



United States Senate
Permanent Subcommittee on Investigations
199 Russell Senate Office Building
Washington, D.C. 20510

Memorandum

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TO: COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS

FROM: ELISE J. BEAN 
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Permanent Subcommittee on Investigations

RE: PSI ACTIVITIES – 113th CONGRESS (2013-2014)

The following is the Activities Report of the Permanent Subcommittee on Investigations for the 113th Congress.

I. Historical Background

A. Subcommittee Jurisdiction

The Permanent Subcommittee on Investigations was originally authorized by Senate Resolution 189 on January 28, 1948. At its creation in 1948, the Subcommittee was part of the Committee on Expenditures in the Executive Departments. The Subcommittee's records and broad investigative jurisdiction over government operations and national security issues, however, actually antedate its creation, since it was given custody of the jurisdiction of the former Special Committee to Investigate the National Defense Program (the so-called "War Investigating Committee" or "Truman Committee"), chaired by Senator Harry S. Truman during the Second World War and charged with exposing waste, fraud, and abuse in the war effort and war profiteering. Today, the Subcommittee is part of the Committee on Homeland Security and Governmental Affairs.¹

The Subcommittee has had nine chairmen: Senators Homer Ferguson of Michigan (1948), Clyde R. Hoey of North Carolina (1949-1952), Joseph R. McCarthy of Wisconsin (1953-1954), John L. McClellan of Arkansas (1955-1972), Henry M. Jackson of Washington (1973-

¹ In 1952, the parent committee's name was changed to the Committee on Government Operations. It was changed again in early 1977, to the Committee on Governmental Affairs, and again in 2005, to the Committee on Homeland Security and Governmental Affairs, its present title.

1978), Sam Nunn of Georgia (1979-1980 and 1987-1994), William V. Roth of Delaware (1981-1986 and 1995-1996), Susan M. Collins of Maine (1997-2001); Norm Coleman of Minnesota (2003-2007); and Carl Levin of Michigan (2001-2002 and 2007-2014).

Until 1957, the Subcommittee's jurisdiction focused principally on waste, inefficiency, impropriety, and illegality in government operations. Its jurisdiction then expanded over time, today encompassing investigations within the broad ambit of the parent committee's responsibility for matters relating to the efficiency and economy of operations of all branches of the government, including matters related to: (a) waste, fraud, abuse, malfeasance, and unethical practices in government contracting and operations; (b) organized criminal activities affecting interstate or international commerce; (c) criminal activity affecting the national health, welfare, or safety, including investment fraud, commodity and securities fraud, computer fraud, and offshore abuses; (d) criminality or improper practices in labor-management relations; (e) the effectiveness of present national security methods, staffing and procedures, and U.S. relationships with international organizations concerned with national security; (f) energy shortages, energy pricing, management of government-owned or controlled energy supplies; and relationships with oil producing and consuming countries; and (g) the operations and management of Federal regulatory policies and programs. While retaining the status of a subcommittee of a standing committee, the Subcommittee has long exercised its authority on an independent basis, selecting its own staff, issuing its own subpoenas, and determining its own investigatory agenda.

The Subcommittee acquired its sweeping jurisdiction in several successive stages. In 1957 – based on information developed by the Subcommittee – the Senate passed a Resolution establishing a Select Committee on Improper Activities in the Labor or Management Field. Chaired by Senator McClellan, who also chaired the Subcommittee at that time, the Select Committee was composed of eight Senators – four of whom were drawn from the Subcommittee on Investigations and four from the Committee on Labor and Public Welfare. The Select Committee operated for 3 years, sharing office space, personnel, and other facilities with the Permanent Subcommittee. Upon its expiration in early 1960, the Select Committee's jurisdiction and files were transferred to the Subcommittee on Investigations, greatly enlarging the latter body's investigative authority in the labor-management area.

The Subcommittee's jurisdiction expanded further during the 1960s and 1970s. In 1961, for example, it received authority to make inquiries into matters pertaining to organized crime and, in 1963, held the famous Valachi hearings examining the inner workings of the Italian Mafia. In 1967, following a summer of riots and other civil disturbances, the Senate approved a Resolution directing the Subcommittee to investigate the causes of this disorder and to recommend corrective action. In January 1973, the Subcommittee acquired its national security mandate when it merged with the National Security Subcommittee. With this merger, the Subcommittee's jurisdiction was broadened to include inquiries concerning the adequacy of national security staffing and procedures, relations with international organizations, technology transfer issues, and related matters. In 1974, in reaction to the gasoline shortages precipitated by the Arab-Israeli war of October 1973, the Subcommittee acquired jurisdiction to investigate the control and management of energy resources and supplies as well as energy pricing issues.

In 1997, the full Committee on Governmental Affairs was charged by the Senate to conduct a special examination into illegal or improper activities in connection with Federal election campaigns during the 1996 election cycle. The Permanent Subcommittee provided substantial resources and assistance to this investigation, contributing to a greater public understanding of what happened, to subsequent criminal and civil legal actions taken against wrongdoers, and to enactment of campaign finance reforms in 2001.

In 1998, the Subcommittee marked the fiftieth anniversary of the Truman Committee's conversion into a permanent subcommittee of the U.S. Senate.² Since then, the Subcommittee has developed particular expertise in complex financial matters, examining the collapse of Enron Corporation in 2001, the key causes of the 2008 financial crisis, structured finance abuses, financial fraud, unfair credit practices, money laundering, commodity speculation, and a wide range of offshore and tax haven abuses. It has also focused on issues involving health care fraud, foreign corruption, and waste, fraud and abuse in government programs. In the half-century of its existence, the Subcommittee's many successful investigations have made clear to the Senate the importance of retaining a standing investigatory body devoted to keeping government not only efficient and effective, but also honest and accountable.

B. Subcommittee Investigations

Armed with its broad jurisdictional mandate, the Subcommittee has conducted investigations into a wide variety of topics of public concern, ranging from financial misconduct, to commodities speculation, predatory lending, and tax evasion. Over the years, the Subcommittee has also conducted investigations into criminal wrongdoing, including money laundering, the narcotics trade, child pornography, labor racketeering, and organized crime activities. In addition, the Subcommittee has investigated a wide range of allegations of waste, fraud, and abuse in government programs and consumer protection issues, addressing problems ranging from unfair credit card practices to health care fraud. In the 113th Congress, the Subcommittee held eight hearings and issued ten reports on a wide range of issues, including bank misconduct, hidden offshore bank accounts, corporate tax avoidance, online advertising abuses, conflicts of interest affecting the stock market, missteps in processing 501(c)(4) applications for tax-exempt status, defense acquisition problems, and inappropriate bank involvement with physical commodities.

(1) Historical Highlights

The Subcommittee's investigatory record as a permanent Senate body began under the Chairmanship of Republican Senator Homer Ferguson and his Chief Counsel (and future Attorney General and Secretary of State) William P. Rogers, as the Subcommittee inherited the

² This anniversary also marked the first date upon which internal Subcommittee records generally began to become available to the public. Unlike most standing committees of the Senate whose previously unpublished records open after a period of 20 years has elapsed, the Permanent Subcommittee on Investigations, as an investigatory body, may close its records for 50 years to protect personal privacy and the integrity of the investigatory process. With this 50th anniversary, the Subcommittee's earliest records, housed in the Center for Legislative Archives at the National Archives and Records Administration, began to open seriatim. The records of the predecessor committee – the Truman Committee – were opened by Senator Nunn in 1980.

Truman Committee's role in investigating fraud and waste in U.S. Government operations. This investigative work became particularly colorful under the chairmanship of Senator Clyde Hoey, a North Carolina Democrat who took the chair from Senator Ferguson after the 1948 elections. The last U.S. Senator to wear a long frock coat and wing-tipped collar, Mr. Hoey was a distinguished southern gentleman of the old school. Under his leadership, the Subcommittee won national attention for its investigation of the so-called "five percenters," notorious Washington lobbyists who charged their clients five percent of the profits from any Federal contracts they obtained on the client's behalf. Given the Subcommittee's jurisdictional inheritance from the Truman Committee, it is perhaps ironic that the "five percenters" investigation raised allegations of bribery and influence-peddling that reached right into the White House and implicated members of President Truman's staff. In any event, the fledgling Subcommittee was off to a rapid start.

What began as colorful soon became contentious. When Republicans returned to the Majority in the Senate in 1953, Wisconsin's junior Senator, Joseph R. McCarthy, became the Subcommittee's Chairman. Two years earlier, as Ranking Minority Member, Senator McCarthy had arranged for another Republican Senator, Margaret Chase Smith of Maine, to be removed from the Subcommittee. Senator Smith's offense, in Senator McCarthy's eyes, was her issuance of a "Declaration of Conscience" repudiating those who made unfounded charges and used character assassination against their political opponents. Although Senator Smith had carefully declined to name any specific offender, her remarks were universally recognized as criticism of Senator McCarthy's accusations that communists had infiltrated the State Department and other government agencies. Senator McCarthy retaliated by engineering Senator Smith's removal, replacing her with the newly-elected Senator from California, Richard Nixon.

Upon becoming Subcommittee Chairman, Senator McCarthy staged a series of highly publicized anti-communist investigations, culminating in an inquiry into communism within the U.S. Army, which became known as the Army-McCarthy hearings. During the latter portion of those hearings, in which the parent Committee examined the Wisconsin Senator's attacks on the Army, Senator McCarthy recused himself, leaving South Dakota Senator Karl Mundt to serve as Acting Chairman of the Subcommittee. Gavel-to-gavel television coverage of the hearings helped turn the tide against Senator McCarthy by raising public concern about his treatment of witnesses and cavalier use of evidence. In December 1954, the Senate censured Senator McCarthy for unbecoming conduct. In the following year, the Subcommittee adopted new rules of procedure that better protected the rights of witnesses. The Subcommittee also strengthened the rules ensuring the right of both parties on the Subcommittee to appoint staff, initiate and approve investigations, and review all information in the Subcommittee's possession.

In 1955, Senator John McClellan of Arkansas began 18 years of service as Chairman of the Permanent Subcommittee on Investigations. Senator McClellan appointed a young Robert F. Kennedy as the Subcommittee's Chief Counsel. That same year, Members of the Subcommittee were joined by Members of the Senate Labor and Public Welfare Committee on a special committee to investigate labor racketeering. Chaired by Senator McClellan and staffed by Robert Kennedy and other Subcommittee staff members, this special committee directed much of its attention to criminal influence over the Teamsters Union, most famously calling Teamsters' leaders Dave Beck and Jimmy Hoffa to testify. The televised hearings of the special

committee also introduced Senators Barry Goldwater and John F. Kennedy to the nation, as well as leading to passage of the Landrum-Griffin Labor Act.

After the special committee completed its work, the Permanent Subcommittee on Investigations continued to investigate organized crime. In 1962, the Subcommittee held hearings during which Joseph Valachi outlined the activities of La Cosa Nostra, or the Mafia. Former Subcommittee staffer Robert Kennedy – who had by then become Attorney General in his brother’s Administration – used this information to prosecute prominent mob leaders and their accomplices. The Subcommittee’s investigations also led to passage of major legislation against organized crime, most notably the Racketeer Influenced and Corrupt Organizations (RICO) provisions of the Crime Control Act of 1970. Under Chairman McClellan, the Subcommittee also investigated fraud in the purchase of military uniforms, corruption in the Department of Agriculture’s grain storage program, securities fraud, and civil disorders and acts of terrorism. In addition, from 1962 to 1970, the Subcommittee conducted an extensive probe of political interference in the awarding of government contracts for the Pentagon’s ill-fated TFX (“tactical fighter, experimental”) aircraft. In 1968, the Subcommittee also examined charges of corruption in U.S. servicemen’s clubs in Vietnam and elsewhere around the world.

In 1973, Senator Henry “Scoop” Jackson, a Democrat from Washington, replaced Senator McClellan as the Subcommittee’s Chairman. During his tenure, recalled Chief Clerk Ruth Young Watt – who served in this position from the Subcommittee’s founding until her retirement in 1979 – Ranking Minority Member Charles Percy, an Illinois Republican, became more active on the Subcommittee than Chairman Jackson, who was often distracted by his Chairmanship of the Interior Committee and his active role on the Armed Services Committee.³ Senator Percy also worked closely with Georgia Democrat Sam Nunn, a Subcommittee member who subsequently succeeded Senator Jackson as Subcommittee Chairman in 1979. As Chairman, Senator Nunn continued the Subcommittee’s investigations into the role of organized crime in labor-management relations and also investigated pension fraud.

Regular reversals of political fortunes in the Senate during the 1980s and 1990s saw Senator Nunn trade the chairmanship three times with Delaware Republican William Roth. Senator Nunn served from 1979 to 1980 and again from 1987 to 1995, while Senator Roth served from 1981 to 1986, and again from 1995 to 1996. These 15 years saw a strengthening of the Subcommittee’s bipartisan tradition in which investigations were initiated by either the Majority or Minority and fully supported by the entire Subcommittee. For his part, Senator Roth led a wide range of investigations into commodity investment fraud, offshore banking schemes, money laundering, and child pornography. Senator Nunn led inquiries into Federal drug policy, the global spread of chemical and biological weapons, abuses in Federal student aid programs, computer security, airline safety, and health care fraud. Senator Nunn also appointed the

³ It had not been uncommon in the Subcommittee’s history for the Chairman and Ranking Minority Member to work together closely despite partisan differences, but Senator Percy was unusually active while in the Minority – a role that included his chairing an investigation of the hearing aid industry.

Subcommittee's first female counsel, Eleanore Hill, who served as Chief Counsel to the Minority from 1982 to 1986 and then as Chief Counsel from 1987 to 1995.

Strong bipartisan traditions continued in the 105th Congress when, in January 1997, Republican Senator Susan Collins of Maine became the first woman to chair the Permanent Subcommittee on Investigations. Senator John Glenn of Ohio became the Ranking Minority Member, while also serving as Ranking Minority Member of the full Committee. Two years later, in the 106th Congress, after Senator Glenn's retirement, Michigan Democrat Carl Levin succeeded him as the Subcommittee's Ranking Minority Member. During Senator Collins' chairmanship, the Subcommittee conducted investigations into issues affecting Americans in their day-to-day lives, including mortgage fraud, deceptive mailings and sweepstakes promotions, phony credentials obtained through the Internet, day trading of securities, and securities fraud on the Internet. Senator Levin initiated an investigation into money laundering. At his request, in 1999, the Subcommittee held hearings on money laundering issues affecting private banking services provided to wealthy individuals, and, in 2001, on how major U.S. banks providing correspondent accounts to offshore banks were being used to advance money laundering and other criminal schemes.

During the 107th Congress, both Senator Collins and Senator Levin chaired the Subcommittee. Senator Collins was chairman until June 2001, when the Senate Majority party changed hands; at that point, Senator Levin assumed the chairmanship and Senator Collins, in turn, became the Ranking Minority Member. In her first six months chairing the Subcommittee at the start of the 107th Congress, Senator Collins held hearings examining issues related to cross border fraud, the improper operation of tissue banks, and Federal programs designed to fight diabetes. When Senator Levin assumed the chairmanship, as his first major effort, the Subcommittee initiated an 18-month bipartisan investigation into the Enron Corporation, which had collapsed into bankruptcy. As part of that investigation, the Subcommittee reviewed over 2 million pages of documents, conducted more than 100 interviews, held four hearings, and issued three bipartisan reports focusing on the role played by Enron's Board of Directors, Enron's use of tax shelters and structured financial instruments, and how major U.S. financial institutions contributed to Enron's accounting deceptions, corporate abuses, and ultimate collapse. The Subcommittee's investigative work contributed to passage of the Sarbanes-Oxley Act which enacted accounting and corporate reforms in July 2002. In addition, Senator Levin continued the money laundering investigation initiated while he was the Ranking Minority Member, and the Subcommittee's work contributed to enactment of major reforms strengthening U.S. anti-money laundering laws in the 2001 Patriot Act. Also during the 107th Congress, the Subcommittee opened new investigations into offshore tax abuses, border security, and abusive practices related to the pricing of gasoline and other fuels.

In January 2003, at the start of the 108th Congress, after the Senate Majority party again changed hands, Senator Collins was elevated to Chairman of the full Committee on Governmental Affairs, and Republican Senator Norm Coleman of Minnesota became Chairman of the Subcommittee. Over the next two years, Senator Coleman held hearings on topics of national and global concern including illegal file sharing on peer-to-peer networks, abusive practices in the credit counseling industry, the dangers of purchasing pharmaceuticals over the Internet, SARS preparedness, border security, and how Saddam Hussein abused the United

Nations Oil for Food Program. At the request of Senator Levin, then Ranking Minority Member, the Subcommittee also examined how some U.S. accounting firms, banks, investment firms, and tax lawyers were designing, promoting, and implementing abusive tax shelters across the country; and how some U.S. financial institutions were failing to comply with anti-money laundering controls mandated by the Patriot Act, using as a case history Riggs Bank accounts involving Augusto Pinochet, the former President of Chile, and Equatorial Guinea, an oil-rich country in Africa.

During the 109th Congress, Senator Coleman held additional hearings on abuses associated with the United Nation's Oil for Food Program, and initiated a series of hearings on federal contractors who were paid with taxpayer dollars but failed to meet their own tax obligations, resulting in billions of dollars in unpaid taxes. He also held hearings on border security issues, securing the global supply chain, federal travel abuses, abusive tax refund loans, and unfair energy pricing. At Senator Levin's request, the Subcommittee held hearings on offshore tax abuses responsible for \$100 billion in unpaid taxes each year, and on U.S. vulnerabilities caused by states forming 2 million companies each year with hidden owners.

(2) More Recent Investigations

During the 110th Congress, in January 2007, after the Senate majority shifted, Senator Levin once again became Subcommittee Chairman, while Senator Coleman became the Ranking Minority Member. Senator Levin chaired the Subcommittee for the next seven years. He focused the Subcommittee on investigations into complex financial and tax matters, including unfair credit card practices, executive stock option abuses, excessive speculation in the natural gas and crude oil markets, and offshore tax abuses involving tax haven banks and non-U.S. persons dodging payment of U.S. taxes on U.S. stock dividends. The Subcommittee's work contributed to enactment of two landmark bills, the Credit Card Accountability Responsibility and Disclosure Act (Credit CARD Act) which reformed credit card practices, and the Foreign Account Tax Compliance Act (FATCA) which tackled the problem of hidden offshore bank accounts used by U.S. persons to dodge U.S. taxes. At the request of Senator Coleman, the Subcommittee also conducted bipartisan investigations into Medicare and Medicaid health care providers who cheat on their taxes, fraudulent Medicare claims involving deceased doctors or inappropriate diagnosis codes, U.S. dirty bomb vulnerabilities, federal payroll tax abuses, abusive practices involving transit benefits, and problems involving the United Nations Development Program.

During the 111th Congress, Senator Levin continued as Subcommittee Chairman, while Senator Tom Coburn joined the Subcommittee as its Ranking Minority Member. During the 111th Congress, the Subcommittee dedicated much of its resources to a bipartisan investigation into key causes of the 2008 financial crisis, looking in particular at the role of high risk home loans, regulatory failures, inflated credit ratings, and high-risk, conflicts-ridden financial products designed and sold by investment banks. The Subcommittee held four hearings and released thousands of documents. The Subcommittee's work contributed to passage of another landmark financial reform bill, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. In addition, the Subcommittee held hearings on excessive speculation in the wheat

market, tax haven banks that helped U.S. clients evade U.S. taxes, how to keep foreign corruption out of the United States, and social security disability fraud.

During the 112th Congress, Senator Levin and Senator Coburn continued in their respective roles as Chairman and Ranking Minority Member of the Subcommittee. In a series of bipartisan investigations, the Subcommittee examined how a global banking giant, HSBC, exposed the U.S. financial system to an array of money laundering, drug trafficking, and terrorist financing risks due to poor anti-money laundering controls; how two U.S. multinational corporations engaged in offshore tax abuses, including how Microsoft shifted profits offshore to dodge U.S. taxes, and Hewlett Packard secretly brought offshore funds back home without paying taxes by utilizing abusive short term loan schemes; and how excessive commodity speculation by mutual funds and others were taking place without Dodd-Frank safeguards such as position limits being put into effect. At the request of Senator Coburn, the Subcommittee also conducted bipartisan investigations into problems with Social Security disability determinations that, due to poor procedures, perfunctory hearings, and poor quality decisions, resulted in over 1 in 5 disability cases containing errors or inadequate justifications; how DHS state and local intelligence fusion centers failed to yield significant, useful information to support federal counterterrorism efforts; and how certain federal contractors that received taxpayer dollars through stimulus funding nevertheless failed to pay their federal taxes.

During the 113th Congress, Senator Levin continued as Chairman, while Senator John McCain joined the Subcommittee as its Ranking Minority Member. They continued to strengthen the Subcommittee's strong bipartisan traditions, conducting all investigations in a bipartisan manner. During the 113th Congress, the Subcommittee held eight hearings and released ten reports on a variety of investigations. The investigations examined high risk credit derivatives trades at JPMorgan; hidden offshore accounts opened for U.S. clients by Credit Suisse in Switzerland; corporate tax avoidance in case studies involving Apple, Caterpillar, and a structured financial product known as basket options; online advertising abuses; conflicts of interest affecting the stock market and high speed trading; IRS processing of 501(c)(4) applications; defense acquisition reforms; and bank involvement with physical commodities. At the end of the 113th Congress, Senator Levin retired from the Senate.

II. Subcommittee Hearings During the 113th Congress

A. JPMorgan Chase Whale Trades: A Case History of Derivatives Risks & Abuse (March 13, 2013)

The Subcommittee's first hearing in the 113th Congress focused on high risk credit derivative trades which were undertaken by JPMorgan Chase out of its London office and which were responsible for losses totaling more than \$6.2 billion. The trades used funds supplied by JPMorgan's Chief Investment Office (CIO), including federally insured deposits from the bank. The trades were conducted by a JPMorgan London trader whose transactions were so large that they triggered speculation over who was behind the "whale" trades and whose identity was unmasked by the media.

The Subcommittee investigation determined that, over the course of the first quarter of 2012, the CIO used a “Synthetic Credit Portfolio” to knowingly engage in high stakes derivatives trading involving a mix of complex credit derivatives. The investigation found that JPMorgan mismarked its trading book to hide increasing portfolio losses; disregarded multiple indicators of increasing risk; breached five different risk limits; manipulated risk models to eliminate or prevent those breaches; dodged regulatory oversight; and misinformed investors, regulators, and the public about what happened. The investigation exposed not only high risk activities and abuses at JPMorgan Chase, but also broader, systemic problems related to the valuation, risk analysis, disclosure, and oversight of synthetic credit derivatives. The evidence also disproved the assertion that credit derivatives inherently lower financial risk.

In March 2013, the Subcommittee released a bipartisan report and held a hearing detailing the JPMorgan Chase whale trades. The first panel of witnesses consisted of three senior JPMorgan Chase Bank officers, Ina Drew, former head of the CIO; Ashley Bacon, acting Chief Risk Officer; and Peter Weiland, former head of Market Risk for the CIO. They discussed the nature of the whale trades, risk management practices, and how the bank handled the increasing losses. The second panel of witnesses presented testimony from Michael J. Cavanagh, who headed a JPMorgan task force reviewing the CIO losses and also served as co-head of JPMorgan Chase’s corporate and investment bank; and Douglas Braunstein, former JPMorgan Chief Financial Officer and then Vice Chairman of the Board of Directors. They discussed bank oversight of the whale trades, JPMorgan’s interaction with regulators, and information provided by the bank to the public and investors. The third panel included Thomas Curry, Comptroller of the Currency and primary regulator of JPMorgan Chase Bank; Scott Waterhouse, federal Examiner-in-Charge at JPMorgan Chase Bank; and Michael Sullivan, Deputy Comptroller for Risk Analysis at the Office of the Comptroller of the Currency (OCC). They discussed JPMorgan’s failure to disclose the existence of the Synthetic Credit Portfolio, the bank’s lack of cooperation with regulators, and the regulators’ failure to detect the high risk portfolio as well as systemic problems with derivative valuation and risk management.

JPMorgan later paid civil fines totaling \$1 billion for misstating its financial results, engaging in unsafe and unsound banking practices, and manipulating the credit market. Two of its traders were indicted for hiding losses, but have resisted standing trial. The London whale trading abuses resulted in stronger implementing regulations for the Volcker Rule to prevent federally insured banks and their subsidiaries from engaging in proprietary trading disguised as risk-reducing hedges. Federal regulators also clarified that banks may not change their derivative valuation methodologies to hide losses, and that U.S. derivatives requirements apply to a U.S. bank’s foreign branches as well as its domestic branches. U.S. and international regulatory bodies also reviewed issues related to the manipulation of bank risk models for derivatives activities.

