

to a corporation (earning all or most of its income abroad) is likely to be prompted by legitimate business considerations if the lender owns as much as 10% of the voting stock of the borrowing corporation. If this is the rationale of the present 10% stock ownership requirement, it should apply regardless of whether the loan comes from the 10% shareholder or from another U.S. corporation, such as an "overseas operations funding subsidiary," which is a member of an affiliate group of corporations (as defined in section 1504) to which the 10% shareholder belongs. There does not appear to be any logic in raising the stock ownership requirement from 10% to 50% simply because the loan and the stock are not held by the same member of the affiliated group.

Unless the proposed new 50% requirement is modified to conform to the present 10% requirement, a U.S. taxpayer owning at least 10% but less than 50% of the voting stock of a foreign corporation will find it advantageous to lend U.S. funds to the foreign corporation rather than to utilize an "overseas operations funding subsidiary" to lend foreign funds to the foreign corporation, thus adversely affecting the balance of payments position of the United States.

Second, the Council believes that the proposed amendment is too restrictive insofar as it specifies that the required voting stock of the foreign borrowing corporation be held by a member of the affiliated group either "directly or through ownership of the stock of another foreign corporation." According to the Report of the Ways and Means Committee at Page 41, "This latter requirement, in effect, means that the borrowing subsidiary may be either a first or second tier foreign subsidiary."

The Council can see no logical basis for denying the benefit of the proposed amendment to interest income received from third or fourth tier foreign subsidiaries. While it is true that dividends received from third or fourth tier foreign subsidiaries do not carry "deemed paid" credits under section 902, this does not afford a persuasive analogy because only interest income (and not dividend income) is affected by the separate "per country" limitation imposed by section 904 (f). It is arbitrary to give effect to stock ownership in first and second tier subsidiaries and to ignore the same percentage of stock ownership in third and fourth tier subsidiaries.

Incidentally, the Council has recently indicated its support of H.R. 15139, introduced by Congressman Secrest, which would amend section 902 of the Internal Revenue Code to reduce the 50% ownership requirement to 25% between the first and second levels and extend the benefits of section 902 to dividends received from a third level foreign corporation if the 25% test is met.

As stated above, the 10% stock ownership requirement appears to be premised on the view that an interest-bearing loan to an affiliate is likely to be motivated by genuine business considerations (rather than tax-saving considerations) if the lender is at least a 10% stockholder. If this assumption is valid (as the Council believes it to be), it is equally valid regardless