds to the complexity for the IRS in its enforcement of the laws and assertion of penalties in appropriate cases because it is yet another set of things that they need to consider, work through, and look at in doing an audit of a taxpayer.

So I think that it has the potential to slow IRS audits, and anything that slows IRS audits is not a good thing. I think what we need at this point is more enforcement, and the IRS being able to complete more audits as rapidly as possible.

Senator GRASSLEY. The next question, and second-to-last question I have, deals with shelter legislation and getting back to the problem we might have with inversion legislation of not just enough time. If we are unable to pass tax shelter legislation, are you going to continue to implement your administrative proposals in this area?

Ms. OLSON. We certainly are going to go forward with our proposals. We have already issued one set of regulations that carry out some of those proposals. We have well under way the development of a second set of regulations. We are going to take every step that we can to address the issue administratively.

The legislative proposals that we suggested and that you included in your legislation, including the codification of some changes that we thought we could do administratively that will certainly be helped by legislative changes, are things we will go forward with.

Senator GRASSLEY. All right. Then the last question, and I will just take a short answer. It is in regard to a letter that I wrote to Secretary O'Neill about the same substance to Commissioner Pitt. You cannot speak for the SEC, but I wrote both asking for reporting to the SEC corporate tax return data.

My question is simple: the extent to which I can expect a formal response to that letter. And I need it very quickly, but I want a thorough response. I need it quickly because of the time of the year that we are in.

Ms. OLSON. We are busily working on the response to the letter and are about finished with our part of it. We are also discussing the issue with the SEC to get their feedback on it as well.

Senator GRASSLEY. All right. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Lincoln?

Senator LINCOLN. Thank you, Mr. Chairman.

Welcome. Congratulations, Ms. Olson. I see you have got your family with you. Thanks. We have certainly enjoyed working with you, as well as your entire family, on so many different issues.

In light of that, together I think we have made some progress on providing estate and gift tax relief to our constituents. We have worked hard at moving towards that. I have consistently supported estate tax repeal since coming to Congress in 1993. As you know, I supported our most recent failed attempt, unfortunately, to make repeal permanent.

While we have made some recent progress, we do not seem to have the votes for the full repeal. The situation we have left on the books creates a 9-year roller coaster ride, basically, which will be problematic, I think, for an awful lot of people—quite frankly, everyone—but in particular for family-owned businesses and farms who have to plan their long-term investments in people and capital.

I would just like to have some of your comments. I believe, and I do not know, but do you not think it is pretty unacceptable to leave America's family-owned businesses and farms in this state of limbo? I wondered what suggestions you would make from your position at the Treasury Department to provide some more immediate estate tax relief for family-owned businesses.

Ms. OLSON. Well, I think the thing that we really need to do, is continue the work to make the repeal permanent. I think that is the most important thing that we can do because that answers the question for everybody. So, I would just encourage you in that effort. But without those votes, which we know we do not have, you do not have any recommendations of other ways that we could try to provide some immediate relief?

Ms. OLSON. No, Senator, I do not. I really think the most important thing for us to do is to continue to work with those who might at some point be inclined to vote with us and get it taken care of. I think we need to continue to illustrate to people that the estate tax really is not consistent with our values, particularly the values that support family farms and small businesses, and we need to get it off the books.

Senator LINCOLN. All right. Well, thank you, and congratulations.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Ms. Olson, as you know, the IRS Commissioner testified not too long ago about the massive number of Americans who have seemingly avoided income taxes with offshore accounts through bank accounts and credit card companies.

In fact, testimony from the IRS is that it could be costing—we do not know for sure—American taxpayers an estimated \$40 billion to \$70 billion a year. We are working with Treasury and IRS to try to crack down on all of these folks.

But these cases are very labor-intensive, requiring about 300 hours to complete, and that there are probably 1 to 2 million American taxpayers who are concealing taxable income through the use of offshore bank accounts. That is in addition to and independent of all of the corporate inversions, the Stanley Works kinds of inversions that are apparently occurring.

We have a problem here. It is an outrage that Americans who are enjoying the benefits of America are unwilling to pay the price, pay their income taxes. It has got to be corrected. It goes to the earlier point I made about voluntary compliance.

If 1 to 2 million Americans know that they do not have to comply, pretty soon they will tell their friends, and pretty soon their friends attempt to do the same thing. With the known audit rate quite low, why not? Why not just play the audit lottery?

It is getting to be a problem. It is a real problem. It also involves lots of people who are not known as white-collar criminals. It includes athletes, doctors, lawyers, authors, business owners, even law professors.

So my question of you is, how far has Treasury come along on this, and do you have sufficient resources to prosecute these cases?

