

March 18, 2011

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

RE: **Notice of Proposed Rulemaking 146097-09**  
**(76 Fed. Reg. 1105 (January 7, 2011))**

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Dear Sir or Madam:

The Florida International Bankers Association (“FIBA”) is pleased to comment on the revised proposed regulations under Section 6049 of the Internal Revenue Code of 1986, as amended (the “Code”). FIBA represents more than 70 financial institutions from 18 countries, the vast majority of which are comprised of either the international offices of banks headquartered in the United States or foreign banks which maintain U.S. branches, U.S. agencies or U.S. representative offices. The geographic market of both U.S. and foreign bank FIBA members is Latin America, and the principle services of our members is (i) U.S.-based banking services for non-U.S. persons and (ii) trade finance and supporting activities.

A. Summary

Similar to regulations proposed in 2001 (REG 126100-00, 66 Fed.Reg. 3925-28) (the “2001 Proposed Regulations”), Notice of Proposed Rulemaking 146097-09 (the “2011 Proposed Regulations”) would require information returns for interest paid to Non-Resident Alien individuals (“NRAs”) from deposits in U.S. financial institutions—regardless of the NRA depositor’s country of residence. FIBA is concerned that the 2011 Proposed Regulations will have a dramatic adverse impact on its members as well as on banks throughout the United States. At the same time, the 2011 Proposed Regulations would not significantly further the United States’ financial interests. Because the issues raised by the 2011 Proposed Regulations are very similar to those that were raised by the

**F.I.B.A.**

2001 Proposed Regulations before they were withdrawn, the concerns expressed in this letter largely follow those articulated in letters submitted on behalf of FIBA and others in response to the 2001 Proposed Regulations.<sup>1</sup> As with the 2001 Proposed Regulations, FIBA respectfully requests that the 2011 Proposed Regulations be withdrawn. Pursuant to the Notice of Proposed Rulemaking, FIBA also requests the opportunity to appear and testify at the April 27, 2011 hearing on the issues outlined in this letter.

FIBA recognizes and appreciates the high degree of professionalism and integrity of IRS personnel responsible for collecting and safeguarding confidential information. Moreover, FIBA acknowledges that information reporting of confidential financial information plays a critical role in ensuring that the IRS can capably enforce the U.S. tax laws. Accordingly, the current framework of information reporting and taxpayer confidentiality rules, which is directed towards those who are subject to U.S. tax, reflects a reasonable balancing of the competing concerns of U.S. tax enforcement against financial privacy, and the administrative and financial burdens of collecting and reporting this information.

In the case of NRAs who have deposits with U.S. financial institutions, interest income from these deposits has long been exempt from U.S. tax. Because there is virtually no U.S. tax at stake for these deposits, the balance between these competing concerns weighs heavily in favor of maintaining financial privacy and mitigating the adverse impact that information collection on the international banking industry in states such as Florida. In addition to the significant direct costs that would be incurred to collect and report this information, the ability of our banks to attract and retain foreign capital in the U.S. would be greatly diminished, which runs counter to the very purpose of exempting interest on NRA deposits from U.S. tax. Moreover, as the Treasury Department itself recognized in 2002, collecting information on all NRA deposits is an excessively broad response to Treasury's efforts to increase participation in reciprocal information sharing with other countries.<sup>2</sup> To this end, FIBA also believes that the 2011 Proposed Regulations do not adhere to President Obama's recent directive to executive agencies and departments to design cost-effective regulations that are compatible with economic growth, job creation, and competitiveness.<sup>3</sup> Similarly, the collection of information that would be required by the 2011 Proposed Regulations fails to adhere to the standards established by the Paperwork Reduction Act as the information is not necessary for the proper performance of the functions of the IRS, and the added reporting burden on filers far exceeds any benefit that the IRS would derive from such information.

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<sup>1</sup> See, e.g., Letter from Miriam Lopez to The Honorable Paul O'Neill (Oct. 1, 2001), 2001 TNT 198-36; Letter from David B. Blair to Internal Revenue Service (Feb. 27, 2001), 2001 TNT 46-23; Letter from Marcos Pereira and Saturnino E. Lucio II to Internal Revenue Service (Feb. 20, 2001), 2001 TNT 46-19.

