Questions for the Record from Senator Carl Levin
to
Kathryn Keneally, Esq., Nominee for
Assistant Attorney General for Tax Division, Department of Justice

1. For the past several years, the Department of Justice (DOJ) Tax Division has been engaged in a sustained effort to curtail offshore tax evasion, using civil and criminal proceedings to identify U.S. taxpayers with unreported accounts at foreign financial institutions. Among other measures, the Tax Division has prosecuted taxpayers with unreported accounts and unpaid taxes as well as bankers, attorneys, and other professionals who facilitated U.S. tax evasion.

a. If confirmed as Assistant Attorney General for the Tax Division, what priority would you place on that ongoing legal effort?

Answer: The Tax Division has currently identified the Offshore Compliance Initiative as its top litigation priority, and I agree with that position. I fully support the Tax Division's Offshore Compliance Initiative. It is important to encourage taxpayers to remedy past non-compliance through voluntary disclosure, and to pursue criminal prosecution and civil penalties against those in non-compliance. The public efforts by the Tax Division to obtain the disclosure of U.S. account-holders by foreign banks, through negotiations and enforcement, have resulted in record numbers of voluntary disclosures and a significant number of convictions. The Tax Division has also correctly and effectively focused enforcement efforts on the bankers, attorneys and other professionals who facilitated U.S. tax evasion. If confirmed, I will advocate that these efforts should be continued and must remain a priority.

b. What is your view of efforts by some foreign jurisdictions to provide a cash settlement in place of providing the names of U.S. taxpayers with unreported accounts in their jurisdictions?

Answer: The only information that I have concerning efforts by any foreign jurisdictions to provide a cash settlement in place of providing the names of U.S. taxpayers with unreported accounts comes from press reports. It is my view that cash settlements cannot serve the same law enforcement goals as obtaining the names of U.S. taxpayers with unreported accounts. It is essential that the Tax Division focus on enforcement that fosters voluntary compliance by taxpayers. When it became known that foreign banks would provide names of U.S. taxpayers with unreported accounts, a record number of taxpayers came forward to make voluntary disclosures. It was the fact that names might be disclosed that enabled the IRS to bring many thousands of taxpayers, and hundreds of millions of dollars, back into the tax system. It is also through the provision of names of U.S. taxpayers with unreported foreign bank accounts that the Tax Division has been able to prosecute criminal tax evasion.

2. In October 2000, a federal court approved a request by the Internal Revenue Service (IRS) to issue a John Doe summons to credit card companies to obtain the names of the holders of credit

cards issued by banks in three offshore tax havens, Antigua and Barbuda, the Bahamas, and the Cayman Islands. In 2001, you authored an article entitled, "Targeting Offshore Activities; The IRS's Next Step." In that article, you wrote that the IRS summons was unprecedented in scope and purpose and that the court's approval of the summons was "perfunctory," criticizing the court's determination that the IRS had met the three legal criteria for approval: that the IRS had identified an ascertainable class; the IRS had established that a reasonable basis existed to believe that the persons within that class may have violated tax laws; and the information sought by the subpoena was not readily available from other sources. You also noted the "extreme deference of the court in yielding to the IRS assertions," and called the summons a "fishing expedition," because it sought the records of all credit card holders at banks in the three offshore jurisdictions.

a. Do you still believe that the court's approval of the summons was perfunctory?

Answer: I believe that subsequent events proved the correctness of the John Doe summons in the investigation of the use of credit cards affiliated with offshore bank accounts to evade U.S. taxes. The October 2000 summons led to effective and significant tax enforcement. I also believe that the more recent use of John Doe summonses in connection with the enforcement efforts by the IRS and the Tax Division against the use of offshore bank accounts has been appropriate and highly effective.

b. You characterized the court as giving "extreme deference" to the IRS's assertions presented in its petition to the court. Do you believe that such deference was incorrect?