B. Offshore Profit Shifting and the U.S. Tax Code – Part 2 (Apple, Inc.) (May 21, 2013)

The Subcommittee’s second hearing was the latest in a Subcommittee series on corporate offshore profit shifting, and focused on a case study involving a leading U.S. multinational corporation, Apple Inc. For the last decade, the Subcommittee has examined how multinational corporations and wealthy individuals use offshore tax schemes to dodge U.S. taxes, leaving other

taxpayers to make up the difference. According to the Congressional Research Service, the share of corporate income taxes in the United States has fallen from a high of 32% of federal tax revenue in 1952, to less than 10% in 2012. Meanwhile, payroll taxes – which almost every working American must pay – have increased from 10% of federal revenue to 35%.

In May 2013, the Subcommittee investigation released a bipartisan memorandum and held a hearing showing how Apple Inc. established three Irish subsidiaries with no tax residency anywhere, ran those subsidiaries from the United States, and shifted more than \$74 billion in profits over four years to Ireland while dodging payment of U.S. taxes. The Irish subsidiaries, Apple Operations International, Apple Sales International, and Apple Operations Europe, were controlled by the U.S. parent company, Apple Inc. Since Ireland bases tax jurisdiction over companies that are managed and controlled in Ireland, and the United States bases tax residency on where a company is incorporated, Apple exploited the gap between the two, and its subsidiaries failed to file an income tax return in either country, or any other country, for at least five years. One did pay taxes in Ireland on a tiny fraction of its income, resulting, for example, in an effective 2011 Irish tax rate of only five hundredths of one percent. The hearing also showed that, in addition to creating non-tax resident foreign affiliates, Apple Inc. utilized U.S. tax loopholes to avoid U.S. taxes on \$44 billion in otherwise taxable offshore income over four years.

The hearing heard from three panels of witnesses. The first panel consisted of two international corporate tax experts, Stephen E. Shay, former head of international tax policy at the U.S. Department of the Treasury and professor at Harvard Law School; and J. Richard Harvey, professor of law at Villanova University School of Law. Both criticized actions taken by Apple to avoid U.S. corporate taxes. The second panel presented testimony from three senior Apple executives, Timothy D. Cook, the CEO; Peter Oppenheimer, the Chief Financial Officer; and Phillip A. Bullock, the head of Tax Operations. All three defended Apple's actions, but admitted the company had formed three Irish subsidiaries with no tax residency anywhere. The third panel consisted of Mark J. Mazur, Treasury Assistant Secretary for Tax Policy, and Samuel M. Maruca, Director of Transfer Pricing Operations in the Large Business & International Division at the Internal Revenue Service. While neither would comment on the Apple case in particular, both expressed concerns about corporate tax loopholes that enabled U.S. companies to avoid payment of U.S. taxes.

The bipartisan memorandum released by the Subcommittee offered recommendations to strengthen U.S. transfer pricing rules and reform the so-called “check-the-box” and “look-through” loopholes that enable multinationals to shield offshore income from U.S. taxes. As a result of this and other examples of multinational corporate tax abuse, in 2013, G8 world leaders called for an end to offshore corporate profit shifting and initiated international efforts to stop multinational corporate tax avoidance. G8 leaders also reached consensus on the need for an international template for multinational corporations to disclose their tax payments on a country-by-country basis. In addition, Ireland changed its law to prevent multinational corporations from establishing Irish subsidiaries with no tax residency in any country.

C. Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions In Hidden Offshore Accounts (February 26, 2014)

The Subcommittee's next hearing built upon two earlier hearings, held by the Subcommittee in 2008 and 2009, showing how well-known international banks, located in secrecy jurisdictions and tax havens, were deliberately helping U.S. clients cheat on their taxes by opening offshore accounts never reported to the Internal Revenue Service (IRS), despite U.S. laws requiring their disclosure. The earlier hearings focused, in part, on UBS, Switzerland's largest bank, which made a dramatic admission at the 2008 hearing that it had facilitated tax evasion by opening undisclosed Swiss accounts for U.S. clients. After the hearing, in 2009, UBS signed a deferred prosecution agreement with the U.S. Department of Justice (DOJ) on charges of conspiring to defraud the United States by impeding U.S. tax collection, paid a \$780 million fine, disclosed the names of some U.S. clients with hidden Swiss accounts, and agreed to no longer provide U.S. clients with undeclared Swiss accounts.

In February 2014, the Subcommittee released a bipartisan report and held a hearing on how Credit Suisse, Switzerland's second largest bank, engaged in similar conduct and delayed closing Swiss accounts for some U.S. clients for up to five years. The Subcommittee investigation disclosed that, at its peak, Credit Suisse had over 22,000 U.S. customers with Swiss accounts containing more than 12 billion Swiss francs, which translated into \$10 to \$12 billion U.S. dollars. Nearly 1,500 of those accounts were opened in the names of offshore shell companies to hide U.S. ownership. Another nearly 2,000 were opened at Clariden Leu, Credit Suisse's own private bank. Almost 10,000 were serviced by a special Credit Suisse branch at the Zurich airport which enabled clients to fly in to do their banking without leaving airport grounds. One client disclosed that, at Credit Suisse headquarters in Zurich, he was ushered into a remotely controlled elevator with no floor buttons, and escorted into a bare room with white walls to conduct his banking transactions, all dramatizing the bank's focus on secrecy.

In addition to disclosing Credit Suisse's actions, the investigation criticized DOJ for failing to use U.S. legal tools, such as grand jury subpoenas and John Doe summonses, to obtain the names of U.S. tax evaders with hidden Credit Suisse accounts, choosing instead to file Swiss treaty requests with little success. The investigation noted that, over a five-year period, due to Swiss secrecy laws, DOJ had obtained information, including U.S. client names, for only 238 undeclared Swiss accounts out of the tens of thousands that Credit Suisse opened. The hearing criticized DOJ for its slow enforcement efforts to collect unpaid taxes on funds held offshore, and hold accountable the tax evaders, banks, and bankers involved.

The hearing heard from two panels of witnesses. The first consisted of senior officers from Credit Suisse, including Brady Dougan, the CEO; Romeo Cerutti, the General Counsel; and Hans-Ulrich Meiser and Robert Shafir, co-heads of the Private Banking and Wealth Management division. While the officers admitted that the bank had moved too slowly to close the hidden Swiss accounts, they also asserted that the misconduct was the result of rogue bankers rather than bank policy. The second panel of witnesses consisted of James M. Cole, Deputy Attorney General at DOJ, and Kathryn M. Keneally, Assistant Attorney General for the Tax Division. Both defended DOJ's use of Swiss treaty requests instead of U.S. discovery tools to obtain accountholder names, DOJ's failure to request the extradition of any of the seven Credit Suisse

bankers indicted in 2011 for facilitating tax evasion, and DOJ's failure to obtain the names of thousands of U.S. tax evaders with hidden Credit Suisse accounts.

After the hearing, Credit Suisse entered a guilty plea to DOJ charges of aiding and abetting U.S. tax evasion, and paid a \$2.6 billion penalty, including \$1.8 billion to DOJ, \$100 million to the Federal Reserve, and \$715 million to the New York State Department of Financial Services. Credit Suisse also paid a \$196 million fine to the U.S. Securities and Exchange Commission for providing broker-dealer and investment advisory services to U.S. clients without first registering with the agency. In addition, in July 2014, the Foreign Account Tax Compliance Act (FATCA), inspired in part by Subcommittee hearings on secret offshore accounts, took effect and made it more difficult to conceal offshore accounts opened for U.S. clients in the future.

D. Caterpillar's Offshore Tax Strategy (April 1, 2014)

The Subcommittee's next hearing was another in its series of hearings on corporate offshore profit shifting, this time focused on a case study involving Caterpillar Inc., an American manufacturer of heavy equipment. As explained earlier, for the last decade, the Subcommittee has examined how multinational corporations and wealthy individuals have been using offshore tax schemes to dodge U.S. taxes, leaving other taxpayers to make up the difference.

In April 2014, the Subcommittee held a hearing and issued a majority staff report examining how Caterpillar Inc. shifted \$8 billion in profits from its foreign parts business – a business run primarily from the United States – to a Swiss affiliate to avoid paying \$2.4 billion in U.S. taxes to date. The case history showed that, in 1999, Caterpillar paid its accountant, PriceWaterhouseCoopers (PWC), over \$55 million to develop and implement the offshore tax strategy. The strategy called for Caterpillar Inc. to issue a license to one of its Swiss affiliates, Caterpillar SARL, to sell Caterpillar parts worldwide. The parts license changed almost nothing in the actual functioning of Caterpillar's parts business. Its Swiss affiliate lacked the personnel, infrastructure, and expertise to actually run the worldwide parts operation and instead simply paid Caterpillar Inc. to continue running the business. The Swiss affiliate also paid Caterpillar Inc. a "royalty payment" equal to about 15% of the parts profits, while attributing the remaining profits to Switzerland. The result was that Caterpillar switched from reporting 85% or more of its foreign parts profits on its U.S. tax return to reporting 85% or more of those same profits on its Swiss tax return, subject to at a negotiated effective Swiss tax rate of 4% to 6%. PWC, in its role as independent accountant for the company, approved Caterpillar's use of the offshore tax strategy, essentially auditing the very tax strategy it had developed and sold to the company.

Although Caterpillar had spent 90 years working to build up its international parts business, Caterpillar gave its Swiss affiliate the license to sell its parts worldwide without requiring any compensation for developing the business. In an arm's length transaction, no company would turn over a profitable business that took decades to develop without receiving compensation. Nor would a business relinquish 85% of the ongoing profits from that business in exchange for 15% of the profits. But that was the arrangement Caterpillar entered into with its affiliate. The result was that, from 2000 to 2012, the Swiss tax strategy shifted \$8 billion in

profits from Caterpillar Inc. to its Swiss affiliate, cutting Caterpillar's U.S. tax bill by \$2.4 billion. Caterpillar's actions provided additional evidence of the need to close unjustified U.S. corporate tax loopholes that enable profitable corporations to avoid paying U.S. taxes.

The hearing heard from three panels of witnesses. The first panel consisted of two international corporate tax experts, Reuven S. Avi-Yonah, the Irwin I. Cohn Professor Law at the University of Michigan School of Law, and Bret Wells, Assistant Professor of Law at the University of Houston Law Center. Both criticized Caterpillar's offshore tax strategy as an improper attempt to avoid U.S. corporate taxes. The second panel of witnesses presented testimony from three PWC accountants who helped develop and implement Caterpillar's Swiss tax strategy, Thomas F. Quinn, TWC tax partner; Steven R. Williams, PWC managing director; and James G. Bowers, PWC tax partner. All three defended the company's use of the PWC-developed tax strategy and denied that PWC had a conflict of interest in developing, selling, auditing, and approving use of that tax strategy. The third panel consisted of three senior Caterpillar officers, Robin D. Beran, Chief Tax Officer; Rodney Perkins, former Senior International Tax Manager; and Julie A. Lagacy, Vice President from the Finance Services Division. All three defended Caterpillar's use of its offshore tax strategy and shifting its parts profits from the United States to Switzerland.

Caterpillar's actions, as well as other examples of multinational corporate tax abuse, contributed to G8 world leaders, in 2013, calling for an end to offshore profit shifting and initiating international efforts to stop multinational corporate tax avoidance. G8 leaders also reached consensus on the need for an international template for multinational corporations to disclose their tax payments on a country-by-country basis. In addition, the Public Company Accounting Oversight Board initiated a review of the propriety of an independent accounting firm auditing an offshore tax strategy that the firm sold to its client.

E. Online Advertising and Hidden Hazards to Consumer Security and Data Privacy (May 15, 2014)

The Subcommittee's next hearing addressed a new investigative topic initiated by Ranking Member John McCain related to data privacy. In May 2014, the Subcommittee held a hearing and released a bipartisan report examining how current online advertising practices expose online consumers to hidden hazards, including data breaches, malware attacks, and other cybercrimes.

In 2013, U.S. online advertising revenues for the first time surpassed that of broadcast television advertising as companies spent \$42.8 billion to reach consumers. The hearing examined the enormous complexity of the online advertising ecosystem, including the many parties involved in delivering a single ad. The investigation showed that a simple display of an online advertisement can trigger consumer interactions with a chain of other companies, many of which are unknown to the consumer and each of which could compromise the consumer's privacy or become a source of vulnerability for cybercriminals. In one instance, for example, the investigation found that visiting a popular tabloid news website triggered a user interaction with some 352 other web servers as well. On radio or television, the content of an advertisement is generally transmitted by the same party that hosts the rest of the content on the station. In

contrast, host websites commonly sell ad space on their sites through an intermediary company, most often associated with a well-known tech company. The intermediary — often referred to as an ad network or exchange — typically directs an internet user’s browser to display an advertisement from a server controlled by neither the ad network nor the original host website. The investigation disclosed that host websites often do not select and cannot predict which intermediary advertising networks will deliver advertisements to consumers visiting their sites, exposing consumers to unmanaged risks. Today, most ad networks also have limited control over the content of the advertisements whose placements they facilitate.

The growth of online advertising has also brought with it a rise in cybercriminals attempting to use mainstream websites to infect consumers’ computers with advertisement-based malware or “malvertising.” Some estimates indicate that malvertising increased over 200% in 2013, to over 209,000 incidents generating over 12.4 billion malicious ad impressions. A recent study found that more than half of internet website publishers have suffered a malware attack through a malicious advertisement. The report detailed examples in which consumers were subjected to malicious software delivered through the online advertising network. The complexity and many vulnerabilities of the online advertising ecosystem also made it difficult for individual industry participants to adopt effective long-term security countermeasures. The investigation disclosed that host websites often operate under voluntary compliance regimes or contractual arrangements that are ineffective, unreliable, or poorly enforced. In addition, as the online advertising industry grows more complex, it is also becoming more difficult to ascertain responsibility when consumers are hurt by malicious advertising or data collection. Moreover, there is currently no standard reporting requirement that informs the public when an ad network is compromised by malware or cybercriminals. The lack of accountability and disclosure requirements in online advertising may lead to lax security regimes, creating serious vulnerabilities for Internet users. The investigation determined that the Federal Trade Commission also needs tools to protect consumers from online advertising abuses.

The hearing heard from two panels of witnesses. The first panel consisted of three individuals with industry experience in online advertising problems and data privacy threats. They included Alex Stamos, Chief Information Security Officer for Yahoo! Inc.; George F. Salem, Senior Product Manager for Google Inc., and Craig Spiegle, Executive Director, founder and President of Online Trust Alliance. All three discussed instances of malicious online advertising and what is being done and can be done by the private sector to protect online consumers. The second panel heard from Maneesha Mithal, Federal Trade Commission Associate Director for the Division of Privacy and Identity Protection; and Lou Mastria, Managing Director of the Digital Advertising Alliance. Both discussed the development of standards and procedures to protect online consumers from malicious online advertising and the need for stronger FTC tools to combat online advertising abuses.

F. Conflicts of Interest, Investor Loss of Confidence, and High Speed Trading in U.S. Stock Markets (June 17, 2014)

The Subcommittee’s next hearing focused on conflicts of interest affecting how stock brokers place trading orders in U.S. stock markets, including for high speed traders. The

conflicts arise from millions of dollars in opaque payments made to brokers in order to attract client orders, including “payments for order flow” made by wholesale brokers to retail brokers, and so-called “maker-taker” rebates and fees paid by trading venues to broker dealers, both of which created incentives for brokers to put their financial interests before those of their clients, fueling public distrust of U.S. stock markets.

The June 2014 hearing examined both conflicts of interest affecting broker placement of trading orders. The first conflict, involving payment for order flow, arose when a retail broker chose a wholesale broker to execute client trades and accepted payment from that wholesale broker for placing those orders. One reason wholesale brokers pay for order flow is to enable the wholesale broker to fill the orders out of its own inventory and profit from the trades. The Subcommittee investigation determined that payments from wholesale to retail brokers can add up to millions of dollars, yet were rarely disclosed or passed on to retail customers. The second conflict of interest, involving maker-taker rebates and fees, arose when a broker decided to place client orders on a trading venue rather than with a wholesale broker, and chose the venue based upon the broker’s financial interest, rather than on best execution for its clients. Under the maker-taker system, when a broker makes an offer on a venue to buy or sell a stock at a certain price, the broker is generally classified as a “maker,” and most trading venues will pay the broker a rebate when that offer is accepted. A broker who accepts a maker’s offer to buy or sell is called a “taker,” and will generally pay a fee to the trading venue. The investigation found that, by routing customer orders in a manner that maximizes maker rebates and avoids taker fees, a broker dealer can add millions of dollars to its bottom line, creating a powerful incentive for the broker dealer to send client orders to the trading venues that are in the broker’s best interest even if they are not in the clients’ best interest. The investigation also found that the extent of those payments were largely undisclosed by broker dealers. In addition, the investigation found that the market complexity and fragmentation caused by the maker-taker system could be exploited by high frequency traders.

The hearing heard from two panels of witnesses. The first panel included Bradley Katsuyama, President and CEO of IEX exchange, who discussed the conflicts of interest affecting U.S. stock markets and advocated action to address them. In addition, Robert H. Battalio, Professor of Finance at the Mendoza College of Business at the University of Notre Dame, discussed research he had conducted indicating that when given a choice, four leading retail brokers sent their orders to the trading venues offering the biggest maker rebates, even when those venues did not offer the best execution for clients. The second panel heard from four senior industry officials with differing views on the nature of the conflicts of interest and what should be done about them. They included Thomas W. Farley, President of the New York Stock Exchange, which described the conflicts as having a “corrosive impact” on stock markets; Joseph P. Ratterman, CEO of BATS Global Markets, which did not view the conflicts as creating substantial problems; Joseph P. Brennan, Global Equity Index head at the Vanguard Group, a major mutual fund company that has expressed concerns about the broker conflicts of interest; and Steven Quirk, Senior Vice President of the Trader Group at TD Ameritrade, a retail broker that derived significant revenues from payments for order flow and maker rebates.

After the hearing, the Financial Industry Regulatory Authority launched a probe into how retail brokers route customer orders. The inquiry seeks to determine, among other things, how

brokers determine where to route orders so that customers receive the best price possible under prevailing market conditions. The Securities and Exchange Commission also told the Subcommittee that it would consider issuing a rule to enhance order routing disclosures.

G. Abuse of Structured Financial Products: Misusing Basket Options to Avoid Taxes and Leverage Limits (July 22, 2014)

The Subcommittee's next hearing addressed a capital gains tax scheme involving hedge funds avoiding the payment of billions of dollars in federal taxes. It exposed how, from 1999 through 2013, two global banks used a structured financial product known as a basket option to help more than a dozen hedge funds dodge limits on trading with borrowed money, earn huge trading profits, and then claim that those profits qualified for the lower long-term capital gains tax rate, even for trades that lasted seconds. One hedge fund, Renaissance Technology Corp. (RenTec), used this scheme to avoid paying taxes estimated at more than \$6 billion.

In July 2014, the Subcommittee held a hearing and issued a bipartisan report detailing the misuse of basket options to avoid U.S. taxes. The two banks, Deutsche Bank and Barclays Bank, sold 199 basket options to hedge funds that used them to make over \$100 billion in trades, including 79 involving RenTec, the largest participant. To produce the tax savings, each bank opened a designated account in its own name, appointed the hedge fund as the "investment advisor" for the account, authorized the investment advisor to buy and sell securities for the account, and then gave the hedge fund an "option" on the account with a payoff equal to any profits generated by the "basket" of securities in the account. The hedge fund put up 10% of the cash needed to buy the securities, while the bank lent the other 90%. The hedge fund made all the trading decisions and reaped all the trading profits, while in effect holding an "option" on its own trading efforts. RenTec estimated that it used the basket option accounts to make 100,000 – 150,000 trades per day or approximately 30 million trades per year per bank.

The key to the tax savings was the claim that basket options exercised after one year produced trading profits that qualified for the reduced long-term capital gains tax rate, even if the underlying trades had lasted seconds or were executed the day before the option was exercised. The lower long-term capital gains tax rate is intended to provide an incentive for investors to risk capital on long-term investments that grow the economy and create jobs; the high-volume trading that, for example, RenTec conducted through its basket options did not meet that test.

In addition, the banks used the basket options to enable the hedge funds to trade stocks using borrowed money, in excess of regulatory limits. The 1929 stock market crash harmed the U.S. economy, not just by the collapse of thousands of stock speculators, but also by the failure of thousands of banks that had lent them money and couldn't collect on the loans. In response, Congress enacted limits on the use of borrowed money to trade securities. Had the hedge funds used normal brokerage accounts, they would have been subject to the 2-to-1 federal leverage limit; instead the banks used basket options to provide the hedge funds with leverage of up to 20-to-1, by treating the funds deposited into the option accounts as deposits of their own money rather than as loans, despite charging the hedge funds financing fees for use of the funds. The end result was that the hedge funds, facilitated by the banks, claimed billions of dollars in

unjustified tax savings while avoiding leverage limits that protect the U.S. financial system from systemic risks caused by stock speculation fueled by borrowed funds.

As part of its investigation, the Subcommittee commissioned and released, along with other Senators, a Government Accountability Office (GAO) report disclosing that the Internal Revenue Service (IRS) audits less than 1% of large partnerships per year, including partnerships that function as hedge funds. GAO found that, in 2012, just 0.8% of large partnerships, defined as having \$100 million or more in assets and 100 or more direct and indirect partners, underwent an IRS audit versus 27% of traditional C corporations. That low audit rate made it difficult for the IRS to detect abusive tax practices and underpayment of U.S. taxes by hedge funds, including in connection with basket options.

The hearing heard from three panels of witnesses. The first panel consisted of Steven Rosenthal, a Senior Fellow at the Urban-Brookings Tax Policy Center, who criticized the basket option tax scheme; and James R. White, Director of Tax Issues at GAO, who discussed the GAO report on IRS audits of large partnerships. The second panel heard testimony from four senior officials at the banks and RenTec, all of whom defended their basket option activities. They included Martin Malloy, Managing Director at Barclays Bank; Satish Ramakrishna, Managing Director at Deutsche Bank Securities; Mark Silber, RenTec's Chief Financial Officer, Chief Compliance Officer, Chief Legal Officer, and Vice President; and Jonathan Mayers, RenTec's Counsel. The third panel consisted of high level officials from the banks and RenTec, including Gerard LaRocca, Chief Administrative Officer for the Americas at Barclays; M. Barry Bausano, President and Managing Director of Deutsche Bank Securities; and Peter Brown, Co-CEO and Co-President of RenTec. They also defended their use of basket options.

The Subcommittee investigation called for the IRS to review the hedge funds' basket option activities; for the U.S. Securities and Exchange Commission to review the hedge funds' and banks' circumvention of federal leverage limits; and for federal bank regulators to review the banks' facilitation of the basket option tax schemes.

H. Wall Street Bank Involvement With Physical Commodities (November 20 and 21, 2014)

The Subcommittee's final hearing during the 113th Congress, and Chairman Levin's final hearing as Subcommittee Chairman, examined Wall Street bank involvement with physical commodities.

In November 2014, the Subcommittee held a hearing and released a bipartisan report detailing case studies of Goldman Sachs, Morgan Stanley, and JPMorgan Chase, and their extensive physical commodity activities, including warehousing aluminum, copper, and other metals, trading uranium, mining coal, operating oil and gas storage and pipeline facilities, supplying jet fuel to airlines, and controlling power plants. The Subcommittee investigation also described a three-year review of those physical commodity activities by Federal Reserve examiners who identified a host of risks and recommended steps to reduce those risks. The investigation examined not only the catastrophic event and environmental risks incurred by the banks, but also their involvement with commodity price manipulation and use of non-public information to gain unfair trading advantages in financial commodity markets.

The hearing took place over two days and heard from five panels of witnesses. On the first day, three panels presented evidence. The first panel consisted of two witnesses involved with Goldman's aluminum warehousing activities, Christopher Wibbelman, President and CEO of Metro International warehouse, and Jacques Gabillon, head of Goldman's Global Commodities Principal Investing Group and Chairman of the Board of the warehouse company. Both admitted that the wait to remove aluminum from the warehouse had grown dramatically during Goldman's ownership of the company, and that the warehouse had engaged in so-called merry-go-round transactions to keep aluminum from leaving the warehouse system, but denied that those actions manipulated aluminum supplies or prices, or that Goldman took advantage of non-public warehouse information when trading aluminum-related financial products. The second panel consisted of two aluminum experts, Jorge Vazquez, Founder and Managing Director of Harbor Aluminum Intelligence, and a leading aluminum analyst; and Nick Madden, Senior Vice President and Chief Supply Chain Officer for Novelis Inc., the largest purchaser of aluminum in the world. Both testified that Goldman's activities had disrupted normal aluminum pricing, and that confidential warehouse information could be used to gain trading advantages. The third panel for the day consisted of senior officials from the three banks, Gregory A. Agran, Co-Head of Goldman's Global Commodities Group; Simon Greenshields, Co-Head of Morgan Stanley's Global Commodities group; and John Anderson, Co-Head of JPMorgan's Global Commodities group. All three answered questions about their physical commodity activities.

