DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

September 3, 2009

MEMORANDUM FOR ERIC M. THORSON
INSPECTOR GENERAL

FROM: Rich Delmar
Counsel to the Inspector General

SUBJECT: Inquiry Regarding IRS Notice 2008-83

On September 30, 2008, the Internal Revenue Service issued Notice 2008-83 (Ex. 1), which provided guidance to tax payers and practitioners on appropriate ways to apply the loss limitation rules set out in Internal Revenue Code Section 382. This guidance was issued just at the time that two major bank takeovers were occurring, leading to media and Congressional questions about the timing and propriety of this guidance, which was viewed in some quarters as improperly favoring certain companies, and as overstepping the proper limits on tax guidance.

By letter to you dated November 14, 2008 (Ex. 2), Senator Charles Grassley, ranking minority member of the Senate Finance Committee, asked that you conduct an investigation into the circumstances of the Notice's creation, promulgation, and implementation, and specifically investigate the possibility of favoritism toward Wells Fargo Bank. By reply dated November 17, 2008 (Ex. 3), you told Senator Grassley that the OIG would conduct an inquiry into the circumstances, starting with a focus on whether the Notice was developed in accordance with applicable rules. On the same day you tasked me to conduct an inquiry into these matters.

We met with then-General Counsel Robert Hoyt, who thereafter issued a memo (Ex. 4) to all Treasury bureaus and offices tasking them to identify and provide all records, including emails, bearing on the issue of the Notice's initiation, development, review, promulgation, and implementation. In response to that memo, I obtained records from the Office of the Under Secretary for Domestic Finance, the Office of Tax Policy, the Office of Public Affairs, the Office of General Counsel, and the IRS. Because the inquiry dealt with the IRS, I coordinated with the Chief Counsel of the Treasury Inspector General for Tax Administration. I reviewed relevant records, conducted my own research, and interviewed current and former employees of the Department who had been most involved in the initiation, development, review, and promulgation of this Notice. I did not cause a proactive forensic search of stored emails in servers or in other storage media, nor did I seek to have anyone's office searched for potentially responsive material. Rather I surveyed the available information and had the most involved Treasury employees make formal statements regarding what they knew and what they did in this matter. My initial report was followed by discussions with Senator Grassley's staff, as a result of which I made further inquiries and render further information.

For most of the witnesses, I conducted in-person interviews, which were memorialized as written, signed question and answer statements, all acknowledged as being made pursuant to the authority of the IG Act and Treasury Employee Rule of Conduct 31 C.F.R. § 0.207. Some information from IRS employees is recorded as a series of e-mailed messages, and former Secretary Paulson responded to my written questions by a letter through his attorney. The following former and current employees provided information:

Henry Paulson – Secretary of the Treasury
Robert Hoyt – General Counsel
Eric Solomon – Assistant Secretary for Tax Policy
Karen Gilbreath-Sowell – Deputy Assistant Secretary for Tax Policy
Marc Countryman – Office of Tax Legislative Counsel
James Mackie – Director, Office of Tax Analysis
Matthew Knittel – Financial Economist, Office of Tax Analysis
William Alexander – Associate Chief Counsel (Corporate), IRS Office of Chief Counsel
Richard Todd – Attorney, Office of Associate Chief Counsel (Corporate).
Henry Schneiderman, Special Counsel, IRS Office of Chief Counsel

This report addresses several issues regarding the intent and development process for Notice 2008-83. I concluded, based on the available evidence, that there was no misconduct, favoritism, or purposeful violation of law, rule or regulation in the process.

After my initial work, we met with several staffers to answer questions, and agreed that I would make further inquiries to expand the scope of the report. I have expanded the discussion about the legal underpinning of the Notice, and present in more detail contemporaneous arguments that it was a usurpation of authority. I obtained a statement from former Secretary Paulson that relates to the staff's concerns about undue influence in the Notice's development. I have expanded the discussion regarding the IRS's compliance with the Congressional Review Act. I remain of the view that there was no misconduct, favoritism, or purposeful violation of law, rule or regulation in the process. There was a delay in complying with the Congressional Review Act's notification requirement, though I found no indication that it was deliberate or wrongfully done. More significantly, I found that the arrangement between Treasury and the Office of Management and Budget by which Treasury guidance is evaluated under the Act for heightened Congressional scrutiny appears to allow unilateral determinations by Treasury. This process may warrant further inquiry and consideration.

