

## MEMORANDUM FOR FINANCE COMMITTEE MEMBERS

From: Senate Finance Committee Staff

Date: November 18, 2009

Re: Lael Brainard Nomination

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This memo describes the results of the Senate Finance Committee staff review of the 2005, 2006, 2007 and 2008 tax returns and other documentation of Lael Brainard in connection with her March 23, 2009 nomination to be the Under Secretary of the Treasury for International Affairs.

### Background

Finance Committee staff has conducted a routine review of Ms. Brainard's Senate Finance Committee Questionnaire, her tax returns for 2005, 2006, 2007 and 2008, and her financial disclosure statements. As part of this review, a due diligence meeting was held with the nominee and her tax return preparer on May 28, 2009. Staff has submitted at least 10 rounds of questions in order to obtain complete, accurate and consistent answers from the nominee. The nominee has provided at least 11 rounds of responses. Speculation in the media that consideration of Ms. Brainard's nomination has been treated inconsistently with Committee procedures is unfounded and not accurate. Three issues have been identified as a result of these actions that have been determined appropriate to bring to the attention of Committee members.

### Senate Finance Committee Questionnaire (Real Estate, Personal Property and Unemployment Insurance Taxes)

The Senate Finance Committee Statement of Information Requested of Nominee (Questionnaire), Part F. Financial Data, Question 10, asks, "Have you paid all Federal, State, local, and other taxes when due (including extensions) for each of the past 10 years? If not, provide details." Ms. Brainard disclosed on her original Questionnaire, dated April 13, 2009, that she made several late payments to the District of Columbia for unemployment insurance for household employees; that all payments, including applicable late fees and penalties, were made; and that she is current on all payments. No other late payments were identified by the nominee.

During the course of the review of Ms. Brainard's tax returns, Committee staff asked the nominee to provide "substantiation of real property billings and payments" for two plots of land in Rappahannock County, Virginia owned by the nominee and her husband. Information provided to the Committee on June 1, 2009 showed that the real estate taxes on this property for years 2005, 2006, and 2007 all were paid late. Five payments were less than one month late; five other payments ranged from one month to thirteen months late. Interest in the amount of \$121.75 and penalties totaling \$1,279.34 were paid in connection with these late payments. An additional receipt supplied by the nominee indicated late payment for 2007 of a tangible personal property tax on a vehicle; a penalty of \$44.12 was paid in connection with that tax. See Attachment A for an analysis of these amounts.

On June 3, 2009, the Committee asked Ms. Brainard for a revised response to Part F. Question 10 of the Questionnaire to reflect the late payments, interest and penalties that had been identified. The revised response submitted by the nominee on June 4, 2009 acknowledged the late payments and disclosed payment of \$121.75 in interest and only \$626.41 in penalties. The revision did not disclose the late payment of the 2007 tangible personal property tax or the associated penalty. Upon being advised that the Questionnaire still was incorrect, the nominee submitted another revised Questionnaire on October 12, 2009. The October 12, 2009 revision disclosed additional late payments of taxes to the District of Columbia made by the nominee's mortgage company in 2005 and 2006 that she stated her preparer learned from the DC tax office's website (the DC tax receipts previously submitted to the Committee did not include any indications that amounts had been paid late). In addition, a late payment of 2008 Rappahannock County real property taxes, with a penalty in the amount of \$498.00 and interest in the amount of \$410.83, also was newly disclosed on the October 12, 2009 revision.

On November 5, 2009, the nominee was asked whether all Rappahannock County personal property taxes were timely paid for 2005, 2006 and 2008. As a result of the examination of public records, the Committee independently determined that Rappahannock County personal property taxes were not timely paid for 2006. The nominee responded on November 12, 2009 that these taxes were not timely paid for 2006, and submitted a fourth version of the Questionnaire on November 12, 2009 disclosing the late payment, including interest in the amount of \$4.32 and penalties in the amount of \$48.32. See Attachments B1 through B4.

