

sources and therefore would generate less profit subject to U.S. tax. Although the provisions would not take effect until 1971, there would without doubt be an earlier withdrawal of deposits.

One provision of the bill exempts foreign currency deposits in branches abroad but subjects U.S. dollar deposits to the tax. This provision would result in the complete disappearance from U.S. branches of dollar deposits and a large outflow of dollars from the United States to Europe. Dollar deposits maintained by non-U.S. residents in U.S. branches abroad represent extremely large sums, reaching into the hundreds of millions of dollars. In the case of our bank, more than half of the dollar deposits maintained in our London branches in the year 1965 were held by the branches in an interbranch account with our head office. No doubt, a similar situation exists in other U.S. banks. The balance of the dollar deposits of our branches, those not transferred to the United States, are used for financing in Europe or for activities of our branches in the United Kingdom. In the event the dollar deposits of our London branches were transferred to other banks, we would be forced to transfer substantial sums abroad to maintain our branch operations.

We recognize that the proposed legislation is not designed to apply a withholding tax to all deposits from abroad. Time deposits from foreign official institutions would continue to be exempted and demand deposits (which do not earn interest) would not seem to be affected. However, there is a strong interrelationship between the various types of foreign deposit accounts and our foreign financing activities. The disappearance of interest-bearing U.S. dollar deposits from private sources would substantially reduce the funds we lend abroad. As a consequence demand deposits related to foreign financing would be reduced, as would time deposits from official institutions which are frequently held with us as compensating balances in connection with foreign loans. About 95 percent of our dollar deposits in London comes from commercial banks; these would be directly subject to the withholding tax. About the same percentage of our foreign time deposits in the United States comes from official institutions; while these would continue to be exempted, the indirect result would be a reduction in official time deposits.

It is surprising that a bill which was designed to improve the U.S. balance of payments should contain new withholding tax provisions which would make it unattractive for foreigners to maintain interest-bearing dollar deposits with U.S. banks and would thus inevitably have an adverse effect on our balance of payments. H.R. 11297 would remove the withholding tax exemption on deposits of nonresident aliens, which has been part of the law since 1921 and which we understand was designed to encourage foreigners to transact financing business through U.S. banks. I feel sure that you will agree that the bill should be modified to exclude its present provisions for applying a new withholding tax on the interest earned by foreigners on deposits with U.S. banks.

Sincerely,

DAVID M. KENNEDY.