LEGISLATIVE HISTORY

OF

H.R. 13103

89th Congress

FOREIGN INVESTORS TAX ACT OF 1966

PUBLIC LAW 89-809

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

NINETIETH CONGRESS

FIRST SESSION

PART 1

Prepared by the Staff of the Committee on Ways and Means for the use of the Committee on Ways and Means

---

U.S. GOVERNMENT PRINTING OFFICE

71-297 O WASHINGTON : 1967

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 Price $3.50

COMMITTEE ON WAYS AND MEANS

WILBUR D. MILLS, Arkansas, *Chairman*

CECIL R. KING, California
HALE BOGGS, Louisiana
FRANK M. KARSTEN, Missouri
A. S. HERLONG, JR., Florida
JOHN C. WATTS, Kentucky
AL ULLMAN, Oregon
JAMES A. BURKE, Massachusetts
MARTHA W. GRIFFITHS, Michigan
GEORGE M. RHODES, Pennsylvania
DAN ROSTENKOWSKI, Illinois
PHIL M. LANDRUM, Georgia
CHARLES A. VANIK, Ohio
RICHARD H. FULTON, Tennessee
JACOB H. GILBERT, New York

JOHN W. BYRNES, Wisconsin
THOMAS B. CURTIS, Missouri
JAMES B. UTT, California
JACKSON E. BETTS, Ohio
HERMAN T. SCHNEEBELI, Pennsylvania
HAROLD R. COLLIER, Illinois
JOEL T. BROYHILL, Virginia
JAMES F. BATTIN, Montana
BARBER B. CONABLE, JR., New York
GEORGE BUSH, Texas

WILLIAM H. QUEALY, *Minority Counsel*

LEO H. IRWIN, *Chief Counsel*
JOHN W. MARTIN, JR., *Assistant Chief Counsel*
JOHN P. BAKER, *Professional Staff*
RAYMOND A. DRISCOLL, *Professional Staff*
HAROLD T. LAMAR, *Professional Staff*
JAMES W. KELLEY, *Professional Staff*

INTRODUCTION

The legislative history of H.R. 13103 is a compilation of legislative history materials relating to the enactment of Public Law 89–809. The purpose of this history is to make readily available all of the public documents containing pertinent information relative to the enactment of the law.

This document sets forth in chronological order the action taken by Congress with respect to this law. For example, section 1 sets forth the public law; section 2, H.R. 5916 as introduced in the House of Representatives; section 3, an explanation by the Treasury Department of the act to remove tax barriers to foreign investment in the United States, which was inserted in the Congressional Record on March 8, 1965, by Chairman Wilbur D. Mills, and so on.

This document contains: (*a*) the hearings on H.R. 5916 before the Committee on Ways and Means on June 30 and July 1, 1965 (which include: H.R. 5916 as introduced in the House of Representatives; press release of the Committee on Ways and Means, dated June 18, 1965, announcing invitation for interested persons to submit written statements on H.R. 5916; and press release of the Committee on Ways and Means, dated June 24, 1965, announcing public hearings on H.R. 5916); (*b*) written statements by interested individuals and organizations on H.R. 11297 submitted to the Committee on Ways and Means (which include: H.R. 11297 as introduced in the House of Representatives on September 28, 1965, together with summary of principal provisions and comparative print showing changes which would be made in existing law); and (*c*) hearings on H.R. 13103 before the Committee on Ways and Means on March 7, 1966 (which include: press release of the Committee on Ways and Means, dated February 24, 1966, announcing the hearings on H.R. 13103 and H.R. 13103 as introduced in the House of Representatives).

The hearings held by the Senate Committee on Finance on H.R. 13103 are also contained in this document. Included in these hearings is H.R. 13103 as passed by the House of Representatives and referred to the Senate Committee on Finance.

Documents incorporated in the hearings and written statements mentioned above are not set out separately in this document; however, appropriate cross-references are made.

The material contained herein has been inserted in toto; therefore, the original pagination appears in all cases.

In order to facilitate the utilization of the House and Senate floor debates on H.R. 13103, this document contains an alphabetical listing of Members of Congress with cross-references to their remarks on the floor of the House or the Senate, as the case may be. In this connection, however, the page numbers refer to the pages of this document. The floor debates are taken from the Congressional Record for the

date indicated. The page numbers of the daily Congressional Record are bracketed.

During the course of its consideration of H.R. 13103, the Senate Committee on Finance added amendments to the bill, some of which were the substance of bills that were reported by the Committee on Ways and Means and in some cases, had been passed by the House of Representatives. One situation involves a Senate-passed bill that was reported by the Committee on Ways and Means. These bills appear in the appendix to this document along with the appropriate committee reports and House and Senate floor debates where appropriate.

CONTENTS

TABLE SHOWING CONTENTS OF EACH PART

APPENDIX

CHRONOLOGICAL HISTORY OF THE LEGISLATION

Date Fowler task force report presented to the President	Apr. 27, 1964.
House bill number	H.R. 5916.
Date bill introduced in House of Representatives	Mar. 8, 1965.
Dates of public hearings before the House Committee on Ways and Means (on H.R. 5916).	June 30 and July 1, 1965.
House bill number (superseding H.R. 5916)	H.R. 11297.
Date bill introduced in House of Representatives	Sept. 28, 1965.
House bill number (superseding H.R. 11297)	H.R. 13103.
Date bill introduced in House of Representatives	Feb. 28, 1966.
Date of public hearings before the House Committee on Ways and Means (on H.R. 13103)	Mar. 7, 1966.
Date bill reported by Committee on Ways and Means	Apr. 26, 1966.
House report number	H. Rept. No. 1450.
Date rule obtained—H. Res. 880, providing for a closed rule, waiving points of order against, 3 hours of debate, committee amendments, and one motion to recommit	June 7, 1966.
Date of House floor debate and final passage	June 15, 1966.
Rule: H. Res. 880 adopted by voice vote. Final passage: Passed by a voice vote.	
Dates of public hearings before the Senate Committee on Finance	Aug. 8, 9, and 10, 1966.
Date bill reported by Senate Committee on Finance	Oct. 11, 1966.
Senate report number	S. Rept. No. 1707.
Dates of Senate floor debate	Oct. 12 and 13, 1966.
Date bill passed the Senate	Oct. 13, 1966.
Final passage: Passed by a record vote—58 yeas, 18 nays, 24 not voting.	
Date conference report filed	Oct. 19, 1966.
Conference report number	Rept. No. 2327.
Date conference report presented to House of Representatives	Oct. 19, 1966.
Date conference report adopted by House of Representatives	Oct. 20, 1966.
Vote: 171 yeas, 46 nays, 221 not voting.	
Date conference report presented to and adopted by the Senate	Oct. 22, 1966.
Date signed by the President	Nov. 13, 1966.
Public law number	Public Law 89-809.

ALPHABETICAL LISTING OF MEMBERS OF CONGRESS WITH CROSS-REFERENCES TO FLOOR DEBATES

A. House Floor Debate on Bill

Members of the House

B. Senate Floor Debate on Bill

Members of the Senate

C. House Floor Debate on Conference Report

Members of the House

D. Senate Floor Debate on Conference Report

Members of the Senate

SECTION 1
PUBLIC LAW 89-809

Public Law 89-809
89th Congress, H. R. 13103
November 13, 1966

An Act

80 STAT. 1539

To provide equitable tax treatment for foreign investment in the United States, to establish a Presidential Election Campaign Fund to assist in financing the costs of presidential election campaigns, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Foreign Investors Tax Act of 1966 and Presidential Election Campaign Fund Act of 1966.

SECTION 1. TABLE OF CONTENTS, ETC.

(a) TABLE OF CONTENTS.—

TITLE I—FOREIGN INVESTORS TAX ACT—Continued

TITLE II—OTHER AMENDMENTS TO INTERNAL REVENUE CODE

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, wherever in titles I, II, and III, of this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference is to a section or other provision of the Internal Revenue Code of 1954.

TITLE I—FOREIGN INVESTORS TAX ACT

SEC. 101. SHORT TITLE.

This title may be cited as the "Foreign Investors Tax Act of 1966".

SEC. 102. SOURCE OF INCOME.

(a) INTEREST.—

(1)(A) Subparagraph (A) of section 861(a)(1) (relating to interest from sources within the United States) is amended to read as follows: 68A Stat. 275. 26 USC 861.

"(A) interest on amounts described in subsection (c) received by a nonresident alien individual or a foreign corporation, if such interest is not effectively connected with the conduct of a trade or business within the United States,".

(B) Section 861 is amended by adding at the end thereof the following new subsection:

"(c) INTEREST ON DEPOSITS, ETC.—For purposes of subsection (a)(1)(A), the amounts described in this subsection are—

"(1) deposits with persons carrying on the banking business,

"(2) deposits or withdrawable accounts with savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, but only to the extent that amounts paid or credited on such deposits or accounts are deducti-

68A Stat. 78, 204.
26 USC 265, 591.

ble under section 591 (determined without regard to section 265) in computing the taxable income of such institutions, and

"(3) amounts held by an insurance company under an agreement to pay interest thereon. Effective with respect to amounts paid or credited after December 31, 1972, subsection (a)(1)(A) and this subsection shall cease to apply."

26 USC 861.

(2) Section 861(a)(1) is amended by striking out subparagraphs (B) and (C) and inserting in lieu thereof the following:

"(B) interest received from a resident alien individual or a domestic corporation, when it is shown to the satisfaction of the Secretary or his delegate that less than 20 percent of the gross income from all sources of such individual or such corporation has been derived from sources within the United States, as determined under the provisions of this part, for the 3-year period ending with the close of the taxable year of such individual or such corporation preceding the payment of such interest, or for such part of such period as may be applicable,

"(C) interest received from a foreign corporation (other than interest paid or credited after December 31, 1972, by a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business), when it is shown to the satisfaction of the Secretary or his delegate that less than 50 percent of the gross income from all sources of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the payment of such interest (or for such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States,

"(D) in the case of interest received from a foreign corporation (other than interest paid or credited after December 31, 1972, by a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business), 50 percent or more of the gross income of which from all sources for the 3-year period ending with the close of its taxable year preceding the payment of such interest (or for such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States, an amount of such interest which bears the same ratio to such interest as the gross income of such foreign corporation for such period which was not effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources,

"(E) income derived by a foreign central bank of issue from bankers' acceptances, and

"(F) interest on deposits with a foreign branch of a domestic corporation or a domestic partnership, if such branch is engaged in the commercial banking business."

(3) Section 861 (relating to income from sources within the United States) is amended by adding after subsection (c) (as added by paragraph (1)(B)) the following new subsection:

"(d) SPECIAL RULES FOR APPLICATION OF PARAGRAPHS (1)(B), (1)(C), (1)(D), AND (2)(B) OF SUBSECTION (a).—

"(1) NEW ENTITIES.—For purposes of paragraphs (1)(B), (1)(C), (1)(D), and (2)(B) of subsection (a), if the resident alien individual, domestic corporation, or foreign corporation, as the case may be, has no gross income from any source for the 3-year period (or part thereof) specified, the 20 percent test or the 50 percent test, as the case may be, shall be applied with respect to the taxable year of the payor in which payment of the interest or dividends, as the case may be, is made.

"(2) TRANSITION RULE.—For purposes of paragraphs (1)(C), (1)(D), and (2)(B) of subsection (a), the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States."

(4)(A) Section 895 (relating to income derived by a foreign central bank of issue from obligations of the United States) is amended to read as follows: 75 Stat. 64. 26 USC 895.

"SEC. 895. INCOME DERIVED BY A FOREIGN CENTRAL BANK OF ISSUE FROM OBLIGATIONS OF THE UNITED STATES OR FROM BANK DEPOSITS.

"Income derived by a foreign central bank of issue from obligations of the United States or of any agency or instrumentality thereof (including beneficial interests, participations, and other instruments issued under section 302(c) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1717)) which are owned by such foreign central bank of issue, or derived from interest on deposits with persons carrying on the banking business, shall not be included in gross income and shall be exempt from taxation under this subtitle unless such obligations or deposits are held for, or used in connection with, the conduct of commercial banking functions or other commercial activities. For purposes of the preceding sentence the Bank for International Settlements shall be treated as a foreign central bank of issue." 78 Stat. 800; Ante, p. 164.

(B) The table of sections for subpart C of part II of subchapter N of chapter 1 is amended by striking out the item relating to section 895 and inserting in lieu thereof the following:

"Sec. 895. Income derived by a foreign central bank of issue from obligations of the United States or from bank deposits."

(b) DIVIDENDS.—Section 861(a)(2)(B) (relating to dividends from sources within the United States) is amended to read as follows: 68A Stat. 275. 26 USC 861.

"(B) from a foreign corporation unless less than 50 percent of the gross income from all sources of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period which was effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources; but dividends (other than dividends for which a deduction is allowable under section 245(b)) from a foreign corporation shall, for purposes of subpart A of part III (relating to foreign tax credit), be treated as income from sources without the United States to the extent (and only to the extent) exceeding the amount which is 100/85ths of the amount of the deduction allowable under section 245 in respect of such dividends, or". Post, p. 1558. 26 USC 901-905; Post, p. 1568.

(c) PERSONAL SERVICES.—Section 861(a)(3)(C)(ii) (relating to income from personal services) is amended to read as follows:

"(ii) an individual who is a citizen or resident of the United States, a domestic partnership, or a domestic corporation, if such labor or services are performed for an office or place of business maintained in a foreign country

or in a possession of the United States by such individual, partnership, or corporation."

68A Stat. 278. 26 USC 864. (d) DEFINITIONS.—Section 864 (relating to definitions) is amended—

(1) by striking out "For purposes of this part," and inserting in lieu thereof

"(a) SALE, ETC.—For purposes of this part,"; and

(2) by adding at the end thereof the following new subsections:

"(b) TRADE OR BUSINESS WITHIN THE UNITED STATES.—For purposes of this part, part II, and chapter 3, the term 'trade or business within the United States' includes the performance of personal services within the United States at any time within the taxable year, but does not include—

"(1) PERFORMANCE OF PERSONAL SERVICES FOR FOREIGN EMPLOYER.—The performance of personal services—

"(A) for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

"(B) for an office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation,

by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000.

"(2) TRADING IN SECURITIES OR COMMODITIES.—

"(A) STOCKS AND SECURITIES.—

"(i) IN GENERAL.—Trading in stocks or securities through a resident broker, commission agent, custodian, or other independent agent.

"(ii) TRADING FOR TAXPAYER'S OWN ACCOUNT.—Trading in stocks or securities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in stocks or securities, or in the case of a corporation (other than a corporation which is, or but for section 542(c)(7) or 543(b)(1)(C) would be, a personal holding company) the principal business of which is trading in stocks or securities for its own account, if its principal office is in the United States.

Post, p. 1559.

"(B) COMMODITIES.—

"(i) IN GENERAL.—Trading in commodities through a resident broker, commission agent, custodian, or other independent agent.

"(ii) TRADING FOR TAXPAYER'S OWN ACCOUNT.—Trading in commodities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in commodities.

"(iii) LIMITATION.—Clauses (i) and (ii) shall apply only if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the

transaction is of a kind customarily consummated at such place.

"(C) LIMITATION.—Subparagraphs (A)(i) and (B)(i) shall apply only if, at no time during the taxable year, the taxpayer has an office or other fixed place of business in the United States through which or by the direction of which the transactions in stocks or securities, or in commodities, as the case may be, are effected.

"(c) EFFECTIVELY CONNECTED INCOME, ETC.—

"(1) GENERAL RULE.—For purposes of this title—

"(A) In the case of a nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year, the rules set forth in paragraphs (2), (3), and (4) shall apply in determining the income, gain, or loss which shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(B) Except as provided in section 871(d) or sections 882 (d) and (e), in the case of a nonresident alien individual or a foreign corporation not engaged in trade or business within the United States during the taxable year, no income, gain, or loss shall be treated as effectively connected with the conduct of a trade or business within the United States. Post, pp. 1547, 1555.

"(2) PERIODICAL, ETC., INCOME FROM SOURCES WITHIN UNITED STATES—FACTORS.—In determining whether income from sources within the United States of the types described in section 871 (a)(1) or section 881(a), or whether gain or loss from sources within the United States from the sale or exchange of capital assets, is effectively connected with the conduct of a trade or business within the United States, the factors taken into account shall include whether—

"(A) the income, gain, or loss is derived from assets used in or held for use in the conduct of such trade or business, or

"(B) the activities of such trade or business were a material factor in the realization of the income, gain, or loss.

In determining whether an asset is used in or held for use in the conduct of such trade or business or whether the activities of such trade or business were a material factor in realizing an item of income, gain, or loss, due regard shall be given to whether or not such asset or such income, gain, or loss was accounted for through such trade or business. In applying this paragraph and paragraph (4), interest referred to in section 861(a)(1)(A) shall be considered income from sources within the United States. Ante, p. 1541.

"(3) OTHER INCOME FROM SOURCES WITHIN UNITED STATES.—All income, gain, or loss from sources within the United States (other than income, gain, or loss to which paragraph (2) applies) shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(4) INCOME FROM SOURCES WITHOUT UNITED STATES.—

"(A) Except as provided in subparagraphs (B) and (C), no income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(B) Income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States by a nonresident alien individual or a foreign corporation if such person has an office or other fixed place of business within the United States to which such income, gain, or loss is attributable and such income, gain, or loss—

"(i) consists of rents or royalties for the use of or for the privilege of using intangible property described in section 862(a)(4) (including any gain or loss realized on the sale of such property) derived in the active conduct of such trade or business;

68A Stat. 277.
26 USC 862.

"(ii) consists of dividends or interest, or gain or loss from the sale or exchange of stock or notes, bonds, or other evidences of indebtedness, and either is derived in the active conduct of a banking, financing, or similar business within the United States or is received by a corporation the principal business of which is trading in stocks or securities for its own account; or

"(iii) is derived from the sale (without the United States) through such office or other fixed place of business of personal property described in section 1221(1), except that this clause shall not apply if the property is sold for use, consumption, or disposition outside the United States and an office or other fixed place of business of the taxpayer outside the United States participated materially in such sale.

26 USC 1221.

"(C) In the case of a foreign corporation taxable under part I of subchapter L, any income from sources without the United States which is attributable to its United States business shall be treated as effectively connected with the conduct of a trade or business within the United States.

73 Stat. 112.
26 USC 801-820.

"(D) No income from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States if it either—

"(i) consists of dividends, interest, or royalties paid by a foreign corporation in which the taxpayer owns (within the meaning of section 958(a)), or is considered as owning (by applying the ownership rules of section 958(b)), more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or

76 Stat. 1018.
26 USC 958.

"(ii) is subpart F income within the meaning of section 952(a).

26 USC 952.

"(5) RULES FOR APPLICATION OF PARAGRAPH (4)(B).—For purposes of subparagraph (B) of paragraph (4)—

"(A) in determining whether a nonresident alien individual or a foreign corporation has an office or other fixed place of business, an office or other fixed place of business of an agent shall be disregarded unless such agent (i) has the authority to negotiate and conclude contracts in the name of the nonresident alien individual or foreign corporation and regularly exercises that authority or has a stock of merchandise from which he regularly fills orders on behalf of such individual or foreign corporation, and (ii) is not a general commission agent, broker, or other agent of independent status acting in the ordinary course of his business,

"(B) income, gain, or loss shall not be considered as attributable to an office or other fixed place of business within the United States unless such office or fixed place of business is a material factor in the production of such income, gain, or loss and such office or fixed place of business regularly carries on activities of the type from which such income, gain, or loss is derived, and

"(C) the income, gain, or loss which shall be attributable to an office or other fixed place of business within the United States shall be the income, gain, or loss property allocable thereto, but, in the case of a sale described in clause (iii) of

such subparagraph, the income which shall be treated as attributable to an office or other fixed place of business within the United States shall not exceed the income which would be derived from sources within the United States if the sale were made in the United States."

(e) EFFECTIVE DATES.—

(1) The amendments made by subsections (a), (c), and (d) shall apply with respect to taxable years beginning after December 31, 1966; except that in applying section 864(c)(4)(B)(iii) of the Internal Revenue Code of 1954 (as added by subsection (d)) with respect to a binding contract entered into on or before February 24, 1966, activities in the United States on or before such date in negotiating or carrying out such contract shall not be taken into account.

(2) The amendments made by subsection (b) shall apply with respect to amounts received after December 31, 1966.

SEC. 103. NONRESIDENT ALIEN INDIVIDUALS.

(a) TAX ON NONRESIDENT ALIEN INDIVIDUALS.—

(1) Section 871 (relating to tax on nonresident alien individuals) is amended to read as follows: 68A Stat. 278. 26 USC 871.

"SEC. 871. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

"(a) INCOME NOT CONNECTED WITH UNITED STATES BUSINESS—30 PERCENT TAX.—

"(1) INCOME OTHER THAN CAPITAL GAINS.—There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual as—

"(A) interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

"(B) gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), and gains on transfers described in section 1235 made on or before October 4, 1966, 26 USC 402, 403, 631, 1235.

"(C) in the case of bonds or other evidences of indebtedness issued after September 28, 1965, amounts which under section 1232 are considered as gains from the sale or exchange of property which is not a capital asset, and 26 USC 1232.

"(D) gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property, or of any interest in any such property, to the extent such gains are from payments which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, or from payments which are treated as being so contingent under subsection (e),

but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

"(2) CAPITAL GAINS OF ALIENS PRESENT IN THE UNITED STATES 183 DAYS OR MORE.—In the case of a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year, there is hereby imposed for such year a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from the sale or exchange at any time during such year of capital assets exceed his losses, allocable to sources within the United States, from the sale or exchange at any time during such year of capital assets. For purposes of this paragraph, gains and losses shall be taken

into account only if, and to the extent that, they would be recognized and taken into account if such gains and losses were effectively connected with the conduct of a trade or business within the United States, except that such gains and losses shall be determined without regard to section 1202 (relating to deduction for capital gains) and such losses shall be determined without the benefits of the capital loss carryover provided in section 1212. Any gain or loss which is taken into account in determining the tax under paragraph (1) or subsection (b) shall not be taken into account in determining the tax under this paragraph. For purposes of the 183-day requirement of this paragraph, a nonresident alien individual not engaged in trade or business within the United States who has not established a taxable year for any prior period shall be treated as having a taxable year which is the calendar year.

68A Stat. 320.
26 USC 1202.
26 USC 1212.

"(b) INCOME CONNECTED WITH UNITED STATES BUSINESS—GRADUATED RATE OF TAX.—

"(1) IMPOSITION OF TAX.—A nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 1 or 1201(b) on his taxable income which is effectively connected with the conduct of a trade or business within the United States.

26 USC 1, 1201; Post, p. 1550.

"(2) DETERMINATION OF TAXABLE INCOME.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

"(c) PARTICIPANTS IN CERTAIN EXCHANGE OR TRAINING PROGRAMS.—For purposes of this section, a nonresident alien individual who (without regard to this subsection) is not engaged in trade or business within the United States and who is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended (8 U.S.C. 1101(a)(15) (F) or (J)), shall be treated as a nonresident alien individual engaged in trade or business within the United States, and any income described in section 1441(b) (1) or (2) which is received by such individual shall, to the extent derived from sources within the United States, be treated as effectively connected with the conduct of a trade or business within the United States.

66 Stat. 168; 75 Stat. 534.
75 Stat. 536.
26 USC 1441.

"(d) ELECTION TO TREAT REAL PROPERTY INCOME AS INCOME CONNECTED WITH UNITED STATES BUSINESS.—

"(1) IN GENERAL.—A nonresident alien individual who during the taxable year derives any income—

"(A) from real property held for the production of income and located in the United States, or from any interest in such real property, including (i) gains from the sale or exchange of such real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631 (b) or (c), and

68A Stat. 213.
26 USC 631.

"(B) which, but for this subsection, would not be treated as income which is effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (b)(1) whether or not such individual is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the

consent of the Secretary or his delegate with respect to any taxable year.

"(2) ELECTION AFTER REVOCATION.—If an election has been made under paragraph (1) and such election has been revoked, a new election may not be made under such paragraph for any taxable year before the 5th taxable year which begins after the first taxable year for which such revocation is effective, unless the Secretary or his delegate consents to such new election.

"(3) FORM AND TIME OF ELECTION AND REVOCATION.—An election under paragraph (1), and any revocation of such an election, may be made only in such manner and at such time as the Secretary or his delegate may by regulations prescribe.

"(e) GAINS FROM SALE OR EXCHANGE OF CERTAIN INTANGIBLE PROPERTY.—For purposes of subsection (a)(1)(D), and for purposes of sections 881(a)(4), 1441(b), and 1442(a)— 68A Stat. 357. 26 USC 1441. Post, pp. 1555, 1557.

"(1) PAYMENTS TREATED AS CONTINGENT ON USE, ETC.—If more than 50 percent of the gain for any taxable year from the sale or exchange of any patent, copyright, secret process or formula, good will, trademark, trade brand, franchise, or other like property, or of any interest in any such property, is from payments which are contingent on the productivity, use, or disposition of such property or interest, all of the gain for the taxable year from the sale or exchange of such property or interest shall be treated as being from payments which are contingent on the productivity, use, or disposition of such property or interest.

"(2) SOURCE RULE.—In determining whether gains described in subsection (a)(1)(D) and section 881(a)(4) are received from sources within the United States, such gains shall be treated as rentals or royalties for the use of, or privilege of using, property or an interest in property.

"(f) CERTAIN ANNUITIES RECEIVED UNDER QUALIFIED PLANS.—For purposes of this section, gross income does not include any amount received as an annuity under a qualified annuity plan described in section 403(a)(1), or from a qualified trust described in section 401(a) which is exempt from tax under section 501(a), if— 72 Stat. 1622. 26 USC 403. 26 USC 401, 501.

"(1) all of the personal services by reason of which such annuity is payable were either (A) personal services performed outside the United States by an individual who, at the time of performance of such personal services, was a nonresident alien, or (B) personal services described in section 864(b)(1) performed within the United States by such individual, and Ante, p. 1544.

"(2) at the time the first amount is paid as such annuity under such annuity plan, or by such trust, 90 percent or more of the employees for whom contributions or benefits are provided under such annuity plan, or under the plan or plans of which such trust is a part, are citizens or residents of the United States."

"(g) CROSS REFERENCES.—

"(1) For tax treatment of certain amounts distributed by the United States to nonresident alien individuals, see section 402(a)(4).

"(2) For taxation of nonresident alien individuals who are expatriate United States citizens, see section 877.

"(3) For doubling of tax on citizens of certain foreign countries, see section 891.

"(4) For adjustment of tax in case of nationals or residents of certain foreign countries, see section 896.

"(5) For withholding of tax at source on nonresident alien individuals, see section 1441.

"(6) For the requirement of making a declaration of estimated tax by certain nonresident alien individuals, see section 6015(i)."

68A Stat. 7.
26 USC 1.

(2) Section 1 (relating to tax on individuals) is amended by redesignating subsection (d) as subsection (e), and by inserting after subsection (c) the following new subsection:

"(d) NONRESIDENT ALIENS.—In the case of a nonresident alien individual, the tax imposed by subsection (a) shall apply only as provided by section 871 or 877."

Ante, p. 1547; Post, p. 1551.

(b) GROSS INCOME.—

26 USC 872.

(1) Subsection (a) of section 872 (relating to gross income of nonresident alien individuals) is amended to read as follows:

"(a) GENERAL RULE.—In the case of a nonresident alien individual, gross income includes only—

"(1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and

"(2) gross income which is effectively connected with the conduct of a trade or business within the United States."

75 Stat. 536.

(2) Subparagraph (B) of section 872(b)(3) (relating to compensation of participants in certain exchange or training programs) is amended by striking out "by a domestic corporation" and inserting in lieu thereof "by a domestic corporation, a domestic partnership, or an individual who is a citizen or resident of the United States".

(3) Subsection (b) of section 872 (relating to exclusions from gross income) is amended by adding at the end thereof the following new paragraph:

"(4) CERTAIN BOND INCOME OF RESIDENTS OF THE RYUKYU ISLANDS OR THE TRUST TERRITORY OF THE PACIFIC ISLANDS.—Income derived by a nonresident alien individual from a series E or series H United States savings bond, if such individual acquired such bond while a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands."

(c) DEDUCTIONS.—

26 USC 873.

(1) Section 873 (relating to deductions allowed to nonresident alien individuals) is amended to read as follows:

"SEC. 873. DEDUCTIONS.

"(a) GENERAL RULE.—In the case of a nonresident alien individual, the deductions shall be allowed only for purposes of section 871(b) and (except as provided by subsection (b)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary or his delegate.

"(b) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income which is effectively connected with the conduct of a trade or business within the United States:

"(1) LOSSES.—The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property located within the United States.

78 Stat. 43.
26 USC 165.

"(2) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts allowed by section 170.

68A Stat. 58.
26 USC 170.

"(3) PERSONAL EXEMPTION.—The deduction for personal exemptions allowed by section 151, except that in the case of a nonresident alien individual who is not a resident of a contiguous country only one exemption shall be allowed under section 151.

26 USC 151.

"(c) CROSS REFERENCES.—

"(1) For disallowance of standard deduction, see section 142(b)(1).
"(2) For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1)."

(2) Section 154(3) (relating to cross references in respect of deductions for personal exemptions) is amended to read as follows: 68A Stat. 45. 26 USC 154.

"(3) For exemptions of nonresident aliens, see section 873(b)(3)."

(d) ALLOWANCE OF DEDUCTIONS AND CREDITS.—Subsection (a) of section 874 (relating to filing of returns) is amended to read as follows: 26 USC 874.

"(a) RETURN PREREQUISITE TO ALLOWANCE.—A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return, in the manner prescribed in subtitle F (sec. 6001 and following, relating to procedure and administration), including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. This subsection shall not be construed to deny the credits provided by sections 31 and 32 for tax withheld at source or the credit provided by section 39 for certain uses of gasoline and lubricating oil." 26 USC 31, 32. 79 Stat. 167. 26 USC 39.

(e) BENEFICIARIES OF ESTATES AND TRUSTS.—

(1) Section 875 (relating to partnerships) is amended to read as follows: 68A Stat. 281. 26 USC 875.

"SEC. 875. PARTNERSHIPS; BENEFICIARIES OF ESTATES AND TRUSTS.

"For purposes of this subtitle—

"(1) a nonresident alien individual or foreign corporation shall be considered as being engaged in a trade or business within the United States if the partnership of which such individual or corporation is a member is so engaged, and

"(2) a nonresident alien individual or foreign corporation which is a beneficiary of an estate or trust which is engaged in any trade or business within the United States shall be treated as being engaged in such trade or business within the United States."

(2) The table of sections for subpart A of part II of subchapter N of chapter 1 is amended by striking out the item relating to section 875 and inserting in lieu thereof the following:

"Sec. 875. Partnerships; beneficiaries of estates and trusts."

(f) EXPATRIATION TO AVOID TAX.—

(1) Subpart A of part II of subchapter N of chapter 1 (relating to nonresident alien individuals) is amended by redesignating section 877 as section 878, and by inserting after section 876 the following new section: 26 USC 877.

"SEC. 877. EXPATRIATION TO AVOID TAX.

"(a) IN GENERAL.—Every nonresident alien individual who at any time after March 8, 1965, and within the 10-year period immediately preceding the close of the taxable year lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B, shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection exceeds the tax which, without regard to this section, is imposed pursuant to section 871. 26 USC 1-2524. Ante, p. 1547.

"(b) ALTERNATIVE TAX.—A nonresident alien individual described in subsection (a) shall be taxable for the taxable year as provided in section 1 or section 1201(b), except that— 26 USC 1, 1201; Ante, p. 1550.

"(1) the gross income shall include only the gross income described in section 872(a) (as modified by subsection (c) of this section), and

Ante, p. 1550.

"(2) the deductions shall be allowed if and to the extent that they are connected with the gross income included under this section, except that the capital loss carryover provided by section 1212(b) shall not be allowed; and the proper allocation and apportionment of the deductions for this purpose shall be determined as provided under regulations prescribed by the Secretary or his delegate.

78 Stat. 99.
26 USC 1212.

For purposes of paragraph (2), the deductions allowed by section 873(b) shall be allowed; and the deduction (for losses not connected with the trade or business if incurred in transactions entered into for profit) allowed by section 165(c)(2) shall be allowed, but only if the profit, if such transaction had resulted in a profit, would be included in gross income under this section.

Ante, p. 1550.
68A Stat. 49.
26 USC 165.

"(c) SPECIAL RULES OF SOURCE.—For purposes of subsection (b), the following items of gross income shall be treated as income from sources within the United States:

"(1) SALE OF PROPERTY.—Gains on the sale or exchange of property (other than stock or debt obligations) located in the United States.

"(2) STOCK OR DEBT OBLIGATIONS.—Gains on the sale or exchange of stock issued by a domestic corporation or debt obligations of United States persons or of the United States, a State or political subdivision thereof, or the District of Columbia.

"(d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to a nonresident alien individual whose loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487).

66 Stat. 236.

"(e) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction for the taxable year in the taxes on his probable income for such year, the burden of proving for such taxable year that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B shall be on such individual."

26 USC 1-2524.

(2) The table of sections for subpart A of part II of subchapter N of chapter 1 is amended by striking out the item relating to section 877 and inserting in lieu thereof the following:

"Sec. 877. Expatriation to avoid tax.
"Sec. 878. Foreign educational, charitable, and certain other exempt organizations."

(g) PARTIAL EXCLUSION OF DIVIDENDS.—Subsection (d) of section 116 (relating to certain nonresident aliens ineligible for exclusion) is amended to read as follows:

26 USC 116.

"(d) CERTAIN NONRESIDENT ALIENS INELIGIBLE FOR EXCLUSION.—In the case of a nonresident alien individual, subsection (a) shall apply only—

"(1) in determining the tax imposed for the taxable year pursuant to section 871(b)(1) and only in respect of dividends which are effectively connected with the conduct of a trade or business within the United States, or

Ante, p. 1547.

"(2) in determining the tax imposed for the taxable year pursuant to section 877(b)."

Ante, p. 1551.

(h) WITHHOLDING OF TAX ON NONRESIDENT ALIENS.—Section 1441 (relating to withholding of tax on nonresident aliens) is amended— 68A Stat. 357. 26 USC 1441.

(1) by striking out ", or of any partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens," in subsection (a) and inserting in lieu thereof "or of any foreign partnership";

(2) by striking out "(except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States)" in subsection (b);

(3) by striking out "and amounts described in section 402(a)(2)" and all that follows in the first sentence of subsection (b) and inserting in lieu thereof "gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), amounts subject to tax under section 871(a)(1)(C), gains subject to tax under section 871(a)(1)(D), and gains on transfers described in section 1235 made on or before October 4, 1966.";

26 USC 402, 403, 631, 1235, Ante, p. 1547.

(4) by adding at the end of subsection (b) the following new sentence:

"In the case of a nonresident alien individual who is a member of a domestic partnership, the items of income referred to in subsection (a) shall be treated as referring to items specified in this subsection included in his distributive share of the income of such partnership.";

(5) by striking out paragraph (1) of subsection (c) and inserting in lieu thereof the following new paragraph:

"(1) INCOME CONNECTED WITH UNITED STATES BUSINESS.—No deduction or withholding under subsection (a) shall be required in the case of any item of income (other than compensation for personal services) which is effectively connected with the conduct of a trade or business within the United States and which is included in the gross income of the recipient under section 871(b)(2) for the taxable year.";

(6) by amending paragraph (4) of subsection (c) to read as follows: 75 Stat. 536.

"(4) COMPENSATION OF CERTAIN ALIENS.—Under regulations prescribed by the Secretary or his delegate, compensation for personal services may be exempted from deduction and withholding under subsection (a).";

(7) by striking out "amounts described in section 402(a)(2), section 403(a)(2), section 631 (b) and (c), and section 1235, which are considered to be gains from the sale or exchange of capital assets," in paragraph (5) of subsection (c) and inserting in lieu thereof "gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), gains subject to tax under section 871(a)(1)(D), and gains on transfers described in section 1235 made on or before October 4, 1966,", and by striking out "proceeds from such sale or exchange," in such paragraph and inserting in lieu thereof "amount payable,";

(8) by adding at the end of subsection (c) the following new paragraph: 70 Stat. 563.

"(7) CERTAIN ANNUITIES RECEIVED UNDER QUALIFIED PLANS.—No deduction or withholding under subsection (a) shall be required in the case of any amount received as an annuity if such amount is, under section 871(f), exempt from the tax imposed by section 871(a)."; and

(9) by redesignating subsection (d) as (e), and by inserting after subsection (c) the following new subsection:

"(d) EXEMPTION OF CERTAIN FOREIGN PARTNERSHIPS.—Subject to such terms and conditions as may be provided by regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply

in the case of a foreign partnership engaged in trade or business within the United States if the Secretary or his delegate determines that the requirements of subsection (a) impose an undue administrative burden and that the collection of the tax imposed by section 871(a) on the members of such partnership who are nonresident alien individuals will not be jeopardized by the exemption."

Ante, p. 1547.

68A Stat. 360. 26 USC 1461.

(i) LIABILITY FOR WITHHELD TAX.—Section 1461 (relating to return and payment of withheld tax) is amended to read as follows:

"SEC. 1461. LIABILITY FOR WITHHELD TAX.

"Every person required to deduct and withhold any tax under this chapter is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this chapter."

26 USC 1441-1465.

74 Stat. 1000. 26 USC 6015.

(j) DECLARATION OF ESTIMATED INCOME TAX BY INDIVIDUALS.—Section 6015 (relating to declaration of estimated income tax by individuals) is amended—

(1) by striking out that portion of subsection (a) which precedes paragraph (1) and inserting in lieu thereof the following:

"(a) REQUIREMENT OF DECLARATION.—Except as otherwise provided in subsection (i), every individual shall make a declaration of his estimated tax for the taxable year if—";

(2) by redesignating subsection (i) as subsection (j); and

(3) by inserting after subsection (h) the following new subsection:

"(i) NONRESIDENT ALIEN INDIVIDUALS.—No declaration shall be required to be made under this section by a nonresident alien individual unless—

26 USC 3401-3404.

"(1) withholding under chapter 24 is made applicable to the wages, as defined in section 3401(a), of such individual,

"(2) such individual has income (other than compensation for personal services subject to deduction and withholding under section 1441) which is effectively connected with the conduct of a trade or business within the United States, or

"(3) such individual is a resident of Puerto Rico during the entire taxable year."

(k) COLLECTION OF INCOME TAX AT SOURCE ON WAGES.—Subsection (a) of section 3401 (relating to definition of wages for purposes of collection of income tax at source) is amended by striking out paragraphs (6) and (7) and inserting in lieu thereof the following:

"(6) for such services, performed by a nonresident alien individual, as may be designated by regulations prescribed by the Secretary or his delegate; or".

(l) DEFINITIONS OF FOREIGN ESTATE OR TRUST.—

76 Stat. 988. 26 USC 7701.

(1) Section 7701(a)(31) (defining foreign estate or trust) is amended by striking out "from sources without the United States" and inserting in lieu thereof ", from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States,".

Repeal. 68A Stat. 365. 26 USC 1493.

(2) Section 1493 (defining foreign trust for purposes of chapter 5) is repealed.

26 USC 932.

(m) CONFORMING AMENDMENT.—The first sentence of section 932(a) (relating to citizens of possessions of the United States) is amended to read as follows: "Any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States shall be subject to taxation under this subtitle in the same manner and subject to the same conditions as in the case of a nonresident alien individual."

26 USC 1-1563.

(n) EFFECTIVE DATES.—

(1) The amendments made by this section (other than the amendments made by subsections (h), (i), and (k)) shall apply with respect to taxable years beginning after December 31, 1966.

(2) The amendments made by subsection (h) shall apply with respect to payments made in taxable years of recipients beginning after December 31, 1966.

(3) The amendments made by subsection (i) shall apply with respect to payments occurring after December 31, 1966.

(4) The amendments made by subsection (k) shall apply with respect to remuneration paid after December 31, 1966.

SEC. 104. FOREIGN CORPORATIONS.

(a) TAX ON INCOME NOT CONNECTED WITH UNITED STATES BUSINESS.—Section 881 (relating to tax on foreign corporations not engaged in business in the United States) is amended to read as follows: 68A Stat. 282. 26 USC 881.

"SEC. 881. TAX ON INCOME OF FOREIGN CORPORATIONS NOT CONNECTED WITH UNITED STATES BUSINESS.

"(a) IMPOSITION OF TAX.—There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as—

"(1) interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

"(2) gains described in section 631 (b) or (c), 26 USC 631.

"(3) in the case of bonds or other evidences of indebtedness issued after September 28, 1965, amounts which under section 1232 are considered as gains from the sale or exchange of property which is not a capital asset, and 26 USC 1232.

"(4) gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property, or of any interest in any such property, to the extent such gains are from payments which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, or from payments which are treated as being so contingent under section 871(e), Ante, p. 1547.

but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

"(b) DOUBLING OF TAX.—

"For doubling of tax on corporations of certain foreign countries, see section 891."

(b) TAX ON INCOME CONNECTED WITH UNITED STATES BUSINESS.—(1) Section 882 (relating to tax on resident foreign corporations) is amended to read as follows: 26 USC 882.

"SEC. 882. TAX ON INCOME OF FOREIGN CORPORATIONS CONNECTED WITH UNITED STATES BUSINESS.

"(a) NORMAL TAX AND SURTAX.—

"(1) IMPOSITION OF TAX.—A foreign corporation engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 11 or 1201(a) on its taxable income which is effectively connected with the conduct of a trade or business within the United States. 78 Stat. 25; Post, p. 1557. 26 USC 11. 26 USC 1201.

"(2) DETERMINATION OF TAXABLE INCOME.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

"(b) GROSS INCOME.—In the case of a foreign corporation, gross income includes only—

"(1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and

"(2) gross income which is effectively connected with the conduct of a trade or business within the United States.

"(c) ALLOWANCE OF DEDUCTIONS AND CREDITS.—

"(1) ALLOCATION OF DEDUCTIONS.—

"(A) GENERAL RULE.—In the case of a foreign corporation, the deductions shall be allowed only for purposes of subsection (a) and (except as provided by subparagraph (B)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary or his delegate.

68A Stat. 58. 26 USC 170.

"(B) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts provided by section 170 shall be allowed whether or not connected with income which is effectively connected with the conduct of a trade or business within the United States.

"(2) DEDUCTIONS AND CREDITS ALLOWED ONLY IF RETURN FILED.—A foreign corporation shall receive the benefit of the deductions and credits allowed to it in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return, in the manner prescribed in subtitle F, including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. The preceding sentence shall not apply for purposes of the tax imposed by section 541 (relating to personal holding company tax), and shall not be construed to deny the credit provided by section 32 for tax withheld at source or the credit provided by section 39 for certain uses of gasoline and lubricating oil.

26 USC 6001-7852.

26 USC 541.

26 USC 32. 79 Stat. 167. 26 USC 39.

"(3) FOREIGN TAX CREDIT.—Except as provided by section 906, foreign corporations shall not be allowed the credit against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

Post, p. 1568.

26 USC 901; Post, p. 1569.

"(4) CROSS REFERENCE.—

"For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1).

"(d) ELECTION TO TREAT REAL PROPERTY INCOME AS INCOME CONNECTED WITH UNITED STATES BUSINESS.—

"(1) IN GENERAL.—A foreign corporation which during the taxable year derives any income—

"(A) from real property located in the United States, or from any interest in such real property, including (i) gains from the sale or exchange of real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631 (b) or (c), and

26 USC 631.

"(B) which, but for this subsection, would not be treated as income effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the

United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

"(2) ELECTION AFTER REVOCATION, ETC.—Paragraphs (2) and (3) of section 871(d) shall apply in respect of elections under this subsection in the same manner and to the same extent as they apply in respect of elections under section 871(d). Ante, p. 1547.

"(e) INTEREST ON UNITED STATES OBLIGATIONS RECEIVED BY BANKS ORGANIZED IN POSSESSIONS.—In the case of a corporation created or organized in, or under the law of, a possession of the United States which is carrying on the banking business in a possession of the United States, interest on obligations of the United States shall—

"(1) for purposes of this subpart, be treated as income which is effectively connected with the conduct of a trade or business within the United States, and

"(2) shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the United States during the taxable year.

"(f) RETURNS OF TAX BY AGENT.—If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return required under section 6012 shall be made by the agent." 68A Stat. 732. 26 USC 6012.

(2)(A) Subsection (e) of section 11 (relating to exceptions from tax on corporations) is amended by inserting "or" at the end of paragraph (2), by striking out "; or" at the end of paragraph (3) and inserting a period in lieu thereof, and by striking out paragraph (4). 78 Stat. 25. 26 USC 11.

(B) Section 11 (relating to tax on corporations) is amended by adding at the end thereof the following new subsection:

"(f) FOREIGN CORPORATIONS.—In the case of a foreign corporation, the tax imposed by subsection (a) shall apply only as provided by section 882." Ante, p. 1555.

(3) The table of sections for subpart B of part II of subchapter N of chapter 1 is amended by striking out the items relating to sections 881 and 882 and inserting in lieu thereof the following:

"Sec. 881. Tax on income of foreign corporations not connected with United States business.
"Sec. 882. Tax on income of foreign corporations connected with United States business."

(c) WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.—Section 1442 (relating to withholding of tax on foreign corporations) is amended to read as follows: 68A Stat. 358. 26 USC 1442.

"SEC. 1442. WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.

"(a) GENERAL RULE.—In the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 or section 1451 a tax equal to 30 percent thereof; except that, in the case of interest described in section 1451 (relating to tax-free covenant bonds), the deduction and withholding shall be at the rate specified therein. For purposes of the preceding sentence, the references in section 1441(b) to sections 871(a)(1)(C) and (D) shall be treated as referring to sections 881(a)(3) and (4), the reference in section 1441(c)(1) to section 871(b)(2) shall be treated as referring to section 842 or section 882(a)(2), as the case 26 USC 1-1563. 26 USC 1441, 1451; Ante, p. 1553. Ante, p. 1555. Post, p. 1561.

may be, and the reference in section 1441(c)(5) to section 871(a)(1)(D) shall be treated as referring to section 881(a)(4).

Ante, pp. 1547, 1553, 1555.

"(b) EXEMPTION.—Subject to such terms and conditions as may be provided by regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply in the case of a foreign corporation engaged in trade or business within the United States if the Secretary or his delegate determines that the requirements of subsection (a) impose an undue administrative burden and that the collection of the tax imposed by section 881 on such corporation will not be jeopardized by the exemption."

(d) DIVIDENDS RECEIVED FROM CERTAIN FOREIGN CORPORATIONS.—Subsection (a) of section 245 (relating to the allowance of a deduction in respect of dividends received from a foreign corporation) is amended—

68A Stat. 73; 76 Stat. 977. 26 USC 245.

(1) by striking out "and has derived 50 percent or more of its gross income from sources within the United States," in that portion of subsection (a) which precedes paragraph (1) and by inserting in lieu thereof "and if 50 percent or more of the gross income of such corporation from all sources for such period is effectively connected with the conduct of a trade or business within the United States,";

(2) by striking out "from sources within the United States" in paragraph (1) and inserting in lieu thereof "which is effectively connected with the conduct of a trade or business within the United States";

(3) by striking out "from sources within the United States" in paragraph (2) and inserting in lieu thereof ", which is effectively connected with the conduct of a trade or business within the United States,"; and

(4) by adding after paragraph (2) the following new sentence: "For purposes of this subsection, the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States."

(e) DIVIDENDS RECEIVED FROM CERTAIN WHOLLY-OWNED FOREIGN SUBSIDIARIES.—

(1) Section 245 (relating to dividends received from certain foreign corporations) is amended by redesignating subsection (b) as(c), and by inserting after subsection (a) the following new subsection:

"(b) CERTAIN DIVIDENDS RECEIVED FROM WHOLLY OWNED FOREIGN SUBSIDIARIES.—

"(1) IN GENERAL.—In the case of dividends described in paragraph (2) received from a foreign corporation by a domestic corporation which, for its taxable year in which such dividends are received, owns (directly or indirectly) all of the outstanding stock of such foreign corporation, there shall be allowed as a deduction (in lieu of the deduction provided by subsection (a)) an amount equal to 100 percent of such dividends.

"(2) ELIGIBLE DIVIDENDS.—Paragraph (1) shall apply only to dividends which are paid out of the earnings and profits of a foreign corporation for a taxable year during which—

"(A) all of its outstanding stock is owned (directly or indirectly) by the domestic corporation to which such dividends are paid; and

"(B) all of its gross income from all sources is effectively connected with the conduct of a trade or business within the United States.

"(3) EXCEPTION.—Paragraph (1) shall not apply to any dividends if an election under section 1562 is effective for either— 78 Stat. 117. 26 USC 1562.

"(A) the taxable year of the domestic corporation in which such dividends are received, or

"(B) the taxable year of the foreign corporation out of the earnings and profits of which such dividends are paid."

(2) Subsection (a) of such section 245 is amended by adding at the end thereof (after the sentence added by subsection (d)(4)) the following new sentence: "For purposes of paragraph (2), there shall not be taken into account any taxable year within such uninterrupted period if, with respect to dividends paid out of the earnings and profits of such year, the deduction provided by subsection (b) would be allowable." Ante, p. 1558.

(3) Subsection (c) of such section 245 (as redesignated by paragraph (1)) is amended by striking out "subsection (a)" and inserting in lieu thereof "subsections (a) and (b)".

(f) DISTRIBUTIONS OF CERTAIN FOREIGN CORPORATIONS.—Section 301(b)(1)(C) (relating to certain corporate distributees of foreign corporations) is amended— 76 Stat. 977. 26 USC 301.

(1) by striking out "gross income from sources within the United States" in clause (i) and inserting in lieu thereof "gross income which is effectively connected with the conduct of a trade or business within the United States";

(2) by striking out "gross income from sources without the United States" in clause (ii) and inserting in lieu thereof "gross income which is not effectively connected with the conduct of a trade or business within the United States"; and

(3) by adding at the end thereof the following new sentences: "For purposes of clause (i), the gross income of a foreign corporation for any period before its first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States. For purposes of clause (ii), the gross income of a foreign corporation for any period before its first taxable year beginning after December 31, 1966, which is not effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources without the United States."

