the balance-of-payments problem; second was directed to the Securities and Exchange Commission; and the third to the Treasury and therefore to this committee. The Securities and Exchange Commission, in large part Chairman Cohen, then a member of the Commission, was extremely helpful. In the early days of July of 1964, shortly after the report was filed, the Securities and Exchange Commission issued a release which carried out all of the recommendations which were made by the task force to the SEC.

They were extremely helpful. I will not go into them. They were of a technical nature. I will be glad to answer any specific questions that you have at the end, but I don't believe they are of any material moment to this committee other than that it made it far easier for our investment banking firms to offer securities abroad and far easier to bring foreign participants into the U S. syndicates.

The second area, and probably the most important area, were the recommendations which had to do with the tax bill and tax changes which the committee felt would be helpful in stimulating foreign investment in American securities. The bill that is before you in general carries out each of those recommendations faithfully and goes beyond it in many respects.

There is the one exception that was raised here this morning that of the estate tax. I hope very much that the committee will consider the recommendation of the task force, which is to eliminate all estate taxes on all intangibles, specifically stocks and bonds that are held by foreigners.

The provision in this bill goes a long way as far as rates are concerned. It reduces the rate to a maximum of 15 percent and that amount isn't reached until the estate is over $5 million, so that the rates are not now too important. The figures given you by the Secretary this morning indicate that the magnitude of all estate taxes that were taken in under existing law was $5 million per year and the recommendations in this bill, if this bill is enacted, will reduce these to $2 million.

Two million dollars is a sizable amount of money, but, if the judgment of the investment community is correct, the benefits which would come from the flow of dollars into securities in this country would be far, far, far greater than the $2 million that would be lost in the revenue measure. As the Secretary indicated, the problem is not simply rate. It is not wanting to become involved in our system of estate taxes. I would hope very much that the committee will consider possibly eliminating the estate taxes entirely in this area.

To move into another area, engagement in business in the United States, a technical concept, the committee made recommendations in this area. Those recommendations were carried out, were effected in the bill. They have raised two or three technical problems that I am not sure I am technically competent to describe to you. We have furnished you a technical memorandum on it.

One, however, I would like to comment on. There is a degree of uncertainty in the present law as to whether the granting of discretion to bankers and to brokerage houses in this country to purchase or sell securities may not constitute doing business in the United States with all of the attendant difficulties that doing business in the United States involves. This has been eliminated entirely except for one area.

The bill provides that anyone who is engaged in the securities business abroad, if he gives discretion here, may then, or will then, become engaged in business here. There isn't any doubt but what a foreign security dealer if he is actually engaged in business here should be subject to the same taxes that our own security dealers are, but not simply because they are members of various syndicates that are now being formed to distribute U.S. securities abroad. Incidentally, in connection with General Motors syndicate, some 48 foreign firms were brought in as members of that syndicate. Under the terms of a syndicate agreement discretion is granted to the syndicate managers who are U.S. banking houses to buy and sell and stablize the market in securities, to lay off transactions—I won't go into the details. There should be a technical amendment made here and I have advised the counsel to your committee and Secretary Surrey of the problem—so that it will not discourage the very thing which the action of the SEC and which this bill is intended to encourage, which is to bring foreign security firms in to assist us in selling our securities abroad.

The intercorporate dividend tax provision creates a problem and again I have furnished information in that area to counsel to the committee and Secretary Surrey. With those very limited exceptions not only does this bill carry out all the recommendations in the task force report, but goes beyond it and the private members of the task force are very heavily indebted to Secretary Surrey and his staff and to Chairman Mills for introducing this bill.

I will go on for a moment, if I may have the time, Mr. Chairman, to comment briefly on those recommendations that were directed to the private sector. So complete was the cooperation of the Government sector that the private sector felt that they should go as far as they could to carry out the recommendations which in effect they had made to themselves.

I would like to quickly emphasize that many of the things that I am going to comment on were brought about and occasioned by a combination of events and not alone by this task force recommendation. Therefore I would not want to indicate that the steps that have been taken over the last 12 months to help on the balance-of-payments problem were directly a result of the task force report.

Some of the specific suggestions in the task force report helped to educate both the banking and the industrial community as to the opportunities which did exist abroad for investment there.

One of the areas that was recommended was that we place American securities abroad, and within the last 12 months there have been something in the neighborhood of $100 million in American securities placed abroad.

I won't try to detail them. I have to some extent in the report that has been filed with you. General Motors placed $50 million. Ford was $30 million, Minnesota Mining was $3 million, Cutter Laboratories, and there have been others that I won't bother you with.

Another area that was recommended was that U.S. companies borrow money abroad for their foreign financing rather than to invest our funds here in the foreign company. Fortunately the interest equalization tax does not apply to a corporation that invests money in a foreign subsidiary or any foreign company in which it owns more than 10 percent of the stock, so the equalization tax did not prevent this flow of funds.

As a result of the recent effort of President Johnson and the tightness of the balance of payments there have been substantial borrowings abroad. Socony Mobil has just recently sold an issue of deutsche marks and sterling notes. The General Motors Co. have borrowed upward of $60 million in Belgium to build their plants over there. Again the details of these have been furnished to you.

The task force recommended that investment banking houses here endeavor to place foreign dollar bonds abroad which no longer are attractive to this market because of the interest equalization tax and in the last 12 months over $200 million of foreign dollar bonds have been placed abroad.

There have been several Japanese issues, the city of Tokyo, Nippon Electric. Copenhagen Telephone and a number of Finnish issues have been placed abroad, Mexican issues, Italian issues. The sum is quite substantial.

There was a recommendation that the investment banking houses, the brokerage houses, increase their activity abroad. There are today some 180 branches of New York Stock Exchange houses abroad. That does not represent the last year. That is the aggregate of them. In the last year there was something maybe in the neighborhood of 20. Again the details have been given to you.

There has been very substantial additional activity by these firms abroad. They have many more representatives abroad. The banking houses, the commercial bankers, have done the same thing. Additional branches have been opened. The first National City Bank, the Morgan Guaranty, Bank of America, have been extremely active in disseminating information and endeavoring to bring deposits into this country rather than to have the flow of moneys go out.

On the New York Stock Exchange, recommendations were made that they encourage listing abroad. There have been some 20-odd companies that have listed their securities either in Luxembourg on the Paris Bourse, on the Amsterdam Exchange, or on the London Exchange, and I have given you those.

The Kaiser Co. is one. Three M is another. General Motors has had some additional listing as had Ford, and the details have been furnished you. On investment trusts, recommendations have been made in that area and there have been very substantial activities on the part of investment trusts to sell their shares abroad.

Certain of them have issued bearer deposit receipts to make the securities more salable in Europe. I would be glad to furnish you any additional information that the committee would like to have in this area. I have endeavored to be brief here to save the committee's time.

On the question of the tax bill, I am not technically competent to go much further than I have, but if there are any questions that you would like to have me answer I will endeavor to do it or to provide you with the information.

My associate, who is Peter Nitze, also of New York, is far more familiar in that area than I am. Thank you very much.

Mr. ULLMAN. Mr. Eaton, you have given some very helpful testimony. For the purpose of the record would you state the name of the gentlemen with you.

Mr. EATON. Peter Nitze, N-i-t-z-e. We are both of New York City.

Mr. ULLMAN. Thank you very much. Insofar as the tax bill before us is concerned, as you have indicated, it goes further than your recommendations. Do you and the task force approve of the additional items that are in the tax bill beyond——

Mr. EATON. Never formally. We have not met formally on it, but I can say that both Mr. Meyer and I who were primarily responsible for the tax activity of the committee do approve of it.

Mr. ULLMAN. Thank you, Mr. Eaton. Are there questions?

Mr. BYRNES. I did want to compliment Mr. Eaton and the other members of the task force for the service they performed and the recommendations and the actions that were forthcoming as a result of it. I think they were very salutary and I do appreciate Mr. Eaton's coming to testify and to help us in this tax legislation.

As I understand it, you really only have a difference in one item, between what the task force recommended, and you still recommend, and what the Treasury proposes. That is in the area of the estate tax.

Mr. EATON. That is correct. We have two or three technical points that I have commented on. I don't want to stress their unimportance.

Mr. BYRNES. No.

Mr. EATON. Because they are important. I also should add that there are other areas of changes that might be made in the tax structure that might also be helpful in encouraging foreign investment, but I have limited myself, and I intend to, solely to those that were covered by the task force report, I don't mean by so doing to indicate that there may not be other changes that will be recommended by others that might not also be helpful in the balance-of-payments problem.

Mr. BYRNES. Are there any outstanding recommendations that the task force made with respect to changes in the tax law that are not included in the recommendations of the Treasury?

Mr. EATON. No, other than the estate tax.

Mr. BYRNES. And the other variations that you have are technical aspects that arise out of the application of the specific legislative recommendations of the Treasury as contained in the bill?

Mr. EATON. That is correct.

Mr. BYRNES. Rather than the principle involved necessarily.

Mr. EATON. That is correct.

Mr. BYRNES. Is that right?

Mr. EATON. As always happens when a very technical statue is redrafted, it raises some other problems. As an example, under this bill it would be quite possible for a foreign investment banking house to set up and trade in the United States and not pay any capital gains tax. This ought to be corrected because foreigners who do a security business here ought to be taxed. The Treasury is well aware of that and I am sure will correct it.

Mr. BYRNES. Our technicians and the Treasury technicians have been apprised of the technical points that you have found that may be defective and this should have attention.

Mr. EATON. That is correct. There are only two or three of them and I don't think they present a problem for either of us.

Mr. BYRNES. Thank you very much.

Mr. ULLMAN. Thank you for appearing here. You have been very helpful.

Mr. EATON. Thank you very much.

(Letter to Mr. Mills from Mr. Meyer and Mr. Eaton follows:)

NEW YORK, N.Y. *June 24, 1965.*

Re H.R. 5916: Fowler task force.

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*U.S. House of Representatives,*
*1102 Longworth House Office Building,*
*Washington, D.C.*

DEAR MR. MILLS: The undersigned were members of the Task Force on Promoting Increased Foreign Investment in U.S. Corporate Securities and were assigned the primary responsibility for the tax recommendations of the task force. We are submitting this letter in response to your announcement of June 18, 1965, inviting interested persons to submit statements on H.R. 5916.

H.R. 5916 implements most of the substantive tax recommendations contained in the task force report and we urge strongly that this bill be given prompt and favorable consideration by your committee.

There are, however, certain areas in which we believe the current text of H.R. 5916 would fail to achieve the objectives of the task force.

I. ESTATE TAX

The bill would substantially reduce estate tax rates on estates of nonresident alien decedents. Although this rate reduction may help to increase foreign investment in the United States, it falls considerably short of the task force recommendation that all estate taxes on the intangible property of nonresident alien decedents be eliminated. The task force's recommendation reflects the strong opinion of its members that the severe deterrent effect of U.S. taxation of the estates of nonresident alien decedents cannot be eliminated merely by a reduction in rates. The problem is in very large part psychological resulting from the great reluctance of many potential foreign investors to subject themselves to possible liability for any type of capital levy imposed by another country or to the requirement of filing tax returns in another country.

It is the opinion of the task force that the ability of the United States and foreign banks and securities firms to inform their foreign clients that the purchase of U.S. corporate securities would under no circumstances subject them to U.S. estate taxes or the requirement of filing a U.S. estate tax return would be an important stimulus to the sale of U.S. corporate securities to foreign investors. H.R. 5916 falls short of this goal.

We have been advised that the aggregate of all U.S. estate taxes paid by foreigners on their U.S. property has been in the neighborhood of $3 million to $6 million annually; the proposed new rates undoubtedly would reduce this figure substantially. Thus, adoption of the task force recommendation would involve no large loss of revenue to the United States. We would hope that you would not find this loss of revenue important, particularly in comparison with the very real stimulus to the sale of U.S. corporate securities to foreign investors which would result from adoption of this recommendation.

II. FOREIGN UNDERWRITERS AND SECURITIES DEALERS

We are enclosing a separate memorandum discussing, in some detail, certain problems arising under the provisions of H.R. 5916 relating to the taxation of securities profits of resident foreign corporations and the effect of discretionary authority given to a U.S. agent in connection with securities and commodities trading activity.

One of the problems set forth in the enclosed memorandum is of vital importance to the entire program of promoting increased foreign investment in U.S. corporate securities. Increasingly, U.S. investment banking houses, in response to the recommendations of the task force and to President Johnson's appeal, have included foreign banks and securities firms in underwriting syndicates and selling groups formed to distribute U.S. equity securities. As a result of this trend more than $75 million of such securities have been sold to foreign investors in recent months. (A report furnished to your committee by Ambassador Robert M. McKinney, executive officer of the task force, will further document this trend.)

The task force had made the following recommendation:

"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; * * *."

In an effort to implement this recommendation H.R. 5916 would amend section 871(c) to read, in relevant part, as follows:

"(c) ENGAGED IN TRADE OR BUSINESS DEFINED.—* * * the term 'engaged in trade or business within the United States' * * * does no include—

* * * * * * *

"(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."

In our opinion the proposed amendment easily can be interpreted as implying that a dealer in securities will be deemed to be engaged in trade or business in the United States if any discretion is granted by such dealer to a U.S. agent.

The usual forms of agreement among underwriters employed by U.S. investment banking firms contain provisions whereby the members of the underwriting group grant to the managing underwriter the power, in his discretion, to sell certain of the securities being underwritten to institutions and dealers on behalf of the members of the syndicate, to engage in stabilizing transactions, and to take certain other actions which may result in the realization of a profit by all members of the group. If foreign banks and securities firms believed that participating in a U.S.-managed underwriting syndicate might result in such foreign firms being deemed to be engaged in trade or business in the United States, the present trend of increasing distribution of underwritten securities to foreign investors probably would be reversed.

It is clear that it is not the intent of H.R. 5916 to create an obstacle to the sale of securities to foreign investors. Accordingly, we recommend that through regulation, published ruling, statement in the committee report, or such other manner as may be deemed appropriate, the above described inference that can be drawn from the proposed amendment to IRC section 871(c) be clearly eliminated.

Very truly yours.

ANDRE MEYER.
FREDERICK M. EATON.

JUNE 24, 1965.

Memorandum to: Hon. Wilbur D. Mills, Chairman, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C.

Subject: H.R. 5916.

Review of H.R. 5916 has revealed certain situations in which the provisions of the bill would lead to results which appear inconsistent with the intent of the bill.

*1. Discretionary authority given to a U.S. agent in connection with securities and commodities trading activity*

H.R. 5916 is designed to increase foreign investment in the United States. One of the principal methods for achieving such an increase is the stimulation of a more widespread distribution of securities of U.S. issuers among foreign investors. In order to effect such distribution it is important that foreign banks and securities firms be included in underwriting groups having U.S. managers. As was recognized by the task force in its 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."

One of the principal obstacles to the inclusion of foreign banks and firms in such underwriting groups was eliminated when the Securities and Exchange Commission adopted task force recommendation No. 5 that:

"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 U.S. register as broker-dealers." (See SEC Releases No. 33-4708 and No. 34-7366, July 9, 1964, 29 F.R. 9828.)

However, another of the obstacles to the inclusion of foreign banks and firms in such underwriting groups lies in the tax field. Rather than eliminating this obstacle, the current provision of H.R. 5916 would make it more acute.

In many underwriting groups the syndicate manager reserves the right to sell certain of the securities being underwritten to institutions and dealers on behalf of the members of the syndicate, to engage in stabilizing transactions, and to take certain other actions which may result in the realization of a profit by all members of the group. There is considerable risk that in taking such actions the syndicate manager may be regarded as the agent of all of the other members of the group.

Under section 3 of the bill the definition of "engaged in trade or business within the United States" appearing in IRC section 871(c) would be amended to provide that nonresident alien investors who are not dealers in securities or commodities could grant discretionary authority to a U.S. agent or broker without thereby being deemed to be engaged in trade or business within the United States.

The clear implication of this provision in its current form is that a dealer in securities or commodities will be deemed to be engaged in trade or business in the United States if any discretion is granted to a U.S. agent. Thus, the risks to a foreign bank or securities firm of participating in a U.S.-managed underwriting group would become acute.

The current text of these proposals raises certain other problems. Under the proposed amendments, any foreign bank,[1] securities firm or commodities firm granting discretionary power to a U.S. agent or securities or commodities broker would be regarded as engaged in trade or business here. This would be true even if the discretionary authority was in fact granted on behalf of individual or corporate clients of the foreign bank or firm, or if the discretionary authority was granted with respect to the investment account of the bank or firm.

In view of the fact that a very substantial portion of the securities and commodities business received from nonresident alien individuals and foreign corporations is effected through foreign banks and dealers, it appears that the current text of the proposals would, in many cases, fail to have the intended effect and might, in fact, have an adverse effect on our balance of payments.

As is recognized in the Treasury press release accompanying H.R. 5916, the granting of a discretionary power of investment "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."

The above considerations appear applicable in cases where a foreign bank or securities firm is operating its own investment account or acting on behalf of its customers as well as in cases of a direct grant of authority from a nonresident alien individual to a U.S. broker.

