

## NEW YORK STATE BAR ASSOCIATION, TAX SECTION

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## REPORT OF SUBCOMMITTEE ON INCOME TAX PROBLEMS OF NONRESIDENT ALIENS WITH RESPECT TO H.R. 11297

*Bill section 2(a)(1)(A): IRC section 861(a)(1)(A) and (c)(2)—Interest*

The purpose of this amendment is to extend the present exemption of interest on deposits with persons carrying on the banking business to amounts earned on accounts maintained with Federal or State chartered savings and loan associations (such interest is often labeled a "dividend" by the savings institution). This will end a great deal of current confusion. Nonresident aliens are often surprised when a withholding tax is deducted from interest earned on such accounts due to the fact that the alien is technically a "shareholder" instead of a creditor.

The proposed amendment is limited to cases where the "amounts" paid or credited are "deductible" by the association under section 591, i.e., where such amounts are withdrawable on demand, subject to customary notice. This limitation will cause uncertainty since existing section 861(a)(1)(A) and proposed section 861(c)(1) (interest on deposits with persons carrying on the banking business) contain no such requirement. Further, reference to section 591 requires consideration of section 265, which disallows interest paid to purchase or carry tax-exempt bonds. Since savings and loan associations often purchase municipal bonds, it is possible that, due to application of section 265, a portion of the interest paid to depositors or account holders will not be deductible under section 591.

This bill purports to encourage foreign investment in the United States by removing tax barriers to such investment. In line with this intent, it is suggested that reference to section 591 be deleted; or in the alternative, the addition to the phrase "without regard to section 265" should be inserted after "section 591."

It is further suggested that this amendment be expanded so as to cover certificates of deposit, a form of investment which, in recent years, has expanded enormously. While it is believed that present section 861(a)(1)(A) (and proposed section 861(c)(1)) are applicable to certificates of deposit, there is some uncertainty on the point in banking circles, with the result that many banks are reluctant to sell CD's to nonresident aliens. CD's are technically deposits (reserve requirements apply) and a clarification of the law is in order.

Proposed section 861(c)(3) would further extend the exemption to "amounts held by an insurance company under an agreement to pay interest thereon." While this amendment is probably intended to cover funds left with life insurance companies by beneficiaries, annuitants, and owners of matured policies, the proposed text literally would include interest paid by any insurance company (life or casualty) to its noteholders, bondholders, or other creditors. A clarification of this proposed subsection is necessary.