H.R. 5916 was designed to stimulate foreign investment in the United States by removing existing tax barriers to such investment. It would have revised or eliminated many of the provisions in the present law which tended to complicate or inhibit investment in U.S. securities. For this reason, the Institute's committee on federal taxation favored the proposed legislation, although in its comments submitted to the Committee on Ways and Means of the House of Representatives on June 25, 1965 it recommended certain changes and clarifications.

The new version of the bill, H.R. 11297, differed dramatically from its predecessor. It introduced an entirely new idea of taxing foreign source income under an elusive "effectively connected" concept, provided for the income and estate taxation of deposits in U.S. banks, and provided for higher estate tax rates on nonresident alien decedents. The specific factors which led to the adoption of such changes were not made clear. The Institute's committee on federal taxation opposed such changes in comments submitted to the House Ways and Means Committee on January 12, 1966.

H.R. 13103 modified considerably the objectives of the initial bill. On page 6 of the report of the House Ways and Means Committee it is stated, "While the initial bill proposed by the Treasury Department was designed primarily to stimulate investments by foreigners in the United States, your Committee considered more generally the tax provisions of present law affecting nonresident aliens and foreign corporations."

H.R. 13103 as presently constituted does eliminate some of the objectionable provisions of H.R. 11297; however, H.R. 13103 still contains proposed amendments to the current law that we feel are highly questionable:

1. The introduction of an entirely new concept, that non-resident aliens and foreign corporations engaged in trade or business in the United States would be taxed on certain *foreign source* income as well as U.S. source income "effectively connected" therewith. Current law taxes such persons on their *United States source* income only.

2. After 1971, interest on United States bank deposits would be subject to United States tax although paid to persons not engaged in business here.

3. United States bank deposits would be included in the gross estate of nonresident alien decedents even though not engaged in business in the United States.

Introduction of these new concepts and other changes and the uncertainties created thereby will have the effect of:

a. Forcing foreign controlled businesses with operations in the U.S. to relocate those operations outside the Uinted States, thus resulting in the loss of commercial contacts in the U.S., possible loss of exports, jobs, etc.

b. Causing foreign businesses to change plans for opening operations in the U.S. due to the complexity of U.S. tax laws.

c. Forcing the withdrawal of foreign deposits in U. S. banks, and stopping the further flow of funds to the U.S., thus aggravating our current serious balance of payments problem.

We are aware of the many complex problems inherent in the preparation of this legislation, but we strongly feel that many of the proposed changes in existing law will adversely affect the U.S. economy.

Specific Comments and Recommendations

Bill section 2

1. Proposed code section 861(a)(1)(A) and 861(c)

Interest on U. S. bank deposits (page 4, lines 9–14; page 5, lines 1–21): The effect of the proposed amendments would be to broaden the exemption from U.S. tax for certain interest income for a five year period, but would subject interest on U.S. bank deposits and similar amounts to withholding of tax at source with respect to payments after December 31, 1971. There are two obvious reasons for questioning the proposed withdrawal of the exemptions:

1. The basic exemption which has been in force since 1921, has been considered desirable to encourage the use of U.S. banks by foreign persons for deposits and financial transactions.

2. The nexus of such taxation of income from U.S. bank deposits is so slender as to raise doubts as to the rationale for the change.

While the imposition of tax would be delayed for several years, it is not considered desirable because it creates another complication regarding investment in the United States. Such complications certainly act as a *current* psychological deterrent to U.S. investment by nonresident aliens, even though the actual impact of U.S. withholding tax will not occur until 1971.