American Bankers Association
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CC:PA:LPD:PR (REG–146097–09)
Room 5203
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington, DC 20044

RE: *IRS Proposed Regulations on Reporting Interest Paid to Nonresident Alien Individuals*

Dear Ms. Holman:

The American Bankers Association (ABA) is pleased to submit comments on the *Proposed Regulations on Reporting Interest Paid to Nonresident Alien Individuals* (the "Proposed Regulations") issued by the Internal Revenue Service (IRS) on January 6, 2011. *The ABA represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees.*

In April 1996, the IRS issued final regulations, which, effective January 1, 1997, required U.S. financial institutions to report annually to the IRS payments of interest on deposits made to any nonresident alien (NRA) individual that is a resident of Canada. In January 2001, the IRS proposed new regulations that would have expanded the annual reporting of U.S. bank deposit interest payments to **any** nonresident alien (NRA) individual. The broader 2001 proposed regulations were withdrawn in August 2002 and narrower regulations that would have required interest payment reporting with respect to Canadian residents and residents of 15 other countries were proposed. [1] The 2002 proposed regulations were never finalized. The IRS is now proposing to replace the 1996 final regulations (currently in effect) with the Proposed Regulations, which, like the 2001 regulations, require expansion of NRA interest payment reporting to any NRAs.

The IRS has received letters from members of Congress as well as other industry groups requesting that this new proposal be withdrawn. The ABA continues to support such a request and hence, we strongly urge the IRS to leave the rule as it currently stands. 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 will have a significant negative impact on U.S. banks, including the risk of flight of foreign capital at a time when such capital is very much needed.

In a March 31, 2011 letter to the Hon. Mario Diaz-Balart, the Treasury addresses this point under the section "Impact on U.S. Financial Institutions and U.S. Economy." The letter states that the capital base of U.S. banks

[1] Under the 2002 proposed regulations, the following countries were added to the NRA reporting list: Australia, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden and the United Kingdom. The new Proposed Regulations, like the withdrawn 2001 proposed regulations, encompass all nonresident aliens – regardless of country of residence.

would not be significantly affected because the total deposit base held by nonresident aliens is a fraction of the total U.S. deposit base. However, we understand that some of our community and regional banks in certain states have a disproportionately higher level of NRA deposits relative to the national figures. Further, the letter explains that Canadian deposits in U.S. banks did not decrease after the reporting changes in 1996. It is our contention that the Canadian residents do not share the same privacy and security concerns of residents of some emerging market countries. We continue to believe that a very large number of banks, including community banks, stand to lose billions of dollars in foreign investment because their NRA customers would rather withdraw their funds and close their accounts than be subjected to U.S. banks' disclosure of their U.S. deposit ownership to their home country. In addition to undermining the competitiveness of U.S. banks (especially community banks) by making it difficult for them to maintain or attract foreign deposits, it will negatively impact many sectors of the U.S. economy by driving capital out of U.S. banks. The resulting reduction in the banks' deposit business will significantly reduce funds available for lending and investment, which will further weaken the economy by making it difficult for community banks to provide much needed services to their communities and could hurt the ability of some banks to retain or increase their employee base.

Moreover, this proposal could not have come at a worse time – financial institutions are currently in the process of implementing the costly and burdensome procedures that are required in order to comply with the new section 6050W and the Cost Basis reporting provisions that became effective at the beginning of this year. In addition, the IRS/Treasury are currently working on regulations implementing the Foreign Account Tax Compliance Act (FATCA) provisions enacted last year for which financial institutions will be required over the next year and half to undergo substantial time-consuming and costly processes and systems changes in preparation for the January 1, 2013 effective date.[2] Adding these Proposed Regulations will further strain banks' information technology staff and budgets, *for the sole purpose of providing information to the IRS*, especially when there is the risk that many banks will lose billions of dollars in deposit funds due to the resulting loss of many of their NRA customers.

Our reading of current law tells us that this proposal has no statutory basis – as there is no indication whatsoever that it is Congress' intent to tax NRA deposit interest income or require reporting of such income – it is important to point out that the Service has not conducted any cost-benefit analysis regarding this proposal. Such an analysis would show that there are several legitimate reasons why NRAs place money in U.S. banks. These include; concerns and fears about crime/security in their home country; lack of trust in their governments or financial institutions in their home country; and their view of the U.S. as a reliable place to keep their money. Further, a proper cost-benefit study would show that the cost of compliance for many community banks significantly outweighs any illusory benefits that the Service believes it will derive, because these banks would be forced to incur significant costs to implement a provision that will not collect any new taxes for the U.S., but instead, further damage a financial system that is recovering from an economic downturn. Besides, there is no indication whatsoever that the Proposed Regulations will ensure that each foreign country will have enough information to tax deposit interest paid to its citizens.

