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United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510–6250

April 12, 2011

VIA EMAIL (Notice.Comments@irscounsel.treas.gov)

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

RE: Reporting Bank Deposit Interest Paid to Nonresident Aliens
(REG-146097-09)

Dear Commissioner Shulman:

The purpose of this letter is to express support for the proposed rule to require U.S. banks and broker-dealers to report to the Internal Revenue Service (IRS) any deposit interest income paid on a U.S. account opened in the name of a non-U.S. individual residing in a foreign country. Financial firms operating in the United States already disclose account information to the IRS for all accounts held by U.S. and Canadian residents; the proposed rule would extend the same disclosure requirements to accounts held by individuals residing in other countries as well.[1]

The proposed new disclosure requirement would not only bring parity to how U.S. and non-U.S. resident accounts are disclosed to the IRS, but would also strengthen U.S. tax enforcement efforts in three ways. First, by enabling the United States to provide account information to other countries, the proposed rule would strengthen the ability of the United States to offer cooperative, reciprocal tax information exchange arrangements that would benefit IRS tax enforcement efforts. Second, the expanded disclosure requirements would help detect U.S. taxpayers who are evading U.S. taxes by opening U.S. accounts and fraudulently claiming foreign status. Third, establishing a mechanism to enable the United States to disclose account information to other countries would reaffirm U.S. opposition to international tax evasion, make it clear our country is willing to do its part to stop it, and give moral force to U.S. efforts to convince other countries to share information about U.S. taxpayers with the IRS.

The proposed rule should be further strengthened by making it clear that, if a financial institution knows an individual is the beneficial owner of an account opened in the name of an offshore shell corporation, trust or other entity, it must treat that account as subject to the new disclosure requirement. Without this clarification, the rule could be easily circumvented by individuals who open their accounts in the name of an offshore shell entity.

[1] REG-133254-02, 67 FR 50386.

Going Offshore to Evade Taxes. Tax evasion today often involves the crossing of international boundaries, with U.S. taxpayers using foreign shell companies, offshore financial accounts, and tax havens to hide assets and evade detection. Over the past decade, the U.S. Permanent Subcommittee on Investigations, which I chair, has conducted multiple investigations exposing ways in which U.S. taxpayers use offshore mechanisms to hide taxable income and evade their U.S. tax obligations. In 2003 and 2005, for example, the Subcommittee released reports and held hearings showing how leading accounting firms, such as KPMG, designed, marketed, and implemented abusive tax shelters which, in some instances, made use of offshore financial accounts and transactions to help U.S. taxpayers dodge their tax obligations.[2] In 2006, the Subcommittee presented six case studies showing how financial professionals, including bankers, lawyers, accountants, investment advisors, and others, helped U.S. taxpayers use tax havens to escape U.S. taxes.[3] In 2008, the Subcommittee exposed how some financial institutions helped non-U.S. persons avoid payment of U.S. taxes on U.S. stock dividends by conducting transactions and moving funds through foreign jurisdictions.[4] In 2008 and 2009, the Subcommittee showed how two tax haven banks, UBS AG in Switzerland and LGT Bank in Liechtenstein, assisted tens of thousands of U.S. clients to open hidden foreign accounts that were not disclosed to the IRS.[5] In a recent IRS voluntary tax amnesty program which allowed taxpayers to disclose previously hidden foreign accounts to the IRS with minimal tax penalties, over 15,000 U.S. taxpayers came forward. The Subcommittee has estimated that offshore tax abuse is costing the U.S. Treasury $100 billion in lost revenues each year.

Strengthening Tax Information Exchange. To combat offshore tax abuses by U.S. taxpayers, IRS officials often must obtain information from one or more foreign governments, including information regarding foreign accounts opened by U.S. taxpayers. For years, the United States has been a leading proponent of tax information sharing arrangements that enable the IRS to obtain this information. Its efforts have included developing model tax information exchange agreements,[6] working with multilateral organizations such as the Organization of Economic Cooperation and Development (OECD), the Joint International Tax Shelter Information Centre, and United Nations to address tax evasion issues, and developing the Qualified Intermediary Program to encourage foreign financial institutions to disclose to the IRS U.S. source income in accounts held by U.S. persons and withhold taxes on that income as required by U.S. tax law.[7] The United States has also constructed a network of international agreements, including tax treaties, international tax information exchange agreements (TIEAs),

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[2] "U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals," S.Hrg. 108-473 Nov. 18 and 20, 2003); "The Role of Professional Firms in the U.S. Tax Shelter Industry," S.Rept. 109-54 (April 13, 2005).

[3] "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S.Hrg. 109-797 (Aug. 1, 2006).

[4] "Dividend Tax Abuse: How Offshore Entities Dodge Taxes on U.S. Stock Dividends," S.Hrg. 110-778 (Sept. 11, 2008).

[5] "Tax Haven Banks and U.S. Tax Compliance," S.Hrg. 110-614 (July 17 and 25, 2008); "Tax Haven Banks and U.S. Tax Compliance: Obtaining the Names of U.S. Clients with Swiss Accounts," S.Hrg. 111-30 (March 4, 2009).

