

By imposing this proposed tax the average net return on U.S. bank deposits owned by foreign corporations and nonresident aliens will be reduced by 30 per cent (or lower applicable treaty rate). If the tax were to be 30 per cent, the return on the deposits in the U.S. would equal about half of the return that could be earned on the European Euro-dollar market. This fact, as well as the loss of secrecy due to the information requirements that are necessarily connected with the imposition of a withholding tax, will undoubtedly drive a great number of foreign investors out of U.S. banks and into the hands of foreign institutions, a development which is neither in the international interest of the balance of payments nor in that of the domestic U.S. economy.

Although the delay in the effective date of this provision would alleviate the problem, it is to be expected that new U.S. bank deposits of foreigners would be greatly reduced and that existing deposits gradually withdrawn because of this provision. Whether the withdrawn funds would reappear in other forms of U.S. investments is highly speculative. Certainly the proposed tax would be an important unfavorable factor in our balance of payments problem.

Finally, H.R. 13103 would require U.S. banks, acting as withholding agents, to determine whether or not the interest they would pay on foreign owned deposits would be "effectively connected" with the U.S. business of the depositor. Not only would this requirement impose an extremely heavy administrative burden on U.S. banks but it would necessitate their clerical staff to pass upon an intricate and difficult legal question exceeding their professional capabilities, or obtaining expensive legal opinions. Furthermore, it seems doubtful whether these banks would be able to collect the necessary factual data to enable them to reach a decision in a specific case.

There can be no doubt, therefore that this proposed change of U.S. source rules is neither necessary nor justified, but on the contrary would cause severe economic damage to the economy of this country.

3. Estate taxation of foreign bank deposits

In addition to taxing the interest paid by U.S. banks on deposits of nonresident aliens and foreign corporations, H.R. 13103 if enacted would subject such deposits to the U.S. estate tax.

In view of the fact that this bill was originally intended to encourage foreign investment in the U.S., it is difficult to understand why this provision is included in the bill. As contrasted with the postponement of the effective date of the income taxation of interest on U.S. bank deposits of foreigners (to avoid an immediate adverse effect on the balance of payment problem) the estate tax on such bank deposits would go into effect immediately upon the enactment of this bill. This immediate effect would at least neutralize any advantages resulting from the delay in the income taxation of the interest on bank deposits. Most foreign investors who will be looking for new investment possibilities for the period after 1971 would certainly not be willing to run the risk of being subject to the estate tax during this transitional period. It would be desirable, therefore, to eliminate this provision.

4. Net taxation of nonresident alien individuals

H.R. 13103 finally provides for a flat 30 per cent withholding tax on the investment income of nonresident aliens and also gives such taxpayers the option of elected to be taxed on a net basis with regard to their income from real property. Apart from the fact that it seems difficult to justify taxing the income of nonresidents at a higher rate than that of people living in this country who enjoy the benefits of citizenship and residence, there also seems to be little merit in limiting the optional net taxation of nonresident alien individuals to real property income. For these reasons we respectfully suggest amending H.R. 13103 so that nonresident alien individuals could elect to have all their U.S. source income taxed on a net basis. This amendment would furthermore be consistent with the present withholding system on all fixed or determinable income and all other income described in section 1441 (a) and (b) of the Code inasmuch as it would require the affected taxpayer who wished to be taxed on a net base to apply for a refund. In addition, the newly created section 896 providing for reinstatement of present rules if a foreign country proves recalcitrant could always serve as a means of avoiding any unfavorable effects of such a provision.