

nected" with a U.S. office, because of failure of the bill to allow a credit against the U.S. tax for all foreign taxes imposed on the "effectively connected" income. Such credit should be given regardless of whether the taxing country is the country of source, the country of domicile, or both.

12. *Rental and Royalty Income.* — The bill appears to go much further in attributing rental or royalty income to U.S. offices than it does in the case of sales income, since it does not seem to give recognition to the activities of foreign offices in negotiating and making leases or licenses. It also seems unrealistic to regard royalties paid for the use of a valuable right as being generated entirely by the making of the contract. It is the making of the invention or its use in manufacturing which should be considered to generate the income.

13. *Section 245.* — Under the bill, 15% of any dividends paid by a foreign corporation, out of its "effectively connected" foreign source income, to a U.S. corporate shareholder, would be subject to U.S. tax if 50% or more of the foreign corporation's gross income was "effectively connected" with its U.S. trade or business. However, no foreign tax credits would be allowed to reduce the U.S. income tax on such dividends. It is not believed that the bill should introduce double taxation in this situation.

B. Balance of Payments Considerations.

1. *U.S. Estate Tax.* — The bill gives some reduction in estate tax rates on estates of nonresident aliens, but does not give as great a reduction as was proposed in H.R. 5916, the original bill introduced to implement the Fowler Report.

By including certain classes of intangible property which is excluded from the taxable estate under present law, the bill would have an adverse effect on foreign investment in the U.S.

2. *Interest on U.S. Bank Deposits.* — The bill proposes to terminate, effective at the end of 1971, the long-standing exemption of interest on bank deposits paid to nonresident aliens and foreign corporations, even though the recipient is not engaged in trade or business in the U.S. It is believed that this change will not actually produce additional revenue but that it will rather cause withdrawal of such deposits from the U.S., with a substantial adverse effect on our balance of payments.

3. *Short-Term Promissory Notes.* — Proposed section 881(a)(3) would tax foreign corporations not engaged in trade or business in the U.S. on amounts of original issue discount which are treated as ordinary income received on retirement or sale or exchange of bonds or other evidences of indebtedness issued after September 28, 1965 if held for more than six months. To subject such discount to U.S. income tax will cause foreign corporations not engaged in trade or business in the U.S. to cease to furnish a market for commercial paper, especially since it is feared by