On the second day, two additional panels of witnesses provided testimony at the hearing. The first panel consisted of Saule Omarova, Professor of Law at Cornell University and an expert on banking law; and Chiara Trabucchi, a principal at Industrial Economics Inc. and an expert on financial and environmental risk management. Professor Omarova testified that current bank involvement with physical commodities was unprecedented and contrary to longstanding U.S. principles against mixing banking with commerce. Ms. Trabucchi testified that banks appeared ill prepared to address the catastrophic event risks associated with their physical commodity activities. The second panel consisted of two federal regulators, Daniel K. Tarullo, a Federal Reserve Governor involved with bank holding company oversight, and Larry D. Gasteiger, Acting Director of the Office of Enforcement at the Federal Energy Regulatory Commission (FERC). Mr. Gasteiger discussed FERC's legal actions against banks for manipulating electricity prices and payments, while Mr. Tarullo discussed the Federal Reserve's concerns with bank holding company involvement with physical commodities and its plans to propose a rulemaking in the first quarter of 2015 to reduce related risks.

After the hearing, bipartisan legislation was introduced by the Subcommittee Chairman and Ranking Member to prevent banking entities from engaging in financial commodity trading if they own or have an interest in businesses or facilities involved with the same physical commodities.

III. Legislative Activities During the 113th Congress

The Permanent Subcommittee on Investigations does not have legislative authority, but because its investigations play an important role in bringing issues to the attention of Congress and the public, the Subcommittee's work frequently contributes to the development of legislative

initiatives. The Subcommittee's activity during the 113th Congress was no exception, with Subcommittee hearings and Members playing prominent roles in several legislative initiatives.

A. Cut Unjustified Tax (CUT) Loopholes Act (S. 268)

On February 11, 2013, Senators Levin and Whitehouse re-introduced S. 268, the Cut Unjustified Tax Loopholes or CUT Loopholes Act, to close a series of tax loopholes, not only to increase the fairness of the tax code, but also to produce significant revenues for deficit reduction and avoid the across-the-board budget cuts known as sequestration. The proposed changes to the tax code were the product of a series of Subcommittee hearings on corporate tax avoidance.

The bill included provisions to close a host of corporate offshore tax loopholes, including loopholes allowing corporations to deduct expenses for moving operations offshore, lower their taxes by manipulating foreign tax credits or moving intellectual property moved offshore, and avoid paying taxes by shifting corporate profits to tax havens. The bill also targeted domestic corporate tax loopholes, including those allowing corporations to take stock option tax deductions that were billions of dollars greater than the stock option expenses shown on their books; use a so-called "derivatives blended rate" enabling hedge funds and others to treat earnings from short-term investments in certain derivatives as long-term capital gains; exclude tar sands oil from excise taxes supporting the Oil Spill Liability Trust Fund; and enable investment managers, such as hedge fund managers, to use the so-called carried interest loophole to pay less than ordinary income tax rates on income earned from providing investment management services.

Closing those loopholes was estimated to produce, over ten years, at least \$260 billion in deficit reduction. The bill was referred to the Finance Committee which took no further action.

B. Stop Tax Haven Abuse Act (S. 1533)

On September 19, 2013, Senators Levin, Whitehouse, Shaheen, and Begich – later joined by Senators Markey and Mikulski – reintroduced the Stop Tax Haven Abuse Act, S. 1533, to close offshore tax loopholes and strengthen offshore tax enforcement. This legislation was based upon more than ten years of Subcommittee investigations into offshore tax havens, abusive tax shelters, and the professionals who design, market, and implement tax dodges. While some provisions from earlier versions of this bill were enacted into law, offshore tax abuses have continued and additional reforms are needed. The Subcommittee has estimated that offshore tax abuses cost the Treasury at least \$150 billion per year.

Among other measures, the bill would authorize Treasury to take special measures against foreign jurisdictions and financial institutions that impede U.S. tax enforcement; and establish rebuttable presumptions in tax enforcement cases that offshore companies and trusts are controlled by the U.S. persons who send or receive assets from them. The bill would also prevent companies that are managed and controlled from the United States from claiming foreign status for tax purposes; and close a loophole allowing swap payments to be treated as non-U.S. source income when sent from the United States to persons offshore. Other provisions would require multinational corporations to report the taxes they pay on a country-by-country basis in

public SEC filings; and require U.S. hedge funds and company formation agents to establish anti-money laundering programs. Still other provisions would stop corporations from deducting expenses for moving operations offshore, manipulating foreign tax credit abuses, and using short-term loan abuses to dodge taxes. The bill would also repeal the so-called check-the-box and CFC look-through rules that create tax incentives for U.S. multinationals to shift profits offshore and manipulate their offshore affiliates to avoid paying U.S. taxes on passive income.

This bill is very similar to Title I of the CUT Loopholes Act, described above. The Senate bill was referred to the Finance Committee which took no further action.

C. Incorporation Transparency and Law Enforcement Assistance Act (S. 1465)

On August 1, 2013, Senators Levin, Grassley, Feinstein and Harkin, later joined by Senator Whitehouse, re-introduced S. 1465, the Incorporation Transparency and Law Enforcement Assistance Act, to protect the United States from U.S. corporations with hidden owners being misused to commit crimes, including terrorism, drug trafficking, money laundering, tax evasion, financial fraud, and corruption. The bill is based upon a series of Subcommittee investigations which found that the 50 states establish nearly two million U.S. companies each year without knowing who is behind them, that the lack of ownership information invites wrongdoers to incorporate in the United States, and that the same lack of ownership information impedes U.S. law enforcement efforts when U.S. corporations are misused to commit crimes.

Among other provisions, the bill would require the states to obtain beneficial ownership information for the corporations or limited liability companies formed within their borders; require states to provide that information to law enforcement in response to a subpoena or summons; and impose civil and criminal penalties for persons who knowingly submit false ownership information. The bill would exempt all publicly traded and regulated corporations, as well as certain other corporations whose ownership information was already available.

In 2013, after G8 world leaders called for disclosing corporate owners, the White House issued an action plan championing legislation like the Levin-Grassley bill, which has been endorsed by multiple law enforcement groups. The bill was referred to the Committee on the Judiciary which took no further action.

D. Ending Insider Trading in Commodities Act (S. 3013)

On December 12, 2014, Senators Levin and McCain introduced S.3013, the Ending Insider Trading in Commodities Act. This bill is the product of the Subcommittee's investigation into Wall Street bank involvement with physical commodities, described above, and is intended to prevent price manipulation and unfair trading. It would prevent a large financial institution from trading in physical commodities and commodity-related financial instruments while at the same time in possession of material, non-public information related to the storage, shipment, or use of a commodity arising from its ownership or interest in a business or facility used to store, ship, or use the commodity.

The bill was referred to the Committee on Agriculture which, due to the ending of the Congress, took no further action.

E. Partnership Auditing Fairness Act (S. 3018)

On December 16, 2014, Senators Levin introduced S. 3018, the Partnership Auditing Fairness Act to improve and streamline audit procedures for large partnerships, such as hedge funds, private equity funds, and publicly traded partnerships. According to a report by the Government Accountability Office, in 2012, the Internal Revenue Service (IRS) audited less than 1% of large partnerships compared to 27% of large corporations. The bill is intended to ensure that large for-profit partnerships, like other large profitable businesses, are subject to routine audits by the IRS and eliminate audit red tape that currently impedes IRS oversight. The bill is the product of the Subcommittee's investigation during this Congress into hedge fund use of a structured financial product known as basket options, which was used to avoid billions of dollars in U.S. taxes and demonstrated the need for routine IRS audits of hedge funds and other large partnerships. The bill mirrors a provision in the Tax Reform Act of 2014, introduced in the House of Representatives earlier this year by Congressman David Camp.

The bill was referred to the Committee on Finance which, due to the ending of the Congress, took no further action.

IV. Reports, Prints, and Studies

In connection with its investigations, the Subcommittee often issues lengthy and detailed reports. During the 113th Congress, the Subcommittee released ten such reports, listed below, some of which have already been partly described in connection with Subcommittee hearings.

A. JPMorgan Chase Whale Trades: A Case History of Derivatives Risks & Abuses, March 15, 2013 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on March 15, 2013)

In March 2013, following a nine-month probe, the Subcommittee released its first report of the 113th Congress. This 300-page bipartisan staff report examined the so-called "whale trades" that, in 2012, caused JPMorgan Chase & Co., America's biggest bank and largest derivatives dealer, to lose at least \$6.2 billion. As explained earlier, this report was released in connection with a Subcommittee hearing examining that trading activity.

The report detailed how the whale trades were conducted, presenting information on actions taken by the traders in the London office of the Chief Investment Office (CIO) of JPMorgan Chase Bank, their supervisors, and associated risk management and financial personnel. The report described the nature and extent of the high risk synthetic credit derivative trades executed over the first quarter of 2012, and how JPMorgan Chase personnel handled the mounting losses. It described how the traders mismarked the trading book to hide the losses; managers disregarded multiple indicators of increasing risk and allowed ongoing breaches of five

different risk limits; quantitative experts manipulated the risk models; and the bank dodged regulatory oversight and misinformed investors, regulators, and the public about its risky derivatives trades. The report exposed not only high risk activities and abuses at JPMorgan Chase, but also broader, systemic problems related to the valuation, risk analysis, disclosure, and oversight of synthetic credit derivatives. As indicated earlier, the report presented detailed evidence disproving the assertion that credit derivatives inherently lower financial risk.

The report offered a number of bipartisan recommendations to detect, prevent, and stop high risk derivatives trading involving synthetic credit derivatives at federally insured banks. They included requiring federal bank regulators to identify and obtain performance data for all derivatives investment portfolios at the banks they oversee; require contemporaneous documentation of all hedges, including how each so-called hedge lowered risks associated with specified assets; and strengthen credit derivative valuation procedures to ensure derivatives are accurately priced and valued. The report also recommended that federal regulators identify and investigate all large or sustained breaches of risk limits and all risk or capital evaluation models which, when activated, materially lower the purported risk or capital requirements associated with derivative trading activities. In addition, the report recommended that regulators promptly issue a final regulation implementing the Volcker Rule to stop high risk proprietary trading at federally insured banks, and to impose additional capital charges for those trading activities to ensure banks can cover potential losses.

B. Social Security Disability Benefits: Did a Group of Judges, Doctors, and Lawyers Abuse Programs for the Country's Most Vulnerable?, October 7, 2013 (Report Prepared by the Majority and Minority Staffs of the Committee on Homeland Security and Governmental Affairs and of its Permanent Subcommittee on Investigations, and released by the full Committee in conjunction with a full Committee hearing on October 7, 2013)

In October 2013, the full Committee, under the leadership of Senator Coburn, released a 160-page joint bipartisan staff report from the Chairmen and Ranking Members of the full Committee and the Subcommittee, presenting a case study of how one lawyer living in Kentucky, Eric Conn, engaged in a raft of improper practices to obtain disability benefits for thousands of claimants. This report followed an earlier report, issued by the Subcommittee's Minority staff in September 2012, finding deficiencies in how Social Security administrative law judges (ALJs) decided Social Security disability cases, detailing decisions which "failed to properly address insufficient, contradictory, or incomplete evidence." The 2013 report built upon that earlier work as well as investigative efforts conducted, in part, by the Subcommittee when Senator Coburn was the Subcommittee's Ranking Member during the 112th Congress.

The joint bipartisan report detailed improper Social Security disability practices by Mr. Conn and his law firm, which included the manufacture of boilerplate medical forms, the misuse of waivers to submit disability claims that should have gone elsewhere, the employment of suspect doctors willing to conduct cursory medical exams, and apparent collusion with Social Security ALJs on practices that improperly favored the Conn clients. One ALJ's practices included improperly assigning the Conn cases to himself, secretly informing Mr. Conn of what cases he would decide and what documentation should be submitted, accepting boilerplate

medical forms, relying on conclusory medical opinions to reverse prior benefit denials, skipping hearings, and churning out short, poor quality decisions. The report also presented evidence of repeated unexplained cash payments to the ALJ's bank account. In addition, the report faulted lax oversight by Social Security officials that allowed the abuses to continue for years and exposed U.S. taxpayers to millions of dollars in attorney and physician fees paid to the professionals who engaged in abusive practices.

The report offered a number of bipartisan recommendations to detect, prevent, and stop abusive practices like those exposed in the Conn case study. The recommendations included strengthening Social Security quality reviews of ALJ decisions, reforming outdated medical-vocational guidelines, and prohibiting claimants from submitting medical opinions from doctors with revoked or suspended licenses. The report also recommended that Social Security provide improved training on how ALJs should handle medical opinions that directly conflict with other evidence in a claimant's medical files; and on how AMJs should articulate and support their decisions on claims. In addition, the report recommended that the Social Security Administration Inspector General conduct an annual review of the practices of the law firms earning the most attorney fees from processing disability cases to detect any abusive conduct.

C. Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts, February 26, 2014 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on February 26, 2014)

In February 2014, following a two-year Subcommittee investigation, the Subcommittee released a 175-page bipartisan staff report detailing how Swiss banks aided and abetted tax evasion by their U.S. customers, using Credit Suisse, Switzerland's second largest bank, as a case study. The report described how Credit Suisse opened Swiss accounts for over 22,000 U.S. customers with assets that, at their peak, totaled roughly \$10 billion to \$12 billion, the vast majority of which were hidden from U.S. authorities. The report also described how U.S. law enforcement officials were slow to collect the unpaid taxes and hold accountable both the tax evaders and the bank.

The report provided context for the Credit Suisse case study by describing how, in 2008 and 2009, the Subcommittee held a series of hearings into how Swiss banks, including UBS, Switzerland's largest, had colluded with U.S. tax evaders, aided by Switzerland's bank secrecy laws. It described how, in a 2008 Subcommittee hearing, UBS had acknowledged its wrongdoing and, in the year after the hearing, paid a \$780 million fine, entered into a deferred prosecution agreement with the U.S. Department of Justice (DOJ), and identified thousands of previously undisclosed U.S. accounts to the IRS, including providing U.S. client names. The report explained that Credit Suisse had engaged in similar conduct from at least 2001 to 2008, had been slow to close the hidden Swiss accounts held by U.S. accountholders, and had disclosed almost none of the names of those U.S. accountholders to U.S. tax authorities.

The report described the misconduct engaged in by Credit Suisse, which included sending Swiss bankers into the United States to recruit U.S. customers, opening Swiss accounts, including accounts opened in the name of offshore shell corporations, that were not disclosed to

U.S. authorities, and servicing Swiss accounts here in the United States without leaving a paper trail. The report also described how, after the UBS scandal broke, Credit Suisse began a series of Exit Projects that took five years to close Swiss accounts held by 18,900 U.S. clients. In addition, the report detailed how Credit Suisse had conducted an internal investigation into its activities, but produced no report and identified no leadership failures that allowed the bank to become involved with U.S. tax evasion. The report noted that, despite a 2011 indictment of seven of its bankers and a DOJ letter stating that the bank itself was an investigation target, Credit Suisse had yet to be held legally accountable by DOJ, and none of its bankers had yet stood trial.

The report also examined DOJ conduct. It found that, despite 2008 and 2009 DOJ testimony pledging to use U.S. legal tools such as grand jury subpoenas and John Doe summonses to obtain the names of U.S. tax evaders with hidden offshore accounts, DOJ had failed to use those tools, choosing instead to file Swiss treaty requests with little success. The report noted that, over the prior five years, DOJ had not sought to enforce a single grand jury subpoena against a Swiss bank, had not assisted in the filing of a single John Doe summons to obtain client names or account information in Switzerland, and had not requested the extradition of a single indicted Swiss banker. It also noted that DOJ had prosecuted only one Swiss bank, Wegelin & Co., despite more than a dozen under investigation for facilitating U.S. tax evasion. The report found that, in five years, DOJ had obtained U.S. client names for only 238 undeclared Swiss accounts out of the tens of thousands opened offshore. Finally, the report examined the conduct of the Swiss government in response to allegations that Swiss banks had facilitated U.S. tax evasion. The report described Swiss efforts to preserve bank secrecy, its unwillingness to provide U.S. client names, and its stance against extraditing indicted bankers to stand trial in the United States.

The report made a number of bipartisan recommendations to revitalize U.S. efforts to stop tax haven banks from facilitating U.S. tax evasion. They included urging DOJ to step up its prosecution of tax haven banks and offshore U.S. accountholders, using U.S. legal tools rather than treaty requests to obtain U.S. client names; and to strengthen transparency requirements for tax haven banks with deferred prosecution agreements. The report also recommended that Congress amend U.S. tax laws to streamline the use of John Doe summons procedures to uncover offshore accounts; that the U.S. Senate ratify a 2009 protocol strengthening disclosures under the U.S.-Swiss tax treaty; and that the U.S. Treasury and IRS close legal loopholes enabling offshore accounts held by U.S. persons to remain hidden.

D. Caterpillar's Offshore Tax Strategy, April 1, 2014 (Report Prepared by the Majority Staff of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on April 1, 2014)

In April 2014, following a year-long investigation, the Subcommittee released a 95-page majority staff report detailing how Caterpillar Inc., an American manufacturer of heavy equipment, used a wholly owned Swiss affiliate to shift \$8 billion in profits from the United States to Switzerland to take advantage of a 4-6% corporate tax rate it had negotiated with the Swiss government and defer or avoid paying \$2.4 billion in U.S. taxes to date. This report was

the latest in a series of Subcommittee investigations into tax avoidance by U.S. multinational corporations, including Apple, Microsoft, and Hewlett-Packard.

The report described how Caterpillar paid PricewaterhouseCoopers, acting as both its tax consultant and auditor, over \$55 million to develop and implement its Swiss tax strategy. The report explained that, under that tax strategy, in exchange for a small royalty, Caterpillar gave a license to its wholly controlled Swiss affiliate called CSARL to make all non-U.S. sales of Caterpillar's third party manufactured parts to Caterpillar's non-U.S. dealers. The report noted that Caterpillar redirected those profits from the United States to Switzerland essentially by replacing its name with CSARL on the parts invoices, and without moving any personnel or parts activities to Switzerland. The report presented detailed evidence showing that Caterpillar's global parts business continued to be run from the United States, and that virtually none of the manufacturing, warehousing, distribution, or parts management activities took place in Switzerland. Because CSARL lacked the personnel, infrastructure, and expertise to run the global parts business, CSARL paid Caterpillar to keep doing the work, reimbursing it for its costs plus a small service fee. The report showed that, prior to implementing the Swiss tax strategy, Caterpillar had booked 85% or more of its non-U.S. parts profits in the United States, where 70% of those parts were made and warehoused and where its global parts operation was managed, while afterward it booked 85% or more of the parts profits in Switzerland.

The report offered a number of recommendations to detect, prevent, and stop corporate tax avoidance using suspect offshore tax strategies like that exposed in the Caterpillar case study. The recommendations included urging the Internal Revenue Service (IRS) to analyze the economic substance of all intercompany transactions in which licenses are issued to offshore affiliates to sell U.S. produced products, require U.S. parent corporations to identify and value the functions performed by those offshore affiliates, and require U.S. parents to justify the profit allocation between themselves and their offshore affiliates. The report also recommended that the United States participate in ongoing international efforts to develop better principles for taxing multinational corporations, including by requiring those multinationals to disclose their business operations and tax payments on a country-by-country basis. In addition, the report recommended that public accounting firms be prohibited from simultaneously providing auditing and tax consulting services to the same corporation, to prevent the conflicts of interest that arise when an accounting firm's auditors are asked to audit the tax strategies designed and sold by the firm's tax consultants.

E. Online Advertising and Hidden Hazards to Consumer Security and Data Privacy, May 15, 2014 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on May 15, 2014)

In May 2014, after nearly a year-long investigation under the leadership of Senator McCain, the Subcommittee released a 40-page bipartisan staff report detailing how online advertising, which has surpassed broadcast television as the largest advertising medium in the United States with \$42.8 billion in 2013 revenues, exposed online consumers to hidden hazards, including data breaches, malware attacks, and other cybercrimes.

The report described the complex system used for online advertising, which involves the participation of many parties in delivering a single ad. The report showed how the display of a single online advertisement can trigger online consumer interactions with a chain of other companies, many of which are unknown to the consumer and each of which could compromise the consumer's privacy or become a source of vulnerability for cybercriminals. The report described one instance, for example, in which a consumer visit to a popular tabloid news website triggered the consumer's interaction with over 350 other web servers, even without the consumer's clicking on the advertisement display. The report explained that, on radio or television, the content of an advertisement is generally transmitted by the same party that hosts the rest of the content on the station while, in contrast, host websites commonly sell ad space on their sites through intermediary companies and typically have no control or even notice of the advertisements that will be displayed. The report noted that host websites often do not select and cannot predict which intermediary advertising networks will deliver advertisements to consumers visiting their sites, and typically have limited control over the content of the advertisements whose placements they facilitate. The report also described how cyber criminals use malicious advertising to target consumers, including by using online ads to place malware on consumer devices.

The report offered a number of bipartisan recommendations to detect, prevent, and stop abusive practices in online advertising. The recommendations included urging the online advertising industry to establish better practices and clearer rules to prevent abuses, strengthening cyber threat-related and other security information exchanges within the online advertising industry to detect and prevent abuses, and clarifying specific prohibited practices. The report also recommended that self-regulatory bodies develop comprehensive security guidelines for preventing online advertising malware attacks; that additional "circuit breakers" be developed to introduce check-points to catch malicious advertisements at an earlier stage before transmission to consumers; and that online companies thoroughly vet new advertisers and perform rigorous and ongoing checks to ensure legitimate advertisements do not morph into malware. In addition, the report recommended that the Federal Trade Commission consider issuing comprehensive regulations to prohibit deceptive and unfair online advertising practices that facilitate or fail to take reasonable steps to prevent malware, invasive cookies, and inappropriate data collection delivered to Internet consumers through online advertisements.

F. The Air Force's Expeditionary Combat Support System (ECSS): A Cautionary Tale on the Need for Business Process Reengineering and Complying with Acquisition Best Practices, July 7, 2014) (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations)

In July 2014, under Senator McCain's leadership, the Subcommittee released a 40-page bipartisan staff report on the Air Force's Expeditionary Combat Support System (ECSS) program, a \$1 billion failed effort to form a unified logistics and supply-chain management system to track all Air Force physical assets from airplanes to fuel to spare parts. Following the program's cancellation in 2012, the report analyzed the factors that led to the failure, including a lack of leadership and cultural resistance to adopting "best practices" in Air Force procurements.

The report described the development of the ECSS system. It found, among other problems, that the Air Force admitted it did not understand what it needed to do to implement the ECSS. The report noted that, in the eight years ECSS was active, the Air Force transitioned six program managers and five program executive officers, resulting in constant leadership turnover and leaving no one accountable for ECSS's failure. The report also determined that the Department of Defense (DOD) and Air Force had a strong cultural resistance to change and adoption of "best practices" to improve their procurement systems. The report found that their resistance hindered effective implementation of business process reengineering (BPR) efforts intended to ensure that enterprise resource planning (ERP) systems were effectively integrated into the relevant business units. The report concluded that the Air Force squandered over \$1 billion in taxpayer funds over eight years without producing a workable ECSS capability.

The report offered a number of bipartisan recommendations to prevent future acquisition failures. The recommendations included improving ERP systems outcomes by initiating BPR assessments earlier in the acquisition process, improving oversight to ensure DOD has a sufficient understanding of the existing business processes to be changed, and ensuring sound budget decision making by integrating the Investment Review Boards (IRB) at the beginning of the budget process. The report also recommended reducing duplicative reporting requirements by utilizing a single governance structure for the acquisition of ERP systems, improving accountability by aligning the tenure of program executives with key acquisition decision points, and strengthening resource verifications of self-reporting BPR certification from program offices.

To help alleviate the problems disclosed by the ECSS failure, at Senator McCain's request, the Senate Armed Services Committee included in the fiscal year 2015 defense authorization bill provisions that required DOD to gain an understanding of the existing legacy systems before procuring any large new business system and to complete a report on enhancing the role of DOD civilian and military program managers in developing and carrying out defense acquisition programs.

