Certainly, changing this long-established rule at this time will not have the effect of encouraging such foreign corporations to increase their investments in the stock of U.S. corporations.

The second purpose of the proposed amendment, as indicated by the Treasury, is to segregate the investment income of foreign persons from their active business income in order to subject such investment income to uniform U.S. tax treatment.

Here again, the provisions of the bill in their present form fail to accomphish their aim in some cases and for essentially the same reason—they are too broad in their scope, automatically classifying all dividend income as passive investment income.

In the case of many foreign corporations what is classified as investment income under the bill is in essence business income. This occurs because the proposed amendment fails to treat as business income the dividends received by a resident foreign corporation from domestic corporations in which they have made direct investments.

A foreign corporation which conducts business here through a branch may also, for historical or other reasons, engage in one or more additional businesses in this country through ownership of affiliated domestic subsidiaries.

These are in the nature of direct investments—the type of investment which contains a sufficiently great element of management activity to entitle them to exclusion from the interest equalization tax—which, as you are so well aware, is designed to reach passive portfolio type investments. It seems clear to us, therefore, that dividends received from such affiliated companies are actually business income.

Nevertheless, under the bill they would be treated as passive investment income, and as a consequence, these direct investments by foreigners in U.S. ventures might be adversely affected by the enactment of H.R. 5916.

Furthermore, the Treasury objective of uniform tax treatment on the dividend income of foreign corporations would not be achieved under the proposed amendment since the rate of tax on such income would vary on a country-by-country basis depending upon the difference in the applicable treaty rates.

This issue certainly is not a hypothetical matter. From our own experience we are aware of a number of foreign corporations which conduct substantial active businesses here, both through branch operations and affiliated domestic subsidiaries.

Foreign banks are a good example. In connection with their foreign operations banks generally prefer to conduct business through a branch rather than through a subsidiary, in order to obtain the benefit of their "home office" reserves.

In New York alone, about a dozen foreign banks conduct operations through branch offices and a number of these have wholly owned domestic subsidiaries which engage in businesses that the foreign banking parent is not permitted to engage in directly.

For example, a number of foreign banks have wholly owned domestic subsidiaries carrying on fiduciary and safe-deposit businesses.

Another situation with which we are familiar involves a large Japanese trading company having several branch offices in the United States. This Japanese company has also acquired a substantial stock interest in at least one U.S. operating subsidiary.