

Treas. Reg. Sec. 1.882-3(b) and 1.873-1(a)(1). Section 861(a) which defines income from sources within the United States limits this concept to "items of gross income." Municipal and state bond interest is not included in "gross income" (Section 103).

Thus, to the extent that comparable interest expense on deposits and other expenses are attributable to tax-exempt bond interest income, they are not deductible by a resident foreign banking corporation, although a domestic banking institution can claim such deductions.

In the light of the foregoing we submit that to tax resident foreign banking corporations on their foreign source dividends, interest, and gains from the sale of securities does not achieve equitable tax treatment for their investments in the United States.

In addition, this novel concept of taxing foreign enterprises on their foreign source income is directly contrary to three-quarters of the Income Tax Treaties concluded by the United States with foreign countries which specifically limit U.S. taxation of foreign enterprises to their U.S. source income. (E.g., Australia—Article III, Italy—Article III.) The U.S. Treasury Department Regulations applicable to those few tax treaties whose provisions allow Federal taxation on all income allocable to a U.S. "permanent establishment," limit this rule to income from sources within the United States, thus evidencing the intent of even these treaties not to tax foreign source income. (E.g., Canada—Regulation Section 519.104, France—Regulation Section 514.105). Since Section 10 of the Bill provides that no amendment made by H.R. 13103 shall apply in any case where its application would be contrary to any treaty obligation of the United States, this motive to tax foreign source income would not apply to those countries with whom the United States has an income tax treaty, thus discriminating severely against those nations with whom the United States has not yet concluded a treaty. Since the United States has not concluded an income tax treaty with Hong Kong, our bank would be seriously affected under the proposed Bill in a manner not contemplated at the time these tax treaties were negotiated.

United States taxation of foreign interest income attributable to a U.S. place of business could result in multiple taxation under the Bill without a compensating offset for a foreign tax credit. Let us assume that the resident foreign bank is organized in country A having a corporate income tax rate of 48 per cent. Let us assume it earns interest income of \$10,000 in country B which imposes a 15 per cent withholding tax thereon. The interest income is also attributable to the office in the United States and is taxed at 48 per cent. For purposes of simplification, we will assume that there are no deductible expenses and that the total taxable income subject to tax in country A is \$110,000, including the \$10,000 bond interest. We will also assume that country A has a per country limitation for foreign tax credits but no overall limitation. In other words, the amount of any credit for foreign taxes paid or accrued to any foreign country is limited to the ratio of taxable income from sources within that country to entire taxable income applied to the tax due before credit in country A. The following calculation sets forth the taxes paid to the respective countries after the suitable credits.

|                              | Country A | Country B | United States |
|------------------------------|-----------|-----------|---------------|
| Taxable income.....          | \$110,000 | \$10,000  | \$10,000      |
| Tax computed thereon.....    | 52,800    | 1,500     | 4,800         |
| Less foreign tax credit..... | 1,500     | -----     | 1,500         |
| Net tax due.....             | 51,300    | 1,500     | 3,300         |

The effective rate of tax on the \$10,000 of interest income is 81 per cent (i.e. 33% in country A, 15% in country B, plus 33% in the United States) instead of 48 per cent due to the fact that the credits are limited to the tax imposed by the country of source.

From the foregoing illustration, it is evident that the resident foreign bank will not secure a foreign tax credit in its home land for net United States income taxes paid. Furthermore, while Section 6 of the Bill permits a credit for foreign taxes paid or accrued on income from sources without the United States which is "effectively connected" with the conduct of a trade or business within the