(g) UNRELATED BUSINESS TAXABLE INCOME.—The last sentence of section 512(a) (relating to definition) is amended to read as follows: "In the case of an organization described in section 511 which is a foreign organization, the unrelated business taxable income shall be its unrelated business taxable income which is effectively connected with the conduct of a trade or business within the United States." 68A Stat. 170. 26 USC 512. 26 USC 511.

(h) CORPORATIONS SUBJECT TO PERSONAL HOLDING COMPANY TAX.—

(1) Paragraph (7) of section 542(c) (relating to corporations not subject to personal holding company tax) is amended to read as follows: 68A Stat. 186; 78 Stat. 79. 26 USC 542.

"(7) a foreign corporation (other than a corporation which has income to which section 543(a)(7) applies for the taxable year), if all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations;". 78 Stat. 81. 26 USC 543.

(2) Section 543(b)(1) (relating to definition of ordinary gross income) is amended—

(A) by striking out "and" at the end of subparagraph (A),

(B) by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", and", and

(C) by inserting after subparagraph (B) the following new subparagraph:

"(C) in the case of a foreign corporation all of the outstanding stock of which during the last half of the taxable year is owned by nonresident alien individuals (whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations), all items of income which would, but for this subparagraph, constitute personal holding company income under any paragraph of subsection (a) other than paragraph (7) thereof:"

68A Stat. 189.
26 USC 545.

(3) Section 545 (relating to definition of undistributed personal holding company income) is amended—

(A) by striking out subsection (a) and inserting in lieu thereof the following:

"(a) DEFINITION.—For purposes of this part, the term 'undistributed personal holding company income' means the taxable income of a personal holding company adjusted in the manner provided in subsections (b), (c), and (d), minus the dividends paid deduction as defined in section 561. In the case of a personal holding company which is a foreign corporation, not more than 10 percent in value of the outstanding stock of which is owned (within the meaning of section 958(a)) during the last half of the taxable year by United States persons, the term 'undistributed personal holding company income' means the amount determined by multiplying the undistributed personal holding company income (determined without regard to this sentence) by the percentage in value of its outstanding stock which is the greatest percentage in value of its outstanding stock so owned by United States persons on any one day during such period."; and

26 USC 561.
76 Stat. 1018.
26 USC 958.

(B) by adding at the end thereof the following new subsection:

"(d) CERTAIN FOREIGN CORPORATIONS.—In the case of a foreign corporation all of the outstanding stock of which during the last half of the taxable year is owned by nonresident alien individuals (whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations), the taxable income for purposes of subsection (a) shall be the income which constitutes personal holding company income under section 543(a)(7), reduced by the deductions attributable to such income, and adjusted, with respect to such income, in the manner provided in subsection (b)."

78 Stat. 81.
26 USC 543.

(4)(A) Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new section:

26 USC 6671-6881.
Ante, p. 61.

"SEC. 6683. FAILURE OF FOREIGN CORPORATION TO FILE RETURN OF PERSONAL HOLDING COMPANY TAX.

"Any foreign corporation which—

"(1) is a personal holding company for any taxable year, and

"(2) fails to file or to cause to be filed with the Secretary or his delegate a true and accurate return of the tax imposed by section 541,

26 USC 541.

shall, in addition to other penalties provided by law, pay a penalty equal to 10 percent of the taxes imposed by chapter 1 (including the tax imposed by section 541) on such foreign corporation for such taxable year."

26 USC 1-1388.

(B) The table of sections for such subchapter B is amended by adding at the end thereof the following new item:

"Sec. 6683. Failure of foreign corporation to file return of personal holding company tax."

(i) AMENDMENTS WITH RESPECT TO FOREIGN CORPORATIONS CARRYING ON INSURANCE BUSINESS IN UNITED STATES.—

(1) Section 842 (relating to computation of gross income) is amended to read as follows: 68A Stat. 267. 26 USC 842.

"SEC. 842. FOREIGN CORPORATIONS CARRYING ON INSURANCE BUSINESS.

"If a foreign corporation carrying on an insurance business within the United States would qualify under part I, II, or III of this subchapter for the taxable year if (without regard to income not effectively connected with the conduct of any trade or business within the United States) it were a domestic corporation, such corporation shall be taxable under such part on its income effectively connected with its conduct of any trade or business within the United States. With respect to the remainder of its income, which is from sources within the United States, such a foreign corporation shall be taxable as provided in section 881." 26 USC 801-832. Ante, p. 1555.

(2) The table of sections for part IV of subchapter L of chapter 1 is amended by striking out the item relating to section 842 and inserting in lieu thereof the following:

"Sec. 842. Foreign corporations carrying on insurance business."

(3) Section 819 (relating to foreign life insurance companies) is amended— 73 Stat. 136. 26 USC 819.

(A) by striking out subsections (a) and (d) and by redesignating subsections (b) and (c) as subsections (a) and (b),

(B) by striking out "In the case of any company described in subsection (a)," in subsection (a)(1) (as redesignated by subparagraph (A)) and inserting in lieu thereof "In the case of any foreign corporation taxable under this part,",

(C) by striking out "subsection (c)" in the last sentence of subsection (a)(2) (as redesignated by subparagraph (A)) and inserting in lieu thereof "subsection (b)",

(D) by adding at the end of subsection (a) (as redesignated by subparagraph (A)) the following new paragraph:

"(3) REDUCTION OF SECTION 881 TAX.—In the case of any foreign corporation taxable under this part, there shall be determined—

"(A) the amount which would be subject to tax under section 881 if the amount taxable under such section were determined without regard to sections 103 and 894, and 68A Stat. 29. 26 USC 103.

"(B) the amount of the reduction provided by paragraph (1). Post, p. 1563.

The tax under section 881 (determined without regard to this paragraph) shall be reduced (but not below zero) by an amount which is the same proportion of such tax as the amount referred to in subparagraph (B) is of the amount referred to in subparagraph (A); but such reduction in tax shall not exceed the increase in tax under this part by reason of the reduction provided by paragraph (1).",

(E) by striking out "for purposes of subsection (a)" each place it appears in subsection (b) (as redesignated by subparagraph (A)) and inserting in lieu thereof "with respect to a foreign corporation",

(F) by striking out "foreign life insurance company" each place it appears in such subsection (b) and inserting in lieu thereof "foreign corporation",

(G) by striking out "subsection (b)(2)(A)" each place it appears in such subsection (b) and inserting in lieu thereof "subsection (a)(2)(A)",

(H) by striking out "subsection (b)(2)(B)" in paragraph (2)(B)(ii) of such subsection (b) and inserting in lieu thereof "subsection (a)(2)(B)", and

(I) by adding at the end thereof the following new subsection:

"(c) CROSS REFERENCE.—

"For taxation of foreign corporations carrying on life insurance business within the United States, see section 842."

76 Stat. 989.
26 USC 821.

(4) Section 821 (relating to tax on mutual insurance companies to which part II applies) is amended—

(A) by striking out subsection (e) and by redesignating subsections (f) and (g) as subsections (e) and (f), and

(B) by adding at the end of subsection (f) (as redesignated by subparagraph (A)) the following:

"(3) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842."

68A Stat. 263;
76 Stat. 992.
26 USC 822.

(5) Section 822 (relating to determination of taxable investment income) is amended by striking out subsection (e) and by redesignating subsection (f) as subsection (e).

26 USC 831.

(6) Section 831 (relating to tax on certain other insurance companies) is amended—

(A) by striking out subsection (b) and by redesignating subsection (c) as subsection (b), and

(B) by amending subsection (d) to read as follows:

"(c) CROSS REFERENCES.—

"(1) For alternative tax in case of capital gains, see section 1201(a).
"(2) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842."

26 USC 832.

(7) Section 832 (relating to insurance company taxable income) is amended by striking out subsection (d) and by redesignating subsection (e) as subsection (d).

26 USC 841.

(8) The second sentence of section 841 (relating to credit for foreign taxes) is amended by striking out "sentence," and inserting in lieu thereof "sentence (and for purposes of applying section 906 with respect to a foreign corporation subject to tax under this subchapter),".

Post, p. 1568.

76 Stat. 1008.
26 USC 952.

(j) SUBPART F INCOME.—Section 952(b) (relating to exclusion of United States income) is amended to read as follows:

"(b) EXCLUSION OF UNITED STATES INCOME.—In the case of a controlled foreign corporation, subpart F income does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States."

76 Stat. 1041.
26 USC 1248.

(k) GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS.—Paragraph (4) of section 1248(d) (relating to exclusions from earnings and profits) is amended to read as follows:

"(4) UNITED STATES INCOME.—Any item includible in gross income of the foreign corporation under this chapter—

"(A) for any taxable year beginning before January 1, 1967, as income derived from sources within the United States of a foreign corporation engaged in trade or business within the United States, or

"(B) for any taxable year beginning after December 31, 1966, as income effectively connected with the conduct by such corporation of a trade or business within the United States.

This paragraph shall not apply with respect to any item which is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States."

(l) DECLARATION OF ESTIMATED INCOME TAX BY CORPORATIONS.—Section 6016 (relating to declarations of estimated income tax by corporations) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection: 68A Stat. 738; 78 Stat. 29. 26 USC 6016.

"(f) CERTAIN FOREIGN CORPORATIONS.—For purposes of this section and section 6655, in the case of a foreign corporation subject to taxation under section 11 or 1201(a), or under subchapter L of chapter 1, the tax imposed by section 881 shall be treated as a tax imposed by section 11." 26 USC 6655. 26 USC 11, 801-843, 1201.

(m) TECHNICAL AMENDMENTS.— Ante, pp. 1555, 1557.

(1) Section 884 is amended to read as follows: 26 USC 884.

"SEC. 884. CROSS REFERENCES.

"(1) For special provisions relating to unrelated business income of foreign educational, charitable, and certain other exempt organizations, see section 512(a).

"(2) For special provisions relating to foreign corporations carrying on an insurance business within the United States, see section 842.

"(3) For rules applicable in determining whether any foreign corporation is engaged in trade or business within the United States, see section 864(b).

"(4) For adjustment of tax in case of corporations of certain foreign countries, see section 896.

"(5) For allowance of credit against the tax in case of a foreign corporation having income effectively connected with the conduct of a trade or business within the United States, see section 906.

"(6) For withholding at source of tax on income of foreign corporations, see section 1442."

(2) Section 953(b)(3)(F) is amended by striking out "832(b)(5)" and inserting in lieu thereof "832(c)(5)". 76 Stat. 1009. 26 USC 953.

(3) Section 1249(a) is amended by striking out "Except as provided in subsection (c), gain" and inserting in lieu thereof "Gain". 76 Stat. 1045. 26 USC 1249.

(n) EFFECTIVE DATES.—The amendments made by this section (other than subsection (k)) shall apply with respect to taxable years beginning after December 31, 1966. The amendment made by subsection (k) shall apply with respect to sales or exchanges occurring after December 31, 1966.

SEC. 105. SPECIAL TAX PROVISIONS.

(a) INCOME AFFECTED BY TREATY.—Section 894 (relating to income exempt under treaties) is amended to read as follows: 68A Stat. 284. 26 USC 894.

"SEC. 894. INCOME AFFECTED BY TREATY.

"(a) INCOME EXEMPT UNDER TREATY.—Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

"(b) PERMANENT ESTABLISHMENT IN UNITED STATES.—For purposes of applying any exemption from, or reduction of, any tax provided by any treaty to which the United States is a party with respect to income which is not effectively connected with the conduct of a trade or business within the United States, a nonresident alien individual or a foreign corporation shall be deemed not to have a permanent establishment in the United States at any time during the taxable year. This subsection shall not apply in respect of the tax computed under section 877(b)." Ante, p. 1551.

(b) ADJUSTMENT OF TAX BECAUSE OF BURDENSOME OR DISCRIMINATORY FOREIGN TAXES.—Subpart C of part II of subchapter N of chapter 1 (relating to miscellaneous provisions applicable to nonresident 26 USC 891-895.

aliens and foreign corporations) is amended by adding at the end thereof the following new section:

"SEC. 896. ADJUSTMENT OF TAX ON NATIONALS, RESIDENTS, AND CORPORATIONS OF CERTAIN FOREIGN COUNTRIES.

"(a) IMPOSITION OF MORE BURDENSOME TAXES BY FOREIGN COUNTRY.—Whenever the President finds that—

"(1) under the laws of any foreign country, considering the tax system of such foreign country, citizens of the United States not residents of such foreign country or domestic corporations are being subjected to more burdensome taxes, on any item of income received by such citizens or corporations from sources within such foreign country, than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country,

68A Stat. 4.
26 USC 1-1563.

"(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such taxes so that they are no more burdensome than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country, and

"(3) it is in the public interest to apply pre-1967 tax provisions in accordance with the provisions of this subsection to residents or corporations of such foreign country,

the President shall proclaim that the tax on such similar income derived from sources within the United States by residents or corporations of such foreign country shall, for taxable years beginning after such proclamation, be determined under this subtitle without regard to amendments made to this subchapter and chapter 3 on or after the date of enactment of this section.

26 USC 861-972, 1441-1465.

"(b) IMPOSITION OF DISCRIMINATORY TAXES BY FOREIGN COUNTRY.—Whenever the President finds that—

"(1) under the laws of any foreign country, citizens of the United States or domestic corporations (or any class of such citizens or corporations) are, with respect to any item of income, being subjected to a higher effective rate of tax than are nationals, residents, or corporations of such foreign country (or a similar class of such nationals, residents, or corporations) under similar circumstances;

"(2) such foreign country, when requested by the United States to do so, has not acted to eliminate such higher effective rate of tax; and

"(3) it is in the public interest to adjust, in accordance with the provisions of this subsection, the effective rate of tax imposed by this subtitle on similar income of nationals, residents, or corporations of such foreign country (or such similar class of such nationals, residents, or corporations),

the President shall proclaim that the tax on similar income of nationals, residents, or corporations of such foreign country (or such similar class of such nationals, residents, or corporations) shall, for taxable years beginning after such proclamation, be adjusted so as to cause the effective rate of tax imposed by this subtitle on such similar income to be substantially equal to the effective rate of tax imposed by such foreign country on such item of income of citizens of the United States or domestic corporations (or such class of citizens or corporations). In implementing a proclamation made under this subsection, the effective rate of tax imposed by this subtitle on an item of income may be adjusted by the disallowance, in whole or in part, of any deduction, credit, or exemption which would otherwise

be allowed with respect to that item of income or by increasing the rate of tax otherwise applicable to that item of income.

"(c) ALLEVIATION OF MORE BURDENSOME OR DISCRIMINATORY TAXES.—Whenever the President finds that—

"(1) the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that citizens of the United States not residents of such foreign country or domestic corporations are no longer subject to more burdensome taxes on the item of income derived by such citizens or corporations from sources within such foreign country, or

"(2) the laws of any foreign country with respect to which the President has made a proclamation under subsection (b) have been modified so that citizens of the United States or domestic corporations (or any class of such citizens or corporations) are no longer subject to a higher effective rate of tax on the item of income,

he shall proclaim that the tax imposed by this subtitle on the similar income of nationals, residents, or corporations of such foreign country shall, for any taxable year beginning after such proclamation, be determined under this subtitle without regard to such subsection. 68A Stat. 4. 26 USC 1-1563.

"(d) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

"(e) IMPLEMENTATION BY REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as he deems necessary or appropriate to implement this section."

(c) CLERICAL AMENDMENTS.—The table of sections for subpart C of part II of subchapter N of chapter 1 is amended—

(1) by striking out the item relating to section 894 and inserting in lieu thereof

"Sec. 894. Income affected by treaty.";

(2) by adding at the end of such table the following:

"Sec. 896. Adjustment of tax on nationals, residents, and corporations of certain foreign countries."

(d) EFFECTIVE DATE.—The amendments made by this section (other than subsections (e) and (f)) shall apply with respect to taxable years beginning after December 31, 1966.

(e) ELECTIONS BY NONRESIDENT UNITED STATES CITIZENS WHO ARE SUBJECT TO FOREIGN COMMUNITY PROPERTY LAWS.—

(1) Part III of subchapter N of chapter 1 (relating to income from sources without the United States) is amended by adding at the end thereof the following new subpart: 68A Stat. 285; 76 Stat. 1006. 26 USC 901-972.

"Subpart H—Income of Certain Nonresident United States Citizens Subject to Foreign Community Property Laws

"Sec. 981. Election as to treatment of income subject to foreign community property laws.

"SEC. 981. ELECTION AS TO TREATMENT OF INCOME SUBJECT TO FOREIGN COMMUNITY PROPERTY LAWS.

"(a) GENERAL RULE.—In the case of any taxable year beginning after December 31, 1966, if—

"(1) an individual is (A) a citizen of the United States, (B) a bona fide resident of a foreign country or countries during the entire taxable year, and (C) married at the close of the taxable

year to a spouse who is a nonresident alien during the entire taxable year, and

"(2) such individual and his spouse elect to have subsection (b) apply to their community income under foreign community property laws,

then subsection (b) shall apply to such income of such individual and such spouse for the taxable year and for all subsequent taxable years for which the requirements of paragraph (1) are met, unless the Secretary or his delegate consents to a termination of the election.

"(b) TREATMENT OF COMMUNITY INCOME.—For any taxable year to which an election made under subsection (a) applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as follows:

"(1) Earned income (within the meaning of the first sentence of section 911(b)), other than trade or business income and a partner's distributive share of partnership income, shall be treated as the income of the spouse who rendered the personal services.

76 Stat. 1004.
26 USC 911.

"(2) Trade or business income, and a partner's distributive share of partnership income, shall be treated as provided in section 1402(a)(5).

68A Stat. 354;
68 Stat. 1087.
26 USC 1402.

"(3) Community income not described in paragraph (1) or (2) which is derived from the separate property (as determined under the applicable foreign community property law) of one spouse shall be treated as the income of such spouse.

"(4) All other such community income shall be treated as provided in the applicable foreign community property law.

"(c) ELECTION FOR PRE-1967 YEARS.—

"(1) ELECTION.—If an individual meets the requirements of subsections (a)(1)(A) and (C) for any taxable year beginning before January 1, 1967, and if such individual and the spouse referred to in subsection (a)(1)(C) elect under this subsection, then paragraph (2) of this subsection shall apply to their community income under foreign community property laws for all open taxable years beginning before January 1, 1967 (whether under this chapter, the corresponding provisions of the Internal Revenue Code of 1939, or the corresponding provisions of prior revenue laws), for which the requirements of subsection (a)(1)(A) and (C) are met.

53 Stat. 1.

"(2) EFFECT OF ELECTION.—For any taxable year to which an election made under this subsection applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as provided by subsection (b), except that the other community income described in paragraph (4) of subsection (b) shall be treated as the income of the spouse who, for such taxable year, had gross income under paragraphs (1), (2), and (3) of subsection (b), plus separate gross income, greater than that of the other spouse.

"(d) TIME FOR MAKING ELECTIONS; PERIOD OF LIMITATIONS; ETC.—

"(1) TIME.—An election under subsection (a) or (c) for a taxable year may be made at any time while such year is still open, and shall be made in such manner as the Secretary or his delegate shall by regulations prescribe.

"(2) EXTENSION OF PERIOD FOR ASSESSING DEFICIENCIES AND MAKING REFUNDS.—If any taxable year to which an election under subsection (a) or (c) applies is open at the time such election is made, the period for assessing a deficiency against, and the period for filing claim for credit or refund of any overpayment by, the husband and wife for such taxable year, to the extent such defi-

ciency or overpayment is attributable to such an election, shall not expire before 1 year after the date of such election.

"(3) ALIEN SPOUSE NEED NOT JOIN IN SUBSECTION (c) ELECTION IN CERTAIN CASES.—If the Secretary or his delegate determines—

"(A) that an election under subsection (c) would not affect the liability for Federal income tax of the spouse referred to in subsection (a)(1)(C) for any taxable year, or

"(B) that the effect on such liability for tax cannot be ascertained and that to deny the election to the citizen of the United States would be inequitable and cause undue hardship,

such spouse shall not be required to join in such election, and paragraph (2) of this subsection shall not apply with respect to such spouse.

"(4) INTEREST.—To the extent that any overpayment or deficiency for a taxable year is attributable to an election made under this section, no interest shall be allowed or paid for any period before the day which is 1 year after the date of such election.

"(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) DEDUCTIONS.—Deductions shall be treated in a manner consistent with the manner provided by this section for the income to which they relate.

"(2) OPEN YEARS.—A taxable year of a citizen of the United States and his spouse shall be treated as 'open' if the period for assessing a deficiency against such citizen for such year has not expired before the date of the election under subsection (a) or (c), as the case may be.

"(3) ELECTIONS IN CASE OF DECEDENTS.—If a husband or wife is deceased his election under this section may be made by his executor, administrator, or other person charged with his property.

"(4) DEATH OF SPOUSE DURING TAXABLE YEAR.—In applying subsection (a)(1)(C), and in determining under subsection (c)(2) which spouse has the greater income for a taxable year, if a husband or wife dies the taxable year of the surviving spouse shall be treated as ending on the date of such death."

(2) The table of subparts for such part III is amended by adding at the end thereof the following:

"Subpart H. Income of certain nonresident United States citizens subject to foreign community property laws."

(3) Section 911(d) (relating to earned income from sources without the United States) is amended— 76 Stat. 1005. 26 USC 911.

(A) by striking out **"For administrative"** and inserting in lieu thereof the following: **"(1) For administrative"**; and

(B) by adding at the end thereof the following:

"(2) For elections as to treatment of income subject to foreign community property laws, see section 981."

(f) PRESUMPTIVE DATE OF PAYMENT FOR TAX WITHHELD UNDER CHAPTER 3.—

(1) Section 6513(b) (relating to time tax is considered paid in the case of prepaid income tax) is amended to read as follows: 68A Stat. 812. 26 USC 6513.

"(b) PREPAID INCOME TAX.—For purposes of section 6511 or 6512— 26 USC 6511, 6512.

"(1) Any tax actually deducted and withheld at the source during any calendar year under chapter 24 shall, in respect of the recipient of the income, be deemed to have been paid by him on the 15th day of the fourth month following the close of his taxable year with respect to which such tax is allowable as a credit under section 31. 26 USC 3401-3404. 26 USC 31.

"(2) Any amount paid as estimated income tax for any taxable year shall be deemed to have been paid on the last day prescribed for filing the return under section 6012 for such taxable year (determined without regard to any extension of time for filing such return).

68A Stat. 732. 26 USC 6012.

26 USC 1441-1465.

"(3) Any tax withheld at the source under chapter 3 shall, in respect of the recipient of the income, be deemed to have been paid by such recipient on the last day prescribed for filing the return under section 6012 for the taxable year (determined without regard to any extension of time for filing) with respect to which such tax is allowable as a credit under section 1462. For this purpose, any exemption granted under section 6012 from the requirement of filing a return shall be disregarded."

26 USC 6513.

(2) Section 6513(c) (relating to return and payment of Social Security taxes and income tax withholding) is amended—

(A) by striking out "chapter 21 or 24" and inserting in lieu thereof "chapter 3, 21, or 24"; and

(B) by striking out "remuneration" in paragraph (2) and inserting in lieu thereof "remuneration or other amount".

26 USC 6501.

(3) Section 6501(b) (relating to time returns deemed filed) is amended—

(A) by striking out "chapter 21 or 24" in paragraphs (1) and (2) and inserting in lieu thereof "chapter 3, 21, or 24"; and

(B) by inserting after "taxes" in the heading of paragraph (2) "and tax imposed by chapter 3".

(4) The amendments made by this subsection shall take effect on the date of the enactment of this Act.

SEC. 106. FOREIGN TAX CREDIT.

(a) ALLOWANCE OF CREDIT TO CERTAIN NONRESIDENT ALIENS AND FOREIGN CORPORATIONS.—

26 USC 901-905.

(1) Subpart A of part III of subchapter N of chapter 1 (relating to foreign tax credit) is amended by adding at the end thereof the following new section:

"SEC. 906. NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.

"(a) ALLOWANCE OF CREDIT.—A nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year shall be allowed a credit under section 901 for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year (or deemed, under section 902, paid or accrued during the taxable year) to any foreign country or possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States.

76 Stat. 999.

"(b) SPECIAL RULES.—

"(1) For purposes of subsection (a) and for purposes of determining the deductions allowable under sections 873(a) and 882(c), in determining the amount of any tax paid or accrued to any foreign country or possession there shall not be taken into account any amount of tax to the extent the tax so paid or accrued is imposed with respect to income from sources within the United States which would not be taxed by such foreign country or possession but for the fact that—

Ante, pp. 1550, 1555.

"(A) in the case of a nonresident alien individual, such individual is a citizen or resident of such foreign country or possession, or

"(B) in the case of a foreign corporation, such corporation was created or organized under the law of such foreign country or possession or is domiciled for tax purposes in such country or possession.

"(2) For purposes of subsection (a), in applying section 904 the taxpayer's taxable income shall be treated as consisting only of the taxable income effectively connected with the taxpayer's conduct of a trade or business within the United States. 68A Stat. 287. 26 USC 904.

"(3) The credit allowed pursuant to subsection (a) shall not be allowed against any tax imposed by section 871(a) (relating to income of nonresident alien individual not connected with United States business) or 881 (relating to income of foreign corporations not connected with United States business). Ante, p. 1547. Ante, p. 1555.

"(4) For purposes of sections 902(a) and 78, a foreign corporation choosing the benefits of this subpart which receives dividends shall, with respect to such dividends, be treated as a domestic corporation." 76 Stat. 999, 1001. 26 USC 78, 902.

(2) The table of sections for such subpart A is amended by adding at the end thereof the following:

"Sec. 906. Nonresident alien individuals and foreign corporations."

(3) Section 874(c) is amended by striking out "(c) FOREIGN TAX CREDIT NOT ALLOWED.—A nonresident" and inserting in lieu thereof the following: 68A Stat. 281. 26 USC 874.

"(c) FOREIGN TAX CREDIT.—Except as provided in section 906, a nonresident". Ante, p. 1568.

(4) Subsection (b) of section 901 (relating to amount allowed) is amended by redesignating paragraph (4) as paragraph (5), and by inserting after paragraph (3) the following new paragraph: 26 USC 901.

"(4) NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.—In the case of any nonresident alien individual not described in section 876 and in the case of any foreign corporation, the amount determined pursuant to section 906; and". 26 USC 876.

(5) Paragraph (5) (as redesignated) of section 901(b) is amended by striking out "or (3)," and inserting in lieu thereof "(3), or (4),".

(6) The amendments made by this subsection shall apply with respect to taxable years beginning after December 31, 1966. In applying section 904 of the Internal Revenue Code of 1954 with respect to section 906 of such Code, no amount may be carried from or to any taxable year beginning before January 1, 1967, and no such year shall be taken into account.

(b) ALIEN RESIDENTS OF THE UNITED STATES OR PUERTO RICO.—

(1) Paragraph (3) of section 901(b) (relating to amount of foreign tax credit allowed in case of alien resident of the United States or Puerto Rico) is amended by striking out ", if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country".

(2) Section 901 is amended by redesignating subsections (c) and (d) as subsections (d) and (e), and by inserting after subsection (b) the following new subsection:

"(c) SIMILAR CREDIT REQUIRED FOR CERTAIN ALIEN RESIDENTS.—Whenever the President finds that—

"(1) a foreign country, in imposing income, war profits, and excess profits taxes, does not allow to citizens of the United States residing in such foreign country a credit for any such taxes paid

or accrued to the United States or any foreign country, as the case may be, similar to the credit allowed under subsection (b) (3),

"(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit to citizens of the United States residing in such foreign country, and

"(3) it is in the public interest to allow the credit under subsection (b) (3) to citizens or subjects of such foreign country only if it allows such a similar credit to citizens of the United States residing in such foreign country,

the President shall proclaim that, for taxable years beginning while the proclamation remains in effect, the credit under subsection (b) (3) shall be allowed to citizens or subjects of such foreign country only if such foreign country, in imposing income, war profits, and excess profits taxes, allows to citizens of the United States residing in such foreign country such a similar credit."

68A Stat. 378.
26 USC 2014.

(3) Section 2014 (relating to credit for foreign death taxes) is amended by striking out the second sentence of subsection (a), and by adding at the end of such section the following new subsection:

"(h) SIMILAR CREDIT REQUIRED FOR CERTAIN ALIEN RESIDENTS.—Whenever the President finds that—

"(1) a foreign country, in imposing estate, inheritance, legacy, or succession taxes, does not allow to citizens of the United States resident in such foreign country at the time of death a credit similar to the credit allowed under subsection (a),

"(2) such foreign country, when requested by the United States to do so has not acted to provide such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death, and

"(3) it is in the public interest to allow the credit under subsection (a) in the case of citizens or subjects of such foreign country only if it allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death,

the President shall proclaim that, in the case of citizens or subjects of such foreign country dying while the proclamation remains in effect, the credit under subsection (a) shall be allowed only if such foreign country allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death."

(4) The amendments made by this subsection (other than paragraph (3)) shall apply with respect to taxable years beginning after December 31, 1966. The amendment made by paragraph (3) shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

(c) FOREIGN TAX CREDIT IN RESPECT OF INTEREST RECEIVED FROM FOREIGN SUBSIDIARIES.—

76 Stat. 1002.
26 USC 904.

(1) Section 904(f)(2) (relating to application of limitations on foreign tax credit in case of certain interest income) is amended—

(A) by striking out subparagraph (C) and inserting in lieu thereof the following:

"(C) received from a corporation in which the taxpayer (or one or more includible corporations in an affiliated group, as defined in section 1504, of which the taxpayer is a member) owns, directly or indirectly, at least 10 percent of the voting stock,".

68A Stat. 369.
26 USC 1504.

(B) by adding at the end thereof the following new sentence:

"For purposes of subparagraph (C), stock owned, directly or indirectly, by or for a foreign corporation shall be considered as being proportionately owned by its shareholders."

(2) The amendments made by paragraph (1) shall apply to interest received after December 31, 1965, in taxable years ending after such date.

SEC. 107. AMENDMENT TO PRESERVE EXISTING LAW ON DEDUCTIONS UNDER SECTION 931.

(a) DEDUCTIONS.—Subsection (d) of section 931 (relating to deductions) is amended to read as follows: 68A Stat. 291. 26 USC 931.

"(d) DEDUCTIONS.—

"(1) GENERAL RULE.—Except as otherwise provided in this subsection and subsection (e), in the case of persons entitled to the benefits of this section the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in part I, under regulations prescribed by the Secretary or his delegate. 26 USC 861-864.

"(2) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income from sources within the United States:

"(A) The deduction, for losses not connected with the trade or business if incurred in transactions entered into for profit, allowed by section 165(c)(2), but only if the profit, if such transaction had resulted in a profit, would be taxable under this subtitle. 26 USC 165.

"(B) The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property within the United States. 78 Stat. 43.

"(C) The deduction for charitable contributions and gifts allowed by section 170. 26 USC 170.

"(3) DEDUCTION DISALLOWED.—

"For disallowance of standard deduction, see section 142(b)(2)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to taxable years beginning after December 31, 1966.

SEC. 108. ESTATES OF NONRESIDENTS NOT CITIZENS.

(a) RATE OF TAX.—Subsection (a) of section 2101 (relating to tax imposed in case of estates of nonresidents not citizens) is amended to read as follows: 26 USC 2101.

"(a) RATE OF TAX.—Except as provided in section 2107, a tax computed in accordance with the following table is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States: Post, p. 1573. 26 USC 2106.

"If the taxable estate is:	The tax shall be:
Not over $100,000	5% of the taxable estate.
Over $100,000 but not over $500,000	$5,000, plus 10% of excess over $100,000.
Over $500,000 but not over $1,000,000	$45,000, plus 15% of excess over $500,000.
Over $1,000,000 but not over $2,000,000	$120,000, plus 20% of excess over $1,000,000.
Over $2,000,000	$320,000, plus 25% of excess over $2,000,000."

68A Stat. 397.
26 USC 2102.

(b) CREDITS AGAINST TAX.—Section 2102 (relating to credits allowed against estate tax) is amended to read as follows:

"SEC. 2102. CREDITS AGAINST TAX.

Ante, p. 1571.

"(a) IN GENERAL.—The tax imposed by section 2101 shall be credited with the amounts determined in accordance with sections 2011 to 2013, inclusive (relating to State death taxes, gift tax, and tax on prior transfers), subject to the special limitation provided in subsection (b).

26 USC 2011-2013.

"(b) SPECIAL LIMITATION.—The maximum credit allowed under section 2011 against the tax imposed by section 2101 for State death taxes paid shall be an amount which bears the same ratio to the credit computed as provided in section 2011(b) as the value of the property, as determined for purposes of this chapter, upon which State death taxes were paid and which is included in the gross estate under section 2103 bears to the value of the total gross estate under section 2103. For purposes of this subsection, the term 'State death taxes' means the taxes described in section 2011(a)."

26 USC 2103.

26 USC 2104.

(c) PROPERTY WITHIN THE UNITED STATES.—Section 2104 (relating to property within the United States) is amended by adding at the end thereof the following new subsection:

26 USC 2101-2106.

"(c) DEBT OBLIGATIONS.—For purposes of this subchapter, debt obligations of—

Post, p. 1573.

"(1) a United States person, or

"(2) the United States, a State or any political subdivision thereof, or the District of Columbia,

owned and held by a nonresident not a citizen of the United States shall be deemed property within the United States. With respect to estates of decedents dying after December 31, 1972, deposits with a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business, shall, for purposes of this subchapter, be deemed property within the United States. This subsection shall not apply to a debt obligation to which section 2105(b) applies or to a debt obligation of a domestic corporation if any interest on such obligation, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(B) as income from sources without the United States."

Ante, p. 1542.

26 USC 2105.

(d) PROPERTY WITHOUT THE UNITED STATES.—Subsection (b) of section 2105 (relating to bank deposits) is amended to read as follows:

"(b) CERTAIN BANK DEPOSITS, ETC.—For purposes of this subchapter—

Ante, p. 1541.

"(1) amounts described in section 861(c) if any interest thereon, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(A) as income from sources without the United States, and

"(2) deposits with a foreign branch of a domestic corporation or domestic partnership, if such branch is engaged in the commercial banking business,

shall not be deemed property within the United States."

74 Stat. 1000.
26 USC 2106.

(e) DEFINITION OF TAXABLE ESTATE.—Paragraph (3) of section 2106(a) (relating to deduction of exemption from gross estate) is amended to read as follows:

"(3) EXEMPTION.—

"(A) GENERAL RULE.—An exemption of $30,000.

"(B) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a 'nonresident not a citizen of the United States' under the provisions of section 2209, the exemption shall be the greater of (i) $30,000, or (ii) that proportion of the exemption authorized by section 2052 which the value of that part of

74 Stat. 999.
26 USC 2209.
68A Stat. 389.
26 USC 2052.

the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated."

(f) SPECIAL METHODS OF COMPUTING TAX.—Subchapter B of chapter 11 (relating to estates of nonresidents not citizens) is amended by adding at the end thereof the following new sections: 68A Stat. 397. 26 USC 2101-2106.

"SEC. 2107. EXPATRIATION TO AVOID TAX.

"(a) RATE OF TAX.—A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States dying after the date of enactment of this section, if after March 8, 1965, and within the 10-year period ending with the date of death such decedent lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A. 26 USC 2001.

"(b) GROSS ESTATE.—For purposes of the tax imposed by subsection (a), the value of the gross estate of every decedent to whom subsection (a) applies shall be determined as provided in section 2103, except that—

"(1) if such decedent owned (within the meaning of section 958(a)) at the time of his death 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation, and 76 Stat. 1018. 26 USC 958.

"(2) if such decedent owned (within the meaning of section 958(a)), or is considered to have owned (by applying the ownership rules of section 958(b)), at the time of his death, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of such foreign corporation,

then that proportion of the fair market value of the stock of such foreign corporation owned (within the meaning of section 958(a)) by such decedent at the time of his death, which the fair market value of any assets owned by such foreign corporation and situated in the United States, at the time of his death, bears to the total fair market value of all assets owned by such foreign corporation at the time of his death, shall be included in the gross estate of such decedent. For purposes of the preceding sentence, a decedent shall be treated as owning stock of a foreign corporation at the time of his death if, at the time of a transfer, by trust or otherwise, within the meaning of sections 2035 to 2038, inclusive, he owned such stock. 26 USC 2035-2038.

"(c) CREDITS.—The tax imposed by subsection (a) shall be credited with the amounts determined in accordance with section 2102. Ante, p. 1572.

"(d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to the transfer of the estate of a decedent whose loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401 (b), 1482, or 1487). 66 Stat. 236.

"(e) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction in the estate, inheritance, legacy, and succession taxes in respect of the transfer of his estate, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on the executor of such individual's estate.

"SEC. 2108. APPLICATION OF PRE-1967 ESTATE TAX PROVISIONS.

"(a) IMPOSITION OF MORE BURDENSOME TAX BY FOREIGN COUNTRY.—Whenever the President finds that—

"(1) under the laws of any foreign country, considering the tax system of such foreign country, a more burdensome tax is

imposed by such foreign country on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country,

"(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such tax so that it is no more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, and

"(3) it is in the public interest to apply pre-1967 tax provisions in accordance with this section to the transfer of estates of decedents who were residents of such foreign country,

the President shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to amendments made to sections 2101 (relating to tax imposed), 2102 (relating to credits against tax), 2106 (relating to taxable estate), and 6018 (relating to estate tax returns) on or after the date of enactment of this section.

Ante, pp. 1571, 1572.

"(b) ALLEVIATION OF MORE BURDENSOME TAX.—Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that the tax on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country is no longer more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, he shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to subsection (a).

"(c) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

"(d) IMPLEMENTATION BY REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary or appropriate to implement this section."

68A Stat. 739. 26 USC 6018.

(g) ESTATE TAX RETURNS.—Paragraph (2) of section 6018(a) (relating to estates of nonresidents not citizens) is amended by striking out "$2,000" and inserting in lieu thereof "$30,000".

(h) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 11 (relating to estates of nonresidents not citizens) is amended by adding at the end thereof the following:

"Sec. 2107. Expatriation to avoid tax.
"Sec. 2108. Application of pre-1967 estate tax provisions."

(i) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

SEC. 109. TAX ON GIFTS OF NONRESIDENTS NOT CITIZENS.

26 USC 2501.

(a) IMPOSITION OF TAX.—Subsection (a) of section 2501 (relating to general rule for imposition of tax) is amended to read as follows:

"(a) TAXABLE TRANSFERS.—

"(1) GENERAL RULE.—For the calendar year 1955 and each calendar year thereafter a tax, computed as provided in section 2502, is hereby imposed on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

26 USC 2502.

"(2) TRANSFERS OF INTANGIBLE PROPERTY.—Except as provided in paragraph (3), paragraph (1) shall not apply to the transfer of intangible property by a nonresident not a citizen of the United States.

"(3) EXCEPTIONS.—Paragraph (2) shall not apply in the case of a donor who at any time after March 8, 1965, and within the 10-year period ending with the date of transfer lost United States citizenship unless—

"(A) such donor's loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487), or 66 Stat. 236.

"(B) such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A. 68A Stat. 4.

"(4) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for paragraph (3), result in a substantial reduction for the calendar year in the taxes on the transfer of property by gift, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on such individual." 26 USC 1-2524.

(b) TRANSFERS IN GENERAL.—Subsection (b) of section 2511 (relating to situs rule for stock in a corporation) is amended to read as follows: 26 USC 2511.

"(b) INTANGIBLE PROPERTY.—For purposes of this chapter, in the case of a nonresident not a citizen of the United States who is excepted from the application of section 2501(a)(2)— Ante, p. 1574.

"(1) shares of stock issued by a domestic corporation, and

"(2) debt obligations of—

"(A) a United States person, or

"(B) the United States, a State or any political subdivision thereof, or the District of Columbia,

which are owned and held by such nonresident shall be deemed to be property situated within the United States."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to the calender year 1967 and all calendar years thereafter.

SEC. 110. TREATY OBLIGATIONS.

No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States. For purposes of the preceding sentence, the extension of a benefit provided by any amendment made by this title shall not be deemed to be contrary to a treaty obligation of the United States.

TITLE II—OTHER AMENDMENTS TO INTERNAL REVENUE CODE

SEC. 201. APPLICATION OF INVESTMENT CREDIT TO PROPERTY USED IN POSSESSIONS OF THE UNITED STATES.

(a) PROPERTY USED BY DOMESTIC CORPORATIONS, ETC.—Section 48(a)(2)(B) (relating to property used outside the United States) is amended— 76 Stat. 967. 26 USC 48.

(1) by striking out "and" at the end of clause (v);

(2) by striking out the period at the end of clause (vi) and inserting in lieu thereof "; and"; and

(3) by adding at the end thereof the following new clause:

"(vii) any property which is owned by a domestic corporation (other than a corporation entitled to the

benefits of section 931 or 934(b)) or by a United States citizen (other than a citizen entitled to the benefits of section 931, 932, 933, or 934(c)) and which is used predominantly in a possession of the United States by such a corporation or such a citizen, or by a corporation created or organized in, or under the law of, a possession of the United States."

68A Stat. 291; 74 Stat. 998. 26 USC 931-934.

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years ending after December 31, 1965, but only with respect to property placed in service after such date. In applying section 46(b) of the Internal Revenue Code of 1954 (relating to carryback and carryover of unused credits), the amount of any investment credit carryback to any taxable year ending on or before December 31, 1965, shall be determined without regard to the amendments made by this section.

76 Stat. 963. 26 USC 46.

SEC. 202. BASIS OF PROPERTY RECEIVED ON LIQUIDATION OF SUBSIDIARY.

(a) DEFINITION OF PURCHASE.—Section 334(b)(3) (relating to definition of purchase) is amended by adding at the end thereof the following new sentence:

"Notwithstanding subparagraph (C) of this paragraph, for purposes of paragraph (2)(B), the term 'purchase' also means an acquisition of stock from a corporation when ownership of such stock would be attributed under section 318(a) to the person acquiring such stock, if the stock of such corporation by reason of which such ownership would be attributed was acquired by purchase (within the meaning of the preceding sentence)."

26 USC 334. 26 USC 318.

(b) PERIOD OF ACQUISITION.—Section 334(b)(2)(B) (relating to exception) is amended by striking out "during a period of not more than 12 months," and inserting in lieu thereof "during a 12-month period beginning with the earlier of—

"(i) the date of the first acquisition by purchase of such stock, or

"(ii) if any of such stock was acquired in an acquisition which is a purchase within the meaning of the second sentence of paragraph (3), the date on which the distributee is first considered under section 318(a) as owning stock owned by the corporation from which such acquisition was made,".

(c) DISTRIBUTION OF INSTALLMENT OBLIGATIONS.—Section 453(d)(4)(A) (relating to distribution of installment obligations in certain liquidations) is amended to read as follows:

26 USC 453.

"(A) LIQUIDATIONS TO WHICH SECTION 332 APPLIES.—If—

"(i) an installment obligation is distributed in a liquidation to which section 332 (relating to complete liquidations of subsidiaries) applies, and

26 USC 332.

"(ii) the basis of such obligation in the hands of the distributee is determined under section 334(b)(1),

then no gain or loss with respect to the distribution of such obligation shall be recognized by the distributing corporation."

(d) EFFECTIVE DATES.—The amendment made by subsection (a) shall apply only with respect to acquisitions of stock after December 31, 1965. The amendments made by subsections (b) and (c) shall apply only with respect to distributions made after the date of the enactment of this Act.

SEC. 203. TRANSFERS OF PROPERTY TO INVESTMENT COMPANIES CONTROLLED BY TRANSFERORS.

(a) TRANSFERS TO INVESTMENT COMPANIES.—The first sentence of section 351(a) (relating to transfer to corporation controlled by the transferor) is amended by striking out "to a corporation" and inserting in lieu thereof "to a corporation (including, in the case of transfers made on or before June 30, 1967, an investment company)". 68A Stat. 111. 26 USC 351.

(b) INVESTMENT COMPANIES REQUIRED TO FILE REGISTRATION STATEMENT WITH THE S.E.C.—Section 351 is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) APPLICATION OF JUNE 30, 1967, DATE.—For purposes of this section, if, in connection with the transaction, a registration statement is required to be filed with the Securities and Exchange Commission, a transfer of property to an investment company shall be treated as made on or before June 30, 1967, only if—

"(1) such transfer is made on or before such date,

"(2) the registration statement was filed with the Securities and Exchange Commission before January 1, 1967, and the aggregate issue price of the stock and securities of the investment company which are issued in the transaction does not exceed the aggregate amount therefor specified in the registration statement as of the close of December 31, 1966, and

"(3) the transfer of property to the investment company in the transaction includes only property deposited before May 1, 1967."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply with respect to transfers of property to investment companies whether made before, on, or after the date of the enactment of this Act.

SEC. 204. REMOVAL OF SPECIAL LIMITATIONS WITH RESPECT TO DEDUCTIBILITY OF CONTRIBUTIONS TO PENSION PLANS BY SELF-EMPLOYED INDIVIDUALS.

(a) REMOVAL OF SPECIAL LIMITATIONS.—Paragraph (10) of section 404(a) (relating to special limitation on amount allowed as deduction for self-employed individuals for contributions to certain pension, etc., plans) is repealed. Repeal. 76 Stat. 820. 26 USC 404.

(b) CONFORMING AMENDMENTS.—

(1) Each of the following provisions of section 401 is amended by striking out "(determined without regard to section 404(a)(10))" each place it appears: 26 USC 401.

(A) Subsection (a)(10)(A)(ii).

(B) Subparagraphs (A) and (B) of subsection (d)(5).

(C) Subparagraph (A) of subsection (d)(6).

(D) Subparagraphs (A) and (B)(i) of subsection (e)(1).

(E) Subparagraphs (B) and (C) and the last sentence of subsection (e)(3).

(2) Subparagraph (A) of section 404(e)(2) is amended by striking out "(determined without regard to subsection (a)(10))".

(3) Paragraph (1) and subparagraph (B) of paragraph (2) of section 404(e) are each amended by striking out "(determined without regard to paragraph (10) thereof)".

(c) DEFINITION OF EARNED INCOME.—Section 401(c)(2) (relating to definition of earned income for certain pension and profit-sharing plans) is amended by striking out subparagraphs (A) and (B) and inserting in lieu thereof the following: 76 Stat. 811.

"(A) IN GENERAL.—The term 'earned income' means the net earnings from self-employment (as defined in section 1402(a)), but such net earnings shall be determined—

68A Stat. 353.
26 USC 1402.

"(i) only with respect to a trade or business in which personal services of the taxpayer are a material income-producing factor,

"(ii) without regard to paragraphs (4) and (5) of section 1402(c),

79 Stat. 381.

"(iii) in the case of any individual who is treated as an employee under sections 3121(d)(3) (A), (C), or (D), without regard to paragraph (2) of section 1402(c), and

26 USC 3121.
74 Stat. 945.

"(iv) without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items.

For purposes of this subparagraph, section 1402, as in effect for a taxable year ending on December 31, 1962, shall be treated as having been in effect for all taxable years ending before such date."

(d) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply with respect to taxable years beginning after December 31, 1967.

SEC. 205. TREATMENT OF CERTAIN INCOME OF AUTHORS, INVENTORS, ETC., AS EARNED INCOME FOR RETIREMENT PLAN PURPOSES.

(a) INCOME FROM DISPOSITION OF PROPERTY CREATED BY TAXPAYER.—Section 401(c)(2) (relating to definition of earned income) is amended by adding at the end thereof the following new subparagraph:

Ante, p. 1577.

"(C) INCOME FROM DISPOSITION OF CERTAIN PROPERTY.—For purposes of this section, the term 'earned income' includes gains (other than any gain which is treated under any provision of this chapter as gain from the sale or exchange of a capital asset) and net earnings derived from the sale or other disposition of, the transfer of any interest in, or the licensing of the use of property (other than good will) by an individual whose personal efforts created such property."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years ending after the date of the enactment of this Act.

SEC. 206. EXCLUSION OF CERTAIN RENTS FROM PERSONAL HOLDING COMPANY INCOME.

(a) RENTS FROM LEASES OF CERTAIN TANGIBLE PERSONAL PROPERTY.—Section 543(b)(3) (relating to adjusted income from rents) is amended by striking out "but does not include amounts constituting personal holding company income under subsection (a)(6), nor copyright royalties (as defined in subsection (a)(4) nor produced film rents (as defined in subsection (a)(5)(B))." and inserting in lieu thereof the following: "but such term does not include—

78 Stat. 84.
26 USC 543.

"(A) amounts constituting personal holding company income under subsection (a)(6),

"(B) copyright royalties (as defined in subsection (a)(4)),

"(C) produced film rents (as defined in subsection (a)(5)(B)), or

"(D) compensation, however designated, for the use of, or the right to use, any tangible personal property manu-

factured or produced by the taxpayer, if during the taxable year the taxpayer is engaged in substantial manufacturing or production of tangible personal property of the same type."

(b) TECHNICAL AMENDMENTS.—

(1) Section 543(a)(2) (relating to adjusted income from rents included in personal holding company income) is amended by striking out the last sentence thereof. 78 Stat. 81. 26 USC 543.

(2) Section 543(b)(2) (relating to definition of adjusted ordinary gross income) is amended by adding at the end thereof the following new subparagraph:

"(D) CERTAIN EXCLUDED RENTS.—From the gross income consisting of compensation described in subparagraph (D) of paragraph (3) subtract the amount allowable as deductions for the items described in clauses (i), (ii), (iii), and (iv) of subparagraph (A) to the extent allocable, under regulations prescribed by the Secretary or his delegate, to such gross income. The amount subtracted under this subparagraph shall not exceed such gross income."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after the date of the enactment of this Act. Such amendments shall also apply, at the election of the taxpayer (made at such time and in such manner as the Secretary or his delegate may prescribe), to taxable years beginning on or before such date and ending after December 31, 1965.

SEC. 207. PERCENTAGE DEPLETION RATE FOR CERTAIN CLAY BEARING ALUMINA.

(a) 23 PERCENT RATE.—Section 613(b) (relating to percentage depletion rates) is amended— 68A Stat. 208; 74 Stat. 291. 26 USC 613.