1. What was the purpose of the Notice?

I.R.C. Section 382(h) applies to corporate takeovers and governs the tax use, by the purchaser, of losses incurred by the purchased company. Assistant Secretary

Solomon stated (Ex. 5) that its operation is dependent on issues of valuation. In times of financial crisis such as the current recession, with great market uncertainty, it is very difficult to determine the value of assets, including the loans made by financial institutions that are at issue here. Mr. Solomon explained that the Notice's purpose is to provide valuation guidance, in order to provide certainty to affected taxpayers.

Deputy Assistant Secretary Gilbreath-Sowell indicated (Ex. 6) that during the late summer of 2008, the Office of Tax Policy (OTP) became increasingly aware of, and responsive to, concerns in the financial community regarding the potential negative impact of § 382(h)'s loss restrictions on efforts to strengthen troubled financial institutions. Section 382 was seen as discouraging bank acquisitions by limiting the use of tax losses, and by making asset valuation determinations difficult. OTP undertook several efforts to determine what steps could be taken expeditiously, by administrative action, to ameliorate these difficulties.

Mr. Countryman, formerly with the Office of Tax Legislative Counsel, provided similar explanation (Ex. 7). He stated that, starting in late August and continuing into September, there was growing evidence of systemic problems in the financial sector, a growing likelihood of weak banks failing, and increased consolidation. It was also apparent that IRC § 382 could complicate and even discourage capital infusions, investments, and acquisitions of weak, loss-laden banks. The theme of OTP's work was that tax rules should not be obstacles to financial transactions and acquisitions that were otherwise good for the economy.

The underlying problem was, and is, that the freeze in credit markets has made asset values very hard to determine when they become subject to sale, which makes it impossible to compare value to cost or other basis, and thus impossible to determine if the disposition creates a loss or a gain for the selling entity. The use of losses is governed and limited by § 382; if values can't be determined and the fact of and amount of losses can't be determined, the ability of weak banks to be acquired is compromised. The goal of the notice and other guidance was to make it easier to determine loss, and thus encourage acquisitions.

2. Was this a proper use of the Notice process, and was it a proper interpretation of the statute as opposed to an improper changing of the statute?

All employees interviewed believe that the Notice process, as opposed to a more formal regulation issuance or statutory amendment, was the proper vehicle to promulgate this guidance, and all believe that it is proper interpretation and guidance, and not an improper changing or extending of the statute. Their statements and opinions are summarized as follows:

Mr. Countryman stated that the guidance does not rewrite the statute; rather it shows how to apply facts to the rules set out in the statute. He explained that

Section 382 does not itself say how to compute the amounts of built-in losses; "it just says that if you have them, this is how to apply them." The Notice was an effort to apply certainty and uniformity to necessary valuation in circumstances where normal market mechanisms fail to provide such valuation.

Associate Chief Counsel Alexander stated (Ex. 8) his understanding that the Federal tax law regime provides discretion in choosing the best vehicle to promulgate interpretation or guidance. He did not see the guidance promulgated in Notice 2008-83 as changing the statute. The Notice gives guidance on how to apply the law; it does not substantively change that law. He later stated by email (Ex. 9) that he understood Notice 2008-83 as confirming a tax result that was actually already achievable under the Code. He likened it to a revenue ruling, which he explained is used to describe tax treatments that can be done by current law. He stated that he did not see the need to use IRC § 382(m)'s regulation-writing authority, because the procedure described in the Notice was really a summary of what he viewed as permissible under the law as currently stated.

He explained that, prior to the current economic downturn, a strong secondary market had developed for many of the types of loans made by banks. This made these loans highly liquid and easy to value. This market dried up during the current downturn.

In his view, the current environment presents challenges similar to valuation problems involving charitable donations and sales of closely-held businesses: there are few if any comparable and recent transactions to use as bases for valuation. The guidance and interpretation set out in Notice 2008-83 provides a consistent and certain way to apply section 382(h) to current financial realities. It effectively applies the same rule as is applied to most built-in items under section 382(h)(6) (which is the provision that would govern most of the deductions that are the subject of the Notice): the "all-events" test of the accrual method. Thus it is consistent with and advances the statute's purpose. In response to my question, he stated that Assistant Secretary Solomon's letter to Senator Schumer (Ex. 10), to which he contributed, is a good explanation of the fundamental problem at issue: difficulty in valuation when there is no market reference.

