

as many foreign countries as possible. Since transactions in outstanding securities have generally produced an inflow of funds to the U.S., mutual reductions in the withholding rate could be expected to stimulate foreign purchases of U.S. securities to a greater extent than they would U.S. purchases of foreign securities—even when the adverse effect of the Interest Equalization Tax is taken into account.

VI. ELIMINATION OR EASING OF TAXES ON FOREIGN PENSION TRUSTS

U.S. income taxes imposed on foreign pension trusts and similar investors should be eased. Domestic pension funds enjoy a tax exemption on their investment income. Foreign pension funds, even though qualified for an exemption, can obtain it only by going through the difficult procedure of obtaining approval from numerous agencies of the U.S. government. As a result, these investors are discouraged from investing here, especially if they are exempt from taxes in their country of domicile.

Pension funds in some foreign countries have grown dramatically in recent years. For example, the Joint Economic Committee study of European capital markets showed that pension funds in Great Britain have been one of the fastest growing institutions in that country's financial structure, and had investments of \$10 billion at the end of 1962.¹ Further growth is fully expected. It seems reasonable to assume that a considerable capital flow into the U.S. might be stimulated if foreign pension funds were accorded a tax treatment similar to that enjoyed by domestic funds. Further, the Treasury in its regulations can provide any safeguards necessary to prevent abuse of this legislation.

Consequently, taxes on the income of foreign pension funds and similar institutional investors should be eliminated by law. As a minimum step, the U.S. should work with other countries toward the mutual elimination of taxes on these types of investors.

VII. TREATMENT OF FOREIGN BRANCH BANKS' PORTFOLIO INCOME AS "EFFECTIVELY CONNECTED"

The present law generally taxes nonresident aliens and foreign corporations at the regular individual or corporate rates on all their U.S. source income, if they are engaged in trade or business in this country. If not so engaged, they are taxed at a flat 30% rate or lower treaty rate on all fixed or determinable income. The bill would generally subject the income of a nonresident alien or foreign corporation to the flat 30% or lower treaty rate, if the income is not effectively connected with the conduct of a trade or business in the United States.

Some foreign banks with branches in the United States may suffer adverse effects under the different tax treatment proposed for income "effectively connected" and that "not effectively connected" with the conduct of a "trade or business" under Sections 881 and 882. The income from their investment portfolios of U.S. securities is usual and necessary to an ordinary commercial banking operation. If it is treated as "not effectively connected," the tax will be on the gross income without the allowance of any deductions properly allocable to such income. Such a tax on gross income could have a confiscatory effect upon the portfolio income of foreign banks, since there are generally significant deductions which would otherwise be attributable to such income.

The Exchange believes that foreign banks with branches in the U.S. should have the election of treating the income from their investment portfolios of U.S. securities as "effectively connected" with a trade or business, so that they can have the benefit of deductions which are allocable to such income. Unless an amendment of this type is included, treating such income as "not effectively connected" with the conduct of a trade or business would have a substantial adverse effect on the willingness of such foreign banks to have their U.S. branches hold domestic securities.

CONCLUSION

As noted in the Report of the House Ways & Means Committee, "H.R. 13103 is designed to provide more equitable tax treatment for foreign investment in the U.S." The purpose of the legislation, as initially introduced, was to "stimulate foreign investment in the United States by modifying existing tax rules which

¹ U.S. Congress, Joint Economic Committee, *A Description and Analysis of Certain European Capital Markets*, 1964, page 238.