



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

March 31, 2011

The Honorable Mario Diaz-Balart
U.S. House of Representatives
Washington, DC 20515

Dear Representative Diaz-Balart:

Thank you for your letter to the President concerning the recently proposed Treasury regulations that would require U.S. banks to report to the Internal Revenue Service (IRS) interest paid on deposits held by nonresident aliens. I welcome the opportunity to explain the rationale underlying the proposed regulations as well as emphasize our commitment to the confidentiality of taxpayer information and address the important concerns you express in your letter.

These proposed regulations are an important component of the U.S. Government's efforts to combat tax evasion, which is a top priority of the Administration as well as Congress. Addressing tax evasion through the use of offshore accounts and institutions requires a multi-pronged approach that includes not only domestic legislation and enforcement efforts, but also significant international cooperation.

The United States has long been a global leader in establishing and promoting the adoption of international standards for transparency and information exchange to combat cross-border tax evasion. Securing the amendment of bank secrecy laws to the extent they inhibit tax information exchange between jurisdictions and facilitate tax evasion is a defining objective of these international standards. The United States has worked very hard through the G-20, the Organisation for Economic Co-operation and Development, and bilaterally with other global partners to urge all jurisdictions to amend any laws that protect tax evaders by prohibiting the exchange of bank information. This global focus on combating cross-border tax evasion has proven successful and led to the recent conclusion of agreements that will allow the United States improved access to bank information from jurisdictions such as Switzerland and Luxembourg (new protocols to our existing income tax treaties are pending Senate approval), Liechtenstein and Gibraltar (tax information exchange agreements (TIEAs) are now in force), and most recently Panama (TIEA signed in November 2010), and thereby significantly improved our network of information exchange relationships.

A network of information exchange relationships based on established international transparency standards has been at the center of recent and very successful IRS enforcement efforts against tax evaders who have hidden money in offshore financial institutions. However, our information exchange relationships are founded on cooperation and reciprocity, which are necessary so that the tax enforcement concerns of both the United States and its partners are adequately addressed. A jurisdiction's willingness to share information with the United States to combat offshore tax

evasion depends on our willingness and ability to reciprocate and exchange information. The proposed regulations, by requiring reporting of bank deposit interest to the IRS, ensure that the United States is in a position to exchange such information reciprocally when it is appropriate to do so.

Moreover, to supplement our established information exchange network, Congress, as part of the Hiring Incentives to Restore Employment Act, 111 P.L. 147, enacted a number of provisions to combat offshore tax evasion, including providing for increased information reporting to the IRS from financial institutions outside of the United States. These provisions, commonly referred to as the Foreign Account Tax Compliance Act or “FATCA,” require overseas financial institutions to identify U.S. account holders and report account information directly to the IRS, including the account balance, and, except to the extent provided in regulations, certain gross flows associated with U.S. accounts, including but not limited to interest. A financial institution that fails to comply with the due diligence and reporting requirements of FATCA will be subject to U.S. withholding tax on certain U.S.-source payments (including interest and dividends) and gross proceeds from the disposition of U.S. assets.

Implementation of FATCA will require the cooperation of foreign governments. The proposed regulations, which address the same concerns that motivated enactment of FATCA, namely offshore tax evasion through the use of undisclosed accounts at financial institutions, will better position the United States to exchange information with foreign governments, pursuant to our information exchange agreements and thus subject to their explicit requirements of confidentiality and use only for tax purposes, as well as their implicit requirements of reciprocity.

The proposed regulations are thus an important component of the U.S. strategy to combat offshore tax evasion, and thereby increase collection of taxes owed and reduce the tax gap, by using and improving our information exchange network and by implementing and enforcing domestic legislation that requires reporting by overseas financial institutions on offshore U.S. accounts.

Your letter also raises a number of specific concerns about the proposed regulations, however, that we considered before the proposed regulations were promulgated and that I would like to address directly.

Confidentiality and Improper Use of Information. Your letter expresses concern about the misuse of information by corrupt foreign governments. In this regard, it is important to emphasize that the proposed regulations would require only that interest paid on non-resident bank deposits be reported to the IRS. The regulations do not require reporting directly to foreign governments, nor do they require that the information collected by the IRS be exchanged with other governments.

Information reported to the IRS is not exchanged by the IRS with another government unless and until several conditions are met, including a review of the protections against the misuse of information. First, before the IRS can exchange information with another country, there must be an information exchange agreement in effect with that country (either an income tax treaty or a TIEA). Currently, the United States has in effect 58 income tax treaties and approximately

25 TIEAs (approval of some TIEAs is pending) that provide for information exchange. In this regard I should stress that the proposed regulations do not provide IRS with any additional authority to exchange information with foreign governments nor do they provide access to bank information that was not already available under existing law. Authority to share information and gain access derives from our income tax treaties, TIEAs, and domestic law, and the IRS already can exchange bank information with any of the countries with which we have agreements to exchange tax information in effect, without regard to the proposed regulations. Thus, currently, when a foreign government requests information on bank deposit interest under a treaty or TIEA, the IRS in turn requests the information from banks, which the IRS then provides to the foreign government, as appropriate. Under the proposed regulations, the IRS would have such information on hand which it could use to respond to a specific request or, at its discretion, exchange spontaneously or automatically with a foreign government, subject to the restrictions regarding confidentiality, misuse, and reciprocity.