Answer: I believe that subsequent events proved the correctness of the John Doe summons in the investigation of the use of credit cards affiliated with offshore bank accounts to evade U.S. taxes. The October 2000 summons led to effective and significant tax enforcement. I also believe that the more recent use of John Doe summonses in connection with the enforcement efforts by the IRS and the Tax Division against the use of offshore bank accounts has been appropriate and highly effective.

c. You noted in the article that the IRS is required to petition and obtain approval for the issuance of a John Doe summons. Internal Revenue Code (IRC) Section 7609(h)(2) directs the IRS to proceed ex parte in the proceeding, and the statute expressly provides that the court shall make its determination "solely on the [IRS] petition and supporting affidavits." Do you disagree with the process established in IRC 7609(h)(2)? If so, what changes would you recommend in the statute?

Answer: I have no disagreement with the process established in IRC 7609(h)(2).

d. Do you still believe the summons issued by the IRS was a "fishing expedition"?

Answer: I believe that subsequent events proved the correctness of the John Doe summons in the investigation of the use of credit cards affiliated with offshore bank accounts to evade U.S. taxes. The October 2000 summons led to effective and significant tax enforcement. I also believe that the more recent use of John Doe summonses in connection with the enforcement efforts by the IRS and the Tax Division against the use of offshore bank accounts has been appropriate and highly effective.

e. If you were confirmed as Assistant Attorney General for the Tax Division, would you advocate against the issuance or use of similar types of summonses by the IRS?

Answer: No. If I am given the opportunity to serve as Assistant Attorney General for the Tax Division, I will use and encourage the use of the tools available for effective tax enforcement. The John Doe summons issued in October 2000 in connection with U.S. taxpayers who used credit cards affiliated with offshore bank accounts to evade U.S. taxes, and the more recent use of John Doe summonses in connection with the enforcement efforts by the IRS and the Tax Division against the use of offshore bank accounts, have demonstrated that such summonses can be highly effective in tax enforcement.

f. If confirmed as Assistant Attorney General for the Tax Division, would you advocate against DOJ supporting in court the IRS issuance of similar subpoenas?

Answer: No. If I am given the opportunity to serve as Assistant Attorney General for the Tax Division, I will use and encourage the use of the tools available for effective tax enforcement. The John Doe summons issued in October 2000 in connection with U.S. taxpayers who used credit cards affiliated with offshore bank accounts to evade U.S. taxes, and the more recent use of John Doe summonses in connection with the enforcement efforts by the IRS and the Tax Division against the use of offshore bank accounts, have demonstrated that such summonses can be highly effective in tax enforcement.

g. Do you believe that the John Doe summonses issued by the IRS against UBS Bank and HSBC Bank (subsequently withdrawn) were appropriate in scope? Were the reviews by the courts perfunctory? Did the courts give too much deference to IRS assertions contained in the petitions to the courts in support of those summonses?

Answer: I believe that John Doe summonses have been one of the most effective tools in the enforcement efforts by the IRS and the Tax Division against tax evasion through offshore bank accounts, and that John Doe summonses are a vital tool in tax enforcement. I have only a general familiarity with public reports concerning the proceedings surrounding the John Doe summonses against UBS Bank and HSBC Bank, and therefore cannot comment specifically concerning those proceedings. In conjunction with these John Doe summonses and other enforcement activities, the IRS announced two voluntary disclosure initiatives, in 2009 and 2011, to provide U.S. taxpayers with offshore bank accounts an opportunity to avoid criminal liability and minimize penalties through voluntary disclosure. Based on my experience as a private practitioner representing taxpayers in the voluntary disclosure programs, I know that the publicity surrounding the John Doe summons proceedings, and the disclosure of account-holder names by foreign banks, was highly effective in motivating taxpayers to come into compliance.

h. As Assistant Attorney General for the Tax Division, would you advocate that any additional criteria or procedures be added to internal reviews by the IRS or DOJ before determining to seek judicial approval to serve, or seek enforcement of, a John Doe summons in a tax matter?