G. Abuse of Structured Financial Products: Misusing Basket Options to Avoid Taxes and Leverage Limits, July 22, 2014 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on July 22, 2014)

In July 2014, the Subcommittee released a 95-page bipartisan staff report describing how two global banks, Deutsche Bank AG and Barclays Bank PLC, and more than a dozen hedge funds misused a complex financial structure known as a basket option to claim billions of dollars in unjustified tax savings and avoid leverage limits that protect the financial system from risky debt. This report was the latest in a line of Subcommittee reports documenting bank participation in transactions designed to help clients avoid or evade U.S. taxes.

The report outlined how, over the course of more than a decade, from 1998 to 2013, the banks sold 199 basket options to 13 hedge funds which used them to conduct more than \$100 billion in trades. The report provided detailed information on options involving two of the largest basket option users, Renaissance Technologies Corporation LLC ("RenTec") and George

Weiss Associates. The report explained how the banks and hedge funds used the option structure to open proprietary trading accounts in the names of the banks and create the fiction that the banks owned the account assets, when in fact the hedge funds exercised total control over the assets, executed all the trades, and reaped all the trading profits. The report also explained that when the hedge funds exercised the options shortly after the one-year mark, they claimed that the trading profits were eligible for the lower income tax rate that applies to long-term capital gains on assets held for at least a year, even for short-term trades. The report noted, for example, that RenTec claimed it could treat the trading profits as long term gains, even though it executed an average of 26 to 39 million trades per year and held many assets for mere seconds. The report also noted that, in 2010, the Internal Revenue Service (IRS) had issued an opinion prohibiting the use of basket options to claim long-term capital gains. The report estimated that the hedge funds used the basket option structures to avoid taxes in excess of \$6 billion.

The report also explained that, in addition to avoiding taxes, the basket option structure was used by the banks and hedge funds to evade federal leverage limits on trading securities with borrowed money. Leverage limits were enacted into law after the stock market crash of 1929, when stock losses led to the collapse of not only the stock speculators, but also the banks that lent them money and were unable to collect on the loans. Had the hedge funds made their trades in a normal brokerage account, they would have been subject to a 2-to-1 leverage limit – that is, for every \$2 in total holdings in the account, \$1 could be borrowed from the broker. But because the option accounts were in the name of the bank, the option structure created the fiction that the bank was transferring its own money into its own proprietary trading accounts instead of lending to its hedge-fund clients, in some cases leading to a leverage ratio of 20-to-1. The banks pretended that the money placed into the accounts were not loans to its customers, even though the hedge funds paid financing fees for use of the money. While the two banks have stopped selling basket options as a way for clients to claim long-term capital gains, they continue to use the structures to avoid federal leverage limits.

The report offered a number of bipartisan recommendations to detect, prevent, and stop basket option abuses. The recommendations included urging the IRS to audit each of the hedge funds that used basket option products to collect any unpaid taxes; and urging federal financial regulators, as well as Treasury and the IRS, to intensify warnings against, scrutiny of, and legal actions to penalize bank participation in tax-motivated transactions. The report also recommended that Treasury and the IRS revamp the Tax Equity and Fiscal Responsibility Act (TEFRA) regulations to reduce impediments to audits of large partnerships, and that Congress amend TEFRA to facilitate those audits. In addition, the report recommended that the Financial Stability Oversight Council, working with other agencies, establish new reporting and data collection mechanisms to enable financial regulators to analyze the use of derivative and structured financial products to circumvent federal leverage limits on purchasing securities with borrowed funds, gauge the systemic risks, and develop preventative measures.

H. IRS and TIGTA Management Failures Related to 501(c)(4) Applicants Engaged in Campaign Activity, September 5, 2014 (Report Prepared by the Majority Staff of the Permanent Subcommittee on Investigations with Minority Staff Dissenting Views)

In September 2014, after more than a year-long investigation, the Subcommittee released a 225-page report summarizing the Subcommittee's bipartisan investigation into problems with how the Internal Revenue Service (IRS) processed applications for tax exempt status under Section 501(c)(4) of the tax code. The report was prepared by the majority staff and included dissenting views by the minority staff, which did not join the majority staff report. The report was accompanied by the release of over 1,700 pages of documents from the IRS and Treasury Inspector General for Tax Administration (TIGTA), including emails, correspondence, memoranda, charts, handwritten notes, reports, and analyses.

The majority staff report reached many of the same conclusions as an audit report that was released earlier by TIGTA about the 501(c)(4) application process. The majority staff report found that the IRS used inappropriate screening criteria when it flagged for increased scrutiny applications based upon the applicants' names or political views rather than direct evidence of their involvement with campaign activities. The report also presented evidence of significant program mismanagement, including years-long delays in processing 501(c)(4) applications; inappropriate, intrusive, and burdensome questioning of groups; and poor communication and coordination between IRS officials in Washington and Cincinnati. At the same time, like TIGTA, the report found no evidence of IRS political bias in selecting 501(c)(4) applications for heightened review, as distinguished from using poor judgment in crafting the selection criteria. Based on investigative work that went beyond what TIGTA examined, the majority staff report also determined that the same problems affected IRS review of 501(c)(4) applications filed by liberal groups, detailing several examples.

The majority staff report also criticized the TIGTA audit. It found that, by focusing exclusively on how the IRS handled 501(c)(4) applications filed by conservative groups and excluding any comparative data on applications filed by liberal groups, the TIGTA audit produced distorted audit results that continue to be misinterpreted. The report explained that the TIGTA audit engagement letter stated that the audit's "overall objective" was to examine the "consistency" of IRS actions in identifying and reviewing 501(c)(4) applications, including whether "conservative groups" experienced "inconsistent treatment." The report found that, instead, the TIGTA audit focused solely on IRS treatment of conservative groups, and omitted any mention of other groups. For example, while the TIGTA audit report criticized the IRS for using "Tea Party," "9/12," and "Patriot" to identify applications filed by conservative groups, it left out that the IRS also used "Progressive," "ACORN," "Emerge," and "Occupy" to identify applications filed by liberal groups. The majority staff report noted that, while the TIGTA audit report criticized the IRS for subjecting conservative groups to delays, burdensome questions, and mismanagement, it failed to disclose that the IRS subjected liberal groups to the same treatment. The majority staff report explained that the result was that when the TIGTA audit report presented data showing conservative groups were treated inappropriately, it was interpreted to mean conservative groups were handled differently and less favorably than liberal groups, when in fact, both groups experienced the same mistreatment. The majority staff report also criticized

TIGTA for failing to include in its audit report its conclusion that the TIGTA audit had ‘found no evidence of political bias’ by the IRS in processing 501(c)(4) applications, an omission which led to the TIGTA audit report being misconstrued to inaccurately and unfairly damage public confidence in the impartiality of the IRS.

The majority staff report offered a number of recommendations to reform IRS processing of 501(c)(4) applications filed by groups planning to engage in both social welfare and campaign activities. The recommendations included urging the IRS to stop using a “facts and circumstances” test to evaluate the applications and groups, since it produced a time-consuming, case-by-case, non-transparent, subjective, and unpredictable method of evaluation that not only confused and delayed IRS decisionmaking, but also invited public suspicion that the IRS may have been influenced by politics. Instead, the majority staff report recommended developing objective standards and bright line rules to produce more consistent, timely, transparent, and predictable treatment of 501(c)(4) applications filed by groups that engage in campaign activities. The report also recommended that the IRS revise its rules to comply with the statutory requirement that 501(c)(4) groups engage ‘exclusively’ in social welfare activities, including by applying an ‘insubstantial’ test to limit other activities, similar to the one already applied to 501(c)(3) charities, and by applying a percentage test to ensure campaign activities comprise no more than an insubstantial portion of a tax-exempt social welfare organization’s activities. In addition, the report recommended that the IRS require 501(c)(4) groups to provide the IRS with a copy of any filing submitted to the Federal Election Commission, so that the IRS can use those filings to identify 501(c)(4) groups warranting heightened review for campaign activity.

The dissenting views filed by the minority staff disagreed that the IRS mistreated both conservative and liberal groups. The dissenting views found that, while some liberal groups were examined by the IRS from May 2010 to May 2012, there were far fewer such groups, they were systematically separate from the review of conservative groups, their questioning was far less intrusive, and, in some cases, the liberal groups were affiliates of specific organizations that had behaved illegally in the past and could reasonably have expected additional scrutiny. The dissenting views found that the inclusion of a few liberal groups by the IRS did not bear comparison to the targeting of conservative groups, that conservative groups received the bulk of unfair and burdensome treatment, and that the IRS screening resulted in a clearly disparate impact on conservative group applications. The dissenting views also noted that, while the majority and minority staffs were unable to come to agreement in their analysis, the Subcommittee conducted its investigation through joint interviews and document requests, and continued its tradition of in-depth fact finding and frequent consultations that are the hallmark of the Subcommittee’s oversight work and led to a deepened understanding of key issues.

I. Defense Acquisition Reform: Where Do We Go from Here? A Compendium of Views by Leading Experts, October 2, 2014 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations)

In October 2014, under the leadership of Senator McCain, the Subcommittee released a bipartisan staff report containing a collection of 31 essays from a variety of defense acquisition experts offering views on defense acquisition reform. While the Subcommittee made no

recommendations of its own, the report's experts provided a comprehensive review of current shortcomings in the acquisition process and provided a wide range of options to improve the defense acquisition system. This compendium provides a starting point for defense acquisition reforms in the next Congress.

J. Wall Street Bank Involvement With Physical Commodities, November 20 and 21, 2014 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on November 20 and 21, 2014)

In November 2014, after a two-year investigation, the Subcommittee released a 400-page bipartisan staff report detailing the nature and extent of the involvement of large Wall Street banks with physical commodities. The report explained how physical commodity activities were eroding the longstanding separation of banking and commerce; increasing risks to the banks, their holding companies, and the financial system; and raising questions about price manipulation and unfair trading in commodity markets.

The report presented three case studies involving Goldman, Morgan Stanley, and JPMorgan Chase. In each case study, the report provided detailed evidence on several examples of physical commodity activities, including warehousing aluminum and other metals, trading uranium, mining coal, operating oil and gas storage and pipeline facilities, supplying jet fuel to airlines, constructing a compressed natural gas facility, and controlling power plants. The report provided detailed information about Goldman's ownership of Metro Trade Services International, a U.S. warehouse company which was certified to store aluminum warranted by the London Metal Exchange for use in settling trades and which operated a number of Detroit-area warehouses. The report noted that, after Goldman bought Metro in 2010, Metro warehouses accumulated 85% of the LME aluminum storage market in the United States, began to engage in so-called "merry-go-round" deals that shuttled metal from building to building without actually shipping aluminum out of Metro's system; and increased the wait to withdraw LME-warranted metal from storage from about 40 days to more than 600, reducing aluminum availability and tripling the U.S. premium for storage and delivery costs. The report noted that, during the same period, Goldman engaged in massive aluminum trades in both the physical and financial markets, further increasing the length of the warehouse queue and raising concerns about whether Goldman was manipulating aluminum prices or making trades using non-public warehouse information.

The report also detailed how JPMorgan amassed physical commodity holdings equal to nearly 12% of its Tier 1 capital, while telling regulators its holdings were far smaller; owned or controlled 30 electrical power plants across the country; and incurred a \$410 million penalty for manipulative bidding strategies that produced excessive electricity payments that hurt consumers in California and the Midwest. The report also described JPMorgan's involvement with stockpiling and trading copper and designing an exchange traded fund based on copper prices. In addition, the report described how, at one time, Morgan Stanley controlled 55 million barrels of oil storage capacity as well as 6,000 miles of pipeline, while also working to build its own compressed natural gas facility and supplying major airlines with jet fuel. The report also described how the Federal Reserve conducted an intensive review of the physical commodity activities being engaged in by financial holding companies, determined they carried novel and

troubling risks to both the holding companies and the financial system, and was considering new rules to rein in physical commodity risks.

The report offered a long list of bipartisan recommendations to reduce physical commodity activities at banks and their holding companies. The recommendations included urging the Federal Reserve to reaffirm the separation of banking from commerce, and reconsider all of the rules and practices related to physical commodity activities in light of that principle; to issue a clear and comprehensive limit on the size of a financial holding company's physical commodity activities; and strengthen public disclosures of those activities to support effective oversight. The report also recommended narrowing the scope of the legal authorities permitting physical commodity activities, and establishing capital and insurance minimums to protect against potential losses from catastrophic events. In addition, the report recommended barring large traders, including financial holding companies, from using material non-public information gained from physical commodities activities to benefit their trading activities in the financial markets. The report also urged the Federal Reserve to use its upcoming rulemaking to address these concerns and reduce the risks associated with financial company involvement in physical commodity activities.

V. Requested and Sponsored Reports

In connection with its investigations, the Subcommittee makes extensive use of the resources and expertise of the Government Accountability Office (GAO), the Offices of Inspectors General (OIGs) at various federal agencies, and other entities. During the 113th Congress, the Subcommittee requested a number of reports and studies on issues of importance. Several of these reports have already been described in connection with Subcommittee hearings. Several additional reports that were of particular interest, and that were not covered by Subcommittee hearings, are the following.

A. Corporate Income Tax: Effective Tax Rates Can Differ Significantly from the Statutory Rate (GAO-13-520), May 30, 2013

Over the past ten years, the Subcommittee has conducted a series of investigations into corporate nonpayment of U.S. income taxes. In 2008, in part at the Subcommittee's request, GAO issued a report on corporate tax payments (GAO-08-957) which found that nearly 55% of all large U.S.-controlled corporations reported no federal tax liability in at least one year between 1998 and 2005. In response to a bipartisan request from the Subcommittee to update that report five years later, GAO assessed the extent to which corporations pay U.S. corporate income tax, and compared the average effective tax rate for corporations to the U.S. statutory corporate tax rate of 35%.

The GAO report determined that large, profitable U.S. corporations paid an average effective federal tax rate of 12.6% in 2010, or only about one-third of the U.S. statutory rate. The report's findings added to a growing body of evidence that large, profitable corporations bear a dwindling share of the U.S. tax burden, and that the Treasury collects far less revenue from large, profitable corporations than might be expected under the 35% statutory tax rate.

GAO's year-long study examined, in particular, how effective tax rates are typically calculated, and then developed a new, more accurate methodology using actual corporate tax return data. GAO compiled the tax return data from large corporations for tax years 2008 through 2010, using M-3 tax returns filed with the Internal Revenue Service by corporations with at least \$10 million in assets. Using actual tax return data enabled GAO to develop more accurate figures for the taxes paid by large U.S. corporations than studies using tax information provided in corporate financial statements. The GAO report noted that the amounts reported in the corporate tax returns were, on the whole, lower than the tax liabilities reported in the corporate financial statements filed with the Securities and Exchange Commission. The GAO report explained that average corporate effective tax rates are generally computed as the ratio of taxes paid or tax liabilities accrued in a given tax year over the net income declared by the corporation during that same year.

GAO found that, on average, large, profitable U.S. corporations paid U.S. federal income tax amounting to just 12.6% of their worldwide income. In addition, GAO found that the relatively low effective tax rate paid by U.S. corporations did not substantially increase when other taxes paid by those corporations were taken into account. For example, GAO found that, in 2010, adding foreign, state, and local taxes to federal income taxes increased the average effective tax rate of large, profitable U.S. corporations by about 4 percentage points to 16.9% of their worldwide income. That composite tax rate was still less than half the U.S. statutory rate.

GAO noted that some studies calculating effective tax rates included unprofitable corporations in their analysis, but explained that "[t]he inclusion of unprofitable firms, which pay little if any actual tax, can result in relatively high estimates because the losses of unprofitable corporations greatly reduce the denominator of the effective rate" and "do not accurately represent the tax rate on the profitable corporations that actually pay the tax." GAO calculated that when unprofitable corporations were included in its data, the average effective federal tax rate rose from 12.6% to 16.6%, because those corporations had lost \$315 billion and thereby reduced the overall net income against which the corporate tax payments were compared. GAO concluded that the resulting tax rate overstated the effective tax rate actually paid by large, profitable U.S. corporations.

GAO's finding that corporations pay far less than the U.S. statutory rate was consistent with other Subcommittee investigative work detailing the many tax loopholes and tax shelters used by some U.S. profitable corporations to avoid or evade paying U.S. taxes. It was also consistent with other studies demonstrating that large, profitable corporations are often able to minimize, if not entirely avoid, paying U.S. income taxes. GAO did not make any recommendations in its report.

B. Disability Insurance: Work Activity Indicates Certain Social Security Disability Insurance Payments Were Potentially Improper (GAO-13-635), August 15, 2013

For a number of years, the Subcommittee has examined issues related to Social Security disability programs and benefits. In August 2013, in response to a bipartisan request from the Subcommittee, GAO examined the extent to which the federal Social Security Disability

Insurance (DI) program may be overpaying benefits. This program is the nation's largest cash assistance program for workers with disabilities. Although program rules allow beneficiaries to engage in a limited amount of certain types of work, other work activities indicate that the beneficiaries are not disabled and therefore not entitled to DI benefits. Consequently, the Social Security Administration (SSA) may overpay beneficiaries if the agency does not detect disqualifying work activity and suspend benefits appropriately.

GAO estimated that, as of January 2013, SSA made \$1.29 billion in potential cash benefit overpayments to about 36,000 individuals, representing an estimated 0.4% of all primary DI beneficiaries as of December 2010. GAO developed this estimate by analyzing SSA data on individuals who were DI beneficiaries as of December 2010, and earnings data from the National Directory of New Hires (NDNH). GAO noted that the exact number of individuals who received improper disability payments and the exact amount of improper payments cannot be determined without detailed case investigations. GAO also noted that SSA, using a different methodology, had estimated its DI overpayments in fiscal year 2011 at \$1.62 billion, or 1.27% of all DI benefits in that fiscal year.

GAO explained that its estimate included consideration of work activity performed by two populations of individuals. The first population performed work activity during the DI program's mandatory 5-month waiting period – a statutory program requirement to help ensure that SSA does not pay benefits to individuals who do not have long-term disabilities. Prior to receiving benefits, individuals must complete a 5-month waiting period, in which the individual cannot exceed a certain level of earnings, known as substantial gainful activity, during any month in order to be eligible for DI benefits. Earnings that exceed program limits during the waiting period indicate that individuals might not have long-term disabilities. The second population performed work activity beyond the program's trial work period which allows certain types of work for up to 9 months, to see if the beneficiary can do that work and no longer requires DI benefits. Beneficiaries whose earnings consistently exceed program limits after completing the trial work period are generally no longer entitled to DI benefits. GAO determined that SSA uses its enforcement operation to generate alerts for potentially disqualifying earnings, but those alerts are not issued for earnings that occur in all months of the waiting period and potentially disqualifying work activity may remain undetected. SSA officials indicated to GAO that modifying its enforcement operation could be costly, and that the agency had not performed a cost assessment for making that modification.

GAO recommended that SSA assess the cost and feasibility of establishing a mechanism to detect potentially disqualifying earnings during all months of the waiting period. SSA concurred, despite raising concerns about GAO's estimates.

C. IRS's Offshore Voluntary Disclosure Program: 2009 Participation by State and Location of Foreign Bank Accounts (GAO-14-265R), January 6, 2014

For a number of years, the Subcommittee has examined issues related to offshore tax abuses, including actions taken by banks located in tax havens to open offshore accounts for U.S. clients without disclosing those accounts to the Internal Revenue Service (IRS). At a 2008

Subcommittee hearing, UBS, Switzerland's largest bank, admitted that it had facilitated U.S. tax evasion by opening undisclosed Swiss accounts for U.S. clients. In 2009, UBS signed a deferred prosecution agreement with the United States on charges of conspiring to defraud the United States by impeding U.S. tax collection, paid a \$780 million fine, and agreed to disclose the names of some U.S. clients with hidden Swiss accounts. Also in 2009, the IRS established an Offshore Voluntary Disclosure Program to encourage U.S. taxpayers to disclose the existence of their offshore accounts and, using a system of reduced penalties, pay the back taxes, interest, and penalties they owed for evading U.S. taxes. As a condition to participating in the program, the IRS required taxpayers to provide information about the offshore banks, investment firms, law firms, and others that helped them hide their assets offshore.

In March 2013, at the request of the Finance Committee and others, GAO issued a report (GAO-13-318) analyzing the Offshore Voluntary Disclosure Program. The report found that, as of December 2012, the IRS had received more than 39,000 disclosures from taxpayers and revenues exceeding \$5.5 billion. GAO also analyzed about 10,500 taxpayer filings from the program and determined that, during the 2009 initiative, the median offshore account amount was \$570,000, while accounts with penalties greater than \$1 million represented only about 6% of the cases, but accounted for almost half the penalties. In addition, GAO determined that many other taxpayers had made so-called "quiet disclosures" of offshore assets or income, by either amending a past return or disclosing offshore income for the first time on a current return, without paying any back taxes, interest, or penalties on previously hidden income. GAO noted, for example, that from tax year 2007 through tax year 2010, IRS estimated that the number of taxpayers reporting foreign accounts had nearly doubled to 516,000. GAO described these quiet disclosures as resulting in lost revenues while also undermining the effectiveness of the Offshore Voluntary Disclosure Program, and recommended review by the IRS.

In January 2014, in response to a request from the Subcommittee, GAO issued a report providing supplemental information about the taxpayers who participated in the 2009 Offshore Voluntary Disclosure Program. GAO found that the participants had together filed over 12,800 Foreign Bank and Financial Account Reports (FBARs), as part of their disclosure obligations. GAO reported that its review of a sample of those FBARs found that some participants disclosed dozens of offshore accounts with multiple banks in multiple countries, while other participants disclosed only one account. Of the 12,800 FBARs reviewed, GAO determined that about 5,400 or 42% reported at least one account in Switzerland, while the next highest country total was the United Kingdom with about 1,000 accounts. GAO also determined that U.S. taxpayers across the country filed those FBARs, with the most filed by taxpayers in the five states with generally the largest populations, California, New York, Florida, New Jersey, and Texas. No comparable analysis has yet been performed for FBARs filed in later stages of the Offshore Voluntary Disclosure Program, nor has any analysis been made public regarding other types of information provided by program participants. GAO did not make any recommendations in this report.

D. Large Partnerships: Characteristics of Population and IRS Audits (GAO-14-379R), March 19, 2014; and Large Partnerships: With Growing Number of Partnerships, IRS Needs to Improve Audit Efficiency (GAO-14-732), September 18, 2014

Over the years, the Subcommittee has examined a number of tax issues involving partnerships, including hedge funds. In March and September 2014, in response to a bipartisan request from the Subcommittee, GAO examined the IRS audit rate for large partnerships, defined by GAO as those with at least 100 direct and indirect partners and \$100 million in assets. They include hedge funds, private equity funds, and publicly traded partnerships. The March report provided preliminary graphics and data, while the September report provided a more comprehensive examination of IRS audits of large partnerships.

In its reports, GAO determined that, from 2002 to 2011, the number of large partnerships had tripled to over 10,000, while the number of C corporations being created, including the largest U.S. publicly traded corporations, fell by 22%. GAO found that large partnerships had also increased in both the average number of direct partners and average asset size. GAO also found that some of those partnerships had revenues totaling billions of dollars per year and estimated that they collectively held more than \$7.5 trillion in assets. In addition, GAO found that the IRS was auditing only a tiny fraction of the partnerships. According to GAO, in 2012, the IRS audited less than 1% of large partnerships compared to 27% of C corporations, making C corporations 33 times more likely to face an audit than a partnership.

The GAO report described the complexity of some large partnerships, which made them difficult for the IRS to audit effectively. GAO reported that some partnerships had 100,000 or more partners arranged in multiple tiers, and some of those partners were not individuals or corporate entities but pass-through entities – essentially, partnerships within partnerships. In addition, at publicly traded partnerships, the partners can change on a daily basis. GAO reported that one IRS official calculated that there were more than 1,000 partnerships with more than a million partners in 2012.

The GAO report also discussed a number of statutory obstacles to IRS audits of large partnerships. The report explained that the key statute, the Tax Equity and Fiscal Responsibility Act (TEFRA), was three decades old, was enacted at a time when many partnerships had 30 to 50 partners, and was not designed to handle partnerships with a million partners or a partnership roster that changed on a daily basis. Among the TEFRA problems identified by the report was a requirement that the IRS identify a “tax matters partner” to represent the partnership on tax issues, even though many partnerships did not designate such a partner, and simply identifying one in a complex partnership could take months. Second, the report described notification requirements that essentially required the IRS to notify individual partners prior to commencing an audit of the partnership, even though such notices were time consuming, carried large costs, and produced few, if any, benefits. Third, the report noted that TEFRA required any tax adjustments called for by an audit to be passed through to the partnership’s taxable partners, even though the IRS’s process for identifying, assessing, and collecting from those partners was laborious, time consuming, costly, and subject to error. In addition, the report explained that, under TEFRA, any tax adjustments had to be applied to past tax years, using complicated and

expensive filing and amendment requirements, instead of being applied to the year in which the audit was performed and the adjustment made.