He did not think the guidance provided in the Notice required the exercise of the regulatory authority conferred in section 382(m). While a regulation would have been a potential option for the guidance, it was not required. He stated that the main advantage to a regulation is the higher level of deference it is accorded against challenges by taxpayers, but he concluded this was not an important consideration in this instance.

He stated his belief that a notice was the best choice because it is relatively quick and easy to draft, and in his view it was consistent with its use earlier in Notice 2003-65 as the vehicle for Treasury's previous guidance on the subject of built-in items under section 382(h) He did note that the guidance could have been issued as a revenue procedure, because in his view there is no real difference between a

notice and a revenue procedure in terms of its status as authority, and the drafting and clearance processes are the same.

While he did not specifically review the guidance promulgation procedures set out in Internal Revenue Manual Part 32 (discussed further below), he noted that the Notice was developed just like several other pieces of guidance, and he had no reason to doubt that it was developed in conformance with the requirements, including IRM Part 32. He observed that, given the number of persons and offices involved in the development and clearance process, if there had been an error or missed step, someone would have noted the problem.

Mr. Countryman stated that the decision to promulgate the guidance by Notice was driven by the perception of being in an economic and financial crisis, where the need for action and new guidance was strong and immediate. Of the various forms of guidance available in tax law and administration, private letter rulings and revenue rulings were not appropriate, as they are used to address issues affecting particular taxpayers or particular, discrete classes of taxpayers. Regulations take a very long time to develop and review. Notices were an appropriate way to quickly announce an official interpretation and application of Section 382(h). He stated that a revenue procedure announcement might have been appropriate as well, and that if it had been used, it would have read the same as it reads in its notice format.

In his view the guidance was not improper statutory revision because it did not cancel the applicability of § 382(h)'s restrictions on uses of losses; rather it addressed the current, temporary circumstance that asset and loss values couldn't be accurately determined because markets are frozen.

At our meeting with Senator Grassley's staffers, they noted the proliferation of significant contemporaneous commentary critical of the Service's promulgation of this Notice. Many of these presentations in the tax and legal press and opinion pieces on law firm web sites, which express doubt on the Department's "extrastatutory" revision of Section 382(h)'s clear intent, are collected in Exhibit 11. These critiques noted that the statute strictly limits the amount of losses existing in a bank targeted for acquisition that can be used after the acquisition by an acquiring bank to lessen its own tax liability. They observed that the effect of the Notice was to remove such limits, both in amount and in reach back to earlier tax years, and that this amounted to administrative revision of the statute's clear intent without proper legislative action. Associate Chief Counsel Alexander, when asked to discuss one such article, "Let Uncle Sam Pay for Your Acquisition," Hovde Industry Update, XXII:1, January 2009 (Ex. 12), which specifically referred to the pending acquisition of Wachovia Bank by Wells Fargo, stated that at the time the Notice was being developed, he had no idea that the notice would or could affect any Wachovia acquisition. He said that he first became aware that it might have by reading a story in the newspaper the weekend after the notice was issued.

He had not seen the Hovde article before I presented it to him in mid August. He denied an ability to evaluate its portrayal of the particular taxpayers' situation, having no access to the parties' tax information, and an inability to analyze the public financial data they disclosed. He did observe that the analysis fails to discuss two rules that might have been expected to be discussed either in relation to this taxpayer or to others evaluating similar transactions. One was Notice 2003-65, which would relate to the section 382 treatment of bad debt deductions in the absence of Notice 2008-83. The other was the potential effect of section 56(g)(4)(G), which concerns the computation of the alternative minimum tax base for corporations with a NUBIL at the time of an ownership change.

I further asked Mr. Alexander to respond to a specific question posed by staffer Tony Coughlan regarding the computation of NUBIL. Mr. Coughlan stated:

> the rationale given for Notice 2008-83 was that given the frozen state of the market, NUBILs were too difficult to value, and thus, banks could just value them at $0. However, tax law contains numerous cases of difficult valuation issues – for example, in the estate tax area. But I'm not aware of another example in tax law where taxpayers can just assume an asset in question is worth zero because it's so difficult to come up with the proper value"

Mr. Alexander responded:

> The short answer is that the notice was not about whether there is a NUBIL. NUBIL is a company-wide calculation and can be determined without reference to the value of any particular asset. Section 382(h)(8), where it applies, mandates the use of such a methodology, essentially using the right hand side of the balance sheet as a proxy for the left, since they should be equal. The notice is about matching up the individual losses and deductions taken on the post-change return with this aggregate number. It does not assume that the loans are worth zero but it gets close to the result of assuming that the loans are worth their individual book values. I don't think it would be appropriate for me at this point to write about the pros and cons of this approach, given that Congress has determined in favor of the cons. I note that in his letter to Senator Schumer, Eric Solomon set out his view of the rationale for the notice.

