GENERAL COMMENT

If the United States lack general jurisdiction over a person realizing income from U.S. sources, it simply cannot make a seamless web of the tax law applicable to him unless it adopts withholding rules so harsh and impractical that they will cripple ordinary business transactions and drive bona fide foreign investors away from the United States. Upon analysis, it seems that section 341 and section 1232 (particularly the former) cannot apply fairly and effectively to foreigners over whom we do not have personal jurisdiction. Under these circumstances, it seems preferable to admit the deficiency and devote administrative and legislative effort to other problems which are more pressing than the closing of theoretical gaps which these provisions of the code may present.

II

Policy Problem Suggested by Proposed Amendment of the Source Rule for Interest Paid by Foreign Branches of Domestic Banks

The events of the last 6 months have demonstrated that the existing source rule for commercial bank interest puts U.S. banks operating abroad through branches at a disadvantage in comparison with foreign banks and those U.S. banks which operate through foreign subsidiaries rather than branches. U.S. corporations attempting to comply with the President's balance-of-payments objectives have raised extensive funds by long-term borrowings in European capital markets on the bonds of their financing subsidiaries so that the financing of their offshore operating subsidiaries may be accomplished without a dollar drain. Pending their ultimate use, the proceeds of these so-called Eurodollar bonds have been placed on short-term interest-bearing deposit. The financing subsidiaries which are the issuers of Eurodollar bonds must, as a practical matter, limit their income to foreign source income.[2] Accordingly, Eurodollar bond proceeds have been placed with foreign banks or the foreign affiliates of U.S. banks, depriving the foreign branches of U.S. banks of substantial business which they could have attracted under other source rules.

The proposed new section 861(a)(1)(D) would amend the interest source rules so that interest paid on foreign currency deposits by a foreign branch of a U.S. bank would be foreign source income. However, this would not substantially ameliorate the practical disadvantage imposed upon foreign branches of U.S. banks by the present source rule, since the principal completitive area in which the existing rules create a disadvantage is one in which dollar deposits are involved. It is submitted that the last clause of the proposed section 861(a)(1)(D) should be deleted and it should provide that any interest paid by a foreign branch of a U.S. corporation will be regarded as foreign source income so long as the foreign branch itself is engaged in a commercial banking business and the interest paid is on an obligation incurred in the course of that business by that branch.

Very truly yours,

JOHN P. CARROLL, Jr., Esq.

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[2] These financing subsidiaries would be required to withhold U.S. tax on their interest payments if they did not realize more than 80 percent of their income from foreign sources. Sec. 861(a)(1). European investors have been willing to invest in their debt instruments only on the condition that these financing subsidiaries indemnify the investors for withholding from them. Accordingly, withholding liabilities would be borne not by the European investors but by the financing subsidiaries.