GAO offered several recommendations for Congress and the IRS in its September report. GAO recommended that Congress consider requiring large partnerships to identify a partner to represent them during audits and to pay taxes on audit adjustments at the partnership level. GAO recommended that the IRS take multiple actions, including defining large partnerships, tracking audit results using revised audit codes, and implementing project planning principles for the audit procedure projects.

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1978), Sam Nunn of Georgia (1979-1980 and 1987-1994), William V. Roth of Delaware (1981-1986 and 1995-1996), Susan M. Collins of Maine (1997-2001); Norm Coleman of Minnesota (2003-2007); and Carl Levin of Michigan (2001-2002 and 2007-2014).

Until 1957, the Subcommittee's jurisdiction focused principally on waste, inefficiency, impropriety, and illegality in government operations. Its jurisdiction then expanded over time, today encompassing investigations within the broad ambit of the parent committee's responsibility for matters relating to the efficiency and economy of operations of all branches of the government, including matters related to: (a) waste, fraud, abuse, malfeasance, and unethical practices in government contracting and operations; (b) organized criminal activities affecting interstate or international commerce; (c) criminal activity affecting the national health, welfare, or safety, including investment fraud, commodity and securities fraud, computer fraud, and offshore abuses; (d) criminality or improper practices in labor-management relations; (e) the effectiveness of present national security methods, staffing and procedures, and U.S. relationships with international organizations concerned with national security; (f) energy shortages, energy pricing, management of government-owned or controlled energy supplies; and relationships with oil producing and consuming countries; and (g) the operations and management of Federal regulatory policies and programs. While retaining the status of a subcommittee of a standing committee, the Subcommittee has long exercised its authority on an independent basis, selecting its own staff, issuing its own subpoenas, and determining its own investigatory agenda.

The Subcommittee acquired its sweeping jurisdiction in several successive stages. In 1957 – based on information developed by the Subcommittee – the Senate passed a Resolution establishing a Select Committee on Improper Activities in the Labor or Management Field. Chaired by Senator McClellan, who also chaired the Subcommittee at that time, the Select Committee was composed of eight Senators – four of whom were drawn from the Subcommittee on Investigations and four from the Committee on Labor and Public Welfare. The Select Committee operated for 3 years, sharing office space, personnel, and other facilities with the Permanent Subcommittee. Upon its expiration in early 1960, the Select Committee's jurisdiction and files were transferred to the Subcommittee on Investigations, greatly enlarging the latter body's investigative authority in the labor-management area.

The Subcommittee's jurisdiction expanded further during the 1960s and 1970s. In 1961, for example, it received authority to make inquiries into matters pertaining to organized crime and, in 1963, held the famous Valachi hearings examining the inner workings of the Italian Mafia. In 1967, following a summer of riots and other civil disturbances, the Senate approved a Resolution directing the Subcommittee to investigate the causes of this disorder and to recommend corrective action. In January 1973, the Subcommittee acquired its national security mandate when it merged with the National Security Subcommittee. With this merger, the Subcommittee's jurisdiction was broadened to include inquiries concerning the adequacy of national security staffing and procedures, relations with international organizations, technology transfer issues, and related matters. In 1974, in reaction to the gasoline shortages precipitated by the Arab-Israeli war of October 1973, the Subcommittee acquired jurisdiction to investigate the control and management of energy resources and supplies as well as energy pricing issues.

In 1997, the full Committee on Governmental Affairs was charged by the Senate to conduct a special examination into illegal or improper activities in connection with Federal election campaigns during the 1996 election cycle. The Permanent Subcommittee provided substantial resources and assistance to this investigation, contributing to a greater public understanding of what happened, to subsequent criminal and civil legal actions taken against wrongdoers, and to enactment of campaign finance reforms in 2001.

In 1998, the Subcommittee marked the fiftieth anniversary of the Truman Committee's conversion into a permanent subcommittee of the U.S. Senate.² Since then, the Subcommittee has developed particular expertise in complex financial matters, examining the collapse of Enron Corporation in 2001, the key causes of the 2008 financial crisis, structured finance abuses, financial fraud, unfair credit practices, money laundering, commodity speculation, and a wide range of offshore and tax haven abuses. It has also focused on issues involving health care fraud, foreign corruption, and waste, fraud and abuse in government programs. In the half-century of its existence, the Subcommittee's many successful investigations have made clear to the Senate the importance of retaining a standing investigatory body devoted to keeping government not only efficient and effective, but also honest and accountable.

B. Subcommittee Investigations

Armed with its broad jurisdictional mandate, the Subcommittee has conducted investigations into a wide variety of topics of public concern, ranging from financial misconduct, to commodities speculation, predatory lending, and tax evasion. Over the years, the Subcommittee has also conducted investigations into criminal wrongdoing, including money laundering, the narcotics trade, child pornography, labor racketeering, and organized crime activities. In addition, the Subcommittee has investigated a wide range of allegations of waste, fraud, and abuse in government programs and consumer protection issues, addressing problems ranging from unfair credit card practices to health care fraud. In the 113th Congress, the Subcommittee held eight hearings and issued ten reports on a wide range of issues, including bank misconduct, hidden offshore bank accounts, corporate tax avoidance, online advertising abuses, conflicts of interest affecting the stock market, missteps in processing 501(c)(4) applications for tax-exempt status, defense acquisition problems, and inappropriate bank involvement with physical commodities.

(1) Historical Highlights

The Subcommittee's investigatory record as a permanent Senate body began under the Chairmanship of Republican Senator Homer Ferguson and his Chief Counsel (and future Attorney General and Secretary of State) William P. Rogers, as the Subcommittee inherited the

² This anniversary also marked the first date upon which internal Subcommittee records generally began to become available to the public. Unlike most standing committees of the Senate whose previously unpublished records open after a period of 20 years has elapsed, the Permanent Subcommittee on Investigations, as an investigatory body, may close its records for 50 years to protect personal privacy and the integrity of the investigatory process. With this 50th anniversary, the Subcommittee's earliest records, housed in the Center for Legislative Archives at the National Archives and Records Administration, began to open seriatim. The records of the predecessor committee – the Truman Committee – were opened by Senator Nunn in 1980.

Truman Committee's role in investigating fraud and waste in U.S. Government operations. This investigative work became particularly colorful under the chairmanship of Senator Clyde Hoey, a North Carolina Democrat who took the chair from Senator Ferguson after the 1948 elections. The last U.S. Senator to wear a long frock coat and wing-tipped collar, Mr. Hoey was a distinguished southern gentleman of the old school. Under his leadership, the Subcommittee won national attention for its investigation of the so-called "five percenters," notorious Washington lobbyists who charged their clients five percent of the profits from any Federal contracts they obtained on the client's behalf. Given the Subcommittee's jurisdictional inheritance from the Truman Committee, it is perhaps ironic that the "five percenters" investigation raised allegations of bribery and influence-peddling that reached right into the White House and implicated members of President Truman's staff. In any event, the fledgling Subcommittee was off to a rapid start.

What began as colorful soon became contentious. When Republicans returned to the Majority in the Senate in 1953, Wisconsin's junior Senator, Joseph R. McCarthy, became the Subcommittee's Chairman. Two years earlier, as Ranking Minority Member, Senator McCarthy had arranged for another Republican Senator, Margaret Chase Smith of Maine, to be removed from the Subcommittee. Senator Smith's offense, in Senator McCarthy's eyes, was her issuance of a "Declaration of Conscience" repudiating those who made unfounded charges and used character assassination against their political opponents. Although Senator Smith had carefully declined to name any specific offender, her remarks were universally recognized as criticism of Senator McCarthy's accusations that communists had infiltrated the State Department and other government agencies. Senator McCarthy retaliated by engineering Senator Smith's removal, replacing her with the newly-elected Senator from California, Richard Nixon.

Upon becoming Subcommittee Chairman, Senator McCarthy staged a series of highly publicized anti-communist investigations, culminating in an inquiry into communism within the U.S. Army, which became known as the Army-McCarthy hearings. During the latter portion of those hearings, in which the parent Committee examined the Wisconsin Senator's attacks on the Army, Senator McCarthy recused himself, leaving South Dakota Senator Karl Mundt to serve as Acting Chairman of the Subcommittee. Gavel-to-gavel television coverage of the hearings helped turn the tide against Senator McCarthy by raising public concern about his treatment of witnesses and cavalier use of evidence. In December 1954, the Senate censured Senator McCarthy for unbecoming conduct. In the following year, the Subcommittee adopted new rules of procedure that better protected the rights of witnesses. The Subcommittee also strengthened the rules ensuring the right of both parties on the Subcommittee to appoint staff, initiate and approve investigations, and review all information in the Subcommittee's possession.

In 1955, Senator John McClellan of Arkansas began 18 years of service as Chairman of the Permanent Subcommittee on Investigations. Senator McClellan appointed a young Robert F. Kennedy as the Subcommittee's Chief Counsel. That same year, Members of the Subcommittee were joined by Members of the Senate Labor and Public Welfare Committee on a special committee to investigate labor racketeering. Chaired by Senator McClellan and staffed by Robert Kennedy and other Subcommittee staff members, this special committee directed much of its attention to criminal influence over the Teamsters Union, most famously calling Teamsters' leaders Dave Beck and Jimmy Hoffa to testify. The televised hearings of the special

committee also introduced Senators Barry Goldwater and John F. Kennedy to the nation, as well as leading to passage of the Landrum-Griffin Labor Act.

After the special committee completed its work, the Permanent Subcommittee on Investigations continued to investigate organized crime. In 1962, the Subcommittee held hearings during which Joseph Valachi outlined the activities of La Cosa Nostra, or the Mafia. Former Subcommittee staffer Robert Kennedy – who had by then become Attorney General in his brother’s Administration – used this information to prosecute prominent mob leaders and their accomplices. The Subcommittee’s investigations also led to passage of major legislation against organized crime, most notably the Racketeer Influenced and Corrupt Organizations (RICO) provisions of the Crime Control Act of 1970. Under Chairman McClellan, the Subcommittee also investigated fraud in the purchase of military uniforms, corruption in the Department of Agriculture’s grain storage program, securities fraud, and civil disorders and acts of terrorism. In addition, from 1962 to 1970, the Subcommittee conducted an extensive probe of political interference in the awarding of government contracts for the Pentagon’s ill-fated TFX (“tactical fighter, experimental”) aircraft. In 1968, the Subcommittee also examined charges of corruption in U.S. servicemen’s clubs in Vietnam and elsewhere around the world.

In 1973, Senator Henry “Scoop” Jackson, a Democrat from Washington, replaced Senator McClellan as the Subcommittee’s Chairman. During his tenure, recalled Chief Clerk Ruth Young Watt – who served in this position from the Subcommittee’s founding until her retirement in 1979 – Ranking Minority Member Charles Percy, an Illinois Republican, became more active on the Subcommittee than Chairman Jackson, who was often distracted by his Chairmanship of the Interior Committee and his active role on the Armed Services Committee.³ Senator Percy also worked closely with Georgia Democrat Sam Nunn, a Subcommittee member who subsequently succeeded Senator Jackson as Subcommittee Chairman in 1979. As Chairman, Senator Nunn continued the Subcommittee’s investigations into the role of organized crime in labor-management relations and also investigated pension fraud.

Regular reversals of political fortunes in the Senate during the 1980s and 1990s saw Senator Nunn trade the chairmanship three times with Delaware Republican William Roth. Senator Nunn served from 1979 to 1980 and again from 1987 to 1995, while Senator Roth served from 1981 to 1986, and again from 1995 to 1996. These 15 years saw a strengthening of the Subcommittee’s bipartisan tradition in which investigations were initiated by either the Majority or Minority and fully supported by the entire Subcommittee. For his part, Senator Roth led a wide range of investigations into commodity investment fraud, offshore banking schemes, money laundering, and child pornography. Senator Nunn led inquiries into Federal drug policy, the global spread of chemical and biological weapons, abuses in Federal student aid programs, computer security, airline safety, and health care fraud. Senator Nunn also appointed the

³ It had not been uncommon in the Subcommittee’s history for the Chairman and Ranking Minority Member to work together closely despite partisan differences, but Senator Percy was unusually active while in the Minority – a role that included his chairing an investigation of the hearing aid industry.

Subcommittee's first female counsel, Eleanore Hill, who served as Chief Counsel to the Minority from 1982 to 1986 and then as Chief Counsel from 1987 to 1995.

Strong bipartisan traditions continued in the 105th Congress when, in January 1997, Republican Senator Susan Collins of Maine became the first woman to chair the Permanent Subcommittee on Investigations. Senator John Glenn of Ohio became the Ranking Minority Member, while also serving as Ranking Minority Member of the full Committee. Two years later, in the 106th Congress, after Senator Glenn's retirement, Michigan Democrat Carl Levin succeeded him as the Subcommittee's Ranking Minority Member. During Senator Collins' chairmanship, the Subcommittee conducted investigations into issues affecting Americans in their day-to-day lives, including mortgage fraud, deceptive mailings and sweepstakes promotions, phony credentials obtained through the Internet, day trading of securities, and securities fraud on the Internet. Senator Levin initiated an investigation into money laundering. At his request, in 1999, the Subcommittee held hearings on money laundering issues affecting private banking services provided to wealthy individuals, and, in 2001, on how major U.S. banks providing correspondent accounts to offshore banks were being used to advance money laundering and other criminal schemes.

During the 107th Congress, both Senator Collins and Senator Levin chaired the Subcommittee. Senator Collins was chairman until June 2001, when the Senate Majority party changed hands; at that point, Senator Levin assumed the chairmanship and Senator Collins, in turn, became the Ranking Minority Member. In her first six months chairing the Subcommittee at the start of the 107th Congress, Senator Collins held hearings examining issues related to cross border fraud, the improper operation of tissue banks, and Federal programs designed to fight diabetes. When Senator Levin assumed the chairmanship, as his first major effort, the Subcommittee initiated an 18-month bipartisan investigation into the Enron Corporation, which had collapsed into bankruptcy. As part of that investigation, the Subcommittee reviewed over 2 million pages of documents, conducted more than 100 interviews, held four hearings, and issued three bipartisan reports focusing on the role played by Enron's Board of Directors, Enron's use of tax shelters and structured financial instruments, and how major U.S. financial institutions contributed to Enron's accounting deceptions, corporate abuses, and ultimate collapse. The Subcommittee's investigative work contributed to passage of the Sarbanes-Oxley Act which enacted accounting and corporate reforms in July 2002. In addition, Senator Levin continued the money laundering investigation initiated while he was the Ranking Minority Member, and the Subcommittee's work contributed to enactment of major reforms strengthening U.S. anti-money laundering laws in the 2001 Patriot Act. Also during the 107th Congress, the Subcommittee opened new investigations into offshore tax abuses, border security, and abusive practices related to the pricing of gasoline and other fuels.

In January 2003, at the start of the 108th Congress, after the Senate Majority party again changed hands, Senator Collins was elevated to Chairman of the full Committee on Governmental Affairs, and Republican Senator Norm Coleman of Minnesota became Chairman of the Subcommittee. Over the next two years, Senator Coleman held hearings on topics of national and global concern including illegal file sharing on peer-to-peer networks, abusive practices in the credit counseling industry, the dangers of purchasing pharmaceuticals over the Internet, SARS preparedness, border security, and how Saddam Hussein abused the United

Nations Oil for Food Program. At the request of Senator Levin, then Ranking Minority Member, the Subcommittee also examined how some U.S. accounting firms, banks, investment firms, and tax lawyers were designing, promoting, and implementing abusive tax shelters across the country; and how some U.S. financial institutions were failing to comply with anti-money laundering controls mandated by the Patriot Act, using as a case history Riggs Bank accounts involving Augusto Pinochet, the former President of Chile, and Equatorial Guinea, an oil-rich country in Africa.

During the 109th Congress, Senator Coleman held additional hearings on abuses associated with the United Nation's Oil for Food Program, and initiated a series of hearings on federal contractors who were paid with taxpayer dollars but failed to meet their own tax obligations, resulting in billions of dollars in unpaid taxes. He also held hearings on border security issues, securing the global supply chain, federal travel abuses, abusive tax refund loans, and unfair energy pricing. At Senator Levin's request, the Subcommittee held hearings on offshore tax abuses responsible for \$100 billion in unpaid taxes each year, and on U.S. vulnerabilities caused by states forming 2 million companies each year with hidden owners.

(2) More Recent Investigations

During the 110th Congress, in January 2007, after the Senate majority shifted, Senator Levin once again became Subcommittee Chairman, while Senator Coleman became the Ranking Minority Member. Senator Levin chaired the Subcommittee for the next seven years. He focused the Subcommittee on investigations into complex financial and tax matters, including unfair credit card practices, executive stock option abuses, excessive speculation in the natural gas and crude oil markets, and offshore tax abuses involving tax haven banks and non-U.S. persons dodging payment of U.S. taxes on U.S. stock dividends. The Subcommittee's work contributed to enactment of two landmark bills, the Credit Card Accountability Responsibility and Disclosure Act (Credit CARD Act) which reformed credit card practices, and the Foreign Account Tax Compliance Act (FATCA) which tackled the problem of hidden offshore bank accounts used by U.S. persons to dodge U.S. taxes. At the request of Senator Coleman, the Subcommittee also conducted bipartisan investigations into Medicare and Medicaid health care providers who cheat on their taxes, fraudulent Medicare claims involving deceased doctors or inappropriate diagnosis codes, U.S. dirty bomb vulnerabilities, federal payroll tax abuses, abusive practices involving transit benefits, and problems involving the United Nations Development Program.

During the 111th Congress, Senator Levin continued as Subcommittee Chairman, while Senator Tom Coburn joined the Subcommittee as its Ranking Minority Member. During the 111th Congress, the Subcommittee dedicated much of its resources to a bipartisan investigation into key causes of the 2008 financial crisis, looking in particular at the role of high risk home loans, regulatory failures, inflated credit ratings, and high-risk, conflicts-ridden financial products designed and sold by investment banks. The Subcommittee held four hearings and released thousands of documents. The Subcommittee's work contributed to passage of another landmark financial reform bill, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. In addition, the Subcommittee held hearings on excessive speculation in the wheat

market, tax haven banks that helped U.S. clients evade U.S. taxes, how to keep foreign corruption out of the United States, and social security disability fraud.

During the 112th Congress, Senator Levin and Senator Coburn continued in their respective roles as Chairman and Ranking Minority Member of the Subcommittee. In a series of bipartisan investigations, the Subcommittee examined how a global banking giant, HSBC, exposed the U.S. financial system to an array of money laundering, drug trafficking, and terrorist financing risks due to poor anti-money laundering controls; how two U.S. multinational corporations engaged in offshore tax abuses, including how Microsoft shifted profits offshore to dodge U.S. taxes, and Hewlett Packard secretly brought offshore funds back home without paying taxes by utilizing abusive short term loan schemes; and how excessive commodity speculation by mutual funds and others were taking place without Dodd-Frank safeguards such as position limits being put into effect. At the request of Senator Coburn, the Subcommittee also conducted bipartisan investigations into problems with Social Security disability determinations that, due to poor procedures, perfunctory hearings, and poor quality decisions, resulted in over 1 in 5 disability cases containing errors or inadequate justifications; how DHS state and local intelligence fusion centers failed to yield significant, useful information to support federal counterterrorism efforts; and how certain federal contractors that received taxpayer dollars through stimulus funding nevertheless failed to pay their federal taxes.

During the 113th Congress, Senator Levin continued as Chairman, while Senator John McCain joined the Subcommittee as its Ranking Minority Member. They continued to strengthen the Subcommittee's strong bipartisan traditions, conducting all investigations in a bipartisan manner. During the 113th Congress, the Subcommittee held eight hearings and released ten reports on a variety of investigations. The investigations examined high risk credit derivatives trades at JPMorgan; hidden offshore accounts opened for U.S. clients by Credit Suisse in Switzerland; corporate tax avoidance in case studies involving Apple, Caterpillar, and a structured financial product known as basket options; online advertising abuses; conflicts of interest affecting the stock market and high speed trading; IRS processing of 501(c)(4) applications; defense acquisition reforms; and bank involvement with physical commodities. At the end of the 113th Congress, Senator Levin retired from the Senate.

II. Subcommittee Hearings During the 113th Congress

A. JPMorgan Chase Whale Trades: A Case History of Derivatives Risks & Abuse (March 13, 2013)

The Subcommittee's first hearing in the 113th Congress focused on high risk credit derivative trades which were undertaken by JPMorgan Chase out of its London office and which were responsible for losses totaling more than \$6.2 billion. The trades used funds supplied by JPMorgan's Chief Investment Office (CIO), including federally insured deposits from the bank. The trades were conducted by a JPMorgan London trader whose transactions were so large that they triggered speculation over who was behind the "whale" trades and whose identity was unmasked by the media.

The Subcommittee investigation determined that, over the course of the first quarter of 2012, the CIO used a “Synthetic Credit Portfolio” to knowingly engage in high stakes derivatives trading involving a mix of complex credit derivatives. The investigation found that JPMorgan mismarked its trading book to hide increasing portfolio losses; disregarded multiple indicators of increasing risk; breached five different risk limits; manipulated risk models to eliminate or prevent those breaches; dodged regulatory oversight; and misinformed investors, regulators, and the public about what happened. The investigation exposed not only high risk activities and abuses at JPMorgan Chase, but also broader, systemic problems related to the valuation, risk analysis, disclosure, and oversight of synthetic credit derivatives. The evidence also disproved the assertion that credit derivatives inherently lower financial risk.

In March 2013, the Subcommittee released a bipartisan report and held a hearing detailing the JPMorgan Chase whale trades. The first panel of witnesses consisted of three senior JPMorgan Chase Bank officers, Ina Drew, former head of the CIO; Ashley Bacon, acting Chief Risk Officer; and Peter Weiland, former head of Market Risk for the CIO. They discussed the nature of the whale trades, risk management practices, and how the bank handled the increasing losses. The second panel of witnesses presented testimony from Michael J. Cavanagh, who headed a JPMorgan task force reviewing the CIO losses and also served as co-head of JPMorgan Chase’s corporate and investment bank; and Douglas Braunstein, former JPMorgan Chief Financial Officer and then Vice Chairman of the Board of Directors. They discussed bank oversight of the whale trades, JPMorgan’s interaction with regulators, and information provided by the bank to the public and investors. The third panel included Thomas Curry, Comptroller of the Currency and primary regulator of JPMorgan Chase Bank; Scott Waterhouse, federal Examiner-in-Charge at JPMorgan Chase Bank; and Michael Sullivan, Deputy Comptroller for Risk Analysis at the Office of the Comptroller of the Currency (OCC). They discussed JPMorgan’s failure to disclose the existence of the Synthetic Credit Portfolio, the bank’s lack of cooperation with regulators, and the regulators’ failure to detect the high risk portfolio as well as systemic problems with derivative valuation and risk management.

JPMorgan later paid civil fines totaling \$1 billion for misstating its financial results, engaging in unsafe and unsound banking practices, and manipulating the credit market. Two of its traders were indicted for hiding losses, but have resisted standing trial. The London whale trading abuses resulted in stronger implementing regulations for the Volcker Rule to prevent federally insured banks and their subsidiaries from engaging in proprietary trading disguised as risk-reducing hedges. Federal regulators also clarified that banks may not change their derivative valuation methodologies to hide losses, and that U.S. derivatives requirements apply to a U.S. bank’s foreign branches as well as its domestic branches. U.S. and international regulatory bodies also reviewed issues related to the manipulation of bank risk models for derivatives activities.

B. Offshore Profit Shifting and the U.S. Tax Code – Part 2 (Apple, Inc.) (May 21, 2013)

The Subcommittee’s second hearing was the latest in a Subcommittee series on corporate offshore profit shifting, and focused on a case study involving a leading U.S. multinational corporation, Apple Inc. For the last decade, the Subcommittee has examined how multinational corporations and wealthy individuals use offshore tax schemes to dodge U.S. taxes, leaving other

taxpayers to make up the difference. According to the Congressional Research Service, the share of corporate income taxes in the United States has fallen from a high of 32% of federal tax revenue in 1952, to less than 10% in 2012. Meanwhile, payroll taxes – which almost every working American must pay – have increased from 10% of federal revenue to 35%.