(1) by inserting "clay, laterite, and nephelite syenite" after "anorthosite" in paragraph (2)(B); and

(2) by striking out "if paragraph (5)(B) does not apply" in paragraph (3)(B) and inserting in lieu thereof "if neither paragraph (2)(B) nor (5)(B) applies".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 208. PERCENTAGE DEPLETION RATE FOR CLAM AND OYSTER SHELLS.

(a) 15 PERCENT RATE.—Section 613(b) (relating to percentage depletion rates) is amended—

(1) by striking out "mollusk shells (including clam shells and oyster shells)," in paragraph (5)(A), and

(2) by inserting "mollusk shells (including clam shells and oyster shells)," after "marble," in paragraph (6).

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 209. PERCENTAGE DEPLETION RATE FOR CERTAIN CLAY, SHALE, AND SLATE.

(a) 7½ PERCENT RATE.—Section 613(b) (relating to percentage depletion rates) is amended—

(1) by renumbering paragraphs (5) and (6) as (6) and (7), respectively, and by inserting after paragraph (4) the following new paragraph:

"(5) 7½ percent—clay and shale used or sold for use in the manufacture of sewer pipe or brick, and clay, shale, and slate used or sold for use as sintered or burned lightweight aggregates.";

(2) by striking out in paragraph (3)(B) (as amended by section 207(a)(2)) "if neither paragraph (2)(B) nor (5)(B) applies" and inserting in lieu thereof "if neither paragraph (2)(B), (5), or (6)(B) applies";

(3) by striking out in paragraph (6) (as renumbered by paragraph (1)) "shale, and stone, except stone described in paragraph (6)" and inserting in lieu thereof "shale (except shale described in paragraph (5)), and stone (except stone described in paragraph (7))";

(4) by striking out, in subparagraph (B) of paragraph (6) (as so renumbered), "building or paving brick," and by striking out "sewer pipe,"; and

(5) by inserting after "any such other mineral" in paragraph (7) (as so renumbered) "(other than slate to which paragraph (5) applies)".

74 Stat. 293. 26 USC 613.

(b) CONFORMING AMENDMENT.—Section 613(c)(4)(G) (relating to treatment processes) is amended by striking out "paragraph (5)(B)" and inserting in lieu thereof "paragraph (5) or (6)(B)".

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 210. STRADDLES.

72 Stat. 1644. 26 USC 1234.

(a) TREATMENT AS SHORT-TERM CAPITAL GAIN.—Section 1234 (relating to options) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) SPECIAL RULE FOR GRANTORS OF STRADDLES.—

"(1) GAIN ON LAPSE.—In the case of gain on lapse of an option granted by the taxpayer as part of a straddle, the gain shall be deemed to be gain from the sale or exchange of a capital asset held for not more than 6 months on the day that the option expired.

"(2) EXCEPTION.—This subsection shall not apply to any person who holds securities for sale to customers in the ordinary course of his trade or business.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) The term 'straddle' means a simultaneously granted combination of an option to buy, and an option to sell, the same quantity of a security at the same price during the same period of time.

"(B) The term 'security' has the meaning assigned to such term by section 1236(c)."

68A Stat. 330. 26 USC 1236.

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to straddle transactions entered into after January 25, 1965, in taxable years ending after such date.

SEC. 211. TAX TREATMENT OF PER-UNIT RETAIN ALLOCATIONS.

(a) TAX TREATMENT OF COOPERATIVES.—

76 Stat. 1046. 26 USC 1382.

(1) Section 1382(a) (relating to gross income of cooperatives) is amended by striking out the period at the end thereof and inserting "or by reason of any amount paid to a patron as a per-unit retain allocation (as defined in section 1388(f))."

26 USC 1388.

(2) Section 1382(b) is amended—

(A) by striking out "(b) PATRONAGE DIVIDENDS.—" and inserting in lieu thereof "(b) PATRONAGE DIVIDENDS AND PER-UNIT RETAIN ALLOCATIONS.—",

(B) by striking out "or" at the end of paragraph (1),

(C) by striking out the period at the end of paragraph (2) and inserting a semicolon in lieu thereof,

(D) by striking out the sentence following paragraph (2) and inserting in lieu thereof the following:

"(3) as per-unit retain allocations, to the extent paid in qualified per-unit retain certificates (as defined in section 1388(h)) with respect to marketing occurring during such taxable year; or Post, p. 1583.

"(4) in money or other property (except per-unit retain certificates) in redemption of a nonqualified per-unit retain certificate which was paid as a per-unit retain allocation during the payment period for the taxable year during which the marketing occurred.

For purposes of this title, any amount not taken into account under the preceding sentence shall, in the case of an amount described in paragraph (1) or (2), be treated in the same manner as an item of gross income and as a deduction therefrom, and in the case of an amount described in paragraph (3) or (4), be treated as a deduction in arriving at gross income."

(3) Section 1382(e) is amended to read as follows: 76 Stat. 1047.

"(e) PRODUCTS MARKETED UNDER POOLING ARRANGEMENTS.—For purposes of subsection (b), in the case of a pooling arrangement for the marketing of products— 26 USC 1382.

"(1) the patronage shall (to the extent provided in regulations prescribed by the Secretary or his delegate) be treated as patronage occurring during the taxable year in which the pool closes, and

"(2) the marketing of products shall be treated as occurring during any of the taxable years in which the pool is open."

(4) Section 1382(f) is amended by striking out "subsection (b)" and inserting in lieu thereof "paragraphs (1) and (2) of subsection (b)".

(5) The heading for section 1383 is amended by striking out the period at the end thereof and inserting "OR NONQUALIFIED PER-UNIT RETAIN CERTIFICATES." 26 USC 1383.

(6) Section 1383(a) is amended—

(A) by striking out "section 1382(b)(2)" and inserting in lieu thereof "section 1382(b)(2) or (4),",

(B) by striking out "nonqualified written notices of allocation" each place it appears and inserting in lieu thereof "nonqualified written notices of allocation or nonqualified per-unit retain certificates", and

(C) by striking out "qualified written notices of allocation" and inserting in lieu thereof "qualified written notices of allocation or qualified per-unit retain certificates (as the case may be)".

(7) Section 1383(b)(2) is amended—

(A) by striking out "nonqualified written notice of allocation" and inserting in lieu thereof "nonqualified written notice of allocation or nonqualified per-unit retain certificate",

(B) by striking out "qualified written notice of allocation" and inserting in lieu thereof "qualified written notice of allocation or qualified per-unit retain certificate (as the case may be)",

(C) by striking out "such written notice of allocation" and inserting in lieu thereof "such written notice of allocation or per-unit retain certificate", and

(D) by striking out "section 1382(b)(2)" and inserting in lieu thereof "section 1382(b)(2) or (4),".

(8) The table of sections for part I of subchapter T of chapter 1 is amended by striking out—

"Sec. 1383. Computation of tax where cooperative redeems nonqualified written notices of allocation."

and inserting in lieu thereof—

"Sec. 1383. Computation of tax where cooperative redeems nonqualified written notices of allocation or nonqualified per-unit retain certificates."

(b) TAX TREATMENT BY PATRONS.—

76 Stat. 1048. 26 USC 1385. (1) Section 1385(a) is amended by striking out "and" at the end of paragraph (1), by striking out the period at the end of paragraph (2) and inserting in lieu thereof ", and", and by adding at the end thereof the following new paragraph:

"(3) the amount of any per-unit retain allocation which is paid in qualified per-unit retain certificates and which is received by him during the taxable year from an organization described in 26 USC 1381. section 1381(a)."

(2) The heading for section 1385(c) is amended by striking out "ALLOCATION" and inserting in lieu thereof "ALLOCATION AND CERTAIN NONQUALIFIED PER-UNIT RETAIN CERTIFICATES".

(3) Section 1385(c)(1) is amended to read as follows:

"(1) APPLICATION OF SUBSECTION.—This subsection shall apply to—

"(A) any nonqualified written notice of allocation which—

"(i) was paid as a patronage dividend, or

"(ii) was paid by an organization described in section 1381(a)(1) on a patronage basis with respect to earnings derived from business or sources described in section 26 USC 1382. 1382(c)(2)(A), and

"(B) any nonqualified per-unit retain certificate which was paid as a per-unit retain allocation."

(4) Section 1385(c)(2) is amended—

(A) by striking out "nonqualified written notice of allocation" and inserting in lieu thereof "nonqualified written notice of allocation or nonqualified per-unit retain certificate", and

(B) by striking out "such written notice of allocation" each place it appears and inserting in lieu thereof "such written notice of allocation or per-unit retain certificate".

(5) The table of parts for subchapter T of chapter 1 is amended by striking out—

"Part II. Tax treatment by patrons of patronage dividends."

and inserting in lieu thereof—

"Part II. Tax treatment by patrons of patronage dividends and per-unit retain allocations."

(c) DEFINITIONS.—

26 USC 1388. (1)(A) Section 1388(e)(1) is amended by striking out "allocation)" and inserting in lieu thereof "allocation or a per-unit retain certificate)".

(B) Section 1388(e)(2) is amended by striking out "allocation" and inserting in lieu thereof "allocation or qualified per-unit retain certificate".

(2) Section 1388 is amended by adding at the end thereof the following new subsections:

"(f) PER-UNIT RETAIN ALLOCATION.—For purposes of this subchapter, the term 'per-unit retain allocation' means any allocation, by an organization to which part I of this subchapter applies, other than

by payment in money or other property (except per-unit retain certificates) to a patron with respect to products marketed for him, the amount of which is fixed without reference to the net earnings of the organization pursuant to an agreement between the organization and the patron.

"(g) PER-UNIT RETAIN CERTIFICATE.—For purposes of this subchapter, the term 'per-unit retain certificate' means any written notice which discloses to the recipient the stated dollar amount of a per-unit retain allocation to him by the organization.

"(h) QUALIFIED PER-UNIT RETAIN CERTIFICATE.—

"(1) DEFINED.—For purposes of this subchapter, the term 'qualified per-unit retain certificate' means any per-unit retain certificate which the distributee has agreed, in the manner provided in paragraph (2), to take into account at its stated dollar amount as provided in section 1385(a). 76 Stat. 1048.

"(2) MANNER OF OBTAINING AGREEMENT.—A distributee shall agree to take a per-unit retain certificate into account as provided in paragraph (1) only by— 26 USC 1385.

"(A) making such agreement in writing, or

"(B) obtaining or retaining membership in the organization after—

"(i) such organization has adopted (after the date of the enactment of this subsection) a bylaw providing that membership in the organization constitutes such agreement, and

"(ii) he has received a written notification and copy of such bylaw.

"(3) PERIOD FOR WHICH AGREEMENT IS EFFECTIVE.—

"(A) GENERAL RULE.—Except as provided in subparagraph (B)—

"(i) an agreement described in paragraph (2)(A) shall be an agreement with respect to all products delivered by the distributee to the organization during the taxable year of the organization during which such agreement is made and all subsequent taxable years of the organization; and

"(ii) an agreement described in paragraph (2)(B) shall be an agreement with respect to all products delivered by the distributee to the organization after he received the notification and copy described in paragraph (2)(B)(ii).

"(B) REVOCATION, ETC.—

"(i) Any agreement described in paragraph (2)(A) may be revoked (in writing) by the distributee at any time. Any such revocation shall be effective with respect to products delivered by the distributee on or after the first day of the first taxable year of the organization beginning after the revocation is filed with the organization; except that in the case of a pooling arrangement described in section 1382(e) a revocation made by a distributee shall not be effective as to any products which were delivered to the organization by the distributee before such revocation. 76 Stat. 1046. 26 USC 1382.

"(ii) Any agreement described in paragraph (2)(B) shall not be effective with respect to any products delivered after the distributee ceases to be a member of the organization or after the bylaws of the organization cease to contain the provision described in paragraph (2)(B)(i).

"(i) NONQUALIFIED PER-UNIT RETAIN CERTIFICATE.—For purposes of this subchapter, the term 'nonqualified per-unit retain certificate' means a per-unit retain certificate which is not described in subsection (h)."

(d) INFORMATION REPORTING.—

76 Stat. 1054. 26 USC 6044.

(1) AMOUNTS SUBJECT TO REPORTING.—Section 6044(b)(1) is amended by striking out "and" at the end of subparagraph (B), by striking out the period at the end of subparagraph (C) and inserting in lieu thereof ", and", and by adding after subparagraph (C) the following new subparagraphs:

Ante, p. 1582.

"(D) the amount of any per-unit retain allocation (as defined in section 1388(f)) which is paid in qualified per-unit retain certificates (as defined in section 1388(h)), and

Ante, p. 1581.

"(E) any amount described in section 1382 (b)(4) (relating to redemption of nonqualified per-unit retain certificates)."

(2) DETERMINATION OF AMOUNT PAID.—

(A) Section 6044(d)(1) is amended by striking out "allocation)" and inserting in lieu thereof "allocation or a qualified per-unit retain certificate)".

(B) Section 6044(d)(2) is amended by striking out "allocation" and inserting in lieu thereof "allocation or a qualified per-unit retain certificate".

(e) EFFECTIVE DATES.—

(1) The amendments made by subsections (a), (b), and (c) shall apply to per-unit retain allocations made during taxable years of an organization described in section 1381(a) (relating to organizations to which part I of subchapter T of chapter 1 applies) beginning after April 30, 1966, with respect to products delivered during such years.

76 Stat. 1045. 26 USC 1381.

(2) The amendments made by subsection (d) shall apply with respect to calendar years after 1966.

(f) TRANSITION RULE.—

(1) Except as provided in paragraph (2), a written agreement between a patron and a cooperative association—

(A) which clearly provides that the patron agrees to treat the stated dollar amounts of all per-unit retain certificates issued to him by the association as representing cash distributions which he has, of his own choice, reinvested in the cooperative association,

(B) which is revocable by the patron at any time after the close of the taxable year in which it was made,

(C) which was entered into after October 14, 1965, and before the date of the enactment of this Act, and

(D) which is in effect on the date of the enactment of this Act, and with respect to which a written notice of revocation has not been furnished to the cooperative association,

shall be effective (for the period prescribed in the agreement) for purposes of section 1388(h) of the Internal Revenue Code of 1954 as if entered into, pursuant to such section, after the date of the enactment of this Act.

(2) An agreement described in paragraphs (1)(A) and (C) which was included in a by-law of the cooperative association and which is in effect on the date of the enactment of this Act shall be effective for purposes of section 1388(h) of such Code only for taxable years of the association beginning before May 1, 1967.

SEC. 212. EXCISE TAX RATE ON AMBULANCES AND HEARSES.

(a) CLASSIFICATION AS AUTOMOBILES.—Section 4062 (relating to definitions applicable to the tax on motor vehicles) is amended by adding at the end thereof the following new subsection: 68A Stat. 482; 78 Stat. 1086. 26 USC 4062.

"(b) AMBULANCES, HEARSES, ETC.—For purposes of section 4061 (a), a sale of an ambulance, hearse, or combination ambulance-hearse shall be considered to be a sale of an automobile chassis and an automobile body enumerated in subparagraph (B) of section 4061(a)(2)." 26 USC 4061. 79 Stat. 136.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to articles sold after the date of the enactment of this Act.

SEC. 213. APPLICABILITY OF EXCLUSION FROM INTEREST EQUALIZATION TAX OF CERTAIN LOANS TO ASSURE RAW MATERIALS SOURCES.

(a) EXCEPTION TO EXCLUSION.—Section 4914(d) (relating to loans to assure raw materials sources) is amended by adding at the end thereof the following new paragraph: 78 Stat. 813. 26 USC 4914.

"(3) EXCEPTION.—The exclusion from tax provided by paragraph (1) shall not apply in any case where the acquisition of the debt obligation of the foreign corporation is made with an intent to sell, or to offer to sell, any part of such debt obligation to United States persons."

(b) TECHNICAL AMENDMENTS.—(1) Section 4914(j)(1) (relating to loss of entitlement to exclusion in case of certain subsequent transfers) is amended—

(A) by striking out in subparagraph (A) ", or the exclusion provided by subsection (d),", and

(B) by striking out "subsection (d) or (f)" in subparagraph (D) and inserting in lieu thereof "subsection (f)".

(2) Section 4918 (relating to exemption for prior American ownership) is amended by adding at the end thereof the following new subsection: 78 Stat. 831. 26 USC 4918.

"(g) CERTAIN DEBT OBLIGATIONS ARISING OUT OF LOANS TO ASSURE RAW MATERIAL SOURCES.—Under regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply to the acquisition by a United States person of any debt obligation to which section 4914(d) applied where the acquisition of the debt obligation by such person is made with an intent to sell, or to offer to sell, any part of such debt obligation to United States persons. The preceding sentence shall not apply if the tax imposed by section 4911 has applied to any prior acquisition of such debt obligation." 78 Stat. 809. 26 USC 4911.

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply with respect to acquisitions of debt obligations made after the date of the enactment of this Act.

SEC. 214. EXCLUSION FROM INTEREST EQUALIZATION TAX FOR CERTAIN ACQUISITIONS BY INSURANCE COMPANIES.

(a) NEW COMPANIES AND COMPANIES OPERATING IN FORMER LESS DEVELOPED COUNTRIES.—Section 4914(e) (relating to acquisitions by insurance companies doing business in foreign countries) is amended—

(1) by striking out "at the time of the initial designation" in the last sentence of paragraph (2);

(2) by striking out "An" in the first sentence of paragraph (3)(A)(i) and inserting in lieu thereof "Except as provided in clause (iii), an";

(3) by striking out "under this subparagraph" in paragraph (3)(A)(ii) and inserting in lieu thereof "under clause (i)";

(4) by adding after clause (ii) of paragraph (3)(A) the following new clauses:

"(iii) INITIAL DESIGNATION AFTER OCTOBER 2, 1964.—An insurance company which was not in existence on October 2, 1964, or was otherwise ineligible to establish a fund (or funds) of assets described in paragraph (2) by making an initial designation under clause (i) on or before such date, may establish (and thereafter currently maintain) such fund (or funds) of assets at any time after the enactment of this clause by designating stock of a foreign issuer or a debt obligation of a foreign obligor as a part of such fund in accordance with the provisions of clause (iv) (if applicable) and subparagraph (B) (i).

"(iv) FUNDS INVOLVING CURRENCIES OF FORMER LESS DEVELOPED COUNTRIES.—An insurance company desiring to establish a fund under clause (iii) with respect to insurance contracts payable in the currency of a country designated as a less developed country on October 2, 1964, which thereafter has such designation terminated by an Executive order issued under section 4916(b), shall designate as assets of such fund, to the extent permitted by subparagraph (E), the stock of foreign issuers or debt obligations of foreign obligors as follows: First, stock and debt obligations having a period remaining to maturity of at least 1 year (other than stock or a debt obligation described in section 4916(a)) acquired before July 19, 1963, and owned by the company on the date which the President, in accordance with section 4916(b), communicates to Congress his intention to terminate the status of such country as a less developed country; second, stock and debt obligations having a period remaining to maturity of at least 1 year described in section 4916(a) (and owned by the company on the date of such termination) which, at the time of acquisition, qualified for the exclusion provided in such section because of the status of such country as a less developed country; and third, such stock or debt obligations as the company may elect to designate under subparagraph (B) (i). The period remaining to maturity referred to in the preceding sentence shall be determined as of the date of the President's communication to Congress.";

78 Stat. 827.
26 USC 4916.

(5) by striking out "TO MAINTAIN FUND" in the heading of paragraph (3) (B);

79 Stat. 959.
26 USC 4914.

(6) by striking out "as provided in subparagraph (A) (ii)" in paragraph (3) (B) (i) and inserting in lieu thereof "under subparagraphs (A) (i) and (ii)";

(7) by inserting before the period at the end of the first sentence of paragraph (3) (C) the following: "; except that, with respect to a fund established under subparagraph (A) (iii), stock or debt obligations acquired before the establishment of such fund may not be designated as part of such fund under this subparagraph";

78 Stat. 819.

(8) by striking out "subparagraph (B)," in paragraph (3) (E) (i) and inserting in lieu thereof "subparagraph (A) (iv), (B),";

(9) by striking out "subparagraph (A)" in paragraph (4) (B) (i) and inserting in lieu thereof "subparagraph (A) (i)";

(10) by striking out "paragraph (3) (A)" in paragraph (4) (B) (ii) and inserting in lieu thereof "paragraph (3) (A) (i)"; and

(11) by adding at the end of paragraph (4) the following new paragraph: 78 Stat. 820. 26 USC 4914.

"(C) SPECIAL RULE.—For purposes of subparagraph (A), if a country designated as a less developed country on September 2, 1964, thereafter has such designation terminated by an Executive order issued under section 4916(b), all insurance contracts payable in the currency of such country which were entered into before such designation was terminated shall be treated as insurance contracts payable in the currency of a country other than a less developed country." 78 Stat. 827. 26 USC 4916.

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall take effect on the day after the date of the enactment of this Act.

SEC. 215. EXCLUSION FROM INTEREST EQUALIZATION TAX OF CERTAIN ACQUISITIONS BY FOREIGN BRANCHES OF DOMESTIC BANKS.

(a) AUTHORITY FOR MODIFICATION OF EXECUTIVE ORDERS.—Section 4931(a) (relating to commercial bank loans) is amended by adding at the end thereof the following new sentence: "Clause (A) of the preceding sentence shall not prevent a modification of such Executive order (or any modification thereof) to exclude from the application of subsection (b) acquisitions by commercial banks, through branches located outside the United States, of debt obligations of foreign obligors payable in currency of the United States." 78 Stat. 839. 26 USC 4931.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to acquisitions of debt obligations made after the date of the enactment of this Act.

TITLE III—PRESIDENTIAL ELECTION CAMPAIGN FUND ACT

SEC. 301. SHORT TITLE.

This title may be cited as the "Presidential Election Campaign Fund Act of 1966".

SEC. 302. AUTHORITY FOR DESIGNATION OF $1 OF INCOME TAX PAYMENTS TO PRESIDENTIAL ELECTION CAMPAIGN FUND.

(a) Subchapter A of chapter 61 of the Internal Revenue Code of 1954 (relating to returns and records) is amended by adding at the end thereof the following new part: 68A Stat. 731. 26 USC 6001-6091.

"PART VIII—DESIGNATION OF INCOME TAX PAYMENTS TO PRESIDENTIAL ELECTION CAMPAIGN FUND

"Sec. 6096. Designation by individuals.

"SEC. 6096. DESIGNATION BY INDIVIDUALS.

"(a) IN GENERAL.—Every individual (other than a nonresident alien) whose income tax liability for any taxable year is $1 or more may designate that $1 shall be paid into the Presidential Election Campaign Fund established by section 303 of the Presidential Election Campaign Fund Act of 1966.

"(b) INCOME TAX LIABILITY.—For purposes of subsection (a), the income tax liability of an individual for any taxable year is the amount of the tax imposed by chapter 1 on such individual for such taxable year (as shown on his return), reduced by the sum of the credits (as shown in his return) allowable under sections 32(2), 33, 35, 37, and 38. 26 USC 1-1388. 76 Stat. 962.

"(c) MANNER AND TIME OF DESIGNATION.—A designation under subsection (a) may be made with respect to any taxable year, in such manner as the Secretary or his delegate may prescribe by regulations—

80 STAT. 1587

80 STAT. 1588

"(1) at the time of filing the return of the tax imposed by chapter 1 for such taxable year, or

"(2) at any other time (after the time of filing the return of the tax imposed by chapter 1 for such taxable year) specified in regulations prescribed by the Secretary or his delegate."

68A Stat. 4.
26 USC 1-1388.

(b) The table of parts for subchapter A of chapter 61 of such Code is amended by adding at the end thereof the following new item:

"Part VIII. Designation of income tax payments to Presidential Election Campaign Fund."

(c) The amendments made by this section shall apply with respect to income tax liability for taxable years beginning after December 31, 1966.

SEC. 303. PRESIDENTIAL ELECTION CAMPAIGN FUND.

(a) ESTABLISHMENT.—There is hereby established on the books of the Treasury of the United States a special fund to be known as the "Presidential Election Campaign Fund" (hereafter in this section referred to as the "Fund"). The Fund shall consist of amounts transferred to it as provided in this section.

(b) TRANSFERS TO THE FUND.—The Secretary of the Treasury shall, from time to time, transfer to the Fund an amount equal to the sum of the amounts designated by individuals under section 6096 of the Internal Revenue Code of 1954 for payment into the Fund.

Ante, p. 1587.

(c) PAYMENTS FROM FUND.—

(1) IN GENERAL.—The Secretary of the Treasury shall, with respect to each presidential campaign, pay out of the Fund, as authorized by appropriation Acts, into the treasury of each political party which has complied with the provisions of paragraph (3) an amount (subject to the limitation in paragraph (3)(B)) determined under paragraph (2).

(2) DETERMINATION OF AMOUNTS.—

(A) Each political party whose candidate for President at the preceding presidential election received 15,000,000 or more popular votes as the candidate of such political party shall be entitled to payments under paragraph (1) with respect to a presidential campaign equal to the excess over $5,000,000 of—

(i) $1 multiplied by the total number of popular votes cast in the preceding presidential election for candidates of political parties whose candidates received 15,000,000 or more popular votes as the candidates of such political parties, divided by

(ii) the number of political parties whose candidates in the preceding presidential election received 15,000,000 or more popular votes as the candidates of such political parties.

(B) Each political party whose candidate for President at the preceding presidential election received more than 5,000,000, but less than 15,000,000, popular votes as the candidate of such political party shall be entitled to payments under paragraph (1) with respect to a presidential campaign equal to $1 multiplied by the number of popular votes in excess of 5,000,000 received by such candidate as the

candidate of such political party in the preceding presidential election.

(C) Payments under paragraph (1) shall be made with respect to each presidential campaign at such times as the Secretary of the Treasury may prescribe by regulations, except that no payment with respect to any presidential campaign shall be made before September 1 of the year of the presidential election with respect to which such campaign is conducted. If at the time so prescribed for any such payments, the moneys in the Fund are insufficient for the Secretary to pay into the treasury of each political party which is entitled to a payment under paragraph (1) the amount to which such party is entitled, the payment to all such parties at such time shall be reduced pro rata, and the amounts not paid at such time shall be paid when there are sufficient moneys in the Fund.

80 STAT. 1588
80 STAT. 1589

(3) LIMITATIONS.—

(A) No payment shall be made under paragraph (1) into the treasury of a political party with respect to any presidential campaign unless the treasurer of such party has certified to the Comptroller General the total amount spent or incurred (prior to the date of the certification) by such party in carrying on such presidential campaign, and has furnished such records and other information as may be requested by the Comptroller General.

(B) No payment shall be made under paragraph (1) into the treasury of a political party with respect to any presidential campaign in an amount which, when added to previous payments made to such party, exceeds the amount spent or incurred by such party in carrying on such presidential campaign.

(4) The Comptroller General shall certify to the Secretary of the Treasury the amounts payable to any political party under paragraph (1). The Comptroller General's determination as to the popular vote received by any candidate of any political party shall be final and not subject to review. The Comptroller General is authorized to prescribe such rules and regulations, and to conduct such examinations and investigations, as he determines necessary to carry out his duties and functions under this subsection.

(5) DEFINITIONS.—For purposes of this subsection— Definitions.

(A) The term "political party" means any political party which presents a candidate for election to the office of President of the United States.

(B) The term "presidential campaign" means the political campaign held every fourth year for the election of presidential and vice presidential electors.

(C) The term "presidential election" means the election of presidential electors.

(d) TRANSFERS TO GENERAL FUND.—If, after any presidential campaign and after all political parties which are entitled to payments under subsection (c) with respect to such presidential campaign have been paid the amounts to which they are entitled under subsection (c), there are moneys remaining in the Fund, the Secretary of the Treasury shall transfer the moneys so remaining to the general fund of the Treasury.

SEC. 304. ESTABLISHMENT OF ADVISORY BOARD.

(a) There is hereby established an advisory board to be known as the Presidential Election Campaign Fund Advisory Board (hereafter in this section referred to as the "Board"). It shall be the duty and function of the Board to counsel and assist the Comptroller General in the performance of the duties imposed on him under section 303 of this Act.

80 STAT. 1589
80 STAT. 1590

Membership.

(b) The Board shall be composed of two members representing each political party whose candidate for President at the last presidential election received 15,000,000 or more popular votes as the candidate of such political party, which members shall be appointed by the Comptroller General from recommendations submitted by each such political party, and of three additional members selected by the members so appointed by the Comptroller General. The term of the first members of the Board shall expire on the 60th day after the date of the first presidential election following the date of the enactment of this Act and the term of subsequent members of the Board shall begin on the 61st day after the date of a presidential election and expire on the 60th day following the date of the subsequent presidential election. The Board shall select a Chairman from among its members.

Term of office.

Compensation.

(c) Members of the Board shall receive compensation at the rate of $75 a day for each day they are engaged in performing duties and functions as such members, including travel time, and, while away from their homes or regular places of business, shall be allowed travel expenses, including per diem in lieu of subsistence, as authorized by law for persons in the Government service employed intermittently.

(d) Service by an individual as a member of the Board shall not, for purposes of any other law of the United States, be considered as service as an officer or employee of the United States.

SEC. 305. APPROPRIATIONS AUTHORIZED.

There are authorized to be appropriated, out of the Presidential Elections Campaign Fund, such sums as may be necessary to enable the Secretary of the Treasury to make payments under section 303 of this Act.

TITLE IV—MISCELLANEOUS PROVISIONS

SEC. 401. TREASURY NOTES PAYABLE IN FOREIGN CURRENCY.

40 Stat. 505.

Section 16 of the Second Liberty Bond Act, as amended (31 U.S.C. 766), is amended by striking out "bonds" wherever it appears therein and inserting in lieu thereof "bonds, notes,".

SEC. 402. REPORTS TO CLARIFY THE NATIONAL DEBT AND TAX STRUCTURE.

The Secretary of the Treasury shall, on the first day of each regular session of the Congress, submit to the Senate and the House of Representatives a report setting forth, as of the close of the preceding June 30 (beginning with the report as of June 30, 1967), the aggregate and individual amounts of the contingent liabilities and the unfunded liabilities of the Government, and of each department, agency, and instrumentality thereof, including, so far as practicable, trust fund liabilities, Government corporations' liabilities, indirect liabilities not included as a part of the public debt, and liabilities of insurance and annuity programs, including their actuarial status. The report shall also set forth the collateral pledged, or the assets available (or to be realized), as security for such liabilities (Government securities to be separately noted), and shall also set forth all other assets specifically available to

liquidate such liabilities of the Government. The report shall set forth the required data in a concise form, with such explanatory material (including such analysis of the significance of the liabilities in terms of past experience and probable risk) as the Secretary may determine to be necessary or desirable, and shall include total amounts of each category according to the department, agency, or instrumentality involved.

Approved November 13, 1966.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 1450 (Comm. on Ways and Means) and No. 2327 (Comm. of Conference).
SENATE REPORT No. 1707 (Comm. on Finance).
CONGRESSIONAL RECORD, Vol. 112 (1966):
June 15: Considered and passed House.
Oct. 12: Considered in Senate.
Oct. 13: Considered and passed Senate, amended.
Oct. 20: House agreed to conference report.
Oct. 22: Senate agreed to conference report.

71-297 O-67-pt. 1—5

SECTION 2

H.R. 5916 AS INTRODUCED IN THE HOUSE OF REPRESENTATIVES

(See Section 7 of this document, page 123)

SECTION 3

EXPLANATION BY THE DEPARTMENT OF THE TREASURY OF THE ACT TO REMOVE TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES, INSERTED IN THE CONGRESSIONAL RECORD ON MARCH 8, 1965, BY CHAIRMAN WILBUR D. MILLS

[*March 8, 1965*]

[*P. 4260*]

EXPLANATION BY THE DEPARTMENT OF THE TREASURY OF THE ACT TO REMOVE TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES

Mr. MILLS. Mr. Speaker, I ask unanimous consent that there be inserted at this point in the RECORD an explanation prepared by the Treasury Department of the bill H.R. 5916 which I introduced today entitled "An act to remove tax barriers to foreign investment in the United States." I am advised by the Government Printing Office that the estimated cost of printing this explanation is $343. Notwithstanding the cost I request that this be inserted in the RECORD.

The SPEAKER. Is there objection to the request of the gentleman from Arkansas?

There was no objection.

The matter referred to follows:

EXPLANATION OF H.R. 5916, AN ACT TO REMOVE TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES

(Prepared by the Treasury Department)

GENERAL EXPLANATION

Introduction

In his balance-of-payments message of February 10, 1965, the President proposed a series of measures designed to reinforce the program to correct the balance-of-payments deficit of the United States. Among the proposals made by the President is one to remove the tax deterrents to foreign investment in U.S. corporate securities so as to improve our balance of payments by encouraging an increase in such investment. The recommended legislation described herein would effectuate this proposal.

The review of the tax treatment of nonresident foreigners and foreign corporations investing in the United States resulting in these legislative recommendations was prompted in large measure by the report of the Task Force on Promoting Increased Foreign Investment in U.S. Corporate Securities. This task force, which was headed by the then Under Secretary of the Treasury, Henry H. Fowler, was directed, among other things, to review U.S. Government and private activities which adversely affect foreign purchases of the securities of U.S. private companies. In its report, the task force made 39 recommendations designed to help the United States reduce its balance-of-payments deficit and defend its gold reserves. Among these were several directed at changing the tax treatment of foreign investors

[*P. 4261*]

so as "to remove a number of elements in our tax structure which unnecessarily complicate and inhibit investment in U.S. corporate securities without generating material tax revenues." The task force report cautioned, however, that its tax recommendations were not intended to turn the United States into a tax haven, nor to drain funds from developing countries.

The legislation being requested deals with all of the tax areas discussed in the task force report, although in certain instances the action suggested differs from the proposals made by the task force. Furthermore, the draft bill contains recommendations in areas not mentioned in the task force report which deal with problems which came to light in the Treasury Department's study of the present system of taxing nonresident foreigners and foreign corporations. It should be emphasized that the recommendations embodied in the proposed legislation were considered not only from the viewpoint of their impact on the balance of payments, but also to insure that they contributed to a rational and consistent program for the taxation of foreign individuals and foreign corporations. Thus, all legislative suggestions made herein are justifiable on conventional tax policy grounds.

It is estimated that the adoption of these proposals would result in a net revenue loss on an annual basis of less than $5 million.

Foreign purchases of U.S. stocks constitute the largest single source of long-term capital inflow into the United States, with even greater potential for the future. Net purchases have averaged $190 million a year between 1956 and 1963, while the outstanding value of foreign-held stocks has risen from $6.1 to $12.5 billion during this period. It is extremely difficult to measure the precise impact of this proposed legislation on our balance of payments because of the various factors affecting the level of foreign investment in the United States. It is anticipated that, when combined with an expanding U.S. economy, the proposed legislation will result over the years in a significant increase in such investment.

Most provisions of the draft bill are proposed to become effective to taxable years beginning after December 31, 1965. However, those provisions which provide a revised estate tax treatment for the estates of foreigners are made applicable to the estates of decedents dying after the date of enactment of the proposed legislation. In addition, those special provisions applicable to U.S. citizens who have surrendered their U.S. citizenship are made applicable if the surrender occurred after March 8, 1965.

Specific recommendations

The following paragraphs describe the specific changes in the Internal Revenue Code of 1954 which are proposed. For this purpose the technical language of the Internal Revenue Code has been used, e.g., foreigners are described by the technical term "alien."

1. Graduated rates: Eliminate the taxation at graduated rates of U.S. source income of nonresident alien individuals not doing business in the United States.

Under present law, nonresident aliens deriving more than $21,200 of income from U.S. sources are subject to regular U.S. graduated rates and are required to file returns. However, graduated rates on investment income already are eliminated by treaty in the case of almost all industrial countries, except where a taxpayer is doing business in the United States and has a permanent establishment here. Only a very small amount of revenue is collected from graduated rates at present. For example, for 1962 graduated rates resulted in the collection of $746,743 above the taxes already withheld. Although graduated rates are rarely applicable they complicate our tax law and tend to frighten and confuse foreign investors.

Thus, graduated rates, whether applied to investment income or such types of income as pensions, annuities, alimony, and the like, serve no clearly defined purpose, deter foreign investment, and should be eliminated. The elimination of graduated rates will limit the liability of nonresident aliens not engaged in trade or business to taxes withheld, and where the alien is not engaged in trade or business here no return need be made. (However, graduated rates would be retained for the U.S. business income of nonresident aliens engaged in trade or business here.)

2. Segregation of investment and business income and related matters: Provide that (a) nonresident alien individuals engaged in trade or business in the United States be taxed on investment (nonbusiness) income at the 30 percent statutory withholding rate, or applicable treaty rate, rather than at graduated rates; (b) foreign corporations engaged in business in the United States be denied the 85-percent dividends-received deduction and be exempt from tax on their capital gains from investments in U.S. stocks; (c) nonresident alien individuals and foreign corporations not be deemed engaged in trade or business in the United States because of investment activity in the United States or because they have granted a discretionary power to a U.S. banker, broker, or adviser; and (d) nonresident alien individuals and foreign corporations be given an election to compute income from real property and mineral royalties on a net income basis and be taxed at graduated rates on such income as if engaged in trade or business in the United States.

Segregation of business and investment income

Under present law, if a nonresident alien is engaged in trade or business within the United States, he is subject to tax on all his U.S. income (including capital gains), even though some of the income is not derived from the conduct of the trade or business, at the same rate as U.S. citizens.

A nonresident alien individual engaged in trade or business in the United States should be subject to taxation on his investment income on the same basis as a nonresident alien not so engaged. Thus his investment income would be taxed at the 30-percent statutory rate or applicable treaty rate, rather than at graduated rates. For the purpose of determining the applicability of treaty rates the alien will be deemed not to have a permanent establishment in this country. All business income should remain subject to tax at graduated rates, but the rates on business income would be computed without regard to the amount of investment income.

This change conforms to the trend in international treaty negotiations to separate investment income from business income. Whether a taxpayer is helped or harmed by segregating his investment from his business income, separate treatment is proper and equitable. Investment decisions may be made on the same basis whether or not the alien is engaged in business here, since income arising from investments here will not be subject to taxation at graduated rates in either event.

Moreover, a nonresident alien individual engaged in trade or business here should not be taxed on capital gains realized in the United States which are unrelated to the business activity carried on by him in this country, except where he would be subject to tax on those gains under the rules pertaining to nonresident aliens generally.

Tax treatment of income from U.S. stock investments by foreign corporations

Under present law all the activities of a corporation are treated as part of its trade or business. Thus, for example, all its expenses are treated as deductible as business expenses. Accordingly, it would be inappropriate to segregate a foreign corporation's U.S. investment income from its U.S. business income. However, there is one abuse in this area which should be eliminated. Frequently, a foreign corporation with stock investments in the United States engages in trade or business here in some minor way (such as by owning a few parcels of real estate) and then claims the 85-percent dividends-received deduction on its stock investments in the United States. Such a corporation thereby may pay far less than the 30-percent statutory or treaty withholding rate on its U.S. dividend income, although its position is essentially the same as that of a foreign corporation doing business elsewhere which has U.S. investment income.

To eliminate this abuse and treat all foreign corporations with investments in U.S. stocks alike, the 85-percent dividends-received deduction should be denied to foreign corporations doing business here. Their income from stock investments would be made subject to the 30-percent statutory withholding rate, or any lesser treaty rate applicable to such income, rather than regular than regular U.S. corporate rates. For the purpose of determining whether the treaty rates on dividend income apply, a foreign corporation will be deemed not to have a permanent establishment in this country. To fully equate the tax treatment of stock investments of foreign corporations doing business in the United States with that of foreign corporations not doing business here, such corporations are exempted from the U.S. tax on capital gains realized on their U.S. stock investments.

Definition of "engaged in trade or business"

Present law provides that the term "engaged in trade or business" does not include the effecting, through a resident broker, commission agent, or custodian, of transactions in the United States in stocks, securities, or commodities. There is some confusion as to whether the amount of activity in an investment account, or the granting of a discretionary power to a U.S. banker, broker, or adviser, will place a nonresident alien outside of this exception for security transactions so that he is engaged in trade or business in the United States. This uncertainty may deter investment in the United States and is undesirable as a matter of tax policy.

The fact that a discretionary power of investment has been given to a U.S. broker or banker does not really bear a relation to the foreigner's ability to carry out transactions in the United States—the discretionary power is merely a more efficient method of operating rather than having the investor consulted on every investment decision and frequently is merely a safeguard to protect him in case of world turmoil. Nor, where the alien is an investor, is the volume of transactions material in determining whether he is engaged in trade or business.

Accordingly, the proposed legislation makes clear that individuals or corporations are not engaged in trade or business because of in-

vestment activity in the United States or because they have granted a discretionary investment power to a U.S. banker, broker, or adviser. No legislative change is necessary to provide that the volume of transactions is not material in determining whether an investor is engaged in trade or business in the United States as this is the rule under present law.

Real estate income and mineral royalties

Under present law it is not clear whether a nonresident alien (or foreign corporation) is engaged in trade or business in the United States by reason of the mere ownership of unimproved real property or real property subject to a strict net lease, or by reason of an agent's activities in connection with the selection of real estate investments in the United States.

[*P. 4262*]

If because of such activity a nonresident alien is considered as not engaged in trade or business he becomes subject to withholding tax on his gross rents. Since the consequent tax could exceed his net income, the taxation on a gross basis of income from real property should not be continued where taxation on a net basis at graduated U.S. rates would be more appropriate.

Therefore, a nonresident alien or foreign corporation should be given an election to compute their income from real property (including income from minerals and other natural resources) on a net income basis and at regular U.S. rates as if they were engaged in trade or business in the United States. Such an election is comparable to the one now appearing in many treaties to which the Unite dStates is a party. Such an election would not effect the method of taxation applied to his other income.

3. Capital gains: Eliminate the provision taxing capital gains realized by a nonresident alien when he is physically present in the United States, and extend from 90 to 183 days the period of presence in the United States during the year which makes nonresident aliens taxable on all their capital gains.

The underlying policy of U.S. taxation of nonresident alien individuals has been to exempt capital gains realized from sources in this country. This policy has been proper both from a tax policy standpoint and from the viewpoint of our balance of payments. However, existing law has two limitations: U.S. capital gains realized by a nonresident alien while he is physically present in the United States, or realized during a year in which he is present in the United States for 90 days or more, are subject to a U.S. tax of 30 percent.

The limitations now contained in our law, especially the physical presence test, contain illogical elements and are likely to have a negative impact on foreigners who are weighing the advantages and disadvantages of investing in the United States. The physical presence test was added to the law after World War II when many nonresident alien traders were frequently present in this country. Since this is no longer true, and moreover, since the tax may be readily avoided by passing title to the property outside the United States, the provision now serves little purpose. However, it does pose a threat to the foreign investor which may deter him from investing in this country and therefore should be eliminated.

The limitation relating to presence in the United States for 90 days or more in a particular year should be retained, but the period should be lengthened to 183 days. This extension will remove a minor deterrent to travel in the United States and help mitigate the harsh consequences which may arise under the existing rule if a nonresident alien realized capital gains at the beginning of a taxable year during which he later spends 90 days or more in the United States.

4. Personal holding company and "second dividend" taxes: (a) Exempt foreign corporations owned entirely by nonresident alien individuals, whether or not doing business in the United States, from the personal holding company tax; (b) modify the application of the "second dividend tax" of section 861(a)(2)(B) so that it only applies to the dividends of foreign corporations doing business in the United States which have over 50 percent U.S. source income.

Under present law any foreign corporation with U.S. investment income, whether or not doing business here, may be a personal holding company unless it is owned entirely by nonresident aliens, and unless its gross income from U.S. sources is less than 50 percent of its gross income from all sources.

The personal holding company tax should not apply to foreign corporations owned entirely by nonresident aliens. The only reason for applying our personal holding company tax to foreign corporations owned by nonresident aliens has been to prevent the accumulation of income in holding companies organized to avoid the graduated rates. With the elimination of graduated rates as suggested in recommendation 1 (and the revision of the second dividend tax, discussed below), U.S. investment income in the hands of foreign corporations will have borne the U.S. taxes properly applicable to it and accumulation of such income will not result in the avoidance of U.S. taxes imposed on the company's shareholders. Hence, there is no longer any reason to continue to apply the personal holding company tax to these corporations.

With respect to the "second dividend tax," section 861(a)(2)(B) now provides that if a corporation derives 50 percent or more of its gross income for the preceding 3-year period from the United States, its dividends shall be treated as U.S. source income to the extent the dividends are attributable to income from the United States. As a result such dividends are subject to U.S. tax when received by a nonresident alien. This tax is often referred to as the "second dividend tax." However, under section 1441(c)(1) a foreign corporation is not required to withhold tax on its dividends unless it is engaged in business in the United States and, in addition, more than 85 percent of its gross income is derived from U.S. sources.

It is now proposed to levy this second dividend tax only where the foreign corporation does business in the United States, and 80 percent or more of its gross income (other than dividends and capital gains on stock) is derived from U.S. sources. Where a foreign corporation is not doing business in the United States, it will pay U.S. withholding taxes on all investment income and other fixed or determinable gains and profits derived from the United States, and since that is all the tax its foreign shareholders would owe if they received the income directly, no second tax seems warranted.

With the adoption of the rule that the income from the U.S. stock investments of for-

eign corporations doing business here be taxed at flat statutory or treaty withholding rates, no further U.S. tax should be imposed on such income. Therefore, in applying the proposed 80 percent test, such income of the foreign corporation, whether from U.S. or foreign sources, should be disregarded and the test applied only to the corporation's other income. Furthermore, if the 80 percent rule is met, the dividends of such corporations should be subject to tax only to the extent that such dividends are from U.S. source income other than income from stock investments in the United States.

Withholding requirements should conform to the incidence of tax, and therefore withholding should be required on dividends paid by foreign corporations doing business in the United States with 80 percent or more U.S. source income to the extent such dividends are from U.S. source income other than income from stock investments in the United States.

With the adoption of the revisions proposed in U.S. system of taxing nonresident aliens and foreign corporations, the regulations dealing with the accumulated earnings tax will be revised to eliminate the application of this tax to foreign corporations not doing business in the United States which are owned entirely by nonresident aliens. The accumulation of earnings by such corporations will not result in the avoidance of U.S. taxes. However, because of possible avoidance of the revised second dividend tax, the accumulated earnings tax will remain applicable to foreign corporations doing business here.

5. Estate tax and related matters: (a) Increase the $2,000 exemption from tax to $30,000 and substitute for regular U.S. estate tax rates a 5–10–15 percent rate schedule; (b) provide that bonds issued by domestic corporations or governmental units and held by nonresident aliens are property within the United States and therefore are subject to estate tax; and (c) provide that transfers of intangible property by a nonresident alien engaged in business in the United States are not subject to gift tax.

It is generally believed that high estate taxes on foreign investors are one of the most important deterrents in our tax laws to foreign investment in the United States. Our rates in many cases are higher than those of other countries and in these situations, despite tax conventions and statutory foreign estate tax credits, nonresidents who invest in the United States suffer an estate tax burden. Moreover, under present law a nonresident alien's estate must pay heavier estate taxes on its U.S. assets than would the estate of a U.S. citizen owning the same assets.

To mitigate this deterrent to investment and to rationalize the estate tax treatment of nonresident aliens, the exemption for estates of nonresident alien decedents should be increased from $2,000 to $30,000 and such estates should be subject to tax at the following rates:

If the taxable estate is not over $100,000, the tax should be 5 percent of the taxable estate.

If the taxable estate is over $100,000 but not over $750,000, the tax shall be $5,000, plus 10 percent of excess over $100,000.

If the taxable estate is over $750,000, the tax shall be $70,000, plus 15 percent of excess over $750,000.

The increase in exemption and reduced rates will bring U.S. effective estate tax rates on nonresident aliens to a level somewhat higher than those imposed upon resident estates in Switzerland, Germany, France, and the Netherlands, for example, but substantially below those imposed on resident estates in the United Kingdom, Canada, and Italy. Thus U.S. investment from these latter countries bears no higher estate tax than local investment because of foreign tax credits or exemptions provided in such countries. The proposed tax treatment of the U.S. estates of nonresident aliens is similar to the treatment accorded the estates of nonresidents by Canada, whose rates on the estates of its citizens are comparable to our own. Where additional reductions are justified these may be made by treaty.

These changes should result in more appropriate estate tax treatment of nonresident aliens and thereby improve the climate for foreign investment in the United States. Particularly in the case of nonresident alien decedents who have only a small amount of U.S. property in their estates, present U.S. rates and the limited exemption provided result in an excessive effective rate of estate tax. The proposed changes correct this situation. The new rates will produce for nonresident aliens' estates an effective rate of tax on U.S. assets which in many cases is comparable to that applicable to U.S. citizens who may avail themselves of the $60,000 exemption and marital deduction (which are not available to nonresident aliens).

The following figures show the effective rates for nonresident aliens under present law, and the effective rates produced by the proposed exemption and rates as compared to those applicable to the estates of U.S. citizens electing and not electing the marital deduction:

U.S. gross estate	Nonresident alien under present law	Nonresident alien under proposed law	U.S. citizen with marital deduction	U.S. citizen without marital deduction
$60,000	12.5	2.0	----------	----------
100,000	17.3	3.0	----------	3.0
500,000	25.8	7.4	8.0	22.1
1,000,000	38.8	8.8	11.1	26.7
5,000,000	43.0	12.6	16.9	42.3

[*P. 4263*]

As part of this revision of the estate tax, the situs rule with respect to bonds should be changed. The present rule, very frequently modified by treaty, is that bonds have situs where they are physically located. This rule is illogical, permits tax avoidance, and is not a suitable way to determine whether bonds are subject to an estate tax as their location is one of their least significant characteristics for tax purposes. Other intangible debt obligations are presently treated as property within the United States if issued by or enforcible against a domestic corporation or resident of the United States. Accordingly, it is recommended that our law be amended to provide that bonds issued by domestic corporations or domestic governmental units and held by nonresident aliens are property within the United States and therefore subject to estate tax.