The process by which the losses are computed, and their usability determined, depends on asset valuation As noted above, the Treasury officials' argument is essentially that the economic downturn made it difficult, if not impossible, to determine such valuations. Their arguments do seem primarily focused on removing obstacles to acquisition and, arguably, "salvage" of weak, loss-ridden banks, to stop further deterioration in the banking and mortgage sectors. This may be critically viewed as an "ends justifying means" analysis. Several of these critical analyses also made the point that the impact on the fisc would exceed $100

billion; using an estimate from a law firm's web site that was later abandoned (see discussion below). But there was also professional commentary asserting that the Department was within its authority to interpret § 382(h) in this way, and that its interpretation was appropriate in the course of the Department's efforts to stave off systemic failure in the financial sector.

In my view, the commentary critical of the Notice makes a valid point that its effect was to significantly loosen the restrictions imposed by the statute. In the same vein, it is a legitimate argument that this constitutes overstepping by administrative action. However, it is also understandable and plausible that the Notice's intent was to provide a fix for a broken process for making the asset valuations that underlie the statute's operation, and that it was not intended as a deliberate usurpation of legislative authority. I remain of the view that debates like this are not unusual, and underlie much litigation and legislative debate. In the end, of course, the issue was mooted by Section 1261 of the American Recovery and Reinvestment Act of 2009, Pub. L. 111-5, which cancelled all prospective applicability of the Notice. I do not see a basis to conclude that any employee or official of the Department acted improperly in conceiving, developing, or implementing this Notice. There was commentary critical of it and doubtful of its legal underpinnings; there was also commentary that voiced approval and agreement. Disagreement, and even ultimate rejection, does not denote improper action or intent.

3. Were there any contacts with Wells Fargo, Wachovia, or other entities?

I specifically asked every witness if they had been contacted in any way by anyone employed by or representing Wells Fargo, Wachovia, or any other financial institution. All denied it categorically. Assistant Secretary Solomon and Associate Chief Counsel Alexander both stated that while they routinely communicate with persons and entities affected by Treasury and IRS operations, they specifically had no contact relating to this matter from Wells, Wachovia, or any other banking entity. Mr. Countryman stated that claims that this guidance was promulgated in order to help or encourage particular mergers, was "absurd." In his view, the need for such guidance was perceived long before the Wells/Wachovia merger was announced, and the purpose of the guidance was to make the larger financial sector work more efficiently and be more resilient to failure.

As to whether former Secretary Paulson had contacts with Wachovia or Wells Fargo officials regarding the Notice, Mr. Hoyt stated (Ex. 13) that Secretary Paulson told him that he had no such contact. Mr. Paulson's official calendars indicate a number of telephone calls to and from Wachovia's CEO Robert Steel, as well as two officials of Wells Fargo (Ex. 14). I asked Mr. Paulson, through his attorney, if he had ever discussed the Notice with Mr. Steel or any other official of Wachovia or Wells Fargo. His attorney answered that he had no such discussions, and further, that his telephone calls with the bank officials did not involve the Notice (Ex. 15).

Senator Grassley's staff expressed concern about the timing of the Notice's promulgation, coming immediately after the House initially voted to reject passage of the Emergency Economic Stabilization Act. They additionally asked if Wachovia Bank CEO (and former Treasury Under Secretary) Robert Steel, or any other industry representatives, contacted Treasury at any time prior to this decision-making. The formal written statements of former Treasury officials Paulson, Hoyt, Solomon, Gilbreath-Sowell, Countryman, and current IRS Chief Counsel officials Alexander and Schneiderman all address this issue and uniformly explain that this guidance was developed as part of a broader effort to address problems created by the current financial crisis. The staffers also asked if Mr. Steel received a bonus that was at least in part a function of the price that Wachovia received for its acquisition by Wells Fargo.