[6] See Article 26 of the U.S. Model Income Tax Convention, available on the IRS website at www.irs.gov.

[7] For more information about the Qualified Intermediary Program, see 26 U.S.C. §§1441-43; Treas. Reg. §1.1441-1(e)(5); Revenue Procedure 200-12, 2000-4 I.R.B. 387.

and Mutual Legal Assistance Treaties (MLATs), which include mechanisms for exchanging information related to tax enforcement.[8]

These international arrangements typically enable the IRS to request from the tax authority of another country specific information related to a specific taxpayer. Obtaining the requested information often takes considerable time and can be the subject of lengthy negotiations or even litigation. In addition to these arrangements which allow an information exchange upon request, the United States has established an automated information exchange with Canada, which enables the two countries to exchange information on a routine basis regarding accounts opened by their respective citizens. Other countries, such as members of the European Union (EU), have established more extensive automated tax information sharing agreements, such as the EU Savings Directive which enables more than two dozen countries to exchange information on a routine basis about accounts opened by their respective citizens.

In an effort to strengthen its ability to obtain account information on an automated basis, in 2010, Congress enacted the Foreign Account Tax Compliance Act ("FATCA").[9] FATCA essentially requires foreign financial institutions to disclose to the IRS on an ongoing basis information about any account opened by or for a U.S. person, or pay a 30% withholding tax on any U.S. investment income earned by that institution. While FATCA will strengthen the ability of the U.S. to obtain account information on a routine basis from foreign jurisdictions, it does not take effect for several years and is far from comprehensive. For example, not all foreign financial institutions have U.S. investment income, the effectiveness of the disclosure requirement will depend upon collection of the 30% withholding tax from noncompliant institutions, and some foreign governments may attempt to block their financial institutions from providing the requested account information.

The reality is that the United States will have to continue to rely on tax information exchange arrangements to reduce the billions of dollars in lost tax revenue per year due to offshore tax abuses. On a practical level, if the United States wants to foreign jurisdictions to cooperate with its information requests about account information, it must be able to provide similar information on a reciprocal basis. Currently, the United States has not established the procedures needed to be able to exchange information with other countries on accounts opened by their citizens. The proposed rule would establish those procedures.

Stopping Fraudulent Claims of Foreign Status. A second reason to support the proposed rule is that it would create a new mechanism to help detect U.S. taxpayers who are blocking disclosure of their U.S. accounts to the IRS by falsely claiming foreign status. The IRS believes that extending the disclosure requirement to additional accounts will make it more difficult for taxpayers to avoid the U.S. information reporting system.[10] Past Subcommittee investigations show that some U.S. taxpayers have been making those types of false claims and

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[8] For a list of the U.S. tax treaties and TIEAs now in effect, see the IRS website at www.irs.gov.
[9] The FATCA, enacted as part of the Hiring Incentives to Restore Employment Act of 2010, Pub. L. 11-147 (HIRE Act), was signed into law on March 10, 2010.
[10] 76 FR 1105 - 1108 (January 7, 2011).

using them to conceal U.S. accounts from the IRS. For example, two brothers from Texas, Sam and Charles Wyly, created a network of 58 offshore trusts and corporations over a period of 13 years, and directed those entities to open dozens of accounts at U.S. banks and broker-dealers.[11] The financial institutions that opened the accounts knew that Wyly family members were the beneficial owners of the millions of dollars and securities contained in those accounts, yet accepted W-8 forms declaring the accounts to be owned by foreign accountholders and treated them as exempt from the 1099 reports required to be filed with the IRS. For years, the IRS was unaware of the dozens of accounts and the assets held by the Wylys through accounts opened in the name of various offshore shell entities. If the proposed rule were adopted, when the IRS searched for accounts linked to particular individuals, it would have additional information to detect such hidden U.S. accounts.

Accounts Opened by Shell Entities. As currently drafted, the proposed rule requires disclosure of only those accounts that have been opened by nonresident alien individuals. One critical improvement to the proposed rule would be to make it clear how the new disclosure requirement is to be applied to accounts that are opened in the name of a non-U.S. shell corporation, trust, or other entity, but are beneficially owned by individuals. Under current anti-money laundering laws, U.S. banks and broker-dealers are already required to know their customers, including the beneficial owners behind shell entities. The proposed rule should make it clear that, if a financial institution knows that the beneficial owner of an account is a non-U.S. individual, the financial institution should disclose the account to the IRS, even if the account is nominally held in the name of a foreign entity.

Without that clarification, non-U.S. individuals could easily circumvent the new disclosure requirement simply by opening their U.S. accounts in the name of an offshore corporation, trust, or other entity. In fact, without the proposed clarification, the proposed rule may have the unintended consequence of creating a new incentive for foreign individuals to open their U.S. accounts through offshore shell entities, making it even more difficult for tax and law enforcement officials to identify accounts held by individuals. To avoid that unintended burden on tax and law enforcement authorities and to avoid circumvention of the proposed rule, the rule must make it clear that financial institutions cannot rely on W-8 declarations of foreign status filed by a foreign corporation, trust, or other entity if the financial institution knows or should have known, through its anti-money laundering due diligence or otherwise, that the true accountholders are individuals whose accounts are subject to disclosure to the IRS. This clarification would not only strengthen the effectiveness of the proposed rule, but would also help uncover U.S. taxpayers hiding behind foreign shell entities.

