

does result under the existing provisions for taxation of such foreign persons. The Treasury has various ways of dealing with efforts to avoid U.S. income taxes, such as Section 482, arrangements under various income tax treaties, and its ability to challenge such devices as the mere arrangement of title passage outside the United States for tax avoidance purposes.

The majority of our existing tax treaties contain provisions which limit the imposition of tax to income from sources within the taxing country. These include Australia, Austria, Denmark, Finland, Greece, Honduras, Ireland, Italy, Japan, Luxembourg, New Zealand, Norway and Switzerland. Since H.R. 13103 provides that the changes which it would make in U.S. tax law would not contravene any existing treaties, the treaties with the above-named countries would require amendment before the foreign source income of their corporations could be taxed by the United States.

The foreign tax credit proposed under new Section 906 would not be allowed for taxes paid to a country solely by reason of the foreign person being domiciled there for tax purposes. This can obviously result in double taxation where the country of domicile imposes limitations on allowable credits for foreign taxes which are similar to the United States rules. In such a case, where the United States taxes income which is derived from a third country, the country of domicile would not permit a foreign tax credit for the U.S. taxes paid on income derived from the third country.

It should be noted that the foreign source income which may be taxed under the "effectively connected" provisions may be greater than that actually commensurate with the functions performed by the office in the United States.

The uncertainties and possible tax inequities resulting from the "effectively connected" concept will most likely discourage U.S. portfolio investment by foreign persons engaged in trade or business here, because in many cases they could not be sure of obtaining the generally lower rates of tax on investment income.

For the foregoing reasons we believe that it would be preferable to provide that a foreign corporation or a nonresident alien individual engaged in trade or business in the United States be taxed at regular rates only on its *U.S.-source* income "effectively connected" with the U.S. trade or business.

Bill section 4

6. Proposed code section 882(c)(2)

Softening of provision disallowing all deductions for failure to file a return (page 39, lines 1-12) : The disallowance of all deductions and most credits for failure to file a return under proposed Section 882(c)(2), is an unusually harsh provision. Even though this provision is a part of the present law, the purposes of the Bill would seem to indicate that the provision should be softened.

7. Proposed code section 245(a)

Dividend received deduction (page 43, lines 5-24; page 44, lines 1-9) : Consideration should be given to permitting a 100 per cent dividends received deduction to U.S. corporations with respect to an 80% or more owned foreign subsidiary to the extent that the distribution is entitled to a dividend received deduction, otherwise an up-stream dividend tax will be unjustly imposed. It should also be observed that the qualifying period under proposed Section 861(a) and amended Section 245 continue to be different.

We also urge that Code section 245 be amended to substitute the term "10 per cent" wherever the term "50 per cent" presently is used. This would permit a fractionalized dividends received credit in the majority of cases and would ameliorate, although not eliminate, the double taxation problems which we have described above.

Bill section 6

8. Proposed code section 901(c) and 2014(h)

Consistency in provisions requiring thirty-day notice prior to Presidential proclamation (page 66, line 15, and page 67, line 19; cf. page 55, lines 8-12 and page 79, lines 8-12) : To be consistent with proposed Section 896 and 2108, proposed Sections 901(c) and 2014(h) should require a thirty-day notice to Congress before a proclamation is made by the President.

9. Proposed code section 904(f)(2)

Foreign tax credit in case of certain overseas operations funding subsidiaries (page 68, line 9 through page 70, line 2) : The amendment would make the present "per country" limitation with respect to interest income inapplicable to interest