Answer: I have no reason to believe that additional criteria or procedures are necessary.

i. In the same article you were critical of IRS efforts to use Currency Transaction Reports (CTRs) and Cash Monetary Instrument Reports (CMIRs) to obtain information that could identify U.S. taxpayers who are failing to report offshore accounts, as required by law. The article suggested that the CTRs and the CMIRs were being misused by the IRS: "Now the IRS clearly hopes to use evidence developed through the debit and credit card records to tie taxpayers to currency transfers and foreign bank accounts. Instead of using the various reporting requirements to detect crime, the failure to have reported the transactions and the existence of offshore accounts will become the basis for criminal charges." Do you view the failure to report the existence of a foreign bank account on a federal tax form as a potential crime? Do you view the use of CTRs and CMIRs by the IRS to obtain information about unreported offshore accounts as inappropriate?

Answer: The willful failure to report the existence of a foreign bank account on a federal tax form is a crime. The willful failure to file CTRs and CMIRs, and willful conduct to cause CTRs and CMIRs not to be filed, are crimes. The use of CTRs and CMIRs has proven valuable to the IRS in tax enforcement, including in obtaining information about unreported offshore accounts.

It was not my intention that the referenced article suggest that CTRs and CMIRs were being misused by the IRS. The article was intended to alert the practitioner community of a change in the focus of the use of these forms in tax enforcement. To put the article in context, in 1999, the Webster Report had made significant findings that the IRS Criminal Investigation Division had moved from its core mission of tax enforcement, and that instead its resources had been diverted to drug enforcement. In 2000, IRS Criminal Investigation was reorganized and re-dedicated to tax enforcement as its primary mission. I am in general agreement with the conclusions of the Webster Report and the steps that were taken in response. The discussion in the article concerning CTRs and CMIRs was intended to report that these forms, which had previously been used to trace funds in illegal activity such as drug enforcement, would now be the focus of criminal charges in tax cases.

j. As Assistant Attorney General for the Tax Division, would you advocate that the IRS not use information obtained through CMIRs and CTRs as a basis for bringing charges against taxpayers who fail to report offshore accounts?

Answer: No. If I am given the opportunity to serve as Assistant Attorney General for the Tax Division, I will use and encourage the use of the tools available for effective tax enforcement. CTRs and CMIRs have proven to be valuable law enforcement tools.

k. As Assistant Attorney General for the Tax Division, would you advocate against DOJ supporting in court charges brought by the IRS against taxpayers based upon information obtained through CTRs or CMIRs?

Answer: No. If I am given the opportunity to serve as Assistant Attorney General for the Tax Division, I will use and encourage the use of the tools available for effective tax enforcement. CTRs and CMIRs have proven to be valuable law enforcement tools.

3. In the late 1990s and early 2000s, the IRS initiated a concerted effort to stop the marketing and use of abusive tax shelters. The IRS targeted a particularly abusive class of shelters, called "Son of Boss," which were mass marketed, had no economic substance, and in some instances were supported by boiler plate tax opinions that contained blank spaces to fill in the names and details of the taxpayer. The IRS aggressively pursued taxpayers that used the shelters, as well as the lawyers and tax professionals who designed them and issued supportive opinions. In 2004, the IRS implemented a settlement initiative that enabled taxpayers who used the shelters to pay back taxes, interest and, if assessed, penalties and avoid litigation and possibly higher penalties. Those taxpayers who declined to participate in the initiative were denied access to the IRS appeals process and would have to contest tax and penalty assessments through litigation in the courts. In 2008, you co-authored an article that was critical of the IRS settlement initiative. The article characterized it as "a settlement initiative that deprived taxpayers of the right to go to IRS Appeals," stating that the IRS had taken "a broad brush approach to tax shelter enforcement" over the previous years. The article also accused the IRS of putting "a gloss ... on a range of transactions without consideration to the specific merits of any taxpayer's activities." It was also critical of DOJ's indictments of tax professionals who marketed the transactions. Yet, a number of those tax professionals -- including some attorneys -- subsequently pleaded guilty to, or were convicted of, criminal offenses. In addition, the IRS position on those shelters has been upheld in all cases tried through the Appellate level in the federal courts.

a. Do you still believe, in light of the facts associated with the "Son of Boss" shelters, and the IRS' record of success in court, that the IRS settlement initiative put "a gloss ... on a range of transactions without consideration to the specific merits of any taxpayer's activities"?