Ms. OLSON. Well, one of the things that we have spent considerable time on since I got to the Treasury a year and a half ago is to find ways to resolve contentious issues that are nowhere near as serious as the issues that you have just outlined, to make sure that resources that go into things such as whether a small business owner should be on the cash or the accrual method of accounting, to get those kinds of issues resolved so that IRS auditors can focus on the more serious problems.

So one of the things that we have done to try to free up IRS compliance resources, is a real aggressive strategy of published guidance to resolve issues so that the resources can go in the right place.

We have also spent a lot of time with the folks in charge of the Small Business and Self-Employed Division, which is the division at the IRS that is responsible for all of the audits in the offshore credit card area, for example.

We have also spent a lot of time with the Large- and Mid-Sized Business Division, which is the division that is following up on all of the promoter audits. What we have tried to do is to make sure that they have every tool that they could possibly have to track down the promoters of these kinds of things and to go after the individuals who have participated in these kinds of things in order to get them back into the system.

So part of what we are doing, is we hope reallocating resources within the IRS so they have more resources to bring to bear on this. We are also looking for ways to get people to come back into the system voluntarily without having to follow up with the 300-hour audits that you talked about with respect to all of these individuals.

I think that the IRS's position on the street as the cop on the street has not been sufficiently apparent for a number of years now, and that if we can make people understand that, in fact, the cop is on the beat, increase the likelihood of people being audited and having people recognize the fact that there is a greater likelihood that they are going to be audited, that that will go a long ways toward deterring this kind of activity.

Then we need to find the hardcore folks. What the IRS has learned from the research that it has already done on the information that it has gotten from one of the credit card companies, is they have learned that a number of those taxpayers are taxpayers who have never filed returns, or taxpayers who have filed returns claiming that they are either students or that their income is under \$25,000 per year.

Those kinds of hardcore folks, I think once we have identified, we need to make sure that the IRS has the systems network in place so that they can forever after track those kinds of people and make sure that they never leave the system again.

The CHAIRMAN. Right. Words that are often used around here are, we need to do this, we need to do that, and all those kinds of things. We all know that. That is not the issue.

The question I asked, really, is does the Service, the government, have the resources to efficiently prosecute those who deliberately cheat Americans by avoiding the tax system, by avoiding taxes? That is just a very basic question. Do we or do we not have the resources to do this?

The estimates are from the IRS, \$40 to \$70 billion. We had a hearing on this subject on April 11. At that hearing, the IRS estimated that there may be 1 to 2 million taxpayers—that is IRS testimony—concealing taxable income through the use of offshore bank accounts, cost to the government, i.e., American taxpayers, an estimated \$40 to \$70 billion. That is a lot of money, and that is a lot of people.

As I said, our estimates are that these cases are very labor-intensive, close to 300 hours to complete. That is a lot of hours, a lot of people, a lot of money, a lot of other things you are doing. Because you are on the spot.

The administration is on the spot, because they are responsible for enforcing the law. I am not saying this administration, but any administration. They are the executive branch of government and enforce our laws. It is the old 101 Civics. We pass the laws, you enforce them. And we will give you the resources, but we need to know what you need.

So, my honest opinion is that this administration, the IRS, the various law enforcement agencies involved are not prosecuting these cases as vigorously as they should be. I sense it is because of inadequate resources.

I guess you are under some obligation at this hearing not to say you do not have the resources, independent of your private view. But I am just saying to you, this is a huge problem and it is getting worse, not getting better.

I think the IRS does not have the resources to do the job, but it is a little bit bothersome when an administration—not just you. It is unfair to ask you, because this is a confirmation hearing—generally does not ask for the resources that it needs to get the job done. I just hope you would take that back.

I very much hope, as Assistant Secretary for Tax Policy, that you will take some real responsibility and ownership over this issue, and proudly want to do something about it aggressively. By gosh, knowing your intelligence, your perseverance, and your stick-to-it-iveness, I know you will get the job done.

Ms. OLSON. I will certainly carry that back, Senator. It is a concern that I share, and we do want to make sure that we do have the right allocation of resources and that we have enough resources, because this is a very important issue and we really do have to address it.

The CHAIRMAN. Are the credit card companies cooperating?

Ms. OLSON. Yes, they are. To date, they have been cooperating, yes.

The CHAIRMAN. Well, my understanding is that one has; one a little bit, one a little bit less.

Ms. OLSON. One, as I understand it, has tried to limit the information that it provided to the IRS. But I do not think that there will be lack of cooperation once the IRS gets back to them with respect to the information that they have seen and can just demonstrate to them that they do, in fact, need more information than they have gotten.

The CHAIRMAN. All right. But I would like you or a member of Treasury to provide for this committee a report, a letter, by the end of August on the degree to which Treasury believes or does not believe it has enough resources to prosecute these cases and the degree to which credit card companies are or are not cooperating so that IRS gets the information it needs to properly prosecute them.

