November 14, 2002

Internal Revenue Service
CC.DOM:ITA:RU (REG-133254-02)
Room 5226
POB 7604
Ben Franklin Station
Washington, DC 20044

Re: Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens; 67 Fed. Reg. 50386; (August 2, 2002).

Comments and Request to Speak at Public Hearing

Dear Sir or Madam:

The Office of Advocacy of the U.S. Small Business Administration offers the following comments in response to the notice of proposed rulemaking (NPRM), Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens, published by the Department of Treasury's Internal Revenue Service (IRS). The Office of Advocacy's comments are limited to the application of the Regulatory Flexibility Act.

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. The Office of Advocacy is an independent entity within the U.S. Small Business Administration (SBA), so the views expressed by the Office of Advocacy 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, as amended by the Small Business Regulatory Enforcement Fairness Act.[1] On August 13, 2002, President Bush underscored the importance of agency compliance with the RFA and the Office of Advocacy's role in giving a voice to small businesses in the rulemaking process when he signed Executive Order 13272, entitled "Proper Consideration of Small Entities in Agency Rulemaking."

The Special Analyses Section of the preamble to the NPRM asserts that the RFA does not apply to this regulation because the Administrative Procedure Act does not apply to interpretative rules[2] and because the NPRM requires no "collection of information on

[1] Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. § 601 et seq.) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

[2] 5 U.S.C §553 (b), which says in pertinent part, "Except when notice or hearing is required by statute, this subsection [requiring notice and comment rulemaking] shall not apply to interpretative rules…."

small entities." The Office of Advocacy believes that the proposed regulation imposes a collection of information requirement. In fact, all financial institutions, large or small, that pay interest on accounts to nonresident aliens from the named countries will be required to collect information under the proposal. Therefore, after reviewing the NPRM and discussing it with affected small businesses, Advocacy encourages the IRS to publish in the Federal Register for comment an initial regulatory flexibility analysis (IRFA) or a certification that the regulation will not have a significant economic impact on a substantial number of small entities. The IRS and their regulatory process would benefit from gathering and analyzing the information about the industry and the impact of this regulation on them as Congress intended.

Requirements of the Regulatory Flexibility Act

Section 603 of the RFA provides:

> (a) Whenever an agency publishes a proposed rulemaking for an interpretative rule involving the internal revenue laws of the United States, the agency shall prepare and make available for public comment an initial regulatory flexibility analysis. This chapter applies to interpretative rules published in the Federal Register for codification in the Code of Federal Regulations, but only to the extent that such interpretative rules impose on small entities a collection of information requirement.[3]

Section 601 of the RFA defines a "collection of information" to mean:

> obtaining, causing to be obtained, soliciting, or requiring the disclosure to third parties or the public, of facts or opinions by or for an agency, regardless of form or format, calling for … answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, 10 or more persons, other than agencies, instrumentalities, or employees of the United States.[4]

Regulatory Flexibility Act's Application to IRS Proposal

The purpose of this proposed rule is to create a collection of information system that will capture information for the IRS. Section 1.6049-8(a) of the NPRM makes interest that is paid to any nonresident alien in any of 15 designated countries reportable to the IRS, with a copy of the form to the payee. Section 1.6049-4 requires that the financial institution file Form 1042-S[5] with the IRS for any reportable interest paid over an aggregate of ten dollars. The NPRM creates a new category of reports (Form 1042-S sent to the IRS with copies sent to the payee and withholding agent, if applicable) with a requirement for a continuing records maintained by the bank for each payee (either a Form W-8 or W-9 depending on withholding options).

[3] *Id.* §603(a).
[4] *Id.* at §601(7).
[5] Form 1042-S *Foreign Person's U.S. Source Income Subject to Withholding.*

To comply with the proposed rule, any financial institution, large or small, that pays interest to nonresident aliens from the subject countries, needs a tracking system to match withholding or non-withholding instructions and the addresses of all the parties. The financial institution's tracking system will 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.

The paperwork requirement seems evident. The Paperwork Reduction Act (PRA) summary in the preamble of the NPRM refers specifically to the burden per respondent required by the new section 1.6049.4(b)(5)(i) and the new section 1.6049-6(e)(4)(i) and (ii). The PRA discussion also reminds financial institution of their obligation that "books and records relating to the collection of information must be retained as long as their contents may become material."[6]

Significant Economic Impact on a Substantial Number of Small Entities

There are nearly 19,000 banks, credit unions, and savings and loans in the United States that would be subject to this regulation, and the majority of them are small entities. For example, using the most current data available to Advocacy, at least 57% of the nation's 8,000 reporting banks qualify as a small bank under the SBA's size standard.[7] In checking with trade associations representing potentially affected small financial institutions, they indicate that many of their members currently have deposits from nonresident aliens.

For a small financial institution, the burden associated with setting up a system to monitor and report in accordance with the regulation is a significant burden. 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.

Complying with additional regulatory burdens is, therefore, much more expensive per customer for small entities than for their larger competitors.[8] If this regulation is imposed, it will create a barrier to small financial institutions' ability to compete. The information we received indicates the burden is larger than the IRS assumed for PRA

[6] 67 *Fed. Reg.* 50386, 50387 (August 2, 2002).

[7] This statistic is based on an analysis of bank asset data and the former SBA size standard of having less than $100 million in assets. Earlier this year, SBA increased the size standard to $150 million, which we believe would result in an even greater percentage of reporting banks qualifying as small banks.

[8] See *The Impact of Regulatory Costs on Small Firms,* Office of Advocacy, Crain and Hopkins, 2001 where the cost of tax related regulatory compliance per employee was found to be more than twice as expensive for small businesses (firms with fewer than twenty employees) than large businesses (firms with over 500 employees).

purposes.[9]

Conclusion and Request to Testify

The Regulatory Flexibility Act specifically requires the IRS to conduct an initial regulatory flexibility analysis for interpretative rules 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. 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.

Finally, 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.

The Office of Advocacy would like to reserve the right to appear at the hearing scheduled for December 5, 2002 and to have this letter serve as the outline of our comments. If you have any questions or require additional information, please contact Russell Orban at 202-205-6946 or russell.orban@sba.gov. Thank you for this opportunity to contribute to the record.

Sincerely,

S/

Thomas M. Sullivan
Chief Counsel for Advocacy

S/

Russell Orban
Assistant Chief Counsel

[9] The Paperwork Reduction Act Submission filed by the IRS on this Proposal (REG-133254-02 and REG 126100-00) acknowledges system costs, but does not indicate whether the costs are significant for small entities. In addition, the submission does not indicate the basis for the IRS estimation that 2,000 of the 19,000 financial institutions would be required to file reports. The submission does not provide a basis for the estimate of 15 minutes as the burden assessment per respondent to comply with the annual reporting requirements in the proposed rule. For any analysis of burden to be credible, it is important to know the number of nonresident alien depositors, as well as the number of financial institutions that currently hold such deposits, in order to craft a rule that does not harm small financial institutions. The basis for those estimates should be transparent to allow for informed and thoughtful comments about the potential burden such a proposal will impose.