

**Marco Rubio
United States Senator**

Hearing on Proposed Regulations to Require Reporting of Nonresident Alien Deposit Interest Income

**Written Testimony Before the House Financial Services Subcommittee on Financial Institutions and
Consumer Credit**

U.S. House of Representatives

Washington, D.C.

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Chairwoman Capito, Ranking Member Maloney, and Members of the Subcommittee:

Thank you for the opportunity to submit testimony on REG-146097-09, a proposed mandate from the Internal Revenue Service (IRS) which would require U.S. banks to report to the IRS the amount of deposit interest earned by nonresident aliens (NRA). Foreign deposits play an immensely important role in Florida's economy, and I am deeply concerned that the IRS's proposal will cause these deposits to flee to other nations at a time when unemployment remains high and our financial sector continues to struggle. I urge the IRS to permanently withdraw this ill-advised mandate and to work toward maintaining a pro-growth, pro-investment economic climate.

There is not one member of Congress who does not hear from his or her constituents about the state of the economy and the lack of jobs. Unemployment remains above nine percent nationally and above ten percent in Florida. In fact, 45 percent of the unemployed have been without a job for at least six months. Florida's housing market continues to struggle, and businesses across the country are finding it increasingly difficult to access capital and expand operations.

Fortunately, there is no shortage of steps that Congress can take in a bipartisan manner to help grow the economy. Pro-growth tax reform that broadens the tax base and lowers rates for individuals, families, and businesses will provide a major boost to the economy. Regulatory reform that reduces the burden of red tape on businesses will allow job creators to focus their resources on expanding their businesses instead of on complying with government mandates.

Congress must also push back against policies that will have a negative impact on the economy. That is why I am adamantly opposed to REG-146097-09, a proposed mandate from the IRS related to reporting of the interest earned on foreign deposits. This rule will cause a massive capital flight with no benefit to job creation, and I commend Chairwoman Capito and members of the Subcommittee for convening a hearing to examine this important issue.

Foreign Deposits are a Vital Part of Florida's Economy

For 90 years, the United States has encouraged foreign investment in our economy by exempting interest earned by nonresident aliens (NRA) within our borders from taxation and reporting requirements.ⁱ As a result of this pro-growth approach towards foreign investment, the Department of Commerce estimates that foreigners have over \$3.7 trillion invested with U.S. banks and securities brokers.ⁱⁱ These investments spur lending to small businesses, help finance mortgages, and play a vital role in the general health of local communities in Florida. Florida-regulated institutions hold an estimated \$14.2 billion in NRA deposits, and many financial institutions rely heavily on foreign deposits to make up their capital base. For example, eleven out of sixteen banks in South Florida surveyed by the Florida Office of Financial Regulation (OFR) hold reserves comprised of over 30 percent of foreign deposits.ⁱⁱⁱ Fourteen foreign institutions surveyed by the Florida OFR hold foreign deposits that make up over 90 percent of total reserves. Some have estimated that Florida holds up to \$80 billion in NRA deposits in Federal Deposit Insurance Corporation-insured accounts.^{iv}

Treasury Did Not Implement 2001 and 2002 Proposals After Widespread Bipartisan Opposition

In 2001 and 2002, the Internal Revenue Service released two separate proposals that would have expanded reporting of deposit interest income earned by nonresident aliens inside the United States to all countries, and 16 countries, respectively. Specifically, the rules would have included expanded reporting through IRS Form 1042-S.^v As the burden associated with the rules became clear, opposition from members of both parties, public policy groups, and even agencies within the Bush Administration dramatically increased.

