

NEW YORK COUNTY LAWYERS ASSOCIATION COMMITTEE OF TAXATION

Report on H.R. 11297, The Foreign Investors Tax Act of 1965

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A. GENERAL COMMENTS

1. Bank accounts and bonds

Since the Revenue Act of 1921, the interest on bank deposits has been exempt from income tax and such deposits have been excluded from the gross estate for estate tax purposes when received by, or owned by, nonresident aliens not engaged in business in the United States. Such provisions were adopted for the purpose of encouraging nonresident aliens to open and maintain bank deposits in the country.

Section 2(a) of the bill amends the present law to expand the coverage of the present income tax exemption with respect to interest on bank deposits, but then provides for the repeal of the exemption as to interest paid or credited after December 31, 1970. The bill also provides that interest on a deposit made by a nonresident alien with the foreign branch of a U.S. bank will be exempt only if it is payable in a foreign currency and is not effectively connected with a business carried on in the United States. Section 8 of the bill provides that after the date of enactment of the act, a dollar deposit made by a nonresident alien with the foreign branch of a U.S. bank will be subject to estate tax.

Under present law bonds issued by U.S. obligors are subject to estate tax when owned by nonresident aliens, only if the bond is physically located in the United States. Section 8 of the bill, which is effective immediately, will subject bonds to the estate tax irrespective of their location, if issued by U.S. obligors.

A major purpose of the bill is stated to be the encouragement of foreign investment in the United States so as to help the U.S. balance of payments. The 5-year delay in the repeal of the income tax exemption with respect to bank interest presumably was designed to encourage such deposits during the 5-year period. However, aliens are quite sensitive to estate tax liabilities and the possibility of incurring estate tax on such deposits or on bonds of U.S. obligors undoubtedly will induce many nonresident alien individuals to close out their bank deposits and to dispose of bonds of U.S. obligors immediately, despite the temporary continuance of the income tax exemption.

The failure to grant an estate tax exemption as to dollar deposits with foreign branches of U.S. banks also will have an immediate