Ms. OLSON. All right. We will do that, Senator.

The CHAIRMAN. Thank you.

Why do you want this job? [Laughter.]

Ms. OLSON. Mr. Chairman, that is a question I have asked myself a number of times in the last few weeks. I really do think that the tax system is in some trouble right now, and I do think that I can make a positive contribution to addressing some of the issues that it faces, and that is why I am here.

The CHAIRMAN. I wish you luck.

Ms. OLSON. Thank you.

The CHAIRMAN. And thank you very much for taking the time to make the attempt. I think that service is the most noble human endeavor, service to family, service to church, service to community, service to friends, whatever form of service makes the most sense for everybody.

Certainly, your family has served mightily, and you want to serve even more. For one, I deeply appreciate it. I am quite certain I can speak for the rest of the committee, and probably all Americans, in saying we all deeply appreciate your commitment to serve.

Ms. OLSON. Thank you, Mr. Chairman.

The CHAIRMAN. There may be written questions asked, if you could return them to the committee as promptly as possible.

Ms. OLSON. I will certainly do so.

The CHAIRMAN. All right.

The committee is adjourned.

[Whereupon, at 11:51 p.m. the hearing was concluded.]



## APPENDIX

### ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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#### PREPARED STATEMENT OF PAMELA F. OLSON

Mr. Chairman, Senator Grassley, and Members of the Senate Finance Committee: I am honored to appear before this Committee as President Bush's nominee to serve as Assistant Secretary of the Treasury for Tax Policy. I am humbled by the confidence that the President and Secretary O'Neill have placed in me by giving me the opportunity to serve my country in this capacity. I am especially grateful for the courtesy extended to me by this Committee.

The Committee holds a special place for me because of my husband Grant Aldonas' service as Chief Trade Counsel for the Committee prior to his appointment as Undersecretary of Commerce. His admiration and respect for the Members of this Committee only increased as he observed first hand the difficult issues you face, the tough decisions you make, and the grace with which you discuss your differences and serve the country.

Eighteen months ago, I accepted Secretary O'Neill's offer to return to government service as Deputy Assistant Secretary of the Treasury for Tax Policy. During the past 18 months, I have had the opportunity to work with Committee Members and staff. I want to compliment you on the talented staff you have assembled to assist and advise you. The cooperative and bipartisan manner in which the Members and the staff work benefits the country. I pledge to work with the Committee in the same cooperative spirit if confirmed by the Senate.

Difficult issues are routine for this Committee, but I believe the tax system faces several critical issues in the coming years. I hope to have the opportunity to assist the Committee in addressing them. I want to mention just two of these important issues—two that I believe are closely linked: tax complexity and tax compliance.

Emperor Joseph II once said of Mozart's composition, it has "too many notes, my dear Mozart." A similar observation may be fairly made of our tax laws. Unfortunately, while we may reserve Mozart's compositions for talented and trained musicians, being a virtuoso is not a prerequisite for complying with the tax law. Rather ordinary folks must deal with it, and those ordinary folks can no longer handle the complexity. Of course, much complexity may be attributed to the complicated world in which we live and the difficulties inherent in properly defining and measuring income. But that is not the sole source of complexity, and we have not always done all we could to minimize it. Complexity burdens the economy, hinders tax administration, leads to unintended results, feeds the proliferation of tax shelters, and weakens our self-assessment system. I know complexity is a concern of this Committee, and if I am confirmed, I pledge to make it a high priority during my tenure.

This Committee has shown particular leadership in addressing tax compliance concerns. In 1998, the Committee's work resulted in a significant restructuring of the Internal Revenue Service. While the restructuring was painful even to the outside observer of the organization, fundamental change was necessary, and I believe we will see the fruits of that change in the years ahead in the form of increased taxpayer service and better-focused compliance programs.

At the same time, there is much to be done on the compliance front. This Committee has shown thoughtful leadership by keeping compliance front and center. Chairman Baucus and Senator Grassley were among the first to shine the light on the problem of tax shelters. During my 18 months at Treasury, I have been pleased to work with Committee staff in considering many difficult compliance questions, particularly issues related to abusive tax avoidance transactions, and the most effective ways of addressing them. Working together with former Assistant Secretary Mark Weinberger, Commissioner Rossotti, and Chief Counsel B. John Williams, we

have endeavored to resolve and remove from contention other issues—issues more appropriately resolved with published guidance—that absorb too many Internal Revenue Service enforcement resources and distract from far more significant compliance issues.

