

the case of other resident foreign banking corporations, encouraging the investment of surplus funds in U.S. securities. If, however, it is felt that only Puerto Rican banks, because of their anomalous status as insiders in the U.S. monetary and banking structure but outsiders for tax purposes, should receive this relief, then for the words, "foreign corporation . . . business" in the first sentence of subsection (e)(1) as proposed above, there could be substituted the words:

"A corporation organized under the banking laws of Puerto Rico."

Such special treatment for Puerto Rico is not without precedent. In fact the effect of such a provision would merely be to place a Puerto Rican bank on a parity in respect of the right to be taxed only on net income from U.S. sources with the individual citizen and resident of Puerto Rico under Section 876 of the Code as presently in effect.

4. It will be noted that all of the suggested language of the new subsection (e) as quoted above beginning with the words "may elect" is taken verbatim from new subsection (d) of Code Sec. 882 as set forth in Sec. 4(b) of H.R. 13103, including this phrase at the end of the second sentence: "whether or not such corporation is engaged in trade or business within the United States during the taxable year." The inclusion of this phrase would have the effect of making the right of election available to a *non-resident* foreign banking corporation, provided, of course, that it filed proper income tax returns and otherwise complied with the requirements of Code Sec. 882(c). This seems desirable to avoid unfair discrimination between Puerto Rican banks which do not operate branches in the continental United States, but which are nevertheless under the same compulsion to invest heavily in U.S. securities, and those which do operate such branches.

5. As already pointed out (pp. 7-10), there is no apparent reason why the Bill should single out banks for the taxation of interest and capital gains income from sources outside the United States and it is respectfully submitted that Clause (ii) of Code Sec. 864(c)(4)(B) as added by Sec. 2(d) of the Bill should be revised by deleting the words: "banking, financing, or similar business", and substituting therefor the words: "financing or similar business, other than banking."

If there is thought to be any ambiguity as to what is meant by the term "banking" in the phrase "other than banking", a definition could be added to Subparagraph (B) of Sec. 864(c)(4). Such a definition might adapt the language of Code Sec. 581 and read somewhat as follows:

"For the purpose of clause (ii) the term "banking" means the business conducted within the United States by a bank or trust company, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, and which, with respect to the business conducted by it within the United States, is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions."

CONCLUSIONS

In conclusion, it is submitted that the changes made by the Bill in the provisions of Code Secs. 881 and 882 discussed above do not "increase the equity of the tax treatment accorded foreign investment in the United States"; that on the contrary, in many cases, and particularly in the case of foreign banking corporations, they impose drastic and unfair new burdens on such investment wholly at variance with the stated purposes of the Bill; that the best solution for the present would be to make no change in existing law insofar as these provisions of Secs. 881 and 882 are concerned; but that if the new concepts imported into the Code by the Bill are felt to represent progress toward more equitable treatment of foreign taxpayers in other areas, then it is urged most strongly that for the reasons set forth in this memorandum, foreign banking corporations carrying on business in the United States, and especially the Puerto Rican banks, should be given the option suggested above of electing whether to be taxed by the old methods or the new and should also be excluded from the special group of taxpayers singled out by Sec. 864(c)(4)(B) for the novel experiment of taxing foreign corporations on income derived from sources outside the United States.

Respectfully submitted.

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