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United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510-6250

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April 27, 2012

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

RE: Proposed Rule on Dividend Equivalents From Sources within the United States

Dear Commissioner Shulman:

The purpose of this letter is to express support for the proposed rule on dividend equivalent payments from sources within the United States.

In 2008, the U.S. Senate Permanent Subcommittee on Investigations, which I chair, concluded a year-long investigation, held a hearing, and released a bipartisan report detailing how U.S. financial institutions were using swaps, stock loans, and other financial mechanisms to enable foreign clients -- primarily offshore hedge funds, tax haven banks, and other sophisticated foreign investors -- to dodge U.S. taxes owed on U.S. stock dividends. Because the Subcommittee's efforts provide extensive, relevant information about the dividend tax abuse that the proposed regulation is intended to correct, I would like to submit a copy to you of the Subcommittee hearing record, which includes the report authored by myself and Senator Coleman, to be made part of the administrative record supporting the proposed rule.

It was in response to the Subcommittee's investigation that, in 2010, Congress enacted legislation to put an end to this expensive tax dodge. The 2012 proposed regulation on dividend equivalent payments will finally implement the law Congress enacted to stop foreign investors in U.S. stock from escaping their U.S. tax obligations.

Efforts are now underway by some in the financial industry to delay implementation of the law or create loopholes in the proposed regulation so that foreign investors can continue to dodge U.S. taxes and shift their tax burden onto American taxpayers. I urge the IRS to resist those efforts and close the dividend loophole completely, as Congress intended.

Some contend that it would be too difficult under the proposed rule to identify who is receiving the dividend equivalent payment and to determine the dividend amount for which tax is owed. Those arguments are difficult to credit, however, since similar problems are present and have already been resolved in the case of direct U.S. stock dividend payments. Brokers know or can find out who their payment recipients are, and are more than capable of determining the dividend amount and the tax owed. Others protest that the proposed regulation will deter foreign investment, but foreign investors have known for decades that U.S. tax is owed on U.S. stock dividends and have purchased U.S. stock despite the added tax. In addition, Congress has

already made the determination that taxes owed under the law should be paid, even when a dividend payment is embedded within a swap.

The proposed regulation is also important, because it would finally implement the law's requirement to treat this category of swap payments as taxable U.S. source income. Right now, a twenty-year-old IRS regulation inexplicably deems swap payments sent from the United States to another country as non-U.S. source income, turning the meaning of the word "source" on its head. Correcting that approach for swap payments that include dividend equivalents is a critical first step toward reforming the source rule for all swaps.

Thank you for this opportunity to comment on the proposed rule.

Sincerely,



Carl Levin, Chairman
U.S. Senate Permanent Subcommittee on Investigations

Enclosure