<sup>2</sup> See Notice of Proposed Rulemaking, 67 Fed. Reg. 50386 (August 2, 2002).

<sup>3</sup> Exec. Order No. 13563, 76 Fed. Reg. 3821 (Jan. 18, 2011).

The global market for NRA deposits is highly competitive, and subtle differences in the regulatory regimes among countries directly affect the flow of NRA deposits in and out of financial institutions in these countries. Other countries that compete with the U.S. for these deposits often tout the relative advantages of depositing funds in their country. As explained below, NRA depositors have very legitimate concerns regarding any collection or dissemination of their financial information. The information collection and unilateral exchanges of depositor information that would occur under the 2011 Proposed Regulations would lead to a large-scale flight of NRA deposits from U.S. banks into foreign banks. Moreover, the availability of these deposits as an important source of capital for lending to individuals and small businesses in the U.S. would be severely impacted.

With regard to the significant new compliance burden that the 2011 Proposed Regulations would impose on U.S. banks, developing and implementing the required information reporting systems would require large investments in time, resources, and training of bank employees. Initially, banks would have to purchase or enhance their current software to produce Forms 1042-S and train their employees to use the software. Then, the banks would have to pull their Form W-8BEN for each NRA depositor to obtain the information necessary to complete the Forms 1042-S and determine the depositor to whom the Forms 1042-S should be sent. Such information would need to be entered in the software, and internal controls would need to be implemented to ensure the accuracy of the information contained in Forms 1042-S. Even after the new system is established, banks would face significant ongoing compliance costs from monitoring and updating the system and preparing and mailing the Forms 1042-S. Many FIBA member banks are small community banks for which the additional compliance burdens of the proposed regulations would be material.

B. International Banking in Florida

Florida is among the leading international banking centers in both the nation and the world. The success of Florida banks at the international level depends in large part on private banking by NRAs. The core of the private banking relationship involves the NRA's deposits with the bank (deposit accounts, time deposits and money market accounts). Florida banks have been successful in expanding their private banking relationships with NRA customers to include investment counseling, asset management and extensions of credit. However, without the core private banking deposit-based relationship, it would be difficult for Florida banks to expand and remain competitive for their international customers.

NRA customers are willing to make long-term deposits in Florida banks based on the confidentiality and stability of the U.S. banking system and the international banking expertise that Florida banks provide. For NRA depositors, confidentiality typically is the paramount concern and such concern has nothing to do with taxation. Without assurances of confidentiality, the NRA customers will likely withdraw their U.S.

deposits. In many cases, the customers' home countries lack adequate confidentiality rules, those rules are poorly enforced, or local corruption leads to unauthorized leaks of confidential information. Because these same countries often have significant criminal activity and political instability, the lack of confidentiality can lead to devastating results, such as extortions, kidnapping and possibly assassination of high net-worth individuals. Although these crimes and local corruption may sound remote from the perspective of a U.S. resident, they are real and immediate to many NRA customers of FIBA members. From the perspective of these customers, disclosure of their confidential financial information represents a threat and is a potentially decisive factor in their decisions about where to bank.

The 2011 Proposed Regulations threaten the future growth and the current stability of Florida international banking institutions. NRA deposits form a critical component of the overall depositor base for many Florida banks. In a limited sample of FIBA members, with respondents ranging in size from less than \$750 million to over \$4 billion in deposits, NRA deposits in these financial institutions totaled \$12.9 billion and represented between 68% to 100% of their total deposits (depending on the type of banking license). The State of Florida reports that international branches and agencies hold over \$9 billion in NRA deposits. This capital will be very difficult to replace if it leaves the United States – and this amount does not include investment portfolios and other investments that would surely follow. Moreover, NRA deposits are particularly valuable because they tend to be highly stable—often certificates of deposit that roll over upon maturity. If the 2011 Proposed Regulations stimulate a sudden withdrawal of NRA deposits, some FIBA members may experience a lack of liquidity to pay off their depositors because the great majority of their assets are in the form of illiquid loans. Beyond the immediate problem of liquidity, withdrawal of NRA deposits will cause many banks to shrink because they will not have as many deposits to loan. This shrinkage will reduce the banks' revenues, growth, employment, and, in some cases, safety and soundness.