Answer: I believe that the IRS settlement initiative, followed by the criminal prosecutions and civil litigation efforts of the Department of Justice and the IRS, proved highly effective in addressing the challenges to the tax system created by the "Son of BOSS" shelters. The IRS faced a serious enforcement challenge in connection with the recent era of tax shelters, as documented by two significant and detailed reports of the Permanent Subcommittee on Investigations of the U.S. Senate Committee on Homeland Security and Government Affairs. Prominent accounting firms and law firms had put thousands of clients into structured transactions that were ultimately shown to serve no purpose other than tax avoidance or evasion. The IRS settlement initiatives were in general an effective means to resolve a large number of these cases. The IRS and the Tax Division have also engaged in significant and effective litigation against taxpayers who participated in abusive tax shelters, as well as civil injunction and penalty enforcement against tax shelter promoters, including attorneys and other tax professionals. It was also important that criminal charges be brought against the tax professionals, including lawyers and accountants, who engaged in fraudulent activity in developing, promoting, and implementing abusive tax shelters. These combined enforcement efforts addressed a serious challenge to the tax system, resulted in the recovery of billions of dollars in taxes, penalties and interest, and served general and specific deterrence goals.

While the language in the referenced article could have made the point more clearly, my main concern with the IRS settlement initiative was the IRS decision to eliminate review by IRS Appeals in "Son of BOSS" cases. IRS Appeals serves a vital, independent review function. In a number of settlement initiatives subsequent to the "Son of BOSS" settlement initiative, taxpayers were permitted to make presentations at IRS Appeals, in particular on penalty issues. It was my experience as a practitioner that this opportunity allowed taxpayers to feel that their positions had been given a fair hearing, and engendered confidence in the integrity of the tax system. Allowing taxpayers to proceed to IRS Appeals to address unique or unusual circumstances may also have had the beneficial effect of reducing the number of taxpayers who rejected settlement initiatives outright and elected engage in litigation, which imposed additional burdens on the IRS, the Tax Division, and the courts. If confirmed, I would respect the discretion of the IRS to determine its settlement initiatives, and would keep an open mind and give careful consideration to the use of settlement initiatives at all stages in cases handled by the Tax Division. I believe that my experience as a practitioner who has represented taxpayers before the IRS and the Tax Division may provide a helpful perspective on this and other issues.

I would like to note that, although I have represented taxpayers before the IRS and in litigation concerning listed transactions or tax shelters, I have never structured, promoted, or advised a client to participate in these types of transactions, and I have instead advised strongly against participation in such transactions.

b. As Assistant Attorney General for the Tax Division, would you advocate that the IRS await a judicial ruling regarding the validity of a tax shelter -- no matter how abusive that shelter may be -- before offering a settlement initiative like the "Son of Boss" settlement?

Answer: No. Settlement initiatives are a useful mechanism to resolve tax disputes, and can be used effectively at any stage in a proceeding, or at successive stages in a proceeding. If confirmed, I would respect the discretion of the IRS to determine the best use of this tool in its cases, and would keep an open mind and give careful consideration to the use of settlement initiatives at all stages in cases handled by the Tax Division.

c. As Assistant Attorney General for the Tax Division, would you advocate that DOJ not indict or take other legal action against tax professionals or attorneys who designed and marketed a tax shelter -- no matter how abusive that shelter may be -- before a judicial ruling on the validity of the shelter itself?

Answer: No. When there is evidence of criminal conduct, there is no reason to wait for the outcome of civil litigation concerning a tax shelter. Additionally, civil injunctions can be an important tool to stop such activities and to protect taxpayers and the public. In such cases, criminal and civil enforcement against tax professionals and attorneys serves important goals of general and specific deterrence. If confirmed, I will be guided by these principles.

d. As Assistant Attorney General for the Tax Division, would you advocate against the IRS establishing similar settlement conditions in the future? Would you oppose any settlement initiative that required a taxpayer to waive the right to an IRS appeal?