Second, as just noted, even when there is an information exchange agreement in place, and even when a country requests information pursuant to such an agreement, the IRS will not exchange information with that country unless it is satisfied that the country meets strict standards of confidentiality regarding the use of the information and is willing and able to exchange information on a reciprocal basis. Importantly, the proposed regulations include the possibility of further administrative rules on the sharing of information, in particular with regard to confidentiality of taxpayer information as well as reciprocity and usability.

Finally, the proposed regulations would only require reporting of interest income on the accounts of nonresidents, and not account balances or transfers or other transactions. Generally a taxpayer is required to report interest income received as part of their home country tax filing obligations, if such income is subject to home country tax. Our agreements generally only allow for the exchange of tax information for the purpose of administering and enforcing tax laws. Accordingly, because the regulations do not involve the reporting of information beyond what nonresidents generally are obligated to disclose directly to their home governments and because information may be exchanged only to administer and enforce tax laws and only if the information is kept confidential and is not subject to misuse, only nonresidents engaging in offshore tax evasion in jurisdictions that will not misuse the information should be concerned with the additional reporting requirements.

Impact on U.S. Financial Institutions and U.S. Economy. Your letter suggests that these regulations will result in trillions of dollars of capital leaving the United States resulting in harm to the U.S. economy. The Treasury Department certainly has every interest in protecting the U.S. economy from harm. We have looked very carefully at the available data and are comfortable that the proposed regulations will not result in that outcome.

First, based on the latest data prepared by the Treasury Department and that is publicly available, deposits held by all foreign persons (other than foreign banks and official institutions) with U.S. financial institutions are approximately \$458 billion. This number includes not only deposits held by nonresident aliens, but also deposits held by all foreign corporations, partnerships, trusts, and other entities. Thus, deposits held by nonresident aliens are substantially less than \$458 billion. By comparison, total deposits held at U.S. offices of banks and credit unions are approximately \$8.7 trillion.

Moreover, as noted above, while the proposed regulations would require banks in the United States to report to the IRS bank deposit interest paid on all non-resident accounts, the IRS can exchange information only with jurisdictions with which the United States has an information exchange relationship (through an income tax treaty or a TIEA) and only subject to the conditions and controls inherent in those relationships, as described above. Accordingly, the nonresident deposits with respect to which information could be exchanged are less than the total nonresident deposits in the United States.

Second, when the current regulations, which require reporting of bank deposit interest paid to Canadian accounts, were first proposed, similar concerns about capital flight and economic impact were voiced, but did not materialize when the regulations were finalized. At the end of March 1996, just prior to the issuance of the final regulations, Canadian residents held approximately \$1.93 billion in deposits with U.S. financial institutions. Six months later, at the end of September 1996, deposits held by Canadian residents were \$2.70 billion, and one year later, at the end of March 1997, the amount was \$4.07 billion. This may in part reflect the fact that bank deposit interest information was always available on an as-requested basis under our existing information exchange relationship, as noted above. It may also reflect the fact that there are many reasons nonresident aliens want to hold deposits with U.S. financial institutions other than hiding deposits from their home country, including the economic stability of the United States and its financial institutions.

Congressional Intent and Treasury Authority. Your letter questions whether the proposed regulations are consistent with Congressional intent. While Congress chose to exempt bank deposit interest of nonresidents from U.S. taxation, Congress expressly granted in the Internal Revenue Code to the IRS and the Treasury Department the authority to require information reporting on interest payments (including bank deposit interest payments) that are not subject to tax in the United States. Pursuant to the authority granted to Treasury and the IRS, the proposed regulations require only information reporting of nonresident bank deposit interest and do not result in U.S. taxation of that interest income and thus are consistent with Congressional intent.

I appreciate the concerns expressed in your letter and by Florida financial institutions. We are committed to making the United States a competitive location for business and investment, including for accessing financial services, as well being committed to the responsible exchange of tax information with treaty and TIEA partners after ensuring there are appropriate confidentiality and other safeguards in place. We look forward to additional input from the industry on implementing these regulations to ensure that when finalized the regulations do not adversely affect legitimate business and investment in the United States.

Sincerely,



Michael F. Mundaca
Assistant Secretary (Tax Policy)

Identical letter to:

The Honorable Bill Posey
The Honorable Connie Mack
The Honorable Richard Nugent
The Honorable Daniel Webster
The Honorable John L. Mica
The Honorable Debbie Wasserman Schultz
The Honorable Alcee L. Hastings
The Honorable Kathy Castor
The Honorable Allen B. West
The Honorable C.W. Bill Young
The Honorable Cliff Stearns
The Honorable Vern Buchanan
The Honorable Jeff Miller
The Honorable Ander Crenshaw
The Honorable Steve Southerland, II
The Honorable David Rivera
The Honorable Ted Deutch
The Honorable Corrine Brown
The Honorable Ileana Ros-Lehtinen
The Honorable Thomas J. Rooney
The Honorable Sandy Adams
The Honorable Gus M. Bilirakis
The Honorable Dennis A. Ross
The Honorable Frederica Wilson