Furthermore, a present defect in the operation of the credit against the estate tax for State death taxes in the case of nonresident aliens should be corrected. Under present law the the estate of a nonresident alien may receive the full credit

permitted by section 2011 even though only a portion of the property subject to Federal tax was taxed by a State. The amount of credit permitted by section 2011 in the case of nonresident aliens should be limited to that portion of the credit allowed the estate which is allocable to property taxed by both the State and the Federal Government.

Our gift tax law as it applies to nonresident aliens should be revised. Under present law a nonresident alien doing business in the United States is subject to gift tax on transfers of U.S. intangible property. This rule has little significance from the standpoint of revenue and tax equity. Therefore, our law should be amended to provide that transfers of intangible property by a nonresident alien, whether or not engaged in business in the United States, are not subject to gift tax. Gifts or tangibles situated in the United States which are owned by nonresident aliens will continue to be subject to U.S. gift taxes.

6. Expatriate American citizens: Subject the U.S. source income of expatriate citizens of the United States to income tax at regular U.S. rates and their U.S. estates to estate tax at regular U.S. rates, where they surrender their U.S. citizenship within 10 years preceding the taxable year in question unless the surrender was not tax motivated.

As a result of the proposed elimination of graduated rates, taken together with the proposed change in our estate tax as it applies to nonresident aliens, an American citizen who gives up his citizenship and moves to a foreign country would be able to very substantially reduce his U.S. estate and income tax liabilities.

While it may be doubted that there are many U.S. citizens who would be willing to give up their U.S. citizenship no matter how substantial the tax incentive, a tax incentive so great might lead some Americans to surrender their citizenship for the ultimate benefit of their families. Thus, it seems desirable, if progressive rates are eliminated for nonresident aliens and our estate tax on the estates of nonresident aliens is significantly reduced, that steps be taken to limit the tax advantages of alienage for our citizens.

The recommended legislation accomplishes this by providing that a nonresident alien who surrendered his U.S. citizenship within the preceding 10 years shall remain subject to tax at regular U.S. rates on all income derived from U.S. sources. A similar rule would apply for estate tax purposes to the U.S. estates of expatriate citizens of the United States. Thus, the U.S. property owned by expatriates would be taxed at the estate tax rates applicable to our citizens (but without the $60,000 exemption, marital deduction and other such provisions applicable to our citizens), in cases where the alien decedent's surrender of citizenship took place less than 10 years before the day of his death. The $30,000 exemption granted nonresident aliens would be allowed to expatriate citizens.

To prevent an expatriate from avoiding regular U.S. rates on his U.S. income by transferring his U.S. property to a foreign corporation, or disposing of it overseas, the recommended legislation treats profits from the sale or exchange of U.S. property by an expatriate as being U.S. source income. To preclude the use of a foreign corporation by an expatriate to hold his U.S. property and thus avoid U.S. estate taxes at regular U.S. rates, an expatriate is treated as owning his pro rata share of the U.S. property held by any foreign corporation in which he alone owns a 10 percent interest and which he, together with related parties, controls. Furthermore, the recommended legislation makes gifts by expatriates of intangibles situated in the United States subject to gift tax.

These provisions would be applicable only to expatriates who surrendered their citizenship after March 8, 1965, and would not apply if contravened by the provisions of a tax convention with a foreign country. Moreover, they would not be applicable if the expatriate can establish that the avoidance of U.S. tax was not a principal reason for his surrender of citizenship.

7. Retaining treaty bargaining position: Provide that the President be given authority to eliminate with respect to a particular foreign country any liberalizing changes which have been enacted, if he finds that the country concerned has not acted to provide reciprocal concessions for our citizens after being requested to do so by the United States.

One difficulty which may arise from the liberalizing changes being proposed in U.S. tax law is that it may place the United States at a disadvantage in negotiating concessions for Americans abroad as respects foreign tax laws. Moreover, the failure to obtain concessions abroad may have an effect upon our revenues since the foreign income and estate tax credits we grant our citizens mean that the United States bears a large share of the burden of foreign taxation of U.S. citizens. To protect the bargaining power of the United States the President should therefore be authorized to reapply present law to the residents of any foreign country which he finds has not acted (when requested by the United States to do so, as in treaty negotiations) to provide for our citizens as respects their U.S. income or estates substantially the same benefits as those enjoyed by its citizens as a result of the proposed legislative changes. The provisions reapplied would be limited to the area or areas where our citizens were disadvantaged. Furthermore, the provisions reapplied could be partly mitigated, if that were desirable, by treaty with the other country.

It is essential, if we are to revise our system of taxing nonresident aliens as is being suggested, that this recommendation be adopted. Otherwise, we risk sacrificing the interests of our citizens subject to tax abroad and reducing our revenues in an effort to simplify the taxes imposed upon nonresident aliens.

8. Quarterly payment of withheld taxes: Provide that withholding agents collecting taxes from amounts paid to nonresident aliens be required to remit such taxes on a quarterly basis.

Under the present system, withholding agents are required to remit taxes withheld on aliens during any calendar year on or before March 15 after the close of such year. This procedure varies considerably from that applicable to domestic income tax withheld from wages and employee and employer FICA taxes, where quarterly (in some cases monthly) payments are required.

Withholding on income derived by nonresident aliens should be brought more closely into line wtih the domestic income tax system. There is no reason to permit withholding agents to keep nonresident aliens' taxes for periods which may exceed

a full year before being required to remit those taxes, when employers must remit taxes withheld on domestic wages at least quarterly. The Government loses the use of the revenue, which revenue in 1962 exceeded $80 million, for the entire year. Accordingly, section 1461 requiring the return and payment of taxes withheld on aliens by March 15 should be revised to eliminate this specific requirement. The Secretary or his delegate would then exercise the general authority granted him under sections 6011 and 6071 and require withholding agents to return and remit taxes withheld on income derived by nonresident aliens quarterly. However, no detailed quarterly return would be required.

9. Exemption for bank deposits: Under present law, an exemption from income taxes, withholding, and estate taxes is provided for bank deposits of nonresident alien individuals not doing business in the United States. By administrative interpretation, deposits in some savings and loan associations are treated as bank deposits for purposes of these exemptions, but such exemptions do not apply to most savings and loan associations. There does not appear to be any justification for this distinction between types of savings and loan associations and it should be eliminated by extending these exemptions to all such associations.

10. Foreign tax credit—similar credit requirement: Section 901(b)(3) provides that resident aliens are entitled to a foreign tax credit only if their native country allows a similar credit to our citizens residing in that country. Apparently the provision is designed to encourage foreign countries to grant similar credits to our citizens. However, this requirement works a hardship on refugees from totalitarian governments. For example, the Castro government is not concerned with whether Cubans in this country receive a foreign tax credit. Therefore, it is recommended that the similar credit requirement of section 901(b)(3) be eliminated, subject to reinstatement by the President where the foreign country, upon request, refuses to provide a similar credit for U.S. citizens. Of course, no request would ordinarily be made in a case, such as Cuba, where the possible reinstatement of the present reciprocity requirement would have little or no effect upon the foreign government's policy toward U.S. citizens.

11. Stamp taxes on original issuances and transfers of foreign stocks and bonds in the United States to foreign purchasers: Our stamp tax on certificates of indebtedness is imposed on issuances and transfers within the territorial jurisdiction of the United States. The stamp tax on issuances of stock does not apply to stock issued by a foreign corporation, but the transfer tax applies to transfers in the United States. These taxes have forced U.S. underwriters who handle issuances of foreign bonds and stocks and their original distribution to foreign purchasers to handle closings overseas. In view of the limited association of such issuances and transfers with the United States and the fact that these taxes are ordinarily avoided by moving the transactions outside the United States, our law should be revised to exempt original offerings of foreign issuers to foreign purchasers from our stamp taxes where only the issuances and transfers take place in the United States. Such an exemption would facilitate such transactions and their handling by U.S. underwriters and is consistent with our balance-of-payments objectives.

[*P. 4264*]

12. Withholding taxes on savings bond interest: The Ryukyu Islands, the principal island of which is Okinawa, and the Trust Territory of the Pacific, principally the Caroline, Marshall, and Mariana Islands, although under the protection and control of the United States, are technically foreign territory. Thus, the islanders are nonresident aliens and subject to a 30-percent withholding tax on interest on U.S. savings bonds. This interferes with the selling of U.S. savings bonds. Therefore, the 30-percent withholding tax as it applies to the interest income realized from U.S. savings bonds by native residents of these islands should be eliminated.

It addition to the changes discussed above, the proposed legislation makes a number of clarifying and conforming changes to present law.

SECTION 4

PRESS RELEASE OF THE COMMITTEE ON WAYS AND MEANS DATED JUNE 18, 1965, ANNOUNCING INVITATION FOR INTERESTED PERSONS TO SUBMIT WRITTEN STATEMENTS ON H.R. 5916 THE ACT TO REMOVE TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES

(See Section 7 of this document, page 144)

SECTION 5

PRESS RELEASE OF THE COMMITTEE ON WAYS AND MEANS DATED JUNE 24, 1965, ANNOUNCING PUBLIC HEARINGS ON H.R. 5916

(See Section 7 of this document, page 145)

SECTION 6

REPORT TO THE PRESIDENT OF THE UNITED STATES FROM THE TASK FORCE ON PROMOTING INCREASED FOREIGN INVESTMENT IN UNITED STATES CORPORATE SECURITIES AND INCREASED FOREIGN FINANCING FOR UNITED STATES CORPORATIONS OPERATING ABROAD

(FOWLER TASK FORCE)

71-297 O-67-pt. 1—6

Report to the President of the United States

FROM THE TASK FORCE ON

Promoting Increased Foreign Investment

In United States Corporate Securities

AND

Increased Foreign Financing

For United States Corporations

Operating Abroad

CONTENTS

TERMS OF REFERENCE

As one of 10 actions in his program to reduce the deficit in the U.S. balance of payments and defend U.S. gold reserves, President Kennedy, on October 2, 1963, appointed this Task Force and charged it with developing programs in the three following areas:

(1) A broad and intensive effort by the U.S. financial community to market securities of U.S. private companies to foreign investors, and to increase the availability of foreign financing for U.S. business operating abroad;

(2) A review of U.S. Government and private activities which adversely affect foreign purchases of the securities of U.S. private companies; and

(3) The identification and critical appraisal of the legal, administrative, and institutional restrictions remaining in the capital markets of other industrial nations of the free world which prevent the purchase of U.S. securities and hamper U.S. companies in financing their operations abroad from non-U.S. sources.

In December 1963, President Johnson reaffirmed President Kennedy's charge to the Task Force and asked that its report be submitted to him.

LETTER OF TRANSMITTAL

APRIL 27, 1964.

DEAR MR. PRESIDENT:

As charged by President Kennedy and reaffirmed by you, we have examined ways and means of promoting increased foreign investment in the securities of U.S. private companies and increased foreign financing for U.S. business operating abroad.

Herewith we submit our views as to the nature of the problems, the obstacles to be surmounted, and our recommendations for actions by the private sector and the Government. We have endeavored to limit our recommendations to measures which we believe can produce tangible results within at least the medium term.

It should be recognized that no single recommendation of ours can be expected to have a sudden or dramatic effect on the balance of payments. Carrying out our recommendations will require a broad range of actions by U.S. international business organizations and U.S. financial firms, the executive branch of the Government and the Congress. Efforts by the United States to attract and retain foreign investment can succeed, we believe, only if they occur within a framework of sound U.S. fiscal and monetary policies.

Confident that the programs which we recommend can contribute to reducing the deficit in our international transactions, we pledge our own best efforts toward achieving their success.

Very respectfully yours,

HENRY H. FOWLER,
Chairman.
ROBERT M. MCKINNEY,
Executive Officer.
CHARLES A. COOMBS.
FREDRICK M. EATON.
G. KEITH FUNSTON.
GEORGE F. JAMES.
GEORGE J. LENESS.
ANDRE MEYER.
DORSEY RICHARDSON.
ARTHUR K. WATSON.
WALTER B. WRISTON.
JOHN M. YOUNG.
RALPH A. YOUNG.

THE PRESIDENT,
The White House.

I. Introduction

The magnitude and persistence of past U.S. balance-of-payments deficits, accompanied by large gold losses, have been of increasing concern both to the public and private sectors of our country. This situation, if allowed to continue indefinitely, would endanger our international financial position. During the past 9 months there has been an improvement in our balance of payments. Since some of this improvement may be only temporary, the importance of dealing with the basic factors involved in the problem is in no way diminished.

Significantly, our balance-of-payments deficit does not arise because of any general inability to compete in international markets. Indeed, we have had a large export surplus of commercial goods and services. However, this surplus, which includes the current return from U.S. foreign investments, has not been large enough to offset our Government expenditures abroad for defense and for economic aid, together with our outflow of new private capital.

That our exports of capital—especially in the form of long-term investment—have been on a large scale is natural. The U.S. economy generates a large volume of savings. No other country has a comparable capacity to supply capital both at home and abroad. As a result, the United States has supplied much of the free world demand for capital throughout the postwar period. Returns from these investments, already a major favorable element in our balance of payments, will be even more important in the future.

Nevertheless, concentrated outflows of private capital can create severe difficulties, even for a country with the financial strength of the United States. Difficulties arise particularly when such capital movements occur at a time when the dollar is already under pressure for other reasons. The United States experienced such a combination of conditions in 1962 and early 1963. This created a situation which—had it been permitted to continue unchecked—could have imperiled the stability of the dollar and, hence, of the international monetary system.

These conditions led to a series of actions by the U.S. Government in July 1963. This program included measures to: (1) raise short-term interest rates, (2) reduce further Government expenditures overseas, (3) expand commercial exports, (4) increase foreign tourism in the United States, and (5) finance the balance-of-pay-

ments deficit in ways that result in a minimum drain on our gold stock. In addition, the President requested congressional approval of the proposed interest equalization tax on purchases of foreign securities by U.S. residents, designed as a temporary expedient to stem the accelerating outflow of private capital into foreign portfolio investments. In his message presenting this program, President Kennedy announced his decision to create this Task Force and set forth its terms of reference.

In carrying out its assignment, the Task Force called for advice and assistance from major segments of the U.S. industrial and financial communities. The counsel received from representatives of investment banking and brokerage firms, securities exchanges, investment companies, commercial banks and industrial corporations has contributed greatly to the effectiveness and realism of the Task Force's deliberations.

The purpose of our report is to set forth actions which we recommend be taken by the U.S. private sector and the U.S. Government, designed—

1. To improve the U.S. balance of international payments by increasing foreign investment in U.S. corporate securities;
2. To guide U.S.-based international corporations into making increased use of the pools of savings now accumulating in industrial nations in which they do business; and
3. To help establish conditions under which restraining influences on capital flows between the industrially advanced countries—including the proposed U.S. interest equalization tax—can be removed, diminished or allowed to expire.

Because of the favorable prospects for the U.S. economy, some of the savings accumulated in other industrial countries are flowing here for investment. It is not unreasonable to expect that this flow could be increased, particularly if U.S. taxation of foreign investors and other inhibiting factors were alleviated and our private selling efforts reinforced.

The incentives and influences governing international capital flows are, however, complex and not wholly predictable. Habits and fears derived from a lifetime of experience with wars, inflation, depressions, and crises are at least as important in influencing investment decisions as are the day-to-day movements of security prices, dividend rates and economic indicators.

Against this background, the main concern of the Task Force has been to satisfy itself that its recommendations will operate in the right direction, and as promptly as possible.

The findings and recommendations of this report are directed to four main areas:

First, the U.S. financial community; that is, investment banking and brokerage firms, commercial banks, investment companies and securities exchanges.

Second, U.S. industrial corporations with substantial operations overseas.

Third, U.S. taxation of foreign investors in U.S. securities and the clarification of questions which have arisen in connection with the administration of Federal securities laws.

Fourth, the reduction—or elimination, where circumstances permit—of monetary, legal, administrative and institutional restrictions abroad which inhibit investment by foreigners in the securities of U.S. corporations and which hamper U.S. companies in financing their oversea operations from foreign sources.

II. Actions Involving the U.S. Financial Community

This section of the report presents our views as to measures which the U.S. securities industry—brokers, dealers, investment bankers, securities exchanges, and investment companies—and commercial banks, in cooperation with U.S. corporations whose shares are publicly held, can take to increase the ownership of U.S. corporate securities by investors in the other industrial nations of the free world.

Direct ownership of equity securities by the public is not nearly so broad in other countries as in the United States. Foreigners owning U.S. securities tend to be wealthy, sophisticated investors. In most countries facilities for serving a broad investing public have not been developed as intensively as in the United States. Most investors abroad encounter difficulty in obtaining information about companies and securities. Securities transactions are generally handled through banks, which make little or no effort to encourage equity investment by customers with small accounts. Indirect ownership of equities through institutions, such as pension and insurance funds, is at a less-developed stage abroad than in the United States; moreover, the number and size of such institutions are considerably smaller than in the United States. Despite these circumstances, we believe foreign purchases of U.S. securities can be significantly expanded.

Our recommendations here are concerned with (1) selling U.S. corporate securities abroad, (2) adapting U.S. corporate securities to foreign markets, (3) selling U.S. investment company shares abroad, (4) providing information to foreign investors, and (5) attracting foreign bank deposits.

Selling U.S. Corporate Securities Abroad

Recommendation No. 1:

U.S. investment bankers and brokerage firms should intensify their efforts to develop facilities for reaching foreign investors directly.

Recommendation No. 2:

U.S. investment bankers and brokerage firms should seek modification of foreign regulations and practices which unduly restrict the ability

of U.S. firms to promote the sale of U.S. securities or to deal directly with potential foreign customers.

Foreigners may buy U.S. corporate securities by: (1) placing orders with foreign banks or brokers, who in turn may either place the orders with U.S. firms for execution in the U.S. market or execute the orders on a foreign exchange or in the foreign over-the-counter market; or (2) placing orders directly with brokers in the United States or with their oversea offices for execution in the United States. However, not all of these channels are open in all countries.

Despite the recent growth in offices of U.S. brokerage firms abroad, sales efforts by U.S. brokers are hampered in most foreign countries by restrictions on advertising or direct approaches to potential investors. In some countries, U.S. brokerage firms are prohibited from soliciting securities business of any kind. In others they are permitted to deal only with banks.

Opportunities may exist to open new channels for dealing directly with the local investing public. Every effort should be made to find and utilize such opportunities, even though it may require modification of established practices or governmental regulations.

Recommendation No. 3:

U.S. investment bankers and brokerage firms, with the cooperation of interested U.S. corporations, should endeavor to obtain shares of U.S. corporations for distribution abroad.

In certain cases it may be possible for U.S. securities firms to obtain blocks of U.S. securities for distribution exclusively abroad. Distribution abroad may involve a greater amount of time and effort and, possibly, greater compensation to foreign broker-dealer firms than would distribution in the United States. However, as pointed out below, certain circumstances may be present which would significantly increase the attractiveness of exclusive oversea distribution.

One source of such blocks would be outstanding securities that would have to be registered with the Securities and Exchange Commission (SEC) if sold in the United States. However, because of the time and expense involved, or for other reasons, it may not be desirable to register such blocks. Holders of such securities might prefer to have U.S. securities firms undertake distribution abroad, and thus avoid the inconvenience and cost of registration with the Securities and Ex-

change Commission. U.S. corporations could cooperate by directing attention of large stockholders to the possible advantages of selling blocks in foreign markets.

Where the expenses can be justified by sound business purposes, interested U.S. corporations might be willing to absorb costs of distributing their shares abroad. In such circumstances, blocks of shares could be provided by two means: First, corporations wishing to raise additional capital could, where feasible, issue new shares for sale abroad. Second, corporations which consider it advantageous and practical to have increased foreign ownership of their shares, but which do not need new capital, might have blocks of their outstanding shares acquired in the open market for eventual redistribution abroad.

It would be shortsighted, however, to take advantage of lack of regulations in other countries comparable to those of the Securities and Exchange Commission in the United States. As long as adequate disclosures are made when issues are being offered abroad, there should be no need to go through the formality and expense of registration in the United States.

Recommendation No. 4:

The Securities and Exchange Commission should issue a release setting forth the circumstances under which it would normally issue a "no action" letter providing that no registration be required on public offerings of securities outside of the United States to foreign purchasers, including dealers.

The Securities and Exchange Commission heretofore has been helpful in issuing "no action" letters in individual cases when the facts permitted. If a general policy could be set forth, however, it would clarify the position of the Commission in this regard and facilitate the activities of U.S. investment bankers in foreign markets. It would also be helpful if such a policy statement indicated that (1) a simultaneous private placement of the same securities in the United States would not prevent the issuance of a "no action" letter, and (2) the sale could be conducted from and closed in the United States.

Recommendation No. 5:

The Securities and Exchange Commission should issue a release eliminating the require-

71-297 O-67-pt. 1—7

ment that foreign underwriters participating exclusively in distributions of securities to nonresidents of the U.S. register as broker-dealers.

Foreign securities dealers are often asked to participate in a U.S. underwriting or selling syndicate. Although the Securities and Exchange Commission has attempted on a case-by-case basis to free such foreign dealers from the necessity to register as broker-dealers, enough uncertainty remains to make this situation an impediment to the successful distribution of U.S. securities abroad. There should be no requirement for foreign brokers to register even though they may belong to an underwriting or selling group, other members of which are engaged in the distribution of the same securities in the United States.

Recommendation No. 6:

U.S. investment bankers should include foreign banks and securities firms as underwriters, whenever possible, or as selling group members in new offerings and secondary distributions of either domestic or foreign securities.

The inclusion of foreign banks and securities firms as members of the underwriting groups for domestic or foreign securities would directly involve them in the responsibility for the successful distribution of a portion of the offerings abroad.

Recommendation No. 7:

U.S. investment bankers and brokerage firms should organize the underwriting and distribution of dollar-denominated foreign securities issues so that the maximum possible amount is sold to investors abroad.

In the past several years, sales to foreigners of new securities issues underwritten in the United States have been primarily foreign government and foreign corporate bonds (including convertible debt securities) denominated in U.S. dollars. Since the proposal of the interest equalization tax, however, such issues in the U.S. capital market have been practically nonexistent. When final action has been taken on the tax and the market for newly issued foreign securities reopens, U.S. investment bankers should endeavor

to place the largest possible proportion of these securities abroad in order to minimize the impact on our balance of payments. (From the standpoint of the foreign borrower whose securities are subject to the interest equalization tax, this will reduce the amount of the issue subject to the tax.) Similar efforts should be made with respect to foreign securities offered in the U.S. market which are exempt from this tax.

Recommendation No. 8:

U.S. commercial banks should intensify efforts to attract foreign trust accounts for investment in U.S. corporate securities.

Typically, trust accounts of foreigners managed by U.S. commercial banks are invested in U.S. securities; thus their growth is a positive factor in our balance of payments. New trust accounts could be solicited by: (*a*) more intensive use of foreign branches for this purpose; (*b*) oversea sales visits by trust officers; and (*c*) establishment of oversea trust companies or related facilities.

Recommendation No. 9:

The Securities and Exchange Commission should serve as an information center regarding listing requirements, and distribution regulations and practices abroad.

The Securities and Exchange Commission has expressed to the Task Force its willingness to serve as a clearinghouse for information on relevant foreign securities laws and practices and on issuers' experiences in selling securities overseas.

Adapting U.S. Corporate Securities To Foreign Markets

Recommendation No. 10:

Major U.S. corporations should arrange for U.S. banks and trust companies to issue, through their foreign branches and correspondents, depositary receipts for U.S. corporate shares.

The Task Force believes that depositary receipts in bearer or registered form, which would be "good delivery" internationally, would be useful in facilitating foreign investment in U.S. cor-

porate securities. Trading of depositary receipts on foreign stock exchanges would be facilitated by having them (1) denominated in fractions of whole shares, thus bringing the unit prices closer to those customary in foreign markets, and (2) printed in the language of the country in which they are to be traded.

The costs of the depositary receipts now available to European investors are borne by the holders. Corporations whose securities are already available in depositary receipt form, or who wish to initiate depositary receipt arrangements, should consider absorbing some of the costs of the service. Some foreign corporations whose shares are traded in the United States in the form of American Depositary Receipts presently bear such costs.

Selling U.S. Investment Company Shares Abroad

Foreign holdings of U.S. investment company shares have shown a steady increase over the years. Initial foreign participation was primarily through purchase of shares of closed-end investment companies. A few of these have had, and continue to have, substantial foreign shareholders; some are listed on European stock exchanges. With the cooperation of the companies concerned, foreign interest in this medium for investment in the U.S. economy can be increased.

Since the foreign distribution of U.S. open-end investment company (mutual fund) shares is largely through banks and brokers, opportunities for direct solicitation by the issuers are limited. A few specialized U.S. sales organizations solicit foreign investors directly, primarily in countries without developed financial institutions.

Recommendation No. 11:

U.S. investment companies should plan and carry out a program to acquaint foreign investors with the advantages of owning U.S. closed-end investment company shares.

Recommendation No. 12:

Distributors of U.S. open-end investment company shares should devise methods for achieving additional foreign distribution of such shares, where locally permitted.

Recommendation No. 13:

U.S. investment company distributors should seek the modification of foreign regulations and practices which restrict the availability of their shares to foreign investors.

Recommendation No. 14:

U.S. closed-end investment companies should seek to place original and secondary offerings of their shares with foreign investors and, where feasible, list these shares on major foreign exchanges.

The Investment Company Institute has agreed to inform its member companies of the objectives of this Task Force, suggesting that they undertake more active study of foreign distribution opportunities. Some foreign banks and securities dealers on which U.S. investment companies depend for distribution offer shares of their own investment companies. Nevertheless, there are banks and other potential distributors in Europe and elsewhere who do not have competitive issues to offer. More aggressive search for such distributors would undoubtedly develop additional sales.

In addition, the Institute is studying the feasibility of a detailed country-by-country review of legal, tax, and registration requirements to assist the educational and promotional efforts of U.S. mutual fund sponsors. It is also considering translation into foreign languages of basic materials describing investment companies.

Providing Information to Foreign Investors

The flow of information on securities markets and individual corporations which the U.S. public receives as a matter of course from the press, radio, brokerage firms, advisory services, and directly from companies is unique. Abroad, comparable information is not readily available. Thus information disclosed by publicly owned U.S. corporations is one of our most effective potential aids as we seek to channel a growing share of foreign savings into U.S. investments.

Recommendation No. 15:

In order to promote the purchase of U.S. corporate securities abroad—

(*a*) the U.S. financial community should cooperate closely with major U.S. corporations in the dissemination of corporate reports in foreign languages and in the publication of financial data in foreign newspapers;

(*b*) U.S. investment bankers and brokerage firms should prepare research and statistical reports in foreign languages for distribution to foreign investors through local banks and secu-

rities firms and promote the publication of more detailed U.S. stock market and financial information in the foreign press;

(*c*) facilities of U.S. commercial banks should be fully utilized to distribute to foreign financial institutions and investors reports, preferably in foreign languages, on the U.S. economy;

(*d*) U.S. securities exchanges should take advantage of new communication techniques and reduced rates to promote broader use abroad of stock quotation and financial news services;

(*e*) U.S. investment bankers and brokerage firms should offer securities orientation and sales training programs to personnel of foreign banks and securities firms; and

(*f*) U.S. investment bankers, brokerage firms and securities exchanges should work with their foreign counterparts and the foreign press to broaden share ownership by foreign investors.

Some U.S.-based international companies already publish reports in foreign languages. Distribution of reports directly to investors abroad is more difficult than in the United States, however, and is complicated by the predominant foreign practice of not registering shares in the names of beneficial owners. Consequently, it is necessary for such companies to work closely with foreign banks to insure that their reports reach the actual shareowners. Companies also should take particular care to include the foreign news services and the foreign press in news distributions.

U.S. securities firms are an important channel abroad for market information on U.S. securities. But since local regulations or traditions limit their ability to reach the public directly in many countries, U.S. firms now concentrate their efforts on supplying material to foreign banks and brokers. Still missing, however, is a means for providing broader circulation of U.S. market news to the general public abroad. To fill the requirement, U.S. securities firms with foreign offices should supply local newspapers with abridged tables of prices of U.S. securities converted to local currencies. They should ascertain and provide the type of daily market news foreign papers will publish.

U.S. commercial banks now do a thorough job of keeping U.S. firms informed of financial conditions abroad. Beyond this, they

should intensify their efforts to acquaint foreigners with the general desirability of investing in the United States.

The full stock ticker service, which until now has been prohibitively expensive outside the United States and Canada, is making its appearance overseas. Because up-to-the-minute price information is a necessary brokerage service, this should encourage foreign investment in U.S. securities.

Personnel of foreign banks and brokerage firms who deal directly with ultimate purchasers abroad often have little knowledge of U.S. securities or U.S. market procedures. Representatives of U.S. international securities firms should consider offering such personnel condensed versions of the training given registered representatives in the United States.

Educational programs designed to broaden share ownership would be advantageous to all industrialized countries. Here the U.S. securities industry can play a constructive role, both directly and by assisting their foreign counterparts in devising and conducting their own information programs.

Attracting Foreign Deposits in U.S. Banks

Recommendation No. 16:

The Congress should adopt legislation discontinuing mandatory regulation of maximum interest rates on domestic and foreign time deposits.

Recommendation No. 17:

Pending adoption of such legislation, the Federal Reserve Board of Governors should administer Regulation Q in a flexible manner permitting U.S. commercial banks to meet internationally competitive interest rates on both domestic and foreign time deposits.

Foreign time deposits with maturities exceeding 1 year in U.S. banks are similar to foreign purchases of long-term securities in their effect on the U.S. balance of payments. Encouraging such deposits thus is clearly within the terms of reference of the Task Force.

While an increase in short-term deposits in the United States by foreigners would not reduce the U.S. payments deficit as customarily defined, it would tend, at least temporarily, to reduce the volume of liquid dollar assets that foreign central banks might use to buy gold.

Similarly, greater short-term investment in this country by U.S. residents and corporations who would otherwise place their funds abroad would directly reduce the U.S. payments deficit.

The growth in time deposits in U.S. banks in recent years has reflected increases in rates paid on such deposits, following increases in the maximum rates under regulations of the Federal Reserve Board of Governors and the Federal Deposit Insurance Corporation. Foreign official time deposits have likewise risen substantially since their exemption from regulation in October 1962.

The objective of increasing commercial banks' ability to compete for foreign time deposits could be enhanced either (1) by legislation completely abolishing the power of the Board of Governors of the Federal Reserve System to regulate maximum interest rates on time deposits, or (2) by placing that authority on a standby basis, as the present administration has proposed. Members of the Task Force are divided in their opinion as to which of these alternatives should be used to achieve this objective; hence no recommendation as between these alternatives is made.

III. Actions Involving U.S.-Based International Corporations

Dividends, interest, and other receipts from existing U.S. direct investments abroad have, in recent years, been about twice as large as our new direct investment outlays in foreign countries. It is clear, therefore, that foreign operations of U.S.-based international corporations are already making an important positive contribution to the U.S. balance of payments. Nevertheless, for limited periods of time and with respect to certain areas of the world, our outflows of capital can exceed our receipts from those areas. Hence, it is also clear that programs designed to (1) increase foreign ownership of the shares of U.S. corporations and (2) maximize the use of foreign sources of finance can increase the overall positive contribution which U.S.-based international corporations make to the U.S. balance of payments.

We set forth below specific programs we believe will be of interest to managements of international corporations based in the United States. These programs are not presented as detailed prescriptions for action, since the complexity of the subject matter makes that impossible. Rather, they are suggested as general procedures which might prove feasible under certain circumstances.

Increasing Foreign Ownership of the Securities of U.S. Corporations

Increasing foreign ownership of the securities of U.S. corporations will require initiatives by both the U.S. private and public sectors. In section II we have discussed actions by brokerage and investment banking firms, investment companies, commercial banks, and the securities exchanges. In this section we take up actions by the corporations themselves.

Recommendation No. 18:

U.S.-based international corporations should consider the advantages of increased local ownership of their parent company shares in countries in which they have affiliates.

Recommendation No. 19:

Where consideration under Recommendation No. 18 above is favorable, corporations should collaborate with the U.S. financial community in encouraging greater foreign ownership of their shares.

In addition to the balance-of-payments impact, there is yet another dimension to the role of free world international corporations, wherever based. Through their plants, distribution facilities and other business operations, strong local relationships have been developed to encourage and support their growth. These relations would be further strengthened if they were extended to include that of corporation to stockholder.

Recommendation No. 20:

U.S. securities exchanges should submit a plan acceptable to the Securities and Exchange Commission permitting U.S.-based international corporations to encourage foreign ownership of their stock.

Under this plan, which would be publicly announced and open to all brokers, a corporation would be permitted to pay whatever compensation is necessary to achieve distribution of its securities abroad. The broker receiving the compensation would be permitted to pay all or part of such compensation to the employee or foreign broker producing the order. Once initiated, such a plan would continue until terminated by the corporation.

Recommendation No. 21:

The Treasury Department should issue a ruling that would establish the tax deductibility of costs incurred by U.S. corporations in arranging for securities firms to place their securities outside the United States as part of programs to improve their oversea relationships.

The Task Force recognizes that any plan undertaken by a corporation to distribute its shares abroad would involve certain costs. However, in many cases, the good will which would be created by corporations having a substantial number of shareholders in other countries where they do business might be considered to justify the costs. Since many U.S. corporations have already adopted programs in the nature

of institutional advertising, designed to improve their oversea relationships, it would appear that any expenses incurred in encouraging securities firms to place stock overseas as a part of these programs should be appropriate deductions from taxable income as ordinary and necessary business expenses.

Recommendation No. 22:

Corporations should collaborate with U.S. investment bankers in the utilization by the latter of techniques for distribution abroad of new or secondary issues of their stock.

Some corporations may find that there are advantages in having blocks of their stock sold abroad. U.S. investment bankers can suggest a variety of means by which such blocks can be made available for distribution abroad. The cooperation of the U.S. corporations involved is essential to the success of such a distribution.

Recommendation No. 23:

U.S. corporations should offer their shares to employees in foreign countries where stock purchase, supplemental compensation or other incentive plans are feasible and desirable.

Many U.S. corporations encourage employee ownership of parent company shares; some offer financial incentives to promote such ownership by their oversea employees. Most countries permit such plans, although some restrict purchase of foreign shares by their nationals. Where savings plans for foreign employees are currently in force or are under consideration, parent company stock could form an important feature of such plans, subject, of course, to local regulations. Funded pension plans of foreign affiliates may also offer scope for greater investment in U.S. securities.

Many foreign nationals employed by U.S. companies abroad may be unfamiliar with shares but may have had experience with interest-paying investments. Hence, convertible bonds of the parent companies or of their subsidiaries would be in some cases attractive instruments for employee savings plans.

Recommendation No. 24:

U.S.-based international corporations should consider the advantages of listing their shares on foreign stock exchanges.

Many large U.S. corporations are not listed on foreign stock exchanges; other U.S. companies are listed on exchanges of some countries but not on others. Although most foreign trading in listed U.S. corporate securities will probably continue to take place on exchanges in New York, listing of such securities on foreign securities exchanges should stimulate their purchase by foreigners. Financial and other information regarding U.S. corporate issuers derived from listing applications and reporting requirements would be disseminated abroad in local languages. Also, listing would assist in creating local markets for such securities, an important consideration in connection with local public offerings or large private placements of securities.

After initial holdings of their stock abroad have been established, U.S.-based international corporations should make every effort to insure adequate continuing local markets for the shares.

Maximizing the Use of Foreign Sources of Debt Financing

Foreign debt financing raises fewer policy issues for U.S. corporations with foreign subsidiaries than does the issuance and sale of equity securities. The primary factors to be considered are the relative availability of loan funds, the costs of such financing considered in conjunction with exchange risks, and the basic characteristics of local sources of finance.

Many countries strictly limit access to their capital markets by all borrowers. They also limit the amount of credit even if access is gained. It should be emphasized, however, that these limitations are less severe with respect to local companies, even though they may be affiliates of U.S. parent corporations.

Generally speaking, the level of interest rates and other financing costs tend to be higher abroad. These costs and other limitations have been of greater importance in long-term debt issues than in short- and medium-term financing from banks and other financial institutions. Accordingly, many oversea subsidiaries have relied on short-term financing to a greater degree than would be considered sound financial practice in domestic operations.

Such short-term loans are actively sought by foreign banks and foreign affiliates of U.S. banks, within the limits of available funds and local government policies. These banking connections have become important sources of local influence and information for U.S. business firms operating abroad. Consequently, they are often relied on even where costs may be somewhat higher than for other sources of financing.

In this connection, the Task Force notes that the ability of oversea branches and affiliates of U.S. banks to provide foreign debt financing is enhanced by making Public Law 480 and other counter-

part funds available to such branches and affiliates. This practice, already of long standing, should be encouraged to the greatest extent feasible consistent with other objectives of the program, where possible placing such funds on a long-term basis and thereby facilitating badly needed capital loans.

Recommendation No. 25:

U.S.-based international corporations should instruct their senior officers and policy groups to keep foreign financial operations under constant review, examining as standard procedure all proposals for new financing from the standpoint of the effect of their actions on the U.S. balance of payments.

With achievement of a high degree of convertibility and the diminution of exchange risks, the incentives for maximizing foreign sources of financing are not as strong as several years ago. Nevertheless, we believe that the introduction of U.S. balance-of-payments considerations into all corporate financial decisions could do much to increase corporate borrowing abroad.

All corporations operating abroad, as a matter of routine, rely on normal trade credits, accrued tax liabilities, and other sources of working capital not involving borrowing. These sources are significant and opportunities for further expansion should be actively sought.

Recommendation No. 26:

U.S.-based international corporations should, where feasible, finance their foreign operations in a manner which minimizes the outlay of cash.

The use of securities where foreign properties are being acquired improves the balance of payments to the extent that it reduces the immediate outflow of cash funds from the United States or avoids the use of funds which otherwise might be remitted to the United States. Many governments actively solicit the establishment of foreign firms in developing regions. Special inducements are offered, such as low rentals for new plant facilities, tax advantages, and attractive local financing. By taking advantage of these opportunities, U.S. companies planning to produce abroad can reduce the need for capital funds from the United States.

U.S. corporations investing overseas should examine the possibility of utilizing foreign currency loans (the so-called "Cooley Loans") made available in certain countries by the U.S. Govern-

ment out of receipts from the sale of surplus agricultural commodities under Public Law 480.

Recommendation No. 27:

In cases where new capital is required, U.S.-based international corporations should consider, in appropriate cases, broadening local ownership by offering in foreign capital markets bonds or preferred stock of their local affiliates convertible into common shares of the U.S. parent corporation.

Convertible securities should appeal to foreign investors because they can be designed to provide—in addition to conversion privileges—the interest rate, maturity, sinking fund, redemption, and other provisions conforming to the local markets' requirements. Whether converted or not, and whether issued in dollar denominations or in the currency of a foreign country, the sale of such securities would reduce the amount of direct dollar investment by U.S. parent companies. As the issuer of the securities would be a foreign subsidiary, a foreign purchaser would be free of U.S. tax on the dividends or interest payments, although shares issued on conversion would be those of the U.S. parent.

Recommendation No. 28:

U.S.-based international corporations should be encouraged to make available, through trade or banking channels, specific case studies of foreign financing operations to small- or medium-sized U.S. firms interested in foreign operations but less aware of foreign financing opportunities.

As we have seen, commercial banks and agencies of foreign governments provide U.S. firms with information on foreign financing. Industrial corporations and trade associations through well-organized programs could supplement this information by providing special information for U.S. firms planning to operate abroad. Specific case studies of foreign financing operations of individual industrial corporations could be distributed by the corporations themselves or by business schools and business and financial organizations. Such studies would also be appropriate for seminars in schools of business administration. They would be invaluable to small- and medium-sized corporations which may be less aware of the opportunities for foreign financing and its implications for the U.S. balance-of-payments problem.

IV. Actions Involving the U.S. Government

Efforts by the private business community to market U.S. corporate securities to foreign investors and to increase the availability of foreign financing for U.S. corporations operating abroad should be accompanied by U.S. Government efforts to reduce existing deterrents to these activities which arise from practices, regulations, and law here and abroad.

Preceding sections of this report have referred to specific areas where the modification of U.S. laws and Government practices—as administered by the Treasury Department, the Securities and Exchange Commission, and the Federal Reserve Board—would facilitate private programs. In this section, we recommend revision of U.S. taxation of foreign investors in U.S. securities. The Task Force wishes to stress that no tax concessions to U.S. corporations or individuals are recommended. Our recommendations here relate solely to the removal or reduction of obstacles to foreign investment in U.S. securities.

The U.S. Government should take appropriate action where monetary, legal, administrative, and institutional restrictions in other countries inhibit the purchase of U.S. corporate securities by foreign investors and hamper U.S. companies in financing their oversea operations from foreign sources. Primarily, this will involve diplomatic initiatives, either bilaterally or multilaterally. This section will also identify foreign governmental restraints and practices to which diplomatic initiatives should be addressed.

As might be expected, views held by various members of the Task Force reflect the division of opinion over the desirability of the interest equalization tax, fully developed in hearings before the House Ways and Means Committee. It does not seem necessary to review these differences here; nevertheless, nothing said or unsaid in this report is intended to represent any departure from the views individual members may continue to hold on this subject.

Revising U.S. Taxation of Foreign Investors

Revision of U.S. taxation of foreign investors is one of the most immediate and productive ways to increase the flow of foreign capital to this country.

Our recommendations for changes in taxation of foreign investors are intended to remove a number of elements in our tax structure which unnecessarily complicate and inhibit investment in U.S. corporate securities without generating material tax revenues. They are not intended to turn the United States into a tax haven, nor to drain funds from developing countries.

Basic Provisions in Internal Revenue Code for Taxation of Nonresident Alien Individuals and Foreign Corporations

Except as provided in tax treaties with certain countries, nonresident alien individuals not engaged in trade or business in the United States are taxed at a minimum of 30 percent on (*a*) dividends, interest, and other periodic income from U.S. sources, and (*b*) capital gains in the United States under the circumstances specified below. This 30-percent tax is applied against gross income and is withheld at the source, except in the case of taxable capital gains and other minor exceptions. If such gross income from U.S. sources in any year exceeds $19,000,[1] nonresident alien individuals are required to compute the tax on their U.S. source net income at regular rates if this method of computation yields a higher total tax than the minimum 30 percent tax on gross income. Nonresident alien individuals engaged in trade or business within the United States are, in general, subject to tax on all their U.S. source income, including capital gains (whether or not derived from the conduct of such trade or business) on the same basis and at the same rates as U.S. citizens.

Nonresident alien individuals not engaged in trade or business in the United States are taxed, at rates specified above, on capital gains realized in the United States if they are (*a*) physically present in the United States for 90 days or more during a taxable year, or (*b*) physically present in the United States when the gain is realized.

The U.S. property of nonresident alien decedents (which by definition includes shares of U.S. corporations) is subject to U.S. estate tax at normal rates.

Foreign corporations engaged in trade or business in the United States are taxed on all of their U.S. source income, whether or not derived from the conduct of such trade or business, on the same basis and at the same rates as domestic corporations. Foreign corporations not engaged in trade or business within the United States are taxed at a flat rate of 30 percent on the gross amount of dividends, interest, and other periodic income received from U.S. sources, but are not taxed on capital gains.

In addition, any foreign corporation meeting the personal holding company tests is subject, with certain exceptions, to a

[1] $21,200 in 1965 and thereafter.

tax of 70 percent on its undistributed personal holding company income. Moreover, if any such corporation derived more than 50 percent of its gross income for a 3-year period from U.S. sources, that percentage of its dividends equal to the percentage of its gross income derived from U.S. sources is treated as U.S. source income to the shareholders themselves and taxed accordingly.

Reciprocal tax treaties in effect with most of the industrialized countries of the world modify the basic provisions of the Internal Revenue Code which are summarized above. Most of the treaties reduce the rate of withholding tax on dividends and interest paid to residents (both individuals and corporations) of the treaty country. Typically the rate is reduced from 30 percent to 15 percent on dividends and from 30 percent to 15 percent, or in some cases zero, on interest. The provisions for progressive taxation of individuals whose income from U.S. sources in any year exceeds $19,000 generally are eliminated. Certain treaties eliminate capital gains tax liability. Most of the benefits available to foreign investors under the treaties are restricted to residents of the treaty country who are not engaged in trade or business within the United States through a permament establishment.

Specific Recommendations

Our recommendations have been conceived as a package, designed in part to simplify the tax laws and reporting requirements applicable to foreign investors, in part to reduce taxation of foreign investors and in part to make evident to the world that the United States welcomes foreign investment. To the degree that the package approach is discarded and the package is broken down into its components, some being accepted and other rejected, more of the potential impact will be lost than might necessarily be expected by analysis of the financial effect of any particular proposal.

The major source of U.S. tax revenue from foreign investors is the withholding tax currently imposed on dividends and interest paid such investors by U.S. corporations. We have not recommended the removal of, or a reduction in, this tax. Thus adoption of our recommendations would not materially reduce tax revenues and would leave intact the major bargaining point for the United States should it desire in the future to negotiate new or modified reciprocal tax treaties with other countries.

The withholding tax on dividends and interest, in some cases, certainly deters investment by foreigners in the United States, and the different rates of withholding tax provided by the Code and the various treaties are a source of confusion. The United States should, however, first attempt to attract foreign investment by

attacking the several areas of taxation that deter investment without generating material revenues.

Adoption of our recommendations would not eliminate the need to extend and modernize our tax treaties. Among other desirable changes: the United States should work for the reciprocal reduction of withholding taxes on dividends and interest and toward reciprocal elimination of all taxes on the income of pension trusts and similar investors that are exempt from tax in their country of residence. Such changes will, however, take time.

Recommendation No. 29:

Eliminate U.S. estate taxes on all intangible personal property of nonresident alien decedents.

U.S. estate taxes, especially as applied to shares of U.S. corporations owned by nonresident alien decedents (which are subject to U.S. estate taxes irrespective of whether they are held in this country or abroad), are believed to be one of the most important deterrents in our tax laws to foreign investment in the United States. U.S. estate tax rates are materially in excess of those existing in many countries of the world and, despite the treaties in effect with several countries, the taxes paid on a nonresident alien decedent's estate, some portion of which is invested in the United States, generally would be greater than those paid on a nonresident alien decedent's estate, no portion of which is invested in the United States. We understand that the revenues received by the United States as a result of estate taxes levied on intangible personal property in estates of nonresident alien decedents are not large.

Under existing U.S. tax law, a foreigner willing to go through the expense and trouble of establishing a personal holding company, incorporated abroad, and assuring himself that this personnal holding company does not run afoul of the U.S. penalty taxes on undistributed personal holding company income, can already legally avoid estate taxes. Consequently, for such an investor U.S. estate taxes are avoidable through complicated and expensive procedures, while for other foreign investors they are likely to result in a considerable tax penalty. This is an unsound situation which directly deters foreign investment in the United States and significantly worsens the overall image of this country as a desirable place to invest.

Recommendation No. 30:

Eliminate (with respect to income not connected with the conduct of a trade or business) the provisions for progressive taxation of U.S. source income of nonresident alien individuals in excess of $19,000 and provide that no nonresident alien whose tax liability is fully satisfied by withholding shall be required to file returns.

The provision for progressive taxation of foreign investors and the companion requirement to file returns, in our opinion constitutes one of the major sources of confusion and misunderstanding for potential foreign investors in the United States. The revenues produced by this tax are understood to be negligible. Progressive taxation of foreign investors does not exist in many other industrialized countries of the world.

Treaties with most industrialized countries already eliminate the provision for progressive taxation of nonresident alien individuals who are residents of treaty countries. However, there are throughout the world vast sums of capital that have left their countries of origin. Typically, these funds are held in treaty countries by residents of nontreaty countries. If the provisions for progressive taxation of nonresident alien individuals were removed from the Code, the position of the United States in competing with other industrialized nations for such capital would be strengthened.

Furthermore, we must recognize that the actual fiscal impact of this, or any other, tax law on the persons to whom it applies does not measure the extent to which the law deters or limits potential investment by persons who are unwilling or unable to master its complexities. This is especially true when dealing with foreigners, whose familiarity with U.S. laws and practices is limited. Even those foreigners with substantial funds available for investment often find it troublesome and expensive to obtain sound U.S. tax advice, with the result that they channel their investments elsewhere.

Were the Internal Revenue Code amended to eliminate progressive taxation of nonresident alien individuals not engaged in trade or business within the United States, the entire U.S. tax liability of substantially all such aliens would automatically be fully satisfied by withholding at the source. These aliens would have no actual, or potential, additional tax liability and no returns

to file. There could be no confusion as to the applicability of our tax laws to them. This would be highly desirable.

Recommendation No. 31:

Eliminate the provision for taxation of capital gains realized by a nonresident alien individual when he is physically present in the United States; extend from 90 to 180 days during a taxable year the time that a nonresident alien individual may spend in the United States before becoming subject to tax on all capital gains realized by him during such year.

Many foreign countries do not tax capital gains, and the threat of such taxation in the United States, therefore, deters investment in the United States by foreigners. In principle, the United States already exempts from taxation capital gains realized by nonresident alien individuals and foreign corporations not engaged in trade or business in the United States. But this exemption is limited by the imposition of a tax on capital gains realized when a foreign individual is present in the United States and by the imposition of tax on all capital gains realized by a foreigner in any year during which he is present in the United States for 90 days or more. These limitations are sufficiently stringent and, in the case of the physical presence test, sufficiently illogical that they impair the basic concept that capital gains of nonresident alien investors are exempt from U.S. taxation. It is our understanding that the revenues stemming from capital gains taxation imposed as a result of these limitations are small.

The physical presence test would appear to have no practical justification and, although easily avoided, it poses a potential trap for the unwary, unsophisticated or uninformed investor. As such, it contributes to the feeling among foreign investors that investment in the United States is complicated and potentially hazardous from a tax standpoint. The 90-day test is, in our opinion, too short a period.

Eliminating the physical presence test entirely and extending the 90-day period to 180 days would, we believe, remove most of the present unfavorable impact of potential capital gains taxation.

Recommendation No. 32:

Provide that a nonresident alien individual engaged in trade or business within the United States be taxed at regular rates only on income connected with such trade or business.

