

where it is incorporated and where it makes its sales. That income is not subpart (f) income because it is selling within the country of incorporation, but an inquiry comes to the U.S. parent from an adjoining foreign country and the U.S. parent turns it over to the local office of the foreign subsidiary.

They are handling purchasing and they are handling shipments. It is very easy to add the sale to this other country. They make this shipment to the other country. This would be subpart (f).

If the gross income exceeded 30 percent of the total gross income of the foreign subsidiary, but we will assume it doesn't exceed 30 percent, it is incidental. Thirty percent is a rather substantial part of their total gross income. There is a gross profit.

Under existing law that income would not be subject to U.S. tax until brought home. Under this law it might very well be subject immediately to U.S. tax, and when any income of a foreign corporation is subject to U.S. tax it is certain to be subject twice to the same U.S. tax on the same income because when the foreign corporation pays a dividend to its U.S. parent company, that dividend will be subject to U.S. tax again.

The income has been subject to U.S. tax in the hands of the foreign corporation and there is no relief from that situation, such as the foreign tax credit, because a U.S. corporation doesn't get credit for a U.S. tax paid by a foreign subsidiary.

Those are briefly three ways, and above all is the psychological effect that has prevented many small manufacturers in the last 4 years, 5 years, from going into export.

More and more small Middle West manufacturers were going into export and when the 1962 act came and it seemed that the Treasury was determined to penalize exports, they decided they just didn't want to get into the complexities that are involved in subpart (f) and all that that means.

That is a long answer to a question, but I think it is an essential point in the whole picture.

Mr. WATTS. I appreciate that. I think you have covered two of my questions. I have another one.

Why do you think this legislation would be likely to cause retaliation by other countries?

Mr. SEGHERS. Because it would be taxing foreign entities over which we theoretically don't have jurisdiction on income earned by those entities outside the United States and they would say if we can do that they will do the same thing. They will tax U.S. corporations on income not earned within their borders.

Mr. WATTS. Are you saying, if I follow you, because these people outside the United States merely have a sales office here, that we would be imposing a tax on their operation?

Mr. SEGHERS. If the goods were sold here it would be U.S. income, and we don't need this bill. If it admitted these foreign incomes but it is administered out of New York it would be taxable.

Mr. WATTS. Another question.

In what way would legitimate export activities—and I think you have already answered this—of a U.S. manufacturer be burdened by this "effectively connected" concept?