While it is equitable that a foreign bank or firm should not be permitted to operate a regular business in the United States as a securities or commodities dealer without being deemed to be engaged in trade or business here, the bill could be amended to take care of this situation without creating the problems referred to above.

It is suggested that the proposed amendments to IRC section 871(c)(2) be altered to read as follows:

"(2) TRADING IN SECURITIES OR COMMODITIES.—

(A) SECURITIES.—Trading in stock or securities 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 such stocks or securities are held by the taxpayer primarily for sale to customers in the United States in the ordinary course of its trade or business) whether or not any such agent has discretionary authority to make decisions in effecting such transactions, or

(B) COMMODITIES.—Trading in commodities whether transactions are effected directly, or by way of agent, through a resident broker, commission agent, custodian, or other independent agent, and (except where such commodities are held by the taxpayer primarily for sale to customers in the United States in the ordinary course of its trade or business) 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."

[1] Contrary to U.S. practice most foreign banks are "dealers" in securities.

In addition, it should be made clear by regulation or published ruling that a foreign dealer or underwriter would not be deemed to be engaged in trade or business hereby reason of participation in an underwriting group having a U.S. manager.

*2. Taxation of securities profits of resident foreign corporations*

Under section 4 of the bill a resident foreign corporation would be taxed at ordinary rates on its business income from U.S. sources and at a flat 30-percent rate on its nonbusiness income from U.S. sources.

Business income and nonbusiness income are defined as follows in the proposed amendments to IRC section 882:

"(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."

Under these definitions gains realized by a foreign corporation from the sale of corporate stock would be excluded from both business and nonbusiness income and, therefore, totally exempt from U.S. tax.

In most cases this exclusion will serve the basic purpose of H.R. 5916. However, under the bill as currently drafted, it would be possible for U.S. persons to finance and operate a securities dealer business in the United States through the medium of a resident foreign corporation and thereby accumulate profits from trading in corporate stock substantially free of tax at the corporate level.

If the corporation were a "regular dealer in stock or securities," its income from sales of corporate stock would not be "foreign personal holding company income" or "Subpart F income" and the shareholders would be subject to tax only on amounts actually distributed to them by the corporation (see IRC secs. 543(a)(2), 952, 954). Therefore, a substantial tax benefit might be accorded to persons making no contribution to an improvement of the U.S. balance of payments.

This apparently unintended result could be eliminated by amending the definition of business income to read as follows:

"(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 income described in paragraph (4), except that business income shall include net gains from the sale or exchange of stock in corporations only if such stock is held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business."

Mr. ULLMAN. We have two additional witnesses.

Unfortunately, we have to adjourn for the day. Mr. Anderson, will it be possible for you to come back tomorrow?

Mr. ANDERSON. Yes, sir.

Mr. ULLMAN. Tomorrow morning at 10 o'clock. And Mr. Waris?

Mr. WARIS. Yes.

Mr. ULLMAN. We will expect you back here then in this committee room at 10 a.m., and the committee is adjourned until 10 o'clock tomorrow morning.

(Whereupon, at 12:47 p.m., the committee recessed to reconvene at 10 a.m., Thursday, July 1, 1965.)

# REMOVAL OF TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES

THURSDAY, JULY 1, 1965

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in the committee room, Longworth House Office Building, Hon. W. Pat Jennings, presiding.

Mr. JENNINGS. The committee will come to order.

Yesterday when the hearing was suspended the next witness was Mr. Paul Anderson, who wants to appear in behalf of the American Life Insurance Co. and the United States Life Insurance Co. in the city of New York in reference to H.R. 5916.

Is Mr. Anderson present? If you will come forward, Mr. Anderson, we will be glad to hear from you at this time. If you will introduce yourself, Mr. Anderson and give your name to the reporter and the gentleman who is accompanying you, you may proceed.

## STATEMENT OF PAUL M. ANDERSON, AMERICAN LIFE INSURANCE CO. AND THE UNITED STATES LIFE INSURANCE CO. IN THE CITY OF NEW YORK; ACCOMPANIED BY SAUL LESSER, ASSOCIATE GENERAL COUNSEL, UNITED STATES LIFE INSURANCE CO.

Mr. ANDERSON. Thank you, Mr. Chairman. Mr. Chairman and members of the committee, my name is Paul M. Anderson. I am a resident of New York City and a director of the American Life Insurance Co. of Wilmington, Del., and of the United States Life Insurance Co. in the city of New York.

I have been engaged in all aspects of the life insurance business with the exception of actuarial science for 40 years, 17 of which were spent abroad in the service of large life insurance companies which were substantially interested in the foreign market.

I am speaking on behalf of the American Life Insurance Co. and the United States Life Insurance Co. in the city of New York, proposing exemption for interest and earnings paid under life insurance contracts to nonresident aliens not doing business in the United States.

The Life Insurance Association of America and the American Life Convention Associations who represent the bulk of the life insurance companies in the United States, have submitted for the record a statement proposing the same amendment to the bill as we are proposing.

I submitted to you a statement which I am about to read. Under the present law, exemption from income tax and withholding is accorded interest on bank deposits paid to nonresident aliens not engaged in business in the United States.

IRC, section 861(a)(1)(A). H.R. 5916 would extend that exemption to all deposits in savings and loan associations. H.R. 5916, section 2(a), page 2, lines 4–21, amending section 861(a)(1). It is urged that H.R. 5916 be further amended to accord similar exemption from withholding tax to the interest or earnings element paid to nonresident aliens under life insurance company contracts, for the reason that to do so will (*a*) improve the U.S. balance-of-payments position by permitting U.S. life insurance companies to write nonresident alien business now barred to them competitively by the present withholding tax handicap, (*b*) increase the taxable income of U.S. life insurance companies, and (*c*) as a matter of fairness and equity, give purchases of U.S. life insurance company contracts the same treatment as that afforded now to purchasers of bank certificates of deposit, and as proposed with Treasury backing, to be given purchasers of certificates of mutual savings and loan associations.

This amendment can be effected by further amending section 861(a)(1) IRC (relating to interest from sources within the United States) by adding thereto the following subparagraph (at p. 2, line 21 of H.R. 5916):

"(E) interest and earnings paid pursuant to policies or contracts issued by life insurance companies."

It is respectfully submitted that the time is long overdue to give life insurance companies equal treatment with banks by extending to them the same exemption from withholding tax which persons carrying on the banking business have enjoyed since the Revenue Act of 1921.

That the matter may not have been raised in the past four decades is probably due to the fact that U.S. life insurance companies have only in recent years been concerned with sales in the nonresident alien market, especially in less developed countries without double taxation treaties with the United States. That situation has changed.

An increasing number of American life insurance companies are now seeking such business. The success of their efforts is obviously beneficial to the United States in its present balance-of-payments squeeze.

The requirement of withholding on annuity contracts has for decades kept American life insurance companies from competing for annuity business in the nonresident alien market except where treaty exemptions applied.

For this reason, U.S. employers operating in nontreaty territories; for example, most of Latin America, have had to pay our substantial premiums to foreign insurance companies to fund U.S. dollar pension plans for their alien employees.

Very recently this competitive handicap has been compounded by Revenue Ruling 64–51, IRB 1964–6, 11 which requires withholding on the gain derived from life insurance surrenders and endowment maturities.

In effect, U.S. life insurance companies are now non-competitive in the nonresident alien market in all customary lines of life insurance except term insurance.

We have made a careful check of the position of foreign companies who represent our principal competition in the Western Hemisphere. By all odds the severest competition comes from the Canadian companies and we are definitely advised that these companies do not withhold on the gain realized on the surrender of life insurance policies, on the maturity of endowment policies, or on annuity payments and periodic payments of policy proceeds.

The Canadians do withhold on interest—at the rate of 15 percent as against 30 percent for U.S. companies—when policy proceeds are left on deposit with the company and they do withhold at the 15 percent rate on gains when annuity contracts are surrendered prior to maturity.

These two exceptions both represent very unusual situations and even in the area of these exceptions the rate of withholding is one-half that applicable to American companies. The point is that in the typical and usual situation there is no withholding and the competitive advantage of the Canadian companies is complete.

Neither the British nor Swiss companies withhold on ordinary life insurance proceeds paid on surrenders and endowment maturities. They do withhold on annuity income.

The business we are talking about is U.S. source business on which, typically, the policy is issued in the United States and the premium is paid out of dollar funds.

The insureds are nonresident aliens or foreign corporations not doing business in the United States, with U.S. funds at their disposal. In the case of group pension annuities the insureds may be U.S. corporations wishing to fund in U.S. dollars plans for their alien employer.

Under the present law, bank deposits are the only tax-free investment available to such aliens and foreign corporations with dollar funds in hand. Surely it makes sense to give them the alternative investment of U.S. life insurance policies and annuities which earn interest and which also afford insurance protection.

From the point of view of dollar conservation, the alien with dollars who wants insurance today will buy it from non-U.S. companies, and in so doing drain the dollars out of the United States.

Futhermore, the amendment we propose can only help, not hurt, the tax revenue position. Especially since the 1964 revenue ruling, U.S. life insurers are effectively barred in most cases from this nonresident alien market, since they cannot meet foreign competition. The amendment would open up this market to our domestic insurers and thereby increase their taxable revenue income.

It is difficult to estimate what the premium volume might be on this alien business if U.S. life insurance companies could compete for it on equal terms with Canadian and other foreign companies. Because of the present withholding handicap, the premium volume of the U.S. companies is small, and since the 1964 revenue ruling, may be expected to decline in the future.

The relevant premium figures of the Canadian companies are not available to us, but we believe their volume on this business to be substantial. We also believe that if the U.S. companies could compete for this business on an equal footing they would realize many millions of dollars of additional premiums which now go to non-U.S. companies.

It may be argued that to extend the exemption to life insurance companies necessarily opens the door to a further extension to mutual

funds and corporate securities generally. We do not believe that any such logical imperative exists. Banks and insurance companies should be treated alike.

Both are financial institutions which pay out earnings on other people's money committed to their charge. It is otherwise with typical corporate securities issued by commercial and industrial companies which are not in the business of money management.

The line has to be drawn somewhere. Canadian, British and Swiss companies have drawn the line to exempt life insurance proceeds from withholding tax. There is no logical reason why we should not do the same.

There are two points to be made. First, as a matter of equity the earnings on life insurance policies should, in principle, be as free from withholding on earnings as bank deposits, or as proposed with Treasury support, the certificates of mutual savings and loan associations.

Secondly, with regard to our balance-of-payments crisis, foreigners with access to U.S. dollars should be encouraged to invest in U.S. life insurance policies, if life insurance is what they want.

Mr. Chairman, I wish to apologize. I failed to introduce my associate, Mr. Saul Lesser, associate general counsel of the United States Life Insurance Co.

Mr. JENNINGS. Fine, Mr. Anderson. Do you have anything to add to the statement that was just given by Mr. Anderson?

Mr. LESSER. No, I do not.

Mr. JENNINGS. Mr. Anderson, I noticed the proposed amendment on page 2 which reads: "Interest and earnings paid pursuant to policies or contracts issued by life insurance companies." Are you thinking of existing contracts? As I envision this if this amendment were added to the bill you might extend insurance contracts to cover most any type of operation other than just the contractual relation between an insured and the insurance company.

Mr. ANDERSON. We had not thought of anything except the contractual relation. I am not particularly insistent that this be the exact wording. It is more to convey the sense of what we meant, sir.

Mr. JENNINGS. You see the point.

Mr. ANDERSON. Yes, sir.

Mr. JENNINGS. If there were contracts by life insurance companies as broad as this amendment is you could extend most any type of contract. You could even get into the savings and loan business. You could get into the banking business. You could have a contract and have a company say, "Deposit so much with us. We will pay interest on it. That interest will be nontaxable."

As broad as this is I think you could put in most anything.

Mr. ANDERSON. Most of those conditions that you are mentioning we are precluded from engaging in by the regulatory authorities. We are limited to life insurance contracts with insureds or the beneficiaries of insureds.

Mr. JENNINGS. Are there other questions, Mr. Byrnes?

Mr. BYRNES. Mr. Anderson, how are these funds treated under the applicable tax treaties? Are they exempt or not?

Mr. ANDERSON. I would like Mr. Lesser to answer that question, sir.

Mr. LESSER. Under most of the treaties the interest and annuity income is exempt by treaty. However, the treaties do not cover the situation which is the subject of revenue ruling 64–51 which taxes the gain on surrenders of insurance or maturities.

For example, we had a situation with a nonresident alien residing in France whose policy matures after 30 years with a very small gain and the treaty did not cover such a situation and we had to withhold 30 percent on the gain.

We asked for a ruling from the Internal Revenue to equate such a gain on maturity with annuity or income or interest under the treaty and we were advised that it is not the same and it is subject to withholding, so this type of gain is not covered under existing treaties.

Also much of this business which Mr. Anderson is talking about comes from nontreaty countries, particularly in Latin America.

Mr. BYRNES. You mentioned that. That is why I am asking whether these earnings are exempt under treaties we have with the industrial countries. Are the earnings exempt under these treaties?

Mr. LESSER. Not completely. The annuity income may be exempt.

Mr. BYRNES. Let me understand what you mean by not completely.

Mr. LESSER. As I thought I explained, annuity income is usually exempt by treaty. Interest on deposits is usually exempt by treaty, but the gain that a policyholder realizes when a policy matures or is surrendered is not covered under existing treaties.

Mr. BYRNES. I understand. Have you discussed this matter with the Treasury Department, particularly as it relates to the balance-of-payments problem and the policy to encourage greater foreign investment in the United States?

Mr. LESSER. Yes, sir. We met with the staff of the Treasury and we submitted our proposal and we explained our position at length, and we received acknowledgment from Mr. Surrey that it would be given careful consideration, but we have had no further word from the Treasury.

Mr. BYRNES. How long ago was it?

Mr. LESSER. I would say approximately a month ago.

Mr. BYRNES. In other words, it was subsequent to the submission to this committee and the Congress of a draft proposal by the Treasury Department?

Mr. LESSER. It was subsequent to that date; yes, sir.

Mr. BYRNES. Because that was sometime in March.

Mr. LESSER. Yes.

Mr. BYRNES. Thank you very much.

Mr. KARSTEN (presiding). Are there further questions?

If not, we thank you very much, Mr. Anderson, for your appearance. We appreciate the information you have given us.

Mr. ANDERSON. Thank you, sir.

Mr. KARSTEN. Our next witness is Michael Waris. Mr. Waris.

## STATEMENT OF MICHAEL WARIS, JR., BAKER, McKENZIE & HIGHTOWER, WASHINGTON, D.C.; ACCOMPANIED BY PETER L. BRIGER.

Mr. WARIS. Mr. Chairman and members of the committee, my name is Michael Waris, Jr., and appearing with me today is Peter L. Briger. We are both of the law firm of Baker, McKenzie & Hightower and are appearing on its behalf.

We have previously filed with the committee a more formal statement which I believe you have before you. We would like that made a part of the record.

Mr. KARSTEN. Without objection it will be made a part of the record.

(The statement referred to follows:)

STATEMENT SUBMITTED BY IRA T. WENDER, MICHAEL WARIS, JR., AND PETER L. BRIGER, OF BAKER, McKENZIE & HIGHTOWER, RELATING TO H.R. 5916

### I. INTRODUCTION

A. H.R. 5916 is designed to stimulate foreign investment in this country as a means of improving our balance of payments. (In this regard we find the legislation beneficial for the country and practicable.)

B. Secondarily, H.R. 5916 is designed to make the taxation of foreigners more uniform and consistent.

C. In this connection, it contains a proposed amendment which would—

(1) Eliminate the intercorporate dividends received deduction in the case of all resident foreign corporations; and

(2) Exempt such corporations on capital gains realized on U.S. stock investments.

### II. DISCUSSION

A. The purposes of the proposed amendment are as follows:

1. To eliminate the intercorporate dividends received credit for resident foreign corporations that are essentially passive holding or investment companies; and

2. To segregate business income from investment income.

B. The proposed amendment goes beyond its stated purposes:

1. Because of its generalized applicability, the proposed amendment would deny the intercorporate dividends received deduction to foreign corporations engaged in active, substantial business in the United States; and

2. Dividend income received by foreign corporations from affiliated domestic subsidiaries is, in essence, business income.

B. The result of such a broad legislative approach would be an unwarranted disruption and elimination of a traditional and legitimate means which foreign corporations have used to conduct business in the United States.

C. The effect of the proposed amendment might also be to discourage existing and potential long-term investment in this country by foreign corporations.

### III. RECOMMENDATIONS

Foreign corporations that are actively engaged in business in the United States and that have made substantial, permanent type investments in domestic corporations (at least a 10-percent-equity interest) should be permitted to elect either:

(1) The treatment provided under existing law for resident foreign corporations (the availability of the intercorporate dividends received deduction, but a tax on capital gains realized in connection with U.S. stock investments); or

(2) The tax treatment provided in the proposed amendment (no intercorporate dividends received deduction, but exemption from tax on capital gains on U.S. stock investments).

