

**Committee on Ways and Means
Subcommittee on Oversight
U.S. House of Representatives**

“Iran Terror Financing and the Tax Code

Wednesday, November 4, 2015

**Statement of Dr. Jim Walsh
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Mr. Chairman, Mr. Ranking Member, and Members of the Committee:

It is an honor to be with you today to discuss the implementation of the nuclear agreement with Iran and our P5+1 international partners.¹ I want to personally thank you for your efforts to address the Iranian nuclear issue, and I can say with confidence that sustained Congressional leadership is a one reason we have a historic and precedent-setting nuclear agreement. Absent Congressional leadership, we would not be here today, and absent Congressional leadership in the future we will not be where we need to be in the future.

I come to today’s hearing as someone who has provided assessments to Republican and Democratic presidents, as well as to Republican and Democratic Members of Congress, as they have wrestled with these policy challenges. As regards the subject of your hearing today, I have studied Iran, its role in the regional, sanctions, and terrorism for more than 15 years. I have written extensively on Iran and its foreign policy,² edited a book series on terrorism,³ testified before Congress on issues related to terrorism⁴ and to Iran’s nuclear program,⁵ and currently oversee a major project on North Korean sanctions.

¹I would like to thank the many people who helped with my testimony, including Aaron Arnold, Richard Nephew, Daniel Waltz, Hamid Biglari, Angela Nichols, Max Walsh, Corie Walsh, William Luers, Frank Wisner, and Michelle Lee. Of course, my comments are mine alone and are not intended to represent the views of the MIT Security Studies Program or individuals I have consulted in the preparation of this testimony.

² See, for example, “Rivals, Adversaries, and Partners: Iran and Iraq in the Middle East.” In *Iran and Its Neighbors*. London: Palgrave Macmillan. [Forthcoming.]

³ *Terrorism: Documents of International and Local Control*. Vols. 37-41. Dobbs Ferry, N.Y: Oceana Law Publications.

⁴ "Nuclear Regimes and Nuclear Terrorism." Testimony before the Subcommittee on International Security, Proliferation and Federal Services of the Senate Governmental Affairs Committee. *Multilateral Non-proliferation Regimes, Weapons of Mass Destruction Technologies and the War on Terrorism*. February 12, 2002, pp. 1-12.

⁵ In addition to this current project on North Korea sanctions, I have contributed to reports on Iran sanctions in particular, and met repeatedly with the members of the Executive Branch and

In my testimony, I want to directly address the two central questions raised by this hearing, as suggested by former Chairman Ryan in his September 22, 2015 letter to the President.⁶

- 1) Will the Executive Branch waive tax code-related sanctions for the purposes of implementing the JCPOA?
- 2) What are the policy implications of providing or not providing tax code-related sanctions relief? For example, will such relief result in an increase in Iranian state sponsored terrorism?

My summary judgment is that while the President has the authority to issue tax code-related waivers, it is premature to judge whether such authority will be exercised or speculate as to the scope of any possible relief.

As for the potential policy consequences, I judge that any tax code-related relief will have little or no effect on Iran's sponsorship of terrorism. I reach that conclusion for two main reasons. First, the effect of tax code-related relief –whatever its scope-- is likely to be trivial compared to other sanctions relief that is unrelated to the tax code and provided for in the JCPOA. Second, the assertion that sanctions relief will result in increased levels of terrorism is both empirically questionable and logically problematic.

Background: The JCPOA

Before addressing the issue of possible tax-related sanctions relief, it makes sense to step back and consider the agreement itself, and what it accomplishes.

I have spent most of my adult career working on the issue of nuclear proliferation, including the assessment of nonproliferation agreements, from the Nuclear Nonproliferation Treaty (NPT) to the agreement with Libya. My professional judgment is that this agreement is the *strongest, most intrusive nonproliferation agreement ever negotiated*.

The JCPOA is obviously stronger than the wildly successful NPT, which had no enforcement clause and no controls on nuclear materials. It is stronger than the Libyan nonproliferation agreement, which did not have verification procedure beyond the Additional Protocol. The JCPOA is 159 pages long in addition to the UN Security Council resolution. The Agreed

Congress on the issue of Iran sanctions. See for example, “Weighing the Benefits and Cost of International Sanctions against Iran.” New York: The Iran Project. December, 2012, pp. 1-86.

