Testimony of

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Hearing on

"Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens" a rule proposed by the Internal Revenue Service

10 a.m. - December 5, 2002

Members of the review panel:

Thank you for this opportunity to contribute to the record. My name is Russell Orban and I am Assistant Chief Counsel for the Office of Advocacy of the Small Business Administration. I am here on behalf of Advocacy (Advocacy) to offer comments and answer questions about the application of the Regulatory Flexibility Act to the proposed rule *Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens.*

You have a copy of Advocacy's formal comment letter filed for the record on November 14, 2002.

Congress established the Office of Advocacy to represent the views of small business before Federal agencies and Congress. The Office of Advocacy is an independent entity so the views I express here today do not necessarily reflect the views of the SBA or the Administration. Section 612 of the Regulatory Flexibility Act (RFA) also requires the Office of Advocacy to monitor agency compliance with the RFA. Recently, Executive Order 13272 entitled "Proper Consideration of Small Entities in Agency Rulemaking underscored the importance of agency compliance with the RFA.

Normally the Regulatory Flexibility Act applies to every rulemaking required by the Administrative Procedure Act. The RFA requires an initial regulatory flexibility analysis that looks at the impact of proposal on small businesses and reviews alternative methods of regulating that may be less burdensome.

If this regulation is legislative, in other words, if the IRS is making policy decisions without specific direction from Congress and exercising its discretion to impose legal requirements to carry out that policy, then the RFA would apply without question and the IRS must do an analysis of the impact this regulations will have on small financial institutions. Other witnesses testifying today are addressing these policy and discretion issues. They will also discuss the possible impacts on small businesses beyond the administrative and paperwork burden. For that reason, I will limit my remarks to what the law requires if this regulation is interpretative as the IRS claims in the preamble of the NPRM.

In 1996, Congress amended the RFA to require an analysis for IRS regulations even in cases where it is interpretative, if the proposal requires a collection of information.

The Special Analyses Section of the preamble to the NPRM asserts that the RFA does not apply to this regulation apparently because the Administrative Procedure Act does not apply to interpretative rules and because the NPRM requires no "collection of information on small entities."

We believe that RFA does apply in this case. The entire purpose of this proposed rule is to create a collection of information system. The NPRM creates a vast new group of reports that would have to be filed on form 1042S by financial institutions that pay interest to nonresident aliens in the named countries. In addition, there is a continuing requirement on the financial institution to maintain records on each interest payee (either a FormW-8 or W-9 depending on withholding options).

All financial institutions, large and small, that pay interest on accounts to nonresident aliens from the named countries will be required to collect information under the proposal.

After reviewing the NPRM and discussing it with affected small businesses and groups that represent them, it is clear that many of them will be dramatically impacted by this proposal.

First they will need a tracking system for the interest they pay and to match the withholding or non-withholding instructions and the addresses of all the parties. They will also need to discern the depositors' countries of residence, apply the requirements of the proposed rule to designated countries, and prepare and send the correct forms.

Next, they tell us that many of their members currently have deposits from nonresident aliens in the named (and many other) countries. The majority of the financial institutions in the country are small entities. For a small financial institution, the burden associated with setting up a system to monitor and report in accordance with the regulation is significant. It would include the cost of equipment, software and set-up, plus the ongoing costs of operation, maintenance, and/or purchases of services to provide this information.

A small financial institution has a smaller customer base over which to defray these costs. This is just one more cost that makes it difficult for small financial institutions to compete with larger institutions.

In closing, even if this proposed regulation is interpretative, the Regulatory Flexibility Act specifically requires the IRS to conduct an initial regulatory flexibility analysis where a collection of information is required, unless the IRS certifies that the proposed regulation will not have a significant economic impact on a substantial number of small entities. If the IRS does not have specific authority for the elements of this regulation, and so used its discretion to set up a monitoring system, then an initial regulatory flexibility analysis is certainly required. In any event, we believe all the criteria are met

to require an analysis. The Office of Advocacy encourages the IRS to carefully review the comments of affected small entities and take appropriate steps to bring this NPRM into compliance with the requirements of the RFA.