I believe our self-assessment system is strong, but keeping it strong requires the confidence of the citizenry. Complexity is an important component of compliance. The belief that the tax laws bestow on certain taxpayers opportunities to minimize their taxes has a corrosive effect on our tax system. It leads taxpayers to question its fairness. The complexity in our tax laws and the many targeted provisions contribute to taxpayers' concerns that somebody get something they didn't but should have. It also creates crevices and shadows where those who would cut corners can hide. This should concern us all. Research by social scientists suggests that, when it comes to complying with the law, the belief that the laws are legitimate and ought to be complied with has a stronger motivating effect than the fear of being caught.

I hope to have the opportunity to continue to work with the Committee on both of these important issues and the many others that confront the tax system.

I look forward to continuing to serve in the Office of Tax Policy. The staff in the Office of Tax Policy is an extraordinarily talented and dedicated team. Like the staff of this Committee, they have chosen the long hours of public service over the more lucrative opportunities of the private sector.

Finally, I want to recognize the most important people in the world to me, my family. My husband, Grant needs no introduction to this Committee. He has been my mentor, my coach, my compass, my best friend, and my partner in all for nearly 25 years. There is no one whose judgment I would rather have on any difficult issue. My daughters Nicole and Kirsten and son Noah have put up with my long hours, interrupted vacations, and missed dinners. I am so very grateful for their support and the rarity of complaints. I also want to recognize my mother, Inga Olson, who is here today and taught me life's most important lesson—the difference between right and wrong and the importance of doing what's right.

I would be pleased to answer any questions.

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**SENATE FINANCE COMMITTEE  
STATEMENT OF INFORMATION REQUESTED OF NOMINEE**

**A. BIOGRAPHICAL INFORMATION**

1. Name: (Include any former names used.)  
Pamela Faith Olson
2. Position to which nominated:  
Assistant Secretary of the Treasury (Tax Policy)
3. Date of nomination:
4. Address: (List current residence, office, and mailing addresses.)  
2819 N Jefferson Street  
Arlington, VA 22207  
  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220
5. Date and place of birth:  
7/6/54; Fargo, ND
6. Marital status: (include maiden name of wife or husband's name.)  
Married; Grant D. Aldonas
7. Names and ages of children:  
Nicole Aldonas, 21; Kirsten Aldonas, 20; Noah Aldonas, 11
8. Education: (List secondary and higher education institutions, dates attended, degree received, and date degree granted.)  
Farmington High School, High School Diploma, 6/72; University of Minnesota, 9/73 –6/80; BA, 6/76; JD, 6/80; MBA, 6/84
9. Employment record: (List all jobs held since college, including the title or description of job, name of employer, location of work, and dates of employment.)

University of Minnesota, Teaching Assistant and Instructor, Minneapolis, MN, 9/76-6/80; Coopers & Lybrand, intern, 2/79-4/79; Goodsiil, Anderson & Quinn, summer associate, Honolulu, Hawaii, 6/79-9/79; Musicland, Tax Department, St. Louis Park, MN, 9/79 to 5/80; Office of Chief Counsel, IRS; Attorney Advisor and Special Assistant to the Chief Counsel; San Diego, CA and Washington, DC; 1/81-4/86; Skadden, Arps, Slate, Meagher & Flom LLP, associate and partner, Washington, DC, 4/86-2/01; U.S. Treasury Department, Deputy Assistant Secretary (Tax Policy); Washington, DC; 2/01-present

10. Government experience: (List any advisory, consultative, honorary, or other part-time service or positions with Federal, State or local governments, other than those listed above.)

None

11. Business relationships: (List all positions held [for the past 10 years] as an officer, director, trustee, partner, proprietor, agent, representative, or consultant of any corporation, company, firm, partnership, other business enterprise, or educational or other institution.)

Partner, Skadden, Arps, Slate, Meagher & Flom LLP; 4/90 –to 2/01

12. Memberships: (List all memberships and offices held in professional, fraternal, scholarly, civic, business, charitable, and other organizations.)

Council Director, Vice Chair, Chair-Elect, and Chair, ABA Tax Section; Trustee, American Tax Policy Institute; Fellow, American College of Tax Counsel; Fellow, American Bar Foundation

13. Political affiliations and activities:

- a. List all public offices for which you have been a candidate.

None

- b. List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

None

- c. Itemize all political contributions to any individual, campaign organization, political party, political action committee, or similar entity of \$50 or more for the past 10 years.