⁶ Letter from Rep. Paul Ryan, Chairman of the Committee on Ways and Means, U.S. House of Representatives, to President Barack Obama, September 22, 2015. See also, Scott Greenberg, “Sometimes, Tax Policy is Also Foreign Policy,” Tax Foundation, September 24, 2015, <http://taxfoundation.org/blog/sometimes-tax-policy-also-foreign-policy>.

Framework with North Korea was three-pages long, as was President Bush's Moscow agreement with President Putin – the latter having no verification provisions whatsoever.

This positive assessment of the JCPOA is not mine alone but rather one shared by American nuclear weapons scientists, retired diplomats (including three former U.S. Ambassadors to Israel), and retired military officers. Support for the JCPOA has included a broad and bipartisan cross-section of the US national security establishment. In addition, Israel's Atomic Energy Agency and more than 40 retired Israeli defense and government officials have endorsed the agreement, as have our European allies.

The JCPOA reduces Iran's stockpile of uranium by 98%, to a level of less than one bomb's worth of material in the form of 3.67% Low Enriched Uranium (LEU). It restricts Iran's enrichment levels and its centrifuge research and development. It reduces Iran's installed centrifuges by two-thirds, includes adherence to Code 3.1, and goes beyond the Additional Protocol (e.g., access to mines, centrifuge production facilities, and the materials/tools required for centrifuge production, as well as a dedicated procurement channel). Iran's plutonium path to the bomb via the Arak heavy water reactor is blocked, as the reactor will be replaced and no reprocessing will be allowed. The agreement provides for what is tantamount to 24/7 monitoring of Iran's declared nuclear facilities and a first ever expedited procedure for investigating any suspicious undeclared sites. Many of its provision, including snapback sanctions, are unprecedented. Indeed, few experts believed the agreement's provisions were achievable.

Under the agreement, Iran's so-called breakout time – the time required for a state to accumulate one bomb's worth of material-- will have gone from roughly 2 months to 12 months, a 600% improvement over the pre-JPOA status quo. In addition, since the agreement was announced, the International Atomic Energy Agency (IAEA) has suggested that the expanded mandate for verification would entail an additional 150 inspectors, more than doubling the level of the inspectors under Joint Plan of Action (JPOA), which itself had doubled the number of inspectors over what had been operating prior to November 2013. It is difficult to think of simpler but more powerful measure of the difference this agreement makes. If one were to ask virtually anyone whether quadrupling the number of IAEA inspectors and strengthening their verification mandate was a good thing, the answer would undoubtedly be "yes."

Since the JCPOA, some critics have lamented the fact that the agreement does not address terrorism, Iran's activities in the region, the Americans being held in Iran, and other important issues. That is because it is a nuclear agreement, and preventing Iran from acquiring nuclear weapons is the uncontested first priority in US-Iranian relations. Past nuclear agreements did not end Soviet gulags or prevent Colonel Gaddafi from threatening Israel, but they advanced US national security by preventing bad actors from acquiring nuclear weapons. The absence of the JCPOA would do nothing to solve any of these other problems and would likely make them worse. Moreover, there is nothing in this agreement that prevents the US from pursuing policies that would advance American objectives in these other areas. The only thing the JCPOA does is block Iran from acquiring nuclear weapons, and that is the only thing it has to do.

Critics have been unable to offer a plausible alternative that comes close to preventing an Iranian nuclear weapon for 15 years. Saying we should “get a better deal” is not a serious alternative. Many of the same critics who say it is possible to do better (without specifying how) are also the same people who said that the grueling two years of negotiations was taking too long. Moreover, history suggests that unilaterally walking away from the agreement will precipitate Iran’s return to centrifuge construction, reduce IAEA inspections, and result in higher levels of enrichment -- as happened after the collapse of the 2005 EU3 negotiations.

Other analysts have expressed the concern that a nuclear agreement that leaves Iran with any centrifuges will spur countries in the region to develop their own enrichment capabilities and following that, nuclear weapons. This outcome appears unlikely for several reasons.