We have no basis to charge that the timing of the Notice's development, review, and promulgation was driven by a request or plan to affect or assist any particular corporate transaction or to influence or respond to congressional votes on the EESA. I do not see a basis for arguing that the question about a bonus is within the jurisdiction of the OIG, and I do not see any basis to seek such information from Wachovia. I note that in mid-November 2008 the senator wrote a letter to Mr. Steel (Ex. 16) asking for all information about any contacts he had with Treasury; his inquiry was answered later that month by a letter from Wachovia's General Counsel (Ex. 17), averring that there were no contacts, and thus no emails or other documents to provide. In the absence of a specific allegation, I see no basis to make an identical inquiry, or to believe that similar questions by the OIG would elicit a different response.

On a related note, the staff asked why the OIG did not conduct a search of the email records of the Treasury employees and officials involved in the Notice's development, and asked that we do so. As noted above, I obtained formal written statements from relevant Treasury and IRS officials; all denied having, or being aware of, any such communications. Additionally, we obtained, with the cooperation of the Treasury General Counsel, relevant documents, including emails, maintained by the Department. There was no indication of improper communication, nor did we receive any such allegation on our hotline or by other means. With no specific allegation or other basis to form a reasonable suspicion that misconduct occurred and that evidence thereof may exist in Treasury electronic record systems, there is no basis for us to initiate such a search.

4. Did the IRS comply with the requirements of the Congressional Review Act?

The Congressional Review Act, codified at 5 U.S.C. § 801 et seq., requires that before a rule can take effect, the Federal agency promulgating it must submit it, with an explanation and proposed effective date, to each House of Congress and to the Government Accountability Office.

Each house then provides the rule notice to its committees which have jurisdiction over the law underlying the rule. Unless a resolution of disapproval is enacted by Congress, the rule can take effect. Among the records provided by IRS were CRA forms, filled out with details regarding Notice 2008-83. I learned from Associate Chief Counsel Alexander that the IRS official responsible for CRA compliance, Richard Todd, had forwarded this Notice to the Hill in accordance with the CRA. Mr. Todd stated in emails to me (Ex. 18) that he did, in fact, forward Notice 2008-83, and provided me with copies of signed forms, and forms indicating receipt by several Congressional committees. No resolution of disapproval appears to have been proposed or enacted regarding Notice 2008-83.

Regarding the initial determination whether the Notice constituted a rule required to be submitted under the CRA, I interviewed Special Counsel Henry Schneiderman in the Office of Chief Counsel (Ex. 19). He stated his understanding that the Office of the Associate Chief Counsel (Corporate) considers all of its published guidance as being substantive, as opposed to ministerial, and thus, subject to the CRA. No special analysis was undertaken with respect to this particular Notice.

Regarding the timing of the CRA notification for Notice 2008-83, he stated that it was his understanding that the CRA packages relating to the Notice were prepared by Corporate and sent to the Publications and Regulations Branch on October 2, 2008. Courtesy CRA packages were faxed to various Congressional offices, including Senator Grassley's in his role as Ranking Member of the Senate Finance Committee (Ex. 20), on October 2, 2008. The required CRA packages were delivered by Legislative Affairs to the Hill on October 3, 2008. The acknowledgements are dated October 3, 2008.

Regarding the effective date of the Notice, Mr. Schneiderman stated that Notice 2008-83 was released on September 30, 2008. In his view, the Notice does not contain an effective date. It merely states that corporations may rely on the treatment set forth in the Notice unless and until additional guidance is issued. Under section 7805(b)(8), the Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect.

When asked if the CRA package was sent after the Notice's promulgation and effective date, why the delay in transmission occurred, he repeated that the Notice does not contain a stated effective date. With respect to any delay regarding transmission of the CRA packages, he believed that the handling of the CRA packages relating to Notice 2008-83 was within acceptable time frames as described in CCDM 32.2.8.2, and current IRS practices (Ex. 21). There was, however, a delay in Corporate delivering the CRA packages to the Publications and Regulations Branch. It was his understanding that Notice 2008-83 was released late on September 30, 2008, and the person in Corporate who prepared the CRA packages was out of the office the following day for a doctor's appointment so the

packages were not delivered to the Publications and Regulations Branch until October 2, 2008. I found no evidence that anyone suggested or encouraged this delay in the notification.

The CRA imposes greater obstacles to promulgation when rules are determined to be "major;" in such cases more analysis is required, and Congress has a period of time in which to consider the guidance and implement a resolution of disapproval, which would nullify the guidance. The criteria by which a rule is determined to be major are set out in 5 U.S.C. § 804(d); the statute entrusts the determination to the Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget (OMB). One such criterion is the determination that the rule would have an economic impact of $100,000,000 or more in a year. See 5 U.S.C. § 804(2)(A). Mr. Schneiderman, and Mr. Alexander when I later raised the issue with him, stated their understanding that it was not anticipated that Notice 2008-83 would have that type of an impact.