The Senate Finance Committee Statement of Information Requested of Nominee (Questionnaire), Part F. Financial Data, Question 11, asks, "Were all your Federal, State, local, and other tax returns and tax liabilities current (filed and paid) as of the date of your nomination. If not, provide details." The nominee responded, "Yes." Ms. Brainard was nominated on March 23, 2009. The October 12, 2009 revised response to Question 10 of the Committee Questionnaire stated that the 2008 Rappahannock personal property taxes were paid late, and the receipts provided confirmed that the 2008 taxes, due December 5, 2008, were not paid until September 17, 2009. Ms. Brainard acknowledged in her November 12, 2009 response to the Committee that the taxes were paid late, explaining that she was not aware of the outstanding tax bill when she submitted her Committee Questionnaire in April, 2009, that her husband has always paid property taxes on the Rappahannock property, that her accountant first noticed that the 2008 taxes were not timely paid when he was compiling data to prepare her 2008 individual tax return, and that upon notification the nominee promptly submitted an amended Question 10 to the Committee reflecting this information. The nominee has submitted a corrected response for Question 11 of the Committee Questionnaire to clarify that all of her taxes were not up-to-date at the time her nomination was announced. See Attachment C1.

Ms. Brainard also submitted two corrected responses for Question 9 of the Questionnaire to indicate the late filing of the District of Columbia unemployment insurance returns associated with the late payment of unemployment insurance taxes. See Attachments C1 and C2.

#### Forms I-9, Employment Eligibility Verification

The nominee has employed several household employees since 2005. Form I-9, Employment Eligibility Verification, is required to document that each new employee is authorized to work in the United States. The employee section must be completed no later than the time of hire and the employer section must be completed within three business days of the

time of hire and then retained by the employer. According to the Forms I-9 submitted to the Committee by the nominee, all of the employees were U.S. citizens or lawful permanent residents legally eligible to work in the United States. The I-9s contain the following irregularities:

- 1) One form on which the employee signature is dated 5/18/07 and the employer signature date is 04/17/09 (Attachment D).
- 2) Two different I-9 forms for the same employee on which the employee signatures do not match, with one of the signatures appearing to be the nominee's (Attachments E and F).
- 3) Dates that appear to have been written over to change the year (Attachment F).
- 4) One form containing the nominee's signature but the nominee's spouse's name in the employer certification section (Attachment G).
- 5) One form where the employee section has been filled out and signed but the employer section is blank (Attachment H).
- 6) Two forms with time lapses of 32 days and 65 days, respectively, between the date of the employee's signature and the nominee's signature as employer (Attachments G and I).

The nominee was asked by Committee staff about the Forms I-9 during the due diligence meeting. Ms. Brainard stated her general practice was to notify her accountant when she was going to hire a new employee and the accountant would send Forms W-4 and I-9 to her. The nominee stated she would return the forms to her accountant after they were filled out. She stated she did not think there would be a situation when an I-9 was not secured contemporaneously with the hiring of an employee. When further questioned about irregularities with the I-9s the accountant asked to speak with her alone and when the meeting resumed both stated they had no more information to provide pertaining to the I-9s. Subsequent to the due diligence meeting, the nominee has responded to written questions from the Committee regarding the Forms I-9.

Ms. Brainard was asked to provide a written statement to the Chairman and Ranking Member to explain the irregularities. A statement was submitted by the nominee on June 4, 2009. See Attachment J.

On October 13, 2009 the nominee voluntarily submitted additional information to the Committee identifying another household employee who was hired in 2008, including an affidavit confirming that the legal status of the employee had been substantiated at the time of hire and copies of the documents that were reviewed. The nominee stated that she and her husband followed the Employment Eligibility Verification Form I-9 and obtained copies of the appropriate documentation establishing the employee's legal status and eligibility to work. The nominee responded to the Committee on October 29, 2009 that she believes an I-9 was completed at the time of hire but that her accountant had not yet tracked down the associated Form I-9 in his files. In response to an inquiry from Committee staff, the nominee explained the accounting firm has changed recordkeeping procedures since the time the other Forms I-9 were submitted to the Committee and her preparer has been unable to locate a copy of the recently hired employee's I-9 in the new system.