First, in 70 years of nuclear history, there is not a single case of proliferation caused by a safeguarded enrichment program. There have been 10 nuclear weapons states. Some weapons programs began in response to another country’s nuclear weapons program, others not until nuclear tests, but none to a safeguarded enrichment program. Governments tend to be reactive by nature -- not proactive -- and nuclear weapons are not a small undertaking. Non-nuclear weapons states that have safeguarded enrichment programs, like Japan and Brazil, have not caused neighboring countries to acquire nuclear weapons.

Second, if a limited enrichment infrastructure was viewed as a grave, proliferation-tripping threat, then why have the countries in the region failed to do anything for the last 10 years. Iran has had centrifuges since 2003, but Saudi Arabia and others have done virtually nothing. It is difficult to believe that after curtailing its centrifuge program and submitting to new and rigorous verification, the governments in the region would *then* decide to respond.

Third, the set of countries cited as potential proliferation threats -- Saudi Arabia, Turkey, and Egypt -- appear far from a nuclear weapons option.⁷ There are many reasons for this

⁷ On Turkey see, Mark Hibbs, “The IAEA’s Conclusion About Turkey,” *Arms Control Wonk*, April 16, 2015, <http://carnegieendowment.org/2015/04/16/iaea-s-conclusion-about-turkey/i799>; On Saudi Arabia, see Colin H. Kahl, Melissa G. Dalton, and Matthew Irvine, “Atomic Kingdom: If Iran Builds the Bomb, Will Saudi Arabia Be Next?”, Center for New American Security, February 2013, http://www.cnas.org/files/documents/publications/CNAS_AtomicKingdom_Kahl.pdf; Zachary Keck, “Why Pakistan Won't Sell Saudi the Bomb,” *National Interest*, November 18, 2013, <http://nationalinterest.org/commentary/why-pakistan-wont-sell-saudi-the-bomb-9416>. On Egypt, see Dina Esfandiary and Ariane Tabatabai, “Why Nuclear Dominoes Won't Fall in the Middle East,” *Bulletin of Atomic Scientists*, <http://thebulletin.org/why-nuclear-dominoes-wont-fall-middle-east8236>; Jessica C. Varnum, “Middle East Nuclear Race More Rhetoric Than Reality,” *World Politics Review*, May 14, 2015,

conclusion, not least being that since the Iran-Iraq War, many countries have come to believe that a strong military alliance with the United States is their preferred route to security. A bomb program would put that directly at risk.

In sum, the JCPOA provides a robust and intrusive set of tools to prevent Iran from acquiring nuclear weapons. It is a nuclear agreement – not a terrorism human rights or other agreement. It must be judged first and foremost on that basis, namely, on its nonproliferation bona fides. Based on those principles of assessment, it is clear that it advances both US national security and global nonproliferation.

Sanctions Background: Primary versus Secondary Sanctions

Before addressing the three central questions posed by this hearing, it is important to be clear about the kind of sanctions relief the US government will provide under the JCPOA. Currently the United States imposes two broad categories on sanctions on Iran. *Primary sanctions* are those that prohibit American individuals, companies, and other entities from engaging in business and other transactions with Iran. *Secondary sanctions* prohibit foreign individuals, companies and other entities from commercial and other interactions with Iran, e.g., our European allies.

Of central relevance is the fact that the *JCPOA provides relief primarily from secondary sanctions, not primary sanctions*. With limited exceptions, American primary sanctions will remain in place under the JCPOA for years to come. These prohibitions extend to foreign incorporated US subsidiaries, insofar as American nationals working for those companies will still be prohibited from doing business in or with Iran.

Question 1: Will the Executive Branch waive tax code-related sanctions for the purposes of implementing the Joint Comprehensive Plan of Action (JCPOA)?

It is premature to say whether such waivers will be granted, as the Executive branch has offered no statements of intent, nor issued any relevant regulations. Indeed, a search of the recent, relevant literature turns up no references whatsoever to tax code related sanctions relief for Iran.

More telling perhaps is that last month, when the State Department released the language of its proposed waivers in accordance with the JCPOA's "Adoption Day," there was no reference to tax code-related waivers. Additionally, a search of the text of the 159-page JCPOA produces no references to tax code waivers.⁸

<http://www.worldpoliticsreview.com/articles/15769/middle-east-nuclear-race-more-rhetoric-than-reality#>; Jim Walsh, "Egypt's Nuclear Future: Proliferation or Restraint?", In *Forecasting Proliferation*, William Potter, ed, Palo Alto: Stanford University Press, 2010.

