in Sec. 864(c)(4)(B) for the application of the concept that income from sources *outside* the United States should be taxed if connected with income derived from the conduct of a U.S. business. Report No. 1450, p. 65, contains the statement that "in general, income described in Clause (ii) of subparagraph (B) does not include income from . . . securities purchased for investment purposes only . . ." If this is meant to apply in the case, for example, of a U.S. branch of the Puerto Rican bank investing its funds (derived, of course, principally from customers' deposits) in Puerto Rican mortgages or other non-continental U.S. securities, it is simply not true. Without investing its funds profitably in interest-bearing securities it could not perform its essential banking services. There is surely no more justification for singling the banking business out for the taxation of income from non-U.S. sources than there is in the case of any other taxpayer regularly engaged in the sale of goods or services to the public.

(c) In the third place, if the purpose of these provisions is indeed to accord more equitable tax treatment to foreign taxpayers, and if in so doing it is deemed appropriate to equate the tax treatment of the U.S. branches of foreign banks with that of domestic banks to the extent of taxing the foreign-source income attributable to their U.S. business operations, then the Bill should also take into account the privileged tax position enjoyed by the domestic banks as against their foreign competitors in other areas and make some provision to equate the tax treatment of domestic and foreign banks in these respects also, e.g.:

(1) The provisions of Code Sec. 582(c), under which banks (defined by Sec. 581 to include only domestic banks) are allowed to treat losses from the sale of corporate and government bonds as ordinary losses fully deductible against ordinary income (taxable at 48%) rather than as capital losses which may be offset only against capital gains (taxable at 25%);

(2) The similar provisions of Code Sec. 582(a) in dealing with losses due to securities becoming worthless;

(3) The right accorded only to domestic banks to take advantage of the special rules promulgated by the Treasury Department for determining the amounts allowable as deductions for additions to the reserve for bad debts. (Rev. Rul. 65–92, 1965–1 C.B., p. 112);

(4) The right accorded to domestic, but not to foreign, banks of deducting interest expense even though the funds on which such interest is paid are invested in tax-exempt state and municipal bonds (cf. Rev. Rul. 61–222, 1961–2 C.B. p. 58), whereas foreign banks may deduct only expenses attributable to the earning of *taxable* income from sources within the United States. (Cf. Code Sec. 882(c)(2), Treas. Regs. Sec. 1.882–3(b) and 1.873–1(a)(1)).

By including banks in the category of foreign taxpayers to be taxed on income from foreign sources under clause (ii) of Code Sec. 864(c)(4)(B) while making no attempt to change such discriminatory features of existing law as those listed above, the Bill merely compounds existing inequities.

5. Except as international tax conventions may alter the picture, the foregoing considerations apply equally to all corporations deemed "foreign" for tax purposes, whether incorporated in a foreign country or in Puerto Rico. In the case of a banking corporation incorporated in Puerto Rico, however, there are additional and even more cogent reasons why some modification of the provisions of the Bill here under discussion is required.

The constitutional status of Puerto Rico is, of course, historically anomalous. Puerto Rico has never enjoyed the clearly defined and well-understood status of a "territory" such as Alaska and Hawaii were before they achieved statehood. Nevertheless, like them, or like any State, Puerto Rico falls wholly within the monetary system of the United States and its sole currency is United States currency. Its banks, including Banco de Ponce, are members of and regulated by the Federal Deposit Insurance Corporation and are eligible for membership in the Federal Reserve System. As depositories of Federal funds, the Puerto Rican banks as such must maintain the required liquidity and to do so, must invest in U.S. government securities. The employees of such banks, whether employed in the United States or in Puerto Rico, are covered by the Social Security and Unemployment Insurance Laws of the United States and the banks must file reports and pay taxes accordingly. In short, for almost every conceivable purpose other than income taxation, the status of Banco de Ponce as a Puerto Rican bank is identical with that of a bank organized under the laws of the United States.

Obviously, therefore, the original purpose of the Bill—that of improving the balance of payments position of the United States—has no application whatever