In May 2013, the Subcommittee investigation released a bipartisan memorandum and held a hearing showing how Apple Inc. established three Irish subsidiaries with no tax residency anywhere, ran those subsidiaries from the United States, and shifted more than \$74 billion in profits over four years to Ireland while dodging payment of U.S. taxes. The Irish subsidiaries, Apple Operations International, Apple Sales International, and Apple Operations Europe, were controlled by the U.S. parent company, Apple Inc. Since Ireland bases tax jurisdiction over companies that are managed and controlled in Ireland, and the United States bases tax residency on where a company is incorporated, Apple exploited the gap between the two, and its subsidiaries failed to file an income tax return in either country, or any other country, for at least five years. One did pay taxes in Ireland on a tiny fraction of its income, resulting, for example, in an effective 2011 Irish tax rate of only five hundredths of one percent. The hearing also showed that, in addition to creating non-tax resident foreign affiliates, Apple Inc. utilized U.S. tax loopholes to avoid U.S. taxes on \$44 billion in otherwise taxable offshore income over four years.

The hearing heard from three panels of witnesses. The first panel consisted of two international corporate tax experts, Stephen E. Shay, former head of international tax policy at the U.S. Department of the Treasury and professor at Harvard Law School; and J. Richard Harvey, professor of law at Villanova University School of Law. Both criticized actions taken by Apple to avoid U.S. corporate taxes. The second panel presented testimony from three senior Apple executives, Timothy D. Cook, the CEO; Peter Oppenheimer, the Chief Financial Officer; and Phillip A. Bullock, the head of Tax Operations. All three defended Apple's actions, but admitted the company had formed three Irish subsidiaries with no tax residency anywhere. The third panel consisted of Mark J. Mazur, Treasury Assistant Secretary for Tax Policy, and Samuel M. Maruca, Director of Transfer Pricing Operations in the Large Business & International Division at the Internal Revenue Service. While neither would comment on the Apple case in particular, both expressed concerns about corporate tax loopholes that enabled U.S. companies to avoid payment of U.S. taxes.

The bipartisan memorandum released by the Subcommittee offered recommendations to strengthen U.S. transfer pricing rules and reform the so-called “check-the-box” and “look-through” loopholes that enable multinationals to shield offshore income from U.S. taxes. As a result of this and other examples of multinational corporate tax abuse, in 2013, G8 world leaders called for an end to offshore corporate profit shifting and initiated international efforts to stop multinational corporate tax avoidance. G8 leaders also reached consensus on the need for an international template for multinational corporations to disclose their tax payments on a country-by-country basis. In addition, Ireland changed its law to prevent multinational corporations from establishing Irish subsidiaries with no tax residency in any country.

C. Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions In Hidden Offshore Accounts (February 26, 2014)

The Subcommittee's next hearing built upon two earlier hearings, held by the Subcommittee in 2008 and 2009, showing how well-known international banks, located in secrecy jurisdictions and tax havens, were deliberately helping U.S. clients cheat on their taxes by opening offshore accounts never reported to the Internal Revenue Service (IRS), despite U.S. laws requiring their disclosure. The earlier hearings focused, in part, on UBS, Switzerland's largest bank, which made a dramatic admission at the 2008 hearing that it had facilitated tax evasion by opening undisclosed Swiss accounts for U.S. clients. After the hearing, in 2009, UBS signed a deferred prosecution agreement with the U.S. Department of Justice (DOJ) on charges of conspiring to defraud the United States by impeding U.S. tax collection, paid a \$780 million fine, disclosed the names of some U.S. clients with hidden Swiss accounts, and agreed to no longer provide U.S. clients with undeclared Swiss accounts.

In February 2014, the Subcommittee released a bipartisan report and held a hearing on how Credit Suisse, Switzerland's second largest bank, engaged in similar conduct and delayed closing Swiss accounts for some U.S. clients for up to five years. The Subcommittee investigation disclosed that, at its peak, Credit Suisse had over 22,000 U.S. customers with Swiss accounts containing more than 12 billion Swiss francs, which translated into \$10 to \$12 billion U.S. dollars. Nearly 1,500 of those accounts were opened in the names of offshore shell companies to hide U.S. ownership. Another nearly 2,000 were opened at Clariden Leu, Credit Suisse's own private bank. Almost 10,000 were serviced by a special Credit Suisse branch at the Zurich airport which enabled clients to fly in to do their banking without leaving airport grounds. One client disclosed that, at Credit Suisse headquarters in Zurich, he was ushered into a remotely controlled elevator with no floor buttons, and escorted into a bare room with white walls to conduct his banking transactions, all dramatizing the bank's focus on secrecy.

In addition to disclosing Credit Suisse's actions, the investigation criticized DOJ for failing to use U.S. legal tools, such as grand jury subpoenas and John Doe summonses, to obtain the names of U.S. tax evaders with hidden Credit Suisse accounts, choosing instead to file Swiss treaty requests with little success. The investigation noted that, over a five-year period, due to Swiss secrecy laws, DOJ had obtained information, including U.S. client names, for only 238 undeclared Swiss accounts out of the tens of thousands that Credit Suisse opened. The hearing criticized DOJ for its slow enforcement efforts to collect unpaid taxes on funds held offshore, and hold accountable the tax evaders, banks, and bankers involved.

The hearing heard from two panels of witnesses. The first consisted of senior officers from Credit Suisse, including Brady Dougan, the CEO; Romeo Cerutti, the General Counsel; and Hans-Ulrich Meiser and Robert Shafir, co-heads of the Private Banking and Wealth Management division. While the officers admitted that the bank had moved too slowly to close the hidden Swiss accounts, they also asserted that the misconduct was the result of rogue bankers rather than bank policy. The second panel of witnesses consisted of James M. Cole, Deputy Attorney General at DOJ, and Kathryn M. Keneally, Assistant Attorney General for the Tax Division. Both defended DOJ's use of Swiss treaty requests instead of U.S. discovery tools to obtain accountholder names, DOJ's failure to request the extradition of any of the seven Credit Suisse

bankers indicted in 2011 for facilitating tax evasion, and DOJ's failure to obtain the names of thousands of U.S. tax evaders with hidden Credit Suisse accounts.

After the hearing, Credit Suisse entered a guilty plea to DOJ charges of aiding and abetting U.S. tax evasion, and paid a \$2.6 billion penalty, including \$1.8 billion to DOJ, \$100 million to the Federal Reserve, and \$715 million to the New York State Department of Financial Services. Credit Suisse also paid a \$196 million fine to the U.S. Securities and Exchange Commission for providing broker-dealer and investment advisory services to U.S. clients without first registering with the agency. In addition, in July 2014, the Foreign Account Tax Compliance Act (FATCA), inspired in part by Subcommittee hearings on secret offshore accounts, took effect and made it more difficult to conceal offshore accounts opened for U.S. clients in the future.

D. Caterpillar's Offshore Tax Strategy (April 1, 2014)

The Subcommittee's next hearing was another in its series of hearings on corporate offshore profit shifting, this time focused on a case study involving Caterpillar Inc., an American manufacturer of heavy equipment. As explained earlier, for the last decade, the Subcommittee has examined how multinational corporations and wealthy individuals have been using offshore tax schemes to dodge U.S. taxes, leaving other taxpayers to make up the difference.

In April 2014, the Subcommittee held a hearing and issued a majority staff report examining how Caterpillar Inc. shifted \$8 billion in profits from its foreign parts business – a business run primarily from the United States – to a Swiss affiliate to avoid paying \$2.4 billion in U.S. taxes to date. The case history showed that, in 1999, Caterpillar paid its accountant, PriceWaterhouseCoopers (PWC), over \$55 million to develop and implement the offshore tax strategy. The strategy called for Caterpillar Inc. to issue a license to one of its Swiss affiliates, Caterpillar SARL, to sell Caterpillar parts worldwide. The parts license changed almost nothing in the actual functioning of Caterpillar's parts business. Its Swiss affiliate lacked the personnel, infrastructure, and expertise to actually run the worldwide parts operation and instead simply paid Caterpillar Inc. to continue running the business. The Swiss affiliate also paid Caterpillar Inc. a "royalty payment" equal to about 15% of the parts profits, while attributing the remaining profits to Switzerland. The result was that Caterpillar switched from reporting 85% or more of its foreign parts profits on its U.S. tax return to reporting 85% or more of those same profits on its Swiss tax return, subject to at a negotiated effective Swiss tax rate of 4% to 6%. PWC, in its role as independent accountant for the company, approved Caterpillar's use of the offshore tax strategy, essentially auditing the very tax strategy it had developed and sold to the company.

Although Caterpillar had spent 90 years working to build up its international parts business, Caterpillar gave its Swiss affiliate the license to sell its parts worldwide without requiring any compensation for developing the business. In an arm's length transaction, no company would turn over a profitable business that took decades to develop without receiving compensation. Nor would a business relinquish 85% of the ongoing profits from that business in exchange for 15% of the profits. But that was the arrangement Caterpillar entered into with its affiliate. The result was that, from 2000 to 2012, the Swiss tax strategy shifted \$8 billion in

profits from Caterpillar Inc. to its Swiss affiliate, cutting Caterpillar's U.S. tax bill by \$2.4 billion. Caterpillar's actions provided additional evidence of the need to close unjustified U.S. corporate tax loopholes that enable profitable corporations to avoid paying U.S. taxes.

The hearing heard from three panels of witnesses. The first panel consisted of two international corporate tax experts, Reuven S. Avi-Yonah, the Irwin I. Cohn Professor Law at the University of Michigan School of Law, and Bret Wells, Assistant Professor of Law at the University of Houston Law Center. Both criticized Caterpillar's offshore tax strategy as an improper attempt to avoid U.S. corporate taxes. The second panel of witnesses presented testimony from three PWC accountants who helped develop and implement Caterpillar's Swiss tax strategy, Thomas F. Quinn, TWC tax partner; Steven R. Williams, PWC managing director; and James G. Bowers, PWC tax partner. All three defended the company's use of the PWC-developed tax strategy and denied that PWC had a conflict of interest in developing, selling, auditing, and approving use of that tax strategy. The third panel consisted of three senior Caterpillar officers, Robin D. Beran, Chief Tax Officer; Rodney Perkins, former Senior International Tax Manager; and Julie A. Lagacy, Vice President from the Finance Services Division. All three defended Caterpillar's use of its offshore tax strategy and shifting its parts profits from the United States to Switzerland.

Caterpillar's actions, as well as other examples of multinational corporate tax abuse, contributed to G8 world leaders, in 2013, calling for an end to offshore profit shifting and initiating international efforts to stop multinational corporate tax avoidance. G8 leaders also reached consensus on the need for an international template for multinational corporations to disclose their tax payments on a country-by-country basis. In addition, the Public Company Accounting Oversight Board initiated a review of the propriety of an independent accounting firm auditing an offshore tax strategy that the firm sold to its client.

E. Online Advertising and Hidden Hazards to Consumer Security and Data Privacy (May 15, 2014)

The Subcommittee's next hearing addressed a new investigative topic initiated by Ranking Member John McCain related to data privacy. In May 2014, the Subcommittee held a hearing and released a bipartisan report examining how current online advertising practices expose online consumers to hidden hazards, including data breaches, malware attacks, and other cybercrimes.

In 2013, U.S. online advertising revenues for the first time surpassed that of broadcast television advertising as companies spent \$42.8 billion to reach consumers. The hearing examined the enormous complexity of the online advertising ecosystem, including the many parties involved in delivering a single ad. The investigation showed that a simple display of an online advertisement can trigger consumer interactions with a chain of other companies, many of which are unknown to the consumer and each of which could compromise the consumer's privacy or become a source of vulnerability for cybercriminals. In one instance, for example, the investigation found that visiting a popular tabloid news website triggered a user interaction with some 352 other web servers as well. On radio or television, the content of an advertisement is generally transmitted by the same party that hosts the rest of the content on the station. In

contrast, host websites commonly sell ad space on their sites through an intermediary company, most often associated with a well-known tech company. The intermediary — often referred to as an ad network or exchange — typically directs an internet user’s browser to display an advertisement from a server controlled by neither the ad network nor the original host website. The investigation disclosed that host websites often do not select and cannot predict which intermediary advertising networks will deliver advertisements to consumers visiting their sites, exposing consumers to unmanaged risks. Today, most ad networks also have limited control over the content of the advertisements whose placements they facilitate.

The growth of online advertising has also brought with it a rise in cybercriminals attempting to use mainstream websites to infect consumers’ computers with advertisement-based malware or “malvertising.” Some estimates indicate that malvertising increased over 200% in 2013, to over 209,000 incidents generating over 12.4 billion malicious ad impressions. A recent study found that more than half of internet website publishers have suffered a malware attack through a malicious advertisement. The report detailed examples in which consumers were subjected to malicious software delivered through the online advertising network. The complexity and many vulnerabilities of the online advertising ecosystem also made it difficult for individual industry participants to adopt effective long-term security countermeasures. The investigation disclosed that host websites often operate under voluntary compliance regimes or contractual arrangements that are ineffective, unreliable, or poorly enforced. In addition, as the online advertising industry grows more complex, it is also becoming more difficult to ascertain responsibility when consumers are hurt by malicious advertising or data collection. Moreover, there is currently no standard reporting requirement that informs the public when an ad network is compromised by malware or cybercriminals. The lack of accountability and disclosure requirements in online advertising may lead to lax security regimes, creating serious vulnerabilities for Internet users. The investigation determined that the Federal Trade Commission also needs tools to protect consumers from online advertising abuses.

The hearing heard from two panels of witnesses. The first panel consisted of three individuals with industry experience in online advertising problems and data privacy threats. They included Alex Stamos, Chief Information Security Officer for Yahoo! Inc.; George F. Salem, Senior Product Manager for Google Inc., and Craig Spiegle, Executive Director, founder and President of Online Trust Alliance. All three discussed instances of malicious online advertising and what is being done and can be done by the private sector to protect online consumers. The second panel heard from Maneesha Mithal, Federal Trade Commission Associate Director for the Division of Privacy and Identity Protection; and Lou Mastria, Managing Director of the Digital Advertising Alliance. Both discussed the development of standards and procedures to protect online consumers from malicious online advertising and the need for stronger FTC tools to combat online advertising abuses.

F. Conflicts of Interest, Investor Loss of Confidence, and High Speed Trading in U.S. Stock Markets (June 17, 2014)

The Subcommittee’s next hearing focused on conflicts of interest affecting how stock brokers place trading orders in U.S. stock markets, including for high speed traders. The

conflicts arise from millions of dollars in opaque payments made to brokers in order to attract client orders, including “payments for order flow” made by wholesale brokers to retail brokers, and so-called “maker-taker” rebates and fees paid by trading venues to broker dealers, both of which created incentives for brokers to put their financial interests before those of their clients, fueling public distrust of U.S. stock markets.

The June 2014 hearing examined both conflicts of interest affecting broker placement of trading orders. The first conflict, involving payment for order flow, arose when a retail broker chose a wholesale broker to execute client trades and accepted payment from that wholesale broker for placing those orders. One reason wholesale brokers pay for order flow is to enable the wholesale broker to fill the orders out of its own inventory and profit from the trades. The Subcommittee investigation determined that payments from wholesale to retail brokers can add up to millions of dollars, yet were rarely disclosed or passed on to retail customers. The second conflict of interest, involving maker-taker rebates and fees, arose when a broker decided to place client orders on a trading venue rather than with a wholesale broker, and chose the venue based upon the broker’s financial interest, rather than on best execution for its clients. Under the maker-taker system, when a broker makes an offer on a venue to buy or sell a stock at a certain price, the broker is generally classified as a “maker,” and most trading venues will pay the broker a rebate when that offer is accepted. A broker who accepts a maker’s offer to buy or sell is called a “taker,” and will generally pay a fee to the trading venue. The investigation found that, by routing customer orders in a manner that maximizes maker rebates and avoids taker fees, a broker dealer can add millions of dollars to its bottom line, creating a powerful incentive for the broker dealer to send client orders to the trading venues that are in the broker’s best interest even if they are not in the clients’ best interest. The investigation also found that the extent of those payments were largely undisclosed by broker dealers. In addition, the investigation found that the market complexity and fragmentation caused by the maker-taker system could be exploited by high frequency traders.

The hearing heard from two panels of witnesses. The first panel included Bradley Katsuyama, President and CEO of IEX exchange, who discussed the conflicts of interest affecting U.S. stock markets and advocated action to address them. In addition, Robert H. Battalio, Professor of Finance at the Mendoza College of Business at the University of Notre Dame, discussed research he had conducted indicating that when given a choice, four leading retail brokers sent their orders to the trading venues offering the biggest maker rebates, even when those venues did not offer the best execution for clients. The second panel heard from four senior industry officials with differing views on the nature of the conflicts of interest and what should be done about them. They included Thomas W. Farley, President of the New York Stock Exchange, which described the conflicts as having a “corrosive impact” on stock markets; Joseph P. Ratterman, CEO of BATS Global Markets, which did not view the conflicts as creating substantial problems; Joseph P. Brennan, Global Equity Index head at the Vanguard Group, a major mutual fund company that has expressed concerns about the broker conflicts of interest; and Steven Quirk, Senior Vice President of the Trader Group at TD Ameritrade, a retail broker that derived significant revenues from payments for order flow and maker rebates.

After the hearing, the Financial Industry Regulatory Authority launched a probe into how retail brokers route customer orders. The inquiry seeks to determine, among other things, how

brokers determine where to route orders so that customers receive the best price possible under prevailing market conditions. The Securities and Exchange Commission also told the Subcommittee that it would consider issuing a rule to enhance order routing disclosures.

G. Abuse of Structured Financial Products: Misusing Basket Options to Avoid Taxes and Leverage Limits (July 22, 2014)

The Subcommittee's next hearing addressed a capital gains tax scheme involving hedge funds avoiding the payment of billions of dollars in federal taxes. It exposed how, from 1999 through 2013, two global banks used a structured financial product known as a basket option to help more than a dozen hedge funds dodge limits on trading with borrowed money, earn huge trading profits, and then claim that those profits qualified for the lower long-term capital gains tax rate, even for trades that lasted seconds. One hedge fund, Renaissance Technology Corp. (RenTec), used this scheme to avoid paying taxes estimated at more than \$6 billion.

In July 2014, the Subcommittee held a hearing and issued a bipartisan report detailing the misuse of basket options to avoid U.S. taxes. The two banks, Deutsche Bank and Barclays Bank, sold 199 basket options to hedge funds that used them to make over \$100 billion in trades, including 79 involving RenTec, the largest participant. To produce the tax savings, each bank opened a designated account in its own name, appointed the hedge fund as the "investment advisor" for the account, authorized the investment advisor to buy and sell securities for the account, and then gave the hedge fund an "option" on the account with a payoff equal to any profits generated by the "basket" of securities in the account. The hedge fund put up 10% of the cash needed to buy the securities, while the bank lent the other 90%. The hedge fund made all the trading decisions and reaped all the trading profits, while in effect holding an "option" on its own trading efforts. RenTec estimated that it used the basket option accounts to make 100,000 – 150,000 trades per day or approximately 30 million trades per year per bank.

The key to the tax savings was the claim that basket options exercised after one year produced trading profits that qualified for the reduced long-term capital gains tax rate, even if the underlying trades had lasted seconds or were executed the day before the option was exercised. The lower long-term capital gains tax rate is intended to provide an incentive for investors to risk capital on long-term investments that grow the economy and create jobs; the high-volume trading that, for example, RenTec conducted through its basket options did not meet that test.

In addition, the banks used the basket options to enable the hedge funds to trade stocks using borrowed money, in excess of regulatory limits. The 1929 stock market crash harmed the U.S. economy, not just by the collapse of thousands of stock speculators, but also by the failure of thousands of banks that had lent them money and couldn't collect on the loans. In response, Congress enacted limits on the use of borrowed money to trade securities. Had the hedge funds used normal brokerage accounts, they would have been subject to the 2-to-1 federal leverage limit; instead the banks used basket options to provide the hedge funds with leverage of up to 20-to-1, by treating the funds deposited into the option accounts as deposits of their own money rather than as loans, despite charging the hedge funds financing fees for use of the funds. The end result was that the hedge funds, facilitated by the banks, claimed billions of dollars in

unjustified tax savings while avoiding leverage limits that protect the U.S. financial system from systemic risks caused by stock speculation fueled by borrowed funds.

As part of its investigation, the Subcommittee commissioned and released, along with other Senators, a Government Accountability Office (GAO) report disclosing that the Internal Revenue Service (IRS) audits less than 1% of large partnerships per year, including partnerships that function as hedge funds. GAO found that, in 2012, just 0.8% of large partnerships, defined as having \$100 million or more in assets and 100 or more direct and indirect partners, underwent an IRS audit versus 27% of traditional C corporations. That low audit rate made it difficult for the IRS to detect abusive tax practices and underpayment of U.S. taxes by hedge funds, including in connection with basket options.

The hearing heard from three panels of witnesses. The first panel consisted of Steven Rosenthal, a Senior Fellow at the Urban-Brookings Tax Policy Center, who criticized the basket option tax scheme; and James R. White, Director of Tax Issues at GAO, who discussed the GAO report on IRS audits of large partnerships. The second panel heard testimony from four senior officials at the banks and RenTec, all of whom defended their basket option activities. They included Martin Malloy, Managing Director at Barclays Bank; Satish Ramakrishna, Managing Director at Deutsche Bank Securities; Mark Silber, RenTec's Chief Financial Officer, Chief Compliance Officer, Chief Legal Officer, and Vice President; and Jonathan Mayers, RenTec's Counsel. The third panel consisted of high level officials from the banks and RenTec, including Gerard LaRocca, Chief Administrative Officer for the Americas at Barclays; M. Barry Bausano, President and Managing Director of Deutsche Bank Securities; and Peter Brown, Co-CEO and Co-President of RenTec. They also defended their use of basket options.

The Subcommittee investigation called for the IRS to review the hedge funds' basket option activities; for the U.S. Securities and Exchange Commission to review the hedge funds' and banks' circumvention of federal leverage limits; and for federal bank regulators to review the banks' facilitation of the basket option tax schemes.

H. Wall Street Bank Involvement With Physical Commodities (November 20 and 21, 2014)

The Subcommittee's final hearing during the 113th Congress, and Chairman Levin's final hearing as Subcommittee Chairman, examined Wall Street bank involvement with physical commodities.

In November 2014, the Subcommittee held a hearing and released a bipartisan report detailing case studies of Goldman Sachs, Morgan Stanley, and JPMorgan Chase, and their extensive physical commodity activities, including warehousing aluminum, copper, and other metals, trading uranium, mining coal, operating oil and gas storage and pipeline facilities, supplying jet fuel to airlines, and controlling power plants. The Subcommittee investigation also described a three-year review of those physical commodity activities by Federal Reserve examiners who identified a host of risks and recommended steps to reduce those risks. The investigation examined not only the catastrophic event and environmental risks incurred by the banks, but also their involvement with commodity price manipulation and use of non-public information to gain unfair trading advantages in financial commodity markets.

The hearing took place over two days and heard from five panels of witnesses. On the first day, three panels presented evidence. The first panel consisted of two witnesses involved with Goldman's aluminum warehousing activities, Christopher Wibbelman, President and CEO of Metro International warehouse, and Jacques Gabillon, head of Goldman's Global Commodities Principal Investing Group and Chairman of the Board of the warehouse company. Both admitted that the wait to remove aluminum from the warehouse had grown dramatically during Goldman's ownership of the company, and that the warehouse had engaged in so-called merry-go-round transactions to keep aluminum from leaving the warehouse system, but denied that those actions manipulated aluminum supplies or prices, or that Goldman took advantage of non-public warehouse information when trading aluminum-related financial products. The second panel consisted of two aluminum experts, Jorge Vazquez, Founder and Managing Director of Harbor Aluminum Intelligence, and a leading aluminum analyst; and Nick Madden, Senior Vice President and Chief Supply Chain Officer for Novelis Inc., the largest purchaser of aluminum in the world. Both testified that Goldman's activities had disrupted normal aluminum pricing, and that confidential warehouse information could be used to gain trading advantages. The third panel for the day consisted of senior officials from the three banks, Gregory A. Agran, Co-Head of Goldman's Global Commodities Group; Simon Greenshields, Co-Head of Morgan Stanley's Global Commodities group; and John Anderson, Co-Head of JPMorgan's Global Commodities group. All three answered questions about their physical commodity activities.

