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PROCEEDINGS

(10:06 a.m.)

MS. HWA: We're going to go ahead and get started. Good morning. The first speaker this morning is Maria Vega from Florida International Bankers Association.

MS. VEGA: Good morning and thank you for the opportunity to testify today. My name is Maria Grisel Vega. I am here as a board member and treasurer of the Florida International Bankers Association, also known as FIBA, based out of Miami, Florida. FIBA is an organization of more than 70 financial institutions from 18 countries, which are domestic banks as well as branches, agencies, and representative offices of foreign banks licensed to operate in the United States. Foreign banks comply with U.S. regulatory requirements and are examined by federal and state regulators.

The primary market for FIBA members is Central and South America. FIBA aims to promote international banking and international trade financial based on established best practices and fully complying with U.S. regulatory requirements. On behalf of FIBA I am here to request that you reconsider the proposed NRA reporting regulation and that you request that the proposed regulation be withdrawn.

FIBA understands that the IRS is interested in assuring that all U.S. taxpayers are complying with U.S. tax laws and that they declare their foreign source earnings. FIBA fully supports these goals. We also appreciate the professionalism and the integrity of the IRS personnel regarding the collection and the safeguarding of confidential information. The proposed NRA regulation has little to do with the enforcement of U.S. tax laws. However, they will have a considerable negative effect on the U.S. financial institutions, ultimately impacting the U.S. and Florida market taxpayers. The proposed NRA regulation will result in a flight of capital out of the U.S. to other countries, leading to a weakening of bank liquidity levels, significantly diminishing lending capacity of U.S. banks, and the loss of many U.S. jobs. In addition, this regulation will result in new documentation and recordkeeping requirements and reporting requirements.

Let me start with the enforcement of U.S. tax laws. Contrary to what is stated in the preamble, the proposed NRA regulation has little to do with U.S. tax enforcement and is unlikely to improve the voluntary compliance of U.S. taxpayers. That is the objective of the FATCA legislation. Regarding the information on all NRA deposits will have a serious negative impact to Florida banks, with little to no added reciprocal value to the U.S. From this region. Of the 58 tax treaties currently in effect, only two are from Central and South America, namely, Mexico and Venezuela. It is unclear to FIBA whether the IRS has determined if these countries have met the necessary conditions for reciprocal exchange of information. Within our institutions, the accounting opening due diligence and documentation procedures ensure that U.S. account holders do not go undetected. FIBA members with U.S. regulatory requirements including -- but not limited to -- the Customer Identification Program or the CIP, U.S. Patriot Act -- including due diligence and enhanced due diligence requirements, compliance with IRS regulations to properly identify and complete the W-8, W-8IMY, W-8ECP or W-9 as may be required, and we verify physical and mailing addresses, passports, IDs, et cetera. We constantly update our customer information and confirm NRA status at least every 3 years. Depositors who do not complete the required W-8 form every 3 years or provide incomplete, inconsistent or improperly completed forms will be subject to U.S. Withholding requirements and reported to the IRS on the annual 1042 or 1042S forms.

What is definitely clear is that the NRA proposed regulation will result in a flight of capital from the U.S. Financial institutions to other jurisdictions. NRAs keep their deposits in the United States for safety, personal and political reasons. There are numerous examples of political and financial instability in South and Central American countries over the years and having their deposits in the U.S. is a means for our customers to hedge against these uncertainties. In numerous instances and in various countries our customer deposits in the region have been nationalized, subjected to exchange controls with little or no warning, involuntarily converted into other currencies at unreasonable exchange rates or even confiscated by their local governments. Our customers deposit their funds in the United States due to its long-standing stability, the respect for financial privacy and the confidence in the U.S. banking system. The fear that this information may be sent back to their home countries where the establishments that have not been so consistent over time will encourage many NRAs to take their capital to other stable jurisdictions that will protect their privacy and their security.

Latin American investors also maintain deposits in U.S. banks for personal safety reasons due to kidnapping and ransom that is epidemic in the region. As of 2006, five out of the 10 global kidnap or ransom hotspots are countries in Latin America, namely, Mexico, Brazil, Ecuador, Colombia and Venezuela. Ironically, U.S. tax treaties might be sharing depositor information with two of these countries. According to AIG's Crisis Management Division, there are over 20,000 reported kidnap or ransom incidents annually and 48 percent of them occur in Latin America. Many more cases go unreported. Living in the United States, we do not appreciate this risk, but to our customers this is a reality they live with and try to protect themselves against.

For our customers in the region where their personal safety is a concern, the mere collection of bank deposit information with only the possibility of it being shared with their home country will result in many of the NRAs to withdraw their liquid capital. Florida is a natural base for Central and Latin America countries. This is a very stable deposit base. The loss of this deposit base will weaken the financial stability of area banks and dramatically reduce liquidity levels. This will be detrimental to the safety and soundness of our institutions. Much of the NRA deposits are reinvested into the banking system and into Florida's economy through personal and corporate loans and trade financing vehicles. The loss of these stable deposits will restrict lending capacity and ultimately result in the loss of jobs. In Florida the unemployment rate in March 2001 was over 11 percent. Losing these deposits will result in even more jobs lost in Florida.

My final comment relates to the burdensome and duplicative recordkeeping obligations. The proposed regulation indicates that NRA reporting will represent an estimated burden of 15 minutes per respondent per year. This 15-minute estimate reflects a fundamental misunderstanding of bank verification processes and procedures. The reporting will require the purchase, setup, update and ongoing maintenance of software, annual repurchase of forms, collecting the data in addition to the information currently collected, validating that data and the amounts that are being reported are balanced and reconciled to the main systems, printing, stuffing, stamping and sending the information to our customers, electronically submitting the forms, storing and maintaining data for 5 years, plus additional audit and examiner reviews of the processes and the reports.

In conclusion, the NRA proposed regulation does little to enhance compliance with U.S. tax law but will result in the flight of capital to other jurisdictions, diminished bank liquidity, restricting bank lending capacity, loss of jobs and burdensome and duplicative recordkeeping requirements. For these reasons

FIBA believes that the NRA proposed regulation should be withdrawn. Thank you again for allowing me to testify on this very important issue to us.

MS. HWA: Next we will hear from Alejandro Sanchez with the Florida Bankers Association.

MR. SANCHEZ: Good morning. My name is Alex Sanchez, President and CEO of the Florida Bankers Association. Thank you for this opportunity for us to testify against the IRS proposal on the reporting of interest earned by nonresident aliens.

The Florida Bankers Association is 122 years old. We represent over 300 financial institutions in the State of Florida and we ask that this proposal be withdrawn by the IRS. We are joined by many in Congress. In my hand is a letter signed by Republicans and Democrats from our entire House delegation from Florida to the President dated March 2, 2011, asking him to withdraw this proposal. Our Senators have written to the President and to the Treasury Secretary and other members of Congress as well.

We are concerned with this proposal and its impact that it will have on our banks and obviously our economy. The withdrawal of capital at this very important time as our economy is trying to recover by this proposal will be fatal. It would be a very negative impact, and at a time when the President of United States himself in January at this State of the Union called for less rules and regulation, this department, the IRS, at that point in time approximately in January proposed this regulation that according to many could take out 100 billion plus in capital of our country, money as Grisel just pointed out earlier is lent by our banks to small businesses in the United States, the main creator of jobs in our country.

We appreciate the professionalism of the IRS and the Treasury officials we met with and we are very, very considerate for the time that you've given us. This proposal would not tax the nonresident aliens and our banks, as Grisel pointed out, do all the necessary paperwork and comply with all the rules and regulations to determine who is a nonresident alien. But since 1922 it's been the intent of Congress to encourage the flight of capital to the United States, which is why we have not taxed the interest earned by nonresident aliens. This rule in effect overrules the congressional intent by pouring cold water on that congressional intent to discourage the flight of capital to the United States.

The market for NRA deposits is very competitive and subtle differences in the regulatory regimes in the competing countries affect the flow of NRA deposits in and out of U.S. banks. Competitors from other countries will seek these funds as they did 11 years ago when this department first proposed this regulation. And I think for many of our banks in Florida -- and there are other states that have written in, but for our state, the fourth-largest state in the country, many of our banks -- especially in the southern part of our state where substantial NRA deposits are held, the percentages in some of our banks is up to 40 to 50 percent. That could cause a tremendous liquidity crisis, a crisis we want to further avoid in the banking industry through the Great Recession our country has suffered the last 3 years.

These deposits, let's not kid ourselves, will leave our country, as the George Mason University study from 2006 pointed out, and I'll refer to that more in detail in a few minutes. These NRA deposits are particularly valuable because they tend to be very stable and often are certificates of deposits that roll over upon maturity. This money has been generational and it's been in the United States for many, many years for reasons that we know and primarily there are two. People are concerned about kidnappings back home and they're concerned about the stability and the safety of their economies in their countries. Most of the NRA deposits in Florida banks tend to be from our friends in the southern part of our hemisphere, from South and Latin America. Unlike the freedom, democracy and stability that we enjoy in the United States, the folks are worried about kidnappings. They're worried about the IRS reporting to the equivalent department in their home countries and someone will squeal to the kidnappers that these folks have monies in the United States, substantial amount of monies. Unfortunately it's sad, but there are a lot of kidnappings and other types of crimes that occur down there due to the wealth that people have in possession.