## Office-in-Home

Ms. Brainard deducted 1/6, or 16.7 %, of her household expenses from her partnership income as an office-in-home deduction (\$13,091, \$14,518 and \$14,703 in 2005, 2006 and 2007, respectively). Committee staff asked the nominee several times to substantiate 1/6 as an accurate percentage of space and were provided inconsistent information. External information from the DC Treasurer's website and the MLS listing for the nominee's home that was for sale at the time was considered during this process.

Meeting between nominee and her accountant and Committee staff, May 28: The office-in-home deduction became an issue when a general question was asked about the deduction and staff was told that 1/6 of space was used, the space had not been measured, and storage space for books and papers on the second floor and in the basement was considered in the estimated percentage of 16.7%. The nominee says that the comparable rooms method was used; staff notes state this method was not used. The nominee was advised by staff that storage space for books and papers is not allowable space and was asked to provide the total square footage of her home and the office square footage.

Written answers received from nominee on June 1 in response to questions from May 28 meeting with Committee: The response on the preparer's letterhead provided several square footage numbers, including finished areas of the main floor and any finished areas above the main floor (2490), total square feet with the addition of the 3<sup>rd</sup> floor (3211), total office space (465, included in 3<sup>rd</sup> floor) and total additional storage (240). These measurements include basement storage space and do not include the total amount of finished basement space. The response noted that these estimates would yield an estimate of the office-in-home space of 21.9% counting storage space and the office space, but that the business percentage reported was 16.7%.

Written answers received from nominee on June 25 in response to questions from Senator Grassley sent on June 19: Ms. Brainard explained that her accountant determined the 16.7% office-in-home based on the number of rooms used for business compared to the total number of rooms in the home, but did not provide details of the computation. The response cited IRS Publication 587 as support for the percentage, which says "any reasonable method of allocation" is allowable and cites two commonly used methods, including the total rooms method, which the nominee states was used on the return. Staff notes from the due diligence meeting on May 28, 2009 state the rooms method was not used.

The nominee stated that if storage space were not counted, the office-in-home percentage based on square footage would be 18.6% (this assumes total square footage of 2490, the space shown on the DC Treasurer's website, which was not updated to reflect the addition of the third floor office space of 465 square feet).

Written answers received from nominee on July 7 in response to questions from Senator Grassley sent on July 6: Ms. Brainard stated that to reach the 16.7%, the numerator included 2 rooms (the 3<sup>rd</sup> floor office space) and the denominator included 10 rooms, including one room in the basement ( $2/10 = 20\%$ ). The nominee stated that the basement was counted as part of the home and restated that her measurement of total square footage was 3211. Based on the June 25 response, the 3211 figure includes basement storage space. The nominee reiterated her statement made during the due diligence meeting that there was storage space on the second floor and in

the basement. Ms. Brainard repeated written statements that the total rooms method was used to determine the office-in-home deduction when the tax return was filed.

Written answers received from nominee on July 31 in response to questions from Senator Grassley sent on July 17: The nominee described the square footage of the rooms she said were considered in determining the 16.7% office-in-home. The rooms were of the following square footage: 255 and 210 (office); and 340, 169, 130, 200, 399, 340, 169, 324 (other). The nominee stated the 324 square foot room was the basement recreation room and that these measurements do not include bathrooms, hallways and storage spaces. IRS Publication 587 requires the rooms to be approximately the same size to use this method of determining office-in-home percentage.

The nominee again stated that the home was 3211 square feet in size, including the basement, all storage spaces, finished rooms, bathrooms and hallways; however, using data provided by the nominee, staff has identified at least 3619 square feet in the home counting the basement recreation room with 324 square feet and in-law suite with 84 square feet.

On October 29, 2009, the nominee stated that because Committee staff had asked questions regarding the size of the office-in-home deduction for the 2005, 2006 and 2007 returns, the nominee and her husband decided to reduce the size of the home office deduction on their 2008 partnership return by half, to 1/12. The reduced percentage was claimed on an amended partnership return. In response to questions dated November 5, 2009, the nominee told staff on November 12, 2009 that prior year partnership returns have not been amended because they “reflected a reasonable method of allocation for determining the portion of our former home deductible as a home office.”