## I. INTRODUCTION

The purpose of this memorandum is to express our views upon one particular aspect of the proposed legislation contained in H.R. 5916. Before doing that, we would like to indicate that we believe the basic legislation contained therein to be good for the country and practicable from an operational and administrative standpoint. Therefore, in general, we are in favor of the bill. However, there is one specific portion thereof which we believe runs counter to the fundamental purpose of the bill and would cause unwarranted disruption of traditional, legitimate business patterns. The particular provision to which we refer is a proposed amendment to section 882 of the Internal Revenue Code of 1954 and is contained in section 4(b) of H.R. 5916. The proposed amendment would (1) eliminate the the intercorporate dividends received deduction in the case of all resident foreign corporations and (2) exempt such corporations from tax on capital gains realized in connection with their U.S. stock investments.

Dividends received would thus become subject to the 30-percent statutory withholding rate or any lesser treaty rate applicable to such income, rather than the previous 7.2-percent maximum rate of tax thereon. Essentially, the proposed amendment presents the following three problems: (1) it applies to a much wider class of taxpayers than is necessary to curb the specific abuse which led to its proposal; (2) it would, in its present form, disrupt and foreclose a traditional and legitimate means that a number of foreign corporations have historically used to conduct business in this country; and (3) unless modified, it might very well have the effect of discouraging existing and potential long-term investment here by large foreign corporations despite the fact that the avowed purpose of H.R. 5916 is to stimulate and foster foreign investment in the United States as part of a program to improve our balance of payments.

## II. DISCUSSION

*A. The purpose of the proposed amendment*

The purpose of the proposed amendment, as indicated in the Treasury release dated March 8, 1965, accompanying H.R. 5916, would appear to be twofold. (1) First of all, the amendment is designed to curb a rather narrow and limited abuse which occurs when certain foreign corporations, that are essentially passive investment or holding companies, engage in trade or business in the United States in some minor way (such as through the ownership of several parcels of real estate) and thereby qualify for the 85-percent intercorporate dividends received deduction with respect to their U.S. stock investments. The proposed amendment, however, goes far beyond this stated purpose. Because of its generalized applicability, the amendment would deny the intercorporate dividends received deduction even to foreign corporations which are actively engaged in substantial, active business operations in this country. (2) In the second place, the proposed amendment is designed to segregate business income from investment income in connection with the taxation of foreign persons. The proposed amendment is defective in this respect, for in the case of a number of foreign corporations it would classify as investment income what is, in essence, business income. This occurs because the proposed amendment fails to treat as business income the dividends received by a resident foreign corporation from affiliated domestic subsidiaries. A foreign corporation which conducts business here through a branch may also, for a variety of reasons, engage in one or more additional businesses in this country through ownership of affiliated domestic subsidiaries. The dividend income received from such affiliated companies is actually business income.

*B. The result of such a broad legislative approach would be to foreclose to resident foreign corporations a traditional and legitimate means of conducting business in this country*

While this statement is not being made on behalf of any particular foreign corporation, it appears to us on the basis of our own experience that there are a number of concerns that (1) would be adversely affected by the proposed amendment as presently drafted and (2) would have to alter substantially the nature of their operations in this country as a result of the loss of the intercorporate dividend deduction. It is true that, for the most part, foreign corporations conducting business in the United States will do so through a domestic subsidiary in order to avoid complicated problems of allocation of income. However, there is a large number of foreign corporations which, for historical or other reasons, conduct

substantial active businesses here through branches. Foreign banks are one example of the type of foreign corporation that would be adversely affected by the proposed amendment.

Generally, banks in their foreign operations prefer to conduct business through a branch, rather than through a subsidiary, in order to have the benefit of their "home office" reserves or deposits. In New York alone, there are about a dozen foreign banks that conduct operations through branch offices. A number of such banks have wholly owned domestic subsidiaries which engage in businesses that the parent is not permitted to engage in directly. Thus, a number of foreign banks have wholly owned domestic subsidiaries that conduct a fiduciary business or a safe deposit business.

There are undoubtedly a number of other legitimate business reasons which require foreign corporations to conduct their business operations in the United States in branch form rather than through domestic subsidiaries. For example, a foreign corporation might not be permitted to assign certain assets (such as a license, franchise, or trademark) needed in the conduct of a particular business in this country. Or it may be that charter provisions or debt restrictions prevent a foreign corporation from transferring assets to a U.S. subsidiary or from conducting particular activities through a U.S. subsidiary.

Aside from the banking fields, there are other areas where the proposed amendment would work undue hardship. At least one of the large Japanese trading companies has several branch offices in the United States. These branch offices generate annual sales of between $300 and $400 million. This Japanese trading company has also acquired a majority stock interest in at least one U.S. operating subsidiary. Perhaps the widest use by foreign corporations of branch offices, together with affiliated domestic subsidiaries, as a means of conducting business in this country occurs in the insurance field. It is interesting to note that foreign insurance companies which conduct an insurance business here through branch offices are not affected by the proposed amendment. The reason that their right to the intercorporate dividend deduction was not disturbed is probably because of the Treasury's recognition of the wide use made of this type of operation in the insurance industry. (It is likely, however, that there are situations where foreign insurance companies do, through branch operations, engage in other types of business in this country, such as the management of domestic subsidiaries which conduct an insurance or other business. Such foreign insurance companies would be adversely affected by the proposed amendment.)

The issue certainly is not a hypothetical matter, for the above-described situations represent specific, concrete examples of foreign corporations which conduct business here in branch form and which would be hurt by the proposed amendment although they do not fit within the specific rationale underlying the amendment. To deprive foreign corporations, which conduct business through this type of structure, of the intercorporate dividends received deduction would cause severe dislocation of legitimate, long-standing business operations in this country by foreign corporations.

*C. The effect of the proposed amendment might also be to discourage existing and potential investment in this country by foreign corporations with branch offices here*

Although the amendments to sections 881 and 882 proposed by the Treasury would in general appear to stimulate investment in U.S. securities (especially by foreign individuals and probably to a lesser extent by foreign corporations) as a result of the elimination of any tax on capital gain realized upon U.S. stock investments,[1] the amendment might very well have the additional effect of discouraging existing and potential long-term investment in this country by a number of large foreign corporations which conduct substantial, active businesses here through branch operations and through domestic subsidiaries. This result appears unwarranted and unintended in view of the fact that (1) the manifest purpose of H.R. 5916 is to stimulate foreign investment in the United States and (2) this type of operation involves no abuse or element of tax avoidance.

### III. RECOMMENDATIONS

It is our belief that dividends received by foreign corporations from U.S. subsidiaries in which they have made significant and permanent-type investments

[1] It is a well-known fact that the yield on U.S. stocks is generally lower than on foreign stocks, but that the appreciation factor on U.S. stocks is often attractive to foreign investors.

should be regarded as business income. In view of the fact that a 10-percent stock interest has been recently used as an indicia of significant control (cf. sec. 951 and sec. 4915 of the Internal Revenue Code of 1954), perhaps a 10-percent equity ownership test would provide a suitable yardstick for determining whether dividend income qualifies as business income.

Over the years, Congress has consistently taken great pains to provide exceptions and savings clauses in tax legislation in order to avoid inequity and unintended hardship that may occur in connection with the adoption of a new general rule. We submit that the instant situation needs such distinguishing treatment. The abuse that the Treasury is concerned with is the cloaking of what is essentially an investment operation with a thin veneer of operating activity. If it is that type of avoidance which the Treasury is interested in preventing, the result could be accomplished, without discouraging foreign investment of a permanent type in this country and without dislocating existing foreign business structures, through the application of some type of "active business" test. The "active business" tests set forth in the regulations under section 954 (Treas. Regs. sec. 1.954–2(d)(1) (i) (ii) and (iii)) or section 355 (Treas. Regs. sec. 1.355–1(c)) would seem to provide pertinent guidelines that could be utilized in connection with the proposed amendment.

In our opinion the underlying purpose of H.R. 5916 and the elimination of the specific abuse about which the Treasury is concerned can be most suitably effected by extending to those foreign operations, that satisfy an "active business" test and a "permanent investment" requirement, the option to elect either (1) the tax treatment provided in the proposed amendment (no intercorporate dividends received deduction, but an exemption from tax on capital gains on U.S. stock investments) or (2) the tax treatment provided for resident foreign corporations under the existing provisions of the law (the avalability of the intercorporate dividends received deduction, but a tax on capital gains realized in connection with U.S. stock investments).

Mr. WARIS. Thank you. I would like then today to proceed on the basis of a less formal statement which I believe you also have before you.

Mr. KARSTEN. We will be pleased to hear you.

Mr. WARIS. We would first like to state that we wholeheartedly support the general objectives of H.R. 5916. The aim of this legislation, to promote increased investment by foreigners in stock of U.S. corporations by removing existing tax barriers, is a highly desirable one at the present time. The bill is all the more praiseworthy because of its positive character.

Our purpose here today is to comment on one specific provision in the bill which has an effect directly opposite to the bill's important basic objective. This provision would tend to discourage significant direct investment by foreign corporations in U.S. operating subsidiaries and to disrupt legitimate patterns that foreign corporations have traditionally employed in connection with their conduct of business in this country.

The particular provision to which we refer is the proposed amendment to section 882 of the Internal Revenue Code of 1954 and is contained in section 4(b) of H.R. 5916.

This amendment would (1) eliminate the 85-percent intercorporate dividends received deduction in the case of all resident foreign corporations, and (2) exempt such corporations from tax on capital gains realized on their U.S. stock investments. The proposed amendment would have the effect of subjecting dividends received by resident foreign corporations to the 30-percent statutory withholding rate or any lesser treaty rate applicable to such income, rather than the previous 7.2-percent maximum rate of tax.

Essentially, what we are concerned about is the mandatory application of the proposed amendment to foreign corporations which

conduct active substantial businesses in this country, both through a branch operation as well as through direct investments in U.S. operating companies.

Although the proposed amendment might tend to stimulate somewhat the purchase of U.S. stocks by foreign corporations seeking to earn capital gains in connection with trading activities, on the other hand, the amendment would also tend to discourage long-term direct investment in domestic operating companies by other foreign corporations.

To us this result appears unwarranted and, indeed, perhaps unintended in view of the basic purpose of the bill (namely to stimulate foreign investment in this country), and in view of the two specific reasons advanced by the Treasury in support of the proposed amendment.

To understand some of Treasury's reasons for this proposal and the objections which we have to it, it is helpful to refer to the Treasury's explanation of the provision which is dated March 8, 1965, and which accompanied the bill when it was sent to the Congress. I quote now the Treasury explanation.

> 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.

We have no quarrel with Treasury's desire to curb this type of abuse.

On the other hand, we do object to the remedy which the Treasury proposes. Essentially, the proposed amendment presents the following three problems: (1) it applies to a much wider class of taxpayers than is necessary to curb the specific abuse which led to its proposal; (2) it would, in its present form, disrupt a traditional and legitimate means that a number of foreign corporations have historically used to conduct business in this country; and (3) unless modified, it might very well have the effect of discouraging existing and potential long-term investment here by large foreign corporations despite the fact that the avowed purpose of H.R. 5916 is to stimulate and foster foreign investment in the United States as part of our program to improve our balance of payments.

Why, particularly in the context of H.R. 5916 should a foreign corporation which is actively engaged in substantial business here be treated less favorably than a domestic corporation with respect to dividends received from U.S. operating affiliates?

The theory of the 85-percent, dividends-received deduction is to relieve income which has already been subjected to a full layer of U.S. corporate income tax from another large tax at the corporate level.

There appears to be no good reason for failing to apply this theory to dividends received from domestic operating subsidiaries by a foreign corporation actively engaged in business in this country.

Certainly, changing this long-established rule at this time will not have the effect of encouraging such foreign corporations to increase their investments in the stock of U.S. corporations.

The second purpose of the proposed amendment, as indicated by the Treasury, is to segregate the investment income of foreign persons from their active business income in order to subject such investment income to uniform U.S. tax treatment.

Here again, the provisions of the bill in their present form fail to accomphish their aim in some cases and for essentially the same reason—they are too broad in their scope, automatically classifying all dividend income as passive investment income.

In the case of many foreign corporations what is classified as investment income under the bill is in essence business income. This occurs because the proposed amendment fails to treat as business income the dividends received by a resident foreign corporation from domestic corporations in which they have made direct investments.

A foreign corporation which conducts business here through a branch may also, for historical or other reasons, engage in one or more additional businesses in this country through ownership of affiliated domestic subsidiaries.

These are in the nature of direct investments—the type of investment which contains a sufficiently great element of management activity to entitle them to exclusion from the interest equalization tax—which, as you are so well aware, is designed to reach passive portfolio type investments. It seems clear to us, therefore, that dividends received from such affiliated companies are actually business income.

Nevertheless, under the bill they would be treated as passive investment income, and as a consequence, these direct investments by foreigners in U.S. ventures might be adversely affected by the enactment of H.R. 5916.

Furthermore, the Treasury objective of uniform tax treatment on the dividend income of foreign corporations would not be achieved under the proposed amendment since the rate of tax on such income would vary on a country-by-country basis depending upon the difference in the applicable treaty rates.

This issue certainly is not a hypothetical matter. From our own experience we are aware of a number of foreign corporations which conduct substantial active businesses here, both through branch operations and affiliated domestic subsidiaries.

Foreign banks are a good example. In connection with their foreign operations banks generally prefer to conduct business through a branch rather than through a subsidiary, in order to obtain the benefit of their "home office" reserves.

In New York alone, about a dozen foreign banks conduct operations through branch offices and a number of these have wholly owned domestic subsidiaries which engage in businesses that the foreign banking parent is not permitted to engage in directly.

For example, a number of foreign banks have wholly owned domestic subsidiaries carrying on fiduciary and safe-deposit businesses.

Another situation with which we are familiar involves a large Japanese trading company having several branch offices in the United States. This Japanese company has also acquired a substantial stock interest in at least one U.S. operating subsidiary.

To deprive these, and similarly situated foreign corporations, of the intercorporate dividend received deduction at this time would cause an unwarranted and perhaps unintended, disruption of traditional and legitimate patterns of doing business in this country by foreign corporations.

As I have mentioned several times now, we feel that such a step might well discourage these companies from making further U.S. stock investments in the future.

Finally, I would like to call your attention to one interesting note, that one group of foreign corporations in which this pattern of doing business is fairly common will be completely unaffected by the amendment in question. These are foreign insurance companies.

Under the bill the dividends received deduction is withdrawn only from those foreign corporations which are taxed under section 11. Since foreign insurance companies are taxed under section 801 and following sections, they are not affected by the bill.

Obviously, we think this treatment of insurance companies is proper and fully in keeping with the objectives of H.R. 5916. We think other foreign corporations with bona fide business operations in this country should be taxed in the same manner.

In view of the foregoing we offer the following recommendations: That foreign corporations which are actively engaged in business in the United States and that have made substantial, permanent type investments in domestic corporations for example, at least a 10 percent equity interest, should be permitted to elect either:

(1) The treatment provided under existing law for resident foreign corporations, that is, they would have the availability of the intercorporate dividends received deduction, but a tax on capital gains realized in connection with U.S. stock investments or the alternative.

(2) The tax treatment provided in the proposed amendment, that is, no incorporate dividend received deduction, but be exempt from the tax on capital gains when they dispose of their U.S. stocks.

Thank you, Mr. Chairman.

Mr. KARSTEN. Dies that conclude your statement, Mr. Waris?

Mr. WARIS. That does.

Mr. KARSTEN. Are there questions of Mr. Waris? If not, we thank you for your appearance and we appreciate your giving us the benefit of your views on this legislation.

Mr. WARIS. Thank you.

Mr. KARSTEN. That concludes the witnesses scheduled for this morning. In fact it concludes the public hearings on this legislation. The committee will stand adjourned.

(Whereupon, at 10:45 a.m., the committee was adjourned.)

# WRITTEN STATEMENTS RECEIVED BY THE COMMITTEE ON WAYS AND MEANS ON H.R. 5916, REMOVING TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES AND MAKING CERTAIN TECHNICAL AMENDMENTS

TRUST DIVISION,
THE AMERICAN BANKERS ASSOCIATION,
*New York, N.Y., June 24, 1965.*

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*House of Representatives,*
*Washington, D.C.*

DEAR MR. MILLS: I am writing to you, on behalf of the Trust Division of the American Bankers Association, in connection with the provisions imposing the estate tax on nonresident aliens, proposed in H.R. 5916.

The imposition of any estate tax on estates of nonresident aliens will always be a deterrent to their investing in U.S. securities, and the difference between no tax and a small tax is not just one of degree but of principle. However, if the estate tax on such nonresident aliens cannot be eliminated entirely, then we urge that the provisions of H.R. 5916 be amended to incorporate the recommendation of the Fowler Tax Force to "Eliminate U.S. estate taxes on all intangible personal property of nonresident alien decedents."

As pointed out in the Fowler report, a foreigner with sufficient funds who is willing to go to the necessary trouble and expense can establish a personal holding company in such a way as to avoid estate taxes legally. On the other hand, foreigners with amounts to invest which do not justify a holding company are reluctant to buy U.S. securities because of the possibility of the estate tax.

