



CENTER FOR FREEDOM & PROSPERITY

April 7, 2011

Department of the Treasury
Internal Revenue Service
CC:PA:LDP:PR
Room 5203
PO Box 7604
Ben Franklin Station
Washington, DC 20044

RE: IRS REG-146097-09

Dear Sir or Madam:

I am writing on behalf of the Center for Freedom and Prosperity, a 501(c)(4) citizen organization that lobbies Congress and the Administration on tax competition, financial privacy and fiscal sovereignty. I am pleased to have this opportunity to express our strong opposition to the proposed regulation on reporting the interest paid to nonresident aliens.

When a similar proposal was first offered in the early 2000s, it was met by strong opposition from the financial sector, public policy experts and members of Congress. At the time, I provided testimony documenting some of this opposition, including from 111 members of Congress. The issues they objected to are the same we face today, such as an IRS that seems intent upon advancing the interests of foreign governments ahead of US interests and law, that has failed in its duty to undertake a cost-benefit analysis for significant regulatory action, that is willing to endanger human rights, and that is attempting to overturn the express will of Congress.

Congress has for more than 90 years chosen to make the U.S. an attractive destination for foreign deposits by refraining from taxing deposit interest paid to non-resident aliens. Congress took this action for the specific reason of attracting and keeping capital in the U.S. economy, a policy decision which unelected bureaucrats at the IRS should not undermine. As tax attorney Marshall J. Langer explained in *Tax Notes International* in March 2001, "Collecting information concerning such deposit interest and passing it on to other countries will almost certainly have the same effect as imposing tax on the interest."

Many depositors are particularly sensitive to maintaining their financial privacy as a means of self protection. In much of the world, governments are brutal and corrupt, and if they aren't directly threatening to arbitrarily seize the wealth of their citizens, they're handing over personal information to criminals willing to engage in extortion, or even kidnapping. The presence of such complicated human rights issues is partly why Congress is the appropriate body for deciding profound policy changes.

To add insult to injury, the IRS has chosen not only to flout Congressional policy, but is also ignoring proper legal procedures for implementing economically disruptive regulation. Executive Order 12866

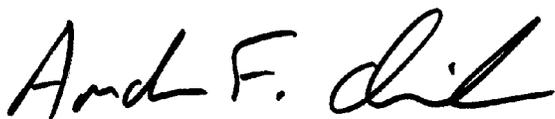
requires a cost-benefit analysis for “significant regulatory action,” which it defines as having “an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy.” With over \$3 trillion in foreign deposits in US financial institutions, according to the Treasury Departments, it is preposterous for the IRS to simply conclude that this regulation does not qualify. A study by the Mercatus Center determined that the previous rule would drive \$87 billion out of the U.S. economy. Last time I checked, \$87 billion is a lot more than \$100 million.

The Executive Order also requires a cost-benefit analysis if a regulation will adversely affect a particular sector of the economy. There's no excuse for again ignoring the impact this regulation would have on the financial sector, as numerous financial institutions have previously explained the adverse affect such interest reporting would have on their business.

On Monday, April 11 2011, the Center for Freedom and Prosperity Foundation will also be releasing a video explaining objections based on many of these points, and I have included a copy of the transcript of the upcoming video with this letter. It will be made available on our website at <http://www.freedomandprosperity.org>, and I will also bring copies on DVD to the public hearing for submission into the record.

Given the compelling body of evidence I have outlined, it is truly disappointing that the IRS has again decided to try and push through this unnecessary regulation. As I noted in my testimony in 2002, the public responded with near unanimous objection to this regulation. Understanding that it does not serve U.S. interests, the public, financial institutions and Congress are again objecting. I urge the IRS to listen to the people it serves and withdraw this regulation.

Sincerely,

A handwritten signature in black ink that reads "Andrew F. Quinlan". The signature is written in a cursive, flowing style.

Andrew F. Quinlan
President
Center for Freedom and Prosperity

Center for Freedom and Prosperity Foundation
April 11, 2011
Forthcoming Video Script

“An Example of the IRS Run Amok”

I’m not a big fan of the Internal Revenue Service, but I try not to demonize the bureaucrats because politicians actually deserve most of the blame for America’s complex, unfair, and corrupt tax system. The IRS generally is in the unenviable position of simply trying to enforce very bad laws.

But sometimes the IRS runs amok and the agency deserves to be held in contempt by the American people

In this Center for Freedom and Prosperity video, we’re going to look at a grotesque example of IRS misbehavior. It deals with a seemingly arcane issue, but it has big implications for the US economy, the rule of law, and human rights. I’m Dan Mitchell of the Cato Institute.

