

outside the United States (and it may not be taxed by the country of residence of the taxpayer if it does not tax its residents on income arising outside that country under the source rules of that country). In accordance with this tax treatment, the bill allows a foreigner whose foreign source income is so taxed in the United States a foreign tax credit for creditable foreign taxes paid on such foreign source income if the foreign tax is levied on the basis of source jurisdiction by the foreign country.

*Personal holding companies and "second dividend tax."*—H.R. 13103 changes the personal holding company provisions of the Internal Revenue Code as applied to the U.S. investment income of foreign corporations and also modifies the application of the so-called second dividend tax. Under the bill, foreign corporations owned entirely by foreigners would be exempt from the personal holding company tax as respects their U.S. income. This is desirable because of the elimination of graduated rates as applied to individual foreigners which is contained elsewhere in the bill, and which makes the application of the personal holding company provisions to corporations wholly owned by foreigners no longer appropriate since a withholding tax on its income has already been collected.

Under the bill, the "second dividend tax" (which under present law is levied on dividends distributed by a foreign corporation to its shareholders (whether foreigners or U.S. citizens) if the corporation derives 50 percent or more of its gross income from the United States) would be applied only to the dividend distributions of foreign corporations doing business in the United States which derive 80 percent or more of their business income from their U.S. business. It is desirable to retain this part of the tax to cover those cases where a resident foreign corporation has the great bulk of its business operations in the United States, so as to treat dividends of such a corporation as being from U.S. sources.

These changes should have the effect of eliminating application of the personal holding company tax and "second dividend tax" in many cases where they now apply, and where they may now act as a deterrent to foreign investment.

*Bank deposits.*—Under present law, interest on deposits with U.S. banks paid to foreigners not doing business within the United States is not subject to U.S. income tax and the deposit is not subject to estate tax. This is an exception to the general rule which subjects to U.S. income tax all interest paid by residents of the United States, corporate or individual. The House saw from the standpoint of tax equity no basis for such an exception but, because of balance-of-payments considerations, deferred the repeal of this bank deposit interest income tax exception until 1972. The repeal of the bank deposit estate tax exemption will become effective for decedents dying after the date of the enactment of the bill.

Where the interest is paid on a deposit of a foreigner in a foreign branch of a U.S. bank, the House liberalized the present bank deposit rule by providing that interest from such deposits with foreign branches of U.S. banks shall no longer be subject to U.S. tax except under limited circumstances. Under present law such interest income is subject to income tax when received by foreigners engaged in business within the United States; and subject to U.S. estate tax in the hands of nonresidents not citizens.