It may quite properly be argued that the present bill by providing for an increased exemption and lower tax rates should encourage investments by aliens of relatively small means. However, as long as there is a tax aliens will be concerned about what the future rate of tax might be and this one fact would still be the major deterrent to their investing in this country.

The revenues received by the United States from estate taxes on intangible personal property in estates of nonresident alien decedents are said to be relatively minor. The elimination of the tax would not cost much in revenue, would encourage foreign investment in the United States, and what little revenue is lost might very well be more than made up by the increased income taxes paid by U.S. banks and brokers on their increased foreign business. The principle of jurisdiction to tax that intangibles follow the person is still a pretty sound one, and it would fully justify treating intangibles differently from tangible property situated in this country.

Respectfully yours,

REESE H. HARRIS, Jr.

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## COMMITTEE ON FEDERAL TAXATION OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Comments and recommendations regarding H.R. 5916, a bill to amend the Internal Revenue Code of 1954 to remove tax barriers to foreign investment in the United States.

### GENERAL COMMENTS

A principal purpose of H.R. 5916 is to alleviate this country's balance-of-payments problem by decreasing or removing tax barriers to foreign investment here. The institute's committee on Federal taxation is in favor of the underlying aims of the proposed legislation. Certain provisions, however, appear to contradict the intent of the bill. Other provisions seem to need clarification.

The granting of tax benefits to nationals and entities of other countries is unilateral in nature and could hamper efforts to obtain similar benefits for U.S. citizens and entities in treaty negotiations. Accordingly, we support the principle of section 5 of the bill (line 21, p. 27, through line 11, p. 30) pertaining to the application of pre-1966 tax provisions. It will give the U.S. team of treaty negotiators an aid they will need.

Bill section 3:
Proposed code section:

(1)

871(a) *Subject of the tax on nonresident alien individuals (page 4, line 6, 9–11; page, 5, lines 3–4)*

In proposed Sections 871 (a) and (b), the words "gross income, of" should replace the words "amount received, by" to conform to Regulations Section 1.871–7(b)(1).

(2)

871(a) It appears that the words "salaries," "wages," "compensation," and "emoluments" in proposed Section 871(a) would never have any effect, since such income under proposed Section 871(c) could be realized only from engaging in a trade or business. While this language is taken from present Section 871(a) and also appears elsewhere (e.g., present Section 1441), confusion might be avoided by eliminating these words from proposed Section 871(a).

(3)

871(c) *Suggested change in purposes for which the term trade or business is defined (page 5, line 23)*

Proposed Section 871(c) commencing at line 22 of page 5 pertains to the definition of engaging in trade or business in the case of the tax on nonresident alien individuals. Present Sections 881 and 882 are mentioned on line 23. These sections pertain to foreign corporations. It is suggested that mention of these sections might be more appropriate elsewhere.

(4)

871(c)(1) *Performance of Personal Services for Foreign Employer (Page 6, lines 3–14)*

The Bill states that the term "engaged in trade or business within the United States" does not include the performance of personal services within the United States by a nonresident alien individual for designated types of foreign employers if the individual is temporarily present in the United States for not more than 90 days during a year and his compensation for such services does not exceed $3,000. Among the types of foreign employers covered are offices or places of business maintained by a domestic corporation in a foreign country or in a possession of the United States. The provisions would not apply to an office or place of business maintained by a U.S. citizen or resident alien or by a domestic partnership in a foreign country. This situation appears to be inequitable.

It is suggested that the inequity be removed by adding immediately after the words "domestic corporation" in line 8, page 6 the words "domestic partnership, U.S. citizen, or resident alien." It is further suggested that the Bill be amended to make these same changes in present Section 861(a)(3)(c)(ii).

(5)

871(d) *Conforming the Phraseology Applicable to Gains and Losses (Page 7, lines 18 and 19)*

The phrase used in lines 18 and 19, page 7, in reference to the word "losses" is: "allocable to sources within the United States." It would seem preferable to continue to use the phrase "derived from sources within the United States" as it is used in lines 16 and 17 with reference to the word "gains."

(6)

871(d)
871(b) (1), (2), (3) *Clarification of Taxation of Capital Gains of Nonresident Alien Individuals Under Certain Circumstances (Page 7, lines 20–25)*

Proposed Section 871(d) starting at line 10, page 7, appears to mean that a nonresident alien individual present in the United States for 183 days or more in a

taxable year is to be subjected to a tax of 30% on net capital gains derived from sources within the United States. But then lines 20 through 25, page 7 seem to state, through reference to proposed Section 871(b)(1), lines 17–25, page 4, as modified by proposed Sections 871(b)(2) and 871(b)(3), lines 1–21, page 5 that capital gains are not to be taxed. We suggest that clarification is needed.

It is assumed that the intent of the Bill is to subject nonresident aliens who are present in the United States for 183 days or more during a year to a 30-percent rate of tax. This provision places such an alien in a disadvantageous position in comparison with a domestic investor, because under the provisions of lines 1–4, page 8, the alternative tax and capital loss carryover provisions are not to be allowed. This seems contrary to the intent of the Bill.

Bill section 4:
Proposed code section:

(7)

881

*Suggested Reduction in Rate of Tax on Portfolio Investments of Foreign Corporations Not Engaged in Business in the United States (Page 21, lines 1–7)*

It is noted that the 30-percent rate of present Section 881 on portfolio investments of foreign corporations not engaged in business in the United States is not proposed to be changed. We believe some reduction should be made to further the purpose of the legislation to provide an incentive for investments in the United States.

(8)

882(c)(1)

*Softening of Provision Disallowing All Deductions for Failure to File a Return (Page 21, line 22 through page 22, line 7)*

The disallowance of all deductions for failure to file a return under proposed Section 882(c)(1), is an unusually harsh provision. Even though this provision is a part of the present law, the purposes of the Bill would seem to indicate that the provision should be softened.

71-297 O-67-pt. 1—15

Bill section 6:
Proposed code section:

901(c)

(9)

*Consistency in Provisions Requiring Thirty-Day Notice Prior to Presidential Proclamation (Page 32, line 12)*

To be consistent with proposed Sections 896 and 2108, proposed Section 901(c) should require a thirty-day notice to Congress before a proclamation is made by the President.

Bill section 7:
Proposed code section:

931(d)(2)

(10)

*Apparent Inequity in Deductions Allowed to U.S. Possessions Corporations (Page 33, lines 17–18, and 23–24; page 34, line 3)*

Section 7 of the Bill commencing at line 22, page 32, is entitled "Amendment to Preserve Existing Law on Deductions Under Section 931." Present Section 931 pertains to citizens of the United States or domestic corporations deriving income from sources within possessions of the United States. The deductions granted under proposed Section 931(d)(2), lines 12–25, page 33, are those described in present Sections 165(c)(2) and 165(c)(3) pertaining to individuals and not to corporations. Accordingly, the Bill seems to provide that if goods are purchased in the United States and lost by fire while still in this country, a deduction will be allowed to an individual owner of such goods, but not to a U.S. possessions corporation. This does not seem to be equitable.

Bill sections 8 and 9:
Proposed code section:
2107
2501(a)(3)
2511(b)

(11)

*Suggested Softening of Estate and Gift Tax Provisions Affecting U.S. Property of Expatriates (Page 38, line 12 to page 40, line 11; page 43, lines 16–25; page 44, lines 6–24)*

Section 8 of the bill, starting at line 13, page 34, will substantially revise and lower the estate tax of nonresidents who are citizens of the United States. However, pro-

posed Section 2107 commencing at line 12, page 38 would retain to a major extent the existing provisions of our estate tax law with respect to those nonresident aliens who, within a ten-year period ending with the date of death, lost U.S. citizenship, and such loss had for one of its principal purposes the avoidance of U.S. taxes. Such an expatriate would be subject to the present estate tax rates with respect to that portion of his estate, which at the date of death was located in the United States. The following types of property would be deemed to be located within the United States: stock in U.S. corporations, debt obligations issued by or enforceable against U.S. persons, and stock in foreign corporations controlled by the decedent at the date of death to the extent of the decedent's proportional interest in the value of assets owned by that foreign corporation which are situated in the United States.

Under proposed Section 2107(e), 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 decedent's estate. It will be difficult for the executors of any expatriate to meet this burden of proof. In the ordinary case such a result is probably appropriate. However, in the case of an individual who became a U.S. citizen by naturalization process and then loses his U.S. citizenship or surrenders it upon returning to his native country, the provisions of proposed Section 2107 should apply only to that portion of the gross estate situated in the United States, which is in the ratio of the portion of such gross estate going to U.S. heirs to the total of such gross estate.

Section 9 of the Bill commencing on line 1, page 43, would substantially change the liability to gift tax of nonresident alien individuals. Proposed Section 2501(a)(3) and proposed Section 2511(b) would continue the present gift tax liability with respect to expatriates. The burden of proving an absence of tax avoidance purpose in the loss of United States citizenship is on the donor. As in the case of the estate tax, where a naturalized U.S. citizen loses his U.S. citizenship or surrenders it upon returning to his native country, the provisions of proposed Sections 2501(a)(3) and 2511(b) which are applicable to expatriates, should apply only to gifts to U.S. citizens.

(12)

*Treaty obligations; absence of permanent establishment (page 45, line 25; page 46, line 7)*

The effect of Section 11(b) of the Bill is to treat a nonresident alien individual or a resident foreign corporation which is engaged in trade or business within the United States as not having a permanent establishment in the United States. Such persons would thus be entitled to the lower treaty withholding rates on nonbusiness income. This benefit should also be extended to nonresident alien individuals and foreign corporations which are not engaged in trade or business, but which do have a permanent establishment in the United States. For example, ownership of certain real property in the United States may constitute having a permanent establishment without being engaged in trade or business. Proposed Sections 871(f) (starting at line 20, page 8) and 881(b) (starting at line 22, page 19) provide elections to treat real property income as business income; however, there may be non-income-producing real property which could constitute a permanent establishment.

(13)

*Other provisions of the present code requiring clarification*

The application of a withholding tax to salaries of nonresident aliens for services performed in the United States is now unclear, since present Section 3401(a)(6) exempts wages paid to an alien individual so that withholding will fall under present Section 1441. The Bill provides that all salaries, wages, etc. will be taxable at regular graduated rates. Since it is already proposed that present Section 1441 be amended to provide no withholding on income taxed under proposed Section 871(b)(1), present Section 3401 should also be amended so that a nonresident alien will be subject to the withholding tax under present Section 3401 in the same manner as any citizen or resident.

AMERICAN LIFE CONVENTION AND LIFE INSURANCE ASSOCIATION OF AMERICA

JUNE 30, 1965.

Re H.R. 5916, to remove tax barriers to foreign investment in the United States.

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*U.S. House of Representatives, Washington, D.C.*

DEAR CONGRESSMAN MILLS: The American Life Convention and the Life Insurance Association of America are two associations with an aggregate membership of 329 life insurance companies in the United States and Canada which have in force approximately 94 percent of the legal reserve life insurance written in the United States.

H.R. 5916 would encourage the investment of foreign funds in the United States by removing tax barriers to such investment. To this end the bill would, among other things, exempt from the 30 percent withholding tax "amounts" paid to nonresident aliens not engaged in business within the United States on deposits with savings and loan associations. Since 1921 interest paid to such liens on bank deposits has been exempted from tax.

In contrast, similar amounts paid to such nonresident aliens under life insurance contracts have been, and would under the bill remain subject to the 30-percent withholding tax. These amounts include such items as interest on dividend accumulations, interest on amounts held under supplementary contracts, certain amounts received under an annuity contract, and (more recently) certain amounts received on the surrender of a life insurance contract or on the maturity of an endowment contract.

We believe that these amounts should receive the same exemption as amounts paid by savings and loan associations or banks. Such treatment would both accomplish equity and further the overall purpose of the bill.

We therefore respectfully urge that the Ways and Means Committee amend section 2 of H.R. 5916 to exempt amounts of the type referred to above paid under life insurance, endowment, or annuity contracts.

Sincerely yours,

AMERICAN LIFE CONVENTION,
GLENDON E. JOHNSON,
*Vice President and General Counsel.*

LIFE INSURANCE ASSOCIATION OF AMERICA,
KENNETH L. KIMBLE,
*Vice President and General Counsel.*

ASSOCIATION OF STOCK EXCHANGE FIRMS,
*New York, N.Y., June 24, 1965.*

Re: H.R. 5916, an act to remove tax barrier to foreign investors in the United States.

Hon. WILBUR D. MILLS,
*Chairman, Ways and Means Committee,*
*House of Representatives, Washington, D.C.*

DEAR CHAIRMAN MILLS: As president of the Association of Stock Exchange Firms, I would like to express my enthusiastic approval of H.R. 5916 now before your committee. The Association of Stock Exchange Firms is the voluntary trade organization for some 600 member firms of the New York Stock Exchange. The association's membership is nationwide, and many of our members have foreign branches as well.

The members of our organization have long felt the need for an effective program designed to encourage foreign investment in American securities. We believe that the application of certain U.S. tax laws to foreigners and foreign institutions has greatly restricted the growth of such investments to the detriment of the U.S. international balance of payments.

In conclusion, I would like to state that I have read the statement of the president of the New York Stock Exchange, filed with your committee on June 25, and wish to express the wholehearted approval of this association for all that is contained in that statement. We urge your committee to take prompt action in this area of much needed tax reform.

Sincerely,

WILLIAM T. KEMBLE, *President.*

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THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK,
*June 1965.*

COMMITTEE ON TAXATION

Comments on H.R. 5916, an act to remove tax barriers to foreign investment in the United States

MEMBERS OF THE COMMITTEE

| | |
|---|---|
| Clifford L., Porter, chairman | Wilbur H. Friedman |
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| Hans J. Frank | David E. Watts |
| Victor H. Frank, Jr. | H. Gilmer Wells |

Set forth below are the comments of the Committee on Taxation of the Association of the Bar of the City of New York on H.R. 5916. The committee has restricted its review to the technical aspects of

the bill and does not comment on the tax policy and economic policy considerations involved.

*Section 1(a)*

The committee is of the view that the short title of the act is much too long and unwieldy and recommends that a shorter title, such as "Foreigners Investment Act of 1965," be adopted.

*Section 2(b)*

The term "gross business income" is undefined in the proposed section 861(a)(2)(B). To remove any doubt as to its meaning, it is suggested that immediately following the phrase "gross business income" in the second sentence of the section there be inserted "as defined in section 882(a)(3)."

In its present form the proposed amendment to section 861(a)(2)(B) could subject to U.S. taxation dividends from a foreign corporation engaged in business within the United States so long as 80 percent of its gross business income was derived from sources within the United States even though the gross business income of such corporation constituted only an insignificant portion of the corporation's entire income. For example, if only 10 percent of a corporation's entire income constituted gross business income and 80 percent or more of such gross business income was derived from sources within the United States, an insignificant fraction of the dividends paid by such corporation would be deemed income from sources within the United States. The insignificant amount of revenue derived from this does not justify the burden imposed upon the payor corporation or the administrative difficulties imposed upon the Internal Revenue Service. It is therefore suggested that a de minimis rule be adopted and that it be provided that section 861(a)(2)(B) not be applicable unless, for example, at least 25 percent of the foreign corporation's entire income constitutes gross business income as defined in section 882(a)(3).

*Section 2(c)*

This provision, pertaining to the effective date of section 2, should be amended so as to make it clear that it applies to interest credited as well as interest paid. It is suggested that it be amended to read as follows: "The amendments made by this section shall apply with respect to interest paid or credited or dividends paid in taxable years beginning after December 31, 1965." With this amendment the provision would conform with section 2(a) of the bill.

*Section 3*

Proposed section 871(b)(3), defining business income, excludes from that category "dividends or gain from the sale or exchange of stock in a corporation." Interest and gain from the sale of securities apparently would be treated as "business income." No reason is apparent for the differentiation between dividends and interest or between gain from the sale of securities as distinguished from stock. It therefore is suggested that consideration be given in section 871(b)(3) and in section 882(a)(3) to the exclusion from the category of business income of interest as well as dividends and gain from the sale of securities as well as stock. An exception could be made for interest earned in the conduct of a banking business. Consideration should be given here and at section 882(a)(3) to the intended treat-

ment of gains which are treated as capital gains, although not derived from a sale or exchange, such as distributions under section 301(c)(3)(A) and section 852(b)(3)(B).

It also appears that in its present form proposed section 871(b)(3) would exclude from the category of business income, gains from the sale or exchange of stock by a dealer in securities. It is not clear that this result is intended. Section 871(c)(2)(A) impliedly provides that a dealer in securities is engaged in trade or business within the United States. Section 871(b)(3) and section 882(a)(3) should be reviewed from the policy viewpoint to determine whether or not there should be included in the category of business income, gains realized upon the sale of stock or securities by a dealer in securities.

The Treasury Department release of March 8, 1965, accompanying H.R. 5916, states that 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 since this is the rule under existing law. It is not felt that the existing law in this regard is as clear as the Treasury release would indicate and it therefore is suggested that a specific clause be inserted in the proposed section 871(c)(2) affirmatively stating that the volume of securities or commodities transactions is not material in the determination of whether an investor is engaged in trade or business within the United States.

