present "passage of title" test in the case of sales income. Such a change would not only present abuse of the source rules but would also favor exports and discourage imports thereby alleviating to some extent the present balance of payments problem.

Another objection against the "effectively connected" concept is that it provides no answer to the question whether a foreign corporation could be engaged in more than one "trade or business". If, for instance, a foreign corporation selling merchandise to other foreign countries through a U.S. sales office is deemed to have realized sales income "effectively connected" with its U.S. place of business and at the same time also earns U.S. source service income through another one of its U.S. offices, it is not clear whether H.R. 13103 would allow the separate taxation of income from each "business activity", or require an aggregate taxation of both the sales and services profits.

Apart from the above-mentioned objections, which alone would justify the elimination of the "effectively connected" concept, the practical application of this concept also presents formidable difficulties. Due to the fact that this concept had its origin in various international tax treaties which have been in existence for some time, it was possible for the Report of the Ways and Means Committee to lay down rather specific guidelines, which presumably would be incorporated in regulations, for determining when U.S. source income would be "effectively connected" with a business and when it would be derived from investments. By contrast, it apparently was not possible for the Ways and Means Committee to lay down guidelines for application of the "effectively connected" concept to foreign source income. This may be due to the fact that there is to our knowledge no other tax system which allows the "effectively connected" concept to supersede or conflict with domestic source rules. This in turn may be the reason why the Committee Report limits itself to the statement (p. 63) that one or another factor alone will not suffice to subject certain foreign source income to U.S. taxation and failed to give any general rules that could serve as guidelines for future judicial or administrative interpretation. This, of course, makes it impossible to foresee the future implications of this concept to foreign source income.

For these reasons it is respectfully submitted that the "effectively connected" concept should be eliminated from H.R. 13103 altogether, or at least limited in its application to U.S. source income. Under no circumstances should it be permitted to conflict with or supersede traditional U.S. source rules which could well be amended to prevent abuses from the use of the U.S. as a tax haven.

2. *Taxation of interest paid on deposits of foreigners*

H.R. 13103 would subject currently exempt interest on U.S. bank deposits of nonresident aliens and foreign corporations to U.S. income taxation. Such tax would go into effect on January 1, 1972, and would be collected by withholding at source.

Legal, economic and administrative considerations militate against the enactment of this provision. The Report of the Ways and Means Committee states that the primary reason for the proposed change of this source rule was "that it is questionable whether interest income of this type, which is so clearly derived from U.S. sources should be treated as though derived from sources without the U.S. and thereby escape U.S. taxation" (Report p. 7). In view of the fact that the majority of the developed European Countries, such as France,[2] Holland,[3] Sweden[4] and the United Kingdom,[5] which play an important role in the capital markets of the world, do not impose similar taxes, there is an overriding economic argument against the tax, namely, that of a free flow of capital. There can be no doubt that the enactment of this proposed provision would create a barrier against the inflow of capital into the U.S. and encourage the withdrawal of substantial bank deposits from this country. It seems strange for the United States, with its serious balance of payment deficit, to change a long existing source rule which now conforms to that of many of the developed countries of the world, for purely formalistic reasons.

Furthermore, such a change does not even seem justifiable from an equitable point of view as there is no reason why residents and citizens should be treated in the same manner as nonresident aliens since they do not receive the same measure of benefits from the United States government.

---

[2] World Tax Series, Taxation in France, p. 753 and chapt. 9/1.2e.
[3] Amended Income Tax Law of 1941, Part V, Chapt. 1.
[4] World Tax Series, Taxation in Sweden, chapt. 11/4.10, p. 487.
[5] Revenue Act 1952.