On the second day, two additional panels of witnesses provided testimony at the hearing. The first panel consisted of Saule Omarova, Professor of Law at Cornell University and an expert on banking law; and Chiara Trabucchi, a principal at Industrial Economics Inc. and an expert on financial and environmental risk management. Professor Omarova testified that current bank involvement with physical commodities was unprecedented and contrary to longstanding U.S. principles against mixing banking with commerce. Ms. Trabucchi testified that banks appeared ill prepared to address the catastrophic event risks associated with their physical commodity activities. The second panel consisted of two federal regulators, Daniel K. Tarullo, a Federal Reserve Governor involved with bank holding company oversight, and Larry D. Gasteiger, Acting Director of the Office of Enforcement at the Federal Energy Regulatory Commission (FERC). Mr. Gasteiger discussed FERC's legal actions against banks for manipulating electricity prices and payments, while Mr. Tarullo discussed the Federal Reserve's concerns with bank holding company involvement with physical commodities and its plans to propose a rulemaking in the first quarter of 2015 to reduce related risks.

After the hearing, bipartisan legislation was introduced by the Subcommittee Chairman and Ranking Member to prevent banking entities from engaging in financial commodity trading if they own or have an interest in businesses or facilities involved with the same physical commodities.

III. Legislative Activities During the 113th Congress

The Permanent Subcommittee on Investigations does not have legislative authority, but because its investigations play an important role in bringing issues to the attention of Congress and the public, the Subcommittee's work frequently contributes to the development of legislative

initiatives. The Subcommittee's activity during the 113th Congress was no exception, with Subcommittee hearings and Members playing prominent roles in several legislative initiatives.

A. Cut Unjustified Tax (CUT) Loopholes Act (S. 268)

On February 11, 2013, Senators Levin and Whitehouse re-introduced S. 268, the Cut Unjustified Tax Loopholes or CUT Loopholes Act, to close a series of tax loopholes, not only to increase the fairness of the tax code, but also to produce significant revenues for deficit reduction and avoid the across-the-board budget cuts known as sequestration. The proposed changes to the tax code were the product of a series of Subcommittee hearings on corporate tax avoidance.

The bill included provisions to close a host of corporate offshore tax loopholes, including loopholes allowing corporations to deduct expenses for moving operations offshore, lower their taxes by manipulating foreign tax credits or moving intellectual property moved offshore, and avoid paying taxes by shifting corporate profits to tax havens. The bill also targeted domestic corporate tax loopholes, including those allowing corporations to take stock option tax deductions that were billions of dollars greater than the stock option expenses shown on their books; use a so-called "derivatives blended rate" enabling hedge funds and others to treat earnings from short-term investments in certain derivatives as long-term capital gains; exclude tar sands oil from excise taxes supporting the Oil Spill Liability Trust Fund; and enable investment managers, such as hedge fund managers, to use the so-called carried interest loophole to pay less than ordinary income tax rates on income earned from providing investment management services.

Closing those loopholes was estimated to produce, over ten years, at least \$260 billion in deficit reduction. The bill was referred to the Finance Committee which took no further action.

B. Stop Tax Haven Abuse Act (S. 1533)

On September 19, 2013, Senators Levin, Whitehouse, Shaheen, and Begich – later joined by Senators Markey and Mikulski – reintroduced the Stop Tax Haven Abuse Act, S. 1533, to close offshore tax loopholes and strengthen offshore tax enforcement. This legislation was based upon more than ten years of Subcommittee investigations into offshore tax havens, abusive tax shelters, and the professionals who design, market, and implement tax dodges. While some provisions from earlier versions of this bill were enacted into law, offshore tax abuses have continued and additional reforms are needed. The Subcommittee has estimated that offshore tax abuses cost the Treasury at least \$150 billion per year.

Among other measures, the bill would authorize Treasury to take special measures against foreign jurisdictions and financial institutions that impede U.S. tax enforcement; and establish rebuttable presumptions in tax enforcement cases that offshore companies and trusts are controlled by the U.S. persons who send or receive assets from them. The bill would also prevent companies that are managed and controlled from the United States from claiming foreign status for tax purposes; and close a loophole allowing swap payments to be treated as non-U.S. source income when sent from the United States to persons offshore. Other provisions would require multinational corporations to report the taxes they pay on a country-by-country basis in

public SEC filings; and require U.S. hedge funds and company formation agents to establish anti-money laundering programs. Still other provisions would stop corporations from deducting expenses for moving operations offshore, manipulating foreign tax credit abuses, and using short-term loan abuses to dodge taxes. The bill would also repeal the so-called check-the-box and CFC look-through rules that create tax incentives for U.S. multinationals to shift profits offshore and manipulate their offshore affiliates to avoid paying U.S. taxes on passive income.

This bill is very similar to Title I of the CUT Loopholes Act, described above. The Senate bill was referred to the Finance Committee which took no further action.

C. Incorporation Transparency and Law Enforcement Assistance Act (S. 1465)

On August 1, 2013, Senators Levin, Grassley, Feinstein and Harkin, later joined by Senator Whitehouse, re-introduced S. 1465, the Incorporation Transparency and Law Enforcement Assistance Act, to protect the United States from U.S. corporations with hidden owners being misused to commit crimes, including terrorism, drug trafficking, money laundering, tax evasion, financial fraud, and corruption. The bill is based upon a series of Subcommittee investigations which found that the 50 states establish nearly two million U.S. companies each year without knowing who is behind them, that the lack of ownership information invites wrongdoers to incorporate in the United States, and that the same lack of ownership information impedes U.S. law enforcement efforts when U.S. corporations are misused to commit crimes.

Among other provisions, the bill would require the states to obtain beneficial ownership information for the corporations or limited liability companies formed within their borders; require states to provide that information to law enforcement in response to a subpoena or summons; and impose civil and criminal penalties for persons who knowingly submit false ownership information. The bill would exempt all publicly traded and regulated corporations, as well as certain other corporations whose ownership information was already available.

In 2013, after G8 world leaders called for disclosing corporate owners, the White House issued an action plan championing legislation like the Levin-Grassley bill, which has been endorsed by multiple law enforcement groups. The bill was referred to the Committee on the Judiciary which took no further action.

D. Ending Insider Trading in Commodities Act (S. 3013)

On December 12, 2014, Senators Levin and McCain introduced S.3013, the Ending Insider Trading in Commodities Act. This bill is the product of the Subcommittee's investigation into Wall Street bank involvement with physical commodities, described above, and is intended to prevent price manipulation and unfair trading. It would prevent a large financial institution from trading in physical commodities and commodity-related financial instruments while at the same time in possession of material, non-public information related to the storage, shipment, or use of a commodity arising from its ownership or interest in a business or facility used to store, ship, or use the commodity.

The bill was referred to the Committee on Agriculture which, due to the ending of the Congress, took no further action.

E. Partnership Auditing Fairness Act (S. 3018)

On December 16, 2014, Senators Levin introduced S. 3018, the Partnership Auditing Fairness Act to improve and streamline audit procedures for large partnerships, such as hedge funds, private equity funds, and publicly traded partnerships. According to a report by the Government Accountability Office, in 2012, the Internal Revenue Service (IRS) audited less than 1% of large partnerships compared to 27% of large corporations. The bill is intended to ensure that large for-profit partnerships, like other large profitable businesses, are subject to routine audits by the IRS and eliminate audit red tape that currently impedes IRS oversight. The bill is the product of the Subcommittee's investigation during this Congress into hedge fund use of a structured financial product known as basket options, which was used to avoid billions of dollars in U.S. taxes and demonstrated the need for routine IRS audits of hedge funds and other large partnerships. The bill mirrors a provision in the Tax Reform Act of 2014, introduced in the House of Representatives earlier this year by Congressman David Camp.

The bill was referred to the Committee on Finance which, due to the ending of the Congress, took no further action.

IV. Reports, Prints, and Studies

In connection with its investigations, the Subcommittee often issues lengthy and detailed reports. During the 113th Congress, the Subcommittee released ten such reports, listed below, some of which have already been partly described in connection with Subcommittee hearings.

A. JPMorgan Chase Whale Trades: A Case History of Derivatives Risks & Abuses, March 15, 2013 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on March 15, 2013)

In March 2013, following a nine-month probe, the Subcommittee released its first report of the 113th Congress. This 300-page bipartisan staff report examined the so-called "whale trades" that, in 2012, caused JPMorgan Chase & Co., America's biggest bank and largest derivatives dealer, to lose at least \$6.2 billion. As explained earlier, this report was released in connection with a Subcommittee hearing examining that trading activity.

The report detailed how the whale trades were conducted, presenting information on actions taken by the traders in the London office of the Chief Investment Office (CIO) of JPMorgan Chase Bank, their supervisors, and associated risk management and financial personnel. The report described the nature and extent of the high risk synthetic credit derivative trades executed over the first quarter of 2012, and how JPMorgan Chase personnel handled the mounting losses. It described how the traders mismarked the trading book to hide the losses; managers disregarded multiple indicators of increasing risk and allowed ongoing breaches of five

different risk limits; quantitative experts manipulated the risk models; and the bank dodged regulatory oversight and misinformed investors, regulators, and the public about its risky derivatives trades. The report exposed not only high risk activities and abuses at JPMorgan Chase, but also broader, systemic problems related to the valuation, risk analysis, disclosure, and oversight of synthetic credit derivatives. As indicated earlier, the report presented detailed evidence disproving the assertion that credit derivatives inherently lower financial risk.

The report offered a number of bipartisan recommendations to detect, prevent, and stop high risk derivatives trading involving synthetic credit derivatives at federally insured banks. They included requiring federal bank regulators to identify and obtain performance data for all derivatives investment portfolios at the banks they oversee; require contemporaneous documentation of all hedges, including how each so-called hedge lowered risks associated with specified assets; and strengthen credit derivative valuation procedures to ensure derivatives are accurately priced and valued. The report also recommended that federal regulators identify and investigate all large or sustained breaches of risk limits and all risk or capital evaluation models which, when activated, materially lower the purported risk or capital requirements associated with derivative trading activities. In addition, the report recommended that regulators promptly issue a final regulation implementing the Volcker Rule to stop high risk proprietary trading at federally insured banks, and to impose additional capital charges for those trading activities to ensure banks can cover potential losses.

B. Social Security Disability Benefits: Did a Group of Judges, Doctors, and Lawyers Abuse Programs for the Country's Most Vulnerable?, October 7, 2013 (Report Prepared by the Majority and Minority Staffs of the Committee on Homeland Security and Governmental Affairs and of its Permanent Subcommittee on Investigations, and released by the full Committee in conjunction with a full Committee hearing on October 7, 2013)

In October 2013, the full Committee, under the leadership of Senator Coburn, released a 160-page joint bipartisan staff report from the Chairmen and Ranking Members of the full Committee and the Subcommittee, presenting a case study of how one lawyer living in Kentucky, Eric Conn, engaged in a raft of improper practices to obtain disability benefits for thousands of claimants. This report followed an earlier report, issued by the Subcommittee's Minority staff in September 2012, finding deficiencies in how Social Security administrative law judges (ALJs) decided Social Security disability cases, detailing decisions which "failed to properly address insufficient, contradictory, or incomplete evidence." The 2013 report built upon that earlier work as well as investigative efforts conducted, in part, by the Subcommittee when Senator Coburn was the Subcommittee's Ranking Member during the 112th Congress.

The joint bipartisan report detailed improper Social Security disability practices by Mr. Conn and his law firm, which included the manufacture of boilerplate medical forms, the misuse of waivers to submit disability claims that should have gone elsewhere, the employment of suspect doctors willing to conduct cursory medical exams, and apparent collusion with Social Security ALJs on practices that improperly favored the Conn clients. One ALJ's practices included improperly assigning the Conn cases to himself, secretly informing Mr. Conn of what cases he would decide and what documentation should be submitted, accepting boilerplate

medical forms, relying on conclusory medical opinions to reverse prior benefit denials, skipping hearings, and churning out short, poor quality decisions. The report also presented evidence of repeated unexplained cash payments to the ALJ's bank account. In addition, the report faulted lax oversight by Social Security officials that allowed the abuses to continue for years and exposed U.S. taxpayers to millions of dollars in attorney and physician fees paid to the professionals who engaged in abusive practices.

The report offered a number of bipartisan recommendations to detect, prevent, and stop abusive practices like those exposed in the Conn case study. The recommendations included strengthening Social Security quality reviews of ALJ decisions, reforming outdated medical-vocational guidelines, and prohibiting claimants from submitting medical opinions from doctors with revoked or suspended licenses. The report also recommended that Social Security provide improved training on how ALJs should handle medical opinions that directly conflict with other evidence in a claimant's medical files; and on how AMJs should articulate and support their decisions on claims. In addition, the report recommended that the Social Security Administration Inspector General conduct an annual review of the practices of the law firms earning the most attorney fees from processing disability cases to detect any abusive conduct.

C. Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts, February 26, 2014 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on February 26, 2014)

In February 2014, following a two-year Subcommittee investigation, the Subcommittee released a 175-page bipartisan staff report detailing how Swiss banks aided and abetted tax evasion by their U.S. customers, using Credit Suisse, Switzerland's second largest bank, as a case study. The report described how Credit Suisse opened Swiss accounts for over 22,000 U.S. customers with assets that, at their peak, totaled roughly \$10 billion to \$12 billion, the vast majority of which were hidden from U.S. authorities. The report also described how U.S. law enforcement officials were slow to collect the unpaid taxes and hold accountable both the tax evaders and the bank.

The report provided context for the Credit Suisse case study by describing how, in 2008 and 2009, the Subcommittee held a series of hearings into how Swiss banks, including UBS, Switzerland's largest, had colluded with U.S. tax evaders, aided by Switzerland's bank secrecy laws. It described how, in a 2008 Subcommittee hearing, UBS had acknowledged its wrongdoing and, in the year after the hearing, paid a \$780 million fine, entered into a deferred prosecution agreement with the U.S. Department of Justice (DOJ), and identified thousands of previously undisclosed U.S. accounts to the IRS, including providing U.S. client names. The report explained that Credit Suisse had engaged in similar conduct from at least 2001 to 2008, had been slow to close the hidden Swiss accounts held by U.S. accountholders, and had disclosed almost none of the names of those U.S. accountholders to U.S. tax authorities.

The report described the misconduct engaged in by Credit Suisse, which included sending Swiss bankers into the United States to recruit U.S. customers, opening Swiss accounts, including accounts opened in the name of offshore shell corporations, that were not disclosed to

U.S. authorities, and servicing Swiss accounts here in the United States without leaving a paper trail. The report also described how, after the UBS scandal broke, Credit Suisse began a series of Exit Projects that took five years to close Swiss accounts held by 18,900 U.S. clients. In addition, the report detailed how Credit Suisse had conducted an internal investigation into its activities, but produced no report and identified no leadership failures that allowed the bank to become involved with U.S. tax evasion. The report noted that, despite a 2011 indictment of seven of its bankers and a DOJ letter stating that the bank itself was an investigation target, Credit Suisse had yet to be held legally accountable by DOJ, and none of its bankers had yet stood trial.

The report also examined DOJ conduct. It found that, despite 2008 and 2009 DOJ testimony pledging to use U.S. legal tools such as grand jury subpoenas and John Doe summonses to obtain the names of U.S. tax evaders with hidden offshore accounts, DOJ had failed to use those tools, choosing instead to file Swiss treaty requests with little success. The report noted that, over the prior five years, DOJ had not sought to enforce a single grand jury subpoena against a Swiss bank, had not assisted in the filing of a single John Doe summons to obtain client names or account information in Switzerland, and had not requested the extradition of a single indicted Swiss banker. It also noted that DOJ had prosecuted only one Swiss bank, Wegelin & Co., despite more than a dozen under investigation for facilitating U.S. tax evasion. The report found that, in five years, DOJ had obtained U.S. client names for only 238 undeclared Swiss accounts out of the tens of thousands opened offshore. Finally, the report examined the conduct of the Swiss government in response to allegations that Swiss banks had facilitated U.S. tax evasion. The report described Swiss efforts to preserve bank secrecy, its unwillingness to provide U.S. client names, and its stance against extraditing indicted bankers to stand trial in the United States.

The report made a number of bipartisan recommendations to revitalize U.S. efforts to stop tax haven banks from facilitating U.S. tax evasion. They included urging DOJ to step up its prosecution of tax haven banks and offshore U.S. accountholders, using U.S. legal tools rather than treaty requests to obtain U.S. client names; and to strengthen transparency requirements for tax haven banks with deferred prosecution agreements. The report also recommended that Congress amend U.S. tax laws to streamline the use of John Doe summons procedures to uncover offshore accounts; that the U.S. Senate ratify a 2009 protocol strengthening disclosures under the U.S.-Swiss tax treaty; and that the U.S. Treasury and IRS close legal loopholes enabling offshore accounts held by U.S. persons to remain hidden.

D. Caterpillar's Offshore Tax Strategy, April 1, 2014 (Report Prepared by the Majority Staff of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on April 1, 2014)

In April 2014, following a year-long investigation, the Subcommittee released a 95-page majority staff report detailing how Caterpillar Inc., an American manufacturer of heavy equipment, used a wholly owned Swiss affiliate to shift \$8 billion in profits from the United States to Switzerland to take advantage of a 4-6% corporate tax rate it had negotiated with the Swiss government and defer or avoid paying \$2.4 billion in U.S. taxes to date. This report was

the latest in a series of Subcommittee investigations into tax avoidance by U.S. multinational corporations, including Apple, Microsoft, and Hewlett-Packard.

The report described how Caterpillar paid PricewaterhouseCoopers, acting as both its tax consultant and auditor, over \$55 million to develop and implement its Swiss tax strategy. The report explained that, under that tax strategy, in exchange for a small royalty, Caterpillar gave a license to its wholly controlled Swiss affiliate called CSARL to make all non-U.S. sales of Caterpillar's third party manufactured parts to Caterpillar's non-U.S. dealers. The report noted that Caterpillar redirected those profits from the United States to Switzerland essentially by replacing its name with CSARL on the parts invoices, and without moving any personnel or parts activities to Switzerland. The report presented detailed evidence showing that Caterpillar's global parts business continued to be run from the United States, and that virtually none of the manufacturing, warehousing, distribution, or parts management activities took place in Switzerland. Because CSARL lacked the personnel, infrastructure, and expertise to run the global parts business, CSARL paid Caterpillar to keep doing the work, reimbursing it for its costs plus a small service fee. The report showed that, prior to implementing the Swiss tax strategy, Caterpillar had booked 85% or more of its non-U.S. parts profits in the United States, where 70% of those parts were made and warehoused and where its global parts operation was managed, while afterward it booked 85% or more of the parts profits in Switzerland.

The report offered a number of recommendations to detect, prevent, and stop corporate tax avoidance using suspect offshore tax strategies like that exposed in the Caterpillar case study. The recommendations included urging the Internal Revenue Service (IRS) to analyze the economic substance of all intercompany transactions in which licenses are issued to offshore affiliates to sell U.S. produced products, require U.S. parent corporations to identify and value the functions performed by those offshore affiliates, and require U.S. parents to justify the profit allocation between themselves and their offshore affiliates. The report also recommended that the United States participate in ongoing international efforts to develop better principles for taxing multinational corporations, including by requiring those multinationals to disclose their business operations and tax payments on a country-by-country basis. In addition, the report recommended that public accounting firms be prohibited from simultaneously providing auditing and tax consulting services to the same corporation, to prevent the conflicts of interest that arise when an accounting firm's auditors are asked to audit the tax strategies designed and sold by the firm's tax consultants.

E. Online Advertising and Hidden Hazards to Consumer Security and Data Privacy, May 15, 2014 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on May 15, 2014)

In May 2014, after nearly a year-long investigation under the leadership of Senator McCain, the Subcommittee released a 40-page bipartisan staff report detailing how online advertising, which has surpassed broadcast television as the largest advertising medium in the United States with \$42.8 billion in 2013 revenues, exposed online consumers to hidden hazards, including data breaches, malware attacks, and other cybercrimes.

The report described the complex system used for online advertising, which involves the participation of many parties in delivering a single ad. The report showed how the display of a single online advertisement can trigger online consumer interactions with a chain of other companies, many of which are unknown to the consumer and each of which could compromise the consumer's privacy or become a source of vulnerability for cybercriminals. The report described one instance, for example, in which a consumer visit to a popular tabloid news website triggered the consumer's interaction with over 350 other web servers, even without the consumer's clicking on the advertisement display. The report explained that, on radio or television, the content of an advertisement is generally transmitted by the same party that hosts the rest of the content on the station while, in contrast, host websites commonly sell ad space on their sites through intermediary companies and typically have no control or even notice of the advertisements that will be displayed. The report noted that host websites often do not select and cannot predict which intermediary advertising networks will deliver advertisements to consumers visiting their sites, and typically have limited control over the content of the advertisements whose placements they facilitate. The report also described how cyber criminals use malicious advertising to target consumers, including by using online ads to place malware on consumer devices.

The report offered a number of bipartisan recommendations to detect, prevent, and stop abusive practices in online advertising. The recommendations included urging the online advertising industry to establish better practices and clearer rules to prevent abuses, strengthening cyber threat-related and other security information exchanges within the online advertising industry to detect and prevent abuses, and clarifying specific prohibited practices. The report also recommended that self-regulatory bodies develop comprehensive security guidelines for preventing online advertising malware attacks; that additional "circuit breakers" be developed to introduce check-points to catch malicious advertisements at an earlier stage before transmission to consumers; and that online companies thoroughly vet new advertisers and perform rigorous and ongoing checks to ensure legitimate advertisements do not morph into malware. In addition, the report recommended that the Federal Trade Commission consider issuing comprehensive regulations to prohibit deceptive and unfair online advertising practices that facilitate or fail to take reasonable steps to prevent malware, invasive cookies, and inappropriate data collection delivered to Internet consumers through online advertisements.

F. The Air Force's Expeditionary Combat Support System (ECSS): A Cautionary Tale on the Need for Business Process Reengineering and Complying with Acquisition Best Practices, July 7, 2014) (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations)

In July 2014, under Senator McCain's leadership, the Subcommittee released a 40-page bipartisan staff report on the Air Force's Expeditionary Combat Support System (ECSS) program, a \$1 billion failed effort to form a unified logistics and supply-chain management system to track all Air Force physical assets from airplanes to fuel to spare parts. Following the program's cancellation in 2012, the report analyzed the factors that led to the failure, including a lack of leadership and cultural resistance to adopting "best practices" in Air Force procurements.

The report described the development of the ECSS system. It found, among other problems, that the Air Force admitted it did not understand what it needed to do to implement the ECSS. The report noted that, in the eight years ECSS was active, the Air Force transitioned six program managers and five program executive officers, resulting in constant leadership turnover and leaving no one accountable for ECSS's failure. The report also determined that the Department of Defense (DOD) and Air Force had a strong cultural resistance to change and adoption of "best practices" to improve their procurement systems. The report found that their resistance hindered effective implementation of business process reengineering (BPR) efforts intended to ensure that enterprise resource planning (ERP) systems were effectively integrated into the relevant business units. The report concluded that the Air Force squandered over \$1 billion in taxpayer funds over eight years without producing a workable ECSS capability.

The report offered a number of bipartisan recommendations to prevent future acquisition failures. The recommendations included improving ERP systems outcomes by initiating BPR assessments earlier in the acquisition process, improving oversight to ensure DOD has a sufficient understanding of the existing business processes to be changed, and ensuring sound budget decision making by integrating the Investment Review Boards (IRB) at the beginning of the budget process. The report also recommended reducing duplicative reporting requirements by utilizing a single governance structure for the acquisition of ERP systems, improving accountability by aligning the tenure of program executives with key acquisition decision points, and strengthening resource verifications of self-reporting BPR certification from program offices.

To help alleviate the problems disclosed by the ECSS failure, at Senator McCain's request, the Senate Armed Services Committee included in the fiscal year 2015 defense authorization bill provisions that required DOD to gain an understanding of the existing legacy systems before procuring any large new business system and to complete a report on enhancing the role of DOD civilian and military program managers in developing and carrying out defense acquisition programs.

G. Abuse of Structured Financial Products: Misusing Basket Options to Avoid Taxes and Leverage Limits, July 22, 2014 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on July 22, 2014)

In July 2014, the Subcommittee released a 95-page bipartisan staff report describing how two global banks, Deutsche Bank AG and Barclays Bank PLC, and more than a dozen hedge funds misused a complex financial structure known as a basket option to claim billions of dollars in unjustified tax savings and avoid leverage limits that protect the financial system from risky debt. This report was the latest in a line of Subcommittee reports documenting bank participation in transactions designed to help clients avoid or evade U.S. taxes.