There is obvious justification for taxing nonresident alien individuals at regular rates on earnings from a trade or business conducted within the United States. However, the logic of extending such taxation to the investment income of foreign investors is open to question. This provision certainly deters foreign businessmen operating in the United States from becoming investors in the United States, and may also deter foreigners already investing in the United States from commencing a trade or business here.

The problem posed by the present system of taxation may be particularly acute in the case of foreign investors owning and operating real estate (or having it operated for them). Such investors are deemed engaged in a trade or business, even though the real estate activities may be more in the nature of an investment than a business. Real estate investors of this type are often large potential investors in securities. To the extent that an investor is engaged in one of these two activities, he is to a great degree precluded from engaging in the other.

We recognize the administrative complications the Internal Revenue Service would face in segregating a foreign investor's activities along the lines discussed above. But we believe that this is an important part of the package of recommendations for attracting additional foreign investment and that an attempt should be made to resolve these difficulties.

Recommendation No. 33:

Amend the definition of personal holding companies appearing in the Internal Revenue Code so that foreign corporations owned entirely by nonresident alien individuals are excluded from the definition.

The penalty provisions of the personal holding company tax were designed to prevent the use of holding corporations as a device to

escape the graduated tax rates applicable to individuals. Elimination of progressive taxation on the nonbusiness income of nonresident alien individuals, therefore, would remove a basic reason for imposing penalty taxes on personal holding companies entirely owned by nonresident aliens. Such corporations are currently excluded from the definition of personal holding companies if less than 50 percent of their gross income is derived from U.S. sources. If the exclusion were broadened, as we have recommended, this would remove the substantial incentive existing under current law to limit the portion of such corporations' assets which is invested in the United States. This change would have no effect on the taxation of personal holding companies having U.S. shareholders.

Recommendation No. 34:

Clarify the definitions of engaging in trade or business to make it clear: (i) that a nonresident alien individual or foreign corporation investing in the United States will not be deemed engaged in trade or business because of activity in an investment account or by granting a discretionary investment power to a U.S. banker, broker, or adviser; and (ii) that a nonresident alien individual or foreign corporation will not be deemed engaged in trade or business by reason of the mere ownership of real property, by reason of a strict net lease, or by reason of an agent's activity in connection with the selection of real estate investments in the United States.

There is a general feeling of confusion among foreign investors over the application to investment activities of the tests for engaging in trade or business. This confusion certainly fosters a fear among foreign investors that they may through inadvertence be deemed to have engaged in trade or business and thereby become subject to regular U.S. taxation on their income and gains. These fears, whether or not realistic, unquestionably are a deterrent to foreign investment in this country.

Clarification of three major points through the issuance of regulations or rulings would aid materially in eliminating the existing confusion and fears. One would be to make it clear that the degree of activity in a securities account is not a factor in determining

whether or not a nonresident alien individual or foreign corporation is engaged in trade or business in the United States.

The second would be to affirm that the granting by a nonresident alien individual or a foreign corporation of a discretionary power for the purchase and sale of securities to a U.S. banker, broker, or adviser does not constitute engaging in trade or business in the United States.

Third, under present law, many advisers feel that any ownership of real property by foreign investors creates a question of doing business. Clarification of this question should have a favorable effect on the amount of real estate investments made by foreign investors in the United States and probably also on the amount of security investments made by foreign investors desiring to own both real estate and stocks.

Implementation

Basic to our recommendations is the belief that any steps taken must be unilateral moves by the United States. Negotiation of reciprocal tax treaties typically extends over many years and results in separate rules for each treaty country. To attempt to implement our recommendations through treaty negotiation would vitiate the possibility of their having an immediate impact on the balance of payments. Decisive unilateral action is necessary to preserve the package concept which is essential if our recommendations are to have their maximum favorable impact on investor psychology throughout the world.

We do not believe it sound to defer changes in U.S. taxation of foreign investors on the grounds that there still exist restrictions on the ability of U.S. securities firms to market the securities of U.S. corporations abroad. Although such restrictions do exist, many important industrialized countries do not prevent their residents from purchasing U.S. securities through one channel or another. Thus there are substantial sums of foreign capital that are susceptible to being attracted to the United States for investment, if the tax laws of this country are amended to make such investment more attractive. In fact, the existence of other restrictions on the flow of foreign investment to the United States and the time needed to have these restrictions removed are strong arguments in favor of making unilateral changes in our tax laws. These changes can be made with a minimum of delay.

Conclusion

Our recommendations for tax revision, if adopted as a package, would greatly simplify the entire question of U.S. taxation of

foreign investors. Adoption of our recommendations would remove the substantial deterrent to foreign investment in the United States posed by a certain unwillingness among potential foreign investors to undertake complicated procedures for minimizing U.S. taxes. These procedures are often necessary if the investor is to avoid tax burdens which limit the attractiveness of investment in the United States. Complexities of the current system of U.S. taxation of foreign investors discourage these investors and advisers who endeavor to live within the confines of the law and good conscience. These complexities result in minuscule tax revenue, substantially reduce the incentive to invest here and encourage disrespect for our laws.

Reducing Restraints on the Sale of U.S. Securities in Other Capital Markets

The monetary disturbances of the 1930's, followed by World War II and the abnormal needs and circumstances of reconstruction, left Europe and most other advanced areas of the world with relatively small and inefficient capital markets. These markets were separated from each other and from the remainder of the world by numerous monetary, legal, administrative, and institutional restrictions. Much progress has been made in recent years toward removing controls on the movement of capital between industrial countries and toward improving the internal functioning of their capital markets. Nevertheless, restrictions still impede foreign purchases of U.S. securities and limit the ability of U.S. firms to obtain long-term financing for their oversea operations from foreign sources.

Although the Task Force has conducted an intensive study of restrictions in other capital markets, we have not attempted to set forth all of our findings here. The identification and critical appraisal of restrictions remaining in the capital markets of other industrial countries have been covered extensively in a recent study by the Treasury Department, made publicly available by the Joint Economic Committee of Congress. In this section of our report, we summarize the most important legal and administrative obstacles abroad which impede foreign investment in U.S. corporate securities. No useful purposes would, we believe, be served by making detailed recommendations as to the removal of foreign restrictions or methods by which other countries could improve their domestic capital markets. In each country these matters are often complex and technical; they involve delicate domestic relationships; frequently they transcend financial considerations and encompass national policies well beyond the terms of reference of the Task Force. It should be noted that efforts to remove restraining

influences on sales of U.S. securities to foreigners will raise in foreign financial markets the question of the continuance of the U.S. interest equalization tax as a factor affecting the sales of foreign securities to U.S. citizens, however temporary and special its basis.

Exchange Controls

Recommendation No. 35:

The Department of State and the Treasury Department should take bilateral diplomatic action aimed at securing the step-by-step removal of remaining exchange controls on capital transactions between advanced capital-forming countries and the discontinuance or liberalization of special exchange markets or procedures for investment transactions.

Substantial progress has been made in removing exchange controls, yet the situation is still far from satisfactory. Only the United States, Canada, Germany and Switzerland are free of exchange controls. Although adopting the aim of full liberalization, France, Italy, the Benelux countries and Austria have preserved certain restrictions. A third group of countries, which includes the United Kingdom, Ireland, Japan, Australia, Spain and the Scandinavian countries, retain a wide range of controls for balance of payments and monetary policy reasons.

The impact of exchange controls varies according to the operations regulated. In general, treatment of direct investment is the most liberal; the treatment of financial loans (that is, loans not linked to commercial transactions) is the least liberal. Treatment of portfolio investment has been formally "liberalized" in Austria and the Common Market countries, but even some of these countries retain practices which tend to be restrictive.

In some countries, for example, foreign securities may be purchased only through authorized banks. In some cases, certificates of ownership of foreign securities must be kept on deposit at these banks; in other cases purchases of foreign securities which are not listed on securities exchanges sometimes require the prior approval of exchange control authorities.

Japan, Australia, Spain, Ireland and the Scandinavian countries all exercise tight control over foreign portfolio investments; except in rare instances, their nationals are not permitted to buy foreign securities. Although residents of the United Kingdom may freely acquire foreign listed securities and certain U.S. over-the-counter securities, they can do so only with funds obtained from

the limited pool of "investment dollars" which now sell at a premium of about 11 percent, after having been as high as 14 percent earlier in 1964. These "investment dollars" represent primarily the proceeds of sales for dollars or other foreign currencies, of foreign securities held by United Kingdom residents.

Capital Issues Control

Recommendation No. 36:

The Department of State and the Treasury Department should encourage and support the enlargement of free world capital markets and urge countries with balance of payments surpluses to relax their capital issues control in order to permit an expanded volume of international lending.

New issues of foreign securities are carefully controlled in most major countries. The liberalization of capital issues raises sensitive questions because sales of new securities issues have a direct impact on interest rates, patterns of investment and the balance of payments. Some countries restrict distributions of foreign securities in attempts to prevent heavy demand for capital by foreign borrowers from driving up domestic interest rates and siphoning off a high proportion of domestic savings. In some countries direct controls over securities issues are in part designed to channel financial resources into investments considered of high priority by the government concerned. Although there has been some recent relaxation with respect to foreign borrowing in the United Kingdom, the capital issues control policy of that country generally has been to reserve the London new issues market for sterling securities for residents of the sterling area and the European Free Trade Area.

Regulation of Institutional Investors

Recommendation No. 37:

The Department of State and the Treasury Department should request that the Organization of Economic Cooperation and Development (OECD) initiate a comprehensive review of the practices and regulations in member countries relating to investment portfolios of financial institutions.

Regulations governing the investment portfolios of institutions such as commercial banks, insurance companies, savings banks, investment companies and pension funds—while principally designed to protect depositors, shareholders, or policyholders—often tend in practice to create protected markets for certain privileged borrowers and to restrict foreign investment. Foreign securities, even when denominated in domestic currencies or protected against exchange risks, are usually discriminated against by regulatory authorities. Offerings of new or secondary issues of foreign securities in particular are much more difficult to market abroad when certain large institutional investors are not allowed to subscribe.

Financial institutions in most countries have gradually been permitted to increase the proportion of their assets held in equities. The risk involved in holding good-quality foreign securities would, in many cases, be no greater than the risk involved in investing in many domestic securities. We believe serious consideration should be given to relaxing restrictions on the amount of securities denominated in foreign currencies that can be held by such institutions.

Role of International Organizations

Recommendation No. 38:

The Department of State and the Treasury Department should, through appropriate international bodies, particularly the OECD, advocate the step-by-step relaxation of monetary, legal, institutional, and administrative restrictions on capital movements, together with other actions designed to increase the breadth and efficiency of free world capital markets.

The international movement of capital is kept under constant review by the Organization for Economic Cooperation and Development, to which the United States belongs. This organization can and should be more intensively utilized as a forum for review and confrontation on restrictions impeding the flow of capital among its members. Similarly, the OECD can assist in developing more effective capital markets in countries where these markets have lagged behind rapid industrial growth.

Recommendation No. 39:

The Department of State and the Treasury Department should urge the International Monetary Fund to encourage step-by-step elimination

of capital controls. The Fund should be requested to prepare a study dealing with remaining capital controls and how their elimination can encourage stabilizing movements of long-term capital and thus contribute to balanced international payments.

The International Monetary Fund can play an important role in eliminating restrictions on long-term capital movements associated with security purchases. Member countries are required to inform the Fund of capital restrictions they impose. Annual consultations of the Fund provide an opportunity for review and for comments by the U.S. Executive Director. Although the Fund cannot formally take exception to capital restrictions—since its approving jurisdiction is limited to restrictions on current transactions—it can indicate that removal of capital restrictions would be helpful to the international financial mechanism. The decision by the Fund in 1961 to make its resources available to finance balance-of-payments deficits arising from capital outflows should help encourage countries to eliminate capital controls.

V. Conclusion

Other industrial nations, especially those in Western Europe, have made impressive economic progress in the postwar period. This has been reflected in the growing volume of savings and the strengthened balance-of-payments position of most of these countries.

Moreover, the institutional framework for foreign portfolio investment in U.S. corporate securities has been strengthened in recent years. U.S. financial firms have a large and growing number of oversea branches and affiliates staffed with highly trained personnel. This, together with the current vigor of the U.S. economy, has created an environment favorable to increased sales abroad of the shares of U.S. corporations.

At the same time, many U.S. corporations have established themselves in industrial countries where capital markets are expanding; prospective investors in these countries can readily identify these corporations with products and services of internationally recognized quality. The framework for financing abroad these foreign operations of U.S. corporations has thus also been strengthened.

In our investigations, however, we have found a number of obstacles—both at home and abroad—which limit increased foreign investment in U.S. private companies. In this report, we have identified the more important of these restraints and have made recommendations which, in our opinion, could improve the U.S. balance-of-payments position in this area within a reasonable period of time. Concerted efforts in both the public and private sectors of our country are required if these recommendations are to prove effective.

U.S. corporations and financial firms are already making an important and growing contribution to our receipts from abroad. Because of our overall balance-of-payments problem, however, it is imperative that every effort be made to increase this contribution. To this end, our report has outlined a variety of actions in several areas. Collectively, these actions could yield impressive results.

We urge the U.S. financial community, U.S. industrial corporations, and the U.S. Government to give close and continuing attention to the problems and opportunities set forth in our report.

The increased freedom of capital movement and increased participation by foreign citizens and financial institutions in the ownership and financing of U.S. business will serve to strengthen the economic and political ties of the free world as well as its monetary system.

Therefore, we attach special importance to our recommendations concerning possible reduction or elimination of obstacles to the international flow of capital.

The work of the Task Force has, we feel, resulted in increased exchange of information in areas of potential cooperation between the financial community, industrial corporations, and public agencies. Our final recommendation is that this exchange of information and cooperation be continued.

SECTION 7

HEARINGS BEFORE THE COMMITTEE ON WAYS AND MEANS ON H.R. 5916

REMOVAL OF TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES

HEARINGS

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

EIGHTY-NINTH CONGRESS

FIRST SESSION

ALONG WITH WRITTEN COMMENTS SUBMITTED TO THE COMMITTEE ON WAYS AND MEANS

ON

H.R. 5916

TO REMOVE TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES

JUNE 30 AND JULY 1, 1965

Printed for the use of the Committee on Ways and Means

COMMITTEE ON WAYS AND MEANS

WILBUR D. MILLS, Arkansas, *Chairman*

CECIL R. KING, California
HALE BOGGS, Louisiana
EUGENE J. KEOGH, New York
FRANK M. KARSTEN, Missouri
A. S. HERLONG, JR., Florida
JOHN C. WATTS, Kentucky
AL ULLMAN, Oregon
JAMES A. BURKE, Massachusetts
CLARK W. THOMPSON, Texas
MARTHA W. GRIFFITHS, Michigan
W. PAT JENNINGS, Virginia
GEORGE M. RHODES, Pennsylvania
DAN ROSTENKOWSKI, Illinois
PHIL M. LANDRUM, Georgia
CHARLES A. VANIK, Ohio
RICHARD H. FULTON, Tennessee

JOHN W. BYRNES, Wisconsin
THOMAS B. CURTIS, Missouri
JAMES B. UTT, California
JACKSON E. BETTS, Ohio
HERMAN T. SCHNEEBELI, Pennsylvania
HAROLD R. COLLIER, Illinois
JOEL T. BROYHILL, Virginia
JAMES F. BATTIN, Montana

LEO H. IRWIN, *Chief Counsel*
JOHN M. MARTIN, JR., *Assistant Chief Counsel*
WILLIAM H. QUEALY, *Minority Counsel*

II

CONTENTS

STATEMENTS OF GOVERNMENT WITNESSES

STATEMENTS OF PUBLIC WITNESSES

WRITTEN STATEMENTS BY PUBLIC WITNESSES

MATERIAL SUPPLIED FOR THE RECORD

REMOVAL OF TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES

WEDNESDAY, JUNE 30, 1965

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to call, in the committee room, Longworth House Office Building, Hon. A. S. Herlong, Jr., presiding.

Mr. HERLONG. The committee will come to order.

This hearing is for the purpose of receiving testimony on H.R. 5916, a bill introduced at the request of the administration, to remove tax barriers to foreign investment in the United States. This bill was developed on the basis of the so-called Fowler task force. That task force consisted of a very distinguished group of tax specialists.

Without objection, a copy of the bill, H.R. 5916, a copy of the press release announcing these hearings, a copy of the press release which was issued earlier inviting written comments by the interested public and a Treasury Department release dated March 8, 1965, explaining the proposed legislation, will be made a part of the record at this point. Also, without objection, the written comments which we have received from the interested public will be made a part of the published record.

(The information referred to follows:)

[H.R. 5916, 89th Cong., 1st sess.]

A BILL To amend the Internal Revenue Code of 1954 to remove tax barriers to foreign investment in the United States, to make certain technical amendments, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Act to remove tax barriers to foreign investment in the United States".

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

SEC. 2. INCOME FROM SOURCES WITHIN THE UNITED STATES.

(a) INTEREST FROM UNITED STATES SOURCES.—Section 861(a)(1) (relating to interest from sources within the United States) is amended by striking out "and" at the end of subparagraph (B), by striking out the period at the end of subparagraph (C) and inserting in lieu thereof ", and", and by adding at the end thereof the following new subparagraph:

> "(D) Amounts paid to, or credited to the accounts of, depositors or holders of accounts not engaged in business within the United States on deposits or withdrawable accounts with savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, if such amounts are deductible under section 591 in computing the taxable income of such institutions."

1

(b) DIVIDENDS FROM UNITED STATES SOURCES.—Section 861(a)(2)(B) (relating to dividends from sources within the United States) is amended to read as follows:

"(B) from a foreign corporation engaged in trade or business within the United States unless less than 80 percent of the gross business income of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of this part; but only in an amount which bears the same ratio to such dividends as the gross business income of the corporation for such period derived from sources within the United States bears to its gross income from all sources; but dividends from a foreign corporation shall, for purposes of subpart A of part III (relating to foreign tax credit), be treated as income from sources without the United States to the extent exceeding the amount which is 100/85ths of the amount of the deduction allowable under section 245 in respect of such dividends, or".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to interest or dividends paid in taxable years beginning after December 31, 1965.

SEC. 3. NONRESIDENT ALIEN INDIVIDUALS.

(a) TAX ON NONRESIDENT ALIEN INDIVIDUALS.—Section 871 (relating to tax on nonresident alien individuals) is amended to read as follows:

"SEC. 871. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

"(a) NO UNITED STATES BUSINESS—30 PERCENT TAX.—There is hereby imposed for each taxable year, in lieu of the tax imposed by section 1, on the amount received, by every nonresident alien individual not engaged in trade or business within the United States, from sources within the United States, as interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income (including amounts described in section 402(a)(2), section 403(a)(2), section 631 (b) and (c), and section 1235, which are considered to be gains from the sale or exchange of capital assets), a tax of 30 percent of such amount.

"(b) UNITED STATES BUSINESS.—

"(1) BUSINESS INCOME—GRADUATED RATE OF TAX.—A nonresident alien individual engaged in trade or business within the United States shall be taxable as provided in section 1 on that portion of his taxable income from sources within the United States which is business income, and the amount of tax under this paragraph shall be determined without taking into account any income which is not business income.

"(2) NONBUSINESS INCOME—33 PERCENT TAX.—There is hereby imposed for each taxable year, in lieu of the tax imposed by section 1, on the amount received, by every nonresident alien individual engaged in trade or business within the United States, from sources within the United States, as income other than income taxable under paragraph (1), a tax of 30 percent of such amount. The tax imposed by this paragraph shall not apply to gains from the sale or exchange of capital assets but shall apply to amounts described in section 402(a)(2), section 403(a)(2), section 631 (b) and (c), and section 1235 which are considered to be gains from the sale or exchange of capital assets.

"(3) BUSINESS INCOME DEFINED.—In the case of a nonresident alien individual, business income includes all income derived from the conduct of a trade or business, wherever carried on, by such individual, including gains derived from the sale or exchange of property used in the conduct of a trade or business, except that such income shall not include dividends or gain from the sale or exchange of stock in a corporation.

"(c) ENGAGED IN TRADE OR BUSINESS DEFINED.—For purposes of part I, this this section, sections 881 and 882, and chapter 3, the term 'engaged in trade or business within the United States' includes the performance of personal services within the United States at any time within the taxable year, but does not include—

"(1) PERFORMANCE OF PERSONAL SERVICES FOR FOREIGN EMPLOYER.—The performance of personal services, for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or for an office or place of business maintained by a domestic corporation in a foreign country or in a possession of the United States, by a

nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000, or

"(2) TRADING IN SECURITIES OR COMMODITIES.—

"(A) SECURITIES.—Trading in stocks or securities for one's own account, whether transactions are effected directly, or by way of an agent, through a resident broker, commission agent, custodian, or other independent agent, and, except where the person so trading is a dealer in securities, whether or not any such agent has discretionary authority to make decisions in effecting such transactions, or

"(B) COMMODITIES.—Trading in commodities for one's own account, whether transactions are effected directly, or by way of agent, through a resident broker, commission agent, custodian, or other independent agent, and, except where the person so trading is a dealer in commodities, whether or not any such agent has discretionary authority to make decisions in effecting such transactions, if such commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place.

"(d) CAPITAL GAINS OF ALIENS PRESENT IN THE UNITED STATES 183 DAYS OR MORE.—In the case of a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year there is hereby imposed for such year, in lieu of the tax imposed by section 1, a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from the sale or exchange at any time during such year of capital assets exceeds his losses, allocable to sources within the United States, from the sale or exchange at any time during such year of capital assets. For purposes of this subsection, gains and losses shall be taken into account only if, and to the extent that, they would be recognized and taken into account if such individual's total income were business income on which the tax were being determined under subsection (b)(1), except that such gains and losses shall be determined without regard to section 1202 (relating to deduction for capital gains) and such losses shall be determined without the benefits of the capital loss carryover provided in section 1212. Any gain or loss which is taken into account in determining the tax under subsection (a) or (b) shall not be taken into account in determining the tax under this subsection.

"(e) PARTICIPANTS IN CERTAIN EXCHANGE OR TRAINING PROGRAMS.—For purposes of this section, a nonresident alien individual who (without regard to this subsection) is not engaged in trade or business within the United States and who is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended (8 U.S.C. 1101(a)(15) (F) or (J)), shall be treated as a nonresident alien individual engaged in trade or business within the United States, and any income described in section 1441(b) (1) or (2) which is received by such individual shall be treated as business income.

"(f) ELECTION TO TREAT REAL PROPERTY INCOME AS BUSINESS INCOME.—

"(1) IN GENERAL.—Notwithstanding subsections (a) and (b)(2), a nonresident alien individual who during the taxable year derives from sources within the United States any income from real property, or from any interest in real property, including gains from the sale or exchange of real property, rents or royalties from the operation of mines, wells, or other natural deposits, and dividends (to the extent constituting income from real property) received from a real estate investment trust described in section 857, may, under regulations prescribed by the Secretary or his delegate, elect for such taxable year to treat all such income as business income which is taxable in the manner provided by subsection (b)(1). An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

"(2) ELECTION AFTER REVOCATION.—If an election has been made under paragraph (1) and such election has been revoked, a new election may not be made under such paragraph for any taxable year prior to the fifth taxable year which begins after the first taxable year for which such revocation is effective, unless the Secretary or his delegate consents to such new election.

"(3) FORM AND TIME OF ELECTION AND REVOCATION.—An election under paragraph (1), and any revocation of such an election, may be made only in such manner and at such time as the Secretary or his delegate may by regulations prescribe.

"(g) CROSS REFERENCES.—

"(1) For tax treatment of certain amounts distributed by the United States to nonresident alien individuals, see section 402(a)(4).

"(2) For taxation of expatriate United States citizens on income from United States sources, see section 878.

"(3) For doubling of tax on citizens of certain foreign countries, see section 891.

"(4) For reinstatement of pre-1966 tax provisions in the case of residents of certain foreign countries, see section 896.

"(5) For exemption from withholding on nonresident alien individuals electing to treat certain real property income as business income, see section 1441(c)(7).

"(6) For the requirement of making a declaration of estimated tax by nonresident alien individuals described in paragraph (5), see section 6015(a).

"(7) For taxation of gains realized upon certain transfers to domestic corporations, see section 1250(d)(3)."

(b) EXCLUSIONS FROM GROSS INCOME.—Section 872(b) (relating to exclusions from gross income of nonresident alien individuals) is amended by adding at the end thereof the following new paragraph:

"(4) BOND INTEREST OF RESIDENTS OF THE RYUKYU ISLANDS OR THE TRUST TERRITORY OF THE PACIFIC ISLANDS.—Interest on series E and series H United States savings bonds owned by nonresident alien individuals who during the entire taxable year are residents of the Ryukyu Islands or the Trust Territory of the Pacific Islands."

(c) DEDUCTIONS.—Section 873 (relating to deductions allowed to nonresident alien individuals) is amended to read as follows:

"SEC. 873. DEDUCTIONS.

"(a) GENERAL RULE.—Except as provided in section 871(d) and subsection (b), in the case of a nonresident alien individual the deductions shall be allowed only if and to the extent that they are connected with business income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in part I, under regulations prescribed by the Secretary or his delegate.

"(b) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income from sources within the United States:

"(1) LOSSES.—The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property within the United States.

"(2) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts allowed by section 170, but only for contributions or gifts made to domestic corporations, or to community chests, funds, or foundations, created in the United States.

"(3) PERSONAL EXEMPTION.—The deduction for personal exemptions allowed by section 151, except that in the case of a nonresident alien individual who is not a resident of a contiguous country only one exemption under such section shall be allowed.

"(c) STANDARD DEDUCTION.—For disallowance of standard deduction, see section 142(b)(1)."

(d) EXPATRIATION TO AVOID TAX.—Subpart A of part II of subchapter N of chapter 1 (relating to nonresident alien individuals) is amended by inserting after section 877 the following new section:

"SEC. 878. EXPATRIATION TO AVOID TAX.

"(a) IN GENERAL.—Every nonresident alien individual who at any time within the 10-year period immediately preceding the close of the taxable year lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of United States taxes, shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection exceeds the tax which, without regard to this section, is imposed for such taxable year under section 871.

"(b) ALTERNATIVE TAX.—A nonresident alien individual described in subsection (a) shall be taxable for the taxable year as provided in section 1 except that—

"(1) the gross income shall include only the gross income derived from sources within the United States, determined as provided in part I to the extent not otherwise provided in subsection (c), and

"(2) the deductions shall be allowed to the extent, and in the manner provided by, section 931 in the case of a citizen of the United States entitled to the benefits of such section, except that the capital loss carryover provided by section 1212(b) shall not be allowed.

"(c) SPECIAL RULES OF SOURCE.—For purposes of subsection (b), the following items of gross income shall be treated as income from sources within the United States:

"(1) SALE OF PROPERTY.—Gains, profits, and income derived from the sale or exchange of property (other than stock in corporations or debt obligations) situated in the United States.

"(2) STOCKS OR DEBT OBLIGATIONS.—Gains, profits, and income derived from the sale or exchange of stocks or debt obligations issued by or enforceable against United States persons.

"(d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to a nonresident alien individual who has lost United States citizenship under section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487).

"(e) BURDEN OF PROOF.—For purposes of subsection (a), the burden of proving that an individual's loss of United States citizenship did not have for one of its principal purposes the avoidance of United States taxes shall be on such individual."

(e) CREDIT FOR PARTIALLY TAX-EXEMPT INTEREST.—Subsection (c) of section 35 (relating to certain nonresident aliens ineligible for credit) is amended to read as follows:

"(c) CREDIT NOT APPLICABLE TO TAX ON CERTAIN INCOME OF NONRESIDENT ALIENS.—In the case of a nonresident alien individual, credit shall be allowed under subsection (a) only—

"(1) against the tax imposed for the taxable year under section 871(b)(1) and only in respect of interest which constitutes business income, or

"(2) against the tax imposed for the taxable year under section 878(b)."

(f) PARTIAL EXCLUSION OF DIVIDENDS.—Subsection (d) of section 116 (relating to certain nonresident aliens ineligible for exclusion) is amended to read as follows:

"(d) CERTAIN NONRESIDENT ALIENS INELIGIBLE FOR EXCLUSION.—In the case of a nonresident alien individual, subsection (a) shall apply only in determining the tax imposed for the taxable year under section 878(b)."

(g) WITHHOLDING OF TAX ON NONRESIDENT ALIENS.—Section 1441 (relating to withholding of tax on nonresident aliens) is amended—

(1) by striking out "(except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States)" in subsection (b);

(2) by strinking out paragraph (1) of subsection (c) and inserting in lieu thereof the following new paragraph:

"(1) BUSINESS INCOME.—No deduction or withholding under subsection (a) shall be required in the case of any item of income which is business income on which a tax is imposed for the taxable year under section 871(b)(1)."; and

(3) by adding at the end of subsection (c) the following new paragraph:

"(7) ELECTION TO TREAT REAL PROPERTY INCOME AS BUSINESS INCOME.—No deduction or withholding under subsection (a) shall be required in the case of any income from real property described in section 871(f) if such income is treated as business income pursuant to an election made under such section."

(h) LIABILITY FOR WITHHELD TAX. Section 1461 (relating to return and payment of withheld tax) is amended to read as follows:

"SEC. 1461. LIABILITY FOR WITHHELD TAX.

"Every person required to deduct and withhold any tax under this chapter is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this chapter."

(i) DECLARATION OF ESTIMATED INCOME TAX BY INDIVIDUALS.—Section 6015 (relating to declaration of estimated income tax by individuals) is amended—

(1) by striking out that portion of subsection (a) which precedes paragraph (1) and inserting in lieu thereof the following:

"(a) REQUIREMENT OF DECLARATION.—Except as otherwise provided in subsection (i), every individual shall make a declaration of his estimated tax for the taxable year if—"; and

(2) by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) NONRESIDENT ALIEN INDIVIDUALS.—No declaration shall be required to be made under this section by a nonresident alien individual unless—

"(1) withholding under chapter 24 is made applicable to the wages, as defined in section 3401 (a), of such individual,

"(2) such individual is a resident of Puerto Rico during the entire taxable year,

"(3) such individual is an expatriate United States citizen whose tax for the taxable year is imposed pursuant to section 878(b),

"(4) such individual is exempt under section 1441(c)(1) for the taxable year from deduction and withholding under section 1441(a) on business income, or

"(5) such individual is exempt under section 1441(c)(7) for the taxable year from deduction and withholding under section 1441(a) on income from real property."

(j) GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.—The second sentence of paragraph (3) of section 1250(d) (relating to certain tax-free transactions) is amended to read as follows: "This paragraph shall not apply to—

"(A) a disposition to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter, or

"(B) a transfer of property by a nonresident alien individual, a foreign estate or trust, or a foreign partnership, to a domestic corporation in exchange for stock or securities in such corporation in a transaction to which section 351 applies."

(k) TECHNICAL AMENDMENTS.—

(1) Section 154(3) (relating to cross references in respect of deductions for personal exemptions) is amended to read as follows:

"(3) For exemptions of nonresident aliens, see section 873(b)(3)."

(2) The table of sections for subpart A of part II of subchapter N of chapter 1 (rlating to nonresident alien individuals) is amended by inserting at the end thereof the following:

"Sec. 878. Expatriation to avoid tax."

(l) EFFECTIVE DATES.—

(1) The amendments made by this section (other than the amendments made by subsection (g)) shall apply with respect to taxable years beginning after December 31, 1965, except that subsection (d) shall apply only in the case of an individual who has lost United States citizenship after March 8, 1965.

(2) The amendments made by subsection (g) shall apply with respect to payments occurring after December 31, 1965.

SEC. 4. FOREIGN CORPORATIONS.

(a) TAX ON FOREIGN CORPORATIONS NOT ENGAGED IN BUSINESS IN UNITED STATES.—Section 881 (relating to imposition of tax) is amended—

(1) by striking out "(except interest on deposits with persons carrying on the banking business)" in subsection (a);

(2) by redesignating subsection (b) as subsection (c); and

(3) by adding after subsection (a) the following new subsection:

"(b) ELECTION TO TREAT REAL PROPERTY INCOME AS BUSINESS INCOME.—Notwithstanding subsection (a), a foreign corporation, not engaged in trade or business within the United States, which during the taxable year derives from sources within the United States any income from real property, or from any interest in real property, including gains from the sale or exchange of real property, rents or royalties from the operation of mines, wells, or other natural deposits, and dividends (to the extent constituting income from real property) received from a real estate investment trust described in section 857, may, under regulations prescribed by the Secretary or his delegate, elect for such year to treat all such income as business income which is taxable in the manner provided by section 882(a)(1). The election provided by this subsection shall be made in accordance with, and subject to, the provisions of section 871(f)."

(b) TAX ON RESIDENT FOREIGN CORPORATIONS.—Section 882 (relating to tax on resident foreign corporations) is amended to read as follows:

"SEC. 882. TAX ON RESIDENT FOREIGN CORPORATIONS.

"(a) IMPOSITION OF TAX.—

"(1) BUSINESS INCOME—NORMAL TAX AND SURTAX.—A foreign corporation engaged in trade or business within the United States shall be taxable as

provided in section 11 on that portion of its taxable income from sources within the United States which is business income, and the amount of tax under this paragraph shall be determined without taking into account any income which is not business income.

"(2) NONBUSINESS INCOME—30 PERCENT TAX.—There is hereby imposed for each taxable year, in lieu of the taxes imposed by section 11, on the amount received by every foreign corporation engaged in trade or business within the United States, from sources within the United States, as nonbusiness income, a tax of 30 percent of such amount.

"(3) BUSINESS INCOME DEFINED.—In the case of a foreign corporation business income includes all income derived from sources within the United States other than the income described in paragraph (4), except that business income shall not include gain from the sale or exchange of stock in a corporation.

"(4) NONBUSINESS INCOME DEFINED.—In the case of a foreign corporation nonbusiness income shall consist of dividends and amounts described in section 631 (b) and (c) which are considered to be gains from the sale or exchange of capital assets.

"(b) GROSS INCOME.—In the case of a foreign corporation, gross income includes only the gross income from sources within the United States.

"(c) ALLOWANCE OF DEDUCTIONS AND CREDITS.—

"(1) DEDUCTIONS ALLOWED ONLY IF RETURN FILED.—A foreign corporation shall receive the benefit of the deductions allowed to it in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true true and accurate return of its total income received from all sources in the United States, in the manner prescribed in subtitle F, including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions.

"(2) ALLOCATION OF DEDUCTIONS.—

"(A) GENERAL RULE.—Except as provided in subparagraph (B), in the case of a foreign corporation the deductions shall be allowed only if and to the extent that they are connected with business income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in part I, under regulations prescribed by the Secretary or his delegate.

"(B) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts allowed by section 170 shall be allowed whether or not connected with income from sources within the United States.

"(3) FOREIGN TAX CREDIT.—Foreign corporations shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

"(d) RETURNS OF TAX BY AGENT.—If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return required under section 6012 shall be made by the agent."

(c) CROSS REFERENCES.—Section 884 (relating to cross references) is amended to read as follows:

"SEC. 884. CROSS REFERENCES.

"(1) For special provisions relating to unrelated business income of foreign educational, charitable, and certain other exempt organizations, see section 512(a).

"(2) For special provisions relating to foreign insurance companies, see subchapter L (sec. 801 and following).

"(3) For rules applicable in determining whether any foreign corporation is engaged in trade or business within the United States, see section 871(c).

"(4) For reinstatement of pre-1966 tax provisions in the case of corporations of certain foreign countries, see section 896.

"(5) For withholding at source of tax on income of foreign corporations, see section 1442.

"(6) For exemption from withholding on foreign corporations electing to treat certain real property income as business income, see section 1441(c)(7).

"(7) For the requirement of making a declaration of estimated tax by foreign corporations described in paragraph (6), see section 6016(a)."

(d) DECLARATIONS OF ESTIMATED INCOME TAX BY CORPORATIONS.—Subsection (a) of section 6016 (relating to the requirement of declarations) is amended to read as follows:

"(a) REQUIREMENT OF DECLARATION.—Every corporation subject to taxation under section 11 or 1201(a), or subchapter L of chapter 1 (relating to insurance companies), including every foreign corporation which is exempt under section 1441(c)(7) for the taxable year from deduction and withholding under section 1442, shall make a declaration of estimated tax under chapter 1 for the taxable year if its income tax imposed by chapter 1 for such taxable year, reduced by the credits against tax provided by part IV of subchapter A of chapter 1, can reasonably be expected to exceed $100,000."

(e) CORPORATIONS SUBJECT TO PERSONAL HOLDING COMPANY TAX.—Paragraph (7) of section 542(c) (relating to corporations not subject to the personal holding company tax) is amended to read as follows:

"(7) a foreign corporation if all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through other foreign corporations;".

(f) AMENDMENTS TO PRESERVE EXISTING LAW WITH RESPECT TO CERTAIN FOREIGN INSURANCE COMPANIES.—

(1) TAXABLE INVESTMENT INCOME OF CERTAIN MUTUAL INSURANCE COMPANIES.—Subsection (e) of section 822 (relating to foreign mutual insurance companies other than life or marine) is amended by striking out the period at the end thereof and inserting in lieu thereof the following: ", determined as though the entire gross income from sources within the United States were business income."

(2) TAXABLE INCOME OF MUTUAL MARINE INSURANCE AND OTHER INSURANCE COMPANIES.—Subsection (d) of section 832 (relating to taxable income of foreign insurance companies other than life or mutual and foreign mutual marine) is amended by striking out the period at the end thereof and inserting in lieu thereof the following: ", determined as though the entire gross income from sources within the United States were business income."

(g) DIVIDENDS RECEIVED FROM CERTAIN FOREIGN CORPORATIONS.—Subsection (a) of section 245 (relating to the allowance of a deduction in respect of dividends received from a foreign corporation) is amended—

(1) by striking out "as the gross income of such foreign corporation" in paragraph (1) and inserting in lieu thereof "as the sum of the gross business income and the gross nonbusiness income of such foreign corporation"; and

(2) by striking out "as the gross income of such foreign corporation" in paragraph (2) and inserting in lieu thereof "as the sum of the gross business income and the gross nonbusiness income of such foreign corporation".

(h) TECHNICAL AMENDMENTS.—

(1) Subsection (e) of section 11 (relating to exceptions from the application of the normal tax and surtax to corporations) is amended by striking out "or" at the end of paragraph (3), by striking out the period at the end of paragraph (4) and inserting in lieu thereof, "or", and by adding at the end thereof the following new paragraph:

"(5) section 882(a)(2) (relating to nonbusiness income of a foreign corporation engaged in trade or business within the United States) to the extent that the income of such corporation is subject to the tax imposed by such section."

(2) Subsection (i) of section 170 (relating to other cross references in respect of charitable contributions) is amended by redesignating paragraphs (5) through (8) as paragraphs (6) through (9) and by adding after paragraph (4) the following new paragraph:

"(5) For charitable contributions of resident foreign corporations, see section 882(c)(2)."

(3) Section 891 (relating to doubling of rates of tax on citizens and corporations of certain countries) is amended by striking out "and 881" and inserting in lieu thereof "881, and 882".

(i) EFFECTIVE DATE.—The amendments made by this section shall apply in respect of taxable years beginning after December 31, 1965. In applying the amendment made by subsection (g)(2), the gross income of the foreign corporation for taxable years beginning before January 1, 1966, shall be determined without regard to the amendments made by such subsection.

SEC. 5. SPECIAL TAX PROVISIONS.

(a) APPLICATION OF PRE-1966 TAX PROVISIONS.—Subpart C of part II of subchapter N of chapter 1 (relating to miscellaneous provisions applicable to nonresident aliens and foreign corporations) is amended by adding at the end thereof the following new section:

"SEC. 896. APPLICATION OF PRE-1966 TAX PROVISIONS.

"(a) IMPOSITION OF MORE BURDENSOME TAXES BY FOREIGN COUNTRY.—Whenever the President finds that—

"(1) under the laws of any foreign country, considering the tax system of such foreign country, citizens of the United States not residents of such foreign country or corporations of the United States are being subjected to more burdensome taxes, on any item of income received by such citizens or corporations from sources within such foreign country, than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country,

"(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such taxes so that they are no more burdensome than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country, and

"(3) it is in the public interest to apply pre-1966 tax provisions in accordance with the provisions of this section to residents or corporations of such foreign country,

the President shall proclaim that the tax on such similar income derived from sources within the United States by residents and corporations of such foreign country shall, for taxable years beginning after such proclamation, be determined under this subtitle without regard to amendments made to this subchapter on or after the date of enactment of this section.

"(b) ALLEVIATION OF MORE BURDENSOME TAXES.—Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that such citizens or corporations of the United States are no longer subject to more burdensome taxes on such item of income derived by such citizens or corporations from sources within such foreign country, he shall proclaim that the tax on such similar income derived from sources within the United States by residents and corporations of such foreign country shall, for any taxable year beginning after such proclamation, be determined under this subtitle by taking into account amendments made to this subchapter on or after the date of enactment of this section.

"(c) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least thirty days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

"(d) IMPLEMENTATION BY REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as he deems necessary or appropriate to implement this section."

(b) CLERICAL AMENDMENT.—The table of sections for subpart C of part II of subchapter N of chapter 1 is amended by adding at the end thereof the following:

"Sec. 896. Application of pre-1966 tax provisions."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1965.

SEC. 6. FOREIGN TAX CREDIT.

(a) CREDIT ALLOWED TO ALIEN RESIDENTS OF THE UNITED STATES OR PUERTO RICO.—Subsection (b) of section 901 (relating to the amount of foreign tax credit allowed) is amended to read as follows:

"(b) AMOUNT ALLOWED.—Subject to the applicable limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

"(1) INDIVIDUALS AND DOMESTIC CORPORATIONS.—In the case of an individual who is a citizen or resident of the United States or who is a bona fide resident of Puerto Rico during the entire taxable year and in the case of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

"(2) PARTNERSHIPS AND ESTATES.—In the case of any individual described in paragraph (1), who is a member of a partnership or a beneficiary of an estate or trust, the amount of the proportionate share of the taxes (described in such paragraph) of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be."

(b) SIMILAR CREDIT REQUIREMENTS.—Subsections (c) and (d) of section 901 (relating to corporations treated as foreign and to cross references, respectively)

are redesignated as subsections (d) and (e), and the following new subsection is added after subsection (b):

"(c) SIMILAR CREDIT REQUIRED FOR CERTAIN ALIEN RESIDENTS.—Whenever the President finds that—

"(1) in the case of an alien individual who is a resident of the United States or who is a bona fide resident of Puerto Rico during the entire taxable year, the foreign country of which such alien resident is a citizen or subject, in imposing income, war profits, and excess profits taxes, does not allow to citizens of the United States residing in such foreign country a credit similar to the credit allowed under subsection (b),

"(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit to citizens of the United States residing in such foreign country, and

"(3) it is in the public interest to allow the credit under subsection (b) to such alien resident of the United States or Puerto Rico only if such foreign country allows such a similar credit to citizens of the United States residing in such foreign country,

the President shall proclaim that, for taxable years beginning after such proclamation, such alien resident of the United States or Puerto Rico shall be allowed the credit under subsection (b) only if such foreign country, in imposing income, war profits, and excess profits taxes, allows to citizens of the United States residing in such foreign country a credit similar to the credit allowed under such subsection."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1965.

SEC. 7. AMENDMENT TO PRESERVE EXISTING LAW ON DEDUCTIONS UNDER SECTION 931.

(a) DEDUCTIONS.—Subsection (d) of section 931 (relating to deductions) is amended to read as follows:

"(d) DEDUCTIONS.—

"(1) GENERAL RULE.—Except as otherwise provided in this subsection and subsection (e), in the case of persons entitled to the benefits of this section the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in part I, under regulations prescribed by the Secretary or his delegate.

"(2) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income from sources within the United States:

"(A) The deduction, for losses not connected with the trade or business if incurred in transactions entered into for profit, allowed by section 165(c)(2), but only if the profit, if such transaction had resulted in a profit, would be taxable under this subtitle.

"(B) The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property within the United States.

"(C) The deduction for charitable contributions and gifts allowed by section 170, but, in the case of a citizen of the United States entitled to the benefits of this section, only for contributions or gifts made to domestic corporations, or to community chests, funds or foundations, created in the United States.

"(3) DEDUCTION DISALLOWED.—For disallowance of standard deduction, see section 142(b)(2)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to taxable years beginning after December 31, 1965.

SEC. 8. ESTATES OF NONRESIDENTS NOT CITIZENS.

(a) RATE OF TAX.—Subsection (a) of section 2101 (relating to tax imposed in case of estates of nonresidents not citizens) is amended to read as follows:

"(a) RATE OF TAX.—A tax computed in accordance with the following table, except as provided in section 2107, is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States dying after the enactment of this section:

If the taxable estate is:	The tax shall be:
Not over $100,000	5% of the taxable estate.
Over $100,000 but not over $750,000	$5,000, plus 10% of excess over $100,000.
Over $750,000	$70,000, plus 10% of excess over $750,000."

(b) CREDITS AGAINST TAX.—Section 2102 (relating to credits allowed against estate tax) is amended to read as follows:

"SEC. 2102. CREDITS AGAINST TAX.

"(a) IN GENERAL.—The tax imposed by section 2101 shall be credited with the amounts determined in accordance with sections 2011 to 2013, inclusive (relating to State death taxes, gift tax, and tax on prior transfers), subject to the special limitation provided in subsection (b).

"(b) SPECIAL LIMITATION.—The maximum credit allowed under section 2011 against the tax imposed by section 2101 for State death taxes paid shall be an amount which bears the same ratio to the credit computed as provided in section 2011(b) as the value of the property, at the date of death, upon which State death taxes were paid and which is included in the gross estate under section 2103 bears to the value of the total gross estate under section 2103. For purposes of this subsection, the term 'State death taxes' means the taxes described in section 2011(a)."

(c) PROPERTY WITHIN THE UNITED STATES.—Section 2104 (relating to property within the United States) is amended by adding at the end thereof the following new subsection:

"(c) DEBT OBLIGATIONS.—For purposes of this subchapter debt obligations owned by a nonresident not a citizen of the United States shall be deemed property within the United States if issued by or enforcible against—

"(1) a citizen or resident of the United States, a domestic partnership, domestic estate or trust, or domestic corporation; or

"(2) the United States, a State, or a possession of the United States, or any political subdivision of any of the foregoing, or the District of Columbia."

(d) PROPERTY WITHOUT THE UNITED STATES.—Subsection (b) of section 2105 (relating to bank deposits) is amended to read as follows:

"(b) BANK DEPOSITS AND WITHDRAWABLE ACCOUNTS.—For purposes of this subchapter, the following items shall not be deemed property within the United States:

"(1) BANKING INSTITUTIONS.—Any moneys deposited with any person carrying on the banking business, by or for a nonresident not a citizen of the United States who was not engaged in business in the United States at the time of his death.

"(2) MUTUAL SAVINGS BANKS, ETC.—Any moneys deposited, or placed in withdrawable accounts, with savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, by or for a nonresident not a citizen of the United States who was not engaged in business in the United States at the time of his death, if amounts paid or credited on such deposits or accounts are deductible under section 591 in computing the taxable income of such institutions."

(e) DEFINITION OF TAXABLE ESTATE.—Paragraph (3) of section 2106(a) (relating to deduction of exemption from gross estate) is amended to read as follows:

"(3) EXEMPTION.—

"(A) GENERAL RULE.—An exemption of $30,000.

"(B) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a 'nonresident not a citizen of the United States' under the provisions of section 2209, the exemption shall be the greater of (i) $30,000, or (ii) that portion of the exemption authorized by section 2052 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated."

(f) SPECIAL METHODS OF COMPUTING TAX.—Subchapter B of chapter 11 (relating to estates of nonresidents not citizens) is amended by adding at the end thereof the following new sections:

"SEC. 2107. EXPATRIATION TO AVOID TAX.

"(a) RATE OF TAX.—A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States dying after the date of enactment of this section, if within the 10-year period ending with the date of death such decedent lost United States citizenship and such loss had for one of its principal purposes the avoidance of United States taxes.

"(b) GROSS ESTATE.—For purposes of the tax imposed by subsection (a), the value of the gross estate of every decedent to whom subsection (a) applies shall be determined as provided in section 2103, except that—

"(1) if such decedent owned (within the meaning of section 958(a)) at the time of his death 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation, and

"(2) if such decedent owned (within the meaning of section 958(a)), or is considered to have owned (by applying the ownership rules of section 958(b) without regard to section 958(b)(1)), at the time of his death, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of such foreign corporation,

then that proportion of the fair market value of the outstanding stock of such foreign corporation owned (within the meaning of section 958(a)) by such decedent at the time of his death, which the fair market value of any assets owned by such foreign corporation and situated in the United States, at the time of his death, bears to the total fair market value of all assets owned by such foreign corporation at the time of his death, shall be included in the gross estate of such decedent.

"(c) CREDITS.—The tax imposed by subsection (a) shall be credited with the amounts determined in accordance with sections 2011 to 2013, inclusive (relating to State death taxes, gift tax, and tax on prior transfers).

"(d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to the transfer of the estate of a decedent who lost United States citizenship under section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487).

"(e) BURDEN OF PROOF.—For purposes of subsection (a), the burden of proving that a decedent's loss of United States citizenship did not have for one of its principal purposes the avoidance of United States taxes shall be on the executor of the estate of such decedent.

"SEC. 2108. APPLICATION OF PRE-1966 TAX PROVISIONS.

"(a) IMPOSITION OF MORE BURDENSOME TAX BY FOREIGN COUNTRY.—Whenever the President finds that—

"(1) under the laws of any foreign country, considering the tax system of such foreign country, a more burdensome tax is imposed by such foreign country on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country,

"(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such tax so that it is no more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, and

"(3) it is in the public interest to apply pre-1966 tax provisions in accordance with this section to the transfer of estates of decedents who were residents of such foreign country,

the President shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after such proclamation, be determined under this subchapter without regard to amendments made to such subchapter on or after the date of enactment of this section.

"(b) ALLEVIATION OF MORE BURDENSOME TAX.—Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that the tax on the transfer of estates of decedents who were such citizens of the United States is no longer more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, he shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after such proclamation, be determined under this subchapter by taking into account amendments made to such subchapter on or after the date of enactment of this section.