The 2011 Proposed Regulations threaten not only the economic health of FIBA members, but also the regional economy. Growth in Florida international banking industry has been an important contributing factor to South Florida economic growth. Florida international banking community also has contributed significantly to Florida emergence as a center for international trade. With its proximity to the Caribbean and Latin America and its multi-lingual population, South Florida experienced a dramatic increase in international trade beginning in the 1970s. Today, Miami is the ninth largest container port in the U. S. and serves as a major transshipment port for goods from throughout the world that flow in and out of the Caribbean and Central and South America. FIBA member banks, with their base of NRA deposits, are an important source of financing for this trade.

The loss of NRA deposits also would inhibit FIBA members from investing in their local communities. Although NRA deposits come from abroad, many FIBA

members use these deposits in their local lending programs or loan the NRA funds to domestic banks. Loans by FIBA members in Florida have been an important source of funding to support the growth of Florida's economy.

C. The Current Regulatory Regime and Prior Proposed Regulations

Section 871(i) of the Code provides that U.S. bank deposit interest paid to NRA individuals is exempt from U.S. tax if such interest is not effectively connected with the conduct of a U.S. trade or business. As a corollary to exempting NRA interest from U.S. tax, Sections 1441(c)(10) and 6049(b)(2) of the Code provide specific exceptions to the normal withholding tax and information reporting requirements for interest paid on NRA deposits. In particular, Sections 6049(b)(2) and 6049(b)(5)(B)(iv) of the Code specifically provide that NRA deposit interest shall be exempt from information reporting, "except to the extent otherwise provided in regulations."

The current regulations under Section 6049 of the Code generally implement Congress' directive to exempt NRA deposit interest from information reporting (except in the case of interest from deposits received by Canadian NRAs<sup>4</sup>). These regulations are directed to ensuring accurate information reporting with respect to items of income that would be subject to U.S. tax and place the responsibility for enforcing these documentation requirements squarely on U.S. banks. Accordingly, the regulatory scheme demands from U.S. banks concrete documentation requirements to ensure that persons claiming exemptions from U.S. tax in fact qualify for the exemptions that they claim.<sup>5</sup>

The 2011 Proposed Regulations are similar to the 2001 Proposed Regulations issued by Treasury during the final days of the Clinton Administration.<sup>6</sup> The 2001 Proposed Regulations drew intense criticism, and the IRS received substantial oral and written comments, including comments from FIBA. Much of the criticism focused on the imposition of information reporting and the related administrative burdens in connection with NRA bank deposit interest in return for minimal U.S. tax enforcement benefits to the United States. Other comments focused on the potential negative impact on U.S. banks, particularly those in Florida and other locations with a large NRA deposit base. There also were concerns expressed with regard to the technical application of the proposed regulations.

In response to the heavy criticism of the 2001 Proposed Regulations, Treasury withdrew the 2001 Proposed Regulations and issued revised proposed regulations (the "2002 Proposed Regulations").<sup>7</sup> In its explanation for withdrawing the 2001 Proposed

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<sup>4</sup> See Treas. Reg. section 1.6049-8.

<sup>5</sup> See Treas. Reg. sections 1.6049-5(b)(12), 1.1441-1(e).

<sup>6</sup> Notice of Proposed Rulemaking, 66 Fed. Reg. 3925 (January 17, 2001).

<sup>7</sup> See Notice of Proposed Rulemaking, 67 Fed. Reg. 50386 (Aug. 2, 2002).

Regulations, Treasury stated that “[t]he IRS and Treasury have concluded that the [2001 Proposed Regulations] were overly broad in requiring annual information reporting with respect to U.S. bank deposit interest paid to any nonresident alien” (emphasis added). The 2011 Proposed Regulations are similar to the 2001 Proposed Regulations – and likewise should be withdrawn.