My question to the IRS is have you done an impact on how these countries would protect the privacy to the level that we enjoy here in the United States? I think the answer to that question is no. I've asked the IRS that. Has the IRS done an impact on what it would mean to our economy especially when the President has outlined his main priority is the creation of jobs in our country? What impact would that have to the President's priority, a department that is under his administration? What impact would this have if this rule is implemented to the economy of our great nation?

In a recent study by George Mason University, in a scaled-back version of this rule which the university limited to 15 countries and obviously the rules proposed are written to the entire world, George Mason University estimated that $88 billion would leave American financial institutions. And according to the Commerce Department in the report, they estimated and the university cited that there is $3.2 trillion in U.S. banks and securities brokers. What would happen if we impose this rule? I think from what we saw 10 plus years ago, our competitors already had advertised back then, and I'm looking for those advertisements today, advertising to the nonresident aliens, you know what? The U.S. government is going to do this. Let's take your money and put it in our countries. That is a danger that's going to happen and we've got to be very sensitive to that. The two countries that we have treaties with, Venezuela and Mexico, we've got to be really serious about that. Are we going to exchange information with Hugo Chavez's IRS department? Are we going to exchange information with probably the number one kidnapping country in South America, Mexico? I think the answer to that is no. I think we wouldn't do that. And I certainly would ask the IRS to do a study on what that impact is.

I want to now change tone a little bit and refer to the letter that Assistant Secretary for Tax Policy Michael Mundaca wrote in response to the letters sent by members of Congress on this issue and I want to refer to certain responses that he gave. He said in his letter that there was no requirement that the information be exchanged with other governments. The problem is not that the exchange is mandatory. The problem is the fear of the depositor that it could be exchanged with the IRS in its discretion decides to do so. The IRS counsel told me in a meeting in February that it was our responsibility to tell our customers that this information would not be exchanged. From a practical perspective, that is impossible to do to millions of customers out there and millions of other potential customers. The fact that the IRS may do it at its discretion at whatever time that may happen would obviously be a disaster. The letter says that the information is not exchanged unless and until several conditions are met, including a review of the protections against the misuse of information. There is however no reference to what those conditions are in Mr. Mundaca's letter. What are the conditions? There is no disclosure of how or by whom the review is conducted at the IRS. There is no identification of any written rule, policy procedure about which decision will remain to exchange information. There is no way that the depositor could assess the risk that his or her information could be disclosed. The letter points out that the information can only be exchanged if there is a tax treaty or a tax information exchange agreement. This is of no comfort to the NRA depositor who has had his or here money for generations in the United States unless the treaty has protections built into it.

The letter does not mention what, if any, provisions are made regarding confidentiality or misuse of the information in any treaty. Also the IRS counsel told me that the IRS already has the authority to investigate someone and ask for information from a bank in the United States. The letter states that under existing law, if a foreign government requests bank information regarding deposits under a treaty, the IRS can request that information from banks and provide it to the foreign government. If this is the case, that begs the question why are we doing this? Why are we making this proposal?

MS. HWA: Mr. Sanchez, please conclude your remarks.

MR. SANCHEZ: Yes, ma'am. At the end of the day this will be very harmful to the United States economy, and as 11 years ago Canada was put in to exchange financial with Canada, but I will tell you that Canada is not Latin America or Central America. Canadian citizens to the best of my knowledge are not concerned with a government that does not follow its own rule of law. I respectfully thank you for the time allowed to me and I would ask you that this rule be withdrawn. Thank you very much.

MS. HWA: Thank you. Next we will hear from Thomas Cardwell with the State of Florida Office of Financial Regulation.

MR. CARDWELL: Thank you, lady and gentleman. I am Tom Cardwell and I am the Commissioner for Financial Regulation for the State of Florida and I'm here before you today as the public official who has the responsibility for the safety and soundness of the institutions that are chartered in our state.

This proposed rule causes me some serious safety and soundness concerns. The United States has long been, as we've heard, the recipient of substantial deposits from our foreign residents and this is because of the long connection that the state has with Central and South America historically and geographically. Many of these countries have a history of economic and political instability. There have been regimes that don't follow the rule of law, they're repressive, the government does not control law and order, bribery and corruption are common, individuals have been subjected as we've heard from kidnapping, paying ransom, extortion, disappearance, even murder. Local banking, frankly, is very risky. That's not to say that these conditions at all times and in all places, but the issue is that the possibility and the consciousness of the people who live down there, it's always down there. As a result, many of them have established U.S. bank accounts and it's a competitive advantage frankly the U.S. has over other banking systems.

Most of the deposits in Florida as I've talked to the bankers about are long-standing and they're stable. They are not associated with money laundering, they're not associated with other illegal activity. These are deposits by law-abiding individuals with personal funds and business assets and they put their money here to protect themselves from the economic and political issues that they face just as I'm sure each of us in this room would do if we were subjected to the same considerations.

In Florida you need to note that the effect of this rule is particularly concentrated because the institutions in our part of the state have cultivated relationships in that area. We have done a survey. There are 32 state-chartered banks and 22 foreign banks or banking corporations in the south Florida over which I have regulatory responsibility. We've gotten data from 16 of the state-chartered banks and 21 of the 22 foreign entities. They have about $14.2 billion in deposits in Florida-regulated institutions, and remember this is only a segment of it because it doesn't cover the deposits that are either in national banks, that are state-chartered institutions doing business there or in federally regulated foreign banks, so the $14.2 billion is I would suggest probably less than half of the total that's down there.

The survey shows that with respect to chartered commercial banks, 41 percent of their total deposits are the commercial banks are NRA deposits. That's 41 percent. With respect to the 21 foreign institutions we regulate, 90 percent of their total deposits are NRA deposits. I recognize that all NRA deposits are not subject to reporting requirements, that we have made a supplemental inquiry as to the breakdown between individual and nonindividual NRA accounts, and while the list is not complete, it shows that something in the neighborhood of about 26 percent of the NRA deposits in commercial banks are individual and about 31 percent in the foreign banks, but there's a lot more to the story than just those numbers.

Much of this NRA money is a set of interrelated accounts controlled by a single person so it's common for a person to have a personal account, to have what they call a PIC account in the business, they have private investment company accounts, to have a corporate account or to have family accounts. These are interrelated. What happens is if you lose the individual account, you lose the whole relationship. In addition to that, there's a large amount of money that these people have in brokerage accounts that are, I don't believe, covered by the reporting rule, but nevertheless money that's likely to be exported as these relationships move themselves abroad which they will do. What needs to be understood is that the unwillingness to have a reportable individual account often means a loss of the entire relationship.

Why do we believe the money is going to be run off? That's because customers of banks as they talk to me say that's what their customers tell them they're going to do. We believe it because the rationale behind the accounts is to protect the assets against political, criminal and economic predation. It's fear that's the issue. If there is a possibility that the account information will be made available, then to those who would take it, the depositor and their families and their business assets at risk, if your money is at risk, your incentive is to protect it and that's what they have said they will do and I believe they will.

Let me move on. The effects of the outflow, they are short-term and long-term. First is the liquidity crisis issue. As you all know, when a bank gets deposits, they are not kept as cash in the vault. They loan the money out. The usual ratio is about 85 percent of the deposits are loaned out at any given time, then they're put into loans and the loans are illiquid. So if you get a deposit runoff of about 15 percent, you can put an institution into jeopardy. Why? There is not enough money in the vault to pay as it comes out. What happens then as a regulator? I can tell you. The bank fails. It might otherwise be sound, but if can't pay the people when they ask for the money, it fails, the FDIC gets to take it over in the case of domestic banks and take the loss. A run on the banks is one of the regulators' greatest concerns. This rule causes me a genuine concern that this will happen.

Numbers. If a bank with only 30 percent NRA deposits lost only half those deposits, you'd have a bank at risk. A bank with 60 percent NRA deposits would only have to lose 25 percent to be at risk and we have a substantial number of institutions that fit that profile. We've provided you with that information in a supplemental letter. There is real liquidity risk. This does not make my sleep easily at night.

A runoff on NRA deposits also has long-term effects on safety and soundness. Banks earn money by loaning out at a higher interest rate than they pay for the deposits. The NRA deposits are generally low cost funding for the banks, much more so than others. If they have to be replaced, even if you could replace them, it would be at a higher level or cost. What does this mean? Number one, the bank can make fewer loans. Secondly, it's going to be more difficult for a bank to be more profitable because the interest margin spread is going to squeeze. What is the effect in Florida? I have personally closed 28 banks in Florida in the last 2 years. Last year, 66 percent of the banks that we regulated were unprofitable, 65 percent of them are under regulatory supervision as I stand here today. In other words, the banking system in Florida and particularly in south Florida is in a fragile state. It is extremely important that the banks be able to have this income to be able to work their way out of the problems that they are in. This rule is quite counterproductive to their being able to do that because good deposits are going to go away.

There is one other effect on safety and soundness I want to mention briefly and that is the cost of implementation. Grisel spoke to it earlier. The cost of implementation doesn't fall equally over the industry, it falls on individual banks and a lot of these small banks that I regulate don't have the systems in place to do this. It costs them a ton of money to try to comply with this rule and maybe Bank of American can do it, but the ones that I regulate, which are largely community banks, are not going to be able to do that.