For example, in 2002, the Small Business Administration Office of Advocacy noted that the 2002 rule (REG-133254-02) would impose a “significant burden” on small entities, and warned that the rule would “create a barrier to small financial institutions’ ability to compete.”^{vi} A 2004 study from the Mercatus Center at George Mason University found the 2002 proposed rule would have resulted in a capital flight of more than \$87 billion.^{vii} Stephen Entin, President of the Institute for Research on the Economics of Taxation (IRET), also noted that a capital flight induced from the 2002 rule would have led to a reduction in Gross Domestic Product, wages, employment levels, and tax collections due to lower economic growth.^{viii} Even Donald E. Powell, Chairman of the Federal Deposit Insurance Corporation, warned in a 2003 letter that “A shift of even a modest portion of these funds out of the U.S. banking system would certainly be termed a significant economic impact” and that a capital flight “would be of great concern to me and to many financial institutions -- particularly smaller institutions whose survival is dependent on stable sources of deposits.”^{ix}

Public policy groups including the United States Chamber of Commerce, the American Bankers Association, and the Coalition for Tax Competition, consisting of 30 free-market organizations, strongly opposed the rules. Ultimately, the 2002 rule was not implemented, and to date, only the 1996 reporting regulation requiring interest reporting to Canada remains in effect.

REG-146097-09 is More Burdensome Than Previously-Withdrawn Rules

Congress has on several occasions affirmed that NRA deposit interest shall be exempt from taxation and reporting mandates, and the IRS admits that REG-146097-09 is necessary in part to further “a growing global consensus regarding the importance of cooperative information exchange for tax purposes that has developed,” not to help institute a new tax regime. It is highly disappointing that the IRS is seeking to impose this far-reaching new mandate without the consent of Congress. The rule is particularly daunting given the weak state of Florida’s economy, which is struggling with an unemployment rate near eleven percent and a financial sector weakened by the 2008 recession. For these reasons, the entire Florida delegation in the House of Representatives recently sent a letter to President Obama asking that the proposal be withdrawn.^x I have personally requested that REG-146097-09 be abandoned on several occasions.

Unfortunately, the Administration has done the country a disservice by claiming the rule “will not have a significant economic impact on a substantial number of small entities,”^{xi} therefore shunning a cost-benefit analysis as required by Executive Order 12866. This position is a puzzling assertion given that various studies and comments (notably the 2002 Small Business Administration Office of Advocacy comments) have clearly illustrated the heavy burden that a similar proposal would have placed on small entities like independent and community banks.

Given that the IRS’s latest proposal would apply the new reporting requirements to foreign deposits from every country, not just sixteen as proposed by the 2002 rule, it is difficult to see how REG-146097-09 does not warrant a cost-benefit analysis to better understand the far-reaching costs that the rule would impose on the economy. For example, the American Bankers Association has noted the implementation burdens of establishing new systems to report NRA interest, the large amount of required 1042-S forms mandated by the rule, increased paperwork burdens for customers, and the interaction of the rule with other statutes such as the Foreign Account Tax Compliance Act (FATCA).^{xii} Concerns over the rule’s regulatory costs were recently echoed by House Ways and Means Committee Oversight Subcommittee Chairman Charles Boustany (R-LA), who requested that Treasury Secretary Timothy Geithner suspend REG-146097-09 rule and answer a variety of questions about the IRS’s rulemaking process, including the rule’s economic costs, in a letter dated September 27, 2011.^{xiii}

The Need to Halt REG-146097-09 and Maintain a Favorable Climate for Foreign Investment

I believe that expanded reporting requirements for NRA interest, as embodied by REG-146097-09, must be stopped in their entirety to protect Florida's economy from ill-advised mandates that place the interests of international tax collectors over the interests of my constituents and over our nation's economic health.

For these reasons, I have introduced S.1506 with Senators John Cornyn (TX) and Kay Bailey Hutchison (TX). This bipartisan legislation would stop the IRS from moving ahead with expanded reporting mandates for NRA deposit interest. As of today, the legislation has 17 co-sponsors, including various members of the Senate Finance and Banking Committees. Congressmen Bill Posey (FL) and Gregory Meeks (NY) have introduced identical legislation in the House of Representatives, H.R. 2568.

These measures have been endorsed by a variety of stakeholders, including: the American Bankers Association, the California Bankers Association, the Credit Union National Association, the Center for Freedom & Prosperity, the Conference of State Bank Supervisors, the Florida International Bankers Association, the Florida Bankers Association, the Financial Services Roundtable, the Independent Community Bankers Association, the National Association of Federal Credit Unions, the National Taxpayers Union, the Small Business & Entrepreneurship Council, and the United States Chamber of Commerce. I will continue working with my colleagues in Congress to shed light on the negative consequences of REG-146097-09.