D. Policy Considerations

Treasury and the IRS have identified three reasons for extending the applicability of the 2011 Proposed Regulations to all interest payments on NRA deposits: (i) importance of cooperative information exchange for tax purposes; (ii) need for strengthening the U.S. exchange of information programs by providing reporting of U.S. bank deposit interest paid to any NRA; and (iii) need to improve voluntary compliance by U.S. taxpayers.

The primary stated rationale for a blanket requirement of reporting all interest on NRA deposits is increasing information exchange with other countries. In the same fashion as the 2001 Proposed Regulations, the 2011 Proposed Regulations refer to “the growing global consensus regarding the importance of information exchange,” and indicates that requiring reporting on all NRA deposits will strengthen the U.S. exchange of information program “consistent with adequate provisions for reciprocity, usability, and confidentiality in respect of this information.” Beyond this ambiguous standard, there is no indication of any limitation on the countries with which Treasury would share information reported on NRA deposits.

Our understanding of the current IRS information exchange program is that, for those categories of NRA income that are not exempt from information reporting (e.g., royalties), the IRS receives information reports on Forms 1042-S. If the 2011 Proposed Regulations went into effect, presumably reporting of interest on NRA deposits would become part of this program. In general, however, it does not appear that U.S. treaty partners – let alone any non-U.S. treaty partners – typically compel their financial institutions to report all interest payments to U.S. residents and then compile and send that information to the IRS. Thus, the 2011 Proposed Regulation would establish a one-sided “exchange” of information in which interest paid by U.S. banks to NRAs would automatically be transmitted abroad, while foreign competitors of U.S. banks would not be required to report their interest payments made to NRAs. There is little evidence of any reciprocity for any such information exchange, which became clear recently in the difficulties encountered by U.S. authorities when they attempted to obtain information on U.S. holders of accounts in Switzerland.

Another stated justification for the proposed new reporting regime is that reporting to the IRS all interest on NRA deposits in U.S. banks will improve voluntary

compliance by U.S. taxpayers by making it more difficult to avoid the U.S. information reporting system.

Because interest on NRA deposits generally is exempt from U.S. tax, the compliance concerns of the IRS in this case is limited to those instances where U.S. residents falsely claim NRA status. As described above, the documentation requirements that already apply to U.S. banks with NRA deposits make it difficult for a U.S. resident to open an account at a U.S. bank while falsely claiming NRA status and, in fact, these requirements may be significantly increased for U.S. branches of foreign financial institutions once final regulations are issued under the recently enacted Foreign Account Tax Compliance Act. For those few U.S. persons who succeed in falsely claiming NRA status, the information reports required under the 2011 Proposed Regulations would be based on the same false residence information that the depositor included on the Form W-8BEN. Accordingly, to actually catch a U.S. tax evader in this instance, the person would have to have given a false address in a country which (i) participates in the IRS's information sharing program, (ii) has a regular practice of cross-checking the IRS information against its own records, and (iii) reports back to the IRS on discrepancies. Our understanding is that few countries have either the technical capability or the motivation to complete all of these possible necessary steps.

In sum, the current documentation regulations administered by U.S. banks represent the most reasonably effective way of protecting against persons who falsely claiming NRA status. The 2011 Proposed Regulations would provide little, if any, marginal benefit to ensure accurate assessment of U.S. tax. It is particularly inappropriate for Treasury to pursue this small potential benefit by crippling FIBA members and other U.S. banks in their efforts to compete for NRA deposits. U.S. banks have already taken up front line responsibility for enforcing Treasury's documentation requirements, and they should not be punished for their efforts through further regulations that do little to enhance U.S. compliance while at the same time seriously undermining their ability to attract NRA deposits that are critical to their business. Not only would the U.S. international banking industry lose the benefits of these deposits, but the IRS would lose its current capacity to identify those persons earning bank deposit interest through the information provided in Forms W-8BEN.