Before my time runs out there is another very important point I want to make, which is the impact on Florida's economy of this rule. As I say, I regulate community banks. Community banks are the guys who go out and make lending to small businesses, which is really what we need -- with a lot of government initiatives to do that -- to get it started. The economic textbooks will tell you that for every dollar in deposits that you have, it generates $9 in lending so that the shrinking deposit base that this causes magnifies a loss of lending capacity. Let's say there is $14.2 billion in NRA deposits. A 20 percent shrinkage, which is on the low end, would reduce lending by about $25-1/2 billion. A 30 percent shrinkage would reduce lending by $38.3 billion. If as much as half run off, which is a real possibility, you'd reduce your lending capacity here by about $63.9 billion right at a time and a place, as was pointed out, unemployment is between 11 and 12 percent, 20.4 percent of residential mortgages in Florida are more than 90 days past due and 47 percent of all of them are underwater. We got problems down there and this rule, as it turns out to be focused is going to cause some real genuine damage in Florida and I see that as a regulator to these institutions.

If I am right and I hope I am not, but if I am the damage will be irreversible principally because the money once it flows out isn't going to come back. Once these things go out they aren't going to come back. So I think before we act on this we really need a clear vetting and understanding of what is in the real world actually going to happen to institutions and people if we put this in place.

MS. HWA: Mr. Cardwell, please.

MR. CARDWELL: You've hit me right at the conclusion. I understand the goal of international tax transparency and it is something that is very, very, very important. But this rule as it is drafted which is not a nuanced rule at all, which does not provide any guidance to the terms, conditions and bases on which information will be disclosed, how it's going to be shared is a problem. There is no transparency in this rule. Therefore a person who's sitting on the other side trying to analyze whether their information is really going to be given out has no way to know with any degree of assuredness when, whether and under what circumstances it will be given out. Therefore the fear alone is going to drive the economic determination. So at a minimum this rule could be hugely improved if we understood what it was, when it was, how it was, if a customer and a bank could understand what the risk is as this rule is applied. But to this date and I have personally inquired with some of the people in this agency, what are these terms and conditions that we could look at and as of yet I haven't gotten a clear answer.

Again I understand this is a difficult rule. Anything that's helpful to some person is often difficult to others. I appreciate your time in listening to us on this and me running over. Thank you.

MS. HWA: Thank you. Next we're going to go out of sequence a little bit, we are going to hear from Ryan Ellis with Americans for Tax Reform. He's not here. Sorry. We will not be hearing from him. In that case we will hear from Rebecca Wilkins with the Financial Accountability and Corporate Transparency Coalition.

MS. WILKINS: Good morning. I'm here to tell you the sky is not falling.

My name is Rebecca Wilkins. I'm Senior Counsel for Federal Tax Policy at Citizens for Tax Justice. I'm here today on behalf on the Financial Accountability and Corporate Transparency, the FACT Coalition, of which CTJ is a member. The FACT Coalition is a membership of grassroots financial policy, faith-based, labor, government accountability and small business organizations. And at a time when government budgets around the world are in crisis, there is a huge bleeding of revenues caused by bank secrecy. The financial system that facilitates corruption, tax evasion and money laundering makes it easy for criminals, terrorists, government officials, and even otherwise legitimate multinational corporations to hide their money and make it difficult for law-enforcement and tax officials to do their job.

The FACT Coalition believes that it's critical to debunk the myths and false claims of those who want to keep the status quo in the guise of permitting competition and protecting businesses. Our member organizations are very diverse and they support our goals for various reasons. Some are human-rights organizations, some are concerned with national security, others with job security or fiscal responsibility like Citizens for Tax Justice. But we are united in our belief that the status quo with the shadow banking systems, shell companies and widespread secrecy severely damages both the developed and the developing world.

We'd like to say that we commend the IRS's efforts in this area and we hope that this regulation is only the first step in a series of ongoing efforts to increase the quality and amount of information that the IRS collects about nonresidents that it can share with governments around the world. America should not be a tax haven for tax evaders. We do not believe that the United States should be a tax haven for citizens from other countries who wish to evade their tax obligations to the home country. The United States should not engage in practices that make it easier for citizens of other countries to avoid their obligations or to flout the law.

As the IRS's preamble to the regulation stated, the international community demands action. A lot has changed in the last decade since these regulations were first proposed. There is a growing global consensus that responsible governments must cooperate in exchanging tax information about their citizens, and recent agreements between governments have recognized that bank secrecy should no longer be grounds for refusing requests for information. This proposed rule will greatly improve the U.S. ability to respond to requests from other governments. We have a major stake in assisting those other governments. Not only is it the moral and ethical thing to do, but we need the cooperation of those other countries in protecting our own tax system. We cannot expect cooperation from them if we are not willing to give ours.

This is especially important in light of the recent Financial Account Tax Compliance Act, or FATCA, which requires foreign financial institutions and foreign branches of U.S. institutions to get information about its U.S. account holders. In order to encourage to share information with us, we must be willing to share information with them. These rules are an important step in that direction. In addition, we believe that this rule will help us catch U.S. tax cheats who pose as foreign depositors in the U.S. system. We know that this kind of third-party reporting is critical to our tax system. A 2007 report by the Government Accountability Office said that when income is subject to a high level of reporting like wages reported on a W-2, 98.9 percent of the income is correctly reported on the income tax returns of the recipients. But in cases where reporting is low like France, only 46 percent of income gets correctly reported on recipients' returns. We believe that U.S. taxpayers are evading their tax obligation on this type of interest income by using shell companies in a foreign name or a foreign entity.

The claims of dire economic consequences are completely unfounded. There is no foundation that billions of dollars of deposits will leave the U.S. if these rules take effect. It's estimated that foreigners have invested roughly $10 trillion in the U.S. economy. Only $4 trillion of that is in banks. Three-fourths of that is in the name of foreign governments, international and regional organizations, foreign banks and foreign government officials. Of the less than $1 trillion left, only the amounts held in the names of individuals are subject to this rule and I believe that only those people who are evading tax will move their money as a result of this regulation. And even the money that does leave the U.S. Because of this regulation will likely find its way back into the U.S. system in the deposits of the Cayman Island banks, which is the U.S. banking institutions' biggest foreign liability.

Other speakers have talked about the humanitarian grounds on which these regulations should be withdrawn. The proposed rules only give the IRS the ability to collect the information. They don't require the exchange. The exchange has to be pursuant to a request under a Tax Information Agreement. It has to be a very specific and carefully limited request about the evidence being sought. The request must only be for purposes of tax enforcement. The Treasury has the ability to strengthen those rules in cases where it have concerns about security of the nonresident alien. But let me point out that we don't know of a single case of an antigovernment protestor, an anticorruption campaigner, a trade union official, an investigative journalist or dissident of any kind who has been protected from oppression by virtue of having an offshore bank account. On the other hand, we can name any number of the oppressors, for example, Mubarak, Qaddafi, Pinochet, who have used secrecy jurisdictions extensively to preserve their power and wealth at the expense of millions of their victims. In any case, it is wholly inappropriate to combat unlawful activity in one country by encouraging unlawful conduct in another country. Problems in the resident country need to be dealt with locally, perhaps with international support. And let me assure you that the terrorists and the kidnappers and the ransomers and the drug dealers in those countries already know who the wealthy people are. They don't need the IRS to tell them. People who are wealthy are widely known and the fact that the IRS might report to their government the interest income they're earned in the U.S. won't change their security profile at all. In fact, if the elites in those countries were subject to the same rules and constraints are ordinary folks are, they would have an inordinate amount of influence on that developing country's government to get its house in order. They have the most power and they have the most influence. If they were subject to the same rules and regulations that the other citizens of that country were, they would exert an enormous amount of pressure for the government to clean up its act.

We are also concerned about the anti-money-laundering, the national security, the corruption and the terrorist financing concerns that these regulations will help address. The regulation will not overturn any congressional intent. It will not cause this interest income to be taxed. Congress has never made any statement regarding whether or not this should be reported. The mere collection of this information does not in any way impose tax upon it or conflict with any law enacted by Congress. We also do not believe that this regulation is overly burdensome. Banks already have to report this type of information on their U.S. and Canadian customers. It will only expand the universe of customers that they must report on.

In conclusion I'd like to say that those who oppose these regulations are those who are in favor of tax evasion. There is only one reason to oppose these regulations and that is to make it easy for people in other countries to avoid their obligation to their government. The stakes in tax evasion are very high and the forces in favor of maintaining the status quo are well financed and very politically connected. Corrupt American and international banks have a stake in maintaining tax cheating because they make money from handling those accounts. Corrupt politicians appreciate the political contributions. Wealthy Americans who use tax havens worry that if this regulation is passed and the U.S. cooperates with other countries, their tax cheating will also be discovered. But it's the money of honest taxpaying citizens of all countries that the tax cheats are stealing. Thank you.

MS. HWA: Next we'll hear from Francisca Mordi with the American Banker's Association.

MS. MORDI: Good morning. My name is Francisca Mordi and I'm vice president and senior tax counsel at the American Banker's Association. The ABA is pleased to have the opportunity to testify today regarding this very important issue. The AB represents banks of all sizes and charters and is the voice for the nation's 13 trillion banking industry and its 2 million employees. We understand the government's need to increase transparency and to eliminate cross-border tax evasion; however, we continue to believe that the proposed regulations are not advisable and would have a significant negative impact on U.S. banks. We therefore urge the IRS to withdraw the proposed regulations in order to avoid the risk of flight or flying capital at a time when such capital is very much needed.