Proposed section 871(f) permits a nonresident alien to elect to be taxed on a net basis with respect to income from real property, rents, or royalties from the opration of mines, wells, or other natural deposits, and gains from the sale or exchange of real property, etc. In its present form the section does not cover gains or income from the disposition of timber. Since there appears to be no valid reason for this omission, consideration should be given to the amendment of the section to permit a nonresident alien individual to elect to be taxed on the gains or income from the disposition of timber on a net basis. Such election, however, should be limited to those cases wherein an election under section 631(a) of the code is not made. Section 871(f) should also indicate whether interest on a loan secured by a mortgage on real property falls within the election.

The phrase "under regulations prescribed by the Secretary or his delegate" appearing in the seventh line of proposed section 871(f)(1) should be deleted inasmuch as it is redundant in view of the provisions of proposed section 871(f)(3).

The revision of section 871 accomplished by section 3 of the bill fails to resolve an ambiguity under present law in the use of the term "taxable year." Under this bill, as under present law, tax consequences follow from the presence of the nonresident alien for specified numbers of days "during the taxable year" or from the receipt of specified amounts of income "during the taxable year." Where in the course of a calendar or fiscal year the taxpayer's status changes from a citizen, or resident alien, to a nonresident alien, or vice versa, however, it is not clear whether the change of status is considered to close the taxable year.

For example, an alien, reporting on the calendar year basis, is resident and physically present in the United States for the first 9 months of 1966. On October 1, 1966 he becomes a nonresident alien, and during the remaining 3 months of the year realizes net gains from

capital assets allocable to sources within the United States. If "the taxable year" is the calendar year 1966, proposed section 871(d) is applicable; if "the taxable year" is the period from October 1 to December 31, it is not.

Existing authorities are in conflict. In I.T. 3237, 1938–2 C.B. 188, 2 taxable years were in effect recognized in that the full statutory dollar allowance was permitted in the nonresident period and the additional income in the resident portion of the calendar year was ignored. However, the resident and nonresident portions were in effect treated as a single taxable year in Rev. Rul. 64–60, I.R.B. 1964–9, 7 (standard deduction); I.T. 3926, 1948–2 C.B. 48 (optional tax table); *Van der Elst* v. *Commissioner*, 223 F. 2d 771 (2d Cir. 1955) (capital gain); Rev. Rul. 56–365, 1956–2 C.B. 934, and *Matthew Klaas*, 36 T.C. 239 (1961) (joint return). Cf., G.C.M. 10759, XI–2 C.B. 99 (1932) (one return only). Clarifying legislation therefore is recommended, either in section 441, section 7701(a)(23), or in part II of subchapter N.

*Sections 3(d)(e)(f), 8(f), 9 (a), (b): Expatriation*

While most of the proposed changes in the Internal Revenue Code of 1954 embodied in H.R. 5916 reflect recommendations contained in the April 27, 1964, report of the Task Force on Promoting Increased Foreign Investment, the proposals pertaining to expatriates go beyond that report. In the introduction to its general explanation, the Treasury Department release explaining H.R. 5916 states that "all legislative suggestions made herein are justifiable on conventional tax policy grounds." Such a conclusion, it is submitted, is clearly wrong in the case of the alternative tax provisions intended to penalize, for income, estate and gift tax purposes, certain persons who give up their U.S. citizenship for the purpose of reducing their U.S. taxes. Section 6 of the release, concerning expatriate American citizens, states:

> 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 (referring to the elimination of progressive rates for nonresident aliens and the reduction of estate tax on estates of nonresident aliens) might lead some Americans to surrender their citizenship for the ultimate benefit of their families.

As a practical matter, the complexities which the proposed expatriate tax provisions would introduce into the tax law raise serious doubt as to the wisdom in adopting them even if some Americans thus might be restrained from expatriating themselves. Certainly it is doubtful that much revenue would be gained from these provisions. As a matter policy, it hardly seems necessary or desirable for the United States to engage itself in the enforcement of these complicated provisions against persons willing to give up their citizenship.

*Section 3(d)*

It is recommended that the title of section 878 be changed to "Tax on Certain Expatriates." Compare titles of other sections in part II of subchapter N of chapter 1, particularly sections 871, 881, and 882.

The clause starting with "if the tax" in the last two lines of subsection (a) of section 878, should be changed to read as follows:

> if the tax for the taxable year computed pursuant to such subsection exceeds the tax for the taxable year computed without regard to this section.

In making computations to determine the applicability of an alternative tax it would not seem appropriate to speak of a "tax imposed." See e.g., section 1341(a) of the code.

The phrase "to the extent not otherwise" in the third line of subsection (b)(1) of section 878 should be changed to ", subject to the modifications." The suggested rephrasing is for the purpose of making clear that the determination will still be made under part I.

In the second line of subsection (c)(1) of section 878 "in corporations" should be deleted and "debt obligations" should be changed to read "evidences of indebtedness constituting property." In subsection (c)(2) of section 878 "stocks or debt obligations" should be changed, in both places where those words appear, to read "stock or evidences of indebtedness." These changes are suggested in order to conform the terminology to that used in other areas of the code.

The first two lines of text of subsection (d) of section 878 should be changed to read as follows:

> Subsection (a) shall not apply to a nonresident alien individual whose loss of United States citizenship results from the applicability of * * * .

This change is recommended in order to take into account the case of a person who lost citizenship under one of the indicated provisions, was restored to citizenship and then lost citizenship again for reasons other than the application of one of the listed sections.

It also is noted that section 350 of the Immigration and Nationality Act (8 U.S.C. 1482), unlike the other two provisions cited, involves a voluntary loss of citizenship. It is not clear why this section, applicable to persons who at birth acquired dual nationality, has been included. Its deletion should be considered.

*Section 3(e)*

In paragraph 2 of subsection (c) of section 35 "under" should be changed to read "in accordance with."

*Section 3(f)*

In subsection (d) of section 116 "under" should be changed to read "in accordance with."

*Section 8(f)*

It is recommended that the title of section 2107 be changed to "Tax on Estates of Certain Expatriates."

The definition of expatriate status for purposes of section 2107 should be the same as that for purposes of section 878. Therefore, it is suggested that in subsection (a) of section 2107 the last clause, which starts with "if within the 10-year period," be changed to read as follows:

> If within the 10-year period immediately preceding the date of death such decedent lost United States citizenship, unless such loss did not have as one of its principal purposes the avoidance of United States taxes.

It is recommended that consideration be given to the deletion of subsection (b) of section 2107. This subsection introduces extremely complicated computations into the determination of the taxable estates of expatriates. It is questioned whether the limited revenue benefits would warrant adding to the complexity of the code.

In subsection (c) of section 2107 "sections 2011 to 2013, inclusive" should be changed to read "section 2102." Section 2102, as amended, would modify section 2011, and it already incorporates sections 2011 to 2013. inclusive.

In subsection (d) of section 2107 the first two lines of the text, plus the first word of the third line, should be changed to read as follows:

> Subsection (a) shall not apply to the transfer of the estate of a decedent whose loss of United States citizenship resulted from the applicability of * * *.

The foregoing change is recommended for the same reasons indicated above in regard to section 3(d) of the bill.

*Section 9(a)*

It is recommended that "ending with" in the second line of subsection(a) (3) of section 2501 be changed to read "immediately preceding" and that subparagraphs (A) and (B) of subsection (a)(3) be changed to read as follows:

> (A) such loss did not have for one of its principal purposes the avoidance of United States taxes, or
>
> (B) such loss resulted from the applicability of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487).

As noted above in regard to section 3(d) of the bill, it is not clear why exception is made in the case of voluntary loss of citizenship under section 350 of the Immigration and Nationality Act.

*Section 9(b)*

In subsection (b)(2) of section 2511 "debt obligations" should be changed to read "evidences of indebtedness constituting property which are."

*Section 4(b): Tax on resident foreign corporations*

The bill amends section 882 of the code to subject a resident foreign corporation to normal and surtax upon its taxable income from U.S. sources which is business income and to subject its nonbusiness income to a flat 30-percent tax (or such lesser amount as may be provided by treaty). As a result of classifying dividend income as nonbusiness income, a resident foreign corporation is denied the right to the dividends received deduction. By thus subjecting a resident foreign corporation to a higher rate of tax on dividends as is now the case under existing law, the bill seems to defeat its announced purpose of encouraging foreign investments in the United States. Similarly, a resident foreign corporation is thereby placed at a competitive disadvantage with U.S. corporations. Accordingly, consideration should be given to permitting a resident foreign corporation to continue to utilize the dividends received deduction in respect of its dividend income.

*Section 4(e)*

In order to permit exclusion from personal holding company tax section 542(c)(7) requires that all the stock of a corporation outstanding during the last half of the taxable year be owned by nonresident alien individuals, "whether directly or through other foreign corporations." Consideration should be given to a revision of the quoted phrase, which appears in present law, to cover ownership through foreign trusts, estates or partnerships where all of the partners or beneficiaries are nonresident aliens. (Compare section 958(a)(2).)

*Section 4(g)*

It is suggested that consideration be given to limiting the dividends received deduction provided by section 245(a) for dividends from foreign corporations which are subject to tax under chapter 1 to those received from a foreign corporation which has derived 80 percent or more of its gross business income from sources within the United States rather than to those which have derived 50 percent or more of the gross income from sources within the United States, as presently provided. This change would be consistent with section 2(b) of the bill, which amends section 861(a)(2)(B) so that dividends received by a foreign corporation engaged in a trade or business within the United States would be considered U.S. source income unless less than 80 percent of the gross business income of the foreign corporation is derived from sources within the United States.

*Section 6: Foreign tax credit*

Section 6 of H.R. 5916 amends the foreign tax credit provisions of code section 901 to eliminate the "similar credit" requirement in the case of nonresident aliens, subject to reinstatement by the President where a foreign country on request refuses to provide a similar credit for U.S. citizens.

While the proposed statutory language handles this change satisfactorily, there is an additional substantive change which probably was intended but which the explanatory material submitted by the Treasury does not cover. Under existing section 901(b)(3), if a similar credit is not granted by the native country of an alien resident of the United States or Puerto Rico, no credit will be given such person for taxes paid or accrued to any foreign country. However, no similar credit requirement appears in section 901(b)(2), having to do with taxes paid to a possession of the United States, and hence a nonresident alien is entitled to a credit for taxes paid to a U.S. possession even where no foreign tax credit is available under section 901(b)(3). On the other hand, under section 901 as amended by section 6 of the bill, a presidential proclamation denying a tax credit to alien residents of the United States or Puerto Rico apparently would apply to the entire credit otherwise allowable under new section 901(b), and therefore would deny the credit for taxes paid to a U.S. possession as well as taxes paid to foreign countries.

It should be made clear that under the proposed legislation, as under existing law, a resident alien will have the right to protest a determination by the executive department that a foreign country does not satisfy the similar credit requirement. The fact that such a finding by the President is a condition precedent to his proclamation may indicate that this finding is a matter of discretion which

may not be judicially set aside in seeking to render the proclamation void, absent an abuse of discretion. If so, it seems arguable that this finding also may be exempt from an attack on the merits in determining whether under the proclamation a foreign tax law provides a similar credit. It should be made clear that once a proclamation is issued, the nonresident alien will have the same remedies to contest the denial of a foreign tax credit as he has under existing law.

*Section 8(b): Estates of nonresidents not citizens, credits against tax.*

The maximum credit for State death taxes is limited by proposed section 2102(b). This limitation is defined in terms of a ratio of (1) the value of the property "at the date of death" subject to State death taxes to (2) the value of the total gross estate. If alternate valuation is elected, the use of the date of death value for the numerator of the fraction might result in substantial distortion. Accordingly, the phrase "at the date of death" should be eliminated.

*Section 8(c): Property within the United States*

By this provision of the bill, section 2104(c) of the code is amended to make it clear that where a debt obligation of a U.S. obligor is owned by a nonresident alien, the obligation shall be treated as property within the United States no matter where it is located. However, from the standpoint of clarity it would appear that it should also be made clear that a foreign obligation physically located in the United States will not be treated as property within the United States. This result would seem to be a logical extension of the proposal with respect to U.S. obligations. The same comment can be made under section 9(b) which amends section 2501(a)(2) to set forth similar situs rules in the gift tax area.

*Section 8(f)*

Proposed section 2108 of the code allows the President by proclamation, to apply the pre-1966 estate tax law to residents of foreign countries under certain conditions. It is stated that the President shall proclaim that the tax be determined without regard to amendments made "on or after the date of enactment of this section." Since the nature of amendments which will be made in the future is unknown, it would seem advisable to restrict the presidential authority to the amendments made by the pending bill. If it should be desired to grant the same authority to the President with respect to future amendments, such authority can be granted in the future legislation. This comment is equally applicable to section 5 of the bill.

*Additional considerations*

1. It is submitted that consideration should be given to the inclusion of a provision in the bill that would permit domestic fiduciaries to administer estates and trusts for the exclusive benefit of foreign beneficiaries and remaindermen without being subjected to capital gains tax in respect of gains realized upon the sales of the trusts' or estates' portfolio securities. It is recognized that such a rule would be in derogation of existing case law.

2. Consideration also should be given to abolishing the present requirement that a visiting alien, before departing from the United States, must secure a tax clearance and sailing permit. Present procedures in this regard are harassing and annoying to visiting aliens and do not produce a significant amount of revenue.

CLEARY, GOTTLIEB, STEEN & HAMILTON

JUNE 24, 1965.

## MEMORANDUM REGARDING THE DEFINITION OF NONBUSINESS INCOME UNDER SECTION 4 OF H.R. 5916

In connection with the administration's program to improve the U.S. balance of payments, the Fowler Committee Report of April 27, 1964, proposed a number of related changes in U.S. tax laws governing the receipt of U.S. source income by foreign investors. The recommendations of the Fowler Committee Report have been further developed by the Treasury and are incorporated in H.R. 5916, which is designed, in the words of the Treasury, "to stimulate foreign investment in the United States by removing existing tax barriers to such investment." The principal thrust of this legislation is toward a less complicated and more favorable tax treatment of portfolio investments by foreigners in U.S. corporate securities.

Virtually everyone considers interest income as a form of investment income, and it has been so considered by the Treasury and Congress in the past as, for example, in the definitions of personal holding company income (I.R.C. sec. 543) and subpart F income (I.R.C. secs. 952 and 954). This same policy is employed in section 3 of H.R. 5916, which defines the nonbusiness income of nonresident alien individuals in a manner that would include income from debt securities. (The Treasury press release of Mar. 8, 1965, describing H.R. 5916, refers on p. 2 to foreigners' nonbusiness income, "such as dividends and interest.")

It is with surprise, therefore, that one finds in section 4 of H.R. 5916 that the proposed definition of nonbusiness income of a foreign corporation engaged in trade or business in the United States does not include interest from debt securities. It is not clear to us what policy would be furthered by not including income from debt obligations in the definition of nonbusiness income in this section. If it has been omitted out of a concern over possible tax avoidance possibilities, we believe that any such possibilities should be attacked directly and not by excluding interest income.

Section 4 of H.R. 5916 proposes to amend section 882 of the Internal Revenue Code, relating to the income of foreign corporations, to define "business income" and "nonbusiness income." The characterization of income under these definitions controls the U.S. income tax consequences for foreign corporations in several situations.[1] Nonbusiness income is limited in the proposed definition under section 882(a) (3) and (4) to dividends and capital gains from the sale of corporate stock, and amounts described in section 631 (b) and (c).

Foreign corporate investors, including foreign-based investment companies investing in U.S. securities, frequently include bonds, debentures, and other debt securities of U.S. issuers in their portfolios. We believe that the failure to grant favorable tax treatment for income from such investments on a par with stock investments

[1] The definition of nonbusiness income will be significant in the following principal cases: (1) All foreign corporations (whether or not such corporations are engaged in trade or business in the U.S.) will be subject to a flat 30 percent withholding tax rate on their nonbusiness income; (2) the U.S. second dividend tax under I.R.C. sec. 861(a)(2)(B) will not apply to nonbusiness income.

results in an unwarranted limitation on the flexibility of foreign-owned portfolios of U.S. securities. It would, for example, discourage the investment policy of a number of existing foreign investment companies and mutual funds that now invest exclusively in U.S. stocks and bonds.

In some situations, the discrimination against income from debt securities will result in unnecessarily complex arrangements for foreign portfolios containing investments in U.S. securities. This arises, for example, in the situation in which it is proposed to eliminate the "second dividend" tax of section 861(a)(2)(B) so that such tax will hereafter apply only to dividends paid by foreign corporations that are engaged in business in the United States and which have 80 percent or more of their business income from U.S. sources. (See sec. 2 of H.R. 5916 amending I.R.C. sec. 861(a)(2)(B).) As indicated by the Treasury explanation, if a foreign corporation is an investment company investing in U.S. securities and receiving as its total income only dividend and interest income and capital gains from the sale of securities from U.S. sources, the second dividend tax will be applicable to the corporation's distribution to its stockholders of dividends representing income received in the form of interest or capital gains from the sale or exchange of United States debt securities, i.e., its U.S. business income, unless the foreign corporation has more than 20 percent of its total business income (excluding for this computation all nonbusiness income from all sources) from sources outside of the United States. This imposes a mechanical limitation on foreign investment companies, particularly those investing exclusively in U.S. securities, that seems unwarranted in the light of the purposes of the act.