"(c) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

"(d) IMPLEMENTATION BY REGULATIONS.—The Secretary or his delegqte shall prescribe such regulations as may be necessary or appropriate to implement this section."

(g) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 11 (relating to estates of nonresidents not citizens) is amended by adding at the end thereof the following:

"Sec. 2107. Expatriation to avoid tax.
"Sec. 2108. Application of pre-1966 tax provisions."

(h) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to estates of decedents dying after the date of the enactment of this Act, except that section 2107, as added by subsection (f), shall apply only in the case of a decedent who has lost United States citizenship after March 8, 1965.

SEC. 9. GIFT TAX OF NONRESIDENTS NOT CITIZENS.

(a) IMPOSITION OF TAX.—Subsection (a) of section 2501 (relating to general rule for imposition of tax) is amended to read as follows:

"(a) TAXABLE TRANSFERS.—

"(1) GENERAL RULE.—For the calendar year 1955 and each calendar year thereafter a tax, computed as provided in section 2502, is hereby imposed, except as provided in paragraph (2), on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

"(2) TRANSFERS OF INTANGIBLE PROPERTY.—Except as provided in paragraph (3), paragraph (1) shall not apply to the transfer of intangible property by a nonresident not a citizen of the United States.

"(3) EXCEPTIONS.—Paragraph (2) shall not apply in the case of a donor who at any time within the 10-year period ending with the date of transfer lost United States citizenship unless—

"(A) such donor has lost United States citizenship under section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487), or

"(B) such loss did not have for one of its principal purposes the avoidance of United States taxes.

"(4) BURDEN OF PROOF.—For purposes of paragraph (3)(B), the burden of proving that a donor's loss of United States citizenship did not have for one of its principal purposes the avoidance of United States taxes shall be on such donor."

(b) TRANSFERS IN GENERAL.—Subsection (b) of section 2511 (relating to situs rule for stock in a corporation) is amended to read as follows:

"(b) INTANGIBLE PROPERTY.—For purposes of this chapter, in the case of a donor excepted from the application of section 2501(a)(2)—

"(1) shares of stock owned by such donor and issued by a domestic corporation, and

"(2) debt obligations owned by such donor and issued by or enforcible against—

"(A) a citizen or resident of the United States, a domestic partnership, domestic estate or trust, or domestic corporation, or

"(B) the United States, a State, or a possession of the United States or any political subdivision of any of the foregoing, or the District of Columbia,

shall be deemed to be property situated within the United States."

(c) EFECTIVE DATE.—The amendments made by this section shall apply with respect to the calendar year 1966 and all calendar years thereafter, except that the exception to section 2501(a)(2), as added by subsection (a), shall apply only in the case of a donor who has lost United States citizenship after March 8, 1965.

SEC. 10. DOCUMENTARY STAMP TAXES.

(a) EXEMPTION FOR CERTAIN FOREIGN INSTRUMENTS.—Section 4382 (relating to exemptions from documentary stamp taxes) is amended by adding at the end thereof the following new subsection:

"(c) ORIGINAL OFFERING BY FOREIGN ISSUERS TO FOREIGN PURCHASERS.—The taxes imposed by sections 4311, 4321, and 4331 shall not apply to the issuance, delivery, or transfer of any shares or certificates of stock or certificates of indebtedness to make effective the original issuance of such instruments by a foreign issuer to foreign purchasers, whether or not such transaction is accomplished through a domestic underwriter."

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on January 1, 1966.

SEC. 11. TREATY OBLIGATIONS.

(a) IN GENERAL.—No amendment made by this Act shall apply in any case where its application would be contrary to any treaty obligation of the United States.

(b) ABSENCE OF PERMANENT ESTABLISHMENT.—In determining the rate of tax under section 871(b)(2) or section 882(a)(2), as amended by this Act, on income which is not business income, a nonresident alien individual or foreign corporation shall be deemed, for purposes of applying any treaty obligation of the United States, not to have a permanent establishment in the United States at any time during the taxable year.

TREASURY DEPARTMENT,
Washington, D.C., March 8, 1965.

PROPOSED LEGISLATION TO INCREASE FOREIGN INVESTMENT IN THE UNITED STATES

The Treasury today submitted to the Congress proposed tax legislation designed to increase foreign investment in the United States.

Drafts of the proposed legislation, titled "An Act To Remove Tax Barriers to Foreign Investment in the United States," were sent to Speaker McCormack and Vice President Humphrey. Chairman Mills of the House Ways and Means Committee has stated that he will introduce it.

The proposed legislation is part of President Johnson's program to improve the U.S. balance of payments, which was announced in his message to the Congress on February 10, 1965.

The legislation contains proposed changes in the present tax law. These changes are designed to stimulate foreign investment in the United States by removing existing tax barriers to such investment. The proposed changes grew out of the Treasury study of recommendations made to President Johnson last April by the Task Force on Promoting Increased Foreign Investment in U.S. Corporate Securities. This task force was composed of leaders in the business and financial community and was headed by the then Under Secretary of the Treasury, Henry H. Fowler.

The changes affect the taxation of foreign individuals and foreign corporations. Many of the provisions in the present law which will be revised or eliminated by the proposed legislation have tended to complicate or inhibit investment in U.S. corporate securities without generating any significant tax revenues.

The total annual revenue loss from enactment of the proposed legislation is estimated to be less than $5 million.

Foreign purchases of U.S. corporate securities are the greatest single source of long-term capital inflow for the United States. Between 1956 and 1963, such purchases averaged $190 million a year. During that time the value of foreign-held stocks outstanding more than doubled—going from $6.1 billion to $12.5 billion. There is no estimate of the immediate benefit from the proposed legislation in terms of increased investment, but over time it is expected that the legislation would result in increased purchases of such securities of roughly $100 million to $200 million a year.

The bill proposes three major tax changes affecting foreigners and foreign corporations and a number of minor changes. The major changes are:

1. Reduction of the rate of U.S. estate tax applicable to foreigners to bring the tax treatment of foreigners more in line with the rates usually paid by American citizens, and with general international practice. The reduction would replace the present maximum rate of 77 percent for foreigners with a maximum rate of 15 percent, and replace the present $2,000 exemption with a $30,000 exemption.

2. Elimination of the provision in the present law which makes foreigners' nonbusiness income, such as dividends and interest, subject to tax at regular U.S. individual tax rates if it exceeds $21,200. The tax on such income would be limited to the flat 30 percent withholding rate provided by statute or any lower withholding rate which may be provided by treaty. Business income would continue to be taxed at regular U.S. rates if the foreigner is engaged in business here.

3. Elimination of the present provision for taxation of capital gains realized by a foreigner simply because he was present in the United States at the time of the particular transaction. At the same time, the period that a foreigner may spend in the United States, without becoming subject to tax on all U.S. capital gains for the taxable year, would be extended from 90 days to 183 days.

Since the application of the U.S. estate tax to foreigners is one of the biggest barriers to foreign investment in the United States, its reduction is probably the most important of the major changes. For example, the proposed change would reduce the estate tax for a foreigner with a U.S. gross estate of $100,000 from about $17,300 to about $3,000. A U.S. citizen would pay about the same tax on such an estate if he did not claim the marital deduction, and would pay no tax if he did. (Foreigners are not allowed to claim the marital deduction.)

The proposed legislation also contains provisions dealing with former U.S. citizens who in the future give up their citizenship and live outside the United States in order to avoid U.S. taxes. It would require such former citizens to pay regular U.S. income and estate taxes on income from or property in the United States, if they gave up their U.S. citizenship less than 10 years before. This would not apply to former citizens who could show that the surrender of their citizenship was not tax motivated.

There are also other provisions designed to contribute to more rational and consistent tax treatment of foreigners and foreign corporations.

(A general explanation of the proposed legislation is attached.)

ACT TO REMOVE TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES

General Explanation

INTRODUCTION

In his balance of payments message of February 10, 1965, the President proposed a series of measures designed to reinforce the program to correct the balance-of-payments deficit of the United States. Among the proposals made by the President is one to remove the tax deterrents to foreign investment in U.S. corporate securities so as to improve our balance of payments by encouraging an increase in such investment. The recommended legislation described herein would effectuate this proposal.

The review of the tax treatment of nonresident foreigners and foreign corporations investing in the United States resulting in these legislative recommendations was prompted in large measure by the report of the Task Force on Promoting Increased Foreign Investment in U.S. Corporate Securities. This task force, which was headed by the then Under Secretary of the Treasury, Henry H. Fowler, was directed, among other things, to review U.S. Government and private activities which adversely affect foreign purchases of the securities of U.S. private companies. In its report, the task force made 39 recommendations designed to help the United States reduce its balance-of-payments deficit and defend its gold reserves. Among these were several directed at changing the tax treatment of foreign investors so as "to remove a number of elements in our tax structure which unnecessarily complicate and inhibit investment in U.S. corporate securities without generating material tax revenues." The task force report cautioned, however, that its tax recommendations were not intended to turn the United States into a tax haven, nor to drain funds from developing countries.

The legislation being requested deals with all of the tax areas discussed in the task force report, although in certain instances the action suggested differs from the proposals made by the task force. Furthermore, the draft bill contains recommendations in areas not mentioned in the task force report which deal with problems which came to light in the Treasury Department's study of the present system of taxing nonresident foreigners and foreign corporations. It should be emphasized that the recommendations embodied in the proposed legislation were considered not only from the viewpoint of their impact on the balance of payments, but also to insure that they contributed to a rational and consistent program for the taxation of foreign individuals and foreign corporations. Thus, all legislative suggestions made herein are justifiable on conventional tax policy grounds.

It is estimated that the adoption of these proposals would result in a net revenue loss on an annual basis of less than $5 million.

Foreign purchases of U.S. stocks constitute the largest single source of long-term capital inflow into the United States, with even greater potential for the future. Net purchases have averaged $190 million a year between 1956 and 1963, while the outstanding value of foreign-held stocks has risen from $6.1 billion to $12.5 billion during this period. It is extremely difficult to measure the precise impact of this proposed legislation on our balance of payments because of the

various factors affecting the level of foreign investment in the United States. It is anticipated that, when combined with an expanding U.S. economy, the proposed legislation will result over the years in a significant increase in such investment.

Most provisions of the draft bill are proposed to become effective to taxable years beginning after December 31, 1965. However, those provisions which provide a revised estate tax treatment for the estates of foreigners are made applicable to the estates of decedents dying after the date of the enactment of the proposed legislation. In addition, those special provisions applicable to U.S. citizens who have surrendered their U.S. citizenship are made applicable if the surrender occurred after March 8, 1965.

SPECIFIC RECOMMENDATIONS

The following paragraphs describe the specific changes in the Internal Revenue Code of 1954 which are proposed. For this purpose the technical language of the Internal Revenue Code has been used; e.g., foreigners are described by the technical term "alien."

1. *Graduated rates.*—Eliminate the taxation at graduated rates of U.S. source income of nonresident alien individuals not doing business in the United States.

Under present law, nonresident aliens deriving more than $21,200 of income from U.S. sources are subject to regular U.S. graduated rates and are required to file returns. However, graduated rates on investment income already are eliminated by treaty in the case of almost all industrial countries, except where a taxpayer is doing business in the United States and has a permanent establishment here. Only a very small amount of revenue is collected from graduated rates at present. For example, for 1962 graduated rates resulted in the collection of $746,743 above the taxes already withheld. Although graduated rates are rarely applicable they complicate our tax law and tend to frighten and confuse foreign investors.

Thus, graduated rates, whether applied to investment income or such types of income as pensions, annuities, alimony, and the like, serve no clearly defined purpose, deter foreign investment, and should be eliminated. The elimination of graduated rates will limit the liability of nonresident aliens not engaged in trade or business to taxes withheld, and where the alien is not engaged in trade or business here no return need be made. (However, graduated rates would be retained for the U.S. business income of nonresident aliens engaged in trade or business here.)

2. *Segregation of investment and business income and related matters.*—Provide that (*a*) nonresident alien individuals engaged in trade or business in the United States be taxed on investment (nonbusiness) income at the 30-percent statutory withholding rate, or applicable treaty rate, rather than at graduated rates; (*b*) foreign corporations engaged in business in the United States be denied the 85-percent dividends-received deduction and be exempt from tax on their capital gains from investments in U.S. stocks; (*c*) nonresident alien individuals and foreign corporations not be deemed engaged in trade or business in the United States because of investment activity in the United States or because they have granted a discretionary power to a U.S. banker, broker, or adviser; and (*d*) nonresident alien individuals and foreign corporations be given an election to compute income from real property and mineral royalties on a net income basis and be taxed at graduated rates on such income as if engaged in trade or business in the United States.

Segregation of business and investment income

Under present law, if a nonresident alien is engaged in trade or business within the United States, he is subject to tax on all his U.S. income (including capital gains), even though some of the income is not derived from the conduct of the trade or business, at the same rates as U.S. citizens.

A nonresident alien individual engaged in trade or business in the United States should be subject to taxation on his investment income on the same basis as a nonresident alien not so engaged. Thus his investment income would be taxed at the 30-percent statutory rate or applicable treaty rate, rather than at graduated rates. For the purpose of determining the applicability of treaty rates the alien will be deemed not to have a permanent establishment in this country. All business income should remain subject to tax at graduated rates, but the rates on business income would be computed without regard to the amount of investment income.

This change conforms to the trend in international treaty negotiations to separate investment income from business income. Whether a taxpayer is helped or

harmed by segregating his investment from his business income, separate treatment is proper and equitable. Investment decisions may be made on the same basis whether or not the alien is engaged in business here, since income arising from investments here will not be subject to taxation at graduated rates in either event.

Moreover, a nonresident alien individual engaged in trade or business here should not be taxed on capital gains realized in the United States which are unrelated to the business activity carried on by him in this country, except where he would be subject to tax on those gains under the rules pertaining to nonresident aliens generally.

Tax treatment of income from U.S. stock investments by foreign corporations

Under present law all the activities of a corporation are treated as part of its trade or business. Thus, for example, all its expenses are treated as deductible as business expenses. Accordingly, it would be inappropriate to segregate a foreign corporation's U.S. "investment" income from its U.S. "business" income. However, there is one abuse in this area which should be eliminated. Frequently, a foreign corporation with stock investments in the United States engages in trade or business here in some minor way (such as by owning a few parcels of real estate) and then claims the 85-percent dividends-received deduction on its stock investments in the United States. Such a corporation thereby may pay far less than the 30-percent statutory or treaty withholding rate on its U.S. dividend income, although its position is essentially the same as that of a foreign corporation doing business elsewhere which has U.S. investment income.

To eliminate this abuse and treat all foreign corporations with investments in U.S. stocks alike, the 85-percent dividends-received deduction should be denied to foreign corporations doing business here. Their income from stock investments would be made subject to the 30-percent statutory withholding rate, or any lesser treaty rate applicable to such income, rather than regular U.S. corporate rates. For the purpose of determining whether the treaty rates on dividend income apply, a foreign corporation will be deemed not to have a permanent establishment in this country. To fully equate the tax treatment of stock investments of foreign corporations doing business in the United States with that of foreign corporations not doing business here, such corporations are exempted from the U.S. tax on capital gains realized on their U.S. stock investments.

Definition of "Engaged in trade or business"

Present law provides that the term "engaged in trade or business" does not include the effecting, through a resident broker, commission agent, or custodian, of transactions in the United States in stocks, securities, or commodities. There is some confusion as to whether the amount of activity in an investment account, or the granting of a discretionary power to a U.S. banker, broker, or adviser, will place a nonresident alien outside of this exception for security transactions so that he is engaged in trade or business in the United States. This uncertainty may deter investment in the United States and is undersirable as a matter of tax policy.

The fact that a discretionary power of investment has been given to a U.S. broker or banker does not really bear a relation to the foreigner's ability to carry out transactions in the United States—the discretionary power is merely a more efficient method of operating rather than having the investor consulted on every investment decision and frequently is mreely a safeguard to protect him in case of world turmoil. Nor, where the alien is an investor, is the volume of transactions material in determining whether he is engaged in trade or business.

Accordingly, the proposed legislation makes clear that individuals or corporations are not engaged in trade or business because of investment activity in the United States or because they have granted a discretionary investment power to a U.S. banker, broker, or adviser. No legislative change is necessary to provide that the volume of transactions is not material in determining whether an investor is engaged in trade or business in the United States as this is the rule under present law.

Real estate income and mineral royalties

Under present law it is not clear whether a nonresident alien (or foreign corporation) is engaged in trade or business in the United States by reason of the mere ownership of unimproved real property or real property subject to a strict net lease, or by reason of an agent's activities in connection with the selection of real estate investments in the United States.

If because of such activity a nonresident alien is considered as not engaged in trade or business he becomes subject to withholding tax on his gross rents. Since

the consequent tax could exceed his net income, the taxation on a gross basis of income from real property should not be continued where taxation on a net basis at graduated U.S. rates would be more appropriate.

Therefore, a nonresident alien or foreign corporation should be given an election to compute their income from real property (including income from minerals and other natural resources) on a net income basis and at regular U.S. rates as if they were engaged in trade or business in the United States. Such an election is comparable to the one now appearing in many treaties to which the United States is a party. Such an election would not effect the method of taxation applied to his other income.

3. *Capital gains.*—Eliminate the provision taxing capital gains realized by a nonresident alien when he is physically present in the United States, and extend from 90 to 183 days the period of presence in the United States during the year which makes nonresident aliens taxable on all their capital gains.

The underlying policy of U.S. taxation of nonresident alien individuals has been to exempt capital gains realized from sources in this country. This policy has been proper both from a tax policy standpoint and from the viewpoint of our balance of payments. However, existing law has two limitations: U.S. capital gains realized by a nonresident alien while he is physically present in the United States, or realized during a year in which he is present in the United States for 90 days or more, are subject to a U.S. tax of 30 percent.

The limitations now contained in our law, especially the physical presence test, contain illogical elements and are likely to have a negative impact on foreigners who are weighing the advantages and disadvantages of investing in the United States. The physical presence test was added to the law after World War II when many nonresident alien traders were frequently present in this country. Since this is no longer true, and moreover, since the tax may be readily avoided by passing title to the property outside the United States, the provision now serves little purpose. However, it does pose a threat to the foreign investor which may deter him from investing in this country and therefore should be eliminated.

The limitation relating to presence in the United States for 90 days or more in a particular year should be retained, but the period should be lengthened to 183 days. This extension will remove a minor deterrent to travel in the United States and help mitigate the harsh consequences which may arise under the existing rule if a nonresident alien realized capital gains at the beginning of a taxable year during which he later spends 90 days or more in the United States.

4. *Personal holding company and "second dividend" taxes.*—(*a*) Exempt foreign corporations owned entirely by nonresident alien individuals, whether or not doing business in the United States, from the personal holding company tax; (*b*) modify the application of the "second dividend tax" of section 861(a)(2)(B) so that it only applies to the dividends of foreign corporations doing business in the United States which have over 80 percent U.S. source income.

Under present law any foreign corporation with U.S. investment income, whether or not doing business here, may be a personal holding company unless it is owned entirely by nonresident aliens, and unless its gross income from U.S. sources is less than 50 percent of its gross income from all sources.

The personal holding company tax should not apply to foreign corporations owned entirely by nonresident aliens. The only reason for applying our personal holding company tax to foreign corporations owned by nonresident aliens has been to prevent the accumulation of income in holding companies organized to avoid the graduated rates. With the elimination of graduated rates as suggested in recommendation 1 (and the revision of the second dividend tax, discussed below), U.S. investment income in the hands of foreign corporations will have borne the U.S. taxes properly applicable to it and accumulation of such income will not result in the avoidance of U.S. taxes imposed on the company's shareholders. Hence, there is no longer any reason to continue to apply the personal holding company tax to these corporations.

With respect to the "second dividend tax," section 861(a)(2)(B) now provides that if a corporation derives 50 percent or more of its gross income for the preceding 3-year period from the United States, its dividends shall be treated as U.S. source income to the extent the dividends are attributable to income from the United States. As a result such dividends are subject to U.S. tax when received by a nonresident alien. This tax is often referred to as the "second dividend tax." However, under section 1441(c)(1) a foreign corporation is not required to withhold tax on its dividends unless it is engaged in business in the United States and, in addition, more than 85 percent of its gross income is derived from U.S. sources.

It is now proposed to levy this second dividend tax only where the foreign corporation does business in the United States, and 80 percent or more of its gross income (other than dividends and capital gains on stock) is derived from U.S. sources. Where a foreign corporation is not doing business in the United States, it will pay U.S. withholding taxes on all investment income and other fixed or determinable gains and profits derived from the United States, and since that is all the tax its foreign shareholders would owe if they received the income directly, no second tax seems warranted.

With the adoption of the rule that the income from the U.S. stock investments of foreign corporations doing business here be taxed at flat statutory or treaty withholding rates, no further U.S. tax should be imposed on such income. Therefore, in applying the proposed 80 percent test, such income of the foreign corporation, whether from United States or foreign sources, should be disregarded and the test applied only to the corporation's other income. Furthermore, if the 80 percent rule is met, the dividends of such corporations should be subject to tax only to the extent that such dividends are from U.S. source income other than income from stock investments in the United States.

Withholding requirements should conform to the incidence of tax, and therefore withholding should be required on dividends paid by foreign corporations doing business in the United States with 80 percent or more U.S. source income to the extent such dividends are from U.S. source income other than income from stock investments in the United States.

With the adoption of the revisions proposed in U.S. system of taxing nonresident aliens and foreign corporations, the regulations dealing with the accumulated earnings tax will be revised to eliminate the application of this tax to foreign corporations not doing business in the United States which are owned entirely by nonresident aliens. The accumulation of earnings by such corporations will not result in the avoidance of U.S. taxes. However, because of possible avoidance of the revised second dividend tax, the accumulated earnings tax will remain applicable to foreign corporations doing business here.

5. *Estate tax and related matters.*—(*a*) Increase the $2,000 exemption from tax to $30,000 and substitute for regular U.S. estate tax rates a 5–10–15 percent rate schedule; (*b*) provide that bonds issued by domestic corporations or governmental units and held by nonresident aliens are property within the United States and therefore are subject to estate tax; and (*c*) provide that transfers of intangible property by a nonresident alien engaged in business in the United States are not subject to gift tax.

It is generally believed that high estate taxes on foreign investors are one of the most important deterrents in our tax laws to foreign investment in the United States. Our rates in many cases are higher than those of other countries and in these situations, despite tax conventions and statutory foreign estate tax credits, nonresidents who invest in the United States suffer an estate tax burden. Moreover, under present law a nonresident alien's estate must pay heavier estate taxes on its U.S. assets than would the estate of a U.S. citizen owning the same assets.

To mitigate this deterrent to investment and to rationalize the estate tax treatment of nonresident aliens, the exemption for estates of nonresident alien decedents should be increased from $2,000 to $30,000 and such estates should be subject to tax at the following rates:

If the taxable estate is—	The tax shall be—
Not over $100,000	5 percent of the taxable estate.
Over $100,000 but not over $750,000	$5,000, plus 10 percent of excess over $100,000.
Over $750,000	$70,000, plus 15 percent of excess over $750,000.

The increase in exemption and reduced rates will bring U.S. effective estate tax rates on nonresident aliens to a level somewhat higher than those imposed upon resident estates in Switzerland, Germany, France, and the Netherlands, for example, but substantially below those imposed on resident estates in the United Kingdom, Canada, and Italy. Thus U.S. investment from these latter countries bears no higher estate tax than local investment because of foreign tax credits or exemptions provided in such countries. The proposed tax treatment of the U.S. estates of nonresident aliens is similar to the treatment accorded the estates of nonresidents by Canada, whose rates on the estates of its citizens are comparable to our own. Where additional reductions are justified these may be made by treaty.

These changes should result in more appropriate estate tax treatment of nonresident aliens and thereby improve the climate for foreign investment in the

United States. Particularly in the case of nonresident alien decedents who have only a small amount of U.S. property in their estates, present U.S. rates and the limited exemption provided result in an excessive effective rate of estate tax. The proposed changes correct this situation. The new rates will produce for nonresident aliens' estates an effective rate of tax on U.S. assets which in many cases is comparable to that applicable to U.S. citizens who may avail themselves of the $60,000 exemption and marital deduction (which are not available to nonresident aliens).

The following figures show the effective rates for nonresident aliens under present law, and the effective rates produced by the proposed exemption and rates as compared to those applicable to the estates of U.S. citizens electing and not electing the marital deduction:

U.S. gross estate	Nonresident alien under present law	Nonresident alien under proposed law	U.S. citizen with marital deduction	U.S. citizen without marital deduction
$60,000	12.5	2.0	----------	----------
$100,000	17.3	3.0	----------	3.0
$500,000	25.8	7.4	8.0	22.1
$1,000,000	38.8	8.8	11.1	26.7
$5,000,000	43.0	12.6	16.9	42.3

As part of this revision of the estate tax, the situs rule with respect to bonds should be changed. The present rule, very frequently modified by treaty, is that bonds have situs where they are physically located. This rule is illogical, permits tax avoidance, and is not a suitable way to determine whether bonds are subject to an estate tax as their location is one of their least significant characteristics for tax purposes. Other intangible debt obligations are presently treated as property within the United States if issued by or enforcible against a domestic corporation or resident of the United States. Accordingly, it is recommended that our law be amended to provide that bonds issued by domestic corporations or domestic governmental units and held by nonresident aliens are property within the United States and therefore subject to estate tax.

Furthermore, a present defect in the operation of the credit against the estate tax for State death taxes in the case of nonresident aliens should be corrected. Under present law the estate of a nonresident alien may receive the full credit permitted by section 2011 even though only a portion of the property subject to Federal tax was taxed by a State. The amount of credit permitted by section 2011 in the case of nonresident aliens should be limited to that portion of the credit allowed the estate which is allocable to property taxed by both the State and the Federal Government.

Our gift tax law as it applies to nonresident aliens should be revised. Under present law a nonresident alien doing business in the United States is subject to gift tax on transfers of U.S. intangible property. This rule has little significance from the standpoint of revenue and tax equity. Therefore, our law should be amended to provide that transfers of intangible property by a nonresident alien, whether or not engaged in business in the United States, are not subject to gift tax. Gifts of tangibles situated in the United States which are owned by nonresident aliens will continue to be subject to U.S. gift taxes.

6. *Expatriate American citizens.*—Subject the U.S. source income of expatriate citizens of the United States to income tax at regular U.S. rates and their U.S. estates to estate tax at regular U.S. rates, where they surrendered their U.S. citizenship within 10 years preceding the taxable year in question unless the surrender was not tax motivated.

As a result of the proposed elimination of graduated rates, taken together with the proposed change in our estate tax as it applies to nonresident aliens, an American citizen who gives up his citizenship and moves to a foreign country would be able to very substantially reduce his U.S. estate and income tax liabilities.

While it may be doubted that there are many U.S. citizens who would be willing to give up their U.S. citizenship no matter how substantial the tax incentive, a tax incentive so great might lead some Americans to surrender their citizenship for the ultimate benefit of their families. Thus, it seems desirable, if progressive rates are eliminated for nonresident aliens and our estate tax on the estates of nonresident aliens is significantly reduced, that steps be taken to limit the tax advantages of alienage for our citizens.

The recommended legislation accomplishes this by providing that a nonresident alien who surrendered his U.S. citizenship within the preceding 10 years shall re-

main subject to tax at regular U.S. rates on all income derived from U.S. sources. A similar rule would apply for estate tax purposes to the U.S. estates of expatriate citizens of the United States. Thus, the U.S. property owned by expatriates would be taxed at the estate tax rates applicable to our citizens (but without the $60,000 exemption, marital deduction, and other such provisions applicable to our citizens), in cases where the alien decedent's surrender of citizenship took place less than 10 years before the day of his death. The $30,000 exemption granted nonresident aliens would be allowed to expatriate citizens.

To prevent an expatriate from avoiding regular U.S. rates on his U.S. income by transferring his U.S. property to a foreign corporation, or disposing of it overseas, the recommended legislation treats profits from the sale or exchange of U.S. property by an expatriate as being U.S. source income. To preclude the use of a foreign corporation by an expatriate to hold his U.S. property and thus avoid U.S. estate taxes at regular U.S. rates, an expatriate is treated as owning his pro rata share of the U.S. property held by any foreign corporation in which he alone owns a 10-percent interest and which he, together with related parties, controls. Furthermore, the recommended legislation makes gifts by expatriates of intangibles situated in the U.S. subject to gift tax.

These provisions would be applicable only to expatriates who surrendered their citizenship after March 8, 1965, and would not apply if contravened by the provisions of a tax convention with a foreign country. Moreover, they would not be applicable if the expatriate can establish that the avoidance of U.S. tax was not a principal reason for his surrender of citizenship.

7. *Retaining treaty bargaining position.*—Provide that the President be given authority to eliminate with respect to a particular foreign country any liberalizing changes which have been enacted, if he finds that the country concerned has not acted to provide reciprocal concessions for our citizens after being requested to do so by the United States.

One difficulty which may arise from the liberalizing changes being proposed in U.S. tax law is that it may place the United States at a disadvantage in negotiating concessions for Americans abroad as respects foreign tax laws. Moreover, the failure to obtain concessions abroad may have an effect upon our revenues since the foreign income and estate tax credits we grant our citizens mean that the United States bears a large share of the burden of foreign taxation of U.S. citizens. To protect the bargaining power of the United States the President should, therefore, be authorized to reapply present law to the residents of any foreign country which he finds has not acted (when requested by the United States to do so, as in treaty negotiations) to provide for our citizens as respects their U.S. income or estates substantially the same benefits as those enjoyed by its citizens as a result of the proposed legislative changes. The provisions reapplied would be limited to the area or areas where our citizens were disadvantaged. Furthermore, the provisions reapplied could be partly mitigated, if that were desirable, by treaty with the other country.

It is essential, if we are to revise our system of taxing nonresident aliens as is being suggested, that this recommendation be adopted. Otherwise, we risk sacrificing the interests of our citizens subject to tax abroad and reducing our revenues in an effort to simplify the taxes imposed upon nonresident aliens.

8. *Quarterly payment of withheld taxes.*—Provide that withholding agents collecting taxes from amounts paid to nonresident aliens be required to remit such taxes on a quarterly basis.

Under the present system, withholding agents are required to remit taxes withheld on aliens during any calendar year on or before March 15 after the close of such year. This procedure varies considerably from that applicable to domestic income tax withheld from wages and employee and employer FICA taxes, where quarterly (in some cases monthly) payments are required.

Withholding on income derived by nonresident aliens should be brought more closely into line with the domestic income tax system. There is no reason to permit withholding agents to keep nonresident aliens' taxes for periods which may exceed a full year before being required to remit those taxes, when employers must remit taxes withheld on domestic wages at least quarterly. The Government loses the use of the revenue, which revenue in 1962 exceeded $80 million, for the entire year. Accordingly, section 1461 requiring the return and payment of taxes withheld on aliens by March 15 should be revised to eliminate this specific requirement. The Secretary or his delegate would then exercise the general authority granted him under sections 6011 and 6071 and require withholding agents to return and remit taxes withheld on income derived by nonresident aliens quarterly. However, no detailed quarterly return would be required.

9. *Exemption for bank deposits.*—Under present law, an exemption from income taxes, withholding, and estate taxes is provided for bank deposits of nonresident alien individuals not doing business in the United States. By administrative interpretation, deposits in some savings and loan associations are treated as bank deposits for purposes of these exemptions, but such exemptions do not apply to most savings and loan associations. There does not appear to be any justification for this distinction between types of savings and loan associations and it should be eliminated by extending these exemptions to all such associations.

10. *Foreign tax credit—similar credit requirement.*—Section 901(b)(3) provides that resident aliens are entitled to a foreign tax credit only if their native country allows a similar credit to our citizens residing in that country. Apparently the provision is designed to encourage foreign countries to grant similar credits to our citizens. However, this requirement works a hardship on refugees from totalitarian governments. For example, the Castro government is not concerned with whether Cubans in this country receive a foreign tax credit. Therefore, it is recommended that the similar credit requirement of section 901(b)(3) be eliminated, subject to reinstatement by the President where the foreign country, upon request, refuses to provide a similar credit for U.S. citizens. Of course, no request would ordinarily be made in a case, such as Cuba, where the possible reinstatement of the present reciprocity requirement would have little or no effect upon the foreign government's policy toward U.S. citizens.

11. *Stamp taxes on original issurances and transfers of foreign stocks and bonds in the United States to foreign purchasers.*—Our stamp tax on certificates of indebtedness is imposed on issuances and transfers within the territorial jurisdiction of the United States. The stamp tax on issuances of stock does not apply to stock issued by a foreign corporation, but the transfer tax applies to transfers in the United States. These taxes have forced U.S. underwriters who handle issuances of foreign bonds and stocks and their original distribution to foreign purchasers to handle closings overseas. In view of the limited association of such issuances and transfers with the United States and the fact that these taxes are ordinarily avoided by moving the transactions outside the United States, our law should be revised to exempt original offerings of foreign issuers to foreign purchasers from our stamp taxes where only the issuances and transfers take place in the United States. Such an exemption would facilitate such transactions and their handling by U.S. underwriters and is consistent with our balance-of-payments objectives.

12. *Withholding taxes on savings bond interest.* The Ryukyu Islands, the principal island of which is Okinawa, and the Trust Territory of the Pacific, principally the Caroline, Marshall, and Mariana Islands, although under the protection and control of the United States, are technically foreign territory. Thus, the islanders are nonresident aliens and subject to a 30-percent withholding tax on interest on U.S. savings bonds. This interferes with the selling of U.S. savings bonds. Therefore, the 30-percent withholding tax as it applies to the interest income realized from U.S. savings bonds by native residents of these islands should be eliminated.

In addition to the changes discussed above, the proposed legislation makes a number of clarifying and conforming changes to present law.

MARCH 8, 1965.

[Press release for June 18, 1965]

CHAIRMAN WILBUR D. MILLS, DEMOCRAT, OF ARKANSAS, COMMITTEE ON WAYS AND MEANS, ANNOUNCES INVITATION FOR INTERESTED PERSONS TO SUBMIT WRITTEN STATEMENTS ON H.R. 5916

Subject: H.R. 5916, act to remove tax barriers to foreign investment in the United States

Chairman Wilbur D. Mills, Democrat, of Arkansas, Committee on Ways and Means, U.S. House of Representatives, today announced that interested persons are invited to submit written statements on H.R. 5916, the Act To Remove Tax Barriers to Foreign Investment in the United States. The chairman stated that anyone interested in submitted statements on this legislation should do so not later than the close of business Friday, June 25, 1965.

Cutoff date

As indicated, the cutoff date for the submission of written statements is no later than the close of business Friday, June 25, 1965. It should be noted that this bill was introduced on March 8, 1965, and has been available to interested persons

for study since that time. Forty copies of the written statements should be submitted to Leo H. Irwin, chief counsel, Committee on Ways and Means, 1102 Longworth House Office Building, Washington, D.C.

Committee procedure

The committee will consider these written statements in executive session along with the statement of the Treasury Department setting forth reasons for its proposal of the bill.

Format of written statements

(*a*) *Summary of comments and recommendations.*—The chairman requested that the written statements contain a topical outline or summary of the main points which the interested taxpayer makes relating to the bill. This will facilitate the consideration of the written statements.

(*b*) *Subject headings.*—The chairman also requested that the detailed written statements contain subject headings geared to the summary presented so as to facilitate committee consideration.

[Press release for June 24, 1965]

CHAIRMAN WILBUR D. MILLS, DEMOCRAT, OF ARKANSAS, COMMITTEE ON WAYS AND MEANS, ANNOUNCES PUBLIC HEARING ON H.R. 5916

Subject: H.R. 5916, the act to remove the barriers to foreign investment in the United States.

Chairman Wilbur D. Mills, Democrat, Arkansas, Committee on Ways and Means, U.S. House of Representatives, today announced the details of the hearing on H.R. 5916, the administration proposal to remove tax barriers to foreign investment in the United States. This hearing will be held on Wednesday, June 30, 1965.

Witnesses

The Secretary of the Treasury, the Honorable Henry H. Fowler, will testify in behalf of the administration, and a member of the "Fowler Task Force," the Presidential task force which investigated this area some months ago and the recommendations of which resulted in the development of the legislation, will also testify. If any requests are received from the general public, such witnesses will be scheduled following the above witnesses.

Cutoff date for requests to be heard

The cutoff date for requests to be heard is not later than the close of business Monday, June 28, 1965. Any requests to be heard should be submitted to Leo H. Irwin, chief counsel, Committee on Ways and Means, 1102 Longworth House Office Building, Washington, D.C.

Written comments

It will be recalled on June 18, 1965, an announcement was issued stating that the committee would be pleased to receive any written comments on this bill which interested individuals might care to submit. If any such comments are received, they will be printed as part of the printed record of the hearing.

If anyone requests to appear in person to testify, it is requested that 60 copies of the written statement be submitted at least 24 hours in advance of his scheduled appearance. In the case of those submitting statements in lieu of a personal appearance, at least three copies of such statement should be submitted by the close of business Wednesday, June 30, 1965.

Statements should include a summary sheet, and subject headings.

Notification of witnesses

If any requests are received by the cutoff date, the individual will be advised prior to the date of the hearing by the chief counsel as to scheduling. Any further details will be provided at that time.

Our first witness this morning is the Honorable Henry H. Fowler, Secretary of the Treasury. Mr. Secretary, we are very pleased to have you here and you may proceed as you wish.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY; ACCOMPANIED BY STANLEY S. SURREY, ASSISTANT SECRETARY, DEPARTMENT OF THE TREASURY

Secretary FOWLER. Thank you, Mr. Chairman. I am appearing before you to urge prompt and favorable action on H.R. 5916, legislation which is intended to reduce tax barriers to foreign investment in the United States.

Passage of this bill will serve two important national objectives. First, it constitutes a comprehensive and integrated revision of our present system of taxing foreign individuals and foreign corporations on income derived from the United States, bringing our system of taxing foreigners into line with the rules existing generally in the other developed countries of the world.

Second, the bill will make a significant contribution to our balance of payments by serving to eliminate the impediments now existing in our tax laws to foreign investment in the United States.

The background of these proposals, Mr. Chairman, goes back to mid–1963. In his balance-of-payments message of July 18, 1963, President Kennedy announced he was appointing a task force to review U.S. Government and private activities which adversely affect foreign purchases of the securities of U.S. companies. The group was composed of representatives of finance, business, and government. This task force, of which I had the privilege of serving as chairman, studied various courses of action which could be adopted not only by the public sector, which is the area before the committee today, but also by the private sector, to carry on activities that would be designed to induce larger amounts of investment from abroad in U.S. private corporate securities, real estate, and related matters.

Everyone was conscious at that time of the fact there was a very strong flow of capital out of the United States which was having an unfavorable short-term impact on our balance of payments. Everyone was also conscious that there was, and had historically been, a strong desire on the part of persons and institutions with savings in Western Europe to own U.S. private securities and other properties. Therefore, it was felt that a thorough reexamination of any impediments to the flow of foreign capital to the United States that might exist by reason of laws, regulations, and so forth, was necessary. With this in mind, industrial corporations operating abroad, investment banking houses, commercial banking houses, and brokerage concerns with offices abroad, were all brought together to determine what might be done to encourage the flow of foreign investment capital to the United States, with the thought that over the long pull we should get a better balance in capital flows. Such a result would, of course, have a healthy impact on our balance-of-payments deficit. It would also produce the kind of permanent arrangements that over the long pull would enable us to return to a period of relatively free capital movement, which is what we all want to get back to after the temporary measures we are now pursuing have served their purpose.

So it was in that framework that President Kennedy in his July 1963 message indicated that such a study would be made. It was also in this framework that President Johnson said in his February 10, 1965 message to the Congress that:

In order to stimulate greater inflow of capital from advanced industrial countries, the Secretary of the Treasury will request legislation generally along the lines recommended by a Presidential task force.

Following the initial establishment of the task force in the fall of 1963, it conducted a very intensive examination of the situation both here and abroad. In April 1964, it issued its report containing some 39 recommendations calling for a broad range of actions by U.S. international business organizations and financial firms, as well as by the Federal Government, to bring about broader foreign ownership of U.S. corporate securities.

I would like to interpolate that it was my privilege to serve as chairman of this group and that I have never seen a group of men who so conscientiously and generously devoted their time, effort, and personal resources to such a careful and earnest study of a problem. Although the task force report which emerged was small in terms of bulk, and very sharp and concise on the various areas of concern, the tremendous body of accumulated information and experience made available through the group was synthesized in the preparation of the report. I think not only the President, but the Congress and the general public as well, should be grateful to those who participated in this activity, particularly those in the private sector.

Among the recommendations directed toward the Government, those dealing with the taxation of foreign individuals and foreign corporations have the most significant and immediate impact.

Issuance of the task force report prompted a broad and intensive review by the Treasury of the rules governing taxation by the United States of foreign individuals and foreign corporations.

This review considered these rules not only from the standpoint of the balance of payments, but also from the viewpoint of conventional tax policy considerations.

As a result of this review, the Treasury Department on March 8, 1965, submitted to the Congress legislation containing not only proposals in all of the tax areas dealt with in the task force report, but also in other areas where it appeared that change was desirable to make the present system more consistent with rational tax treatment of foreign investment.

The Treasury Department agrees with the task force conclusion that many of the existing rules applicable to foreign investors in the United States are outmoded and not only serve to deter foreign investment but are inconsistent with sound tax policy. These rules were enacted many years ago and do not reflect the changes in economic conditions which have occurred over the last 15 years.

Examples of tax rules which impede foreign investment in this country are many: The present level of our estate tax—higher on foreigners than on U.S. citizens—is completely out of line with the rates generally prevailing elsewhere in the world and acts as a significant deterrent to potential foreign investors. Also, the fact that we require tax returns from foreigners merely because they make passive investments here is inconsistent with international tax practice and hinders foreign investment. These and other provisions in the Internal Revenue Code contribute to the widely held view that investment in U.S. securities poses such serious tax problems for the ordinary foreign investor that it cannot be undertaken without the benefit of expensive tax advice.

At the same time, some of these provisions are extremely difficult, if not impossible, to enforce, or are susceptible of relatively easy avoidance by the sophisticated foreign investor. Since they deter many foreign investors and are avoided by the rest, they give rise to almost no tax revenue. Enactment of all of the changes proposed in H.R. 5916 before you will result in a revenue loss of less than $5 million annually. However, in proposing these changes, we have kept in mind the importance of not converting the United States into a tax haven nor of diverting funds to the United States from less developed countries.

The purpose of this bill is to remove tax barriers which have served to discourage foreigners from making investments in the United States, in comparison with other competing areas. At the same time we recognize that no purpose will be served if the bill violates international tax standards, thereby setting off a struggle among the developed nations of the world to attract foreign investors through tax devices. To attract foreign investors, the United States must offer not "tax breaks" or "tax gimmicks"—it must offer a growing and dynamic economy. We believe our record of economic growth over the last 5 years and our prospects for the future are sufficient to induce a substantial increase in foreign investment if our tax system does not act as a bar.

Now as to the impact of H.R. 5916 on the balance of payments, which was the governing inspiration of the establishment of the task force in 1963, there is no way of estimating with any degree of precision the impact of the bill on foreign investment in the United States or the resulting benefit to our balance of payments. The factors governing securities investment are many and complex. Even in purely domestic transactions, intangibles such as habit, convenience, and past experience may be as important as yields, price-earnings ratios, and other economic indicators.

Although difficult to quantify, there is ample evidence of a sizable potential for attracting foreign investment in U.S. corporate securities, particularly stocks, by residents of the prosperous countries of continental Europe. After more than a decade of rapidly rising incomes, Europeans have to a large extent fulfilled many of their most pressing consumer needs and are accumulating savings at a high rate. Individuals in Europe are turning increasingly toward securities investment, as shown by the rising activity on European stock exchanges, the large number of new offices opening in Europe by American securities firms, and rising sales of mutual fund shares. Yet, even now, in Europe only one person in 30 is a shareowner as compared to one in 11 in the United States.

At the end of 1964, foreigners held an estimated $12.8 billion of U.S. corporate stocks valued at market prices. In every year since 1950 except two, foreign purchases of U.S. stocks have exceeded foreign sales. In the 6 years between 1959 and 1964, net purchases by foreigners averaged $141 million. These net figures are the residual of much larger gross purchases and sales which in recent years have been on the order of $2½ billion to $3½ billion annually. You can see that a small percentage shift in the ratio of purchases to sales, therefore, could have had a very substantial effect on the net balance of transactions.

If the amount of additional investment expected to result from H.R. 5916 were merely a function of the amount of tax saved, there

would be little improvement in the balance of payments. More important than the small tax savings to foreigners, however, is the substantial effect which will result from the simplification and rationalization of our tax treatment of foreign investors.

Our high estate tax on foreigners, for example, is widely considered by experts to be one of the biggest barriers to foreign investment. While the change in the estate tax proposed by H.R. 5916 would eliminate $3 million out of about $5 million of tax levied each year, existing estate tax rates almost certainly deter many foreigners from investing here at all. This is particularly so when the exemption is limited to only $2,000—any investment whatsoever will subject the estate to tax and require filing of an estate tax return, with the resulting expenses. It is not surprising under these circumstances that the small foreign investor avoids purchasing U.S. stocks because of the inconvenience of the estate tax; the big investor also avoids such purchasing but because of the size of the tax itself.

Viewed in this light, it is clear that the changes contained in H.R. 5916 should in time materially increase the volume of foreign investment in the United States. Based on the sizable potential for foreign purchases of U.S. corporate stocks which is known to exist, we expect that the legislation will eventually result in an additional capital inflow on the order of $100 million to $200 million per year, other factors remaining unchanged. Considerable time—perhaps 1 to 2 years or maybe more—will be required before foreigners can complete the adjustment of their portfolios to take advantage of H.R. 5916, but a substantial impact may be felt in the period just ahead.

Specific proposals contained in H.R. 5916: I will review the principal substantive changes which are embodied in the proposal.

First, as to the estate tax it is generally felt that our current system of taxing the U.S. estates (involving only the U.S. assets) of foreign decedents is inequitable and constitutes one of the most significant barriers in our tax laws to increasing foreign investment in U.S. corporate securities.

Under present law, a foreign decedent is taxable at regular U.S. estate tax rates, ranging up to 77 percent, on U.S. property held at death. Morover, the U.S. estates of foreign decedents are entitled only to a $2,000 exemption, compared with a $60,000 exemption available to U.S. citizen decedents, and are not entitled to the marital deduction available to U.S. citizen decedents. Thus, U.S. estate tax rates applied to nonresidents are in most cases considerably higher than those of other countries and therefore foreigners who invest in the United States suffer an estate tax burden. In addition, a foreign decedent's estate must pay heavier estate taxes on its U.S. assets than would the estate of a U.S. citizen owning the same assets.

H.R. 5916 would increase the exemption for the U.S. estates of foreign decedents from $2,000 to $30,000 and would tax such estates on the basis of a 5-, 10-, 15-percent rate schedule. With this significant increase in the exemption and sharp reduction in rates, the effective U.S. estate tax rate on foreign decedents would no longer be considerably higher than most other countries and would be more closely comparable to the rates prevailing elsewhere.

This change should have an important psychological effect on foreigners contemplating investment in U.S. securities. Where the gross U.S. estate would be less than $30,000, there would be no

estate tax, and no need to file an estate tax return. In those instances where the estate is larger, the effective rate would be sharply reduced and would be comparable to the effective rate of tax of a U.S. citizen who utilizes the $60,000 exemption and the marital deduction.

As to capital gains, the present system of taxing capital gains realized by foreigners has contributed to the view that investment in the United States is something which should be approached cautiously because of the possibility of inadvertently becoming subject to tax. The Internal Revenue Code now provides for a general exemption from capital gains tax for nonresident foreigners not doing business in the United States with two exceptions. First, the foreigner's gains are subject to U.S. capital gains tax if he is physically present in the United States when the gain is realized, and second, all gains during the year are taxable if he spends 90 days or more in the United States during that year.

The physical presence restriction can be easily avoided by the experienced foreign investor if he arranges to be outside the country when the gain is realized, but is a potential trap to the foreigner who is not aware of its existence. The bill would eliminate this restriction from the general capital gains exemption.

In addition, the bill would extend the 90-day period which a foreigner may spend here without being subject to capital gains tax to 183 days. This will make the provision more consistent with international standards governing the taxation of foreigners residing in a country for a substantial period. It will also minimize the possibility that a foreigner will be taxed on capital gains realized at the beginning of a taxable year if he later spends a substantial amount of time in the United States during that year.

As to graduated income tax rates at the present time, foreign individuals not doing business in the United States who derive more than $21,200 of investment income from U.S. sources are subject to regular U.S. income tax graduated rates on that income and are required to file returns. These requirements have produced little revenue, in part because we have eliminated graduated rate taxation of investment income in almost all of our treaties with the other industrialized countries and in part because of the ease with which this provision is avoided. Moreover, it has been indicated that graduated rate taxation and the accompanying return requirement may represent a substantial deterrent to foreign investment in the United States.

H.R. 5916 eliminates all progressive taxation of nonresident foreigners not doing business here and removes the requirement for filing returns in such cases. The liability of foreign investors deriving U.S. investment income would thus be limited to the tax withheld at the statutory 30-percent rate or the lower applicable treaty rate. The legislation would continue graduated rate taxation for foreigners who are doing business in the United States. These rules are consistent with the practices of most other industrialized countries.

The fourth recommendation has to do with segregation of investment and business income. Under present law, if a foreign individual is doing business in the United States he is subject to tax on all of his U.S. income, whether or not connected with his business operations, on the same basis in general as a U.S. citizen. H.R. 5916 would separate the business income of a foreign individual engaged in business here from his nonbusiness income, and would tax the nonbusiness

income at the 30-percent statutory withholding rate or at the lower appropriate treaty rate. All business income would remain subject to tax at graduated rates.

With respect to foreign corporations doing business in the United States (so-called resident foreign corporations), which also have stock investments here, H.R. 5916 would likewise separate dividend income from the other income of the foreign corporation. Under the legislation, a resident foreign corporation deriving such dividend income from the United States would thus be taxable on its dividend income at the statutory 30-percent rate or at the lower applicable treaty rate. As a result, the foreign corporation would no longer receive the deduction now afforded under the Internal Revenue Code to dividends received by one corporation from another corporation.