Conclusion

REG-146097-09 is an unnecessary mandate that would overturn decades of well-established tax policy and impose a disproportionate burden on Florida at a time when our economy is struggling. Previous proposals released in 2001 and 2002 were never implemented because a sweeping coalition of members of Congress and stakeholders expressed their strong concerns that increased NRA reporting would hurt the economy and is not necessary to enforce U.S. tax law.

I urge the Administration to permanently withdraw REG-146097-09 and immediately send a signal to international investors that the United States remains open for business. I thank the Subcommittee for its interest in this important issue and for the opportunity to submit testimony.

Citations for Senator Marco Rubio - Written Testimony Before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit

- ⁱ Mitchell, Daniel J. *Who Writes the Law: Congress on the IRS?* (February 15, 2003). <http://freedomandprosperity.org/2003/publications/who-writes-the-law-congress-or-the-irs/>
- ⁱⁱ Bureau of Economic Analysis, U.S. Department of Commerce. *U.S. Net International Investment Position at Yearend 2010*. (June 28, 2011). <http://www.bea.gov/newsreleases/international/intinv/2011/pdf/intinv10.pdf>.
- ⁱⁱⁱ Cardwell, J. Thomas, Commissioner. *Florida Office of Financial Regulation Re: Supplemental Material, Notice of Proposed Rulemaking 146097-09*. (May 9, 2011).
- ^{iv} Sanchez, Alex. *A Wrong Time to Drive Foreign Deposits Away*. American Banker. (September 1, 2011). http://www.americanbanker.com/magazine/121_9/a-wrong-time-to-drive-foreign-deposits-away-1041371-1.html?zkPrintable=true
- ^v Internal Revenue Service. *Notice of proposed rulemaking: Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens*. (August 2, 2002). <http://www.irs.gov/pub/irs-regs/13325402.pdf>.
- ^{vi} Small Business Administration Office of Advocacy. *Letter Re: Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens*. (November 14, 2002). http://archive.sba.gov/advo/laws/comments/irs02_1114.html.
- ^{vii} Cochran, III, Jay. *An Economic Analysis of the Proposed IRS Rule Governing the Reporting of Deposit Interest Paid to Nonresident Aliens*. (March 9, 2004). <http://mercatus.org/sites/default/files/publication/Deposit%20Interest.pdf>.
- ^{viii} Institute for Research on the Economics of Taxation. *Congressional Advisory: Proposed IRS Regulation a Threat to Foreign Investment, U.S. Banks, the Dollar, and the Economy*. (November 12, 2002). <http://iret.org/pub/ADVS-142.PDF>.
- ^{ix} Powell, Donald. *Letter to the Honorable Kenneth W. Dam, Deputy Secretary, Department of Treasury*. (January 2, 2003). <http://archive.freedomandprosperity.org/fdic.pdf>.
- ^x Florida House of Representatives Delegation. *Letter to President Obama*. (March 2, 2011). <http://posey.house.gov/UploadedFiles/IRS-DelegationLetter-March3-2011.pdf>
- ^{xi} Internal Revenue Service. *Notice of Proposed Rulemaking; Notice of Public Hearing; and Withdrawal of Previously Proposed Rulemaking Guidance on Reporting Interest Paid to Nonresident Aliens*. (February 22, 2011). http://www.irs.gov/irb/2011-08_IRB/ar13.html
- ^{xii} American Bankers Association. *Re: IRS Proposed Regulations on Reporting Interest Paid to Nonresident Alien Individuals*. (April 7, 2011). <http://www.aba.com/aba/documents/news/NRaliens4811.pdf>.
- ^{xiii} Congressman Charles Boustany (R-LA). *Letter to the Honorable Timothy Geithner*. (September 27, 2011). http://waysandmeans.house.gov/UploadedFiles/Letter_on_NRA_taxation_final.pdf