EFFECT OF H.R. 13103 ON U.S. BRANCH OPERATIONS

Most interest income earned by the U.S. branches of the bank, which could be subject to U.S. income tax, consists of interest on loans, overdrafts, investments and bills. Interest is also earned by way of discount which is, of course, another term for interest. By way of illustration, foreign source interest income attributable to a U.S. place of business might arise in the following manner:

1. A U.S. company (an exporter) draws a bill of exchange (i.e., a demand draft) on a United Kingdom company abroad. It presents the draft and documents (e.g. commercial invoice, bill of lading, consular invoice, certificate of origin, etc.) to the New York branch of the bank. The New York branch wil type the details on covering schedules; instruct the London branch as to th manner in which the bill should be collected and what to do if the Unite Kingdom importer does not honor and pay the bill; and will remit the bill documents and instructions to the London branch. The documents are place in the hands of the drawee on the bill (the United Kingdom importer) onl upon the instructions of the drawer of the bill (the U.S. exporter). Th London branch will notify the United Kingdom importer, who examines th draft and documents, and, if all is in order, he will pay the amount of th draft to the London branch. The proceeds will be remitted to the New Yor branch for payment to the exporter. Sometimes the foreign importer is not in position to pay the amount of the draft drawn by the U.S. exporter and th New York branch will advance the proceeds to the U.S. exporter charging th foreign importer with interest on the loan. In this case, the foreign sourc interest income would be effectively connected with the conduct of the U. banking business subject to Federal income tax under the Foreign Investo Tax Act.

2. A company organized in India (an exporter) might draw a bill of exchan payable in U.S. dollars (i.e. a 90 day time draft) on a Turkish importer. T steps in the transaction are similar to those set forth in the first case. T Indian company needs cash immediately and discounts the draft with the Ne York branch of the bank who remits the funds to its Bombay office. At maturit the New York branch will collect the face amount of the bill and retain t proceeds, the discount earned representing interest income on the transactio Since the proceeds of the draft are paid by the Turkish importer, the intere income is earned from foreign sources. It would be taxable in the United Stat since the assets of the New York branch were utilized to discount the bill f the foreign exporter.

3. A French shoe manufacturer not engaged in business in the United Stat might import raw hides from the United States. He opens a letter of cre through the Paris office of the bank in favor of the U.S. exporter. The letter credit provides that upon presentation of the required draft and documents accordance with the terms of the letter of credit, the exporter will be paid f the shipment. However, the French importer does not have the cash to cov the letter of credit and borrows the necessary funds from the bank. Whe the New York branch pays the U.S. exporter, it is in effect making a loan to t French importer. The interest earned by the New York branch of the ba from this transaction is foreign source income since the payor is a foreign enti not engaged in trade or business in the United States.

4. Dollar loans might be made by the New York branch of the bank to a forei government to be used to finance the construction of dams, electrical plan schools and other facilities. The interest thereon would be foreign source inco attributable to the U.S. place of business and subject to Federal income tax.

While there may be other types of transactions generating foreign source i come attributable to a U.S. place of business, the foregoing illustrations point the fact that there are many cases in which a foreign banking corporation e gaged in trade or business in the United States can be subject to U.S. income t on foreign source income under proposed Section 864(c)(4)(B)(ii). While agree that this is undoubtedly one of the objectives of the Foreign Investors T Act, it is our view that such income should not be subjected to Federal inco tax for the reasons cited below.

CONSIDERATIONS FOR EXCLUDING FROM TAX FOREIGN SOURCE INTEREST INCO OF AGENCY AND BRANCH BANKS

The object of the Bill is "to provide more equitable tax treatment for forei investment in the United States" as stated on page 1 of Report No. 1450 of t Committee on Ways and Means of the House of Representatives to accompa