Pamela Olson  
Erdahl for Congress Committee: \$500  
Skadden Arps PAC: \$240  
Alliance for American Leadership : \$250  
Skadden Arps Pac: \$360  
Pete Wilson for President Committee Inc.: \$500

John Meckley for Congress Committee: \$250  
 Friends of Dylan Glenn: \$250  
 Kerry for U.S. Senate Committee: \$1,000  
 Skadden Arps Pac: \$215  
 Skadden Arps Pac: \$215  
 Portman for Congress Committee: \$300  
 Skadden Arps Pac: \$356  
 Skadden Arps Pac: \$475  
 Bush for President Inc.: \$1,000  
 Ohioans for Ken Blackwell: \$50

Grant Aldonas (spouse)  
 Ed Zschau for US Senate Committee: \$500  
 Lynn Martin for Senate: \$500  
 Lynn Martin for Senate: \$500  
 Miller & Chevalier Chartered Political Action Committee: \$333  
 Arlington County Republican Committee-Federal: \$200  
 Wish List: \$250  
 Pete Wilson for President Committee Inc.: \$500  
 Republican National Committee: \$205  
 Republican National Committee: \$205  
 Arlington County Republican Committee-Federal: \$250  
 Republican National Committee: \$230  
 Republican National Committee: \$230  
 Republican National Committee: \$230  
 Republican National Committee: \$1,000

14. Honors and Awards: (List all scholarships, fellowships, honorary degrees, honorary society memberships, military medals, and any other special recognitions for outstanding service or achievement.)

Minnesota State Scholarship; St. Paul Companies Fellowship; Phi Beta Kappa; Chief Counsel's Award; Fellow, American Bar Foundation; Fellow, American College of Tax Counsel; University of Minnesota Board of Regents Outstanding Achievement Award

15. Published writings: (List the titles, publishers, and dates of all books, articles, reports, or other published materials you have written.)

"Industry Specialization in Chief Counsel's Office," The Tax Executive (1985).  
 "Some Thoughts on Anti-Abuse Rules," 48 Tax Lawyer 817 (Spring 1995).  
 I have prepared materials in connection with presentations at conferences, but do not have a list or cites for such materials.

16. Speeches: (List all formal speeches you have delivered during the past five years which are on topics relevant to the position for which you have been nominated. Provide the Committee with two copies of each formal speech.)

I have been a frequent speaker at tax conferences, seminars, and continuing professional education courses. I have only once written a speech before delivering it. Two copies of that speech are attached.

17. Qualifications: (State what, in your opinion, qualifies you to serve in the position to which you have been nominated.)

I have practiced as a tax lawyer for over 20 years, serving in the government and in the private sector. I have been a leader of the legal profession, a frequent speaker and writer on tax administration and tax policy matters. I understand at many levels the challenges facing our tax system and the importance of a sound tax policy response from the Administration and the Congress to those challenges.

**B. FUTURE EMPLOYMENT RELATIONSHIPS**

1. Will you sever all connections with your present employers, business firms, associations, or organizations if you are confirmed by the Senate? If not, provide details.

All were severed when I joined Treasury in February 2001. I am a continuing participant in the defined contribution pension plan sponsored by my former firm. The plan is fully-funded, fully-vested, and there are no further contributions by myself or my former firm.

2. Do you have any plans, commitments, or agreements to pursue outside employment, with or without compensation, during your service with the government? If so, provide details.

No

3. Has any person or entity made a commitment or agreement to employ your services in any capacity after you leave government service? If so, provide details.

No

4. If you are confirmed by the Senate, do you expect to serve out your full term or until the next Presidential election, whichever is applicable? If not, explain.

Yes

**C. POTENTIAL CONFLICTS OF INTEREST**

1. Indicate any investments, obligations, liabilities, or other relationships which could involve potential conflicts of interest in the position to which you have been nominated.

None

2. Describe any business relationship, dealing or financial transaction which you have had during the last 10 years, whether for yourself, on behalf of a client, or

acting as an agent, that could in any way constitute or result in a possible conflict of interest in the position to which you have been nominated.

None

3. Describe any activity during the past 10 years in which you have engaged for the purpose of directly or indirectly influencing the passage, defeat, or modification of any legislation or affecting the administration and execution of law or public policy. Activities performed as an employee of the Federal government need not be listed.

As an officer of the ABA Tax Section, I met often with IRS, Treasury, and Congressional staff regarding legislation and regulations or other guidance. I also submitted comments from time to time for clients on pending legislation or regulations.

4. Explain how you will resolve any potential conflict of interest, including any that may be disclosed by your responses to the above items. (Provide the Committee with **two** copies of any trust or other agreements.)

I don't believe I will have any conflicts since I previously severed all business relationships, and my husband and I have disposed of all individual stock holdings. Any potential conflict of interest will be resolved in accordance with my ethics agreement, which is memorialized in my letter to Kenneth R. Schmalzbach, the Designated Agency Ethics Official in the Department of the Treasury. Should any matter come before me that might involve a conflict, or the appearance of a conflict, I will seek the advice of the Department's ethics counsel.