[2] Moreover, the banking industry is currently dealing with the massive volume of regulations that resulted from the Dodd-Frank Act, and many community banks are having a difficult time understanding the scope of their impact and absorbing the content. Adding these Proposed Regulations, which would have the effect of diminishing their deposit base, will cripple many community banks.

Finally, we believe that the IRS's statement that the Proposed Regulations will "help to improve voluntary compliance by US taxpayers by making it more difficult to avoid the US information reporting system (such as through false claims of foreign status)" is vastly overstated and is in fact, unlikely. Because a foreign customer is generally not required by law to have a taxpayer identification number (TIN), any U.S. person that is intent on avoiding disclosure of interest income or evading taxes with respect to such income can misrepresent themselves as foreign persons not required to provide any personal identifying number. Any information reported to the IRS under this rule would not be useful in identifying such U.S. taxpayers since there is no social security number (SSN) that the IRS can use to identify or match the customer to any U.S. taxpayer or U.S return.

If the Service ultimately decides to go forward with the Proposed Regulations, we suggest that at a minimum, the Service delay implementation and take the time to conduct a proper cost-benefit analysis and during such analysis, consider the issues contained in this letter that banking institutions view as problematic with respect to the rules. Moreover, it will be impossible for banks to be ready to comply within a time frame that is less than one year because of systems and procedures that would have to be put in place prior to implementation. Thus, we strongly recommend that the rules not be finalized until the study is completed and, subsequent to the study, provide a minimum one year before the regulations become final. We suggest that the Service take the appropriate amount of time needed to fully engage in the cost-benefit study and engage with Congress to ensure that its post-study position clearly reflects Congress' intent on this topic.

Coordination with Other Rules and Forms

Since there is a high possibility that the IRS will revise the Form W-8 series due to the requirements imposed on financial institutions under the provisions of FATCA, it is only reasonable that the IRS delay this proposed NRA deposit interest reporting rule until the systemic and procedural needs for complying with FATCA's certification, tax withholding, and information reporting requirements are known. It would not make sense for a bank to embark on the changes required for compliance with one set of rules and then in a short while embark on new changes that are necessitated by a new and different set of rules and requirements. Not only will this be extremely expensive, but also disruptive to daily operations and counter-productive. For instance, any changes to Form W-9 or the Form W-8 will generally necessitate major systemic modifications to a bank's procedures relating to account opening and recertification, tax withholding and information reporting, and tax certification review (which in the case of W-8 certifications are more likely to be manual than automated). Changes to all these procedures will also be required by FATCA. It would be more practical for banks to design, build, test, and implement these changes only once, instead of doing it more than once within a very short space of time. Hence, we suggest that the IRS issue a single, integrated set of W-8 certification and 1042-S reporting guidelines for compliance with both FATCA and the proposed NRA deposit interest reporting rules – if they are finalized – so that banks can coordinate the changes required by both sets of rules at the same time, and not have to backtrack and undo/re-do their work to comply with requirements issued separately.

In addition to the points raised above, the items listed below must be addressed prior to issuing any further regulations on this topic.

Implementation Burdens

- As noted above, financial institutions that do not currently have systems that can readily adapt to the requirements of the Proposed Regulations will need a reasonable amount of time to design, build, test and implement the system changes needed for the proposed NRA deposit interest reporting rule. In general, these banks cannot add projects to the systems development queue unless they are necessitated by actual IRS requirements, not mere proposals. Once there is an actual IRS requirement, each system enhancement must be scoped out, and resource allocations (time/money/personnel) "sized," before the project goes into the development queue. Large projects generally need to be placed in queue at least six to nine months before development work can begin, and the subsequent development and implementation of such projects can take up to an additional six to nine months. Hence, it is very unlikely that these banks will have enough time to ensure proper implementation for payments made starting January 1, 2012. As recommended above, the effective date of the Proposed Regulations – if finalized this year – should be no earlier than January 1, 2013. If a bank can readily adapt, the final regulations should permit early adoption.

- Furthermore, we believe that an optional phase-in structure for NRA bank deposit interest reporting should be permitted. This can help provide more accurate reporting and to some extent, lessen the burden created under this rule. Thus, we suggest that the NRA deposit interest reporting rule, at the option of the bank, be phased in over the extended implementation period requested above for newly opened accounts, and then over a three-year period as existing accounts come up for recertification and their Form W-8 line 3 and line 4 data is captured for reporting purposes.

