

expense for a typical taxable year. On the basis of these figures, the Bank's tax under existing law on \$2,000,000 of gross income from U.S. sources would amount to \$233,500.

II. EFFECT OF H.R. 13103

1. The new bill makes many changes in the Code provisions dealing with the taxation of non-resident aliens and foreign corporations, but the particular points that concern us here are:

(a) The provisions of Sec. 4 of the Bill amending Code Secs. 881 and 882 so that these two sections would no longer be mutually exclusive, but instead would tax the foreign corporation under either or both of these sections depending on whether its income is or is not "*effectively connected* with the conduct of a trade or business within the United States"; and

(b) The provisions of Sec. 864(c)(4) as added to the Internal Revenue Code by Sec. 2(d) of the Bill which have the effect of including in the definition of the term "income which is effectively connected with the conduct of a trade or business within the United States" certain types of income derived from sources outside the United States.

In other words, under these provisions of Bill, all income *not* deemed effectively connected with the conduct of a trade or business within the United States, to the extent that it is taxable at all, would be taxable under Sec. 881 at the 30% rate on the gross amount received, while all income which is deemed so connected would be taxable under Sec. 882 at regular domestic corporate rates on the net amount received after the allowance of related deductions and this will be so, in the case of the interest income of a bank, even though it is derived from sources outside the United States. Thus, the Bill, while making no change in the case of a bank having no branch or agency here, completely changes the approach in the case of the Bank which does have branches or agencies here, so that unless the interest received can be made to meet the test of being "*effectively connected*" with the United States operation, it will be taxed on the gross amount of such interest at the 30% rate without any offsets for expenses or losses, as if it had no United States business operations at all, while the rest of its United States operations, including any interest or capital gains income from sources outside the United States that can be deemed "*effectively connected*" with the United States operations, will be taxed at domestic rates on net income.

2. The effect of these changes in the law are illustrated in the annexed Schedule II, from which it will be seen that on the basis of the same income and expense figures as those used in Schedule I, the Bank's tax computed under the Bill would be \$421,300 as compared with \$233,500 under existing law, an increase of \$187,800 or more than 80%.

III. PROVISIONS OF H.R. 13103 REQUIRING REVISION

1. The severity of the Bill's impact on taxpayers in Banco de Ponce's position as disclosed in the preceding paragraph raises the question of whether this result is consistent with what the Bill is intended to accomplish. Obviously any provision of the Bill which operates in specific factual situations so as to defeat its basic purposes is defective and requires revision. These purposes are indicated in general terms by its title: "A bill to provide equitable tax treatment for foreign investment in the United States," and are clearly described in the Ways and Means Committee Report on the Bill, in which the Committee in discussing the background of the Bill (House Report No. 1450, pp. 5 and 6) points out that the proposed legislation was originally prepared by the Treasury Department and introduced in Congress as H.R. 5916, a bill "designed to increase foreign investment in the United States . . . as part of the President's program to improve the balance of payments." In the course of its consideration of this Bill, the Committee decided to expand the scope of the legislation to include a general overhaul of the taxation of non-resident aliens and foreign corporations, as the result of which H.R. 5916 was ultimately superseded by the present Bill, H.R. 13103, a bill designed, as the Report states (p. 8), "to increase the equity of the tax treatment accorded foreign investment in the United States." It is, however, made clear throughout the Report that the original, more limited objective of encouraging foreign investments in the United States through an amelioration of unduly severe tax burdens is still contemplated by H.R. 13103. For example, in giving the reasons for the provisions of Secs. 2 and 4 of the Bill already referred to (pp. 2 and 3, above), the Committee Report criticizes existing law as deterring foreign businessmen and corporations from investing in the