Unless section 882 is amended, as suggested above, after enactment of H.R. 5916 the present 48-percent U.S. corporate tax rate will continue to be imposed on interest income from U.S. sources where a foreign corporation is engaged in trade or business in the United States.[2] A combination of the U.S. corporate tax rate, in addition to the potential second dividend withholding tax, would continue to be an impediment to investment in U.S. debt securities for portfolios of foreign corporate investors. Notwithstanding the attempted clarification of H.R. 5916 of when a foreign corporation is engaged in trade or business in the United States, the answer to this question will not always be clear and foreign investors and their tax advisors will not be certain of the impact of U.S. taxes imposed on the basis of that determination. It seems to be doubtful policy to have such uncertainty extend to the U.S. tax treatment of interest income.

CLEARY, GOTTLIEB, STEEN & HAMILTON.

[2] The present 30-percent withholding rate (or a lower tax treaty rate) would remain in effect in the case of corporations not engaged in trade or business in the United States.

WILLIAM R. ENGSTROM

BOSTON, MASS., *June 28, 1965.*

THE WAYS AND MEANS COMMITTEE,
*The House of Representatives,*
*Washington, D.C.*

GENTLEMEN: In regard to your forthcoming deliberations toward liberalizing tax barriers to foreign investment in the United States, may I request that these factors be also entertained:

1. U.S. foreign policy is best served by the strengthening of the economies of other countries, particularly the lesser developed ones, since with the strengthening of these economies their internal politics also strengthen. But to the extent that foreign entrepreneurs invest in the United States we debilitate the program of investment in foreign countries and thereby undermine our own foreign policy.

2. The U.S. balance-of-payments position is not really as critical as the present method of bookkeeping may indicate and if the Congress passes this legislation it will give the appearance of panic, since this is hardly as sound an approach to solving the problem as, say, would be the institution of giving tax relief on export sales as a method of encouraging greater exports.

Cordially yours,

SEDGWICK, ENGSTROM & CO., INC.
WILLIAM R. ENGSTROM.

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FIRST NATIONAL CITY BANK,
*New York, N.Y., June 29, 1965.*

Re H.R. 5916.

LEO H. IRWIN, Esq.,
*Chief Counsel, Committee on Ways and Means,*
*1102 Longworth House Office Building,*
*Washington, D.C.*

DEAR SIR: Enclosed is a proposed amendment to H.R. 5916 dealing with interest payments by foreign branches of U.S. banks, together with our supporting memorandum. We urge that the Ways and Means Committee include our proposed language in the bill when it is reported to the House.

Sincerely yours,

WALTER B. WRISTON.

FOREIGN BRANCH BANK INTEREST

MEMORANDUM IN SUPPORT OF PROPOSED AMENDMENT TO INTERNAL REVENUE CODE SECTION 861(A)(1)

*Summary of comments*

This memorandum relates to a proposed new subparagraph (B) to be added to Internal Revenue Code, section 861(a)(1), to exclude from the definition of income from sources within the United States interest paid by foreign branches of U.S. banks. Under existing law interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States is not

income from sources within the United States. The proposed amendment would also exclude interest paid by foreign branches of U.S. banks without regard to whether the depositor was engaged in business in the United States.

*Competitive disadvantages to U.S. banks operating abroad*

The proposed amendment would remove an ambiguity in existing law that has imposed a severe hardship on U.S. banks operating through foreign branches, by placing them at a competitive disadvantage in their efforts to offer services to their foreign customers comparable to those offered by foreign banks. The question of whether a foreign corporation is engaged in business in the United States is frequently not free from doubt, particularly where the foreign corporation is affiliated in some manner with a U.S. corporation. While the foreign corporation would prefer to keep its time deposits with a foreign branch of a U.S. bank, it frequently deposits its money with a foreign bank because it fears that in the event it should at some later date be held to be engaged in business in the United States, interest income from the foreign branch of the U.S. bank would be taxable, while interest income from a foreign bank would clearly not be taxable as income from sources within the United States.

*Separate identity of foreign branch banks*

The proposed amendment comports with existing nontax law and banking practice in treating a foreign branch of a U.S. bank as a separate foreign corporation. This proposal recognizes the realities of overseas banking, where practically for all but tax purposes a foreign branch is regarded as a separate foreign corporation. For example not only is a foreign branch of a U.S. bank exempt from certain regulations of the Federal Reserve Board of Governors, such as those limiting interest rates it may pay, but for the express purpose of permitting foreign branches to compete on equal terms with local banks of other foreign countries, the same regulations also may permit the foreign branch to exercise powers which a domestic U.S. bank could not exercise (12 U.S.C. § 604(a). H. Rept. 2047, 87th Cong., 2d sess. 1962, United States Code Congressional & Administrative News, p. 242).

In addition, foreign branches of U.S. banks are subject to the regulatory laws of a foreign country. Deposits in these branches are regarded for nontax purposes as payable there and only there; thus, amounts standing to the credit of a depositor of a Havana branch of a bank with a head office in New York have been held not subject to attachment served by process on the head office. *Clinton Trust Co.* v. *Compania Azucarera Central, Mabay*, (S.A., 172 Misc. 148, 14 N.Y.S. 2d 743 (Sup. Ct. N.Y. Co. 1939) aff'd 258 App. Div. 780). A nonresident alien depositor in a foreign branch has no substantial contacts with the United States as to that deposit whether or not he is otherwise engaged in business in the United States. The deposit is made outside the United States pursuant to an agreement made outside the United States and under the laws of a foreign country. The funds derived by foreign branches of U.S. banks are almost always loaned or invested outside the United States.

It should be kept in mind that foreign branches of American banks are not merely windows through which deposits are made and with-



71-297 O-67-pt. 1—16

drawn from a general pool of assets. Each deposit contract is made with a particular branch in a particular country, subject to the laws and exchange controls of that country. It is payable at that branch only, and only in the currency that was deposited. A foreign corporation cannot make a French franc deposit in France and expect to draw against it in dollars in New York. In order to use in the United States the deposits which it has in a foreign branch, the depositor would have to transfer funds out of that branch, and, if a different currency is involved, would have to make a sale of his funds in exchange for the dollars that he would want. Thus, foreign branches of U.S. banks operate, as a matter of economics and banking law, in basically the same way as banks incorporated locally in the countries where they do business; and the interest which these branches pay is not attributable to earning assets of the depositor in the United States.

*The futility of trying to tax foreign source interest income*

The present law attempts to tax income generated wholly outside the United States, payable to recipients who are not U.S. persons. It does not attempt to tax these payments in all cases, however, but only where the payor happens to be incorporated in the United States and then only when it operates through foreign branches rather than locally incorporated foreign subsidiaries. In view of this peculiar twist in the law, any foreign person or corporation suspecting that it may be found to do business in the United States, has merely to withdraw its money from the foreign branch of an American bank and place it on deposit with a local bank across the street. The issue presented by the proposed amendment is not whether these foreign interest payments will be taxed—they are not taxed under present law, except in a few cases where the corporate treasurer is unenlightened. The real issue is whether the strained language of the present Internal Revenue Code, section 861, will continue to keep these interest-bearing deposits out of the foreign branches of American banks.

*The corporate treasurer's decision*

As the law now stands, before the treasurer of a foreign corporation will put an interest-bearing deposit with the foreign branch of an American bank he must satisfy himself that his corporation is not doing business in the United States. In making this decision he must bear in mind that his conclusion does not control but rather that the findings of an Internal Revenue Service agent, perhaps several years later, will determine whether his interest is taxed under the terms of section 861. If his conclusion differs from that of the agent, he is faced with expensive legal proceedings, or payment of the tax, or both. His decision is obvious: The money must be put with the foreign bank regardless of what his opinion may be on this question. The American bank therefore loses not only those deposits which are taxable under section 861 but other deposits which are frightened away through the corporate treasurer's understandable caution. Many of these corporations are American owned or controlled and, other factors being equal, would prefer to do business with an American bank if they could. The possibility of an ultimately favorable decision on the question of doing business will not, and should not, satisfy the prudent corporate treasurer. The legal terms are too hard

for him to define, and the safe alternative, banking with a local bank, is too easy to use.

While under some tax treaties interest is taxed at a lower rate, this consideration would not overcome the prudent corporate treasurer's reluctance to deposit funds with a foreign branch of an American bank. The United States still does not have tax treaties with many countries, and, even where it does, a lower rate of tax on interest still does not equal the absolute freedom from U.S. taxes afforded by depositing funds in a local bank.

*Strengthening competitive position of U.S. banks helps balance of payments*

The proposed amendment would permit U.S. banks operating abroad through branches to meet foreign competition engendered not by any business skill or acumen of the foreign banks but solely by the unfavorable U.S. tax laws. Strengthening the competitive position of the U.S. banks operating abroad not only comports with the expressed purposes of the Foreign Banking Act, but also expresses a policy reflected elsewhere in the Internal Revenue Code and Regulations. For example, Executive Order 1198 (February 10, 1965) issued by the President under the interest equalization tax (IRC 4931(a)) specifically exempts from the tax foreign branch loans made in a foreign currency by a commercial bank at a branch located outside the United States. Moreover, loans of this nature arising out of foreign branch deposits do not worsen the balance-of-payments position of the United States. Indeed, even the tightly restrictive "Federal Reserve Guidelines for Foreign Lending Activities" (Circular No. 5628, March 5, 1965) recognize that the balance-of-payments program is not designed to hamper the lending activities of foreign branches insofar as the funds utilized are derived from foreign sources and do not add to the dollar outflow. This is true whether the loans and deposits are made in foreign currencies or European dollars.

The proposed amendment supports the overall purpose of H.R. 5916 in easing the balance-of-payments problem in two ways. First, it encourages foreign individuals and, more particularly, corporations to deposit funds with U.S. banks. Second, it strengthens U.S. banking in foreign areas permitting them to render important supporting functions to American export trade. Exports, it has been emphasized by the late President Kennedy, are the only ultimate solution to the balance-of-payments problem. (See President's message on balance of payments, July 18, 1963, p. 3; H. Rept. 1046, 88th Cong., 1st sess., p. 17.)

It is believed that any revenue loss arising out of the proposed amendment would be negligible, since deposits of foreign corporations or individuals who are or may be engaged in business in this country are not now being made in foreign branches of U.S. banks, so no taxes are being paid on any interest derived therefrom. Any possible revenue loss, moreover, would, in all probability, be more than made up by the increased taxes paid by U.S. banks on increased foreign branch earnings which, of course, would continue to be taxed by the United States whether repatriated in dollars or not.

The exemption which the amendment proposes is the only means to induce these foreign corporations to channel their overseas deposits

into American bank branches. The result will be a net gain both in the Federal tax revenue and in the U.S. balance of payments.

FOREIGN BRANCH BANK INTEREST PROPOSED AMENDMENT TO H.R. 5916

Section 2. Income from sources within the United States:

(*a*) *Interest from U.S. sources.*—Section 861(a)(1) (relating to interest from sources within the United States) is amended to read as follows:

SEC. 861. (a) GROSS INCOME FROM SOURCES WITHIN THE UNITED STATES.—The following items of gross income shall be treated as income from sources within the United States.

(1) INTEREST.—Interest from the United States, any territory, any political subdivision of a territory, or the District of Columbia, and interest on bonds, notes or other interest-bearing obligations of residents, corporate or otherwise, not including—

(A) interest on deposits with any persons carrying on the banking business paid to persons not engaged in business within the United States;

(B) interest on deposits with foreign branches of persons carrying on the banking business. For purposes of this subparagraph, the term "foreign branch" shall mean a foreign branch established under the authority of section 9 or section 25 of the Federal Reserve Act (12 U.S.C. 321 or 601);

(C) interest received from a resident alien individual, a resident foreign corporation, 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 of such resident payor or domestic 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 payor preceding the payment of such interest, or for such part of such period as may be applicable;

(D) income derived by a foreign central bank of issue from bankers' acceptances; and

(E) amounts paid to, or credited to the accounts of, depositors or holders of accounts not engaged within the United States on deposits or withrdrawable 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.

HERRICK, SMITH, DONALD, FARLEY & KETCHUM,
*Boston, Mass., June 23, 1965.*

Hon. WILBUR D. MILLS,
*Chairman, House Ways and Means Committee,*
*House Office Building, Washington, D.C.*

DEAR CONGRESSMAN MILLS: It is understood that your committee has invited comments on proposed legislation to encourage foreigners to invest in the United States.

The observations below are addressed to the provisions affecting the U.S. estate tax in H.R. 5916, 89th Congress, 1st session, which you introduced in the House of Representatives on March 8.

*1. Expatriation to avoid estate tax*

H.R. 5916, page 38, would add a new section 2107 to the Interna Revenue Code, providing in part:

> (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.*

The main purpose of the underlined portion is doubtless to discourage resident U.S. citizens from renouncing their citizenship and thereby having their estates taxed at the rates applicable to nonresidents. It can be expected that an executor will have a heavy burden in proving that a decedent who renounced his citizenship did not have as one of his principal purposes the avoidance of U.S. taxes. This burden is entirely appropriate when a U.S. citizen residing in the United States on March 8, 1965, thereafter renounces his citizenship. It is, I believe, an unfair burden to place upon the executor of a U.S. citizen who was a nonresident of the United States for most of his life or for many years before 1965.

The following situation is not uncommon: F, a Canadian, emmigrated to the United States in 1920, became naturalized here, married a woman born in Canada, and died in 1923 leaving a child, C, who was born in the United States and, therefore, a citizen of the United States. Upon her husband's death, the widow returns to her home in Canada with the infant C. C lives in Canada for the rest of his life. Many reasons may prompt C to renounce his U.S. citizenship and become a citizen of the country in which he was brought up, educated, and has made his living. In these circumstances the executor should not have the burden above mentioned if C happens to become a Canadian citizen within 10 years prior to his death. It is recommended that 2107(d) be amended as follows:

> (d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to the transfer of the estate of a decedent
>
> (1) who lost U.S. 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

(2) who was a nonresident of the United States throughout the 10-year period ending with the date upon which he lost U.S. citizenship.

*2. U.S. estate taxes on intangible personal property of nonresident aliens*

The Fowler Committee's recommendation No. 29 is as follows (p. 24): [1]

> *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.* [Emphasis added.]

The adoption of recommendation No. 29 of the Fowler committee will establish a rule easily understood by foreigners and will do more to encourage foreigners to purchase securities of U.S. corporations than will the limited approach of special estate tax rates for foreigners.

*3. Provisions disregarding the corporate entity conflict with estate tax conventions*

The proposed new section 2107(b), pages 38–39 of H.R. 5916, disregards the separate existence of foreign corporations in certain cases when a U.S. citizen expatriates himself in order to have the reduced estate tax rates apply to his estate.

The adoption of this principle of disregarding the corporate entity appears to be in conflict with estate tax conventions, for example, the United States-Canada Estate Tax Convention signed February 17, 1961 as interpreted by the Committee on Foreign Relations.[2]

Under section 2107(b) if a foreign decedent owns a stated percentage of the shares of a foreign corporation which owns assets situated in the United States, the value of a stated proportion of the assets of the foreign corporation would be included in his U.S. gross estate. Under the situs rules of the United States-Canada Estate Tax Convention shares of stock of a foreign corporation have a situs outside the United States and real estate located in the United States has a situs in the United States for taxation purposes. The Foreign Relations Committee specifically dealt with the situation of a foreign corporation owning various types of property. That committee acted

[1] Report to the President of the United States from the Task Force on Promoting Increased Foreign Investment in U.S. Corporate Securities, etc., dated Apr. 27, 1964.

[2] Tax Treaties, Commerce Clearing House, No. 1318Q gives the text of the Foreign Relations Committee's Report on the United States-Canada Estate Tax Convention.

upon the Convention with the understanding that in these circumstances the real property in the United States owned by the foreign foreign corporation should not have a situs for estate tax purposes in the United States. The same principle was illustrated in the committee's report with respect to other types of property, such as ships and aircraft.

It would be regrettable to depart from the principle established by the Foreign Relations Committee by adopting section 2107(b), even for the entirely worthy cause of discouraging U.S. resident citizens from surrendering their citizenship for the sake of lower estate taxes. If, however, the rules of section 2107(b) are retained in the bill, it is suggested that conflict with the Estate Tax Convention be kept to a minimum by a clear statement that, for estate tax purposes, the corporate entity of a foreign corporation is to be disregarded only in the situation where the foreign decedent has given up his U.S. citizenship for purposes of avoiding or reducing the U.S. estate taxes.

A copy of this letter is being sent to each member of the Committee on Ways and Means.

Respectfully submitted.

FULTON C. UNDERHAY.

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INVESTMENT CO. INSTITUTE,
*New York, N.Y., June 23, 1965.*

Re H.R. 5916, "Act to remove tax barriers to foreign investment in the United States."