- The Proposed Regulations will result in burdensome expanded reporting for banks. Under current law – for Canadian residents that are validly certified as NRAs – banks must file Form 1042-S with the IRS to report deposit interest income paid to the customer. However, if such Canadian resident does not provide a valid Form W-8 to the bank, the customer is treated as an undocumented U.S. person and the bank is required to withhold on deposit interest payments made to the customer. If the customer subsequently provides a valid Form W-8 during the year, the bank will typically refund to the customer the amounts that have been withheld by the end of the tax year. If the withheld amounts are refunded, the bank only needs to file a Form 1042-S for such a Canadian resident customer – to report the deposit interest payments made to the customer that year. If the amounts are not refunded, the bank must file both a Form 1042-S to report the interest deposit payments made to the customer after a valid Form W-8 was provided and a Form 1099-INT to report the deposit interest payments made and the withheld amounts during the period that the Canadian resident was treated as an undocumented U.S. person.[3] For all other NRAs, the bank does not file Form 1042-S to report bank deposit interest payments.

[3] In general, the bank will institute withholding if it has a "bad" or no W-8 on file for the NRA. Most banks refund the current year's withholding once the W-8 has been provided or corrected and, thus, would have no need to file the 1099-INT. In cases where the withholding is not refunded during the taxable year, the bank files the 1099-INT reporting the amount withheld and applicable interest to the IRS. The filing of the 1099-INT necessitates the filing of Form 945, which is used to report withheld federal income tax from non-payroll payments, such as backup withholding amounts.

However, if such an NRA fails to provide a valid Form W-8, the NRA is treated as an undocumented U.S. person and subject to withholding on deposit interest payments. If a valid Form W-8 is received and the bank refunds the withheld amounts before the end of the year, no forms are filed for the NRA. If a valid Form W-8 is never received or the bank does not refund the withheld amounts prior to the end of the year after a valid W-8 is received, the bank will file a Form 1099-INT to report the deposit interest amount paid to the NRA and the withholding. This 1099-INT does not provide any useful information to the IRS other than the fact that an amount was withheld. In effect, if a bank withholds on payments to a Canadian resident (and the withheld amounts are not refunded prior to year-end after a valid W-8 is received), it files both Forms 1042-S and 1099-INT for the same year. For all other NRAs, the bank does not file any forms, unless there is unrefunded withholding from a part of the year when a valid W-8 was not on file, in which case, it will file only a 1099-INT. The Proposed Regulation will change the general rule by requiring a bank to file both forms for all NRAs (where there is unrefunded withholding), instead of just one form under current law. This requirement will create undue burdens for banks, especially community banks. For instance, a bank that currently has 1,000 Canadian customers and 10,000 other NRAs will now have to file 10,000 more Forms 1042-S, in addition to a possible increased in Form1099-INT filings because it will no longer be able to monitor only its small Canadian residents customer base to ensure that excess withholdings are refunded in order to avoid filing two forms. This expanded function will be costly and require additional manpower for the bank.

Furthermore, many banks currently have technology systems that are designed to process only a specific number of Forms 1042-S. (This is because under current law, these forms are filed to report deposit interest payments made solely to Canadian resident individuals and not other NRA individuals). A requirement to process any more than that specific number will result in many banks incurring significant costs to not only replace their current software, but also equip their systems with software that does not limit the number of forms 1042-S that can be processed (because the form will have to be filed for all NRAs and the bank cannot limit the number unless it plans to turn away NRA customers after it reaches its limit). For instance, Bank A has 1,000 Canadian customers and 10,000 other NRA customers. Its current software is able to process Form 1042-S for 5,000 Canadians. Because of the Proposed Regulations, Bank A will have to replace its current software with one that is able to process an indefinite number of Forms 1042-S. It will not be able to limit its cost by acquiring software that can only process a specific number of forms because its Form 1042-S processing will now apply to every NRA individual who has a bank deposit interest-bearing account that earns more than $10.00 or more in interest.

- The Proposed Regulations will result in detailed changes in account coding for banks. Under current rules, Canadian-resident NRA deposit accounts that are validly certified with a W-8BEN are flagged for 1042-S reporting using one certification code, and all other NRA and foreign entity accounts with a valid W-8BEN (but not subject to 1042-S reporting) are be flagged with a second code. Under the new reporting rules, there could still be two W-8BEN certification codes, but the other NRA/foreign entity account code would have to be redefined and expanded to create two separate sub codes within that code; one for NRA individuals, and one for non-individual foreign entities. Any new definition assigned a code must be reflected in all related system programming (front-end, back-end, and downstream), written policies and procedures, quality assurance protocols, and internal audit

examination criteria. Account-opening forms, W-8 solicitation mailings, and other customer communications (paper and online) would have to be reviewed and updated if necessary. Finally, telephone bankers and branch staff would have to be trained to answer anticipated questions from NRA individuals who will be receiving the Form 1042-S for the first time.

