The stimulus given to foreign investment in the U.S. by the reductions in the estate tax rates could in part be negated by this change in the situs rule. The result of a change in the rule would be decidedly adverse to the U.S. balance of payments. Therefore, the Exchange urges that the situs rule regarding bonds not be changed.

Under President Johnson's voluntary program to reduce capital outflows, American companies are being urged to finance their overseas investment through local borrowing. About $600 million worth of bonds were floated abroad in 1965 and the first quarter of 1966 in response to the President's appeal. The proposed change in the situs rule could jeopardize this program by impeding the efforts of American firms to finance their overseas expansion in foreign capital markets. Foreign investors would clearly become reluctant to purchase bonds of American companies if this exposed them to United States estate taxation.

Moreover, it would be extremely difficult administratively to enforce this change in the law. Since bonds are generally issued in bearer form, we know of no practical way of identifying their owners for tax collection purposes.

III. EXCLUSION OF CUSTOMER'S CASH BALANCES FROM ESTATE TAXATION

Under present law, foreign customers' cash balances with brokers are subject to U.S. estate taxation. The Exchange suggests that, if foreigners remain subject to the estate tax, Section 2105 of the Internal Revenue Code should be amended so that *all* funds awaiting investment not be considered property within the U.S. for estate tax purposes. This should apply not only to deposits in banks and savings and loan associations, as discussed below, but also to the "counterpart" to such deposits in the securities industry—customers' cash balances held by brokers awaiting investment or reinvestment.

IV. REVISED TREATMENT OF BANK DEPOSITS OF FOREIGNERS

Under the present law, interest received by foreigners from funds on deposit in the U.S. with persons engaged in the banking business or with some state-chartered savings and loan associations is considered as non-U.S. income and is currently exempt from United States taxes. Similarly, the principal amount held for foreigners by all banking institutions is exempt from United States estate taxes. H.R. 13103 changes these provisions and makes such interest taxable, whether or not the foreigner is engaged in business here, and also subjects the principal to the estate tax. But, in recognition of the current balance of payments problem, the bill defers the taxation of such interest until after December 31, 1971.

This recognition of the balance of payments problem, however, is not carried forward in the estate tax provision. Even though the interest collected is not subject to income tax until after 1971, the deposit itself becomes subject to estate tax on the effective date of H.R. 13103.

Both of these changes would surely lead to a sizable outflow of foreign capital. Knowledgeable bank officials have estimated that several billion dollars of bank deposits would be potentially subject to either the estate tax or to annual taxation of interest income if the proposed legislation becomes law. It seems reasonable to assume that a large part of these deposits would then be withdrawn over time from banks within the U.S. There is every reason to assume that these deposits would not be shifted to foreign branches of U.S. banks. Even if they were, the transfer would represent a capital outflow in the balance of payments.

Consequently, the Exchange strongly urges that the proposed legislation be revised to omit those sections which change the treatment of bank deposits of foreigners. An impediment to the free flow of international capital funds would thereby be avoided, and our balance of payments position remain unaffected.

V. DISCONTINUATION OF WITHHOLDING TAXES ON INTEREST AND DIVIDEND PAYMENTS

Present law requires the withholding of income tax on dividend and interest payments to foreigners. This acts as a deterrent to foreign investment in U.S. securities. To remove this obstacle and help improve the balance of payments, the Exchange recommends that the pending bill be amended to eliminate these withholdings taxes.

If the potential revenue loss makes repeal undesirable, the U.S. should press through treaty arrangements for mutual reduction in the withholding tax with