Answer: No. Settlement initiatives are a useful mechanism to resolve tax disputes, and can be used effectively at any stage in a proceeding, or at successive stages in a proceeding. The tax shelter industry posed a grave threat to the tax system, and the settlement initiatives served an important function in resolving a large number of cases in a challenging area of tax enforcement. If confirmed, I would respect the discretion of the IRS to determine the best use of this tool in its cases, and would keep an open mind and give careful consideration to the use of settlement initiatives at all stages in cases handled by the Tax Division.

IRS Appeals serves a vital, independent review function, and plays a valuable role in facilitating settlements. I believe that my experience as a practitioner who has represented taxpayers before the IRS and the Tax Division may provide a helpful perspective on this and other issues. If confirmed, I would keep an open mind and listen to and consider all views.

e. Would you advocate against DOJ supporting in court similar IRS settlement initiatives in the future?

Answer: No. The tax shelter industry posed a grave threat to the tax system, and the settlement initiatives served an important function in resolving a large number of cases in a challenging area of tax enforcement. If confirmed, I would respect the discretion of the IRS to determine the best use of this tool in its cases, and would keep an open mind and give careful consideration to the use of settlement initiatives at all stages in cases handled by the Tax Division.

4. In 2009, you co-authored an article that was highly critical of the First Circuit's decision in Textron Inc. and the IRS' approach to gaining access to corporate tax accrual work papers.

a. Do you still view corporate tax accrual work papers as attorney work product that should not be requested by the IRS?

Answer: I have never viewed corporate tax accrual work papers as attorney work product per se. In some circumstances, corporate tax accrual work papers may contain material that constitutes attorney work product. I am in agreement with the general principles set out in the IRS "Policy of Restraint," which is part of the Internal Revenue Manual.

b. If confirmed as Assistant Attorney General for the Tax Division, would you advocate that the IRS not request access to corporate tax accrual work papers or advocate that DOJ decline to enforce such a request in court?

Answer: No. If I am given the opportunity to serve as Assistant Attorney General for the Tax Division, I will use and encourage the use of the tools available for effective tax enforcement, including access to corporate tax accrual workpapers in the appropriate case. I also recognize that the issue of whether to enforce a request in court concerning corporate tax accrual work papers must include consideration of legal precedent on this issue, including the *Textron* decision.

c. As Assistant Attorney General for the Tax Division, would you advocate that any additional criteria or procedures be added to internal reviews by the IRS or DOJ before making a request for corporate tax accrual work papers or defending requests for such papers in court? If so, what changes would you advocate?

Answer: If I am given the opportunity to serve as Assistant Attorney General for the Tax Division, my first priority will be to listen and to learn about the current policies, practices, and enforcement efforts of the Tax Division. I am in agreement with the general principles set out in the IRS "Policy of Restraint," which is part of the Internal Revenue Manual. I am also aware that the litigation needs of the Tax Division may differ from and be broader than the needs of the IRS in an examination. I have an open mind on this and all issues.

5. The articles cited above are highly critical of IRS efforts to combat tax abuse and suggest that the reviewed IRS initiatives were too aggressive. If confirmed as Assistant Attorney General for the Tax Division, would you attempt to rein in those initiatives or similar future initiatives and, if so, in what ways?

Answer: Through my experience as a tax practitioner representing clients in matters before the IRS and the Tax Division, and in my review of public information available about the IRS and the Tax Division's current initiatives, I am familiar with a number of current tax enforcement initiatives. I am not aware of any on-going initiatives by the IRS or the Tax Division that I would seek to "rein in." I have the highest regard for the IRS and the Tax Division, and have expressed this regard many times in my writings and in public presentations. While I have had disagreements with specific actions taken by the IRS from time to time, I welcome this opportunity to state in the strongest terms that the role of the IRS is vital to the functioning of the United States. It has been my experience that IRS agents, IRS leadership, and the attorneys and leaders of the Tax Division are dedicated professionals who act with the best of intention in the service of the tax system. The tax gap is a serious challenge to the United States. The failure of some taxpayers to meet their obligations serves as a great unfairness to the majority of taxpayers who are in compliance. It is a privilege to be considered for the position of Assistant Attorney General for the Tax Division. To be given this opportunity to work with the dedicated professionals in the IRS and the Tax Division in this capacity would be a high responsibility and a true honor.