- The Proposed Regulations will result in increased paperwork for many bank customers. Many banks' deposit systems are generally not currently designed to distinguish, for 1042-S reporting purposes, between W-8BEN certified deposit accounts of foreign customers who are individuals, other than Canadian individuals, and those that are entities (because such data is not currently required to be captured for Form 1042-S reporting purposes, even though such data is included on the Form W-8). Therefore, all existing deposit accounts that are certified with W-8BENs would have to be re-papered and the customers' responses processed, or alternatively, all existing W-8BENs would have to be re-examined and the customers' account records updated on reprogrammed systems. These are both intensively manual back-office processes, neither of which could realistically be completed in less than six months. Moreover, the scope of either task would be greater for banks that require W-8 certification of foreign customers' non-interest-bearing accounts as well as those that are interest-bearing. (There are two primary reasons for this: so that customers can convert a non-interest-bearing account to interest-bearing without having to close and reopen the account or provide a new tax certification; and to identify deposit accounts for certain financial reporting required by the Treasury). The re-papering or re-examination workload could easily exceed 1,000,000 accounts at the largest banks.

- Implementation of the Proposed Regulations would result in a significant increase in banks' Form 1042-S statement printing and postage costs. In addition, the increased Form 1042-S mailing volume is expected to result in significant increases in undeliverable and returned mail, which typically must be "worked" manually by the back-office, piece-by-piece. This will generate a significant amount of administrative costs for banks.

- The Form 1042-S file transmitted to the IRS would be significantly larger under the proposal, and would require substantial clean-up since it would be the first time that a Form 1042-S is filed for many accounts. The number of customers receiving Form 1042-S for the first time would create significant customer service challenges, since many customers who call the phone number listed on the Form 1042-S will need assistance in languages other than English, Spanish, or any others currently offered in customer service.

- The impact of this new requirement goes far beyond banks' existing retail consumer checking account, savings account, and certificate of deposit systems. It will affect all systems that pay U.S.-source bank deposit interest in all lines of business, such as commercial banking systems holding tenants' lease security deposits, commercial lending systems holding borrowers' cash collateral, real estate escrow accounts, etc.

- The new requirement will affect downstream application interfaces, such as when an NRA is required to establish a demand deposit account (DDA) in conjunction with a brokerage account or other relationship, and the tax certification status assigned to the DDA account maps over to the downstream

system that holds the other account or relationship. A large bank could have dozens or hundreds of these downstream application interfaces, and the way each one obtains data from the DDA system would need to be examined and modified if necessary, to ensure that: (a) each foreign customer's certified status as an individual or non-individual; and (b) each individual's permanent residence country will map over correctly to the proper data field of the downstream application.

- If the Proposed Regulations are finalized, retail consumer account systems would likely need major reprogramming to capture the customer's permanent residence country in a manner that can be fed into the bank's Form 1042-S reporting program. In many instances, the only mailing sent to most retail NRA customers today is their monthly account statement; hence, many banks' retail systems only capture the customer's W-8BEN line 5 mailing address. The line 4 permanent residence address is not captured in a way that can feed into a mailing or information reporting program, but is only examined by the back office for proper completion and to determine if any U.S. address was properly cured. If required to add a new field for capturing the permanent residence data for reporting, many banks will incur significant expenses because it will involve an extremely complicated process and require considerable testing prior to implementation.

Guidance

- Guidance should clarify whether reporting will be required for NRAs who have a U.S. permanent residence address on their Form W-8BEN line 4, but cure it in accordance with Reg. 1.1441-7(b)(5)(i)(A). While the "Supplementary Information" section of the Proposed Regulations state that the new requirement applies to NRAs who are "residents of any foreign country," the actual language contained in the Proposed Regulations does not limit reporting to NRAs with a non-U.S. address. If Form 1042-S reporting will be required for NRAs with a U.S. address on Form W-8BEN line 4 (for instance, embassy employees), guidance should clarify what "default" country a bank should indicate in box 16 of Form 1042-S – whether it should be (a) the issuing country of the NRA's passport or other documentary evidence most recently provided to support the NRA's claim of foreign status, (b) the NRA's country of citizenship provided at account opening, or (c) some other country acceptable to the IRS.

- Guidance should clarify that withholding agents may furnish Form 1042-S to recipients by email or other electronic delivery methods.

Penalties

If the Proposed Regulations are finalized, we strongly recommend that the IRS waive all penalties for deposit interest reporting errors or failures for at least two years after the effective date of the new regulations, so that payors can capture the necessary information from all NRA customers as new accounts are opened, and as existing customers' W-8BEN forms expire and are recertified.

As noted above, implementation of the Proposed Regulations will be extremely complex, costly and burdensome, and cannot be realistically completed within a short time frame. Thus, errors are bound to occur.

A two-year period in which penalties are waived – with a showing of reasonable efforts to comply – should be provided in order to ensure a smooth transition period for filers under this reporting requirement.

Please feel free to contact me at fmordi@aba.com or 202.663.5317 to discuss these comments further or answer any questions you may have.

Sincerely,

Francisca N. Mordi