What is noteworthy is that Treasury and OMB have a long-standing agreement whereby many types of guidance, including rulings, do not have to be reviewed by OIRA before being effective. The agreement, set out in an exchange of letters, is attached as Exhibit 22. It does specifically exempt "rulings." All the officials I interviewed said that IRS Notices are very similar in purpose, effect, and development process to revenue rulings; thus it appears understandable that Notices such as this would be regarded within the Department as within this arrangement. Associate Chief Counsel Alexander specifically stated that it was his understanding that the Service therefore does not view revenue rulings, Notices, and similar guidance as "major," and that therefore the $100,000,000/year economic impact criterion in CRA § 804(d) was not applicable.

Mr. Schneiderman opined that the currently applicable Executive Order on this point is consistent with the long-standing agreement between Treasury and OMB. He specifically argued that the agreement is within the authority granted to the Administrator of OIRA pursuant to section 3(d)(4) of Executive Order 12866, which, he believed, does not require OIRA to report to Congress regarding exemptions granted under that provision.

Executive Order 12866 was amended, expanded, and updated by the issuance of Executive Order 13422 on January 18, 2007, with its attached OMB Bulletin on Agency Good Guidance Practices (Ex. 23). The Bulletin includes the $100 million annual effect standard as an exemption from the definition of economically significant guidance documents. Mr. Schneiderman thus concluded that Notice 2008-83 would not have been subject to OMB review under Executive Order 12866, as amended.

It can be argued that consideration should have been given to the $100 million/year criterion in the course of determining whether the Notice should have been treated as a "major rule" for CRA purposes. It can also be argued that the process by

which many Treasury guidance documents are withheld from OIRA review warrants re-examination. What is asserted to be a statement of legislative intent on this point, set out in the Congressional Record for April 18, 1996 at page S3683-S3687 (Ex. 24), specifically states that a "major rule" is to be defined broadly, and that the authority to determine what rules are "major" was intended to be centralized in OIRA. Specifically, it was stated, at page S3687, that OIRA's Administrator

> may request the recommendation of any agency covered by this chapter on whether a proposed rule is a major rule within the meaning of subsection 804(2), but the Administrator is responsible for the ultimate determination. Thus, all agencies or entities covered by this chapter will have to coordinate their rulemaking activity with OIRA so that the Administrator may make the final, major rule determination.

What would the Notice's Impact on Tax Revenues Have Been?

There was early and widespread speculation that the Notice would cause a decrease in tax revenues of well over $100 billion. This was largely, and inaccurately, based on a memo written by the law firm Jones Day, and posted for a short time on its website (Ex. 25). This estimate posited a number of hypothetical events and projected what could be a tax loss of $140 billion if all the events occurred together. In addition, the estimate failed to specify whether this impact would occur in one tax year, or over a period of years. Jones Day later posted a memo that largely explained away the reasoning and conclusions of the initial memo (Ex. 26).

Messrs. Mackie (Ex. 27) and Knittel (Ex. 28) both stated that the Office of Tax Analysis did a study which estimated that the total revenue diminution for the FY 09 – FY 19 period would be six billion dollars. They both stated that their office reached this conclusion by the following analysis:

OTA conducts such studies occasionally, if a change in law, regulation, or guidance appears likely to have a material effect on projected revenues. There is no standard definition of materiality in this sort of financial/economic analysis –the office exercises judgment based on its knowledge of and research into particular industries or sectors of the economy. The office identifies issues meriting such analysis by constant review of developments, as reported in the press and elsewhere.

OTA monitored discussions in the press on the Notice, and the speculation on the tax savings it could generate, and determined, consistent with OTA's practice of looking at possible material effects on revenues, that this Notice merited study.

Mr. Knittel stated that he reviewed tax data for firms in the banking industry, including income, deduction, and tax payment and refund numbers, particularly for

Wells Fargo, Wachovia, PNC, and National City Bank, and reviewed historical data regarding incurred losses and their tax treatment in the industry over several years,

He stated that while there is no standard methodology in OTA for doing such work, in this case he used recognized economic analysis processes and tools. He obtained information about the intended effect of the Notice from OTP officials Eric Solomon, Karen Gilbreath-Sowell, and Marc Countryman.

