Coalition for Tax Competition

November 13, 2002

The Honorable Paul O'Neill
Secretary of the Treasury
Department of Treasury
1500 Pennsylvania Avenue
Washington, DC 20220

Dear Secretary O'Neill,

We are strongly opposed to the Internal Revenue Service's recent proposal to require the reporting of bank deposit interest paid to nonresident aliens (regulation 133254-02). If implemented, this regulation will harm America's economy and undermine the competitiveness of U.S. financial institutions. This is a high price to pay, particularly for a proposed rule that the IRS does not have the authority to issue.

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 bank deposit interest paid to nonresident aliens. Congress also has repeatedly decided 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. **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, attracting about one trillion dollars 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 substantial share of their funds to London, Hong Kong, and other jurisdictions that protect the interests of investors – and therefore protect their own national interests.

4. **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 about one trillion dollars. 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.

5. **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.

6. **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 our borders. But the new regulation would sabotage tax reform, as it would help foreign governments double-tax income earned in America.

7. **The IRS failed to perform legally-required cost/benefit analysis** – The IRS is ignoring laws requiring 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.

8. **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 encourage governments to "race to the top" by increasing marginal tax rates on mobile capital.

9. **The IRS is playing the politics of divide-and-conquer with the regulation** – The current regulation is a slightly modified version of a rule proposed in the waning days of the prior Administration. The original Clinton-era proposal sought the reporting of deposit interest paid to all nonresident aliens, but lobbying from some banking associations led to the withdrawal of that proposal and the release of the current version, which seeks to collect information from 15 nations. This bait-and-switch gimmick may or may not fool the banking industry, but it does not make the proposal any less unpalatable – particularly since it is abundantly clear that the IRS fully intends to extend the regulation to all nations if the current proposal survives.

10. **The regulation violates the Treasury Department's position on information-sharing** – Last but not least, it is worth noting that this regulation is contrary to the Administration's position on the treatment of confidential taxpayer information. On several occasions, you and other Treasury officials have stated that the United States government does not support automatic information sharing. Instead, you stated, information should only be provided on a case-by-case basis in response to specific requests – and with full respect for due process legal protections and individual privacy rights. The IRS's proposed regulation unambiguously violates this commitment since any information collected automatically would be forwarded to foreign governments. To add insult to injury, it is increasingly obvious that this aspect of the regulation was deliberately misrepresented during meetings that led to the introduction of the proposed rule.

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,

Andrew F. Quinlan – President, Center for Freedom and Prosperity
Daniel Mitchell – Senior Fellow, The Heritage Foundation
Veronique de Rugy -- Fiscal Policy Analyst, The Cato Institute
David R. Burton – The Argus Group
Robert B. Carleson -- Senior Fellow, Free Congress Foundation for Education and Research
Bruce Chapman -- President, Discovery Institute
Carl D. DeMaio -- President, The Performance Institute
Stephen J. Entin -- President, Institute for Research on the Economics of Taxation
Tom Giovanetti -- President, Institute for Policy Innovation
John C. Goodman -- President, National Center for Policy Analysis
Jim Harper -- Editor, Privacilla.org
Kevin Hassett -- Resident Scholar, American Enterprise Institute
Lawrence Hunter -- Chief Economist, Empower America
Charles W. Jarvis -- Chairman, United Seniors Association
Gordon S. Jones -- President, Association of Concerned Taxpayers
David A. Keene -- Chairman, American Conservative Union
Karen Kerrigan -- Chairman, Small Business Survival Committee
Matt Kibbe -- Executive Vice President, Citizens for a Sound Economy
James L. Martin -- President, 60 Plus Association
Steve Moore -- President, The Club for Growth
Grover Glenn Norquist -- President, Americans for Tax Reform
Duane Parde -- Executive Director, American Legislative Exchange Council
Nancy M. Pfotenhauer -- President, Independent Women's Forum
George Pieler -- Former Tax Counsel, Senate Finance Committee
John Pugsley -- Chairman, The Sovereign Society
Don Racheter – President, Public Interest Institute
Gary Robbins -- President, Fiscal Associates
Terrence Scanlon -- President, Capital Research Center
Tom Schatz -- President, Council for Citizens Against Government Waste
Eric V. Schlecht -- Director of Congressional Relations, National Taxpayers Union
Solveig Singleton -- Senior Analyst, Competitive Enterprise Institute
Lewis K. Uhler -- President, National Tax Limitation Committee
Paul M. Weyrich -- National Chairman, Coalitions for America
Neal C. White -- President, National Retail Sales Tax Alliance, Inc.

Cc: CEA Chairman Glenn Hubbard
Economic Advisor Larry Lindsey
IRS Deputy Commissioner Robert Wenzel
IRS Associate Chief Counsel Alexandra Helou (International)
All United State Senators
All Members of Unites States House of Representatives