The inability to maintain or attract foreign deposits that will result from the implementation of the rule will undermine the competitiveness of many U.S. banks and make it difficult for them to provide much needed services to their communities.

Let me address some of the comments that were included in the March letter that the Treasury sent to Honorable Mario Diaz-Balart. In the letter, the Treasury stated that the capital base of U.S. banks would not be significantly affected because the total deposit base held by nonresident aliens is a small fraction of the total U.S. Deposit base.

It should be noted that some community and regional bank members in certain states -- for instance, Florida -- as you have heard, have a disproportionately higher level of NRA depositors relative to the national figures. These banks stand to lose billions of dollars in foreign investments because their NRA customers would rather withdraw their funds, close their accounts -- which would include deposit accounts and all other kinds of account relationships they have with the banks -- rather than be subjected to U.S. bank disclosure of their U.S. deposit ownership to their home country.

The Treasury letter also notes that Canadian deposits in the U.S. did not decrease after the deposit interest payment reporting changes were finalized in 1996. And that is true, but we point out that Canadian residents do not share the same privacy and security concerns as some of the residents of emerging market counties currently do, so the risk of foreign flight of capital is greater under this proposed regulation than it was under the 1996 regulations.

While the Treasury letter indicates that some research has been conducted by the government on this issue, there's no indication that the IRS has conducted or taken into account any cost-benefit analysis with respect to the proposal. We strongly urge the IRS to conduct such an analysis and take into consideration the significant and overwhelming burdens that banks will have to deal with which we believe will be greater than any perceived benefit the government expects to obtain.

Further, the Treasury letter noted that the proposed regulations ensure that the United States is in a position to exchange information on bank deposit interest reciprocally when it is appropriate to do so and only with countries with which the U.S. has an information exchange relationship through a treaty or TIEA. In effect, banks will incur significant costs, undergo very complicated and burdensome system changes and procedures in order to implement a rule that provides information that may or may not be useful to the IRS. Banks would have to inform their NRA depositors that the interest income will be reported to the IRS and that the information may then be reported to their home country without any further explanation of how such information will be used.

There is no doubt that a lack of clear understanding or certainty about how the information may be used could cause some NRA individuals to doubt the benefits of holding deposits in U.S. banks.

There is absolutely no evidence that finalizing these proposed regulations will help the government catch U.S. taxpayers that represent themselves as residents of other countries in order to avoid U.S. tax.

We understand that the IRS has received comments in support of the proposed regulations and the presenter before me just basically also outlined reasons why the proposed regulations should be finalized and we have responded to some of the comments that support the proposed regulations. First, one comment states that the proposed rule will help the fraudulent claims of foreign status by providing additional information that would help the IRS detect U.S. accounts owned by individuals trying to hide such accounts. We should point out to the government that FACA has been enacted to address the issue of U.S. persons that establish foreign entities to invest in the U.S. As a matter of fact, the proposed regulations would not require reporting of the foreign entity-owned accounts as cited in the supporting comment letter received by the IRS and will not include U.S. persons owning those foreign entities or any foreign entity owners. Since FACA will address this issue in a way that the proposed regulations will not, we continue to recommend that the Service abandon the rule.

The second comment, 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, a financial institution shall disclose the account to the IRS, even if the account is nominally held in the name of a foreign entity.

Now, this assertion, in effect, would expand NRA reporting to foreign entity accounts established by foreign individuals and result in a variety of complex and substantial issues, so I won't even go into that comment. This comment is just asking for more, which we totally oppose because now we're going into duplicating what FACA is doing and we're having enough problems with FACA as it is.

Another comment says the proposed regulations do not create any new burdens. Now, we assert that this just reinforces our view that the government's perception continues to be that all banks have to do is flip a switch and everything is ready for compliance. The government should not simply ignore the fact that there are always substantial costs involved in complying with new laws. Many banks will need to engage in several burdensome steps in order to capture the required information for this purposed reporting. Please see our April 7th letter for an outline of some of the serious burdens that will be created by the proposed regulations.

And the last -- the final comment is that there has been some misplaced concern regarding capital outflow. There is no evidence that most foreign account holders at U.S. financial institutions are tax evaders in their home jurisdictions. We totally agree with this statement. In fact, we believe that this is the main reason why the proposed rule should be abandoned.

The proposed expansive reporting will require reporting on all NRA individuals when, in fact, most foreign account holders are not tax evaders. As we have noted several times, the benefit of expanded reporting will be small. Most foreign account holders are not tax evaders. While the costs to comply and potential risks, for instance, flight of capital, deposits due to security concerns and resulting impact on small U.S. community banks, will be huge. The government should not continue to use sledgehammers to kill flies at the expense of banks through unfunded mandates of reporting.

In conclusion, we would like to restate that the implementation burdens associated with these proposed regulations will be significant and costly for many banks. We have outlined some of those significant burdens in our letter and we hope that the IRS will take them seriously into consideration as it continues to make its determinations regarding these proposed regulations. Thank you.

MS. HWA: Next we'll hear from Daniel Mitchell with the CATO Institute.

SPEAKER: He's not here.

MS. HWA: He's not here. Thank you. Then we will move to Bradley Jansen with The 60 Plus Association.

MR. JANSEN: Thank you for having me. My name is Brad Jansen. I'm with the Center for Financial Privacy and Human Rights and here speaking on behalf of The 60 Plus Association.

The main points that I wanted to address are concerns about the abuse of information that's collected. There is no shortage of database abuse examples in the media. There is an expectation of privacy concern that I think is being misapplied here, and as a personal victim of identity fraud I also wanted to bring that up, that this is a growing concern. The more times that we share information, the more information that's shared, we exponentially increase that likelihood. This is already a huge problem for way too many Americans.

In addition, there are legitimate and considerable human rights implications on the exchange of this information with foreign governments and this is not just for tax evasion. Beyond that, there are regulatory burdens that are spoken for by others and there's a hugely disproportionate regulatory burden there that also disproportionally affects seniors and vulnerable people in our society, immigrants, racial and ethnic minorities, especially.

When this regulation was proposed, or a version of it, a decade ago, I spoke out against it then. You've got at the end of the testimony copies of my op-eds then. One of the examples that I used on the abuse of database information then was Theresa Hill, who was an FDIC employee, who was convicted of an identity fraud ring where she herself, using the information she got from working at the

FDIC and the information that was reported, to steal the identities of different people, run up credit card debt, and cause lots of other problems. She was convicted, spent time in jail. So the idea that this is a cost-free proposition -- so long as it's involving human beings, there's the risk there -- there's going to be great risk for identity fraud and human rights implications.

Much more recently we had the example of the Epsilon case where a great number of companies had their data exposed through this third party marketing, including Target, Kroger, U.S. Bank, JPMorgan Chase, Capital One, Citibank, Home Shopping Network, and the list goes on. Again, the more information that's shared, the greater the risk for abuse, and I don't think that the IRS has fully taken that into consideration. They did last time, which is why it was limited to just Canada, and I think that was a much better approach, but to do this on a global scale is just to invite global disaster.

The rules are promulgated under the idea of the premise of the Bank Secrecy Act Supreme Court decisions. The Bank Secrecy Act violated state constitution, common law privacy protections, and also, I believe, Fourth Amendment privacy protections as well under the (inaudible) Supreme Court case and others. The Court ruled that so long as the information has a high degree of usefulness for U.S. Government officials on law enforcement and regulatory issues, that it would be acceptable. I think that was the wrong decision, but even then, I think this is being misapplied here because there is no benefit to law enforcement here. So, the high degree of usefulness standard is not met by this proposed regulation since all reporting for U.S. law is already being done.

In addition, there's a widespread and growing understanding among the Congress and the public policy circles that we need to control abuses of information and be aware of new technologies that are coming up. In fact, just this week Senator Leahy introduced legislation to reform ECPA, the Electronic Communications Privacy Act, so this is a 10-year-old law; ECPA was done in '86.

The ease of which information is being shared and distributed and hacked, in many cases, needs to be more fully addressed. And I think that for the IRS to be at the forefront of this before Congress has a way of addressing these questions with ECPA reform is seriously putting the cart before the horse, and we need to wait and let Congress hold their hearings and hold their deliberations and address the ways in which we sell and share information, and the ways in which law enforcement regulatory agencies have that information. For the IRS to step in before Congress has a chance to address those issues, I think, is chutzpah beyond any recognition.

As I explained to the House Banking Committee in 2005, there were reports again of bank employees and state government agencies and regulators that were selling information to identity theft rings. That is still a legitimate concern and that is a source of terrorist financing and we know that from other hearings, I won't go into that now.

So, again, the more -- the looser the control of information, the greater the dangers that we've got -- including on human rights and terrorist financing. And, again, there are no shortage of examples in history despite what my predecessor said here at the podium of human rights abuses and civil liberties -- civil rights and civil liberties abuses from bank data.

My home state of Ohio tried to circumvent a law on protecting political speech by using bank records to come up with membership lists of the Socialist Workers Party, for example, and the Supreme Court ruled that that was an unconstitutional breach of their rights and violated their First Amendment freedom of association. It's also no secret that Stalin and Hitler and others used bank information and financial information for those. In fact, the first list of Jews that Hitler got was from getting the information from the insurance agent -- from the insurance companies.