5. **Two** copies of written opinions should be provided directly to the Committee by the designated agency ethics officer of the agency to which you have been nominated and by the Office of Government Ethics concerning potential conflicts of interest or any legal impediments to your serving in this position.

6. The following information is to be provided only by nominees to the positions of United States Trade Representative and Deputy United States Trade Representative:

Have you ever represented, advised, or otherwise aided a foreign government or a foreign political organization with respect to any international trade matter? If so, provide the name of the foreign entity, a description of the work performed (including any work you supervised), the time frame of the work (e.g., March to December 1995), and the number of hours spent on the representation.

N/A

**D. LEGAL AND OTHER MATTERS**

1. Have you ever been the subject of a complaint or been investigated, disciplined, or otherwise cited for a breach of ethics for unprofessional conduct before any

court, administrative agency, professional association, disciplinary committee, or other professional group? If so, provide details.

No

2. Have you ever been investigated, arrested, charged, or held by any Federal, State, or other law enforcement authority for a violation of any Federal, State, county or municipal law, regulation, or ordinance, other than a minor traffic offense? If so, provide details.

No

3. Have you ever been involved as a party in interest in any administrative agency proceeding or civil litigation? If so, provide details.

Plaintiff in Small Claims Court regarding a failed automobile repair

4. Have you ever been convicted (including pleas of guilty or *nolo contendere*) of any criminal violation other than a minor traffic offense? If so, provide details.

No

5. Please advise the Committee of any additional information, favorable or unfavorable, which you feel should be considered in connection with your nomination.

**E. TESTIFYING BEFORE CONGRESS**

1. If you are confirmed by the Senate, are you willing to appear and testify before any duly constituted committee of the Congress on such occasions as you may be, reasonably requested to do so?

Yes

2. If you are confirmed by the Senate, are you willing to provide such information as is requested by such committees?

Yes

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RESPONSES TO QUESTIONS FROM SENATOR BAUCUS

*Question 1:* Does the IRS have sufficient resources to pursue the taxpayers who have participated in offshore credit card scams?

*Answer:* The use of foreign bank accounts to conceal income and assets poses a serious threat to the integrity of our tax system. Individuals can use major credit cards to readily access these foreign bank accounts to withdraw cash or pay for goods and services in the U.S. The identification of the individuals who have used these scams to evade taxes, and the collection of the taxes they owe, is critical. The IRS is in the process of obtaining from credit card companies the information needed to accurately assess the full extent of these scams. Based on the IRS' preliminary estimates, however, the IRS does not have the resources to pursue each probable case using traditional enforcement techniques. The IRS is devoting additional resources to these issues, but more may be needed. In considering the addition of resources, it is important that a balance be struck because the need to train, supervise, and administer new IRS personnel places significant limits on how quickly new (as opposed to existing) audit resources can be added productively for these cases.

Accordingly, the IRS has been engaged in a thorough evaluation of how its existing resources can be re-allocated without diminishing the IRS' ability to meet its traditional compliance responsibilities. The Treasury Department and the IRS are working with the taxpayer community on a number of resource-intensive issues that might be resolved through additional guidance, thereby freeing up additional audit

resources. The Treasury Department and the IRS also are exploring ways to streamline the enforcement process for taxpayers who have participated in these scams. AT present, the Treasury Department and the IRS are focusing on administrative steps that might be taken to expedite the identification and resolution of these cases. It is possible that this effort may lead to legislative proposals, as well, if measures are identified that would expedite the enforcement process without undermining taxpayer rights.

*Question 2:* Have the credit card companies been cooperating with the IRS' efforts to identify taxpayers who have participated in offshore credit card scams?

*Answer:* The IRS is using summonses to request information from three credit card companies (Mastercard, American Express, and Visa) that will allow it to identify individuals who may be using foreign bank accounts to conceal income or assets. Because these summonses require court approval, the IRS sought court approval through litigation instituted by the Department of Justice. The identification process has been and will continue to be a major challenge. While the IRS has concerns with the length of time it is taking to obtain the requested information, the IRS and the Department of Justice are working actively with each company to expedite the process. Each of the companies appears supportive of the IRS' goal of identifying U.S. taxpayers who may be evading taxes. Mastercard and American Express have produced some of the records sought by the summonses to them. We cannot yet assess whether the companies have cooperated fully with the IRS in its efforts to shut down these scams.

The status of each of these summons proceedings is described briefly below. In addition, the IRS, through litigation instituted by the Department of Justice, on August 29, 2002, requested court permission to serve summonses on a number of merchants that have accepted credit cards from cardholders who appear to be U.S. taxpayers. The information that Mastercard has provided to the IRS in many cases does not allow the IRS to identify the individuals who have used these credit cards to purchase goods and services in the U.S., so the IRS must obtain additional identifying information. The IRS believes that these merchants, which include airlines, hotels, and rental car companies, collect and retain information identifying the purchasers as part of these merchants' routine course of business.

