

United States, such credit is only allowed for the foreign tax levied by the country of source and not the country of organization. Therefore, no credit would be allowed in the United States for taxes paid to country A since the income is sourced in country B. As a result there would be multiple taxation due to the inability to claim full foreign tax credits.

Finally, it has always been fundamental to American democratic philosophy that the Federal government's right to tax is not based upon mere physical force but on the underlying theory that the consideration given for taxation is the protection of life and property, and that the income rightly to be levied upon to defray the burdens of government is that income which is created by activities and property protected by the government or obtained by persons enjoying such protection. (Mertens, Section 45.27). This basic tenet of tax philosophy is violated by the provisions of the Foreign Investors Tax Act that propose to tax foreign source income of a foreign corporation controlled by non-U.S. persons merely because it is deemed to be attributable to a United States place of business. The fact that a bill of exchange, promissory note, or bond, the instrument evidencing a debt, is physically located in the United States or is accounted for in the U.S., does not mean that the United States is protecting the property represented by that document.

The residence of the obligor determines the location of the property right, and it is that country who properly exercises the jurisdiction to tax the income earned thereon since it protects the property rights represented by the security. By the same token, the country of organization of the obligee may also choose to tax the income because it offers world-wide protection to the taxpayer entity. This latter country will generally allow a foreign tax credit for income taxes paid to the country of source, if it also chooses to tax the same income. Let us take the case of a typical resident foreign banking institution such as this taxpayer. It negotiates the purchase of overseas bonds through its Head Office in Hong Kong and the funds for the purchase are provided by the Head Office and not by the U.S. branches. The bonds are not governed by the laws of the U.S., none of the parties to the transaction are located in the United States, and all transfers of currency concerning principal and interest take place outside of the United States. Nevertheless, the resident foreign bank could be taxed in the United States on the interest income earned from these bonds simply because they are utilized in the United States as New York assets in setting credit limitations by the New York State banking authorities. Yet, the foreign bank cannot sue the United States courts to enforce the property rights represented by these bonds, such as the payment of principal or interest. It must turn to the courts outside the U.S. for redress and protection. Furthermore, since the United States is not the country of organization, it does not offer world-wide protection to this entity, which is fundamental to the philosophy for taxing a U.S. entity on foreign source income.

To illustrate the principle, if the bonds were to be used to secure loans made in the United States, it would seem that the proper income to tax is the income generated by utilizing such loan funds, not the foreign source income earned by the security provided for such loans. In other words, it is the U.S. source income from such loans which is properly attributable to the U.S. place of business, not the foreign source income from the bonds used as security to obtain the loans. Therefore, it would seem that to tax the interest income derived from such bonds would be an undue extension of the authority of the Federal government in exercising its taxing jurisdiction.

It can also be seen that the above argument applies to any other evidence of indebtedness, such as a bill of exchange or a promissory note, where the obligor and obligee are foreign individuals or foreign entities and the income earned herefrom is foreign source income.

In conclusion, it is submitted that the Foreign Investors Tax Act will discriminate against resident foreign banking institutions instead of providing more equitable tax treatment for their investments in the United States. If Congress wishes to fulfill its stated objective, then it should choose between either not taxing resident foreign banks on their foreign source dividends, interest and gains from the sale of securities or else extend to them the same tax privileges accorded to domestic banks.

It is recommended that this inequity be corrected by excluding resident foreign banks from Section 864(c) (4) (B) (ii) added to the Internal Revenue Code by Section 2(d) (2) of H.R. 13103.

It is respectfully requested that, at such time as the Senate Finance Committee may hold a public hearing on the Foreign Investors Tax Act, The Hongkong and