The report outlined how, over the course of more than a decade, from 1998 to 2013, the banks sold 199 basket options to 13 hedge funds which used them to conduct more than \$100 billion in trades. The report provided detailed information on options involving two of the largest basket option users, Renaissance Technologies Corporation LLC ("RenTec") and George

Weiss Associates. The report explained how the banks and hedge funds used the option structure to open proprietary trading accounts in the names of the banks and create the fiction that the banks owned the account assets, when in fact the hedge funds exercised total control over the assets, executed all the trades, and reaped all the trading profits. The report also explained that when the hedge funds exercised the options shortly after the one-year mark, they claimed that the trading profits were eligible for the lower income tax rate that applies to long-term capital gains on assets held for at least a year, even for short-term trades. The report noted, for example, that RenTec claimed it could treat the trading profits as long term gains, even though it executed an average of 26 to 39 million trades per year and held many assets for mere seconds. The report also noted that, in 2010, the Internal Revenue Service (IRS) had issued an opinion prohibiting the use of basket options to claim long-term capital gains. The report estimated that the hedge funds used the basket option structures to avoid taxes in excess of \$6 billion.

The report also explained that, in addition to avoiding taxes, the basket option structure was used by the banks and hedge funds to evade federal leverage limits on trading securities with borrowed money. Leverage limits were enacted into law after the stock market crash of 1929, when stock losses led to the collapse of not only the stock speculators, but also the banks that lent them money and were unable to collect on the loans. Had the hedge funds made their trades in a normal brokerage account, they would have been subject to a 2-to-1 leverage limit – that is, for every \$2 in total holdings in the account, \$1 could be borrowed from the broker. But because the option accounts were in the name of the bank, the option structure created the fiction that the bank was transferring its own money into its own proprietary trading accounts instead of lending to its hedge-fund clients, in some cases leading to a leverage ratio of 20-to-1. The banks pretended that the money placed into the accounts were not loans to its customers, even though the hedge funds paid financing fees for use of the money. While the two banks have stopped selling basket options as a way for clients to claim long-term capital gains, they continue to use the structures to avoid federal leverage limits.

The report offered a number of bipartisan recommendations to detect, prevent, and stop basket option abuses. The recommendations included urging the IRS to audit each of the hedge funds that used basket option products to collect any unpaid taxes; and urging federal financial regulators, as well as Treasury and the IRS, to intensify warnings against, scrutiny of, and legal actions to penalize bank participation in tax-motivated transactions. The report also recommended that Treasury and the IRS revamp the Tax Equity and Fiscal Responsibility Act (TEFRA) regulations to reduce impediments to audits of large partnerships, and that Congress amend TEFRA to facilitate those audits. In addition, the report recommended that the Financial Stability Oversight Council, working with other agencies, establish new reporting and data collection mechanisms to enable financial regulators to analyze the use of derivative and structured financial products to circumvent federal leverage limits on purchasing securities with borrowed funds, gauge the systemic risks, and develop preventative measures.

H. IRS and TIGTA Management Failures Related to 501(c)(4) Applicants Engaged in Campaign Activity, September 5, 2014 (Report Prepared by the Majority Staff of the Permanent Subcommittee on Investigations with Minority Staff Dissenting Views)

In September 2014, after more than a year-long investigation, the Subcommittee released a 225-page report summarizing the Subcommittee's bipartisan investigation into problems with how the Internal Revenue Service (IRS) processed applications for tax exempt status under Section 501(c)(4) of the tax code. The report was prepared by the majority staff and included dissenting views by the minority staff, which did not join the majority staff report. The report was accompanied by the release of over 1,700 pages of documents from the IRS and Treasury Inspector General for Tax Administration (TIGTA), including emails, correspondence, memoranda, charts, handwritten notes, reports, and analyses.

The majority staff report reached many of the same conclusions as an audit report that was released earlier by TIGTA about the 501(c)(4) application process. The majority staff report found that the IRS used inappropriate screening criteria when it flagged for increased scrutiny applications based upon the applicants' names or political views rather than direct evidence of their involvement with campaign activities. The report also presented evidence of significant program mismanagement, including years-long delays in processing 501(c)(4) applications; inappropriate, intrusive, and burdensome questioning of groups; and poor communication and coordination between IRS officials in Washington and Cincinnati. At the same time, like TIGTA, the report found no evidence of IRS political bias in selecting 501(c)(4) applications for heightened review, as distinguished from using poor judgment in crafting the selection criteria. Based on investigative work that went beyond what TIGTA examined, the majority staff report also determined that the same problems affected IRS review of 501(c)(4) applications filed by liberal groups, detailing several examples.

The majority staff report also criticized the TIGTA audit. It found that, by focusing exclusively on how the IRS handled 501(c)(4) applications filed by conservative groups and excluding any comparative data on applications filed by liberal groups, the TIGTA audit produced distorted audit results that continue to be misinterpreted. The report explained that the TIGTA audit engagement letter stated that the audit's "overall objective" was to examine the "consistency" of IRS actions in identifying and reviewing 501(c)(4) applications, including whether "conservative groups" experienced "inconsistent treatment." The report found that, instead, the TIGTA audit focused solely on IRS treatment of conservative groups, and omitted any mention of other groups. For example, while the TIGTA audit report criticized the IRS for using "Tea Party," "9/12," and "Patriot" to identify applications filed by conservative groups, it left out that the IRS also used "Progressive," "ACORN," "Emerge," and "Occupy" to identify applications filed by liberal groups. The majority staff report noted that, while the TIGTA audit report criticized the IRS for subjecting conservative groups to delays, burdensome questions, and mismanagement, it failed to disclose that the IRS subjected liberal groups to the same treatment. The majority staff report explained that the result was that when the TIGTA audit report presented data showing conservative groups were treated inappropriately, it was interpreted to mean conservative groups were handled differently and less favorably than liberal groups, when in fact, both groups experienced the same mistreatment. The majority staff report also criticized

TIGTA for failing to include in its audit report its conclusion that the TIGTA audit had ‘found no evidence of political bias’ by the IRS in processing 501(c)(4) applications, an omission which led to the TIGTA audit report being misconstrued to inaccurately and unfairly damage public confidence in the impartiality of the IRS.

The majority staff report offered a number of recommendations to reform IRS processing of 501(c)(4) applications filed by groups planning to engage in both social welfare and campaign activities. The recommendations included urging the IRS to stop using a “facts and circumstances” test to evaluate the applications and groups, since it produced a time-consuming, case-by-case, non-transparent, subjective, and unpredictable method of evaluation that not only confused and delayed IRS decisionmaking, but also invited public suspicion that the IRS may have been influenced by politics. Instead, the majority staff report recommended developing objective standards and bright line rules to produce more consistent, timely, transparent, and predictable treatment of 501(c)(4) applications filed by groups that engage in campaign activities. The report also recommended that the IRS revise its rules to comply with the statutory requirement that 501(c)(4) groups engage ‘exclusively’ in social welfare activities, including by applying an ‘insubstantial’ test to limit other activities, similar to the one already applied to 501(c)(3) charities, and by applying a percentage test to ensure campaign activities comprise no more than an insubstantial portion of a tax-exempt social welfare organization’s activities. In addition, the report recommended that the IRS require 501(c)(4) groups to provide the IRS with a copy of any filing submitted to the Federal Election Commission, so that the IRS can use those filings to identify 501(c)(4) groups warranting heightened review for campaign activity.

The dissenting views filed by the minority staff disagreed that the IRS mistreated both conservative and liberal groups. The dissenting views found that, while some liberal groups were examined by the IRS from May 2010 to May 2012, there were far fewer such groups, they were systematically separate from the review of conservative groups, their questioning was far less intrusive, and, in some cases, the liberal groups were affiliates of specific organizations that had behaved illegally in the past and could reasonably have expected additional scrutiny. The dissenting views found that the inclusion of a few liberal groups by the IRS did not bear comparison to the targeting of conservative groups, that conservative groups received the bulk of unfair and burdensome treatment, and that the IRS screening resulted in a clearly disparate impact on conservative group applications. The dissenting views also noted that, while the majority and minority staffs were unable to come to agreement in their analysis, the Subcommittee conducted its investigation through joint interviews and document requests, and continued its tradition of in-depth fact finding and frequent consultations that are the hallmark of the Subcommittee’s oversight work and led to a deepened understanding of key issues.

I. Defense Acquisition Reform: Where Do We Go from Here? A Compendium of Views by Leading Experts, October 2, 2014 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations)

In October 2014, under the leadership of Senator McCain, the Subcommittee released a bipartisan staff report containing a collection of 31 essays from a variety of defense acquisition experts offering views on defense acquisition reform. While the Subcommittee made no

recommendations of its own, the report's experts provided a comprehensive review of current shortcomings in the acquisition process and provided a wide range of options to improve the defense acquisition system. This compendium provides a starting point for defense acquisition reforms in the next Congress.

J. Wall Street Bank Involvement With Physical Commodities, November 20 and 21, 2014 (Report Prepared by the Majority and Minority Staffs of the Permanent Subcommittee on Investigations and released in conjunction with the Subcommittee's hearing on November 20 and 21, 2014)

In November 2014, after a two-year investigation, the Subcommittee released a 400-page bipartisan staff report detailing the nature and extent of the involvement of large Wall Street banks with physical commodities. The report explained how physical commodity activities were eroding the longstanding separation of banking and commerce; increasing risks to the banks, their holding companies, and the financial system; and raising questions about price manipulation and unfair trading in commodity markets.

The report presented three case studies involving Goldman, Morgan Stanley, and JPMorgan Chase. In each case study, the report provided detailed evidence on several examples of physical commodity activities, including warehousing aluminum and other metals, trading uranium, mining coal, operating oil and gas storage and pipeline facilities, supplying jet fuel to airlines, constructing a compressed natural gas facility, and controlling power plants. The report provided detailed information about Goldman's ownership of Metro Trade Services International, a U.S. warehouse company which was certified to store aluminum warranted by the London Metal Exchange for use in settling trades and which operated a number of Detroit-area warehouses. The report noted that, after Goldman bought Metro in 2010, Metro warehouses accumulated 85% of the LME aluminum storage market in the United States, began to engage in so-called "merry-go-round" deals that shuttled metal from building to building without actually shipping aluminum out of Metro's system; and increased the wait to withdraw LME-warranted metal from storage from about 40 days to more than 600, reducing aluminum availability and tripling the U.S. premium for storage and delivery costs. The report noted that, during the same period, Goldman engaged in massive aluminum trades in both the physical and financial markets, further increasing the length of the warehouse queue and raising concerns about whether Goldman was manipulating aluminum prices or making trades using non-public warehouse information.

The report also detailed how JPMorgan amassed physical commodity holdings equal to nearly 12% of its Tier 1 capital, while telling regulators its holdings were far smaller; owned or controlled 30 electrical power plants across the country; and incurred a \$410 million penalty for manipulative bidding strategies that produced excessive electricity payments that hurt consumers in California and the Midwest. The report also described JPMorgan's involvement with stockpiling and trading copper and designing an exchange traded fund based on copper prices. In addition, the report described how, at one time, Morgan Stanley controlled 55 million barrels of oil storage capacity as well as 6,000 miles of pipeline, while also working to build its own compressed natural gas facility and supplying major airlines with jet fuel. The report also described how the Federal Reserve conducted an intensive review of the physical commodity activities being engaged in by financial holding companies, determined they carried novel and

troubling risks to both the holding companies and the financial system, and was considering new rules to rein in physical commodity risks.

The report offered a long list of bipartisan recommendations to reduce physical commodity activities at banks and their holding companies. The recommendations included urging the Federal Reserve to reaffirm the separation of banking from commerce, and reconsider all of the rules and practices related to physical commodity activities in light of that principle; to issue a clear and comprehensive limit on the size of a financial holding company's physical commodity activities; and strengthen public disclosures of those activities to support effective oversight. The report also recommended narrowing the scope of the legal authorities permitting physical commodity activities, and establishing capital and insurance minimums to protect against potential losses from catastrophic events. In addition, the report recommended barring large traders, including financial holding companies, from using material non-public information gained from physical commodities activities to benefit their trading activities in the financial markets. The report also urged the Federal Reserve to use its upcoming rulemaking to address these concerns and reduce the risks associated with financial company involvement in physical commodity activities.

V. Requested and Sponsored Reports

In connection with its investigations, the Subcommittee makes extensive use of the resources and expertise of the Government Accountability Office (GAO), the Offices of Inspectors General (OIGs) at various federal agencies, and other entities. During the 113th Congress, the Subcommittee requested a number of reports and studies on issues of importance. Several of these reports have already been described in connection with Subcommittee hearings. Several additional reports that were of particular interest, and that were not covered by Subcommittee hearings, are the following.

A. Corporate Income Tax: Effective Tax Rates Can Differ Significantly from the Statutory Rate (GAO-13-520), May 30, 2013

Over the past ten years, the Subcommittee has conducted a series of investigations into corporate nonpayment of U.S. income taxes. In 2008, in part at the Subcommittee's request, GAO issued a report on corporate tax payments (GAO-08-957) which found that nearly 55% of all large U.S.-controlled corporations reported no federal tax liability in at least one year between 1998 and 2005. In response to a bipartisan request from the Subcommittee to update that report five years later, GAO assessed the extent to which corporations pay U.S. corporate income tax, and compared the average effective tax rate for corporations to the U.S. statutory corporate tax rate of 35%.

The GAO report determined that large, profitable U.S. corporations paid an average effective federal tax rate of 12.6% in 2010, or only about one-third of the U.S. statutory rate. The report's findings added to a growing body of evidence that large, profitable corporations bear a dwindling share of the U.S. tax burden, and that the Treasury collects far less revenue from large, profitable corporations than might be expected under the 35% statutory tax rate.

GAO's year-long study examined, in particular, how effective tax rates are typically calculated, and then developed a new, more accurate methodology using actual corporate tax return data. GAO compiled the tax return data from large corporations for tax years 2008 through 2010, using M-3 tax returns filed with the Internal Revenue Service by corporations with at least \$10 million in assets. Using actual tax return data enabled GAO to develop more accurate figures for the taxes paid by large U.S. corporations than studies using tax information provided in corporate financial statements. The GAO report noted that the amounts reported in the corporate tax returns were, on the whole, lower than the tax liabilities reported in the corporate financial statements filed with the Securities and Exchange Commission. The GAO report explained that average corporate effective tax rates are generally computed as the ratio of taxes paid or tax liabilities accrued in a given tax year over the net income declared by the corporation during that same year.

GAO found that, on average, large, profitable U.S. corporations paid U.S. federal income tax amounting to just 12.6% of their worldwide income. In addition, GAO found that the relatively low effective tax rate paid by U.S. corporations did not substantially increase when other taxes paid by those corporations were taken into account. For example, GAO found that, in 2010, adding foreign, state, and local taxes to federal income taxes increased the average effective tax rate of large, profitable U.S. corporations by about 4 percentage points to 16.9% of their worldwide income. That composite tax rate was still less than half the U.S. statutory rate.

GAO noted that some studies calculating effective tax rates included unprofitable corporations in their analysis, but explained that "[t]he inclusion of unprofitable firms, which pay little if any actual tax, can result in relatively high estimates because the losses of unprofitable corporations greatly reduce the denominator of the effective rate" and "do not accurately represent the tax rate on the profitable corporations that actually pay the tax." GAO calculated that when unprofitable corporations were included in its data, the average effective federal tax rate rose from 12.6% to 16.6%, because those corporations had lost \$315 billion and thereby reduced the overall net income against which the corporate tax payments were compared. GAO concluded that the resulting tax rate overstated the effective tax rate actually paid by large, profitable U.S. corporations.

GAO's finding that corporations pay far less than the U.S. statutory rate was consistent with other Subcommittee investigative work detailing the many tax loopholes and tax shelters used by some U.S. profitable corporations to avoid or evade paying U.S. taxes. It was also consistent with other studies demonstrating that large, profitable corporations are often able to minimize, if not entirely avoid, paying U.S. income taxes. GAO did not make any recommendations in its report.

B. Disability Insurance: Work Activity Indicates Certain Social Security Disability Insurance Payments Were Potentially Improper (GAO-13-635), August 15, 2013

For a number of years, the Subcommittee has examined issues related to Social Security disability programs and benefits. In August 2013, in response to a bipartisan request from the Subcommittee, GAO examined the extent to which the federal Social Security Disability

Insurance (DI) program may be overpaying benefits. This program is the nation's largest cash assistance program for workers with disabilities. Although program rules allow beneficiaries to engage in a limited amount of certain types of work, other work activities indicate that the beneficiaries are not disabled and therefore not entitled to DI benefits. Consequently, the Social Security Administration (SSA) may overpay beneficiaries if the agency does not detect disqualifying work activity and suspend benefits appropriately.

GAO estimated that, as of January 2013, SSA made \$1.29 billion in potential cash benefit overpayments to about 36,000 individuals, representing an estimated 0.4% of all primary DI beneficiaries as of December 2010. GAO developed this estimate by analyzing SSA data on individuals who were DI beneficiaries as of December 2010, and earnings data from the National Directory of New Hires (NDNH). GAO noted that the exact number of individuals who received improper disability payments and the exact amount of improper payments cannot be determined without detailed case investigations. GAO also noted that SSA, using a different methodology, had estimated its DI overpayments in fiscal year 2011 at \$1.62 billion, or 1.27% of all DI benefits in that fiscal year.

GAO explained that its estimate included consideration of work activity performed by two populations of individuals. The first population performed work activity during the DI program's mandatory 5-month waiting period – a statutory program requirement to help ensure that SSA does not pay benefits to individuals who do not have long-term disabilities. Prior to receiving benefits, individuals must complete a 5-month waiting period, in which the individual cannot exceed a certain level of earnings, known as substantial gainful activity, during any month in order to be eligible for DI benefits. Earnings that exceed program limits during the waiting period indicate that individuals might not have long-term disabilities. The second population performed work activity beyond the program's trial work period which allows certain types of work for up to 9 months, to see if the beneficiary can do that work and no longer requires DI benefits. Beneficiaries whose earnings consistently exceed program limits after completing the trial work period are generally no longer entitled to DI benefits. GAO determined that SSA uses its enforcement operation to generate alerts for potentially disqualifying earnings, but those alerts are not issued for earnings that occur in all months of the waiting period and potentially disqualifying work activity may remain undetected. SSA officials indicated to GAO that modifying its enforcement operation could be costly, and that the agency had not performed a cost assessment for making that modification.

GAO recommended that SSA assess the cost and feasibility of establishing a mechanism to detect potentially disqualifying earnings during all months of the waiting period. SSA concurred, despite raising concerns about GAO's estimates.

C. IRS's Offshore Voluntary Disclosure Program: 2009 Participation by State and Location of Foreign Bank Accounts (GAO-14-265R), January 6, 2014

For a number of years, the Subcommittee has examined issues related to offshore tax abuses, including actions taken by banks located in tax havens to open offshore accounts for U.S. clients without disclosing those accounts to the Internal Revenue Service (IRS). At a 2008

Subcommittee hearing, UBS, Switzerland's largest bank, admitted that it had facilitated U.S. tax evasion by opening undisclosed Swiss accounts for U.S. clients. In 2009, UBS signed a deferred prosecution agreement with the United States on charges of conspiring to defraud the United States by impeding U.S. tax collection, paid a \$780 million fine, and agreed to disclose the names of some U.S. clients with hidden Swiss accounts. Also in 2009, the IRS established an Offshore Voluntary Disclosure Program to encourage U.S. taxpayers to disclose the existence of their offshore accounts and, using a system of reduced penalties, pay the back taxes, interest, and penalties they owed for evading U.S. taxes. As a condition to participating in the program, the IRS required taxpayers to provide information about the offshore banks, investment firms, law firms, and others that helped them hide their assets offshore.

In March 2013, at the request of the Finance Committee and others, GAO issued a report (GAO-13-318) analyzing the Offshore Voluntary Disclosure Program. The report found that, as of December 2012, the IRS had received more than 39,000 disclosures from taxpayers and revenues exceeding \$5.5 billion. GAO also analyzed about 10,500 taxpayer filings from the program and determined that, during the 2009 initiative, the median offshore account amount was \$570,000, while accounts with penalties greater than \$1 million represented only about 6% of the cases, but accounted for almost half the penalties. In addition, GAO determined that many other taxpayers had made so-called "quiet disclosures" of offshore assets or income, by either amending a past return or disclosing offshore income for the first time on a current return, without paying any back taxes, interest, or penalties on previously hidden income. GAO noted, for example, that from tax year 2007 through tax year 2010, IRS estimated that the number of taxpayers reporting foreign accounts had nearly doubled to 516,000. GAO described these quiet disclosures as resulting in lost revenues while also undermining the effectiveness of the Offshore Voluntary Disclosure Program, and recommended review by the IRS.

In January 2014, in response to a request from the Subcommittee, GAO issued a report providing supplemental information about the taxpayers who participated in the 2009 Offshore Voluntary Disclosure Program. GAO found that the participants had together filed over 12,800 Foreign Bank and Financial Account Reports (FBARs), as part of their disclosure obligations. GAO reported that its review of a sample of those FBARs found that some participants disclosed dozens of offshore accounts with multiple banks in multiple countries, while other participants disclosed only one account. Of the 12,800 FBARs reviewed, GAO determined that about 5,400 or 42% reported at least one account in Switzerland, while the next highest country total was the United Kingdom with about 1,000 accounts. GAO also determined that U.S. taxpayers across the country filed those FBARs, with the most filed by taxpayers in the five states with generally the largest populations, California, New York, Florida, New Jersey, and Texas. No comparable analysis has yet been performed for FBARs filed in later stages of the Offshore Voluntary Disclosure Program, nor has any analysis been made public regarding other types of information provided by program participants. GAO did not make any recommendations in this report.

D. Large Partnerships: Characteristics of Population and IRS Audits (GAO-14-379R), March 19, 2014; and Large Partnerships: With Growing Number of Partnerships, IRS Needs to Improve Audit Efficiency (GAO-14-732), September 18, 2014

Over the years, the Subcommittee has examined a number of tax issues involving partnerships, including hedge funds. In March and September 2014, in response to a bipartisan request from the Subcommittee, GAO examined the IRS audit rate for large partnerships, defined by GAO as those with at least 100 direct and indirect partners and \$100 million in assets. They include hedge funds, private equity funds, and publicly traded partnerships. The March report provided preliminary graphics and data, while the September report provided a more comprehensive examination of IRS audits of large partnerships.

In its reports, GAO determined that, from 2002 to 2011, the number of large partnerships had tripled to over 10,000, while the number of C corporations being created, including the largest U.S. publicly traded corporations, fell by 22%. GAO found that large partnerships had also increased in both the average number of direct partners and average asset size. GAO also found that some of those partnerships had revenues totaling billions of dollars per year and estimated that they collectively held more than \$7.5 trillion in assets. In addition, GAO found that the IRS was auditing only a tiny fraction of the partnerships. According to GAO, in 2012, the IRS audited less than 1% of large partnerships compared to 27% of C corporations, making C corporations 33 times more likely to face an audit than a partnership.

The GAO report described the complexity of some large partnerships, which made them difficult for the IRS to audit effectively. GAO reported that some partnerships had 100,000 or more partners arranged in multiple tiers, and some of those partners were not individuals or corporate entities but pass-through entities – essentially, partnerships within partnerships. In addition, at publicly traded partnerships, the partners can change on a daily basis. GAO reported that one IRS official calculated that there were more than 1,000 partnerships with more than a million partners in 2012.

The GAO report also discussed a number of statutory obstacles to IRS audits of large partnerships. The report explained that the key statute, the Tax Equity and Fiscal Responsibility Act (TEFRA), was three decades old, was enacted at a time when many partnerships had 30 to 50 partners, and was not designed to handle partnerships with a million partners or a partnership roster that changed on a daily basis. Among the TEFRA problems identified by the report was a requirement that the IRS identify a “tax matters partner” to represent the partnership on tax issues, even though many partnerships did not designate such a partner, and simply identifying one in a complex partnership could take months. Second, the report described notification requirements that essentially required the IRS to notify individual partners prior to commencing an audit of the partnership, even though such notices were time consuming, carried large costs, and produced few, if any, benefits. Third, the report noted that TEFRA required any tax adjustments called for by an audit to be passed through to the partnership’s taxable partners, even though the IRS’s process for identifying, assessing, and collecting from those partners was laborious, time consuming, costly, and subject to error. In addition, the report explained that, under TEFRA, any tax adjustments had to be applied to past tax years, using complicated and

expensive filing and amendment requirements, instead of being applied to the year in which the audit was performed and the adjustment made.

GAO offered several recommendations for Congress and the IRS in its September report. GAO recommended that Congress consider requiring large partnerships to identify a partner to represent them during audits and to pay taxes on audit adjustments at the partnership level. GAO recommended that the IRS take multiple actions, including defining large partnerships, tracking audit results using revised audit codes, and implementing project planning principles for the audit procedure projects.

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