eral language standards to be used in determining which deductions are to be apportioned to U.S. and foreign income on some form of "reasonable basis" and which deductions are to be apportioned across the board to U.S. and foreign income based on mechanical gross income ratios. But this amplification of language appears to be a mere gloss on the existing regulations. No ameliorative changes have been made.

To the extent that a taxpayer wishes to show that his directly incurred U.S. expenses relate to U.S. income and not to foreign income, there is little in the regulations to aid him. Expenses not directly connected with foreign income are still to be allocated to such income, and the inequities of the existing regulations continue substantially unchanged.

In the typical situation where a domestic parent performs services for a foreign subisdiary, the proposed regulations tie in to the new Section 482 regulations and state that expenses are to be apportioned to the gross income that the taxpayer gets or should get under the new regulations under § 1.482–2 for performing such services.

Under § 1.482–2(b) (3) of the new proposed regulations, the cost of the services is equal to the arm's length charge for such services which must be taken into account by the person rendering the services. Presumably, if the expenses of the services are greater than the amount charged, the taxpayer will have to take into account additional taxable income against which income there will be applied, for foreign source taxable income determination, the expenses incurred.

While it is difficult to follow the reasoning involved in the proposed rule requiring allocation of expenses incurred by a domestic corporation for its subsidiary to some sort of imputed reimbursement received from the subsidiary for the services rendered, two examples given in the proposed regulations indicate the impossibility of applying the proposed rule to the affairs of a large corporation.

In Example (1), a domestic corporation is said to have incurred $60,000 of direct selling expenses and $40,000 of indirect expenses (executive salaries, rents, utilities, expenses of staff departments, etc.) on behalf of its foreign subsidiary which amount is reimbursed by the foreign subsidiary which also pays a dividend of $90,000. According to Example (1), the $100,000 of expenses is allocated to the $100,000 of reimbursement and none of this $100,000 is allocated to the dividend income. However, whatever reason and sense there may be in Example (1) is completely nullified by Example (3) which points out that Example (1) does not take into account other significant corporate expenses. Under Example (3), the president's salary and other indirect expenses related thereto, as well as interest expense on general indebtedness, must be apportioned to foreign income on "some reasonable basis," while expenses for U.S. income tax return preparation and expenses for meetings of the U.S. parent's board of directors and shareholders must be apportioned to foreign income on the basis of gross income ratios.

The net effect of all this, it is respectfully submitted, is that the taxpayer has been taken up the hill and down the hill and back to the old rule. The new examples and the confusing complex generalities of language that the new regulations contain merely perpetuate the old, admittedly inequitable rule which, at least, had the advantage of simplicity: direct expenses are allocated to items of income to which they directly relate and indirect U.S. expenses are allocated on the basis of gross income ratios to foreign source income.

The basic question is whether this old rule is right or wrong, fair or unfair, in limiting available foreign tax credits to U.S. corporations operating abroad. These corporations have maintained that the old rules are unfair, hurt the taxpayer and, indirectly, the United States. And the Treasury Department has, in large measure, stated that it agrees with the taxpayer's complaints.

If this be so, it is submitted that the basic rule needs to be changed by legislation and not perpetuated by confused, camouflaged regulatory language which, by design or accident, serves merely to perpetuate admitted inequities.

Gentlemen, I respectfully urge your consideration of an amendment to the bill to accomplish this objective.

Thank you for the opportunity to appear before you.

Senator ANDERSON. Senator Carlson.

Senator CARLSON. Just this, Mr. Chairman.

Mr. Seath, you mentioned this proposed revised regulation or these revised regulations under section 862 which were supposed to ease the