⁸ Using the search terms "tax" and "tax code." It is worth noting parenthetically that the text of the JCPOA does refer, in Annex II 4.B.5.1.2, to sanctions relief with regard to "non-US entities that are owned or controlled by a U.S. person to engage in activities with Iran that are consistent

Obviously, the President could decide to provide no waivers whatsoever, provide a broad, blanket waiver, or alternatively, offer limited waivers based on a number of different parameters.

It would seem prudent, therefore, to wait until the President, the Treasury Department, or other agencies actually declare a policy rather than to speculate about what might or might not be the case. I would be happy to submit additional written testimony or appear before the committee, if and when the administration issues a statement or regulations on this topic.

Question 2: What are the policy implications of providing or not providing tax code-related sanctions relief? For example, will such relief result in an increase in Iranian state sponsored terrorism?

Concern that tax code-related sanctions relief might directly or indirectly fund Iranian policies that are contrary to American national interests or international law, including but not limited to the sponsorship of terrorism, are worthy of consideration. Nevertheless, based on a review of the evidence, I judge that even the unlikely scenario of the issuance of broad waivers of tax code-related sanctions is unlikely to result in increased rates of terrorism.

A full waiver for U.S. owned foreign subsidiaries is, by itself, unlikely to generate new trade with or investment in Iran for a variety of reasons.

1. American primary and other sanctions remain in force.

The JCPOA leaves in place U.S primary sanctions that prohibit US nationals and firms from engaging Iran. These sanctions continue to be enforced and have the effect of prohibiting direct involvement by U.S. nationals, regardless of where they are employed. In addition, the architecture created by the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA) and Iran Freedom Support Act (ILSA) -- particularly as it relates to money laundering, terrorism, and other issues -- continues on the books and with enforcement.

2. Few subsidiaries of U.S. companies likely to engage Iran.

2a. American affiliated companies are unlikely to be welcomed in Iran.

Iranian politics are deeply factional and often pit conservative hardliners who hew to the ideology of the Islamic Republic's founder (Ayatollah Khomeini) against more centrist and pragmatic elements in the political elite who favor engagement with countries outside the region. The former group is especially suspicious of the U.S. and is inclined to see every interaction with the U.S. as an attempt to infiltrate and eventually overthrow the "values of

with the JCPOA." (p. 67 of the PDF). This would not be through waiver but rather via the OFAC licensing authority, and here again, the U.S. government has issued no statements or regulations regarding its plans related to this provision.

the revolution” as well as the Iranian government itself. In addition, this hardline faction wants to deprive its political adversaries the ability to claim any political victories.

Perhaps it is not surprising, therefore, that Supreme Leader Khamenei’s October 22 letter to President Rouhani endorsed the JCPOA but simultaneously emphasized the need for a “resistance economy” and warned that American firms and their wares would not be welcome in Iran.

“...the resolution of current challenges will not be easy unless the Resistance Economy is taken seriously and is completely implemented. ...You must also be vigilant that the lifting of sanctions is not followed by the unrestrained importation [of goods]. In particular, the importation of any kind of consumer materials from America must be seriously avoided.”⁹

2b. The recent arrest of an Iranian-American businessman will likely further dampen interest by American firms and their subsidiaries.

As if the warning of the Supreme Leader were not enough, the recent arrest of businessman Siamak Namazi is already having an effect on businesses considering projects in Iran. As reported in the Wall Street Journal,

“Everyone is now hitting the pause button,” said an Iranian businessman in London. “If they don’t want the benefit of our knowledge, money and network then that’s fine. We will take our business elsewhere.”¹⁰

2c. Even absent these recent developments, American affiliated firms would likely have been wary of getting involved with Iran.

In the modern world of corporate compliance, Americans, American firms, and most especially American banks, tend to be risk averse and avoid even the possibility of becoming the target of sanctions enforcement. For example, despite clearly stated exceptions in U.S. sanctions laws with respect to medicines, medical devices, and humanitarian assistance, few American firms and no banks have participated in the provision of such goods.

3. Even with full waivers and the absence of any Iranian discouragement or business wariness, the effects of tax code-related sanctions relief would be quite modest, if not irrelevant.