I would be happy to update the Committee on the IRS' progress, and on the cooperation of these credit card companies, as these cases develop.

*MASTERCARD (MasterCard International)*

In October 2000, the IRS, with court approval, served a summons on MasterCard seeking information on credit cards issued by banks located in three foreign financial centers. Following a series of discussions, MasterCard and the government agreed that MasterCard would produce transaction records that had not yet been archived by MasterCard. This agreement preserved the Department of Justice's right to request archived information once the initial information received had been evaluated. Pursuant to this agreement, MasterCard produced records for approximately 1.7 million transactions.

Based on the information provided by MasterCard, the IRS has identified a number of U.S. taxpayers with foreign bank accounts that are accessed by credit card in the U.S. Enforcement actions already have been initiated against many of these taxpayers, and additional cases are being developed.

On August 20, 2002, the IRS was granted permission by the United States District Court for the Southern District of Florida to serve an additional summons on MasterCard. This summons requests information on credit cards issued by banks located in 33 foreign financial centers, including the three covered by the original summons.

*AMERICAN EXPRESS (American Express Travel Related Services Co.)*

In October 2000, the IRS, with court approval, served a summons on American Express seeking information on credit/charge cards used in the United States based on criteria indicating that the cards may be involved in an offshore credit card scam. American Express has claimed that it is unable to comply with the original summons request because its records do not reflect the citizenship of its cardholders, because its records are maintained in a form (*i.e.*, microfilm) that is burdensome to search, and because of alleged statutory and contractual restrictions that require American Express to notify its cardholders before the requested information can be provided.

After lengthy negotiations intended to address American Express' concerns, the Department of Justice and American Express agreed in March 2002 to a compromise basis for compliance with the summons. This compromise preserves the government's right to seek additional information. Under the compromise, American

Express is to provide complete application, credit investigation, and account information for the accounts meeting certain charge-history criteria. American Express has represented that approximately 600 accounts satisfy those criteria, and account statements were provided in April 2002. American Express, however, has claimed difficulty in locating application and credit investigation information for these accounts. This information would allow the IRS to more easily identify the cardholders. The IRS is still working with American Express to obtain the information it agreed to provide under the compromise, and additional information is being provided as it is located by American Express.

*VISA (Visa International)*

In March 2002, the IRS, with court approval, served a summons on VISA seeking information on credit cards issued by banks located in 33 foreign financial centers. VISA has expressed concerns that the information requested is extremely voluminous and that complying with the summons would impose considerable burden and expense on VISA. IRS and Department of Justice representatives have been meeting with VISA in an effort to address VISA's concerns and reach agreement on how VISA will comply with the summons. Because these discussions are ongoing, it is too early to assess whether VISA will cooperate fully with the IRS.

#### RESPONSES TO QUESTIONS FROM SENATOR GRAHAM

*Question 1:* I have introduced legislation, S. 1305, along with Senator Grassley that will clarify that professional employer organizations (PEOs) can collect and remit payroll taxes and provide health and retirement benefits. Last year Commissioner Rossotti wrote that the legislation would "facilitate . . . tax administration by reducing the number of returns we process and by reducing errors in calculating and paying employment taxes." Does the Treasury Department continue to support this legislation?

*Answer:* The Administration would support S. 1305, which would clarify the rules regarding PEOs. The Treasury Department and the IRS, in fact, recently released guidance regarding the maintenance of 401(k) plans by PEOs and are working on guidance regarding the collection of payroll taxes by PEOs.

*Question 2:* The Employee Benefit Research Institute reports that a growing percentage of retirement plan participants are holding on to all or part of their lump sum distributions rather than spending them on consumption. This is good news for those of us who are concerned whether Americans are financially prepared for their retirement. The tax code attempts to dissuade participants from prematurely consuming amounts set aside for retirement by subjecting them to a 10% penalty. I have been working on a proposal that would allow individuals who have previously withdrawn funds from their retirement plans to re-contribute those funds at a later date. The proposal doesn't quite put the worker back into the position he or she would have been in if the withdrawal had never been taken, because the 10% penalty would not be refunded and the contributions would be made on an after-tax basis. Nonetheless, it would provide an opportunity for a taxpayer to reverse a prior decision that had an adverse effect on his or her retirement security. Would the Administration support such a provision?