So, information is collected for one purpose and then often used for other ones with very disastrous results. And whatever the honorable intentions of the IRS in collecting the information, you have to realize that when you share this more broadly, that that information is going to be used for other purposes and you cannot control how that's going to be used. And to the extent that we're sharing the -- potentially sharing the information with countries that do not respect human rights, civil liberties, and civil rights the way we do, you're opening up gross violations of those from an American perspective.

I go into more of those in other detail but I'm trying to go quickly here.

In addition, I wanted to explain how it affects seniors and vulnerable populations in the United States. Because of the disproportionate regulatory burden that's been spoken about by some of the other banking institutions here, the smaller institutions are more likely to be detrimentally affected. And in addition to that you're raising the barrier of entry for new entrants into the marketplaces, so that from the senior's perspective, they're more likely, through the course of their lives, to have accumulated great savings and put those into different banks. They put them into different banks because under the current FDIC rules, you're only protected up to a certain amount, so by putting it across multiple smaller institutions you can better protect your savings for your retirement.

We know now Social Security and other things aren't going to be there protecting (inaudible) are. We need not go attacking seniors' private savings accounts, and this is the net effect of what this regulation could do by harming the community banks that the seniors rely on and the necessary requirement they rely on, multiple institutions with the FDIC regulations.

In addition to seniors relying on community banks, credit unions, and smaller depository institutions, the most vulnerable parts of our society do too. They're generally not cost-effective for the large money center banks, so immigrant populations, racial and ethnic minorities, are disproportionately more reliant on smaller financial institutions, credit unions, and community banks where the large money center banks are not serving their communities. They often don't have automobiles, they don't speak, you know, languages and others, and they rely on those community institutions to protect their financial assets, and we need them to be greater integrated into the American financial system.

The concerns of the un-banked is widely discussed and this regulation, if enacted, would contradict our concerns of integrating the un-banked into the American financial system. Doing so, by bringing the un-banked into the formal financial system, would give greater financial intelligence to law enforcement, would help with tax compliance, and would help the economic instability and achievement of the country.

The other instance of the disproportionate regulatory burden would contribute to the too-big-to-fail problem that we've got in this country and the greater likelihood of taxpayer bailouts. If the regulatory burden is disproportionately harder on smaller institutions, and it is, we're contributing to that too big to fail problem.

So, in conclusion I would just like to say that government mandated information sharing regulations are at the heart of our identity theft problem. This proposal would exacerbate this problem by sending U.S. financial record information abroad without adequate controls and already some U.S. financial regulators have abused access to our data. Just imagine the Russians, the Chinese, the Nigerians, or the Venezuelans have in store for us. We know from the Arab uprisings -- you know, someone brought up Mubarak before. Title III of the U.S. PATRIOT Act was supposed to go after corrupt foreign officials. I was an opponent of that approach then; I said it was doomed to fail. It has failed, which is why we're still bringing it up now. Continuing down that wrong path is still not going to correct the problem. Thank you.

MS. HWA: Thank you. Next we will hear from Elise Bean with Senator Carl Levin's office.

MS. BEAN: Thank you very much. I'm Elise Bean, the staff director and chief counsel for the Permanent Subcommittee on Investigations in the U.S. Senate. I'm here on behalf of Senator Carl Levin, who's the chairman of the subcommittee and who strongly supports the proposed reg. He supports it not just to curb bank secrecy, which fuels tax evasion, terrorism, money laundering, financial fraud and other crimes, but because he wants to strengthen the tools that are available to the IRS to go after U.S. Tax evasion.

Tax evasion in the United States today routinely crosses international boundaries. PSI, for the last decade, has documented how that happens. In 2003, we looked at how accounting firms, including KPMG, helped U.S. Citizens use various tax shelters to avoid paying taxes including OPUS, which went across international boundaries.

In 2006, we looked at the Wiley's, Sam and Charles Wiley, who used a network of 58 offshore corporations and trusts to hide their money offshore. We also looked at the point strategy, which was a strategy in the Isle of Man where they set up some phony shell companies that then generated phony losses so that people could shelter their income. In 2008, we looked at stock dividends and how offshore hedge funds were using derivatives and stock loans in offshore transactions to avoid paying taxes on U.S. stock dividends. In 2008 and 2009, we looked at some tax haven banks and how they were helping people, United States citizens, avoid their taxes. In particular we looked at UBS, which its documents show that 52,000 Americans had accounts in Switzerland that had not been declared to the U.S. That just isn't fair.

What the subcommittee has calculated is that we're losing $100 billion each year to offshore tax abuses, that's why the IRS has elevated international tax matters as one of their priorities. In addition, Congress last year passed the Foreign Account Tax Compliance Act, FATCA, to help force foreign banks to identify accounts that are held by U.S. taxpayers, but FATCA is still years away from being implemented and its effectiveness is unknown.

The fact is that for years upcoming to combat offshore tax evasion, the United States and the IRS is going to have to get cooperation from foreign tax authorities. To get that cooperation, we need to give the cooperation as well.

There's an international consensus that bank secrecy should not be used to protect tax evasion. The United States has been a leader in that international effort because it's part of their effort to get U.S. Taxpayers to get information about them so that we can stop them from cheating on their taxes. If we're going to tell the rest of the world you shouldn't use bank secrecy to protect tax evasion, we need to be consistent at home. And so we have to be able to provide information to other countries to get their cooperation.

We've heard today some very sincere concerns that if we put the proposed reg into place that there are going to be problems, there will be capital outflow problems, there will be misuse of the information, and I'd like to address those because those are matters of concern to Senator Levin as well, and I want to explain why he thinks that those concerns are misplaced.

First of all, on capital outflows. As mentioned earlier, there's $10 trillion invested in the United States right now by foreign investors. Federal Reserve data shows that $4 trillion of those deposits are in bank accounts here, but most of that money, nearly $3 trillion, are in counts held by foreign governments, official institutions, international organizations, and foreign banks. That money is completely unaffected by the proposed reg and won't be going anywhere.

The remaining trillion dollars, a lot of that is from businesses and legal entities doing business in the United States, that money is also unaffected by the proposed reg.

The United States is a safe haven for individuals, that's why they put their money here, and most of those individuals, as we heard from the ABA, they believe they're law abiding, the Florida commissioner said he believes they're law abiding, these are long-term deposits, these are people who are not engaged in tax evasion. If that's true, why would they suddenly pull their money?

We have specific examples showing that that's not what happens. When we have this agreement with Canada where we have the automatic data exchange that this is modeled after, Canadians did not pull their money from the United States; they have plenty of money here in U.S. bank accounts. When the EU instituted its savings directive, which is very similar to this program, people predicted terrible outflows of money and everybody would pull their money from European banks. Didn't happen.

In the United States itself, we have plenty of tax evasion -- plenty of tax evasion -- and yet everybody gets a 1099 filed on their bank account. Our tax evaders don't stop using banks. They need banks. They need it for checking accounts, they need it for all of the reasons -- they want to have their money invested, they want their money protected and safe. None of that is going to change.

But let's suppose for a moment that some people say, well, some people from some countries will be so frightened that they're going to pull their money from the United States and put it somewhere else. Well, they're not going to put it in the EU because there's plenty of automatic information exchange there. Let's suppose they put it in the Cayman Islands or some other country. If they want to keep it in U.S. dollars, which many do because they want the safety of the U.S. dollar, they want to make U.S. dollar investments, it's going to end up in a corresponding account right back in United States banks.

When the Cayman Islands says they have $8 trillion of investment there, that money is not actually sitting in the Cayman Islands. No, they have accounts at U.S. banks. All that money is in U.S. banks. I know it's kind of complicated, but if you really want to think about this in a sophisticated way, if people are going to keep their money in U.S. dollars, even if it's in a foreign bank, that foreign bank puts it right back in a U.S. Account because to have U.S. dollars, it has to be in a U.S. account, so we're not going to see that capital outflow.

I'd also like to talk about the concern about the misuse of tax information. Again, we've heard very sincere concerns about that. Well, that is not a new problem. Whenever the IRS shares information with another country, they have to face that problem. They have decades of experience with that problem because right now the IRS, on a case-by-case basis, answers a request for information from all kinds of governments. We have never heard of a case, ever, where a dissident or a human's rights person has had their tax information turned over to a government that is oppressing them. It's simply never happened. Why? Because we have very careful procedures and policies to prevent that from happening. You can only exchange information when there's a tax information agreement in writing. You can only give the information to a tax authority. The United States has all the authority it needs to refuse to provide the information if they feel that it will be misused. The United States has followed that policy in the past, there is no reason to believe that they would turn over decades of experience and start using these tax agreements in ways that don't make sense.

One proof of that is in the FACT Coalition, there are a lot of humans' rights organizations that are very concerned about human rights. They support this proposed reg, so they don't think it's going to be a human rights issue.

