

foreign corporations and also modifies the application of the so-called second dividend tax.

Under the bill, foreign corporations owned entirely by foreigners would be exempt from the personal holding company tax. This is possible because of the elimination of graduated rates as applied to foreigners which is contained elsewhere in the bill, which makes the application of the personal holding company provision to corporations wholly owned by foreigners no longer appropriate.

Under the bill, the "second dividend tax" (which is levied on dividends distributed by a foreign corporation if the corporation derives 50 percent or more of its income from the United States) would be applied only to the dividend distributions of foreign corporations doing business in the United States which have over 80 percent U.S. source income. It is desirable to retain this part of the tax to cover those cases where a resident foreign corporation has the great bulk of its business operations in the United States and to treat dividends of such a corporation as being from U.S. sources.

These changes should have the effect of eliminating application of the personal holding company tax and "second dividend tax" in many cases where they now apply, and which may now act as a deterrent to foreign investment.

As to expatriate American citizens—the provisions of H.R. 5916 which eliminate graduated rates for foreign individuals and substantially reduce the estate tax liability of foreign decedents may create a substantial tax incentive to U.S. citizens who might wish to surrender their citizenship in order to take advantage of these changes in the law.

While it is doubtful whether there are many who would be willing to take such a step, still the incentive would be present and might be utilized. H.R. 5916 deals with this problem by providing that an individual who had surrendered his U.S. citizenship for tax reasons within the preceding 10 years shall be subject to U.S. taxation with respect to his U.S. income and assets at the rates applicable to citizens. Such individuals will therefore not receive the benefits of this legislation but will be taxed as nonresident foreigners are at present. As I mentioned, these provisions would not apply if the expatriate American citizen can establish that the avoidance of U.S. taxes was not a principal reason for his surrender of citizenship.

As to retaining the treaty bargaining position of the U.S.—the risk is present that by making the changes provided in H.R. 5916, the United States may be placed at a considerable disadvantage in negotiating similar concessions for Americans. In order to protect the bargaining position of the United States in international tax treaty negotiations, H.R. 5916 therefore authorizes the President, where he determines such action to be in the public interest, to re-apply present law to the residents of any foreign country which he finds has not acted to provide our citizens substantially the same benefits for investment in that country as those enjoyed by its citizens on their investments in the United States as a result of this legislation. If this authority were invoked, it could be limited to those investment situations as to which U.S. citizens were not being given comparable treatment. We believe that the presence of such a provision will be a material aid in our securing appropriate provisions respecting these matters in our international tax treaties.