The U.S. has maintained a consistent policy of exempting interest on NRA deposits from tax and information reporting since the early part of the 1900s. In 1924, Congress first exempted such interest by providing that interest paid by U.S. banks on NRA deposits would be considered foreign-source income. This unique sourcing rule remained in place until the Tax Reform Act of 1986, when Congress enacted Sections 871(i), 1441(c)(10) and 6049(b)(5)(B)(iv) of the Code. Throughout the history of this exemption, Congress' policy objective has been clear—to encourage and preserve NRA deposits in U.S. banks. For example, when the Senate in 1975 acted to preserve the exemption, it was noted that:

The exemption for bank deposits and similar types of deposits and debt obligations has aided in attracting substantial amounts of funds to the United States. Most of these funds are placed in certificates of deposits having a duration of 12 months or longer. Since the present exemption is to expire on December 31, 1975, it is understood that many of these one year certificates of deposits may not be renewed during 1975 unless the foreign depositors receive some assurance that the interest exemption will be continued.

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The committee takes this action as an emergency measure to prevent during 1975 an outflow of funds held as certificates of deposits with U.S. savings institutions.<sup>8</sup>

Under the pre-1986 Act sourcing rule, NRA deposits were exempt from the U.S. information reporting regime.<sup>9</sup> In 1986, when Congress converted the sourcing rule to an explicit tax exemption, it took deliberate action to preserve this information reporting exemption. Specifically, Congress added Section 6049(b)(5)(B)(iv) to the Code, which provides that interest on NRA deposits is excluded from the definition of reportable interest. There is little doubt that Congress intended the information reporting exemption to be coextensive with the substantive tax exemption and withholding exemption. These provisions operate together to accomplish Congress' clear policy objective of attracting NRA deposits to U.S. banks.

The 2011 Proposed Regulations would effectively repeal Congress' statutory directive that NRA deposit interest is to be exempt from information reporting. Although Congress provided Treasury with authority to regulate this exemption, there is no statutory indication or legislative history to suggest that Congress intended for the Secretary to use its regulatory authority to completely overrule and administratively repeal the directive that interest on NRA deposits be generally exempt from information reporting. To the contrary, the reasonable interpretation of the statutory delegation of regulatory authority in Section 6049(b)(2) of the Code to limit the exemption is that Treasury may place reasonable conditions on the exemption to ensure that only qualified persons (i.e., actual NRAs) benefit from the exemption. The current regulations generally adhere to this interpretation of the exemption while, by comparison, the 2011 Proposed Regulations would effectively repeal the exemption in its entirety—to a greater extent than the 2002 Proposed Regulations, which at least only would do so with respect

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<sup>8</sup> S. Rep. No. 93-1357 at 24 (1975); *see also* S. Rep. No. 91- 552 at 170 (1969) (same).

<sup>9</sup> *See* Code sections 6049(b)(2)(D) and (b)(5)(B)(i) (1985).

to designated countries. Given Congress' clear policy of encouraging NRA deposits through exemptions from U.S. tax, withholding, and information reporting—as well as the statutory language—legislation would be the more appropriate vehicle for Treasury's proposed repeal of the statutory exemption from information reporting.

E. Procedural Concerns Raised By the 2011 Proposed Regulations

Under the Congressional Review Act (Subtitle E of the Small Business Regulatory Enforcement Fairness Act of 1996), “major rules” such as the 2011 Proposed Regulations must be filed with Congress along with a report discussing, among other things, a cost-benefit analysis of the rule. Similarly, Executive Order 12866 defines “significant regulatory action” as “any regulatory action that is likely to result in a rule that may . . . adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, . . . or State [or] local governments or communities.” The 2011 Proposed Regulations would have a significant adverse effect on the ability of U.S. banks to compete internationally for NRA deposits, resulting in sizeable withdrawals of NRA deposits from banks in Florida and elsewhere. This loss of deposits would “adversely affect in a material way” productivity, competition, jobs, and Florida local economy in particular. This type of regulation is exactly the sort that the Congressional Review Act and the Executive Order sought to subject to closer study, and we urge the Treasury Department to examine the potential ramifications more carefully and submit the required report for major rules for Congress' review. At a minimum, the 2011 Proposed Regulations are inconsistent with President Obama's recent directive to executive agencies and departments to design cost-effective regulations that are compatible with economic growth, job creation, and competitiveness.<sup>10</sup>