I'd also like to deal with one issue that hasn't come up a lot and that is something that one way in which the rule needs to be strengthened. Right now it only applies to NRA individuals. We think it also needs to be made clear about what happens if one of those NRA individuals reopens up an account in the name of a shell entity, shell corporation, shell trust. Usually shell corporation is the problem. The IRS has a reg right now that says if a bank opens up an account in the name of a shell entity, it doesn't have to look beyond that and can treat it as a foreign depositor. We think it's absolutely critical that you make clear if a bank knows that a foreign individual is behind that shell entity that they have to be covered by this rule.

One of our investigations shows why that's so important. Sam and Charles Wiley set up this offshore network of 50 corporations and trusts. They opened multiple U.S. bank accounts in the names of these shell entities. For example, they had a company called Devotion, they had another one called Elegance. Well, when a bank gets an account like that, they are required right now, under anti-money laundering rules, to look behind the account. They all knew there were Wileys behind the account. They knew they were U.S. citizens, not criminals, they were legitimate people with legitimate money, although it was all involving tax evasion in Senator Levin's and my opinion. But anyway, they knew the Wileys were behind those accounts and yet under IRS regs, they were allowed to treat those accounts as owned by a foreign corporation.

If we don't address that problem and make it clear that if a bank knows, because it has to know because of their anti-money laundering obligations -- if they know a foreign individual is behind the account, then they should treat that as an NRA individual account and have to report it under the law, otherwise we create a new incentive for everybody to just reopen their accounts in shell companies. That's exactly one of the problems that has happened in the EU savings directive where they didn't address this problem and so they're missing a lot of the money there and a lot of the reporting there because everybody just opens up the accounts in the names of shell companies.

One last issue I want to address is the burden issue. The fact is that banks now are required to file 1099s for all of their U.S. account holders and 1042S forms for all their Canadian account holders. All the systems are in place. They don't have to reinvent the wheel. All they have to do is apply those systems to all of their account holders and if they say it's burdensome, well, this is the cost of doing business. Bank secrecy is not supposed to be used to further tax evasion or all the other crimes that can happen with bank accounts whose owners are hidden.

So, I want to thank you very much for proposing this reg. I think it will make a tremendous difference in terms of U.S. tax evasion and tackling the whole problem of offshore tax abuse. Thank you very much.

MS. HWA: Thank you. Next we will be hearing from John Berlau with The Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.

MR. BERLAU: Thank you for the opportunity to testify at this hearing regarding the proposed regulation providing guidance on reporting interest paid to nonresident aliens.

My name is John Berlau and I'm the director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute. The Competitive Enterprise Institute is a nonprofit public policy organization, think tank, dedicated to advancing the principles of limited government, free enterprise, and individual liberty. Founded in 1984, our mission is to promote both freedom and opportunity. We make the principled case for economic freedom because we believe it is essential for entrepreneurship, innovation, and prosperity to flourish, and we also have serious concerns about privacy rights and civil liberties.

Now, we're a free market, libertarian organization, but we have joined bipartisan coalitions with politically liberal groups, such as the American Civil Liberties Union, to express concerns about anti-drug and anti-terrorism policies that we believe give law enforcement too much latitude to intrude on individual privacy without probable cause or reasonable suspicion.

Mr. Jansen mentioned the revisions by Senator Leahy to the Electronic Privacy Communications Act. We're supporting those and we think there should be some more safeguards as far as cloud computing and other things that we're joining with liberal groups and supporting those new privacy protections.

So, our strong concerns about -- we've just issued, actually, a statement yesterday, a press release yesterday, stating our support of those. Our strong concerns about both economic opportunity and civil liberties prompt us to strongly object to the IRS's proposed rule that would force banks and credit unions to report information on foreign bank account holders to facilitate what has been described as automatic information exchange with their home countries.

I think the proposed rule is simply amazing in the simultaneous divergent harms it would cause, both to the U.S. economy and to human rights throughout the world. All at once, if implemented, the rule would reduce U.S. competitiveness in attracting foreign capital, harm the safety and soundness of U.S. banks and credit unions, and probably cause more financial institutions to fail in areas already hard hit by souring real estate loans, as you've heard from other speakers, threaten the privacy and safety interests of individuals throughout the world by putting sensitive financial information in the hands of governments with lax data security system in which criminal gains could access the data to target victims for kidnapping, and, D, empower corrupt dictators by possibly giving them direct access to financial information of dissidents who may hold U.S. accounts.

Now, if this rule were in place now, U.S. banks would have to report -- they'd have to report to the IRS at the very least, the sensitive financial information of Libyan rebels fighting the regime of Muammar el-Qaddafi, if any of these rebels or their families held accounts here, and there's some evidence that they may, which I'll get to in a minute.

I would also say that -- and this has been mentioned before the proposed rule -- violates President Obama's Executive Order 13563. In January, President Obama issued this Executive Order intended to reemphasize the principles of Executive Order 12866 from the Clinton Administration that governed the regulatory development and review process. Regarding his new Executive Order the President wrote, "We are seeking more affordable, less intrusive means to achieve the same ends. This means writing rules with more input from experts, businesses, and ordinary citizens." And he went on to say, "I am directing federal agencies to do more to account for and reduce the burdens, regulations, being placed on small business."

Unfortunately, the proposed regulation, which effectively would designate the U.S. as tax collector for the world, fails to meet any of these objectives. Not only does the proposal fail to give careful consideration to the benefits and costs, it ignores the requirement of Executive Order 1288866 from the Clinton Administration that 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 effect, in a material way, the economy. Most estimates say this rule's cost to the economy would easily exceed $100 million. In fact, the Merceda Center of George Mason University estimated in 2004 that even a scaled back variant of this rule would drive $87 billion out of the economy and the rule also fails to address global bipartisan concerns concerning privacy and human rights.

And since 1921, with the goal of attracting capital to the U.S. economy, Congress has exempted from U.S. taxation the interest earned on deposits of nonresident aliens. According to the Department of Commerce, nonresident aliens hold more than $4 trillion in U.S. banks, and whether it's $4 trillion or $1 trillion or $500 billion, I would say that's still a lot of money. And they have been estimated to represent as much as one-third of all bank deposits in the state of Florida; in some regions -- this has been mentioned before -- maybe perhaps even more than that. And these deposits enable banks and credit unions to make loans to consumers, homeowners, and small businesses, generating economic activity that produces billions in state and federal tax revenues, but this rule threatens to bring much of this economic activity to a screeching halt and may even take some financial institutions, particularly smaller ones, under.

Now, something has been said about the compliance burden and it's worth noting that financial institutions of all sizes have opposed this rule. Among the comments the IRS has received are letters from the Independent Community Bankers of America and the Credit Union National Association, who say their member institutions will be hit hard by the costly upgrades in technology forced by this rule, as well as a loss of deposits. As far as technology, I think they would know their members as far as what cost the technology upgrades would be. And all this burden for a rule that would raise no revenue for U.S. coffers. In fact, ironically, if Congress, you know -- and everything's on the table for raising revenue, I realize that -- but if Congress were to change its policy and start taxing foreign interests, levy a small tax, it would probably have less effect on the movements of deposits than this information sharing rules would be. And by scaring away current depositors and potential depositors from U.S. financial institutions because of confidentiality or privacy breaches, the IRS may be foreclosing the option for the U.S. to tax foreign interests for a future Congress to explore because the amount of accounts won't be there.

Taxes, as has been mentioned, are one of many reasons, and in many cases probably not the most important reason nonresident aliens patronize U.S. banks. As the Independent Community Banker's Association of America noted in comments to the IRS last month, foreign deposits in U.S. banks are largely a function of the confidentiality, privacy, and stability of our banking system.

In the past, the U.S. has negotiated tax treaties taking into account, as with all treaties, levels of corruption, civil liberties, and just plain stability of the countries in question, but now by requiring U.S. banks to report the financial information of -- in the proposals of any nonresident alien individual from any country and not by specifying criteria for limits to information sharing, the IRS would subject the world citizens in suspect regimes to uncertain fates and may promote interests contrary to U.S. foreign policy. For instance, the U.S. is providing support to rebels trying to take down Libyan dictator Muammar el-Qaddafi, but under this rule if any of the rebels had accounts in a U.S. bank, the bank would have to report this info to the IRS. Would the IRS then hand this info to the Qaddafi government? I would certainly hope not, but this proposal doesn't specify any limits to the information sharing, and this very uncertainty is what would likely cause a mass exodus of foreign accounts from the U.S. So the issues of economic opportunity, civil liberties, and human rights are uniquely linked together. And it's fine to say we won't share it except if they have treaties, we go through a process. This needs to be in the rule, the limitations on the -- the IRS needs to be transparent about, you know, to promote transparent -- about the rules it will use to share information. How you can't just have saying, well, we're going to have every country, not just countries that are reporting -- not that are subject to our treaties, we're going to collect this and then we'll decide and we'll use this, you know, and then separate from the rules , say we'll use this criteria. That needs to be in the proposed rule, the criteria for information sharing once the IRS has the information.

And also, I would -- there was a question of whether -- there was a question of whether rebels or dissidents ever have offshore accounts or accounts overseas. There was a article, a May 4th article, by James McKenzie with Reuters, "Libyan Coalition Tries to Help Rebels Raise Funds," that indicated that they did, perhaps in the U.S. and in Europe, but it was about them trying to access those funds. I will say something about -- and, I mean, traditionally, from Nelson Mandela to Lech Walesa, they've relied on raising foreign funds, so in the modern system they would have foreign bank accounts.

