

ROOT, BARRETT, COHEN, KNAPP & SMITH,
New York, N.Y., March 4, 1966.

Re H.R. 13103.

LEO H. IRWIN, Esq.,
Chief Counsel, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR SIR: An announcement by the chairman of the Committee on Ways and Means, dated February 24, 1966, stated that a public hearing would be held on Monday, March 7, 1966, on the new features of a revised version of H.R. 11297, which have since been introduced in the form of a new bill, H.R. 13103. In accordance with the suggestion contained in the announcement with respect to submission of written statements, this letter is being submitted by the undersigned, as a member of the New York bar, in lieu of a personal appearance.

I wish to draw your attention to what appears to be a technical drafting problem with respect to the possible retroactive application—which may have been unintended—of section 2(d) of H.R. 13103, dealing with the definition of those cases in which income from sources without the United States shall be treated as being “effectively connected with the conduct of a trade or business within the United States.”

Under the new proposed section 864(c) (4) (B) (iii) (at p. 15 of the committee print, lines 18–24, and p. 16, lines 1–2) income derived by a foreign corporation from sources without the United States would be subject to tax if the foreign corporation has an office within the United States to which such income is attributable and such income is derived from one of three listed categories. The third category is income derived from sales of inventory which were made without the United States but through the U.S. office, with the exception of sales for use outside the United States in which an office outside the United States participated materially.

This new test for sales made outside the United States constitutes a sharp departure from existing law, under which a foreign corporation is not taxed on income from the sale of goods without the United States, whether or not such sale was handled through an office or fixed place of business within the United States.

Of particular concern is the possibility that the new test could have retroactive application. Under section 2(e) of the bill, these new provisions are effective with respect to taxable years beginning after December 31, 1966. However, if a long-term contract of sale were concluded by the U.S. office of a foreign corporation prior to the effective date of the act, and foreign source income from shipments made pursuant to that preexisting long-term contract is then received or accrued in taxable years after the effective date of the act, the new subsection might impose a tax on the foreign source income merely because a U.S. office was originally used to make the contract.

It should be noted that long term contracts of sale are frequently employed in international trade, particularly in regard to bulk shipments of oil, minerals, and the like. With respect to these, the possible retroactive application of section 2(e) could have serious adverse effects if the foreign corporation utilized a U.S. office for handling foreign sales, at a time when such utilization was wholly permissible under the law then in effect.

Since it appears likely that such retroactive application of the new test is not intended, it is suggested that the language of the new proposed section 864(c) (4) (B) (iii) (*supra*) be changed by adding the italicized language:

“(iii) is derived from the sale (without the United States) through such office or fixed place of business, *after December 31, 1966*, of personal property described in section 1221(1), except that this clause shall not apply if the property is sold for use, consumption, or disposition outside the United States and *either* an office or other fixed place of business of the taxpayer outside the United States participated materially in such sale *or the agreement pursuant to which such sale was made was executed prior to March 1, 1966.*”

Sincerely yours,

DAVID SIMON.