graph (3) adds a new subsection (c) to amended section 819 containing a cross reference to section 842.

Subparagraph (D) of paragraph (3) adds a new paragraph (3) to section 819(a), as redesignated by subparagraph (A), which provides for the reduction of the tax, if any, imposed under section 881, as amended by section 4(a) of the bill, during a taxable year for which the adjustment required by section 819(a)(1), as so redesignated, is required to be made. Amended section 819(a)(1), as does present law, provides for an adjustment in determining the tax imposed by part I (relating to life insurance companies) of subchapter L (secs. 801 et seq.) for taxable years during which the foreign corporation maintains a surplus in the United States which is less than the special minimum figure determined in accordance with paragraph (2) of amended section 819(a). The section 819(a)(1) adjustment consists of a reduction in the amount of policy and other contract liability requirements and in the amount of the required interest, thereby increasing the amount of tax imposed by part I of subchapter L.

The provisions of new paragraph (3) of section 819(a) provide, in effect, that in cases where the adjustment required by section 819(a)(1) is made with a resulting increase in the tax imposed by part I of subchapter L, a compensating adjustment shall be made by reducing the tax which is otherwise imposed by amended section 881 on the foreign corporation's income from sources within the United States which is not effectively connected with the conduct of a trade or business within the United States. This compensating reduction of the section 881 tax is accomplished by a formula which takes into account the fact that, by reason of exemptions and reductions in rate, the effective rate of the tax imposed by that section may be less than 30 percent.

In determining the reduction in the tax otherwise imposed by section 881 on the income of the foreign corporation which is required to make the section 819(a)(1) adjustment, paragraph (3) of such section provides that there shall first be determined: (1) The total amount of income which would be subject to the tax imposed by section 881 if such income were being determined without regard to the exclusions from gross income provided by sections 103 and 894, and (2) the amount determined under section 819(a)(1) by which the amount of the policy and other contract liability requirements and the amount of the required interest is reduced. The tax otherwise actually imposed by section 881 for the taxable year shall then be reduced by an amount which is the same proportion of such tax (before reduction) as such amount used for reduction purposes under section 819(a)(1) bears to the total amount of income so determined to be subject to tax under section 881. In no case, however, shall the tax otherwise imposed by section 881 be reduced below zero, nor shall the reduction in the tax otherwise imposed by section 881 exceed the increase in tax imposed by part I of subchapter L by reason of the reduction provided in paragraph (1) of section 819(a).

Mutual insurance companies

Paragraph (4) of section 4(g) of the bill amends section 821 of the code (relating to the tax on mutual insurance companies to which pt. II of subch. L applies). Subparagraph (A) of paragraph (4) strikes out subsection (e) of section 821 (relating to foreign