You know, a word about the argument that it's only fair the U.S. impose automatic exchange information on itself since it is effectively requiring other nations to do so through FACA or the Foreign Account Tax Compliance Act. It is indeed true that FACA is imposing an incredible burden on citizens of other countries as well as American diplomats, students, and retirees that have legitimate business in other nations and it's largely Congress's fault, not the IRS's. Publications of The Wall Street Journal have documented horror stories such as individuals having to fill out three different forms for the same item. Yet two wrongs don't make a right, and what these individuals want is not for the U.S. to shoot itself in the foot by imposing a similar requirement on itself, they want Congress to grant them relief from FATCA and Americans, want the IRS to follow the letter and spirit of the Fourth Amendment, conducting reasonable searches and not asking for broad data dumps of sensitive information.

The proposal does not achieve that and it is detrimental to economic growth and it should be scrapped. Thank you for your time and I'd be happy if you want to follow up with any questions.

MS. HWA: Next we'll have Andrew. We'll hear from Andrew Quinlen, who's with Center for Freedom and Prosperity Foundation. Ready when you are.

MR. QUINLAN: I'm never ready, so -- okay, whenever you're ready.

Hello, my name's Andrew Quinlan. I'm the President of the Center for Freedom and Prosperity. We're a 501(c)(4) organization located in Alexandria, Virginia. We also have a 501(c)(3), but I'm here on the 501(c)(4) side today. I also run the -- I coordinate the activities for the Coalition for Tax Competition, which is made up of more than three dozen free-market policy organizations. I hurt my Achilles tendon so that's why I'm like this. For anyone who has had that injury before, it's very devastating for the first six to eight weeks. I'm at week six now so I'm just trying to -- I'm finally getting out and about so I apologize, and I thank the IRS for accommodating me.

I stand here, commenting for the third time, on this proposal for legislation that is not in the best interests of the United States. It's been ten years, 120 weeks, and 3,650 days since the first proposal was -- the first regulation was proposed. As many of the speakers today will highlight or have highlighted, this version of the rule is virtually the same as the one that President Clinton dropped on January 17, 2001.

Before I go into my remarks on the regulation, I'd like to make a few very important points. At a public hearing held on July 21, 2001, 100 percent of the speakers were against the regulation. At a December 5, 2002, hearing, once again every participant spoke out against the proposed rule. From the looks of today's speakers, the vast majority have spoken against it.

Before I go into my remarks on the regulation, I also want to comment on the written comments or speak about the written comments. In 2001 the IRS received very few positive comments. In fact, I was told there was less than 1 percent. The same is true for 2002. I recall reading through all the public comments the IRS released to one of my colleagues, and there were over 200 of them. I only found one short e-mail in support of it.

Now today's current proposal received 71 comment letters that I have seen and only three in support, one being from Senator Levin and one being from

FACT. When we take into account the strong bipartisan opposition from at least 38 current members of lawmakers now, members of Congress -- and I know that there's a couple of more letters in the works -- we're approaching almost 97, 98 percent of the public comments are against this regulation. It's hard to discount the effectiveness of the Florida Congressional Delegation's letter. It was signed by 19 Republicans and six Democrats and one of those Democrats was Debbie Wasserman Schultz, who is the current chairwoman of the Democratic National Committee. I plan on punctuating my remarks with several comments from elected official letters and also some of the letters from the past since we're commenting on the same regulation. I also have copies of those letters for the record, and I ask that they're put in there.

On several occasions the U.S. Congress has examined the tax treatment of indirect foreign investment in the American economy, and there's been at least -- we put out a paper about ten years ago that talked about this, and I think it is part of my packet where it actually cites the debate in Congress. Congress has also -- in every instance a desire to attract capital -- has led lawmakers to decide not to tax bank deposit interest paid to nonresident aliens. Congress also has repeatedly decided not to require the reporting of the income. The proposed IRS regulation, however, seeks to overturn this. In a letter from Senators Kay Bailey Hutchinson and John Cornyn from Texas, "Forgoing the taxation of deposit interest paid in certain global investors is a longstanding tax policy that helps attract capital investment to the U.S. For generations these investors have placed their funds in institutions in Texas and across the United States because of the safety of our banks."

Another reason for many of these investors to deposit funds in America institutions is the instability in their home countries. In the Florida Delegation letter signed by all the members, the regulation flagrantly violates the intent of Congress. On several occasions, lawmakers have chosen to refrain from taxing deposit interest paid to nonresident aliens. These actions were made for the explicit purpose of attracting and keeping capital in the United States' economy.

Okay, now this is a letter that was signed by some members of Congress, the lead signer I would say would be Chairman of the Financial Services Committee, Spencer Bachus. "The regulation is not needed to enforce American tax law. Indeed, the IRS is using the regulatory process to overturn existing law. For 90 years, Congress has sought to attract foreign capital to the U.S. with active tax and privacy rules. The IRS now wants to disregard Congressional intent solely for the purpose of providing information to foreign countries. The proposed regulation also will chase foreign investment out of the U.S. The current tax and privacy rules for foreign investors have been a huge success, attracting about $1 trillion in funds to U.S. institutions. This money helps finance car loans, home mortgages, and small business expansion in America. But if the regulation is approved, foreigners will shift a substantial share of their funds to Panama, Singapore, Hong Kong, and other jurisdictions that protect the interest of investors and, therefore, protect their own national interest." In the Bachus letter, he states, "This misguided proposal would compel U.S. banks to put the interest of foreign tax above U.S. tax law in the American economy. If implemented, the regulation will drive bank deposits directly out of the U.S. and other institutions."

This comment is a little dated. It was by former Senator Phil Gramm, but I like the way that he said it so I'll repeat it. "The ability of people to move their capital is a most effective check on excessive taxes in oppressive government. The United States of America is the world's greatest beneficiary of such capital movements. Why would we want to limit economic freedom and protect overtaxing governments around the world? The benefit, if any, of the IRS proposal are so overwhelmed by dangers if it possesses as to make the adoption unthinkable." Oh, excuse me, "it opposes." I'm sorry.

And then the FCIC sent a letter to the IRS back in 2003 commenting on this also. "Banks have reported that as much as $1 trillion in U.S. deposits are derived from foreign nationals. A shift of even a modest portion of these funds out of the U.S. bank system would certainly be termed a significant economic impact. The regulation will hurt competitiveness if financial institutions from around the world compete for liquid capital. American banks traditionally have been successful in this environment, attracting about $1 trillion." Now this $1 trillion is basically in savings accounts and stuff like that, not the other investment that people have talked about that is about $4 or $5 trillion in liquid assets. And I think it's like $12, $13 trillion now in all foreign assets. "This regulation will make -- money will flow out of America, making it more difficult for U.S. banks to meet their challenges to foreign competition. It will also limit their ability to loan funds."

And then the Florida Delegation also commented on this, saying, "The regulation will negatively affect the solvency of financial institutions. Should this regulation take effect, it will have a negative impact on the balance sheet of U.S. financial institutions and solvency."

Senator Marco Rubio said, "At a time when unemployment remains high and economic growth is lagging, forcing banks to report interest paid to nonresident aliens would encourage the flight of capital overseas jurisdiction without onerous reporting requirements, placing unnecessary burdens on the American economy, put our financial system at a fundamental competitive disadvantage, and would restrict access to capital when our economy can least afford it."

In small business, the Office of Advocacy in 2002 commented on the original regulation, saying, "For small financial institutions, the burden associated with setting up a system to monitor or report in accordance with the regulation is a significant burden. If this regulation is imposed, it would create a barrier to small financial institutions' ability to compete. We believe that there is ample evidence that the impact of the regulation is significant and that a substantial number of small businesses will be impacted."

Several people have talked about the lack of a cost-benefit analysis, and they have quoted Executive Order 12866. There's been several -- there's been at least one major study by Mercatus. The FDIC commented on there'll be a big impact, so I would ask the IRS to reconsider the economic impact it actually has.

And then several people here have spoken on the dangers of to -- like the human rights. Now some have discounted that, but the way the world is now in the Middle East and the reach from China into South America and the instability of some of these countries, do we really want the information sitting around where bureaucrats can pass it on? We wrote a paper years ago, talking about how less than 50 percent of the people in the world are free. So a lot of them are very, very oppressed, so the U.S. is a beacon for them.

In conclusion, this is now the third time that the IRS has gotten a bite at this particular apple and once again, both Congress and the public are staunchly opposed. For the reasons I have outlined, I ask that the regulation be withdrawn. Thank you.

MS. HWA: Thank you and we will hear from Brian Garst with the Center for Freedom and Prosperity Foundation. Great, thank you. Go ahead.

MR. GARST: Thank you. Thank you for this opportunity to share my views with you. My name is Brian Garst, and I serve as Director of Government Affairs with the Center for Freedom and Prosperity. As Andy mentioned, we are a 501(c)(4) so this is an organization that lobbies Congress and the administration on tax competition, financial privacy, and fiscal sovereignty. We are deeply concerned with the impact this rule would have on financial institutions, the U.S. economy, and the welfare of individuals throughout the world who rely on the level of security and privacy historically afforded by the American financial system.