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*House of Representatives 1102 Longworth House Office Building,*
*Washington, D.C.*

DEAR CHAIRMAN MILLS: H.R. 5916 is largely based on the recommendations of the Presidential Task Force on Promoting Increased Foreign Investment in U.S. Corporate Securities. Having had the honor of serving as a member of that task force, I am pleased, personally and as president of the Investment Co. Institute, to express to you approval in general of the bill without reference to its technicalities.

While the bill does not go as far as the task force's recommendation that the U.S. estate tax on intangible personal property of nonresident decedents be eliminated entirely, I understand that there may be technical reasons for this. Assuming these reasons to be valid, the reduction of the maximum rate 77 to 15 percent and the replacement of the present $2,000 exemption with a $30,000 exemption represent a long step in the right direction and should be supported.

Other major provisions of the bill, such as those relating to nonbusiness income and withholding and also relating to taxation of capital gains, are substantially in accordance with the task force's recommendations.

It is gratifying that the Treasury has so promptly acted on the recommendations of the task force designed to increase foreign investment in the United States. I appreciate the opportunity to express these views to you.

Very truly yours,

DORSEY RICHARDSON, *President.*

INVESTORS LEAGUE, INC.,
*New York, N.Y., June 24, 1965.*

Congressman WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*House Office Building, Washington, D.C.*

MY DEAR CONGRESSMAN MILLS: I wish to acknowledge and thank you and other members of your committee for your invitation to the Investors League to submit a statement on H.R. 5916, the "Act to remove tax barriers to foreign investment in the United States."

Believing that such legislation will improve our country's serious balance-of-payments problem, we favor its enactment.

Inasmuch as our written statement would closely parallel that of the New York Stock Exchange, for the convenience of your committee, we are submitting no further written testimony.

Sincerely yours,

WILLIAM JACKMAN, *President.*

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JUNE 29, 1965.

GEORGE F. JAMES

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*U.S. House of Representatives, Washington, D.C.:*

In re hearings on H.R. 5916, as an industry member of the Fowler Task Force I wish to associate myself with support of H.R. 5916 and with the specific recommendations for improvement of this proposed legislation as contained in the letter to you of June 24 from Mr. Andre Meyer and Mr. Frederick M. Eaton.

Respectfully,

GEORGE F. JAMES,
*Socony Mobil Oil Co.*

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ROBERT MCKINNEY

SANTA FE, N. MEX., *June 24, 1965.*

H.R. 5916: Task force.

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means, U.S. House of Representatives, Washington, D.C.*

DEAR MR. MILLS: In response to your announcement of June 18 inviting interested persons to submit written statements with respect to H.R. 5916, I enclose herewith a summary of some of the actions taken by the so-called private sector to implement those recommendations of the Fowler task force directed toward it. I believe that the enclosed report clearly indicates that the private sector has made a substantial contribution to the general effort to improve our balance-of-payments situation.

I should like, in addition, to point out that the help given by Chairman Cohen and his staff at the SEC and by Assistant Secretary Surrey and his staff at the Treasury in implementing those recommendations of the task force directed toward them has been extremely encouraging to the private sector.

Speaking on behalf of the task force I sincerely hope that your committee will give prompt and favorable consideration to H.R. 5916.

Very truly yours,

ROBERT MCKINNEY.

JUNE 22, 1965.

## IMPLEMENTATION OF TASK FORCE RECOMMENDATIONS BY PRIVATE SECTOR [1]

### A. U.S. FINANCIAL COMMUNITY

*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.

(*a*) As of December 31, 1964, NYSE member firms had 182 offices in 27 foreign countries. This compares with a total of 170 offices in 24 countries as of January 1, 1964.

(*b*) The Member Firms Department of the NYSE has embarked on a program of staff visitations of overseas offices of members. One important aim of these visits is to increase the efficiency, volume and scope of such operations. The information obtained on these visits will be used in part to review the appropriateness of present domestically oriented rules and regulations of the exchange to overseas operations of member firms.

(*c*) Since the end of 1963, Merrill Lynch has opened four sales offices outside the United States, improved its internal wire communications system between its United States and its European offices, installed "Quotron" in four of its overseas offices, and is establishing in Europe an over-the-counter trading market for foreign dollar bonds.

(*d*) In December 1964 E. F. Hutton announced it had installed a direct teletype wire service to Banco de Comercio in Mexico City.

(*e*) White, Weld & Co. has five offices abroad which contribute to the distribution of its underwriting participations with foreign investors.

(*f*) On March 15, 1965, Smith, Barney & Co. opened a representative office in Paris under the direction of a person designated vice president and European representative.

(*g*) Kuhn Loeb has increased and strengthened its contacts with foreign investment institutions and individuals with a view toward developing further foreign investment in U.S. securities.

(*h*) Loeb, Rhoades has taken steps to improve its telex communication abroad and to extend and speed the facilities it has for communication with foreign financial institutions which are interested in American securities for its clients.

(*i*) Bache & Co. continues to broaden its coverage of foreign markets through a wide network of foreign branches and representatives.

[1] This information was assembled from March to June 1965. Accordingly, some of the information obtained may not be entirely up to date.

Both as investment bankers and brokers, the firm constantly seeks to improve its contacts with foreign investors and to overcome any restrictions on their ability to invest in U.S. securities. The firm has been instrumental in interesting a number of U.S. firms in listing their securities on foreign exchanges.

*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.

*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.

(*a*) On March 17, 1965, a 2,815,106-share secondary offering of GM common stock was released to the public. It is estimated that approximately 500,000 shares (approximately $100 per share) were sold abroad. The underwriting group was headed by Morgan Stanley & Co.

(*b*) Morgan Stanley & Co. has explored with other clients the possibility of placing blocks of common stock with foreign investors, and has provided a number of its clients information regarding costs and procedures of listing on various foreign exchanges.

(*c*) On July 8, 1964, a 33,000-share nonregistered secondary offering of Cutter Labs common stock was distributed outside the United States to non-U.S. persons. The distribution was handled entirely by Merrill Lynch.

(*d*) Bache & Co. is an important distributor of secondary offerings of the shares of U.S. corporations, and its foreign offices are important participants in such distributions.

(*e*) On June 8, 1965, a secondary distribution of 250,000 shares ($58.625 per share) of Minnesota Mining & Manufacturing Co. common stock was offered to the public. The underwriting was headed by Lazard Freres & Co. Approximately 17 foreign underwriters purchasing approximately 75,000 shares participated in the underwriting group.

(*f*) On June 10, 1965, the First National City Bank offered to stockholders the right to subscribe to an issue of $266,307,500, 4 percent convertible capital notes due 1990. The notes are convertible into capital stock unless previously redeemed. A significant effort to place these notes abroad was and is being made. At least 3 foreign underwriters participated in the underwriting group and approximately 60 foreign dealers were invited to participate in the selling group.

(*g*) On June 22, 1965 the Ford Foundation offered to the public 6 million shares of Ford Motor Co. common stock (approximately $52 per share). Perhaps as much as 10 percent of this offering was sold overseas. Submanagers of a 59-member European syndicate included Deutsche Bank AG for distribution in Germany; Lazard Freres & Cie for the rest of Continental Europe, and Morgan Grenfell & Co. Ltd. and Lazard Brothers & Co., Ltd. jointly for the United Kingdom.

*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.

(*a*) The March 17, 1965, GM secondary underwriting group included 30 overseas investment houses underwriting over 10 percent of the shares.

(*b*) The underwriting syndicate for the April 26, 1965, Chrysler offering of rights includes four Japanese firms. Although the present underwriting is not complete, it is reasonable to assume that some part of it will be purchased by foreign investors.

(*c*) While no foreign underwriters were included in the syndicates, significant amounts of the following issues were placed abroad through foreign selling groups: Baystate Corp. (138,285 shares); Savanna Electric (150,000) shares); the Southern Co. (510,000 shares); Southern California Edison (1,500,000 shares).

(*d*) Private placements and public offerings in which Bache & Co. participates either as manager, syndicate member, or selling group member frequently included foreign banks and securities firms as participants.

*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.

(*a*) During 1964 the NYSE listed three foreign bond issues sold entirely outside the United States as a consequence of the interest equalization tax: Copenhagen Telephone Co., Inc., the Japan Development Bank and the Metropolis of Tokyo. Two additional issues of this type are in process.

(*b*) Between October 1964 and May 1965 the following six offerings of bonds totaling $135 million were registered with the SEC, managed by U.S. investment bankers, and underwritten by international consortiums: (Foreign underwriters participating in each of the underwriting groups placed an average of 36 percent of each such offering).

(1) *May 5, 1965: Commonwealth of Australia.*—$25 million bonds; 43 foreign underwriters, 58 percent of issue.

(The 43 foreign firms are located in 9 European countries. In addition, a substantial number of European dealers participated as selling group members. The entire issue (which is subject to the interest equalization tax) is being placed outside the United States, and application has been made to list the bonds on both the London and New York Stock Exchanges.)

(2) *December 15, 1964: European Investment Bank.*—$25 million bonds; 50 foreign underwriters, 62 percent of issue.

(This issue was placed entirely abroad, although listed on the New York Stock Exchange.)

(3) *October 27, 1964: Mexico.*—$35 million bonds; five foreign underwriters, 26 percent of issue.

(4) *January 19, 1965: Republic of the Philippines.*—$15 million bonds; seven foreign underwriters, 21 percent of issue.

(5) *January 26, 1965: Republic of Portugal.*—$20 million bonds; 33 foreign underwriters, 47 percent of issue.

(These 5¾ percent bonds were exempt from the interest equalization tax. Of the total, $5,377,000 were distributed directly abroad by 36 overseas investment houses in the underwriting group. An additional $3,465,000 were distributed abroad by 49 overseas investment houses who became members of the selling group.

(6) *April 21, 1965: Republic of Venezeula.*—$15 million bonds; three South American underwriters, 5 percent of issue.

(*c*) Two bond issues of the Republic of Finland and one of the city of Helsinki were issued between May 1964 and March 1965. These three issues totaled $40 million of which $23 million were sold to foreigners. The underwriting group included Harriman Ripley, Kuhn Loeb, Lazard and Smith, Barney. The $10 million offering of the city of Helsinki 6¼ percent bonds, due 1977, was offered on March 25, 1965.

(*d*) White Weld invited foreign banks and securities firms as underwriters of the following issues managed by them: (The entire amount of these securities was subscribed for from abroad.)

(1) $8 million Kesko Oy 6½ percent bonds due June 1, 1976.

(2) $12 million Sumitomo Chemical Co. 6¾ percent bonds due December 1, 1979.

(3) 15,000 units (about $15 million) international income fund.

(*e*) The First Boston Corp. has included foreign underwriters as well as foreign selling group members in all of its foreign dollar issues The $20 million Japan Development Bank issue was sold entirely abroad. Foreign sales of the $25 million Mexican Government issue amounted to approximately 50 percent of the total.

(*f*) Certain Japanese securities firms were included as underwriters and several European banks were included as members of the selling group in the $22.5 million offering of Nippon Telegraph & Telephone Public Corp. 5¾ percent guaranteed bonds due 1980, which was offered publicly on April 8, 1965. The managers were Dillon Read, First Boston Corp., and Smith, Barney. The issue was exempt from the interest equalization tax. Distribution studies are still being made but over 12 percent of this issue was distributed directly abroad through 46 overseas investment houses who participated in the selling group.

(*g*) In September 1964, a $15 million issue of city of Oslo 5½ percent sinking fund bonds due September 15, 1984, was offered largely in Europe under the management of four U.S. firms, and many European banks participated in the selling group. This offering was placed entirely outside the United States, although listed on the New York Stock Exchange.

(*h*) In July 1964, three U.S. firms and one European bank made a $15 million offering of 5¾-percent sinking fund debentures due 1984 of the Copenhagen Telephone Co. In addition, several European banks were included in the selling group.

(*i*) The $22,500,000 issue for the metropolis of Tokyo was placed entirely outside the United States in April 1964, although listed on the New York Stock Exchange.

(*j*) In December 1963 an issue of U.S. $5 million 6¼-percent convertible debentures due 1978 of Canon Camera Kabushiki Kaisha was

sold entirely outside the United States by an underwriting group headed by Carl M. Loeb, Rhoades & Co., two London firms and one Tokyo firm.

(*k*) In July 1964 an issue of US$13,745,000, and 45,020,000, DM 5¾ percent bonds of Instituto Per La Ricostruzione Industriale with warrants to purchase Finsider shares was sold entirely outside the United States by an underwriting group headed by Carl M. Loeb, Rhoades & Co. and three European firms. The underwriting group was made up almost entirely by foreign firms.

(*l*) In December 1964 an offering of rights of 953,154 shares of Philippine Long Distance Telephone Co., with standby by an underwriting group headed by Carl M. Loeb, Rhoades & Co. was made public. Foreign firms underwrote 14 percent of the issue. The subscription price was payable either in U.S. dollars or Philippine pesos.

(*m*) Bache & Co. participates in numerous offerings of dollar-denominated foreign securities and employs its foreign facilities to a maximum extent in this regard.

*Recommendation No. 8*

U.S. commercial banks should intensify efforts to attract foreign trust accounts for investment in U.S. corporate securities.

(*a*) FNCB has set up a full-time continental representative office and has greatly increased trips abroad by senior trust officers.

*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.

(*a*) In connection with the March 17, 1956, GM secondary, bearer depositary receipts, each representing one-twentieth of a GM share, were issued by Barclay's bank and listed on the London Stock Exchange.

(*b*) FNCB was instrumental in setting up and making workable through its Brussels branch, Intertrust S.A., which sells depositary receipts for two U.S. mutual funds (Fundamental Investors, Inc., and Diversified Growth Stock Fund, Inc.) which are attracting considerable investment interest in Europe. Other similar efforts are currently under consideration.

*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.

(*a*) In 1964, sales of shares of open end investment companies in Canada and in other foreign countries reached $115.2 million, a substantial increase over the 1963 figure of $61.5 million. The current estimate for the calendar year 1965 indicates another substantial increase to $280 million. This increase stems primarily from an ability of distributors to adapt to the particular legal structures existing in foreign countries.

(*b*) One fund has been incorporated abroad that invests solely in the shares of American mutual funds, and several others are in the process of formation.

(*c*) One closed end investment company group has recently placed a block of shares worth several million dollars abroad, and its investment banking associate is contemplating additional foreign offices. One large closed end investment company was recently listed on the Paris and Amsterdam exchanges.

(*d*) Translations of basic explanations of mutual funds and their advantages have been made available in German, Spanish, Italian, French, Finnish, Dutch, and Chinese. One of the basic publications of the Investment Co. Institute has been translated into Spanish.

(*e*) The Investment Co. Institute has initiated the regular collection of data concerning foreign markets, and a study of foreign investment companies in late 1964 has been circulated to members and the public. The institute has underway a study of foreign investment company holdings of U.S. securities and the changes therein.

(*f*) White Weld has devised a plan to the satisfaction of the British Exchange Control whereby a British subject was permitted to continue his mutual fund investment program after his return to Great Britain, and has shown a Swedish bank how it may lend to an investor in Abyssinia with such a program as collateral.

(*g*) Bache & Co., as a distributor of open end investment company shares, constantly employs its foreign facilities to interest foreign investors in such shares. In its offering of shares of the Japan Fund, Inc., a closed end investment company, in July of 1963, it included the Netherlands Overseas Corp., N.Y., in the underwriting group and subsequently the shares of the fund were listed on the Amsterdam Stock Exchange.

*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 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.

(*a*) On March 25, 1965, the New York Stock Exchange issued a statement in which it proposed to cooperate with stock exchanges throughout the free world to ease the technical difficulties of effecting securities transactions among investors in different countries. In this statement the exchange also offered its services as a clearinghouse of international financial intelligence to American companies and securities firms to aid such companies to list their securities on overseas exchanges, develop stock participation plans for foreign employees and, generally, to broaden overseas distribution of their securities.

(*b*) NYSE ticker tapes are now in Switzerland. More important has been the growth of electronic desk devices that permit foreign brokers to "dial" bid and asked prices of NYSE stocks,. The combination of ticker tapes and desk devices are in operation in most foreign countries. In all, the number of tickers in foreign offices increased from 49 to 68 during 1964.

(*c*) Mr. Funston, president of the NYSE, recently journeyed to Australia mainly for the purpose of encouraging Australian investment in American securities.

(*d*) The NYSE is currently planning a booklet to be published in several foreign languages outlining the advantages of investment in NYSE securities to foreign investors.

(*e*) NYSE is writing to all foreign exchanges requesting information on their listing requirements and hopes to work toward greater unity in standards among exchanges in this matter. In this way the NYSE is able to facilitate foreign listings by American corporations.

(*f*) Approximately a dozen U.S. corporations now print their annual reports in foreign languages; e.g., Philip Morris, GM, Morgan Guaranty, Ford, FNCB, and IBM, et cetera. Many of these corporations printed their annual reports in foreign languages for the first time in 1965. Summaries of GM's annual report are also printed in prominent foreign newspapers and periodicals.

