

Virtually the same objections, set forth above, to the proposed imposition of a withholding tax on interest apply to the proposed estate tax on U.S. bank deposits of nonresident alien individuals.

The obvious reason for the withholding on interest provision not to become effective until January 1, 1972, was the belief that the immediate enactment of the income tax provision would do serious harm to the United States balance of payments. The proposed estate tax by contrast would take effect immediately presumably because of the assumption that such a tax would not cause an outflow of dollars from the United States. This reasoning may well prove to be fallacious as it seems unlikely that an individual nonresident alien who, having the intention of withdrawing his deposits after 1971, would leave his money with a United States bank during the next five years and thus run the additional risk of falling within the ambit of the estate tax provision.

3. H.R. 13103 employs the "effectively connected" concept as a means of subjecting certain foreign source income to U.S. taxation.

H.R. 13103 introduces the novel concept of "effectively connected" (a) to distinguish between business and investment income and (b) to determine the amount of business income that should be subject to progressive United States income tax rates. According to the Report of the Ways and Means Committee, at page 14, the latter function of this concept was intended to curb the abuse of the existing U.S. source rules by foreign taxpayers engaged in trade or business within the United States. According to the bill, specified types of foreign source income, namely, (a) rents and royalties, (b) dividends and interest derived from the active conduct of a banking business and (c) certain sales income, would be subject to United States taxation if such income were "effectively connected" with the taxpayer's United States trade or business and if such taxpayer maintained a fixed place of business within the United States.

This new concept is meant to supersede a very important segment of the traditional source rules and should be as easy to apply as the rules that it would replace. However, it is submitted that the "effectively connected" concept would be far more difficult to administer than existing rules because there are no general guidelines for the future application of this term. This uncertainty about the administrative and judicial interpretation of this concept would, if enacted, tend to discourage prospective foreign investment in the United States.

It might also lead to withdrawal of deposits because interest paid on foreign owned U.S. bank deposits, including interest paid by foreign branches of U.S. banks, might be deemed "effectively connected" with a foreign taxpayer's United States trade or business and thus be subject to United States income taxation prior to January 1, 1972. This possibility would in particular discourage foreign banks which maintain United States branches from depositing dollars with United States banks, including their foreign branches.

Finally, the "effectively connected" concept would require our bank, acting as a withholding agent, to determine whether or not the interest it pays on foreign-owned bank deposits is "effectively connected" with the United States business of the depositor. This requirement would not only impose an extremely heavy administrative burden on the clerical staff of our bank but also would necessitate it either to pass upon intricate legal questions exceeding its professional capabilities or to obtain legal opinions. Apart from these difficulties, it even seems doubtful whether we would be able to collect all the necessary factual data from our clients to reach a decision in a specific case. In view of the personal liability and severe penalties applicable to withholding agents, it would therefore seem likely that United States banks would deem most of the interest paid on foreign-owned bank deposits as not "effectively connected" with the depositor's United States business and thus subject them to the United States withholding tax provided for by H.R. 13103. Such a course of action would, however, not only greatly increase the administrative workload of United States banks but at the same time also defeat the proper and reasonable application of the new "effectively connected" concept.

For these reasons, we submit that the "effectively connected" concept be eliminated from H.R. 13103 altogether, or at least be limited in its application to United States source income.

Based on these considerations, we respectfully request that your Committee eliminate the provisions of H.R. 13103 indicated above.

Sincerely yours,

L. D. BRACE, *Chairman.*