

Germany, France, Holland and Sweden, do not impose a similar tax, it seems certain that the enactment of this provision would not only discourage prospective foreign investors from depositing their money with United States banks, but would drive present foreign deposits out of this country and into the hands of foreign banks. Such a development would be neither in the interest of the American banking industry nor of the national economy as a whole as this would result in an outflow of dollars, which would constitute a potential further drain on the gold reserves of the United States.

It has been alleged that withdrawn deposits would return to the United States in some other form. Such an allegation is pure speculation. A foreign investor, who elected to invest his funds in the form of tax exempt U.S. bank deposits and at the same time to receive the benefits of a politically and economically stable country, might well decide to forego these latter advantages for a higher return by depositing his funds in another country where they would be tax exempt.

That the United States would sustain a dollar drain is indicated in the opinions of Mr. Gustav Glueck, the managing director of the Dresdner Bank AG and that of the Commerzbank, two leading German publicly owned banks. (Appendixes A and B.) In his letter of July 27, 1966, Mr. Glueck states that the provisions of H.R. 13103 affecting foreign owned bank deposits would substantially reduce the willingness of foreigners to deposit funds with American banks. He then draws an analogy to the German withholding tax imposed in 1964 on interest paid on German bonds held by nonresident aliens. He points out that such withholding tax not only stopped the further influx of foreign capital into Germany but also was a decisive factor in the deterioration of the German capital market. Support for Mr. Glueck's statement is found in the June, 1965, issue of "Monatsberichte der Deutschen Bundesbank" ("Monthly Bulletins of the German Centralbank"), Appendix C,* indicating that sales of German bonds by foreign investors exceeded purchases by 550 million DM in the fourteen months' period starting with the publication of the proposed law in March, 1964, and ending in April, 1965. This figure is all the more significant when compared with the 2.36 billion DM of German bonds which foreigners had purchased in the fourteen months' period preceding the publication of this proposed withholding tax law. The graph attached to Appendix C clearly reflects this trend, the red "balance" curve showing a varying excess of sales over purchases of German bonds by foreigners in the period of March, 1964, through May, 1965.

Particularly important in today's economy is the fact that a substantial withdrawal of foreign owned bank deposits would further restrict the already tight money supply of U.S. banks. This, in turn, would increase the pressure for loans from the Federal Savings and Loan institutions and other lending agencies. The net result, of course, would be further pressure to increase domestic interest rates. This, in itself, would be contrary to the present policies of the Federal Reserve Bank, embodied in the latest supplement of the Federal Reserve Bank of Boston to Regulation Q, Par. 217.6 of July 20, 1966. By way of comparison, it may be noted that the interest rate of German bonds rose by more than one percent following the enactment of the German withholding tax (cf. chart 2 of appendix C).

The adverse practical effects of subjecting bank deposits of foreigners to withholding tax appear clearly to outweigh and abstract equitable considerations of treating nonresident aliens on a tax parity with residents and citizens of the United States. This is especially true when such equitable considerations could well be repudiated on the ground that nonresident aliens do not receive the same benefits from the United States as do residents and citizens.

In addition, the proposed withholding tax would not affect all nonresident aliens uniformly since United States tax treaties with developed countries, such as Germany and the United Kingdom, frequently specifically exempt such interest payments from income taxation. In view of this discrimination, it is all the more difficult to accept the purely formalistic argument in support of this provision which seeks to justify this change because "interest income of this type is so clearly derived from United States sources." (See Ways and Means Committee Report, P. 7)

2. H.R. 13103 would subject bank deposits owned by nonresident aliens to the Federal Estate tax effective immediately upon enactment of this bill.

*Appendix C, referred to, may be found in the official files of the Committee.