⁹ Caitlin Shayda Pendleton, “In Letter to Rouhani, Supreme Leader Khamenei Approves the Implementation of the JCPOA,” <http://www.irantracker.org/nuclear/pendleton-khamenei-letter-approves-implementation-of-jcpoa-october-22-2015>

¹⁰ Farnaz Fassihi and Jay Solomon, “Iranian-American Executive Arrested in Iran,” Wall Street Journal, Oct. 29, 2015, <http://www.wsj.com/articles/iranian-american-executive-arrested-in-iran-1446164677>. See also, Michael Kaplan, “After Arrest Of Iranian-American Businessman In Iran, International Business Optimism Turns To Worry Ahead Of Nuclear Deal Sanction Relief,” *International Business Times*, October 30 2015, <http://www.ibtimes.com/after-arrest-iranian-american-businessman-iran-international-business-optimism-turns-2163427>.

The economic impact tax code-related relief – even at maximum levels – is marginal compared with the *non*-tax code related sanctions relief provided for under the JCPOA. It is simply a drop in the proverbial bucket and too small in relative terms to matter. Put another way, if one is getting \$100 of sanctions relief, the impact will derive from the first \$99.95, not the last 5 cents.

For these and other reasons, some of which are delineated below, it would seem likely that even under “maximum” scenarios, any tax code-related sanctions relief will generate little in the way of new trade or investment in Iran and therefore produce little or no new funds for the Iranian government.

The Broader Issue of Sanctions Relief and Terrorism

The jurisdiction of this committee is such that its focus is the impact of tax code-related sanctions relief, a very small, if not theoretical, piece of the broader sanctions relief picture. For the reasons offered above, I assess that this particular aspect of sanctions relief is likely to have little or no impact on the resources available to the Iranian government.

It is worth noting, however, that this concern is part of a larger critique offered by opponents of the JCPOA suggesting that the agreement will lead to an increase in state sponsored terrorism by the government of Iran. Indeed, former Chairman Ryan’s letter contends that the JCPOA will provide “Iran \$100 billion to \$150 billion of previously frozen funds, not to mention hundreds of billions of dollars of increased investment and trade flows” and that this will mean “more resources to increase its support of terrorism.”

In my judgment, both the assumptions of this critique and its conclusions are deeply problematic.

1) The “\$100 to \$150 billion” dollar figure is flawed.

According to a Harvard University assessment of the JCPOA, the figure for Iranian funds frozen abroad is approximately \$115 billion, but about half of that is *already* obliged as payments to other countries for goods and services already delivered or for non-performing loans. That leaves roughly \$56 billion.¹¹ Moreover, after one subtracts funds that Iran will likely keep in foreign banks for currency reserves, the figure is actually closer to 25 billion, rather than the \$150 billion figure frequently cited.¹²

2) The Intelligence Community (IC) has assessed that most of those remaining funds and/or new financial resources will be devoted to rebuilding the economy, not terrorism.

The Los Angeles Times reported that the

“...U.S. intelligence assessment predicts that Iran’s government will pump most of an expected ...windfall from the lifting of international sanctions into the country’s

¹¹ *The Iran Nuclear Deal: A Definitive Guide*, Belfer Center for Science and International Affairs, Harvard University, August 2015, p. 59.

¹² Cyrus Amir-Mokri and Hamid Biglari, “A Windfall for Iran?,” *Foreign Affairs*, November/December 2015, p. 25.

flagging economy and won't significantly boost funding for militant groups it supports in the Middle East.”¹³

Indeed, after decades of sanctions and the mismanagement of the Iranian economy by President Ahmadinejad, Iran will need something on the order of \$1 trillion over the next decade to rebuild its economy – of which \$25 billion is but a small piece.¹⁴

3) Iran received more than \$16 billion of sanctions relief during the two years of the interim nuclear agreement (the Joint Plan of Action), yet there is no evidence pointing to an upsurge in Iranian state sponsored terrorism.

4) When it comes to state sponsored terrorism, money is not the limiting factor. Governments, unlike non-state actors, are sovereign entities with the ability to tax and raise revenues. Terrorism is, in relative terms, an extremely low cost endeavor, and so it would be rare for money to be the limiting factor that determines whether the rate of terrorism increases or decreases. Instead, state sponsored terrorism is more likely to be affected by domestic and international political constraints and pressures rather than simply the availability of funds.

