

Center for Freedom and Prosperity Foundation

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51 Months is Enough: Coalition Urges Immediate Withdrawal of Proposed Clinton-Era IRS Regulation

Washington, DC (March 21, 2005) -- The **Center for Freedom and Prosperity Foundation**, joined by more than 40 of the country's largest and most influential free-market groups, urged Treasury Secretary John Snow to "**permanently withdraw a proposed Internal Revenue Service (IRS) regulation (Reg 133254-02)** that would force U.S. banks to report deposit interest paid to nonresident aliens."

In the **letter sent to the Treasury Secretary**, the members of the **Coalition for Tax Competition** stated, "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. ...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." [Full text of letter below with web link included.]

"Since January 2001, this proposed regulation has undermined U.S. banks as they compete for global capital," said **Andrew Quinlan, President of the Center for Freedom and Prosperity Foundation**. "In the last 51 months, not one Member of Congress has endorsed the proposed rule. In fact, 18 Senators and more than 90 House Members have asked for its withdrawal," added Quinlan.

Daniel Mitchell of the Heritage Foundation said, "This regulation should have been withdrawn more than four years ago. In a gross abuse of the rule-making process, the IRS is trying to use a regulation to overturn 84 years of well-established law." Mitchell also noted that, "The proposed rule would drive capital to London, Zurich, Hong Kong, and other financial centers that would welcome an infusion of job-creating capital."

The four-page Coalition letter lists numerous concerns with the proposed regulation: The IRS is abusing its regulatory authority, the proposed regulation flouts existing law, the rule promotes indiscriminate information sharing which threatens civil liberties and privacy rights, capital and foreign investment will flee the U.S. economy, the regulation will make U.S. banks less competitive, banks will face a heavy paperwork burden, the proposed regulation is bad tax policy, the IRS failed to perform legally required cost/benefit analysis and the proposed regulation will undermine fiscal competition.

Fellow Coalition for Tax Competition members added the following:

Veronique de Rugy of the American Enterprise Institute: "Recent personnel changes at Treasury create a much-needed opportunity for the Treasury Secretary to reassert his control of the Department and ensure that decisions are made that uphold the law and defend U.S. national interests."

Grover Norquist, President of Americans for Tax Reform: "This Clinton era interest reporting requirement runs counter to the progress the taxpayer movement has achieved over the past four year. Each of the past four tax cuts have moved the country closer to taxing income one time inside America's borders. Yet, this regulation moves the nation in the opposite direction by letting foreign governments' double-tax income that is earned in America. Clearly, this regulation needs to be withdrawn immediately."

Paul Gessing, Director of Government Affairs for the National Taxpayers Union: "International tax competition is the single most important check on governments and international bureaucracies like the UN in their never-ending efforts to raise taxes and increase control over people and capital as they participate in the global economy. The proposed IRS regulation will drive \$87 billion out of U.S. banks, thus harming America's economy and its worldwide competitiveness on taxes."

Representatives of the following organization signed the Coalition letter:

60 Plus Association, Alliance for Worker Freedom, American Conservative Union, American Enterprise Institute, American Legislative Exchange Council, American Shareholders Association, Americans for Prosperity Foundation, Americans for Tax Reform, Arkansas Taxpayers' Rights Committee, Capital Research Center, Center for Freedom and Prosperity Foundation, Citizen Outreach, Club for Growth, Competitive Enterprise Institute, Council for Citizens Against Government Waste, Discovery Institute, Free Congress Foundation, The Free Enterprise Fund, FreedomWorks, Frontiers of Freedom, The Heritage Foundation, Idahoans for Tax Reform, Independent Women's Forum, Institute for Policy Innovation, Institute for Research on the Economics of Taxation, Maryland Taxpayers Association, National Center for Policy Analysis, National Retail Sales Tax Alliance, National Tax Limitation Committee, National Taxpayers Union, Ohio Taxpayers Association, Oregon Taxpayers Union, Pacific Research Institute, The Performance Institute, Public Interest Institute, Small Business and Entrepreneurship Council, The Sovereign Society, Taxpayers for Accountable Government (Loudoun County), Taxpayers League of Minnesota and Tennessee Tax Revolt.

More than 160 lawmakers and organizations have denounced the proposed regulation, including Senators (18), Congressmen (93) and public policy and industry groups (50).

[www.freedomandprosperity.org/against-irsreg.pdf].

Link to the full text of the Coalition for Tax Competition Letter:

<http://www.freedomandprosperity.org/ltr/ctc-2005-03-11/ctc-2005-03-11.shtml>

PDF Version of Coalition Letter:

<http://www.freedomandprosperity.org/ltr/ctc-2005-03-11/ctc-2005-03-11.pdf>

For more information on the regulation go to the CF&P's dedicated web page:

<http://www.freedomandprosperity.org/update/irsreg/irsreg.shtml>

Complete list of opposition to IRS Regulation:

<http://www.freedomandprosperity.org/against-irsreg.pdf>

Text of Letter and List of Signers...

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,

Andrew F. Quinlan -- President, Center for Freedom and Prosperity Foundation
Daniel J. Mitchell -- Senior Fellow, The Heritage Foundation
Veronique de Rugy -- Research Fellow, American Enterprise Institute
Grover Norquist -- President, Americans for Tax Reform
Sonia Arrison -- Director, Technology Studies, Pacific Research Institute
David R. Burton -- Partner, The Argus Group
Daniel Clifton -- Executive Director, American Shareholders Association
Carl D. DeMaio -- President, The Performance Institute
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Fred L. Smith -- President, Competitive Enterprise Institute
Oscar Stilley -- President, Arkansas Taxpayers' Rights Committee
David Strom -- President, Taxpayers League of Minnesota
Pat Toomey -- President, Club for Growth
Lewis K. Uhler -- President, National Tax Limitation Committee
Jim Vogt -- President, Taxpayers for Accountable Government (Loudoun County, VA)
Paul M. Weyrich -- Chairman and CEO, Free Congress Foundation
Neal C. White -- President, National Retail Sales Tax Alliance

* Organizational affiliations are included for identification purposes only