Our example deals with a regulation proposed by the IRS on January 7. The regulation, if implemented, would force American financial institutions to put foreign tax law above US tax law. I’m not joking. Banks would be required to report to the IRS any interest they pay to foreigners, but not so the US government can collect tax, but in order to let foreign governments tax this US-source income.

This isn’t the first time the IRS has tried to pull this stunt. At the very end of the Clinton years, the agency proposed a rule to do the same thing. But the bureaucrats were thwarted because of overwhelming opposition from Capitol Hill, the financial services industry, and public policy experts. There was near-unanimous agreement that it would be crazy to drive job-creating capital out of the US economy and there was also near-unanimous agreement that the IRS had no authority to impose a regulation that was completely inconsistent with the laws enacted by Congress.

But like a zombie, this IRS regulation has risen from the grave.

I’m not sure what is most upsetting about this proposed rule, but there are five serious flaws in the IRS’s back-door scheme to turn American banks into deputy tax collectors for foreign governments.

First, the IRS is flouting the law, using regulatory actions to overturn laws enacted through the democratic process. Ever since 1921, and most recently reconfirmed by legislation in 1976 and 1986, Congress specifically has chosen not to tax interest paid to non-resident foreigners. Lawmakers wanted to attract money to the U.S. economy.

Yet rogue IRS bureaucrats want to impose a regulation to overturn the outcome of the democratic process. Heck, if they really think they have that sort of power, why don’t they do us a favor and unilaterally junk the entire internal revenue code and give us a flat tax?

Second, the IRS has failed to perform a cost-benefit analysis, as required by executive order 12866.

Issued by the Clinton Administration, this executive order requires that regulations be accompanied by “An assessment of the potential costs and benefits of the regulatory action” for any regulation that will, “Have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities.”

Yet the IRS blithely asserts that this interest-reporting proposal is “not a significant regulatory action.” Amazing, we have trillions of dollars of foreign capital invested in our economy, perhaps \$1 trillion of which is deposited in banks, and we know some of which definitely will be withdrawn if this regulation is implemented, but the bureaucrats unilaterally decided the regulation doesn’t require a cost-benefit analysis.

During a previous incarnation of this regulation, the IRS’s failure to comply with the rules led the Office of Advocacy at the Small Business Administration to denounce the tax-collection bureaucracy: That office stated that “...there is ample evidence that the impact of the regulation is significant and that a substantial number of small businesses will be impacted.”

Third, the IRS is imposing a regulation that puts America’s economy at risk.

Here’s a chart, based on Commerce Department data, showing that foreigners have invested more than \$10 trillion in the U.S. economy.

And here’s another chart, from the Treasury Department website, showing the funds that foreigners have in American banks and brokerage accounts.

We don’t know how much money will leave America if this regulation is implemented, but there are many financial centers – such as London, Hong Kong, Cayman, Singapore, Tokyo, Zurich, Luxembourg, Bermuda, and Panama – that would gladly welcome the additional investment if the IRS makes the American financial services sector less attractive.

Fourth, the IRS is destabilizing America’s already shaky financial system.

Five years ago, when the banking industry was strong, the IRS regulation would have been bad news. Now, with many banks still weakened by the financial crisis, the regulation could be a death knell. Not only would it drive capital to banks in other nations, it also would impose a heavy regulatory burden.

How bad would it be? Commenting on an earlier version of the regulation, which only would have applied to deposits from 15 countries, the Chairman of the Federal Deposit Insurance Corporation warned that, "[a] shift of even a modest portion of these [nonresident alien] funds out of the U.S. banking system would certainly be termed a significant economic impact." He also noted that potentially \$1 trillion of deposits might be involved. And a study from the Mercatus Center at George Mason University estimated that \$87 billion would leave the American economy. And remember, that estimate was based on a regulation that would have applied to just 15 nations, not the entire world.

So what happens if more banks fail? I guess the bureaucrats at the IRS would probably just shrug their shoulders and suggest another bailout.

Fifth, the IRS is endangering the lives of foreigners who deposit funds in America because of persecution, discrimination, abuse, crime, and instability in their home countries.

If you're from Mexico you don't want to put money in local banks or declare it to the tax authorities. Corruption is rampant and that information might be sold to criminal gangs who then kidnap one of your children. If you're from Venezuela, you have the same desire to have your money in the United States, but perhaps you're more worried about persecution or expropriation by a brutal dictatorship.

There are people all over the world who have good reasons to protect their private financial information. Yet this regulation would put them and their families at risk. The only silver lining is that these people presumably will move their money to other nations. Good for them, bad for America.

Let's wrap this up. Under current law, America is a safe haven for international investors. This is good news for foreigners, and good news for the American economy. That's why it is so outrageous that the IRS, unilaterally and without legal justification, is trying to reverse 90 years of law for no other reason than to help foreign governments.

Share this video so more people can learn about this reprehensible behavior of the IRS running amok.