F. The Paperwork Reduction Act

The Preamble to the 2011 Proposed Regulations invites comments to the Office of Management and Budget (with a copy to the IRS) regarding, in general, the collection of information that would be required under the 2011 Proposed Regulations. In a letter dated March 3, 2011, FIBA submitted written comments to the Office of Management and Budget (OMB) responding to three specific questions regarding the collection of information. Some of the comments are reflected in the discussion above regarding Policy Considerations (Part D). The following are the comments that relate to the estimated burden associated with the information collection process (estimated to be 15 minutes per respondent) and the estimates of start-up costs.

**1. The accuracy of the estimated burden associated with the proposed collection of information.**

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<sup>10</sup> Exec. Order No. 13563, 76 Fed. Reg. 3821 (Jan. 18, 2011).

The Preamble to the 2011 Proposed Regulation estimates that: (i) the estimated total annual reporting burden is 500 hours, (ii) the estimated annual burden per respondent is 15 minutes, and (iii) the estimated number of respondents is 2,000.

FIBA has surveyed its members – large and small financial institutions – in an effort to quantify the estimated burden that would result from the 2011 Proposed Regulation. The preliminary (though incomplete) responses suggest that the above estimates woefully understates the estimated burden associated with the 2011 Proposed Regulation.

A limited sample of Florida financial institutions, with the number of NRA depositors ranging from 1,000 customers to 12,000 customers which will need to be reported annually, determined that the average time necessary to comply with the reporting burden varies from 2.5 to 4 hours per depositor per year. Assuming 3 hours per depositor per year, the smaller size institutions could expect to spend 3,000 hours in compliance time; the larger size institutions could expect to spend 36,000 hours in compliance time. Obviously, the 15-minute estimate reflects a fundamental misunderstanding of the effort that would be necessary to comply with the reporting requirements. Developing and implementing the required information reporting systems will require large investments in time, resources, and training of bank employees. Banks would have to pull their Form W-8BEN for each NRA depositor to obtain the information necessary to complete the Forms 1042-S and determine the depositor to whom the Forms 1042-S should be sent. Even after the new system is established, banks would face significant ongoing compliance costs from monitoring and updating the system and preparing and mailing the Forms 1042-S. Many FIBA member banks are small community banks for which the additional compliance burdens of the proposed regulations would be material.

**2. Estimates of capital or start-up costs and costs of operation, maintenance and purchase of service to provide.**

Related to the estimated reporting burden are the operational costs that will be necessary to operate, maintain, and update the information reporting system. Financial institutions will have to purchase software to produce Forms 1042-S and train their employees to use the software. As one example, a small Florida financial institution has advised FIBA that it will have to spend approximately \$80,000 to purchase the necessary software to ensure compliance with the 2011 Proposed Regulations.

G. Conclusion

FIBA strongly objects to the 2011 Proposed Regulations and urges that they be withdrawn. The proposed rules would have a dramatic adverse impact on NRA deposits in Florida and other U.S. international banking centers, while actually strengthening the competitive advantage enjoyed by banks located in tax haven jurisdictions. The 2011

Proposed Regulations also would impose a significant additional compliance burden on U.S. banks.

Congress has directed that interest on NRA deposits be exempt from information reporting. The 2011 Proposed Regulations would effectively repeal the information reporting exemption. Thus, Treasury's proposal for a wholesale repeal should be addressed through the legislative process, not through administrative fiat. Finally, the adverse economic impact and compliance burden of the 2011 Proposed Regulations: (i) supports further review under Executive Order 12866 and presentation to Congress under the Congressional Review Act, (ii) is inconsistent with President Obama's recent instructions to federal agencies and departments to avoid burdensome regulations that are detrimental to the U.S. economy, and (iii) fails to adhere to the standards established by the Paperwork Reduction Act as the information is not necessary for the proper performance of the functions of the IRS, and the added reporting burden on filers far exceeds any benefit that the IRS would derive from such information.

Sincerely,

A handwritten signature in black ink, appearing to read "Patricia Roth". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Patricia Roth  
Executive Director