

tended and serious tax effects. The changes may also bring other adverse economic effects, particularly on the U.S. balance of payments.

The questionable changes which are proposed in H.R. 11297 are as follows:

(1) The introduction of an entirely new concept, that non-resident aliens and foreign corporations engaged in trade or business in the United States would be taxed on worldwide income "effectively connected" therewith. Current law taxes such persons on their U.S. source income only.

(2) After 1970, interest on U.S. bank deposits would be subject to U.S. tax although paid to persons not engaged in business here.

(3) U.S. bank deposits would be included in the gross estate of nonresident alien decedents even though not engaged in business in the United States.

(4) The bill imposes higher estate tax rates on nonresident alien decedents than those proposed in H.R. 5916.

The committee is aware of the need to evaluate other than balance-of-payments considerations in the preparation of such legislation, but the specific factors which led to the adoption of these changes have not been made clear. That the need for the changes is not immediately obvious is demonstrated by the fact that they were not proposed until very recently, although the kind of changes desirable with regard to U.S. taxation of foreign persons has been under continuous study since the formation of the Fowler task force in October 1963.

The changes cited above are discussed in some detail in items 1, 6, 9, and 10 of the attached "specific comments and recommendations." It is believed that the discussion makes clear the need for public hearings before the Committee on Ways and Means decides to recommend these major tax changes to the House of Representatives.

SPECIFIC COMMENTS AND RECOMMENDATIONS

Bill section 2: Proposed code section 861(a)(1) (A) and (D); 861(c)

(1) *Interest on U.S. bank deposits (p. 4, lines 9-14; p. 5, lines 1-18; p. 6, lines 3-6).*—The effect of the proposed amendments would be to subject interest on U.S. bank deposits and similar amounts to withholding of tax at source with respect to payments after December 31, 1970. There are two obvious reasons for questioning the proposed change:

(1) This exemption, which has been in force since 1921, has been considered desirable to encourage the use of U.S. banks by foreign persons for deposits and financial transactions.

(2) The nexus for such taxation of income from U.S. bank deposits is so slender as to raise doubts as to the rationale for the change.

While the effect of this change would be delayed for several years, it is not considered desirable because it creates another complication regarding investment in the United States. Such complications are believed to act as a current psychological deterrent to U.S. investment by nonresident aliens, even though the financial deterrent of U.S. withholding tax will not occur until 1971.