

deposit funds with foreign branch banks of U.S. corporations since, if (for other reasons) they are considered to be engaged in a trade or business in the United States, the interest paid on their deposits in these foreign branches is subject to U.S. tax. Their reluctance is increased by the fact that foreign persons engaged in business in the United States can avoid U.S. tax on the interest their bank deposits earn by keeping their funds in a bank chartered in their own country or any other country other than the United States, rather than in the foreign branch bank of a U.S. corporation. As a result, foreign branch banks of U.S. corporations are at a serious competitive disadvantage with the banks chartered in the country where they are doing business.

(c) *Explanation of provision.*—To place foreign branch banks of U.S. corporations in a competitive position with the other banks in the foreign countries where they are doing business, your committee's bill provides that the interest on deposits paid by these institutions is to be treated as foreign source income. Thus, nonresident aliens and foreign corporations will not be subject to U.S. tax on this type of interest income.

(d) *Effective date.*—This amendment is effective with respect to taxable years beginning after December 31, 1966.

3. *Foreign central banks and the Bank for International Settlements*
(sec. 2(a) (3) (A) of the bill and sec. 895 of the code)

(a) *Present law.*—Under present law interest received by a foreign central bank of issue from obligations of the U.S. Government is exempt from U.S. tax unless the obligations are used by the central bank in commercial transactions. In addition foreign central banks of issue and the Bank for International Settlements are not subject to tax on interest income from their U.S. bank deposits since bank-deposit interest received by nonresident aliens and foreign corporations not engaged in a trade or business within the United States is deemed to be from sources without the United States.

The central banks of issue are generally the custodians of the banking reserves of their countries and usually carry on most of the monetary functions of their countries in much the same way as our Federal Reserve Board. The Bank for International Settlements is an international organization, in practice, used primarily to aid European central banks of issue in their international financial operations, to promote cooperation among these central banks and to act as trustee in regard to certain international financial settlements. At present, all the central banks of Europe, except that of the Soviet Union, belong to the Bank for International Settlements and over 90 percent of the Bank's deposits are owned by these central banks.

(b) *Reasons for provision.*—By reason of the present exemption of bank-deposit interest paid and the exemption of interest income on their holdings of U.S. Government bonds, foreign central banks of issue in the past have been effectively exempt from practically all U.S. tax. Presumably this was done on the grounds that these foreign central banks of issue, through their monetary activities, were for the most part carrying on essential governmental activities for their foreign governments. However, with the termination in 1971 (as provided elsewhere in this bill) of the foreign source rule for bank-deposit interest, the United States would begin taxing bank-deposit