

should be regarded as business income. In view of the fact that a 10-percent stock interest has been recently used as an indicia of significant control (cf. sec. 951 and sec. 4915 of the Internal Revenue Code of 1954), perhaps a 10-percent equity ownership test would provide a suitable yardstick for determining whether dividend income qualifies as business income.

Over the years, Congress has consistently taken great pains to provide exceptions and savings clauses in tax legislation in order to avoid inequity and unintended hardship that may occur in connection with the adoption of a new general rule. We submit that the instant situation needs such distinguishing treatment. The abuse that the Treasury is concerned with is the cloaking of what is essentially an investment operation with a thin veneer of operating activity. If it is that type of avoidance which the Treasury is interested in preventing, the result could be accomplished, without discouraging foreign investment of a permanent type in this country and without dislocating existing foreign business structures, through the application of some type of "active business" test. The "active business" tests set forth in the regulations under section 954 (Treas. Regs. sec. 1.954-2(d)(1) (i) (ii) and (iii)) or section 355 (Treas. Regs. sec. 1.355-1(c)) would seem to provide pertinent guidelines that could be utilized in connection with the proposed amendment.

In our opinion the underlying purpose of H.R. 5916 and the elimination of the specific abuse about which the Treasury is concerned can be most suitably effected by extending to those foreign operations, that satisfy an "active business" test and a "permanent investment" requirement, the option to elect either (1) the tax treatment provided in the proposed amendment (no intercorporate dividends received deduction, but an exemption from tax on capital gains on U.S. stock investments) or (2) the tax treatment provided for resident foreign corporations under the existing provisions of the law (the availability of the intercorporate dividends received deduction, but a tax on capital gains realized in connection with U.S. stock investments).

Mr. WARIS. Thank you. I would like then today to proceed on the basis of a less formal statement which I believe you also have before you.

Mr. KARSTEN. We will be pleased to hear you.

Mr. WARIS. We would first like to state that we wholeheartedly support the general objectives of H.R. 5916. The aim of this legislation, to promote increased investment by foreigners in stock of U.S. corporations by removing existing tax barriers, is a highly desirable one at the present time. The bill is all the more praiseworthy because of its positive character.

Our purpose here today is to comment on one specific provision in the bill which has an effect directly opposite to the bill's important basic objective. This provision would tend to discourage significant direct investment by foreign corporations in U.S. operating subsidiaries and to disrupt legitimate patterns that foreign corporations have traditionally employed in connection with their conduct of business in this country.

The particular provision to which we refer is the proposed amendment to section 882 of the Internal Revenue Code of 1954 and is contained in section 4(b) of H.R. 5916.

This amendment would (1) eliminate the 85-percent intercorporate dividends received deduction in the case of all resident foreign corporations, and (2) exempt such corporations from tax on capital gains realized on their U.S. stock investments. The proposed amendment would have the effect of subjecting dividends received by resident foreign corporations to the 30-percent statutory withholding rate or any lesser treaty rate applicable to such income, rather than the previous 7.2-percent maximum rate of tax.

Essentially, what we are concerned about is the mandatory application of the proposed amendment to foreign corporations which