

Coalition for Tax Competition

March 11, 2005

The Honorable John Snow
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Snow,

To boost America's economy and uphold the rule of law, we urge you to permanently withdraw the proposed Internal Revenue Service (IRS) regulation (Reg 133254-02) that would force U.S. banks to report deposit interest paid to nonresident aliens. This initiative is inconsistent with current law and it will undermine our economy's performance by causing capital to flee the American banking system. The regulation was misguided when issued in the final days of the Clinton Administration, and the cosmetic changes the IRS put forth in 2002 do not address the proposed regulation's fundamental shortcomings.

Our objections are both procedural and substantive. Signatories to this letter believe that some or all of the following concerns warrant the withdrawal of this misguided proposal. The concerns include:

1. The IRS is abusing its regulatory authority – Executive branch agencies and departments are supposed to issue regulations that implement the laws enacted by Congress. More specifically, the IRS is supposed to promulgate regulations that help enforce U.S. tax law. And since the United States government does not tax bank deposit interest paid to nonresident aliens, there is no need to collect this information. Indeed, the IRS even admits that the purpose of the proposed regulation is to help foreign governments tax U.S.-source income.
2. The proposed regulation flouts existing law – On several occasions, the U.S. Congress has examined the tax treatment of indirect foreign investment in the American economy. In every instance, the desire to attract capital has led lawmakers to decide not to tax deposit interest paid to nonresident aliens. Congress also has repeatedly chosen not to require the reporting of this income. The proposed IRS regulation, however, seeks to overturn the outcome of this democratic process. This undermines the rule-of-law and makes a mockery of the President's effort to rein in regulatory abuses.

3. Indiscriminate information sharing is a threat to civil liberties and privacy rights – Many nations do not have the American tradition of respecting civil rights and civil liberties. In fact, most of the world's population still lives under regimes that do not fully respect fundamental rights and individual liberties. If financial privacy were eliminated and the regulation's information sharing becomes commonplace, law-abiding citizens and businesses of any country would be in danger of having all of their financial information shared with corrupt and even terrorist regimes, subjecting them to extortion, blackmail, and kidnapping.
4. Capital will flee the U.S. economy if the regulation is implemented – The current tax and privacy rules for foreign investors have been a huge success, helping to attract more than two trillion dollars of foreign capital to U.S. financial institutions. This money helps finance car loans, home mortgages, and small business expansion in America. But if the IRS regulation is approved, foreigners will shift a portion of their funds to London, Hong Kong, and other jurisdictions that protect the interests of investors. A Mercedes Center study estimates that \$87 billion of capital will flee if the regulation is implemented.
5. The regulation will make U.S. banks less competitive – Financial institutions from around the world compete for liquid capital. American banks traditionally have been successful in this environment, attracting large amounts of capital to the United States. But this profitable source of deposits will become very unstable if banks are forced to put foreign tax law above U.S. tax law. Money will flow out of America, making it more difficult for U.S. banks to meet the challenge of foreign competition.
6. Banks will face a heavy paperwork burden – The IRS asserts that financial institutions will face an increased regulatory burden of only 500 hours. This estimate is absurdly low. To read the rule, to understand the rule, to get the appropriate legal and accounting advice, and to report on thousands of accounts surely will impose a burden far in excess of the IRS's politically-motivated low-ball estimate.
7. The proposed regulation is bad tax policy – The IRS regulation is a slap in the face to those who support tax reform. All proposals to fix the tax code, such as the flat tax, are based on common-sense principles such as taxing income only once and taxing only income inside national borders. The new regulation would undermine tax reform, as it would help foreign governments double-tax income earned in America.
8. The IRS failed to perform legally required cost/benefit analysis – The IRS flouted existing requirements to conduct a cost benefit analysis. By incorrectly declaring most of its regulations either "interpretative" within the meaning of the Administrative Procedure Act or not "major" within the meaning of Executive Order 12866, the Internal Revenue Service has effectively exempted itself from regulatory oversight. Yet many IRS regulations – particularly the proposed bank deposit interest reporting rule – impose a significant cost on the economy and should be subject to the regulatory review process.

9. The proposed regulation will undermine fiscal competition – Collecting private financial information on nonresident investors and sharing that data with foreign governments hinders jurisdictional competition. It enables high-tax governments to impose levies on income earned outside their borders, particularly discriminatory taxes on capital. This policy will discourage governments from lowering tax rates and reforming their tax codes.

This regulation is bad tax policy and bad regulatory policy. It is inconsistent with President Bush's tax reform agenda and it will hurt the U.S. economy by reducing the amount of capital for workers, consumers, homeowners, and entrepreneurs. We strongly urge the immediate withdrawal of this misguided initiative.

Sincerely,

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