No New Burden. Some have expressed the concern that the proposed rule would impose a costly new administrative burden on U.S. financial institutions, but that is not the case since U.S. banks and brokers already have in place comprehensive automated systems to produce needed information to the IRS on any account. Right now, virtually all U.S. banks and broker-

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[11] For more information about the Wyly case history, see "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S.Hrg. 109-797 (Aug. 1, 2006) at 297.

dealers have automated systems to produce 1099 forms for U.S. accountholders and 1042-S forms for Canadian accountholders. Virtually no new infrastructure would be required to program those same systems to produce 1042-S forms for accounts opened by non-U.S. accountholders from other countries. U.S. banks and broker-dealers already collect information from every non-U.S. accountholder regarding their country of residence, since every non-U.S. accountholder is already required to complete a W-8 form declaring their non-U.S. status and the country in which they reside. U.S. financial institutions could easily use the existing W-8 information to produce 1042-S disclosures for the relevant accounts. Those systems are also already designed to produce a disclosure form with the needed account information, send a copy of the form to the IRS, and send another copy to the last known address of the accountholder.

No New Tax. Others have expressed the concern that the new disclosure requirements would lead to the taxation of funds in the accounts held by non-U.S. individuals. This fear is unfounded, however, since new taxes can be imposed only by statute, and not by regulation. Cooperative information exchanges pursuant to tax sharing arrangements would not in any way alter current U.S. law which exempts interest income in those accounts from federal taxation.

Misplaced Concern Regarding Misuse of Information. Still others have expressed the concern that the proposed rule would require the IRS to disclose financial information to corrupt governments that could misuse the information for malicious purposes, such as theft or extortion. This problem is not a new one, however; it has long applied to existing tax information exchange arrangements, which is why the IRS has developed extensive procedures and policies to prevent abuses.[12] Under current law, tax information can be disclosed to another government only if the foreign government has an information sharing arrangement with the United States and its tax authority makes an official written request for the information. Each such request is then reviewed by the IRS Deputy Commissioner (International) in the Large Business and International Division, who is responsible for determining, among other matters, whether the requested information will be used solely for tax enforcement purposes as required by U.S. tax information sharing arrangements or may instead be misused by the requesting government. Due to the extensive U.S. network of tax treaties, TIEAs, and MLATs, the IRS has years of experience determining the circumstances under which tax information can be safely released to a particular jurisdiction and clear legal authority to decline to provide information that may be misused. That same authority, as well as the underlying procedures, policies, and experience of the IRS, would be used to review requests for information collected under the proposed rule.

Misplaced Concern Regarding Capital Outflow. Finally, others have expressed the concern that, if the United States were to collect information on the accounts held by non-U.S. individuals, those accountholders would close their U.S. accounts, resulting in an outflow of foreign capital. That concern is misplaced for several reasons. First, there is no evidence that most foreign accountholders at U.S. financial institutions are tax evaders in their home

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[12] See, e.g., Internal Revenue Manual, Section 11.3.25, Disclosure to Foreign Countries Pursuant to Tax Treaties, available at *http://www.irs.gov/irm/part 11,irm_11-003-025.html.*

jurisdictions. Canadians, for example, continue to place substantial funds in U.S. accounts despite the longstanding tax information sharing arrangement between the United States and their government. Second, Federal Reserve data indicates that, of the $4 trillion in foreign deposits in U.S. banks, about three-quarters are in accounts held by foreign governments, official institutions, international and regional organizations, and foreign banks, all of which would be unaffected by the proposed rule.[13] Many of the remaining accounts are held by business corporations and other legal entities doing business in the United States, which would also be unaffected by the proposed rule. Third, the United States remains the world's safest haven for global capital and investment. There is virtually no evidence that new disclosure requirements would overcome the United States' other financial advantages and cause investors to cease making U.S. investments. Fourth, when similar information sharing arrangements were applied to accounts in EU countries, a feared outflow of funds did not materialize.

Finally, to the extent that non-U.S. persons are using U.S. accounts to hide assets from their governments, the United States should not facilitate their misconduct or serve as a safe haven for tax cheats. Tax evasion is a crime in this country, and tax cheats are an affront to the many honest citizens in the United States who pay their fair share. Tax evasion by foreign citizens is no better, and our laws should not make it easy for foreign citizens to use our financial institutions to dodge their tax obligations. If we have decided that a policy of disclosure is appropriate and necessary for our own citizens, it surely is equally appropriate for foreign citizens opening financial accounts in the United States.

Thank you for the opportunity to comment on the proposed rule.

Sincerely,

Carl Levin
Chairman
Permanent Subcommittee on Investigations

[13] Federal Reserve Board, Liabilities to Foreigners Reported by Banks in the United States, available at *http://www.federalreserve.gov/econresdata/releases/statbanksus/liabfor20110131.htm#fn11r.*