

to Puerto Rican banks, except perhaps in the negative sense of making it attractive to them to invest in Canadian government securities, on which there would be no taxation at the source. The inequitable, discriminatory, and in some cases confiscatory, effects of the Bill as it affects a foreign bank with branches in the United States are doubly unfair and illogical in the case of Puerto Rican banks, which are not really "foreign" in the fiscal sense and have no choice but to invest heavily in U.S. government securities.

IV. SUGGESTED REMEDIES

1. Inasmuch as this memorandum is concerned with the impact of the Bill on foreign banking corporations regularly engaged in business in the United States, and more particularly with Puerto Rican banks having branches in the United States, we shall limit our suggestions to this area. We would like to point out, however, that the adverse effects of some of the provisions of the Bill extend over a much broader field and might well justify a thorough restudy of the basic concept reflected in this very complex and in some respects revolutionary piece of legislation. Our preferred remedy, therefore, would be to make no changes in Code Secs. 881 and 882 insofar as the provisions discussed on pp. 2 and 3 above are concerned. This would entail the deletion from the Bill of all the provisions thereof utilizing the "effectively connected" concept as applied to foreign corporations.

2. If, however, it is felt that the general effect of the Bill is desirable and would be too greatly compromised by following the suggestion made in the preceding paragraph, it nevertheless remains true, as shown above, that it is not the purpose or intention of the Bill to impose substantially heavier tax burdens on the U.S. income of foreign corporations than those imposed on domestic corporations, but rather to alleviate excessive tax burdens on foreign investment in the United States where they exist and generally accord more equitable tax treatment to such foreign taxpayers than heretofore. Yet in the case of foreign banks with offices here the Bill does in fact impose such burdens, and at levels amounting in some cases to confiscation. A simple solution and the one which does perhaps the least violence to the plan of the Bill as a whole, while solving the problem of taxpayers like the foreign banks, is to allow each foreign bank to elect whether or not its investment income from U.S. sources (otherwise taxable under the proposed new language of Code Sec. 881) is to be deemed effectively connected with its U.S. business and therefore taxable under Code Sec. 882. Such an election is already provided by the Bill in the case of certain real property income, and parallel language and similar safeguards against abuse could easily be provided for investment income. For example, there might be added to Sec. 882 as revised by the Bill a new subsection (e) similar to subsection (d) as contained in Sec. 4(b) of H.R. 13103 reading somewhat as follows:

"(e) ELECTION TO TREAT U.S. SOURCE INVESTMENT INCOME AS INCOME CONNECTED WITH UNITED STATES BUSINESS.

"(1) IN GENERAL.—A foreign corporation engaged in the active conduct of a banking business which during the taxable year derives any income from sources within the United States.

"(A) which consists of dividends, interest or gain or loss from the sale or exchange of stock, notes, bonds, and other evidences of indebtedness, and

"(B) which, but for this subsection, would not be treated as income effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (a) (1) whether or not such corporation is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

"(2) ELECTION AFTER REVOCATION, INC.—Paragraphs (2) and (3) of Section 871(d) shall apply in respect of elections under this subsection in the same manner and to the same effect as they apply in respect of elections under Section 871(d)."

3. This language would cover *all* foreign banking corporations, thereby not only obviating the grossly discriminatory effect of the Bill on Puerto Rican banks with branches in the United States as compared with domestic banks but also, in