5) For many firms, Iran will not be an attractive investment opportunity, thus limiting whatever economic returns it hopes to gain from sanctions relief.

There are a number of factors that affect business decisions regarding trade and investment. As discussed above, these are particularly acute for American foreign subsidiaries considering doing business with Iran, both because of the ongoing sanctions against Iran and because of the hostile attitude of some in Iran's leadership toward anything American.

Yet even for firms with no ties to the U.S., some will be cautious even in the face of new opportunities. As experts have pointed out...

But the end of the sanctions alone will not be enough to attract investors. Although lifting the sanctions will remove a substantial impediment to Iran's economic recovery, it will not automatically create the legal and regulatory framework necessary for sustained investment. Iran's lackluster attempts at market liberalization and its undistinguished record on issues such as corruption and intellectual property rights will continue to give pause to global investors. ...[I]t will need to implement a broad spectrum of reforms, including strengthening property rights, transferring state-owned assets to the private sector, and granting independence to its central bank. Only then can Iran reap the full economic benefit of the nuclear deal.

¹³ Brian Bennett, "Iran Unlikely to Spend Most of Its Post-sanctions Funds on Militants, CIA Says," *Los Angeles Times*, July 16, 2015, <http://www.latimes.com/world/la-fg-iran-intel-20150716-story.html>

¹⁴ Cyrus Amir-Mokri and Hamid Biglari, "A Windfall for Iran?," *Foreign Affairs*, November/December 2015, pp. 25-26.

In addition to issues related Iran's domestic financial and investment infrastructure, there are impediments having to do with international efforts to combat money laundering and counter-terrorism. For example, the 30-plus member countries of the international Financial Action Task Force (FATF) represent most of the major economies in the world. The FATF evaluates individual countries regarding their domestic rules and practices to prevent money laundering and other activities. Banks, particularly in an era of "de-risking," are loath to provide financing for projects in countries that receive a poor score. Iran, along with North Korea and Sudan, receives a particularly poor rating. Thus, even if firms find a way to overcome economic infrastructure obstacles to doing business in Iran, they may still have trouble finding a bank willing to support those projects.

6) The U.S. maintains a variety of policy tools to combat terrorism, with or without the JCPOA.

There is nothing in the JCPOA that inhibits the U.S. government from continuing its aggressive counter-terrorism strategy. The government employs a variety of tools, from intelligence, to interdiction, to special operations forces, and more to combat terrorism. Washington will continue to use those instruments in concert with friends and allies.

7) None of the unwanted practices Iran engages in somehow get better, if Iran has an unconstrained nuclear program.

The logic of agreement critics appears to suggest that one can have no agreement with Iran, if that risks that it would spend a dollar of sanctions relief on terrorism or other objectionable activities. The logical implication of that position is that no nuclear agreement should include sanctions relief. If that is the case, then there will be no nuclear agreement, and Iran's nuclear activities will be left completely unconstrained. This is an odd logic, indeed. No American wants Iran to support terrorism, oppress human rights, or engage in any number of other unsavory activities, but the only thing worse than an Iran that does those things is an Iran that does those things *and has nuclear weapons*.

Conclusion

The JCPOA represents an historic agreement that is arguably the strongest multi-lateral nonproliferation agreement ever negotiated. It has unprecedented features (e.g., snapback sanctions, procurement channel, upstream verification, etc.) and closes off Iran's path to nuclear weapons. It is supported by our negotiating partners, including Britain, France, and Germany.

Of course, it makes sense to be attentive to the possibility that sanctions relief may afford Iran more resources for activities we oppose. The U.S. government and its partners can prepare for that possibility and design policies to prevent or minimize those risks. On the other hand, policymakers also need to be clear about the singular achievement of the JCPOA – preventing Iran from acquiring nuclear weapons. It is difficult to imagine a more important policy achievement.

In my professional judgment, as someone who has studied and sought to reduce the dangers of proliferation for more than 2 decades, I judge that the JCPOA is a huge win for

nonproliferation, one that will advance the national security of the United States -- as well as the security of our friends and allies -- for decades to come.

I thank the Committee for providing me the opportunity to share my views.