

corporation be more onerous than would be the case if such U.S. branch were separately incorporated.

Accordingly our Committee recommends here—as elsewhere—that a Section 482 method of allocation be used to determine the fee or commission that would have been paid at arm's length for the services rendered by the branch if it were a separate entity (see p. 84). This would avoid an inconsistency with many existing treaty obligations which require that this method of allocation be followed (see p. 85).

G. FOREIGN TAX CREDIT

With respect to the foreign tax credit, our Committee makes a number of technical suggestions intended to minimize the risk of double taxation inherent in the Bill as presently framed (see pp. 86-94).

H. PROPOSED LIBERALIZATION OF SECTION 904(f)

The Bill proposes some liberalization, subject to narrow restrictions, with respect to the present limitation on foreign tax credit treatment of interest income from foreign sources. Our Committee urges that further liberalization is needed in order to prevent arbitrary treatment of interest income derived by domestic corporations from indirect as well as direct investments in foreign corporations (see pp. 95-103).

I. RETROACTIVE APPLICATION OF PROPOSED "U.S. OFFICE" TEST

Our Committee recommends that if the proposed "U.S. office" test is to be adopted, the Bill should be amended to make it clear that no tax would be imposed by reason of any U.S. office "activities" occurring prior to the Bill's effective date, January 1, 1967.

Mr. HENDERSON. Our committee focused on this one aspect of the bill because we felt it presented particularly serious problems which the Congress should consider, but which did not appear previously to have been analyzed in depth.

One of the reasons for the previous lack of analysis would appear to be a widespread unawareness of the existence of these provisions in the bill.

I might add that it is the experience of our committee members that even today few in the business community and even few tax lawyers appear to be aware of the existence of these provisions. They know that H.R. 13103 is intended to carry out the Fowler task force recommendations of liberalizing and simplifying the tax treatment of foreign investors, particularly individuals, but they have not examined the bill with care and have not become aware that it contains these complex provisions which would add a new tax on certain foreign business activities in the United States.

These new provisions would impose a tax on three categories of foreign-source income deemed "effectively connected" with the U.S. office of foreign taxpayers.

The policy reasons given for these provisions in the House report are, first, to prevent the United States from being used as a "tax haven" and, second, to impose a U.S. tax on income "generated" from U.S. business activities.

As explained in detail in our report, the new tax would apply, however, even where no tax haven situation is involved. Nor does the bill apply in a consistent or equitable fashion its theory that the described income should be taxed where it is "generated." For example, the bill would subject, to U.S. tax, income it considers "generated" by U.S. office activities—but would not allow taxpayers to exclude from U.S. tax, or even to claim a foreign tax credit for, income similarly "generated" by a foreign office.