The elimination of the dividends received deduction as respects resident foreign corporations is in part designed to end an abuse which has developed. Frequently, a foreign corporation with stock investments in the United States engages in trade or business here in some minor way and then claims the dividends received deduction on its stock investments. Such a corporation ends up paying far less than the 30-percent statutory or applicable treaty rate on its U.S. dividends, even though its position is basically the same as a corporation which is not doing business here which derives investment income from the United States. In those cases where the applicable treaty rate is 5 percent (the rate set by certain treaties where subsidiary dividends are involved), the resident foreign corporation will benefit from this proposed change.

As to definition of the term "engaged in trade of business"—H.R. 5916 makes clear that individuals or corporations are not engaged in trade or business in the United States—and thus subject to tax at regular graduated rates rather than the 30-percent withholding rate or lower treaty rate—because of investment activities here or because they have granted a discretionary investment power to a U.S. banker, broker, or adviser. This provision should have the effect of removing much of the uncertainty which now surrounds the question of what amounts to engaging in trade or business in the United States. Uncertainty of this type is undesirable as a matter of tax policy and has the effect of limiting foreign investment in the United States. Many foreigners are afraid of investing in U.S. stocks if they cannot give a U.S. bank or broker authority to act for them. This change will have relatively limited impact, however, since under the legislation, business income does not include dividends or gains from the sale of stock.

The bill also changes present law by giving foreign individuals and corporations an election to compute their income from real property on a net income basis at regular U.S. rates rather than at the 30-percent withholding rate or lower treaty rate on gross income. This type of treatment is common in the treaties to which the United States is a party and is designed to deal with the problem which arises from the fact that the expenses of operating real property may be high and cannot be taken into consideration if the income from real peoprety is subject to withholding tax.

As to personal holding companies and the "second dividend tax,"—H.R. 5916 changes the personal holding company provisions of the Internal Revenue Code as applied to the U.S. investment income of

71-297 O-67-pt. 1—11

foreign corporations and also modifies the application of the so-called second dividend tax.

Under the bill, foreign corporations owned entirely by foreigners would be exempt from the personal holding company tax. This is possible because of the elimination of graduated rates as applied to foreigners which is contained elsewhere in the bill, which makes the application of the personal holding company provision to corporations wholly owned by foreigners no longer appropriate.

Under the bill, the "second dividend tax" (which is levied on dividends distributed by a foreign corporation if the corporation derives 50 percent or more of its income from the United States) would be applied only to the dividend distributions of foreign corporations doing business in the United States which have over 80 percent U.S. source income. It is desirable to retain this part of the tax to cover those cases where a resident foreign corporation has the great bulk of its business operations in the United States and to treat dividends of such a corporation as being from U.S. sources.

These changes should have the effect of eliminating application of the personal holding company tax and "second dividend tax" in many cases where they now apply, and which may now act as a deterrent to foreign investment.

As to expatriate American citizens—the provisions of H.R. 5916 which eliminate graduated rates for foreign individuals and substantially reduce the estate tax liability of foreign decedents may create a substantial tax incentive to U.S. citizens who might wish to surrender their citizenship in order to take advantage of these changes in the law.

While it is doubtful whether there are many who would be willing to take such a step, still the incentive would be present and might be utilized. H.R. 5916 deals with this problem by providing that an individual who had surrendered his U.S. citizenship for tax reasons within the preceding 10 years shall be subject to U.S. taxation with respect to his U.S. income and assets at the rates applicable to citizens. Such individuals will therefore not receive the benefits of this legislation but will be taxed as nonresident foreigners are at present. As I mentioned, these provisions would not apply if the expatriate American citizen can establish that the avoidance of U.S. taxes was not a principal reason for his surrender of citizenship.

As to retaining the treaty bargaining position of the U.S.—the risk is present that by making the changes provided in H.R. 5916, the United States may be placed at a considerable disadvantage in negotiating similar concessions for Americans. In order to protect the bargaining position of the United States in international tax treaty negotiations, H.R. 5916 therefore authorizes the President, where he determines such action to be in the public interest, to reapply present law to the residents of any foreign country which he finds has not acted to provide our citizens substantially the same benefits for investment in that country as those enjoyed by its citizens on their investments in the United States as a result of this legislation. If this authority were invoked, it could be limited to those investment situations as to which U.S. citizens were not being given comparable treatment. We believe that the presence of such a provision will be a material aid in our securing appropriate provisions respecting these matters in our international tax treaties.

In conclusion, our current system of taxing foreign investors in the United States contains elements which are inconsistent with generally accepted international tax policy principles and which, at the same time, act to discourage foreign investment in the United States. H.R. 5916 is designed to reshape our present system in order to make it a more rational vehicle for taxing foreign individuals and corporations.

The legislation is an essential element of the President's comprehensive program for dealing with our balance-of-payments problem on an enduring basis. This is not a quick emergency action to deal with any special problem in the next year or two. It is a part of the longer term program that I have discussed on occasion with members of this committee that can, over a long period of years, better enable us to return to the free market principles which we hope can be maintained as a permanent basis.

As such, it is one of the aspects of the President's program which is expected to have a longer term impact on our balance of payments. Foreigners will invest in this country as long as our economy remains prosperous and stable. However, it cannot be expected that the level of foreign investment will reach its full potential so long as provisions exist in our tax laws which serve to discourage foreign investment and which are not in accord with international tax standards.

H.R. 5916 will eliminate or modify the provisions of present law which have complicated our system of taxing foreigners but have resulted in little revenue being realized.

Adoption of H.R. 5916 will lead to a simpler and more rational method of taxing foreigners. It will also be an important step in moving toward the elimination of our balance-of-payments deficit and the strengthening of the international position of the dollar and, I might say, of sustaining an equilibrium in our balance of payments over the long pull with the minimum reliance on the temporary measures that are now necessary.

Because this legislation will contribute to these two vital national objectives, I urge you to support it.

One additional comment, Mr. Chairman and members of the committee. Before some of you were able to be present, I said at the outset that to my personal knowledge these recommendations before you did not come out of any quick or superficial examination of the problem. They had their origin in President Kennedy's balance-of-payments message of July 1963, in which he announced that he would designate a task force composed of representatives of business, finance, and government to survey all factors that tended to deter a healthy two-way flow of capital, particularly the flow of foreign investment in U.S. private securities. Such a task force was established in the fall of 1963.

As I said before, the very well informed and experienced group of private citizens who participated devoted large amounts of their time and effort to what I think they viewed as a very real public service. There is no question, and there ought to be no question in anyone's mind, that there was also an element of very appropriate self-interest involved because the benefits flowing from the development of foreign investment in the United States will accrue to not only the public, but also to a more effective participation on the part of U.S. companies, investment banking houses, brokerage concerns, and the whole complex of institutions that are a part of our capital market system.

However, serving as a member and as chairman of the task force, I think it only fair to say that very strenuous and worthwhile effort was devoted to reexamining what was being done, and could be done, on the private sector to complement Government activities and bring about this desired objective.

I understand that the committee will receive from outside sources both written and other communications indicating the extent to which the private sector has inaugurated complementary efforts to this particular proposal. For that reason, I will not speak to that particular issue because those who are better informed about it will have communicated directly with the committee. However, I would like to say that the tax proposals before you were considered both by the private and the public members of the task force as perhaps the most significant element in this program. Therefore, it would be a signal, not only to potential foreign investors but also to the financial community, that the Congress of the United States considered this matter in the national interest and worthy of their attention.

The report was submitted to the President in April 1964 and, as you know, I left Government service shortly thereafter. Therefore, I did not participate actively in the preparation of the proposals that were submitted to the Congress in March of this year. However, I know that Secretary Surrey and his staff and the related staff in the Office of International Affairs devoted a great deal of time in the intervening months to preparation of these proposals.

Many of the proposals are technical in nature. For that reason, I have asked Secretary Surrey to be here with me today since he has the detailed technical familiarity with the way in which they operate in the context of the present tax system, and equally significantly, the way these proposals mesh into the system of international tax treaties which are an important and related part of the topic before you.

I will try to deal with the questions you have and ask Secretary Surrey to participate as the situation may require.

Mr. HERLONG. Thank you, Mr. Secretary. We appreciate your full and complete statement.

The thought just struck me as you were testifying there that we are planning to go into a long-range program to encourage foreign investments in the United States. We have just completed working on a program to discourage American investments in foreign countries.

If this flow starts coming back to us what is to prevent these other countries from putting in their version of an interest equalization tax such as we have just acted on?

Secretary FOWLER. I think, Mr. Chairman, that the gap is the other way. I think if you will examine this task force report as it has to do with the obstacles to foreign investment in the United States that are imposed by foreign governments, you will find that there is a considerable set of barriers. Therefore, an important part of this overall program is to promote an increased two-way flow of capital between the United States and Western Europe, Japan, and other countries. Some of the recommendations of the task force report deal with public and private efforts to encourage other countries to diminish the barriers they established, primarily in the postwar period, when they felt it necessary to restrict, through exchange restrictions and otherwise, the outflow of capital.

There is no doubt in anybody's mind, although I think the members of the task force would have to speak for themselves on this, that we must continue to treat, and think of, the interest equalization tax as a temporary measure and one which we hope can be eliminated with the passage of time.

I think the fact that there is an interest equalization tax measure has served to bring home to many foreign government officials a recognition of the fact that they have their own permanent barriers to investment, which, incidentally, have existed for a long time. I believe that the work of the Organization for Economic Cooperation and Development, of which the United States is a participant, is very much concerned with the prospects of diminishing these permanent obstacles to free capital movements.

I think this objective should continue to be a very important part of the long-range policy objectives of the United States, and I hope, as you and members of the committee hope, that the time can come in which we can remove what we think of, and what should properly be considered, as temporary barriers. I hope we can soon approach an atmosphere in which we can expect a healthy two-way flow of capital to take care of the situation without harsh government control measures either on this side of the water or on the other side of the water.

Mr. HERLONG. Thank you, sir. The only point that was in my mind was as interested as we are, and we are definitely interested, in our balance-of-payments problem, we certainly must assume that the other people on the other side are just as interested in their own balance-of-payments problem.

Secretary FOWLER. That is right.

Mr. HERLONG. Are there questions?

Mr. BYRNES. Mr. Chairman.

Mr. HERLONG. Mr. Byrnes.

Mr. BYRNES. Mr. Secretary, what you have here, as I understand it, is a situation where we have entered into treaties with most of the industrial nations of the world relating to the taxation of dividends and interest primarily, haven't we?

Secretary FOWLER. That is right.

Mr. BYRNES. Let's take dividends, for instance. As I understand it, the rate is 15 percent.

Secretary FOWLER. That is correct in most of the treaty provisions.

Mr. BYRNES. This proposes a rate of 30 percent?

Secretary FOWLER. No, this does not propose any change affecting the countries with which we have treaty arrangements.

Mr. BYRNES. No, but under the law you have a flat rate unless there was a treaty existing and then it would be the lesser of the two.

Secretary FOWLER. That is right.

Mr. BYRNES. But my point is I wonder how much effect this is really going to have when one recognizes the fact that you already have a 15-percent rate, or in other words a lower rate than is in the bill, by treaty with the industrial nations. They are already paying a lower rate of tax.

Secretary FOWLER. Insofar as dividends are concerned, I think it really pretty much leaves the present law the way it is.

Mr. BYRNES. Then the bill does not relieve anyone.

Secretary FOWLER. But don't forget the other provisions, such as those dealing with the estate tax, with capital gains, graduated income tax rates, segregation of business income from investment income——

Mr. BYRNES. You misunderstand the purport of my question. I am not suggesting that the bill itself as a whole doesn't do anything. I am just trying to focus at the one aspect of dividends. We move to a flat 30-percent rate in the absence of treaty.

Secretary FOWLER. That is right.

Mr. BYRNES. While already the rate of tax on dividends of residents of the industrial nations by treaty for the most part is 15 percent, and it will continue to be 15 percent.

Secretary FOWLER. That is right.

Mr. BYRNES. So that I wonder whether the dividend provision will have any particular impact. I am not saying we shouldn't enact it, but I am just wondering whether that would have any particular impact as far as investments here are concerned.

Secretary FOWLER. Insofar as that phase of our taxation of foreign investment is concerned, it is primarily a maintenance of the status quo and it is certainly a debatable point as to whether changes should be effected.

The task force committee considered that at some length. There were differences of opinion. There were those that felt perhaps there should be some, let's say, waiver or diminution of taxation of dividends.

There was another opinion. Our opinion in the Treasury Department was that the retention of the status quo in this particular area, Congressman Byrnes, was an important aspect of retaining, you might say, a degree of adequate bargaining power in connection with the tax treaties.

Mr. BYRNES. You are maintaining some bargaining power because you are maintaining 15 percentage points as an area of bargaining, aren't you?

You can enter into the same kind of a treaty with some other country where you don't have a treaty today. You can offer that country a reduction to 15 percentage points from a 30-percentage-point tax.

Secretary FOWLER. That is correct.

Mr. BYRNES. But you have given up some of your bargaining power, have you not, by going down to the 30 percent as a flat unilateral action by this country?

Secretary FOWLER. I don't think very much, if any. I think we retain the essential bargaining power that we have in that area.

Mr. BYRNES. Either the 30 percent is meaningless or it is a reduction in the rate.

Secretary FOWLER. Let Mr. Surrey comment.

Mr. BYRNES. The 30 percent makes a change in the tax rate applicable where a treaty does not exist. Then they automatically get this. All you leave for treaty bargaining is whether you will go down to 15 percent.

Mr. SURREY. At present, Mr. Byrnes, the rate is 30 percent in the law, but if the individual's total income from the United States is more than $21,000, then we go to graduated rates.

Mr. BYRNES. That is right.

Mr. SURREY. What we have removed, as you said, is the graduated rate provision, leaving the rate at 30 percent for everybody regardless of the level of income.

Mr. BYRNES. That is right.

Mr. SURREY. However, with respect to the right of the President to withdraw that with respect to any country that does not give us reciprocal treatment, that extends also to the graduated rate provision.

Mr. BYRNES. That is one of the things I wanted to get to, which is another revenue concept that we are writing into the law.

Mr. SURREY. Yes.

Mr. BYRNES. This is a new concept, when we reduce the tax, which really is what you are doing here, but the President has the right if he wants to withdraw that lower rate and make the person subject to a higher rate.

Do we have anything analogous to this, where we let the President determine what rate of tax an individual or a group of individuals is going to pay?

Mr. SURREY. We have a present provision in the law that if the President finds another country is discriminating against U.S. citizens, he can so find and the rates of tax on citizens of that country are increased.

In other words, there is a provision now in the law that gives the President authority to act in some cases where he finds discrimination. There are other situations in the law here and there where the treatment given by the Congress is conditional upon reciprocal treatment by the foreign country.

For example, we do not reduce the taxation of foreign shipping companies unless we find that the foreign country in turn does not tax our shipping companies. There are one or two provisions of that nature indicating that certain concessions will not be allowed unless there is reciprocity, and we have taken those analogies and tried to put them into one coherent provision to cover the various situations that the Secretary has indicated.

Mr. BYRNES. We have a situation under section 891, for the doubling of the rate of tax, where the foreign country discriminates against U.S. citizens. Has that ever been used?

Mr. SURREY. It hasn't been used. The fact that it hasn't been used may be due to the presence of the provision. Normally countries try not to discriminate with respect to persons of a single country.

Mr. BYRNES. If memory serves me correctly there was a complaint that the Japanese last year had discriminated in some kind of a tax. I foreget what the details were. I guess this was the section they were referring to that should be invoked by the Government. In other words, this provision in this bill relating to the authority of the President to withdraw the liberalization is not a new concept.

Mr. SURREY. I think it draws its foundations from present concepts, but it takes those present concepts and builds them into a provision which we think is necessary to complement the unilateral action that the United States is taking in this bill.

Mr. BYRNES. This wasn't the recommendation of the task force?

Secretary FOWLER. This was not. I think the problem that we are concerned with here was discussed, but it was not specifically treated in the report.

Mr. SURREY. I think it grew about because the task force thought that we ought to move unilaterally in all these areas, that the United States just by statute grant all these privileges.

The Treasury was initially more concerned about doing this through treaty. The task force thought that process would be too slow, so

this device of acting unilaterally and affording some protection for the United States was discussed.

Mr. BYRNES. What you have done here, it seems to me, is halfway between the treaty concept and the unilateral concept, haven't you, that is being recommended by the Treasury?

Mr. SURREY. It is an endeavor to accomplish really both objectives, to act quickly and unilaterally, but at the same time to preserve an international position for the United States if it becomes necessary where, in engaging in our treaties, we don't get reciprocal action.

Secretary FOWLER. In commenting on tax treaties at one point the task force said, on page 24 of the report:

> Adoption of our recommendations would not eliminate the need to extend and modernize our tax treaties. Among other desirable changes: The United States should work for the reciprocal reduction of withholding taxes on dividends and interest and toward the reciprocal elimination of all taxes on the income of pension trusts and similar investors that are exempt from tax in their country of residence. Such changes will, however, take time.

I don't think that goes to your particular point at all, Congressman Byrnes, and I only cite it as recognition of the fact that you have already observed that this is something of a mixed bag. You can accomplish a certain amount through unilateral action, of which this bill is an example, but there will still be areas, and Secretary Surrey is currently engaged in significant negotiations in the tax treaty area which go beyond the purview of this particular bill.

Mr. BYRNES. Do the presumptions contained in the bill with respect to corporations not having permanent establishment in the country, mean that we presume they don't have a permanent establishment?

Mr. SURREY. No; I wouldn't put it quite that way, Mr. Byrnes. There is a provision in the bill that reads that way, but I think its technical effect is not quite what you read into it.

Mr. BYRNES. You said today that under the treaties if you did not have a permanent establishment in the country, then you would pay the 15-percent rate, but if you had a permanent establishment then you paid the regular U.S. rates.

Mr. SURREY. That is the present law.

Mr. BYRNES. That is the present law?

Mr. SURREY. That is right.

Mr. BYRNES. But what you would be saying under this bill is that a corporation is assumed not to have a permanent establishment.

Mr. SURREY. As to its dividend income.

Mr. BYRNES. As to its dividend income?

Mr. SURREY. The bill happens to say presently just dividends and capital gain.

Mr. BYRNES. You are then liberalizing in a sense what is already contained in treaties?

Mr. SURREY. We are for some corporations and we are for practically all individuals. Some corporations, if they are doing business here in the United States, may prefer the present treatment. That is one of the problems we wanted to discuss because that gives them the intercorporate dividend deduction, which may therefore give a rate of less than 15 percent.

I might say, Mr. Byrnes, with respect to withholding on corporations, where you have a parent company and subsidiaries in the United States the rate sometimes drops to 5 percent under our treaties.

In other words, we run from 5 to 15 percent for withholding with respect to subsidiary-parent relationships and we run about 15 percent for portfolio investments.

Mr. BYRNES. I wondered whether in this again there was another situation where what we were doing was giving away certain bargaining latitude that we might have in getting some concessions for our people.

Mr. SURREY. We are, and again that would be preserved in the overall section dealing with that, because we are presently engaged in some negotiations in which we are seeking this result in treaties. One or two of our recent treaties which will be released shortly move in this direction, but it is a matter in which you do have to bargain with the other country.

Secretary FOWLER. I think, Mr. Byrnes, we could give you some comparison of what the situation is under the treaty and what the situation will be in connection with these proposals.

For example, there is no question but what the estate tax proposal adds up to this: That no treaty we have today is more liberal than the proposal made in this bill, and no treaty substantially parallels H.R. 5916.

I could go down with the other provisions if the committee is interested and give similar comparisons. Take the question of graduated rates. No treaty is more liberal. However, almost all treaties reduce the 30-percent flat withholding on certain types of income, usually to 15 percent, sometimes to 10 percent, sometimes to 5 percent. Sometimes the type of income is exempt, for example interest income.

Therefore, what we have is a proposal, and a recommendation, for unilateral action by the Congress of the United States which may to some degree, as Mr. Surrey has indicated, diminish our bargaining power.

However, to the extent that is a factor, it is our conviction that it is substantially outweighed by the advantages that will accrue in terms of the overall objective of promoting foreign investment in the United States. This, together with the improvements it makes in the tax system and other benefits are the price that we would quite willingly pay for whatever diminution of bargaining power might be entailed.

Mr. BYRNES. Thank you, sir.

The CHAIRMAN. Mr. Secretary, I have before me a verbatim list of the recommendations contained in the Fowler task force report compiled by the staff. There are 39 of those recommendations, as I recall.

At this point I would ask unanimous consent that this list be placed in the record.

(The information referred to follows:)

RECOMMENDATIONS CONTAINED IN THE FOWLER TASK FORCE REPORT

(Compiled by the staff)

1. U.S. investment bankers and brokerage firms should intensify their efforts to develop facilities for reaching foreign investors directly.

2. U.S. investment bankers and brokerage firms should seek modification of foreign regulations and practices which unduly restrict the ability of U.S. firms

to promote the sale of U.S. securities or to deal directly with potential foreign customers.

3. U.S. investment bankers and brokerage firms, with the cooperation of interested U.S. corporations, should endeavor to obtain shares of U.S. corporations for distribution abroad.

4. The Securities and Exchange Commission should issue a release setting forth the circumstances under which it would normally issue a "no action" letter providing that no registration be required on public offerings of securities outside of the United States to foreign purchasers, including dealers.

5. The Securities and Exchange Commission should issue a release eliminating the requirement that foreign underwriters participating exclusively in distributions of securities to nonresidents of the United States register as broker-dealers.

6. U.S. investment bankers should include foreign banks and securities firms as underwriters, whenever possible, or as selling group members in new offerings and secondary distributions of either domestic or foreign securities.

7. U.S. investment bankers and brokerage firms should organize the underwriting and distribution of dollar-denominated foreign securities issues so that the maximum possible amount is sold to investors abroad.

8. U.S. commercial banks should intensify efforts to attract foreign trust accounts for investment in U.S. corporate securities.

9. The Securities and Exchange Commission should serve as an information center regarding listing requirements, and distribution regulations and practices abroad.

10. Major U.S. corporations should arrange for U.S. banks and trust companies to issue, through their foreign branches and correspondents, depositary receipts for U.S. corporate shares.

11. U.S. investment companies should plan and carry out a program to acquaint foreign investors with the advantages of owning U.S. closed-end investment company shares.

12. Distributors of U.S. open-end investment company shares should devise methods for achieving additional foreign distribution of such shares, where locally permitted.

13. U.S. investment company distributors should seek the modification of foreign regulations and practices which restrict the availability of their shares to foreign investors.

14. U.S. closed-end investment companies should seek to place original and secondary offerings of their shares with foreign investors and, where feasible, list these shares on major foreign exchanges.

15. In order to promote the purchase of U.S. corporate securities abroad:

(*a*) The U.S. financial community should cooperate closely with major U.S. corporations in the dissemination of corporate reports in foreign languages and in the publication of financial data in foreign newspapers;

(*b*) U.S. investment bankers and brokerage firms should prepare research and statistical reports in foreign languages for distribution to foreign investors through local banks and securities firms and promote the publication of more detailed U.S. stock market and financial information in the foreign press;

(*c*) Facilities of U.S. commercial banks should be fully utilized to distribute to foreign financial institutions and investors reports, preferably in foreign languages, on the U.S. economy;

(*d*) U.S. securities exchanges should take advantage of new communication techniques and reduced rates to promote broader use abroad of stock quotation and financial news services;

(*e*) U.S. investment bankers and brokerage firms should offer securities orientation and sales training programs to personnel of foreign banks and securities firms; and

(*f*) U.S. investment bankers, brokerage firms, and securities exchanges should work with their foreign counterparts and the foreign press to broaden share ownership by foreign investors.

16. The Congress should adopt legislation discontinuing mandatory regulation of maximum interest rates on domestic and foreign time deposits.

17. Pending adoption of such legislation, the Federal Reserve Board of Governors should administer regulation Q in a flexible manner permitting U.S. commer-

cial banks to meet internationally competitive interest rates on both domestic and foreign time deposits.

18. U.S-based international corporations should consider the advantages of increased local ownership of their parent company shares in countries in which they have affiliates.

19. Where consideration under recommendation No. 18 above is favorable, corporations should collaborate with the U.S. financial community in encouraging greater foreign ownership of their shares.

20. U.S. securities exchanges should submit a plan acceptable to the Securities and Exchange Commission permitting U.S.-based international corporations to encourage foreign ownership of their stock.

21. The Treasury Department should issue a ruling that would establish the tax deductibility of costs incurred by U.S. corporations in arranging for securities firms to place their securities outside the United States as part of programs to improve their oversea relationships.

22. Corporations should collaborate with U.S. investment bankers in the utilization by the latter of techniques for distribution abroad of new or secondary issues of their stock.

23. U.S. corporations should offer their shares to employees in foreign countries where stock purchase, supplemental compensation, or other incentive plans are feasible and desirable.

24. U.S.-based international corporations should consider the advantages of listing their shares on foreign stock exchanges.

25. U.S.-based international corporations should instruct their senior officers and policy groups to keep foreign financial operations under constant review, examining as standard procedure all proposals for new financing from the standpoint of the effect of their actions on the U.S. balance of payments.

26. U.S.-based international corporations should, where feasible, finance their foreign operations in a manner which minimizes the outlay of cash.

27. In cases where new capital is required, U.S.-based international corporations should consider, in appropriate cases, broadening local ownership by offering in foreign capital markets bonds or preferred stock of their local affiliates convertible into common shares of the U.S. parent corporation.

28. U.S.-based international corporations should be encouraged to make available, through trade or banking channels, specific case studies of foreign financing operations to small- or medium-sized U.S. firms interested in foreign operations but less aware of foreign financing opportunities.

29. Eliminate U.S. estate taxes on all intangible personal property of nonresident alien decedents.

30. Eliminate (with respect to income not connected with the conduct of a trade or business) the provisions for progressive taxation of U.S. source income of nonresident alien individuals in excess of $19,000 and provide that no nonresident alien whose tax liability is fully satisfied by withholding shall be required to file returns.

31. Eliminate the provision for taxation of capital gains realized by a nonresident alien individual when he is physically present in the United States; extend from 90 to 180 days during a taxable year the time that a nonresident alien individual may spend in the United States before becoming subject to tax on all capital gains realized by him during such year.

32. Provide that a nonresident alien individual engaged in trade or business within the United States be taxed at regular rates only on income connected with such trade or business.

33. Amend the definition of personal holding companies appearing in the Internal Revenue Code so that foreign corporations owned entirely by nonresident alien individuals are excluded from the definition.

34. Clarify the definitions of engaging in trade or business to make it clear: (i) that a nonresident alien individual or foreign corporation investing in the United States will not be deemed engaged in trade or business because of activity in an investment account or by granting a discretionary investment power to a U.S. banker, broker, or adviser; and (ii) that a nonresident alien individual or

foreign corporation will not be deemed engaged in trade or business by reason of the mere ownership of real property, by reason of a strict net lease, or by reason of an agent's activity in connection with the selection of real estate investments in the United States.

35. The Department of State and the Treasury Department should take bilateral diplomatic action aimed at securing the step-by-step removal of remaining exchange controls on capital transactions between advanced capital-forming countries and the discontinuance or liberalization of special exchange markets or procedures for investment transactions.

36. The Department of State and the Treasury Department should encourage and support the enlargement of free world capital markets and urge countries with balance-of-payments surpluses to relax their capital issues control in order to permit an expanded volume of international lending.

37. The Department of State and the Treasury Department should request that the Organization of Economic Cooperation and Development (OECD) initiate a comprehensive review of the practices and regulations in member countries relating to investment portfolios of financial institutions.

38. The Department of State and the Treasury Department should, through appropriate international bodies, particularly the OECD, advocate the step-by-step relaxation of monetary, legal, institutional, and administrative restrictions on capital movements, together with other actions designed to increase the breadth and efficiency of free world capital markets.

39. The Department of State and the Treasury Department should urge the International Monetary Fund to encourage step-by-step elimination of capital controls. The Fund should be requested to prepare a study dealing with remaining capital controls and how their elimination can encourage stabilizing movements of long-term capital and thus contribute to balanced international payments.

Comparison of H.R. 5916 With Treatment Under Existing Treaties

1. Graduated rates applicable in certain instances

Under the existing statute (altered in many instances by treaty as noted below) a nonresident alien's U.S. source income is taxed at progressive income tax rates if he derives gross income of more than $21,200 from U.S. sources. An individual engaged in a trade or business in the United States is also taxed at progressive rates on his U.S. source income even if he derives less than $21,200 from U.S. sources.

Both the Fowler Task Force and the Treasury recommendations call for elimination of progressive taxation when a nonresident alien's U.S. source income exceeds $21,200. The Fowler Task Force recommended that a nonresident alien individual engaged in a trade or business within the United States be taxed at regular rates only on income connected with such trade or business. The Treasury proposal would tax investment income at the 30 percent statutory holding rate or the applicable treaty rate (whichever is less) rather than graduated rates. For purposes of determining the applicability of treaty rates to dividends and capital gain, the alien will be deemed not to have a permanent establishment in this country.

The following table indicates the treaty rates applicable to investment income under existing treaties with the countries listed. Although the chart is specifically addressed to withholding, the applicable tax rates are the same due to the necessity to withhold from nonresident aliens an amount equal to their tax liability.

It is to be noted that in most instances the favorable treaty rate applicable to investment income only applies where the nonresident alien does not have a permanent establishment in the United States. Under the Treasury recommendations granting the statutory or treaty rate (whichever is lesser) to the investment income of nonresident aliens engaged in a trade or business in the United States, the alien will be deemed not to have a permanent establishment in this country.

[In percent]

Country	Dividends	Interest	Royalties	Real estate rentals and natural resource royalties
Australia	[2] [6] 15	NE	[1] E	[4] NE
Austria	[1] [3] 15	[1] E	[1] E	[4] NE
Belgium	[1] 15	[1] 15	[1] E	[4] NE
Canada	[1] 15	[1] 15	[1] 15	[1] [5] 15
Denmark	[1] [3] 15	[1] E	[1] E	[4] NE
Finland	[3] [6] 15	[1] E	[1] E	[4] NE
France	[1] 15	[1] 15	[1] E	[4] NE
Germany	[1] 15	[1] E	[1] E	[4] NE
Greece	NE	[1] E	[1] E	[4] NE
Honduras	NE	[1] E	[1] E	[4] NE
Ireland	[2] [3] [6] 15	[2] E	[2] E	[2] [4] 15
Italy	[1] [3] 15	NE	[1] E	[4] NE
Japan	NE	[1] 15	[1] 15	[4] NE
Netherlands	[1] [3] 15	[1] E	[1] E	[4] NE
Netherlands Antilles	[1] [3] 15	[1] E	[1] E	[4] NE
New Zealand	[1] [3] [6] 15	NE	NE	NE
Norway	[1] [3] 15	[1] E	[1] E	[4] NE
Pakistan	[1] [7] 15	NE	[1] E	NE
South Africa	NE	NE	NE	[4] NE
Sweden	15	[1] E	E	NE
Switzerland	[1] [3] 15	[1] 5	[1] E	[4] NE
United Kingdom	[2] [3] 15	[2] E	E	[2] [4] 15
United Kingdom colonies	[2] [3] 15	[2] E	E	[2] [4] 15

Definitions:
E—Exempt.
NE—Not exempt: Tax to be withheld at the statutory rate prescribed by secs. 1441 and 1442 of the Internal Revenue Code of 1954 (generally 30 percent).

[1] Applicable if no permanent establishment in the United States.
[2] Applicable if no permanent establishment in the United States and subject to tax of the other contracting party.
[3] The rate is 5 percent on dividends paid by domestic subsidiary corporations subject to prescribed conditions.
[4] Recipient may elect to be subject to tax on a net basis by filing form 1040-B.
[5] Recipient may elect to be subject to tax on a net basis but only on real property by filing form 1040-B.
[6] Applicable to a nonresident alien not engaged in a trade or business in the United States.
[7] Applicable only when certain Pakistani corporations are the recipients.

2. Foreign corporations and investment income

The Treasury recommends that corporations engaged in business in the United States be denied the 95-percent dividends received deduction; be subject to the 30-percent statutory rate or the treaty rate (whichever is lesser) on income from stock investments; and be exempt from tax on their capital gains from investment in U.S. stocks. For determining the applicability of treaty rates, the corporation will be deemed not to have a permanent establishment in this country. The Fowler task force made no comparable recommendations.

The special 15-percent treaty rates applicable for dividends (see chart above) are generally applicable to corporations receiving dividends. In the case of Australia, Denmark, Finland, Ireland, Italy, Netherlands, Netherlands Antilles, New Zealand, Norway, Switzerland, United Kingdom, and United Kingdom colonies, the rate is 5 percent on dividends paid by domestic subsidiary corporations under certain prescribed conditions.

3. Engaging in a trade or business

Both the Fowler task force and the Treasury recommendations would clarify the definition of engaging in a trade or business to make it clear that a nonresident alien investing in the United States will not be deemed engaged in a trade or business because of activity in an investment account or by granting a discretionary investment power to a U.S. banker, broker, or adviser. The Fowler task force also recommended adoption of a provision making it clear that a nonresident alien individual or foreign corporation will not be deemed engaged in a trade or business by reason of the mere ownership of real property, by reason of a strict net lease, or by reason of an agents activity in connection with a selection of real estate investments in the United States. The Treasury did not act on this recommendation.

The questions involved in this recommendation are not generally covered by existing treaties. Treaties are concerned with a question of "a permanent establishment" and not the definition of a trade or business.

4. Real property income and mineral royalties

The Treasury recommends that nonresident alien individuals and foreign corporations be given an election to compute income from real property and mineral royalties on a net income basis and be taxed at graduated rates on such income as if engaged in a trade or business in the United States. The Fowler task force made no comparable recommendation.

Under existing treaties nonresident alien individuals from many countries can now elect to be subject at regular tax rates on a net basis by filing form 1040–B. The countries involved are Australia, Austria, Belgium, Finland, France, Germany, Greece, Honduras, Ireland, Italy, Japan, Netherlands, Netherlands Antilles, Norway, South African, Switzerland, United Kingdom, and United Kingdom colonies. In addition, Canadian nonresident aliens can elect such treatment by filing form 1040–B but only on real property income.

5. Capital gains

The Treasury proposes to eliminate the provision taxing capital gains realized by a nonresident alien when he is physically present in the United States, and to entend from 90 to 183 days the period of presence in the United States during the year which makes nonresident aliens taxable on all their capital gains. The Fowler task force made a similar recommendation, but instead of the figure 183 days used 180 days.

Our treaties with Canada, France, Sweden, and the United Kingdom exempt to some extent capital gains derived by residents of those countries having no permanent establishment in the United States. The United Kingdom and Canadian treaties exempt all capital gains; the Swedish treaty exempts all capital gains except those derived from transfers of real property; and the French treaty exempts only capital gains from transfers of securities.

6. Personal holding company and "second dividend" taxes

The Treasury proposal is identical with the Fowler task force recommendation in exempting foreign corporations owned entirely by nonresident alien individuals, whether or not doing business in the United States, from the personal holding company tax. In addition, the Treasury proposes to nullify the application of the "second dividend" tax of section 861(a)(2)(B) so that it only applies to the dividends of foreign corporations doing business in the United States which have over 80 percent U.S. source income.

7. Estate tax exemption and rates

The Fowler task force recommended eliminating U.S. estate taxes on all intangible personal property of nonresident alien decedents. The Treasury did not act on this recommendation but instead proposes to increase the $2,000 exemption from tax to $30,000 and substitute for regular U.S. estate tax rates (which go as high as 77 percent) a 5–10–15 percent rate schedule.

Under the applicable treaties, debt obligations normally have their situs either in the domicile of the decedent or at his place of residence. However, stocks normally have their situs at the place of incorporation under the treaties. Presumably the stock of U.S. corporations is included in many of the estates of nonresident aliens and the Fowler task force recommendation would have had an impact in these cases.

The proposal of the Treasury to increase the $2,000 exemption to $30,000 will provide benefits to the estates of nonresident aliens where the applicable treaties govern, because of the type of exemption usually provided in the treaties. Under the usual exemption, a contracting state in imposing taxes on a decedent not domiciled at the time of his death in its territory must grant a portion of its specific exemption to the estate. Subject to certain variations, the portion of the exemption granted bears the same proportion to the total exemption as the property taxed bears to the total estate of the decedent. By raising the specific exemption the U.S. raises the dollar amount of the exemption that will normally be granted to a nonresident alien's estate. This type of exemption is granted in the estate tax treaties with Australia, Finland, France, Greece, Italy, Japan, Norway, and Switzerland. The Canadian treaty contains a different exemption which will also be liberalized by the Treasury's proposal.

Due to the credit mechanisms in existing treaties, the Treasury proposal to substitute a 5–10–15 percent rate schedule for the regular U.S. rates will provide benefits to the estates of nonresident aliens that will be largely nullified by increases in the tax they owe in their domiciliary state. Under the usual treaty provisions, the domiciliary state allows a credit against its estate tax for taxes of the other contracting state attributable to property located in the latter state. The credit cannot exceed the lesser of the tax attributable to such property under the laws of the domiciliary state or the other contracting party. The liberalized rates proposed by the Treasury will reduce the credit for U.S. taxes paid available to the estate in filing its tax return in the domiciliary state. However, where U.S. rates greatly exceed the rates of the other contracting party or where no applicable treaty governs, the benefit will not necessarily be canceled out. This type of credit provision is contained in treaties with Canada, United Kingdom, France, Australia, Finland, Greece, Ireland, Italy, Japan, Norway, and Switzerland.

8. Related estate tax matters

The Treasury proposes to: (a) provide that bonds issued by domestic corporations or governmental units and held by nonresident aliens are property within the U.S. and therefore are subject to estate tax; (b) provide that transfers of intangible property by a nonresident alien engaged in business in the United States are not subject to gift tax; and (c) provide that the amount of credit for State death taxes granted nonresident aliens is limited to that portion of the credit allowed the estate which is allocable to property taxed by both the State and the Federal Government.

The Fowler task force made no recommendations in this regard.

9. Expatriate American citizens

The Treasury proposes to subject the U.S. source income of expatriate citizens of the United States to income tax at regular U.S. rates and their U.S. estates to estate tax at regular U.S. rates, where they surrendered their U.S. citizenship within 10 years preceding the taxable year in question unless the surrender was not tax motivated.

The Fowler task force made no recommendations in this regard.

10. Retaining treaty bargaining position

The Treasury proposes to provide that the President be given authority to eliminate with respect to a particular foreign country any liberalizing changes which have been enacted, if he finds that the country concerned has not acted to provide reciprocal concessions for our citizens after being requested to do so by the United States.

The Fowler task force made no recommendations in this regard.

11. Quarterly payment of withheld taxes

The Treasury proposes to provide that withholding agents collecting taxes from amounts paid to nonresident aliens be required to remit such taxes on a quarterly basis.

The Fowler task force made no recommendations in this regard.

12. Exemption for bank deposits

The Treasury proposes to extend to the deposits of savings and loans associations the exemption from income taxes, withholding, and estate taxes provided by present law for bank deposits of nonresident alien individuals not doing business in the United States.

The Fowler task force made no recommendations in this regard.

The following treaties exempt all interest from withholding taxes: Austria, Denmark, Finland, Germany, Greece, Honduras, Ireland, Netherlands, Netherlands Antilles, Norway, United Kingdon, United Kingdom Colonies.

13. Foreign tax credit—Similar credit requirement

The Treasury proposes to amend present law by eliminating the similar credit requirement of section 901(b)(3), subject to reinstatement by the President where the foreign country refuses a request to provide a similar credit for U.S. citizens. The similar credit requirement of present law allows a foreign tax credit to resident aliens only if the native country allows a similar credit to our citizens residing in that country.

The Fowler task force made no recommendations in this regard.

14. Stamp taxes

The Treasury proposes to amend present law to exempt from the stamp tax on certificates original offerings of foreign issuers where only the issuances and transfers take place in the United States.

The Fowler task force made no recommendations in this regard.

15. Withholding taxes on savings bond interest.

The Treasury proposes to eliminate the 30 percent withholding tax as it applies to the interest income realized from U.S. savings bonds by native residents of the Ryukyu Islands (Okinawa and others) and the Trust Territory of the Pacific (principally the Caroline, Marshall, and Mariana Islands).

The Fowler task force made no recommendations in this regard.

(Prepared by office of the minority counsel, Committee on Ways and Means.)

COMPARISON OF TREASURY RECOMMENDATIONS OF H.R. 5916 WITH RECOMMENDATIONS OF FOWLER TASK FORCE

TREASURY RECOMMENDATIONS	FOWLER TASK FORCE
1. *Graduated rates.*—Eliminate the taxation at graduated rates of U.S. source income of nonresident alien individuals not doing business in the United States. Under existing law all of a nonresident alien's U.S. source income is taxed at regular rates if he derives gross income of more than $21,200 from U.S. sources. Where nonresident alien is not engaged in a trade or business in the United States, no return need be made.	1. Eliminate (with respect to income not connected with the conduct of a trade or business) the provisions for progressive taxation of U.S. source income of nonresident alien individuals in excess of $19,000 ($21,200 after 1965) and provide that no nonresident alien whose tax liability is fully satisfied by withholding shall be required to file returns. (Recommendation No. 30.)
2. *Segregation of investment and business income and related matters.*—Provide that—	2.
(*a*) nonresident alien individuals engaged in trade or business in the United States be taxed on investment (nonbusiness) income at the 30-percent statutory withholding rate, or applicable treaty rate (for purposes of determining the applicability of treaty rates, the alien will be deemed not to have a permanent establishment in this country) rather than at graduated rates;	(*a*) Provide that a nonresident alien individual engaged in trade or business within the United States be taxed at regular rates only on income connected with such trade or business. (Recommendation No. 32.)
(*b*) foreign corporations engaged in business in the United States be denied the 85-percent dividends received deduction be subject to the 30-percent rate (or lesser treaty rate assuming a nonpermanent establishment) on income from stock investments; and be exempt from tax on their capital gains from investments in U.S. stocks.	(*b*) None.
(*c*) Nonresident alien individuals and foreign corporations not be deemed engaged in trade or business in the United States because of investment activity in the United States or because they have granted a discretionary power to a U.S. banker, broker, or adviser;	(*c*) Clarify the definitions of engaging in trade or business to make it clear: (i) that a nonresident alien individual or foreign corporation investing in the United States will not be deemed engaged in trade or business because of activity in an investment account or by granting a discretionary investment power to a U.S. banker, broker, or adviser. (Recommendation No. 34(i).) A nonresident alien individual or foreign corporation will not be deemed engaged in trade or business by reason of the mere ownership of real property, by reason of a strict net lease, or by reason of an agent's activity in connection with the selection

TREASURY RECOMMENDATIONS	FOWLER TASK FORCE
(*d*) Nonresident alien individuals and foreign corporations be given an election to compute income from real property and mineral royalties on a net income basis and be taxed at graduated rates on such income as if engaged in trade or business in the United States.	of real estate investments in the United States. (Recommendation No. 34(ii)—not in Treasury bill.) (*d*) None.
3. *Capital gains.*—Eliminate the provisions taxing capital gains realized by a nonresident alien when he is physically present in the United States, and extend from 90 to 183 days the period of presence in the United States during the year which makes nonresident aliens taxable on all their capital gains.	Eliminate the provision for taxation of capital gains realized by a nonresident alien individual when he is physically present in the United States; extend from 90 to 180 days during a taxable year the time that a nonresident alien individual may spend in the United States before becoming subject to tax on all capital gains realized by him during such year. (Recommendation No. 31.)
4. *Personal holding company and "second dividend" taxes.*— (*a*) Exempt foreign corporations owned entirely by nonresident alien individuals, whether or not doing business in the United States, from ther personal holding company tax;	(*a*) Amend the definition of personal holding companies appearing in the Internal Revenue Code so that foreign corporations owned entirely by nonresident alien individuals are excluded from the definition. (Recommendation No. 33.)
(*b*) Modify the application of the "second dividend tax" of section 861(a)(2)(B) so that it only applies to the dividends of foreign corporations doing business in the United States which have over 80 percent U.S. source income.	(*b*) None.
5. *Estate tax and related matters.*— (*a*) Increase the $2,000 exemption from tax to $30,000 and substitute for regular U.S. estate tax rates a 5-, 10-, 15-percent rate schedule;	Eliminate U.S. estate taxes on all intangible personal property of nonresident alien decedents.
(*b*) Provide that bonds issued by domestic corporations or governmental units and held by nonresident aliens are property within the United States and therefore are subject to estate tax; and (*c*) Provide that transfers of intangible property by a nonresident alien engaged in business in the United States are not subject to gift tax.	
6. *Expatriate American citizens.*—Subject the U.S. source income of expatriate citizens of the United States to income tax at regular U.S. rates and their U.S. estates to estate tax at regular U.S. rates, where they surrendered their U.S. citizenship within 10 years preceding the taxable year in question unless the surrender was not tax motivated.	None.

7. *Retaining treaty bargaining position.*—Provide that the President be given authority to eliminate with respect to a particular foreign country and liberalizing changes which have been enacted, if he finds that the country concerned has not acted to provide reciprocal concessions for our citizens after being requested to do so by the United States.	None.
8. *Quarterly payment of withheld taxes.*—Provide that withholding agents collecting taxes from amounts paid to nonresident aliens be required to remit such taxes on a quarterly basis.	None.
9. *Exemption for bank deposits.*—Extends to the deposits of savings and loans associations the exemption from income taxes, withholding, and estate taxes provided by present law for bank deposits of nonresident alien individuals not doing business in the United States.	None.
10. *Foreign tax credit—Similar credit requirement.*—Amends present law by eliminating the similar credit requirement of section 901(b)(3) subject to reinstatement by the President where the foreign country refuses a request to provide a similar credit for U.S. citizens. The similar credit requirement of present law allows a foreign tax credit to resident aliens only if the native country allows a similar credit to our citizens residing in that country.	None.
11. *Stamp taxes.*—Amend present law to exempt from the stamp tax on certificates original offerings of foreign issuers where only the issuances and transfers take place in the United States.	None.
12. *Withholding taxes on savings bond interest.*—Eliminates the 30-percent withholding tax as it applies to the interest income realized from U.S. savings bonds by native residents of the Ryukyu Islands (Okinawa and others) and the Trust Territory of the Pacific (principally the Caroline, Marshall, and Mariana Islands).	None.

(Prepared by office of minority counsel, Committee on Ways and Means.)

The CHAIRMAN. Is there objection? I wanted to ask you, if you would, Mr. Secretary, to point out to the committee wherein the bill, H.R. 5916, differs from the Fowler task force report. Which of the 39 items, for example, are not included in the bill, and which of the recommendations are modified in the bill?

Secretary FOWLER. I think, Mr. Chairman, that the most significant difference, and the only one worth consideration, is No. 29.

The CHAIRMAN. Pardon me for interrupting you, but I thought you or I in the beginning should point out that some of these recommendations, of course, of the Fowler task force report are not actually tax matters.

Secretary FOWLER. Right. The first 28 are really outside the scope of this bill.

The CHAIRMAN. Outside the jurisdiction of taxation and this committee, so my inquiry really is limited to 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, and 39 presumably.

Secretary FOWLER. Actually 29 to 34. Recommendations 35 to 39 have to do with what might be called diplomatic action——

The CHAIRMAN. Rather than tax action. All right.

Secretary FOWLER (continuing). To secure a lowering of the barriers that might exist to foreign investment in the United States by foreign governments.

The CHAIRMAN. Let's put it this way then. With respect to those recommendations of the Fowler task force report which deal with taxation, how do they differ from the provisions of H.R. 5916?

Secretary FOWLER. First, Mr. Chairman, the most significant one I think has to do with recommendation No. 29. The task force report recommended that the Congress eliminate U.S. estate tax on all intangible personal property of nonresident alien decedents.

The recommendations of H.R. 5916 would fall short of that task force recommendation. The bill before you would increase the exemption for U.S. estates of foreign decedents from $2,000 to $30,000 and would tax such estates on the basis of a 5-, 10-, 15-percent rate schedule.

With this significant increase in the exemption and the reduction in rates, the effective U.S. estate tax rate on foreign decedents would no longer be considerably higher than most other countries and would be more comparable to rates prevailing elsewhere.

The task force recommendation which is contained in the report on this matter, I think, is worthy of the committee's attention. In this connection, and with your permission, I would like to read briefly from the task force report:

> U.S. estate taxes, especially as applied to shares of U.S. corporations owned by nonresident alien decedents (which are subject to U.S. estate taxes irrespective of whether they are held in this country or abroad), are believed to be one of the most important deterrents in our tax laws to foreign investment in the United States. U.S. estate tax rates are materially in excess of those existing in many countries of the world and, despite the treaties in effect with several countries, the taxes paid on a nonresident alien decedent's estate, some portion of which is invested in the United States, generally would be greater than those paid on a nonresident alien decedent's estate, no portion of which is invested in the United States. We understand that the revenues received by the United States as a result of estate taxes levied on intangible personal property in estates of nonresident alien decedents are not large.
>
> Under existing U.S. tax law, a foreigner willing to go through the expense and trouble of establishing a personal holding company, incorporated abroad, and assuring himself that this personal holding company does not run afoul of the

U.S. penalty taxes on undistributed personal holding company income, can already legally avoid estate taxes. Consequently, for such an investor U.S. estate taxes are avoidable through complicated and expensive procedures, while for other foreign investors they are likely to result in a considerable tax penalty. This is an unsound situation which directly deters foreign investment in the United States and significantly worsens the overall image of this country as a desirable place to invest.

I think, therefore, that the recommendation in H.R. 5916 and the recommendation of the task force adopt the same basic point of view and the same premise and the same governing considerations. The recommendation of the task force simply goes further and says, in effect, that the advantages we would gain from complete elimination outweigh any revenue we might obtain from a retention of the estate tax law.

I think the Treasury's position can roughly be characterized as limiting relief so that the tax on the estates of nonresident alien decedents is comparable to the tax applicable to estates of U.S. citizens. That is the basic margin of difference between the two.

The CHAIRMAN. Is it the Treasury's position that the Fowler task force recommendation for eliminating the U.S. estate taxes on all intangible personal property of nonresident alien decedents should not be enacted?

