NATIONAL FOREIGN TRADE COUNCIL, INC.,
New York, N.Y., March 7, 1966.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means,
House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: The National Foreign Trade Council has reviewed the Foreign Investors Tax Act of 1966 (H.R. 13103, 89th Cong., 2d sess.) and, in response to your request, welcomes the opportunity to submit comments concerning it.

You will recall our letter of January 14, 1966, pointed out that certain changes in H.R. 11297, as compared with H.R. 5916, appeared to be contrary to the general policies set forth in the report of the Fowler task force. A copy of this letter is enclosed, which we request be given further consideration and be made a part of the record of H.R. 13103.

In accordance with your specific request, the following comments are confined to the further changes made by H.R. 13103.

The council understands that the committee report will contain examples further clarifying the types of income to be subject to tax under this bill and is pleased to note that the "effectively connected" concept has been substantially narrowed. However, the exceptions provided in the proposed section 864(c)(4) may not be adequate to protect legitimate foreign subsidiaries of U.S. corporations from immediate taxation under this law solely as a result of the activities in the United States of the controlling shareholder.

The exception provided in section 864(c)(4)(C)(i) for dividends, interest, and royalties requires the taxpayer to hold a stockownership of more than 50 percent to qualify. It is believed a 10-percent requirement would be more consonant with the realities of present day foreign investment in view of the fact that many foreign countries do not permit a 50-percent foreign ownership and such a high percentage of foreign ownership would discourage participation by local investors in necessary industries. Furthermore, the suggested 10-percent stockownership requirement would be consistent with the stockownership requirement for qualified investments in less developed countries.

Another exception from the rules which would treat certain foreign source income as "effectively connected" is contained in section 864(c)(4)(C)(ii), which excludes subpart F income. The difficulty here is that there are many exclusions and exceptions to the definition of subpart F income such as:

(1) Dividends, interest, and gains from qualified investments in less developed countries.

(2) Income which would otherwise be subpart F income but which constitutes less than 30 percent of the corporation's gross income.

(3) Income of a corporation not created or organized to reduce taxes.

(4) Royalty income derived in the active conduct of a trade or business which is received from unrelated persons.

The council believes the bill should not extend U.S. income tax to the types of income of a controlled foreign corporation which were carefully considered by the Congress in 1962 and were specifically excluded from the application of subpart F. The exception for subpart F income under section 864(c)(4) should be modified to provide that, for the purposes of that exception, the exclusions from foreign base company income contained in section 954 should not apply.

In view of the policy favoring less developed country corporations contained in subpart F, it is submitted that income received by a less developed country corporation, from the manufacture of personal property abroad and its sale abroad, or from the purchase of personal property from unrelated persons and its sale abroad to unrelated persons should not be considered income subject to the provisions of section 864(c)(4)(B)(iii).

It would appear that the exclusion of all income of controlled foreign corporations would be appropriate since Congress has carefully prescribed just what income of such controlled foreign corporations should be currently taxed. This should not be a precedent for other countries to discriminate against U.S. persons operating in their countries. The provisions regarding controlled foreign corporations operate only to impose additional U.S. income taxes on earnings of U.S. controlled companies.

The National Foreign Trade Council supports the treatment of interest paid on foreign currency and U.S. dollar deposits in foreign branches of U.S. banks as foreign source income as proposed under H.R. 13103, and the elimination of such deposits from the U.S. estate tax base of nonresident aliens. These