

established * * * that the * * * organization of the controlled foreign corporation * * * does not have the effect of substantial reduction of * * * taxes."

Query. Does the fact that under section 954(b)(4) the income is not subpart F income mean that the exclusion provided by proposed section 854(c)(4)(C)(ii) does not apply? If so, a company may be taxed under H.R. 13103 on income that is excluded from taxation under the subpart F provisions of the code.

EXAMPLE 2

Under section 954(b)(3) no part of gross income shall be considered as foreign base company income (and hence subpt. F income) if it is less than 30 percent of the gross income of the corporation.

Query. Does this mean that if a corporation avails itself of the 30-70 rules for exclusion of income from taxation under subpart F that the excluded income may therefore be taxable under H.R. 13103 under the same reasoning as in example 1?

EXAMPLE 3

As indicated in previous examples, the proposed bill excludes from effectively connected income, foreign source income which is subpart F income of a controlled foreign corporation. However, in order to be a controlled foreign corporation, it is necessary only that "U.S. shareholders" own more than 50 percent of the stock. Such U.S. shareholders report only their pro rata share of subpart F income.

Query. Would not the exclusion of the entire subpart F income result in failure to subject to tax as much as 49 percent of the effectively connected income; i.e., the 49 percent which is applicable to foreign holders? And would not that portion remain permanently free from U.S. taxation?

We believe that any departure from the traditional source of income rules will create problems and inequities disproportionate to the abuse situations for which a remedy is sought.

COUDERT BROS.,
ATTORNEYS AND COUNSELORS AT LAW,
New York, N.Y., March 4, 1966.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means, House of Representatives, Washington, D.C.
(Attention: Leo Irwin, Esq., Chief Clerk).

DEAR MR. MILLS: We have noted with interest the proposed changes to the Internal Revenue Code as set forth in H.R. 13103 (Foreign Investors Tax Act of 1965) which substitutes for the earlier proposed H.R. 11297.

Although we are gratified that your committee will schedule a hearing on the proposed act on March 7, 1966, we were, at the same time, dismayed by the scarcity of time for study of the act before the 1-day hearing. Because of the complexity involved in the proposed changes to the Internal Revenue Code, and the fact that further hearings cannot be held due to the heavy schedule of the committee announced in your press release dated February 24, 1966, it is vigorously urged that the proposed act be retained in committee and not submitted to the House in its present form. To us it seems imperative that the proposed act must be thoroughly analyzed and studied, and numerous technical mistakes, hereinafter described, corrected before it can be acted upon.

H.R. 13103 is an unsuccessful attempt to contain or define the concept "effectively connected" introduced in H.R. 11297. It is unsuccessful because it attempts to contain the unknown by use of the unclear. For example, the amendment proposed to section 864 by section 2(d), at page 12, commencing at line 15 of the bill, presents mere general language which will not afford a taxpayer any reasonable certainty. At page 13, line 20, use of a "material factor" concept will not be helpful. Again at page 14, line 2, a mere bookkeeping entry apparently aids in determining whether income is "effectively connected" with a trade or business in the United States, provided one can evaluate qualitatively exactly what "due regard" may mean. Further, on page 14, the sentence commencing on line 3 of the bill apparently changes the source rules set forth in section 861(a)(1)(A) with respect to interest. Under the source section, such interest is treated as income not from sources within the United States. Under the bill this last sentence apparently changes this rule for the purposes of apply-