Secretary FOWLER. I am in this position, Mr. Chairman. As a member of the task force and its chairman, I go along with the task force recommendation—and now as Secretary of the Treasury, I approve of the Treasury recommendation.

Insofar as they are different, I would be inclined to say that this Secretary of the Treasury would not strongly resist any effort on the part of the Congress to go further and adopt the task force report.

The CHAIRMAN. I was not endeavoring to in any way embarrass the Secretary by that question.

Secretary FOWLER. You are not embarrassing me at all. I think I am expressing an attitude. I do think that this is something the committee ought to carefully examine and it may well wish to come out for the full elimination which the task force report recommended.

With regard to any further analysis of the reasons for the Treasury position, I would like to have Secretary Surrey comment so that the committee can be informed.

(A memorandum on this matter appears at p. 64).

The CHAIRMAN. Let me ask you briefly, if I may, Mr. Secretary, before we go to Assistant Secretary Surrey, is this now the principal difference, or are there some other differences in the recommendations of the task force report?

Secretary FOWLER. I think this is the only significant difference, and I think to the extent there are other differences the Treasury proposals have gone somewhat beyond the task force recommendations. These additional differences are of a minor nature and not of very great consequence. The proposal fully reflects and carries out the task force recommendations in all the other provisions.

The CHAIRMAN. Is there anything in H.R. 5916 that was not dealt with by the task force report?

Secretary FOWLER. Yes; there are some provisions. In a sense, as the statement indicates, we have made this the occasion not only for implementing the task force report, but for generally revising and dealing with, and in a sense rationalizing, the outworn and obsolete

provisions. We thought the Congress would want to deal with this problem in full at this particular time.

The CHAIRMAN. But there is nothing in the bill, H.R. 5916 I presume that does not deal with the subject matter of removing tax barriers.

Secretary FOWLER. That is correct, sir.

The CHAIRMAN. To foreign investment.

Secretary FOWLER. All additional matters are directly related to the specific problem area that recommendations 29 through 34 are directed.

The CHAIRMAN. Mr. Curtis.

Mr. CURTIS. Mr. Chairman, just following up on that, our minority staff prepared a comparison and I was just going to say that it might be well to put that in the record.

The CHAIRMAN. I was not aware of the fact that the minority staff had prepared this. Let's put it in the record where the other matter was inserted.

All right, without objection then this too will be included in the record at that point.

(The above mentioned material will be found on p. 45.)

Mr. CURTIS. Mr. Fowler, I think I have a list here of 15 points and I roughly counted about 8 recommendations on which the Treasury has incorporated recommendations on which the Fowler task force had no recommendation.

Secretary FOWLER. That is right.

Mr. CURTIS. So any comments you might want to make there would be helpful.

Secretary FOWLER. Thank you, Congressman Curtis.

Mr. CURTIS. Incidentally, as Mr. Mills points out to me, on page 5 of the statement, having read these differences, they mostly seem to be where you are tightening up to insure the fact that we don't create sort of a tax haven.

Secretary FOWLER. That is correct.

Mr. CURTIS. Most of them seem to be of that nature and the Fowler task force apparently didn't get into that.

Secretary FOWLER. The task force didn't get into that technical are in detail.

Mr. CURTIS. I want to pick up a little bit on the line of questioning that Mr. Herlong started to get this picture in relation to the interest equalization tax.

On page 7 of your statement you give this picture:

"At the end of 1964, foreigners held an estimated $12.8 billion of U.S. corporate stocks valued at market prices. In every year since 1950 except 2, foreign purchases of U.S. stocks exceeded foreign sales. In the 6 years between 1959 and 1964, net purchases by foreigners averaged $141 million."

You then go on to say:

"These net figures are the residualed of much larger gross purchases and sales which in recent years have been on the order of $2½ to $3½ billion."

Now, Mr. Secretary, Mr. Funston, president of the New York Stock Exchange, testified before the Ways and Means Committee and pointed out to us that foreigners were the net sellers of outstanding U.S. securities in 1964 for the first time in over 15 years and the net sales of domestic stocks by the foreigners in 1964 totaled $350 million compared to sizable net purchases in the previous 5 years.

The suggestion has been made that this reflects a belief by foreigners that the interest equalization tax was only a first step toward further restrictions on international flow of funds and reflected the fact, as Mr. Funston suggested, that foreign brokers and dealers who cannot sell their securities in the United States are far less receptive to the efforts of U.S. brokers and dealers to sell U.S. securities abroad.

The point of this, if this is an accurate picture, is that this is an entirely different picture of the context than the one on page 7 in your statement.

Doing these kinds of things that are suggested in this bill is going to be incidental to increasing foreign investment in U.S. securities if we have had this kind of impact as a result of the interest equalization tax. I would appreciate any comments you might make. This is the picture apparently and we are heading into sort of a war between countries abroad in further restricting capital flows which many of us suggested was bound to occur if we passed the interest equalization tax. That kind of effort in the proposed bill then is almost meaningless.

Secretary FOWLER. First let me observe what is fairly obvious—that the proposals before you for the tax treatment of foreign investment in this country are, as you have indicated, a part of a much broader complex of problems. The task force report itself necessarily adopted the point of view that this is a very large and complicated problem. The fact that only a half dozen, you might say—I think it is 6 or 7—of the 39 recommendations of the task force are reflected in the legis ation before you indicates this.

Mr. Funston was a member of the task force and we had considerable discussion in our deliberations of the very aspect of the problem that you raise. As a matter of fact, on pages 30 and 31 of the task force report were some general comments on reducing restraints on the sale of U.S. securities in other capital markets. For example, recommendation 35 is to the effect that the Department of State and the Treasury Department should take bilateral diplomatic action aimed at securing the step-by-step removal of remaining exchange controls on capital transactions between advanced capital-forming countries and the discontinuance or liberalization of special exchange markets or procedures for investment transactions. Some of the other recommendations relate to capital issues control, the regulation of institutional investors, and the role of international organizations. All these recommendations are addressed to this problem. Let me quote from page 30 of the report:

> Although the task force has conducted an intensive study of restrictions in other capital markets, we have not attempted to set forth all of our findings here. The identification and critical appraisal of restrictions remaining in the capital markets of other industrial countries have been covered extensively in a recent study by the Treasury Department, made publicly available by the Joint Economic Committee of Congress. In this section of our report, we summarize the most important legal and administrative obstacles abroad which impede foreign investment in U.S. corporate securities. No useful purposes would, we believe, be served by making detailed recommendations as to the removal of foreign restrictions or methods by which other countries could improve their domestic capital markets. In each country these matters are often complex and technical; they involve delicate domestic relationships; frequently they transcend financial considerations and encompass national policies well beyond the terms of reference of the task force. It should be noted that efforts to remove restraining influences on sales of U.S. securities to foreigners will raise in foreign financial markets the

question of the continuance of the U.S. interest equalization tax as a factor affecting the sales of foreign securities to U.S. citizens, however temporary and special its basis.

So I think the question you raise is one that we certainly concerned ourselves with at that time and this statement was an attempt to flag the problem.

Mr. CURTIS. Exactly. As I pointed up, and now Treasury comes in and ignores the flag and actually comes and presents to this committee really not an accurate picture of what this sutation of foreign investments in U.S. corporate stocks really is.

You give a picture here from 1950 to 1964 and then you say: "In the 6 years between 1959 and 1964, net purchases by foreigners averaged $141 million."

I have pointed out that the point that should be stressed is that foreigners were net sellers of outstanding U.S. securities in 1964 for the first time in over 15 years and net sales of domestic stocks by foreigners in 1964 amounted to $350 million.

I note your average figure you give for 5 years, $141 million, conceals this unusual event in 1964 with the contrast of sizable net purchases of the previous 5 years. That gives you a lower average of $141 million actually. Your average if you eliminate the minus $350 million was considerably more, and the stark reality is that here the administration comes in to assist this theory of doing something to encourage removal of tax barriers to foreign investments in the United States, and at the same time if this rationale is right through the interest equalization tax is just making it impossible to encourage foreign investment.

Secretary FOWLER. Congressman Curtis, I think it is just as plain as it can be that the interest equalization tax has been presented and dealt with by the Congress as a temporary measure. The measures before you are part of a long-term program that we hope can be coupled with other activities that are outlined in the task force report which we hope can lead to a situation in which we can, consistent with our responsibilities as a key currency, recommend the discontinuance of the interest equalization tax.

We hope at that time, and in the intervening period, that other countries that have serious restraints on capital flows and on investment by their citizens outside the country can also pull down these barriers; but the important point is, Congressman Curtis, that this is a part of a long-term effort of which I think you are one of the leading advocates.

Mr. CURTIS. I surely am, yes.

Secretary FOWLER. I don't believe that it is necessary for us to review again today, although I am happy to do so, the rationale of the recommendations for a further continuance of the interest equalization tax. Let me point out that this task force report was issued in April 1964. We had had a very good first quarter that year in terms of balance of payments. We were looking forward to what seemed to be a reasonably favorable prospect, and you and I are familiar with what has happened in the last quarter, and the last 6 months, of 1964, and what was continuing in the first month of 1965, We know that we had a particular, we hope a passing, situation to deal with.

I have said repeatedly before this committee that I trust, along with you, that the time can come sometime in the not too distant future when we can throw out these restraints on the free movement of capital without running the grave risk of inviting back a very substantial balance-of-payments deficit.

Mr. CURTIS. Here is the point, Mr. Secretary. Just as your Fowler report points out, although you don't want to get into this business of making detailed recommendations as to removal of foreign restrictions and methods by which other countries could improve their domestic capital markets, you clearly recognize that this is the situation. Now I think you are saying that these kinds of restrictions are being increased by countries abroad, not decreased, because of the very policies that we have taken in the interest equalization tax. That is why it is pertinent to our discussions here because these are tax treaties in which you are going to have to deal with other nations and you can't come in on the one hand—I don't imagine you can have successfully—and argue for a liberalization in the tax area, when at the same time you are imposing these very rough restrictions on U.S. capital flow abroad. I don't see how you can separate the very reasons that you have mentioned, that this is a long-range situation.

You are creating difficulties, I would suggest, through the interest equalization tax. Every day it is on the books the problems become more complex. Foreign nations are looking for news ways of retaliation and certainly the Treasury and the administration should be shocked into some sort of action I would think when the figures of 1964 show this turnaround of net foreign investment in the United States.

Secretary FOWLER. Congressman Curtis, the facts are that the interest equalization tax, rather than causing foreign governments to inaugurate additional and further restrictions, has served as much as any other development to focus the attention of foreign govermnents, and of international bodies such as the OECD, to the very fact that there is a permanent structure of foreign controls on the movements of capital. These controls are getting more attention today in Western Europe than they have at any time since the war.

So the fear that you have has not been realized. I think the emphasis is the other way.

Mr. CURTIS. Mr. Secretary, then please explain to me why in 1964 you had this great turn around where the net sales of domestic stock by foreigners in 1964 totaled $350 million compared to sizable net purchases in the previous 5 years. There is what we are faced with and this is not the context in which your statement is made, because I read what your statement said as far as this picture is concerned.

I just think the administration is hiding from reality. It isn't a question of fear. It is a question of fact. What is your explanation of this fact?

Secretary FOWLER. I don't have an explanation of that fact. I think my statement points out that there are many, many factors that are at work that change the ratios of gross to net in the balance. For example, in 1958 there was also a net sales figure.

Mr. CURTIS. What was that, do you know?

Secretary FOWLER. $56 million.

Mr. CURTIS. I notice there is this actual discrepancy between Mr. Funston's statement and yours. You give 2 years. He has only the one, and I was curious about which year was the other year.

Secretary FOWLER. 1958 is the one, and in 1958 there was a net sales figure of $56 million.

Mr. CURTIS. $56 million.

Secretary FOWLER. Yes, sir; and for the first 4 months of 1965, according to our records, there is still a net sales figure, but it is running at the rate of $33 million for the first 4 months.

Mr. CURTIS. Let me be sure at least for the record that as far as the Treasury is concerned you are not suggesting that there is any other factor other than the interest equalization tax that has brought this turnaround in net sales?

Secretary FOWLER. I certainly am suggesting that there may be many other factors that are at work.

Mr. CURTIS. That is what the record is here for. I have concluded there is a direct causal relation and I just want to be sure that there aren't some factors that the Treasury would like to suggest other than the interest equalization tax that has brought this about.

It certainly isn't our tax laws because they have been the same throughout this period. There has been no change in that.

Well, let's leave the record open so that you can supply any other factors.

(The following material was subsequently submitted by the Treasury Department:)

NET SALES OF U.S. CORPORATE STOCKS IN 1964

As in previous years, the magnitude of gross purchases and of gross sales by foreigners of American corporate stocks in 1964 was in the billions of dollars and it is difficult to isolate the myriad of reasons which produce a particular net figure. Nevertheless, two special factors undoubtedly account in some measure for the turn from net purchases by foreigners to net sales in 1964. The first of these relates to British Government holdings of securities of American corporations which it had acquired from its nationals during World War II. It is the normal practice to exclude such equity holdings from the calculation of foreign exchange reserves, and in order to make its holdings readily available to reinforce British reserves in the event such action should be found to be necessary, the Government of the United Kingdom inaugurated a program designed to increase the proportion of the British Government's holdings of dollar securities which were in a liquid form. While the British Government has not announced the amount of its sales of U.S. securities in 1964 (and 1965), Chancellor Callaghan said on June 30, 1965, "These operations had now carried to a point where the portfolio could be used to reinforce the United Kingdom reserves at short notice.

The second of these special factors was the large-scale repatriation of foreign assets by firms in Switzerland and certain other European countries where domestic credit policies in 1964 had produced a severe shortage of capital. Although the magnitude of this repatriation cannot be quantified, Swiss authorities have indicated publicly there was a relatively large volume of repatriation of foreign assets on the part of Swiss residents in 1964 induced by the tightness of the money market in Switzerland. Similar conditions existed in some other European countries.

Purchases and sales of long-term domestic securities by foreigners

[In millions of dollars; negative figures indicate a net outflow of capital from the United States]

Calendar year or month	U.S. Government bonds and notes [1]						Corporate and other						Net purchases of domestic securities
			Net purchases				Bonds [2]			Stocks			
	Purchases	Sales	Total	Foreign countries		International and regional	Purchases	Sales	Net purchases	Purchases	Sales	Net purchases	
				Official	Other								
1946	414.5	684.2	−269.7	−269.7			(2)	(2)	(2)	367.6	432.1	−64.5	−334.2
1947	344.8	283.3	61.5	−13.0		74.5	(2)	(2)	(2)	226.1	376.7	−150.6	−89.1
1948	282.4	330.3	−47.9	−55.4		7.5	(2)	(2)	(2)	369.7	514.1	−144.3	−192.2
1949	430.0	333.6	96.4	9.4		87.0	(2)	(2)	(2)	354.1	375.3	−21.2	75.2
1950	1,236.4	294.3	942.1	824.2		117.9	107.7	108.3	−.6	666.9	664.0	2.9	944.4
1951	673.6	1,356.6	−683.0	−663.7		−19.3	120.0	141.6	−21.6	739.8	619.5	120.3	−584.3
1952	533.7	231.4	302.3	292.7		9.6	200.1	188.5	11.7	650.2	649.2	1.0	314.9
1953	646.0	728.0	−82.0	−96.7		14.7	212.8	197.4	15.3	589.1	533.9	55.2	−11.5
1954	800.9	792.7	8.2	−60.0		68.3	289.7	283.6	6.1	1,115.1	980.2	135.0	149.3
1955	1,341.1	812.1	529.0	561.7		−32.7	324.7	296.0	28.7	1,561.2	1,433.7	127.5	685.2
1956	883.4	1,018.3	−135.0	−204.9		70.0	287.1	251.8	35.3	1,619.5	1,363.5	256.0	156.4
1957	666.1	718.3	−52.1	117.0		−169.1	310.2	258.9	51.3	1,306.4	1,163.8	142.6	141.8
1958	1,223.9	1,187.6	36.3	−236.7		273.0	361.4	344.0	17.3	1,397.3	1,453.6	−56.3	−2.7
1959	1,216.9	528.0	688.9	523.9		164.9	368.8	296.2	72.6	2,224.4	1,861.5	362.9	1,124.4
1960	1,729.6	1,603.0	126.6	−97.9		224.5	442.4	392.3	50.1	1,976.5	1,774.8	201.7	378.4
1961	1,743.7	1,231.5	512.2	−20.0		532.2	316.9	416.1	−99.2	3,067.3	2,744.6	322.7	735.7
1962	1,779.9	2,507.9	−728.0	−206.6		−521.4	307.7	359.0	−51.3	2,260.2	2,149.1	111.1	−668.2
1963	1,867.1	1,196.2	670.9	369.1		301.8	255.7	246.4	9.3	2,724.0	2,526.5	197.5	877.8
1964	1,149.4	1,487.1	−337.7	−58.7	36.0	−315.2	460.7	284.4	176.3	3,076.2	3,425.3	−349.1	−510.5
1965–January–April [3]	304.9	330.4	−25.5	16.5	63.3	−105.1	167.7	125.5	42.2	1,113.6	1,146.3	−32.7	−16.0
1964:													
April	22.5	27.0	−4.5	3.7	−8.3	.1	30.3	32.6	−2.3	309.8	327.0	−17.3	−24.1
May	221.4	304.2	−82.9	.1	19.5	−102.5	31.4	17.8	13.6	281.1	278.3	2.8	−66.5
June	20.9	9.3	11.6	1.1	10.5	.1	53.5	30.9	22.6	259.7	265.7	−6.0	28.2
July	508.5	525.0	−16.5	−23.2	6.3	.4	33.9	28.3	5.6	250.5	324.3	−73.8	−84.7
August	19.7	117.4	−97.8	−40.0	3.2	−61.0	66.3	18.7	47.6	193.8	243.6	−49.8	−100.0
September	16.4	97.2	−80.8		2.9	−83.7	36.3	27.2	9.1	231.0	273.9	−43.0	−114.7
October	23.2	53.3	−30.2	−13.4	4.2	−21.0	37.0	29.3	7.7	298.4	323.4	−24.9	−47.4
November	31.8	68.8	−37.0	−40.2	3.1	.1	50.6	18.4	32.2	246.8	273.7	−27.0	−31.8
December	92.8	90.3	2.5	.1	2.1	.3	43.3	19.6	23.7	245.3	282.6	−37.2	−11.0
1965:													
January	107.0	173.0	−66.0	−15.3	16.9	−67.6	13.6	22.4	−8.9	226.8	226.6	.2	−74.7
February	99.5	106.9	−7.4	31.8	−1.4	−37.8	13.3	29.7	−16.4	269.5	261.9	7.6	−16.2
March [3]	21.3	38.0	−16.7		−16.9	.2	72.0	49.4	22.6	347.9	339.8	8.1	14.0
April [3]	77.2	12.5	64.7		64.7	(4)	68.8	23.9	44.8	269.4	317.9	−48.6	61.0

[1] Through 1949, includes transactions in corporate bonds.
[2] Through 1949, included with transactions in U.S. Government bonds and notes.
[3] Preliminary.
[4] Less than $50,000.

Mr. CURTIS. Then let me agree with you now that what I am saying still should not deter this committee from considering how we could properly improve our tax laws. I wasn't interjecting the points I have been making as a deterrent. I simply do say, though, that the administration has to start getting its various recommendations to the Congress together so that there is some consistency.

I have pointed this out in trade matters. We are moving to this business in the Canadian-American auto treaty of bilateral, of a specific product dealing, which is the reverse of the theory of the Reciprocal Trade Act of 1962 and the Kennedy Round, and just in so many instances there seems to be no consistent policy of the adminstration in this area of foreign trade and international finance.

Secretary FOWLER. I think we can go on this. I simply repeat again that as far as my position is concerned, when I appeared before this committee earlier to recommend the extension of the interest equalization tax, it was on the same premise—that it was a temporary measure that I hoped, with you, we could at an early date dispense with.

This particular proposal is for a long-term measure that I hope, if it gets on the books, can be maintained indefinitely as one part of a broad effort by our private sector, by foreign governments, and the whole area reflected in these recommendations, to encourage the free movement of capital.

Mr. CURTIS. I don't want to rehash it further. We have done enough rehashing and I think it has been necessary to do so, but this pinpoints what I was saying when I was interrogating you on the interest equalization tax. I was saying I would have liked to have seen some appraisal on the part of Treasury of the damage that was coming about from the interest equalization tax because I am sure when you say that it should be only temporary you are saying that there is some damage being caused, but you think the net benefits are there.

I question that, but I thought your statement presented to the committee on it was gravely lacking in calling to our attention the areas where damage is being created. This is why I have taken this occasion to point up a specific area, and there are many other areas where I would suggest great damage is resulting. If we only put the damage out in relation to the benefits, possibly the administration might change its policy and recognize, or hopefully might see, that the damage is much greater than the temporary benefits.

Secretary FOWLER. While we are assessing benefits let me say that I think one of the additional benefits not necessarily contemplated when the interest equalization tax was proposed is that it has served to focus everyone's attention on the importance of the fact that, in addition to selling foreign securities in U.S. markets, it is important to try to promote the development of the sale of U.S. securities to foreigners. I think over the long pull the interest equalization tax

has focused attention on the fact that there are things we could do in this area which we haven't yet done, but which would serve to create a better opportunity for the movement of capital this way.

Mr. CURTIS. I will at least remark it is an ill wind that doesn't blow some good. Now, there is one area that has not been gone into and I know it is a difficult one to have statistics about, but what about direct investment?

We have been talking really of investment in stocks, but direct investment has been found, as we found out again in the interest equalization tax, to be one of the big areas, and do we have any idea of what the picture is on direct foreign investment?

Secretary FOWLER. I am glad you raised that, Congressman Curtis, because it enables me to say that the task force in interpreting and applying its terms of reference felt that an examination by it of investment by foreign individuals and concerns in brick and mortar or factories, operations of that sort, was not to be included in the purview of the task force. There has been a unit in the Department of Commerce for some years which has been directed to the so-called direct investment factor and we purposely avoided duplicating the studies and examination of what is involved in that particular problem.

To some extent the tax laws and the recommendations that are in front of you would, I think, affect that situation, but that, as well as investment in real estate, was not the focus of the recommendations.

However, I think one of the principal impacts of these recommendations might very well be on foreign investment in U.S. real estate.

Mr. CURTIS. Help me here. What is the ratio of American investment in foreign securities to American direct investment?

Secretary FOWLER. I don't know whether I am completely accurate on that, but my impression is that a rough rule of thumb would be that of our total investment abroad, about two-thirds tends to go into direct investment and the other third into portfolio investment. The reverse is true of foreign investment in this country, by far the predominant percentage of foreign investment in the United States is in securities, or so-called portfolio investment, and only a third of foreign holdings are in what we would call direct investment.

Mr. CURTIS. That is very helpful, and then we will have the record open too so that you can supply more accurate figures if you have them in this area.

Secretary FOWLER. Right.

Mr. CURTIS. And any comments that you would make.

(The following material was received by the committee:)

End of 1963:	*Percent*
U.S. direct investment abroad as percent of total U.S. long-term private investment abroad	69.8
Foreign direct investment in the United States as percent of total foreign long-term private investment in the United States	34.9

Mr. CURTIS. As I was going over these tax recommendations many of them would affect direct investment the same way that they would the other kind.

Secretary FOWLER. Yes.

Mr. CURTIS. And that would be helpful.

Secretary FOWLER. I think to whatever extent they would affect them it would be a beneficial effect.

Mr. CURTIS. I think so.

Secretary FOWLER. And encouraging more direct investment.

Mr. CURTIS. One aspect of your recommendations, particularly estate tax, seemed to be to treat foreigners equally with the way we treat our own citizens.

That of course appeals to me strongly. What worries me, though, as we go on to some of these other recommendations it looks like we might be giving foreigners a privilege which we do not extend to our own taxpayers.

Am I correct in that observation?

Secretary FOWLER. I think I would tend to put it this way: We are tending to follow more closely the pattern of international tax treatment of foreigners followed by other countries. To the extent the element you mention is present, it is one that generally characterizes other countries' tax treatment of their own citizens as compared to tax treatment of foreigners.

Mr. CURTIS. When this committee goes into executive session to consider the details of these recommendations I think that is just one rule of thumb I am going to try to employ, because that is the way to prevent the tax haven rather than some of these somewhat punitive approaches.

For instance, just trying to figure out whether a person has changed his citizenship for tax reasons or for other reasons, I view that with a jaundiced eye. I would much prefer to follow the guidelines of trying to treat our citizens and foreign citizens for tax purposes as equally as we can. To that extent, many of these recommendations would be accepted by applying this rule of equity.

Secretary FOWLER. I think another guideline to follow there, Congressman Curtis, if I may just suggest it again, is that in making these comparisons it would also be useful to compare the proposals with the type of treatment U.S. citizens are given by foreign governments under their tax laws.

Mr. CURTIS. Well, yes; I agree with that.

Secretary FOWLER. I am not talking about the tax haven treatment, but I mean the generalized tax treatment.

Mr. CURTIS. I might as well pick this point up because I had it noted here. On page 20 you refer to "the generally accepted international tax policy principles," and I wasn't quite sure what they were or how you conceive of what are "generally accepted international tax policy principles." Is this the result of study, or is this a general conclusion?

Secretary FOWLER. I would hate to have to produce a compact statement of those principles. What we would have to bring up to you is a large stack of international tax treaties, both those that have

been negotiated between this country and other countries, as well as those negotiated solely between foreign countries. Moreover, the OECD is presently involved in a considerable study in this area for the purpose of harmonizing tax treaty policies.

I also think the Common Market countries are also working toward a similar objective.

Mr. CURTIS. I thought that was the position the committee was going to be in, that we are going to have to sort of look at each one of these tax treaties. Unfortunately we don't have a little handbook to follow to look at as to what the accepted principles are.

On page 11, for example, you point out on capital gains: "The present system of taxing capital gains realized by foreigners has contributed to the view that investment in the United States is something that should be approached cautiously," et cetera, and I was thinking generally with respect to international tax policy principles.

We have a much more liberal interpretation of what is capital gain than the British, for example. Many of the things that we call capital gain they regard as ordinary income and I would wonder, for example, vis-a-vis Great Britain, whether the net result was that we weren't more liberal in our overall tax treatment because we don't regard as ordinary income a number of things that they do.

This would be one of the details we would have to get into in a reconciliation.

Secretary FOWLER. I think I will ask Secretary Surrey to comment on that because he has been dealing with the tax treaty problem rather substantially in recent months.

Mr. SURREY. It is very hard to say. Most of the capital gains that are involved are generally sales of stock and securities and the definitions are roughly the same if the foreign country has a tax on capital gains.

Some foreign countries do not have a tax on capital gains. The British tax on capital gains, if the bill before Parliament is adopted, will be somewhat stiffer than ours. The rate would be higher.

Mr. CURTIS. This is true. You are directing your attention to securities?

Mr. SURREY. Yes.

Mr. CURTIS. The complexities you have to get into in ordinary income are not in this area.

Mr. SURREY. That is right.

Mr. CURTIS. Thank you.

Mr. ULLMAN (presiding). Without objection the record will be kept open in the cases indicated by Congressman Curtis.

Mr. Burke?

Mr. BURKE. Mr. Secretary, do you see anything in this bill that would give a foreign investor an advantage over an American investor, say, in the line of a direct investment because of the tax breaks he would be getting?

Secretary FOWLER. I don't believe I do, Congressman Burke. I don't believe I see any advantage in that respect.

Mr. BURKE. Do you see the possibility of any loophole being established here whereby American money could be turned over to

a foreign investor who could invest that money here in the United States and thereby escape the taxes that would ordinarily be paid?

Secretary FOWLER. This is, of course, the problem that we contend with constantly in our current laws as they are written. I don't believe that the changes before you will materially or substantially change the challenge that always exists to the Internal Revenue Service to deal with that kind of problem.

I think that the principal concern that we have in that regard is reflected in the proposal having to do with treatment of expatriate American citizens. Although there might be some differences, as Congressman Curtis has indicated, about whether the test proposed is the most practical one, we do think some such provision, either that provision or a better provision, is necessary to deal with the problem of the American citizen who would give up his citizenship in order to take advantage of these particular provisions.

Mr. BURKE. Do you think there are sufficient safeguards in this bill to guard against that?

Secretary FOWLER. I think we would take the position that there are sufficient safeguards. I think experience might prove that something more would be necessary, but I think this would be the right basis on which to begin.

Mr. BURKE. Under the provisions of this bill let's just take a hypothetical case. Suppose some company wanted to open up a manufacturing plant here in America, say, for one of these small foreign cars and they invested here in the plant, bought the real estate, owned it lock, stock, and barrel, wouldn't they be in a rather advantageous position over their American competitor?

Secretary FOWLER. I don't think that this bill would change that situation in any particular. The only area which would be at all concerned is if the same concern, in addition to dealing in foreign cars, acquired a number of U.S. corporate securities and earned a good deal of investment income collateral to its regular business.

Then that portion of its income which could be attributed to investment income would be affected by some of the changes, sometimes better and sometimes worse, by the provisions of this bill.

Mr. BURKE. Is there anything in the provisions of this bill whereby there is American money sent abroad to a foreign investor who would invest here in this country and yet that American money is actually part of this foreign investment firm?

Do they receive the benefits of this bill?

Secretary FOWLER. I think what you have in mind is a beneficial real ownership which is masked by what purports to be an outright transfer of funds or release of funds. The situation would be exactly the same as it is today. We have that enforcement problem that we contend with. I don't think it is terribly serious, but it is something that the Internal Revenue Service has to be constantly alert to.

I don't believe that this bill will substantially affect or induce that kind of practice any more than is the case under our tax laws today.

Mr. BURKE. What I am referring to is where American money buys stock, say, in a foreign corporation as an investment corporation in the foreign country and that corporation in turn invests its money back over here.

Secretary FOWLER. I would like to think about it a little bit more and perhaps supply a full answer to your inquiry, Congressman

Burke, but my immediate answer and reaction is that this bill would not benefit or induce that kind of conduct.

Mr. BURKE. What I am trying to get at is, is there anything in this bill here that would induce American money to be sent abroad to invest in foreign investment corporations who would later come back here and invest it here.

Secretary FOWLER. I see exactly what concerns you, but I think our opinion is that that would not be induced or promoted by these proposals. These proposals really go to making it easier for the smaller investor in Western Europe to invest in U.S. securities.

As I have indicated, only 1 person in 30 in Western Europe now has investments in securities. This is not nearly as good a ratio as we have here in the United States; but it is going to come up over the course of time. These provisions really go to encouraging that kind of an individual, whether it be on his own or in some institutional context, to consider American securities as a part of his portfolio.

We do have about $13 billion worth of current investment from abroad in U.S. holdings and securities, but I see, as did the members of the task force, substantial opportunity over the long range for that volume to build up.

I think that is the principal appeal of the proposal. I believe that the practice you referred to goes on and is induced by the tax system generally.

There are great inducements, as you know, in many areas for both individuals and companies to base themselves in a foreign jurisdiction where the rate of local taxation is far less than that in the United States. However, I don't believe that particular practice is going to be substantially changed or increased by the provisions that we have submitted here. There are already large inducements for the person who really is trying to evade taxes in that fashion today.

Mr. ULLMAN. Are there additional questions? Mr. Schneebeli.

Mr. SCHNEEBELI. Mr. Secretary, what is the difference in tax revenues between your recommendations as the task force chairman and your recommendations as Secretary of the Treasury?

Secretary FOWLER. I think about $2 to $3 million.

Mr. SCHNEEBELI. Do we have any figures for the record that would establish the trend of the percentage of foreign ownerships in our securities, 25 or 50 years ago compared with today?

The reason why I ask is I believe there is quite a downward trend since, for instance, at the turn of the century I presume foreign ownership of our railroads was quite large and since then I would assume that there is a downward trend.

Secretary FOWLER. I am perfectly sure you are right in your assumption. I don't have the exact figures.

Mr. SCHNEEBELI. I would be interested in knowing what the foreign ownership in our securities was 50 years ago compared to today. I think it would be very interesting and I think the change would be quite precipitous.

Secretary FOWLER. Yes; I would agree I think it would focus to some extent on this problem.

Mr. SCHNEEBELI. I think it would buttress your argument to show a vast difference in ownership over the years.

Secretary FOWLER. If the record will remain open for us we will try to supply it.

(The information referred to follows:)

Data of the type referred to are not readily available. Some impression of the relative size of foreign holdings, however, can be gained from the following:

Foreign ownership of U.S. stocks as percent of market value of outstanding U.S. corporate stocks

	Percent
End of 1946	2.5
End of 1963	2.1

Mr. SCHNEEBELI. I think the record should show what the percentage was 25 to 50 years ago compared with today.

Mr. ULLMAN. Without objection the record will remain open. Mr. Broyhill?

Mr. BROYHILL. Mr. Secretary, does $141 million in net purchases made during the past 6 years reflect the earnings on those investments, the dividends paid?

Secretary FOWLER. No; that reflects I think more the balance of purchases against sales. In other words, the gross volume of purchases and sales runs in the neighborhood of $2½ to $3½ billion in a year, but when you net it out the $141 million figure represents net purchases.

Mr. BROYHILL. Then under the $141 million there is not much of a margin if there were many dividends paid. Is it possible that we could actually have had a net loss of balance of payments during that period due to dividends being paid out.

Secretary FOWLER. Of course there is no question but what the increase in the rate of foreign holdings in the United States will over the long-term reflect, presumably in dividends or capital gains withdrawn, an outflow of funds. Otherwise there would be no inducement for foreign investment here.

I think you put your finger on a point—that the long-term consequences of increased foreign ownership of U.S. corporate securities does entail a withdrawal of earnings from this country. That is the reason that Great Britain and France prior to the war, and Germany as well, had a policy of encouraging this type of investments for the long pull.

There was a national policy of encouraging that for the very reason you indicate. Since the war this hasn't really caught hold again as a matter of national policy throughout Western Europe. I think that we have to look also at the political consequences of such a policy.

I think my own attitude on this would be that it makes for a healthier set of political and economic interrelationships between citizens of various countries if U.S. citizens have some stake in securities of foreign corporations and if a large number of individuals in other countries have a stake in the United States.

I think it is just like tourism. It is like U.S. companies doing business abroad, foreign companies doing it here. The more this economic interrelationship can be encouraged, I think the better the overall understanding and allegiances, alliances, or friendship, whatever term you want to apply to it, are apt to be engendered.

Mr. BROYHILL. Did I infer correctly from your remarks that there possibly has been a loss in balance of payments during the past 6 years as a result of foreign investment in this country—we are talking about 6 years—with $141 million net gain in purchases? I understand over the long run it has resulted in a loss in balance of pay-

ments, but has there not been an actual loss over the past 6 years? That is when we experienced a lot of additional difficulty in the balance of payments.

Secretary FOWLER. At least $13 billion worth of American securities are owned abroad. The extent dividends have been remitted does, of course, enter into the outflow, but that has to be balanced against what we get from our investments abroad. I don't know what you are netting it against.

That is my difficulty in answering your question. There is an impact on our balance of payments as a U.S. company, and as General Motors Corp., pays dividends on its stock to someone who holds that security in Great Britain.

Mr. BROYHILL. That is what causes some of us, and certainly it is causing me, some difficulty in understanding why the interest equalization tax will not in the long run cause more problems in balance of payments. Should not increase in our investments abroad, in the long run also bring back a favorable increase in the balance of payments.

Secretary FOWLER. I think, to bring the interest equalization tax into this for a moment again, you are looking at a very short-run effect. You are looking at a law which, in a sense, causes an American who has been following foreign securities and building up his portfolio in that particular area to pause at this particular time for what we hope will be a brief span of years. It is a short-term deterrent to U.S. investment in foreign bonds and foreign stocks. That is its very purpose, because we feel at this particular period of time the initial capital investment by the individual will be so far in excess of the early returns that would come in the form of dividends and interest in the years immediately ahead when we presumably are trying to lick this balance-of-payments problem, the balance of benefits for the short term is in the national interest as against perhaps the balance of benefits over a long term.

Mr. BROYHILL. You said in your statement that you did not know for certain as to what balance-of-payments effect this bill would have.

Secretary FOWLER. I would think that over the long term, looking again now into 1975 to 1980 as a span, that a net increase in foreign investments in the United States——

Mr. BROYHILL. Increase of purchases rather than the net dividends, net result of incoming capital.

Secretary FOWLER. That is right. It is the outlay of capital now that I have in mind in making that statement.

Mr. ULLMAN. Are there further questions? Mr. Battin.

Mr. BATTIN. Thank you, Mr. Chairman. Do you have, Mr. Secretary, any idea of what the average foreign investor's capital outlay would be in the United States?

Secretary FOWLER. No, I don't believe we do. I think that you could probably get the best information on that from some of the private institutions, let's say, a brokerage firm like Merrill Lynch that has very extensive brokerage offices in Western Europe. They can give you a much better picture of the makeup of the average customer that comes into that brokerage house.

Mr. BATTIN. What prompts the question is the figure that you use in the exemption that would be applied to the estate tax.

Secretary FOWLER. On the estate tax, I think I can give you some information just in terms of the returns that we have from it now. When the returns filed in 1960 and 1961 are distributed by gross estate classes, approximately 90 percent of the returns are concentrated in the gross estate class zero to $60,000. Out of a total number of returns of 1,375, 1,231 fall in the class, zero to $60,000; 67 returns in the $60,000 to $100,000 category; 22 returns in the $100,000 to $150,000 estate tax class; 21 returns in the $150,000 to $200,000 estate tax class; 14 returns in the $200,000 to $300,000 category; 13 in the $300,000 to $500,000 catagory; 5 returns in the $500,000 to $1 million category, and 2 in the $1 million to $5 million category.

Mr. BATTIN. There have been reports in the press that the industrialized countries of Europe are becoming a little hard pressed for capital, at least in the world capital market.

Again going back to the interest equalization business—and we had as much discussion here this morning about that as the bill before us—I believe in discussing that bill, interest equalization tax, there was an indication by some that it would be helpful if there was in existence outside of the United States another money market.

The paper this morning indicates that you met yesterday with the Chancellor of the British Exchequer to discuss ways to increase the amount of money available to finance world trade.

If at one time you are encouraging capital to come into this country by the elimination of tax restrictions and thus encourage its investment here and at the same time discouraging the export of U.S. capital into the foreign market does it not become basically the position of the United States that at least for a period of time we are not willing to cooperate in trying to finance world trade?

Secretary FOWLER. No, not at all. I think, as a matter of fact, the record of the United States in this regard is thoroughly understood and appreciated by the central bankers, and by the Ministers of Finance in Western Europe. They understand as well as we do that the most substantial contribution the United States can make today to the free world monetary system is to bring its balance of payments into equilibrium and keep it there as a support to the dollar as the key currency.

As a matter of fact, most of the financial and economic authorities in Western Europe that we are in contact with have not the concern that you have attributed to some observers that our progress in dealing with our balance of payments is causing these difficulties.

They are concerned with the continued outflow of dollars in the form of U.S. deficits, in effect creating a tendency to inflationary conditions in those particular areas. I think they are quite receptive to the voluntary program that the President has proposed, and which has been accepted and is being carried on, and tend to applaud our efforts in this regard because of their primary concern, which we share, that our first job here is to get our own balance of payments into equilibrium and keep it there. That is the most substantial thing that we can do to facilitate world trade development.

Now, as we make progress in that area, and I am not trying now to assess the degree of our progress in that area, we recognize along with other people that some mechanism for the orderly creation of additional international liquidity, as it is called, which our dollar deficits

have hitherto supplied, ought to be arrived at. We are just as anxious as we can to negotiate changes in the international monetary arrangements so that over the long pull, and this is not something today or tomorrow—I don't think the other governments are fearful of any current damage that we might do—but over a period of time if we get into a balance and stayed there, then there is a question of where this additional liquidity comes from. Therefore, we share their concern that there be an adequate mechanism for creating the additional liquidity that our deficits have hitherto provided.

We are hopeful that we can work out these arrangements. However, it takes two to tango and they depend upon agreements by others. We cannot agree to changes in the system that amount to what would be a retrogression or diminishing of the effectiveness of the international monetary system.

Mr. BATTIN. Mr. Secretary, I want to share your view that getting our balance of payments into line is probably one of the most important tasks that you have as Secretary and I think the times that you have appeared before this committee since you were sworn in have indicated your real concern in this field.

I would also like to comment, since you were the chairman of the task force that gathered the information presented with this bill, H.R. 5916. I think the suggestions as well as the explanations that have been made with the recommendations are well done and the task force should be congratulated.

Secretary FOWLER. Thank you very much. Very little credit is due to me. Ambassador McKinney, who was the executive director of the force, worked many long, hard months and I can say that every member of the task force, and they include a lot of very, very busy men who had other duties and responsibilities as their business and corporate identification would indicate, contributed most generously of their time and effort. It was really very much of a joint production.

It was not one of these operations in which just a few people from the Government did the work. A great deal of work went into what you have generously indicated is a very small, but I think worthwhile, package.

Mr. ULLMAN. Are there further questions? Mr. Secretary, I believe the record is incomplete in one regard.

You asked Mr. Surrey to give us a brief explanation as to why the Treasury recommended retaining low-rate estate taxes rather than following the recommendations of the task force. Mr. Surrey, would you like to do that and submit it for the record, or could you do it very briefly?

Mr. SURREY. I can do it briefly right now. It doesn't make any difference.

Mr. ULLMAN. We have some witnesses from New York and I think it would be better if you submitted a short statement for the record.

Mr. SURREY. All right.

Mr. ULLMAN. Without objection that will appear in the record at this point.

Mr. SURREY. All right.

(The information referred to follows:)

STATEMENT OF TREASURY POSITION REGARDING THE PROPOSAL CONTAINED IN H.R. 5916 TO AMEND ESTATE TAX PROVISIONS APPLICABLE TO NONRESIDENT ALIEN DECEDENTS

H.R. 5916 would amend our present system of taxing the estates of nonresident alien decedents by increasing the present $2,000 exemption to $30,000, and substituting a 5–10–15 percent rate schedule for the regular U.S. estate tax rates (ranging up to 77 percent) now applicable to the estates of such decedents. The Task Force on Promoting Increased Foreign Investment in U.S. Corporate Securities recommended (recommendation No. 29) that U.S. estate taxes on intangible personal property be eliminated.

The changes contained in H.R. 5916 should result in lower estate taxes on nonresident aliens and thereby improve the climate for foreign investment in the United States. Present U.S. rates and the limited exemption applicable to nonresident alien decedents result in an excessive effective rate of estate tax. These rates have resulted in proper concern that our estate tax is a deterrent to foreign investment in the United States. The proposed changes correct this situation. The new rates effect a sweeping reduction in the present effective rate of tax—from almost 80 to 100 percent of the present tax is eliminated. The new rates will produce for nonresident aliens' estates an effective rate of tax on U.S. assets which in many cases is comparable to that applicable to U.S. citizens who avail themselves of the $60,000 exemption and marital deduction (which are not available to nonresident aliens). The attached tables show the effective rates and dollar amounts of U.S. estate tax for nonresident aliens under present law and the effective rates produced by the proposed exemption, compared with the rates and tax applicable to the estates of U.S. citizens electing and not electing the marital deduction.

It should be pointed out that even the task force did not recommend complete elimination of the estate tax. Even under the task force recommendation, the estate tax would remain applicable to all tangible property, including real property and personalty, owned by a nonresident alien decedent.

The objections to the task force approach are as follows:

(1) Although we receive only $5 million in revenue annually from our estate tax on nonresident aliens, it would appear inequitable to completely relieve nonresident aliens holding U.S. intangible property from estate tax when U.S. citizens are subject to an estate tax.

(2) Elimination of the tax on intangibles, which constitute between 85 and 95 percent of the taxable assets held by nonresident aliens, would remove the principal impact of the tax. Yet the Internal Revenue Service would be required to maintain enforcement activities to collect the tax in those cases where tangible assets were held. Elimination of the tax on intangibles would discriminate against aliens who chose to invest in real property, for example, rather than stocks. In such a case, most aliens investing in real estate would probably incorporate their investments to avoid the tax, reducing the tax base even further.

(3) The matter of international tax rules governing the estate tax has been discussed in the Organization for Economic Cooperation and Development (OECD). Some of the countries are willing to eliminate by treaty the estate tax on intangibles owned by foreign decedents. This is not true, however, of the United Kingdom, Canada, and Japan. Where countries have registered shares rather than bearer shares—such as the United States—they are apparently less willing to eliminate their estate tax on intangible property where foreigners are involved. If other countries begin to utilize registered shares more frequently, it may be expected that they might wish to retain their estate taxes on intangibles since the likelihood of collecting the tax would be far greater.

(4) Elimination of the tax on intangibles would mean that we would be less likely to receive information on the foreign assets of U.S. estates. Our ability to exchange information on alien-owned property in the United States under our treaty arrangements enables us to obtain information about our citizens who die, and have assets abroad, and we may be handicapped here in the future if we have little or no information to exhange. The same may be true of information which other countries may have about Americans who die abroad with assets here.

(5) The changes embodied in H.R. 5916 accomplish the principal objective intended by the task force recommendation and yet do not raise the problems discussed above.

The increase in exemption and reduced rates proposed in H.R. 5916 will bring U.S. effective estate tax rates on nonresident aliens to a level somewhat higher than those imposed upon resident estates in Switzerland, Germany, France, and the

Netherlands, for example, but substantially below those imposed on resident estates in the United Kingdom, Canada, and Italy. Thus, investment in the United States from these latter countries would bear no higher estate tax than investments made domestically because of exemptions or credits that the latter countries allow for U.S. taxes. The proposed tax treatment of the U.S. estates of nonresident aliens is substantially similar to the treatment accorded the estates of nonresidents by Canada, whose rates on the estates of its citizens are comparable to our own. Where additional reductions are justified, these may be made by treaty.

For these reasons, the Treasury urges that the estate tax changes embodied in H.R. 5916 be adopted.

Effective rates of U.S. tax on U.S. estates of nonresident aliens and U.S. citizens

U.S. gross estate [1]	Effective rate of tax			
	Present treatment of nonresident alien	Nonresident alien [2]	U.S. citizen	
			With marital deduction [3]	Without marital deduction [4]
$2,000				
$10,000	2.9			
$30,000	7.7			
$60,000	12.5	2.0		
$100,000	17.3	3.0		3.0
$250,000	23.0	5.8	3.0	16.1
$500,000	25.8	7.4	8.0	22.1
$750,000	27.5	7.9	9.9	24.8
$1,000,000	28.8	8.8	11.1	26.7
$5,000,000	43.0	12.6	16.9	42.3
$10,000,000	53.3	13.0	21.2	52.8

[1] 10 percent of gross estate is deducted for funeral and other expenses of U.S. citizens and nonresident aliens.

[2] Effective rate of tax with $30,000 exemption and rate schedule as follows:

If taxable estate is—	The tax shall be—
Not over $100,000	5 percent of the taxable estate.
Over $100,000 but not over $750,000	$5,000+10 percent of excess over $100,000.
Over $750,000	$70,000 +15 percent of excess over $750,000.

[3] Effective rate of tax on U.S. citizens under current rate schedule with $60,000 exemption and marital deduction.

[4] Effective rate of tax on U.S. citizens under current rate schedule with $60,000 exemption but without marital deduction.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, July 2, 1965.

Dollar amounts of U.S. tax on U.S. estates of nonresident aliens and U.S. citizens

U.S. gross estate [1]	Amounts of U.S. tax			
	Present treatment of nonresident alien	Nonresident alien [2]	U.S. citizen	
			With marital deduction [3]	Without marital deduction [4]
$2,000				
$10,000	$290			
$30,000	2,300			
$60,000	7,500	$1,200		
$100,000	17,300	3,000		$3,000
$250,000	57,500	14,500	$7,500	40,250
$500,000	129,000	37,000	40,000	110,500
$750,000	206,250	59,250	74,250	186,000
$1,000,000	288,000	88,000	111,000	267,000
$5,000,000	2,150,000	630,000	845,000	2,115,000
$10,000,000	5,330,000	1,300,000	2,120,000	5,280,000

[1] 10 percent of gross estate is deducted for funeral and other expenses of U.S. citizens and nonresident aliens.
[2] Effective rate of tax with $30,000 exemption and rate schedule as follows:

If taxable estate is—	The tax shall be—
Not over $100,000	5 percent of the taxable estate
Over $100,000 but not over $750,000	$5,000 plus 10 percent of excess over $100,000
Over $750,000	$70,000 plus 15 percent of excess over $750,000

[3] Effective rate of tax on U.S. citizens under current rate schedule with $60,000 exemption and martial deduction.
[4] Effective rate of tax on U.S. citizens under current rate schedule with $60,000 exemption but without marital deduction.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, July 2, 1965.

Mr. ULLMAN. Mr. Secretary, we thank you very much for your testimony before us. It has been very helpful to us.

Secretary FOWLER. Thank you very much, Mr. Chairman.

Mr. ULLMAN. We have some additional witnesses from out of town and I would like to proceed as long as we can prior to a quorum call. The next witness is Mr. Fredrick Eaton. Is Mr. Eaton here?

Mr. Eaton, we welcome you before the committee. You are a member of the task force and have worked hard and long on this problem. Will you please state your name and who you represent here for the committee and proceed as you wish?

STATEMENT OF FREDRICK M. EATON, NEW YORK, MEMBER OF TASK FORCE ON PROMOTING INCREASED FOREIGN INVESTMENT IN U.S. CORPORATE SECURITIES, ACCOMPANIED BY PETER NITZE

Mr. EATON. Thank You, Mr. Chairman and gentlemen. I will briefly review for you the activities of the task force and its recommendations. My primary purpose here is to tell you in general terms the results that have been accomplished in the private sector in the area of its recommendations.

In some detail, I have furnished this to each of you in a report which was signed by Ambassador McKinney; the executive officer of the task force of which Mr. Fowler was the chairman.

The members of the task force are set forth in the task force report which I believe you have and represented a fairly broad section of both industry and of finance. This group was formed in the summer and fall of 1963 and its report was filed in the spring of 1964.

The report was divided into three major sections. One was suggestions to business and finance as to what could be done to help on