*Answer:* I agree with you that the preservation of retirement assets for retirement is an important matter. The Administration strongly supported the pension portability provisions that are part of the Economic Growth and Tax Relief Reconciliation Act of 2001. Your proposal to allow individuals who had taken earlier distributions from a plan to re-contribute all or part of those amounts would let these individuals restore those amounts to their retirement assets. However, it would be very difficult to administer such a system to ensure that the proper amounts were re-contributed to the plan. Without knowing the mechanics of how plan sponsors and IRA custodians would know whether the extra contribution qualified to be re-contributed and how the IRS could enforce those limits, it would be difficult for the Administration to lend its support to the proposal.

*Question 3:* Recently, questions have arisen about the classification of the YMCA Retirement Fund as a church plan. As you may know, the YMCA Retirement Fund has more than \$3 billion in assets and covers more than 7,500 retired beneficiaries. An adverse ruling would significantly disrupt the operation of the plan. This is particularly troubling because the IRS reviewed, and presumably approved, the plan's status in 1987. Would the Administration support legislation that would allow the YMCA Retirement Fund to maintain its present status?

*Answer:* The YMCA has for numerous years claimed church plan status for its retirement fund. Recently, the IRS reviewed the YMCA Retirement Fund and raised issues regarding whether the YMCA Retirement Fund actually meets the definition

of church plan under section 414(e)(1) of the Internal Revenue Code as “a plan established and maintained . . . by a church or by a convention or association of churches which is exempt from tax under section 501” of the Code. We have been told by representatives of the YMCA Retirement Fund that the IRS has not yet reached a conclusion in its determination.

A church plan does not have to follow many of the provisions of the Internal Revenue Code. For example, the YMCA did not allocate all of the earnings that the trust fund made each year to the account balances of participants; the Fund’s board declared what amount would be credited to participants’ accounts and the excess was credited to a reserve fund. This reserve fund is used by the Fund’s board to provide additional earnings to be credited to account balances and to increase annuity payments to retirees in years when the actual investment earnings on the fund are down. Only church plans are permitted to establish such a reserve fund and that is the reason the YMCA Retirement Fund wants to continue to be treated as a church plan. It should be noted that the information regarding the YMCA Retirement Fund was received by the Treasury Department’s Office of Tax Policy staff from the YMCA and its representatives, and not from the IRS, and that we have not asked the IRS to verify such information.

I understand that legislation designating the YMCA Retirement Fund as a church plan has not been introduced in the Senate. The Administration has not taken a position on this proposal.

*Question 4:* The previous Administration proposed the codification of the economic substance doctrine, arguing that taking such a step is necessary to fight the proliferation of corporate tax shelters. Does the current Administration support that approach? If not, please explain why including specific rules requiring that transactions have an economic purpose beyond creating tax benefits is unwarranted.

The Treasury Department believes that effective tax administration will not be furthered—and, in fact, may be hindered—by the codification of the judicial doctrine of economic substance. On May 2, 2002, I, along with Commissioner Langdon and Chief Counsel Williams, responded to the Committee’s written questions following its March 21, 2002, hearing on Abusive Corporate Tax Shelters. As reflected in those responses, the Treasury Department believes that the application of the economic substance doctrine depends on the particular facts of each case and, therefore, is concerned that an inflexible statutory rule codifying the economic substance doctrine may be both too broad and too narrow. The Treasury Department does not believe that codification of the doctrine would provide more certainty than the existing judicial doctrine.

The economic substance doctrine, along with the other common law doctrines such as the step-transaction and substance-over-form doctrines, are essential tools for attacking abusive tax avoidance transactions. The proper application of these doctrines is best ensured by asserting them in appropriate cases and supporting their application with fully developed facts. The Treasury Department’s Enforcement Proposals for Abusive Tax Avoidance Transactions, issued on March 20, 2002, would require the early disclosure of potentially abusive transactions. In cases where the assertion of a judicial doctrine would be appropriate, early disclosure will allow the IRS to fully develop the legal arguments and the supporting facts. The Treasury Department is gratified that many of these proposals are reflected in the Committee’s Tax Shelter Transparency Act (S. 2498).

More generally, the judicial doctrines are a part of the Treasury Department’s overall strategy to combat abusive tax avoidance transactions. This strategy, which is based on early disclosure, will subject questionable transactions to a rigorous, technical analysis by the Treasury Department and the IRS. In some cases, the alleged compliance with the technical Code requirements may not withstand scrutiny, and the transaction will be challenged on that basis. In other cases, the particular facts may indicate that one or more judicial doctrines should be asserted along with the technical arguments. In addition, where there may be some ambiguity in the law that is perceived to allow the purported tax benefits of an abusive transaction, early disclosure will allow the Treasury Department and the IRS to respond quickly to shut down the transaction through published guidance, including regulations. If an abusive transaction is not susceptible to challenge under existing statutes and judicial doctrines, early disclosure will permit the Treasury Department to move quickly and propose legislative changes to shut the transaction down.