The analysis resulted in an estimate that over the 10 year period 2009 – 2019, banks' use of this guidance to justify claims of losses would generate a cumulative total of six billion dollars in "lost" tax revenue. Mr. Knittel stated that data reported by Wells and PNC support this relatively small level of impact on government revenues. Mr. Knittel's conclusions are set out in the spreadsheet at Exhibit 29. The Wells and PNC data referenced herein came from prospectuses each issued as part of their mergers with, respectively, Wachovia and National City Bank. The relevant excerpts from these documents are attached as Exhibits 30 and 31; both projected some potential tax benefit from the application of the Notice's tax guidance. Additionally, I note that the conference report on H.R. 1, the American Recovery and Reinvestment Act, stated in its discussion of the repeal of the Notice (which was enacted as section 1261 of the Act) that the tax savings from the repeal were estimated at $6.997 billion over ten years; a figure in the same order of magnitude as the OTA projection.

Conclusion

Based on my expanded review of relevant materials and interviews with Treasury officials, I believe that there was no improper intent or practice involved in the creation and promulgation of Notice 2008-83. No purposeful or wrongful violation of law or procedure appears to have been committed. I found no indication of improper influences or considerations in the process. I found consistent and reasonable explanations for the guidance's need, and satisfactory argument that its creators and reviewers believed they had a proper basis for promulgating it, although there was contemporaneous professional commentary which called its legal underpinnings into question. However, there was also contemporaneous professional commentary which concluded that the Department had a proper legal foundation for promulgating the guidance. This debate was mooted by Congress's decision to void the Notice by legislation in early 2009 as part of the ARRA.

I found that the requisite Congressional offices and members were appropriately notified of the proposed guidance, and did not use the prerogative under the Congressional Review Act to formally indicate disagreement, and stop the operation of the guidance. The IRS's notices were delayed for two days, due to a staffing gap; I found no improper purpose in this, or any harmful impact. Of greater significance was the decision to not characterize the Notice as a "major rule;" this decision simplified the notification process and allowed a presumption that the Notice could become effective without waiting for Congress to evaluate

the Notice and possibly enact a resolution of disapproval. The decision-making within the Department and OMB on this point, discussed above, does not appear improper, though it may engender interest by Congressional members or staffers.

Lastly, I found that the popular perception of the economic impact of the Notice, exemplified by Jones Day's hypothetical and later withdrawn $140 billion estimate, was greatly overstated, and was refuted by the analysis conducted by Treasury, and the estimate noted in the Congressional conference report.

EXHIBITS

1. IRS Notice 2008-83, issued September 30, 2008

2. Request letter from Senator Grassley to IG Thorson dated November 14, 2008

3. Letter from IG Thorson to Senator Grassley dated November 17, 2008

4. General Counsel Hoyt preservation directive, dated November 19, 2008

5. Solomon Q & A, dated January 16, 2009

6. Sowell Q & A, dated February 3, 2009

7. Countryman Q & A, dated February 2, 2009

8. Alexander Q & A, dated February 17, 2009

9. Alexander email dated June 29, 2009

10. Letter to Senator Schumer from A/S Solomon, dated December 11, 2008

11. Collected commentary on Notice 2008-83, October 2008 – February 2009

12. Alexander responses dated August 21, 2009

13. Hoyt Q & A, dated January 29, 2009

14. Paulson daily calendars, various dates, August – September 2008

15. Paulson attorney letter dated September 2, 2009 and associated emails

16. Senator Grassley letter to Wachovia CEO Robert Steel, November 18, 2008

17. Wachovia General Counsel Jane Sherburne letter to Senator Grassley, November 25, 2008

18. Todd emails, dated February 17 – 18, 2009

19. Schneiderman Q & A, dated May 1, 2009

20. IRS CRA Notification to Senator Grassley, dated October 2, 2008

21. Internal Revenue Manual sections re CRA compliance

22. OMB –Treasury General Counsel letters of understanding re guidance review

23. Executive Order 13422

24. Congressional Record, April 18, 1996

25. Jones Day initial memo, dated October 2008

26. Jones Day "revisit" memo, dated December 2008

27. Mackie Q & A, dated February 5, 2009

28. Knittel Q & A, dated February 5, 2009

29. Knittel spreadsheet

30. Excerpt from Wells Fargo letter

31. Excerpt from PNC letter