I want to focus my testimony on three key points. One, that this regulation is entirely unnecessary; two, that the IRS is undermining the intent of legislative authorities; and three, that this rule will be detrimental to the U.S. economy. The purpose of Executive Branch agencies and departments is to issue regulations that implement laws enacted by Congress. More specifically, the IRS is supposed to promulgate regulations that help enforce U.S. tax law, yet the primary justification offered for bringing back this proposal, which has previously faced overwhelming opposition from lawmakers and the financial industry, is not to implement any specific law enacted by Congress, but rather the supposed importance of strengthening U.S. exchange of information programs with other countries.

The Center for Freedom and Prosperity is not only philosophically opposed to the view that tax collection requires putting an end to all rights and expectations to financial privacy, but we also disagree with this particular justification as a factual matter. The ability of the U.S. government to essentially bully other nations into providing the information necessary to sustain an ill-conceived worldwide tax system is not dependent on also making the U.S. an undesirable destination for flight capital. Our organization's objections to the Foreign Account Tax Compliance Act aside, foreign financial institutions will either choose to drop their American clients and disinvest in U.S. securities and assets because of its passage, or they will decide that keeping their U.S. customers is worth the additional burdens. In either case, implementation of this rule will have no bearing on their decision process. It is simply not true to suggest that this regulation is required to carry out law as passed by Congress.

The other justification for proposing this rule in what seems to almost to be an afterthought is that the regulation will help improve compliance rates among U.S. taxpayers. Given that the deposits in question are exempt from U.S. tax, the concern is presumably that significant numbers of U.S. residents may falsely claim NRA status. But given the scope of existing reporting requirements, this is highly unlikely. Moreover, the IRS has not even attempted to quantify the question with a cost-benefit analysis, hiding instead behind the flimsy claim that the proposed regulations will not have "a significant economic impact." Time and again Congress has looked at the issue of NRA deposits and decided to exempt them from taxation. In public comments, others have already done a thorough job, highlighting a questionable nature of the authority asserted to require a reporting of these deposits, but what is not at all questionable is that such reporting will undermine the fundamental purpose behind the Congressional exemption from taxation of these deposits. The reason Congress has consistently opted not to tax NRA deposits is so that the U.S. will remain an attractive destination for flight capital, yet the impact from this proposed reporting requirement would be exactly the same as if Congress had itself authorized such a tax. Whether or not U.S. Authorities directly tax those deposits or they give the information to foreign governments so that their own tax collectors may do so, the result will be an exodus of foreign capital toward more hospitable jurisdictions. Such loss of capital stock is never desirable, but would be particularly pernicious as many financial institutions continue to struggle to recover from the recession.

But for many investors and perhaps far more importantly, it is not simply a question of minimizing tax burdens through lawful tax avoidance or mitigation, a practice which authorities increasingly and falsely conflate with tax evasion. Rather it can also be a question of life and death. In many countries, governmental authorities are not just a source of frequent annoyance, they are also a threat to basic civil liberties. For those who live under rampant corruption or must regularly face threats of extortion, blackmail, or kidnapping, financial privacy becomes a matter of personal safety. While we can rest assured that individuals facing such threats will remove their funds from the U.S. if the proposed regulations are approved and thus continue to protect themselves and their families from becoming easy targets, it will be at the expense of the U.S. economy and the citizens this office serves.

Some have argued that the absence of such an exodus by Canadian depositors who already face a reporting requirement is evidence that these fears will not be realized, but it is not evidence of any such thing, as Canada is not the type of country from which people regularly flee. Canadian citizens do not have the same sensitivity to financial privacy concerns as depositors from unstable or corrupt regimes.

To summarize, the proposed rule represents bad governmental process, awful tax and economic policy, and a shameful disregard for basic human rights. It should, therefore, be immediately withdrawn. I thank you for your time.

MS. HWA: Thank you, Brian. Next we will hear from Stephen Entin who is with the Institute for Research on the Economics of Taxation. You have 5 minutes.

MR. ENTIN: Thank you very much. I appreciate the panel's forbearance in allowing me to speak at the last moment, and I welcome the opportunity to comment on the regulations.

My name is Stephen J. Entin. I am President and Executive Director of the Institute for Research on the Economics of Taxation. Before joining IRET, I served as Deputy Assistant Secretary for Economic Policy, Department of the Treasury, from 1981 to 1988. From 1975 to 1981, I was a Staff Economist with the Joint Economic Committee with Congress. My areas of specialization include macroeconomics, international economics, and taxation.

Because of the bank and the U.S. government bond interest income is tax exempt in the United States, if the recipient is a nonresident alien there is currently no requirement for the recipient to report the interest to the IRS except, of course, in the case of Canada. The current system was deliberately enacted by the Congress to allow U.S. financial institutions to compete for business with offshore banks. I testified at an IRS hearing on an earlier version of this regulation on November 12, 2002. At that time I discussed the potentially adverse effects of the regulation on the U.S. economy. The regulation would scare away investment capital from the United States. It would impair our ability to finance government budget deficits without crowding out private investment in job-creating capital. I estimated at that time the reduced capital inflow could lead to higher interest rates unless growth of the domestic economy, shaving as much as perhaps 0.8 of a percent from annual output and income, fewer jobs and a lower GDP would result in lower federal and state and local tax revenue. In today's terms, such a reduction in output might be equivalent to roughly the loss of a million jobs or a scaling back of wages to the same extent.

Now since that time of my earlier testimony, the amount of foreign capital invested in the United States has only gotten larger, and there's potentially more capital that could flee the country. Federal deficits have gotten much larger and more of the resulting debt is held by foreigners. I conclude that if anything, the argument against regulations is even stronger today than nine years ago. Much of the foreign-held debt -- much of the foreign U.S. debt -- excuse me -- much of the foreign-held U.S. debt is owned by governments and central banks. Recent reports indicate that China, the largest foreign holder of U.S. debt by far, has scaled back its holdings while others continue to add to them. We cannot take such official purchases for granted indefinitely. This is not the time to antagonize individual foreign investors in the United States. Foreign individual investors still have the capability of shifting deposits from the United States to friendlier banking centers with the click of a mouse. Even a small outfall could trigger further runs on the dollar by other holders, necessitating a Federal Reserve action and other actions to try to cope with the situation.

Now the regulation is not needed to enforce U.S. tax law. Banks are already required to know the identities of their depositors under various Know Your Customer anti-money laundering, Bank Secrecy Act compliance, U.S.A. Patriot Act, and now FACTA regulations. Many people have already been caught under these regulations. I don't think new ones are needed for those purposes, and therefore, I also am skeptical that there is still much less tax revenue associated with Americans pretending to be foreigners. Rather, the information is being sought to assist foreign tax agencies to track down their citizens holding accounts in the U.S. If these accounts were to flee to other jurisdictions, the IRS would have no useful information to share or to report to other high-tax nations. But U.S. financial institutions and their employees would have lower U.S. profits and wages to report to the IRS, as would other U.S. businesses and employees deprived of the funds to expand investment and hiring.

My conclusion is that the proposed regulations would be hurtful to the economy and would not provide the Treasury with any new revenue or any new powers that it really needs, such it should not be adopted. The real solution to the international information exchange issue is fundamental tax reform here and abroad. Many of the proposals of fundamental tax reform in the economic literature would replace the income tax with a territorial, consumption-based, or consumed-income tax. And the tax system's interest income would receive the same tax treatment currently accorded regular IRAs and pensions where Roth IRAs and tax-exempt bonds. The tax systems would not require the taxation of interest earned outside the United States by U.S. residents. This would be attributable to already taxed principle and it would not be taxable here. Nor would there be any U.S. tax on interest earned in the United States by foreigners. Neither the IRS nor the foreign tax agencies adopting such systems would need the information exchange program that is driving the proposed regulation. I'd like to point out that the largest holder of U.S. debt instruments, China, already has a tax system very similar to that. They don't tax their domestic interest from the banks, and they don't tax domestic capital gains. And it's doing quite well with saving and investment.

Some people say that we should not be importing capital from abroad, that this is a developed country and we should be aiding developing nations abroad. But I remember at a hearing shortly after he became Secretary of the Treasury that Don Regan was asked that question by members of Congress. He was a former head of Merrill Lynch and he said, "It's not my job as Secretary of the Treasury to stand at the Oceanside and hold out my hand and say to the incoming tide of foreign investment, 'You are not welcome here.'" I hope you'll remember the words of the former Treasury Secretary and consider the possibility that these actions would have other effects outside of the immediate concern of the narrow interest of the regulation. Indeed, within the Treasury Department itself, there are other concerns that this might bear upon. There's the issue of bank soundness because some banks in some states might be seriously affected. There is the effect on the entire economy, which would affect total tax receipts and the federal budget.

I have just one concluding thought and that is that people working for the IRS, the Treasury, the U.S. Government, they're here to help the people of the United States. I know there's a very strong tendency in dealing with people in similar jobs abroad to develop a connection and see their problems as well as our problems and perhaps become too close to our colleagues in other positions overseas. But we are here to benefit the United States. We're not here to collect their taxes for them, and I hope that we can find a set of regulations that will serve our needs and that will not have any of the spillover effects that might adversely affect the economy. Thank you very much for your time.

MS. HWA: Last, but not least we'll hear from Karen Kerrigan who is with Small Business Enterprise Council. Did Karen make it? No? Well, that concludes our hearing for the day. Thank you for your attendance.

(Whereupon, at 11:59 a.m., the PROCEEDINGS were adjourned.)

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