

conduct active substantial businesses in this country, both through a branch operation as well as through direct investments in U.S. operating companies.

Although the proposed amendment might tend to stimulate somewhat the purchase of U.S. stocks by foreign corporations seeking to earn capital gains in connection with trading activities, on the other hand, the amendment would also tend to discourage long-term direct investment in domestic operating companies by other foreign corporations.

To us this result appears unwarranted and, indeed, perhaps unintended in view of the basic purpose of the bill (namely to stimulate foreign investment in this country), and in view of the two specific reasons advanced by the Treasury in support of the proposed amendment.

To understand some of Treasury's reasons for this proposal and the objections which we have to it, it is helpful to refer to the Treasury's explanation of the provision which is dated March 8, 1965, and which accompanied the bill when it was sent to the Congress. I quote now the Treasury explanation.

There is one abuse in this area which should be eliminated. Frequently, a foreign corporation with stock investments in the United States engages in trade or business here in some minor way (such as by owning a few parcels of real estate) and then claims the 85-percent dividends received deduction on its stock investments in the United States.

Such a corporation thereby may pay far less than the 30-percent statutory or treaty withholding rate on its U.S. dividend income, although its position is essentially the same as that of a foreign corporation doing business elsewhere which has U.S. investment income.

To eliminate this abuse and treat all foreign corporations with investments in U.S. stocks alike, the 85-percent dividends received deduction should be denied to foreign corporations doing business here.

We have no quarrel with Treasury's desire to curb this type of abuse.

On the other hand, we do object to the remedy which the Treasury proposes. Essentially, the proposed amendment presents the following three problems: (1) it applies to a much wider class of taxpayers than is necessary to curb the specific abuse which led to its proposal; (2) it would, in its present form, disrupt a traditional and legitimate means that a number of foreign corporations have historically used to conduct business in this country; and (3) unless modified, it might very well have the effect of discouraging existing and potential long-term investment here by large foreign corporations despite the fact that the avowed purpose of H.R. 5916 is to stimulate and foster foreign investment in the United States as part of our program to improve our balance of payments.

Why, particularly in the context of H.R. 5916 should a foreign corporation which is actively engaged in substantial business here be treated less favorably than a domestic corporation with respect to dividends received from U.S. operating affiliates?

The theory of the 85-percent, dividends-received deduction is to relieve income which has already been subjected to a full layer of U.S. corporate income tax from another large tax at the corporate level.

There appears to be no good reason for failing to apply this theory to dividends received from domestic operating subsidiaries by a foreign corporation actively engaged in business in this country.