(*g*) Merrill Lynch has offered its facilities to numerous trainees of foreign banks and brokerage houses.[2]

[2] It is noted that many New York banks and financial firms have training programs of this type. Accordingly, the several examples noted under this recommendation No. 15 are illustrative rather than exceptional.

(*h*) The "Transunit" division of Merrill Lynch in Geneva has translated and printed in several languages numerous investment reports.

(*i*) Morgan Stanley & Co. has from time to time accepted personnel of foreign banks, investment firms, and government agencies for training in its methods of underwriting and selling of securities. In addition, financial personnel of various foreign corporate clients have spent varying periods of time in the firm receiving training and orientation in U.S. financial procedures.

(*j*) White Weld has arranged for the foreign employees of its foreign offices to receive formal and practical training in New York, and has occasionally offered training to foreigners not so employed.

(*k*) The First Boston Corp. has from time to time had personnel of foreign banks and securities firms visit New York for extended periods of time, during which visits its officers and personnel explained the various aspects of its business.

(*l*) In October 1964, Smith, Barney & Co. sponsored an investment seminar in Brussels which was attended by 100 to 120 representatives of European banks. This was a research conference specifically aimed at acquainting European investment officers with surveys of American industry, including specific reference to a broad list of American companies in these industries.

(*m*) Kuhn Loeb has continued to offer personnel of foreign banks and securities firms training facilities with its firm, and has instructed them in U.S. techniques of securities analysis and dissemination of information so as to encourage broadened share ownership by foreign investors. Its trainees have come from such diverse countries as the United Kingdom, France, Germany, Belgium, Italy, and Japan.

(*n*) Loeb Rhoades translated in late 1964 into French and German a review and 5-year economic projection of conditions in the United States. This was sent broadly to banks and other financial houses overseas. To some extent the firm has been translating bulletins into French to increase the interest of nationals of the country in U.S. securities.

(*o*) Loeb Rhoades has had a steady stream of trainees of foreign bankers and brokerage firms visiting its offices for varying periods of time to undertake a training in American securities and securities markets.

(*p*) Bache & Co. disseminates a substantial volume of printed information on U.S. securities through its foreign system, supplies latest quotations on many securities to the foreign press via its wire system, and quite frequently plays host to foreign bankers and staff members of foreign securities firms for various periods of time to assist them in better understanding opportunities for investment in the United States.

## B. U.S.-BASED INTERNATIONAL CORPORATIONS

*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.

(*a*) IBM World Trade realizes the advantages of increased foreign ownership of parent company shares and, therefore, has had this stock listed on stock exchanges in Canada, Switzerland, France, and Germany. Listings on exchanges in other countries are under consideration. Collaboration with the U.S. financial community, however, was not felt necessary.

(*b*) Union Carbide has considered the possibility of local ownership of its shares in countries in which it has affiliates. Recently, one of its senior corporate officers spoke in the United Kingdom and Scotland for the purpose of interesting potential foreign investors in Union Carbide.

(*c*) Bache & Co. has consulted with various U.S.-based corporations with a view to offering its cooperation in the implementation of recommendations Nos. 18 and 19.

*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.

(*a*) Such a plan has been approved in principle by the New York Stock Exchange Board of Governors, and discussed with the SEC. However, serious questions have come up regarding the practicability of marketing the securities of U.S. corporations overseas permanently through special sales efforts.

*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.

(*a*) IBM has for some time had a plan designed to promote purchase of its stock by employees in foreign countries.

(*b*) Employees of subsidiary companies, other than Du Pont of Canada who are awarded bonuses under the parent company bonus plan, receive a portion of their bonuses in Du Pont stock as do domestic employees.

(*c*) Currently all GM executives in overseas countries are awarded as part of their bonus awards GM common stock, except in New Zealand where exchange restrictions prohibit such awards. All salaried employees in Canada participate in a savings program for the purchase of common stock and GM is actively engaged in working out ways to institute similar programs in other foreign countries.

(*d*) FNCB has made available a stock purchase plan for all its employees everywhere in the world.



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*Recommendation No. 24*

U.S.-based international corporations should consider the advantages of listing their shares on foreign stock exchanges.

(*a*) Chrysler, Hertz, and Buckingham Corp., have recently listed their shares on the London Stock Exchange. Chrysler stock is now listed on the Toronto, Montreal, Paris, and London Stock Exchanges.

(*b*) IBM has listed its shares on stock exchanges in Canada, Switzerland, France, and Germany, and has under consideration listing on exchanges in other countries such as the London Exchange.

(*c*) Lehman Corp., Libby, McNeill & Libby, and Hertz have listed on the Paris Exchange.

(*d*) Caterpillar Tractor Co. was recently listed on the Paris and the London Exchanges.

(*e*) Litton has listed on the Amsterdam and Zurich Exchanges.

(*f*) W. R. Grace has listed on the Amsterdam Exchange.

(*g*) Since July 1963, 32 Eurodollar issues totaling $448,500,000 have been listed on the Luxembourg Stock Exchange.

(*h*) In 1963 Mobil listed its shares on the Paris Bourse. The corporation has under current review the feasibility of further foreign listings of its shares.

(*i*) GM recently listed on the London Stock Exchange in connection with its March 17, 1965, secondary offering. GM common stock has for several years been listed on two exchanges in Canada, two exchanges in Germany, and on the Paris and Brussels Exchanges.

(*j*) FNCB has listed on the London (prior to April 1964), Amsterdam, Montreal, and Toronto Exchanges (August 1964).

(*k*) Union Carbide shares are listed on stock exchanges in Amsterdam, Brussels, Antwerp, and Paris, and under active consideration is a listing on a German stock exchange. Stock of subsidiaries are listed on stock exchanges in Australia, Brazil, Canada, India, and Mexico.

(*l*) In addition to assisting a few U.S. companies with listing on foreign stock exchanges, White Weld has prepared and made available to most of the large New York banks, and to international law firms, details on the procedures for listing American stocks on the principal European stock exchanges.

(*m*) The First Boston Corp. has from time to time advised and encouraged the listing abroad of the stock of several corporations.

(*n*) A number of Kuhn Loeb's corporate clients have been considering the advantages of listing their shares on foreign stock exchanges, and the firm has assisted them in evaluating the cost and other factors necessary to arrive at a decision on such listing.

(*o*) Celanese has recently listed its stock on the Amsterdam Exchange.

*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.

(*a*) IBM World Trade, Standard Oil (New Jersey), Du Pont, Union Carbide, and GM report that senior officers have been so instructed, etc.

(*b*) The treasurer's department of Socony Mobil prepares regularly for senior management a review of all operations of the corporation which have a bearing on the U.S. balance of payments.

*Recommendation No. 26*

U.S.-based international corporations should, where feasible, finance their foreign operations in a manner which minimizes the outlay of cash.

(*a*) GM is planning to finance a new plant in Antwerp. The required funds will be provided by retained earnings and borrowings in local currency to be repaid out of future earnings. The company has not released figures indicating the amounts involved, but newspapers have noted that the project could involve expenditures equivalent to approximately $100 million. Borrowing arrangements are now being negotiated by the company. It is expected that the major part of the borrowing will be in the form of 5-year loans by Belgium's Societe Nationale de Credit a' L'Industrie and a consortium of banks in Belgium. Under the provisions of Belgium's 1959 incentive law, the Government has agreed to grant a reduction of 2½ percent in the rate of interest to be charged during the first 2 years on one-half of the long-term borrowing.

(*b*) IBM World Trade has for some time sought to make maximum use of foreign source financing and hopes to increase such this year.

(*c*) Chrysler is planning approximately $250 million of expenditures overseas in 1965 and 1966, principally in Australia, France, Canada, and South Africa. The company has stated that substantial funds for such expenditures will come from reinvestment of earnings of foreign subsidiaries or from borrowing outside the United States.

(*d*) Hilton International has scheduled five new hotels for opening in 1965, all of which will make use of foreign capital for fixed assets. Hilton will provide working capital and accept a lease for operating the units.

(*e*) Kennecott Copper Co. is working on an agreement with the Chilean Government under which capital for expansion of the Braden Mine will be supplied by the Government and by international lending agencies.

(*f*) Ford Motor Co. is expected to announce an £8 million sterling long-term debenture by its Australian company. Carrying at least 7¼ percent interest, this debenture will be guaranteed both on capital and income by the parent company.

Henry Ford 2d has said that the company plans to finance virtually all of its expenditures for foreign facility investments in 1965 through funds generated outside the United States, and that these expenditures are estimated at about $300 million.

(*g*) Socony Mobil has formed a subsidiary company, Mobil Oil Holdings S.A., in Luxembourg, specifically to raise funds overseas. The funds will be used to assist in financing the capital needs of Mobil affiliates outside the United States. None of the securities of the new subsidiary will be offered for sale in the United States. On June 16, 1965, Mobil announced completion of arrangements to raise the equivalent of nearly $28 million through the public issuance of bonds by such subsidiary. The bonds will carry an interest coupon of 5¾ percent and be offered at a price of 97 to yield approximately 6.05 percent to maturity. The bonds will not be offered for sale in the

United States and purchasers will have the option of receiving payment of principal or interest in sterling or German marks at a fixed rate of 11.17 DM to the pound.

Socony Mobil is also negotiating a 15-year bond issue with S. G. Warburg, London bankers, in the approximate amount of 10 million pounds sterling.

All in all, the company reports that the net increase during 1964 of its overseas borrowing was almost $50 million, and that a further substantial net increase in such borrowing is anticipated in 1965.

(*h*) Westinghouse Air Brake has stated that it intends to raise 1.6 million pounds sterling outside of the United States.

(*i*) Du Pont notes that in some cases it has rented plant sites rather than purchased them.

(*j*) FNCB's two foreign investment affiliates (First National City Overseas Investment Corp. and International Banking Corp.) have in the last 18 months set up financing affiliates in the United Kingdom, Spain, Philippines, New Zealand, and South Africa which, for modest initial dollar investments, make available many multiples of financing to U.S.-based international corporations.

(*k*) General Foods Corp. borrowed money abroad to finance its recent acquisition of a controlling interest in a coffee business in Spain.

(*l*) Armstrong Cork Co. is revising financing of projects in Britain and West Germany to include more foreign source borrowing.

(*m*) Continued heavy capital expansion of the foreign subsidiaries of Honeywell, Inc., in 1965 is being financed by borrowings outside of the United States.

(*n*) Standard Oil Co. of California will maximize usage of foreign currencies to finance its 1965 capital and exploratory outlays.

(*o*) CIT Financial Corp. is planning a private placement of two issues of notes totaling $95 million. The notes are to be sold in Canada for Canadian dollars, proceeds to be used to finance expansion by the company's Canadian subsidiary, Canadian Acceptance Corp.

(*p*) In October 1964 a 25-percent interest (2,500,000 shares at $24 per share) in the wholly owned major Canadian operating subsidiary of Union Carbide (Union Carbide of Canada, Ltd.) was sold to the Canadian public. This subsidiary now has approximately 13,000 Canadian stockholders. The company plans to raise funds for its European expansion from European banks wherever possible.

(*q*) The Treasury Department has summarized by industry the responses of U.S. corporations to the Commerce Department's program for business concerns under the President's balance-of-payments program as follows:

1. *Mining.*—There are several firms with large mining ventures where the total costs range from $100 to $200 million. In the typical case they expect to obtain about one-third of the total requirement abroad. They have had some success in getting loan commitments from banks in the host countries, but this will provide little additional for the future. The typical company mentions borrowings of over $20 million in Europe, but there are indications that they are having difficulties, especially where they had counted on the United Kingdom money markets. Any financing from Japan is tied in with Japanese equity in the venture.

2. *Manufacturing.*—Manufacturers of durable goods will individually borrow from $3 to over $20 million abroad through local foreign banking and other credit facilities. Funds will be obtained primarily in the United Kingdom, Germany, Canada, Belgium, and Switzerland. In cases where commitments were listed, a total of $10 million will be borrowed in Belgium, $4 million in the United Kingdom, and $2 million in Germany. It was noted that oversea borrowing by foreign subsidiaries has become difficult because of heavy previous borrowing.

3. *Rubber.*—Rubber companies have been substantial borrowers of funds abroad. A typical company hopes to borrow about $20 to $30 million abroad in 1965 to finance new construction, expansion, and modernization of foreign affiliates. Funds will be obtained largely through short or long-term bank credit in host countries.

4. *Transportation equipment.*—Manufacturers of automobiles, automotive products, and other transportation equipment will borrow heavily abroad during 1965. In some cases, foreign financing will exceed $50 million. Funds will be secured primarily from Germany, France, and the United Kingdom. In keeping with traditional policy, foreign expenditures will be restricted to amounts which can be financed through loans in local currencies and cash flows generated abroad.

5. *Petroleum.*—The international oil companies have large outstanding foreign credits, but only a few companies expect important net increases. Where increases are indicated they will involve drawings under standby agreements with British, Dutch, and Swiss banks. A large corporate bond issue has been considered in the German market. One company indicated the intention to borrow nearly $100 million during 1965.

6. *Chemicals.*—Some chemical firms have given a good deal of study to foreign borrowing and have investigated a variety of arrangements. Borrowing by local affiliates is being buttressed by parent company guarantees in the case of one major firm. Insurance company loans, leaseback arrangements and mortgage possibilities have been considered in addition to bank loans. A firm with an active investment program underway has loan commitments totaling $30 million from Italian, British, and French banks. Typical borrowing mentioned by chemical companies were for small net increases in bank credit from a variety of sources. Equity financing is being used extensively in this industry, including even some of the less-advanced countries such as Spain.

(*r*) The Federal Reserve Bank of New York states that the U.S. banking system and nonbank financial institutions have responded wholeheartedly to the voluntary restraint program. As a result, the growth of bank credit has been effectively restricted and the balance-of-payments position has greatly improved.

(*s*) Du Pont of Canada, Ltd., recently offered 500,000 shares at $53.50 per share ($26,750,000) to Canadian investors.

(*t*) Scott Paper of Canada, Ltd., recently offered 35,400 shares at $26.25 per share ($929,250) to Canadian investors.

*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.

(*a*) IBM World Trade has issued debentures in France, Italy, and the United Kingdom.

*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.

(*a*) IBM World Trade has so cooperated by participating in the American Management Association seminars on the financing of foreign operations.

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MANUFACTURING CHEMISTS' ASSOCIATION, INC.,
*Washington, D.C., June 30, 1965.*

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*House of Representatives, Washington, D.C.*

DEAR MR. CHAIRMAN: The Manufacturing Chemists' Association, Inc., wishes to present its views regarding the provisions of H.R. 5916, a proposed act to remove tax barriers to foreign investment in the United States. The association is a nonprofit trade association of 196 U.S. member companies, large and small, that together account for more than 90 percent of the productive capacity of the chemical industry in this country.

Many U.S.-based international corporations have deemed it both advantageous and in the national interest to finance their foreign operations in a manner which minimizes outlays of U.S. dollars. This action has been taken in response to the President's request for the cooperation of the business community in alleviating the deficit in the U.S. balance of payments and is consistent with recommendations 25, 26, and 27, of the report to the President from the task force on "promoting Increased Foreign Investment in U.S. Corporate Securities and Increased Foreign Financing for U.S. Corporations Operating Abroad".

In recent months there has been an indication of increased offerings of bonds in foreign capital markets as specifically suggested in recommendation No. 27 to raise funds for expansion of business operations abroad without detriment to the U.S. balance-of-payments position. As an inducement to foreign purchasers it was noted in the commentary on recommendation No. 27 that, since the issuer of the securities would be a foreign subsidiary, the purchaser would not have to cope with U.S. tax problems.

In making such offerings U.S. corporations have not always found it expedient to have each of their foreign subsidiaries issue securities abroad, but rather to centralize issuance in one entity established for the purpose of financing the subsidiaries in that manner. In addition,

it may be preferable to establish such an international financing organization in the Unied States rather than abroad. Under the present estate tax law of the United States with respect to debt obligations, this can be done without subjecting the estate of a nonresident alien purchaser of the securities to such tax. The law now provides that bonds situated outside of the United States on the date of the nonresident decedent's death are not subject to imposition of U.S. estate tax.

Paragraph (c) of section 8 of H.R. 5916 would change the estate tax situs rule of section 2104 of the Internal Revenue Code of 1954 to provide that debt obligations owned by a nonresident alien shall be deemed to constitute U.S. situs property "if issued by or enforceable against a domestic corporation." This, in fact, would extend the rule presently applied in determining situs of stock of a domestic corporation to debt obligations issued by such entity. Therefore, under this new rule the estate of a nonresident decedent containing bonds issued by a domestic company would for the first time be subject to U.S. estate tax liability.

Although, under the other provisions of the proposed act, the estate tax liability of foreigners owning U.S. property at death would generally be modified favorably and although such provisions would cushion the impact of the broadening of the estate tax base to include U.S. issued bonds, foreign investors understandably are interested in avoiding any estate tax liability in the United States. This consideration may well have a detrimental effect upon a nonresident alien's decision to participate or not to participate in a bond offering abroad by a U.S. corporation. As noted in recommendation 29 of the task force report, "The U.S. estate taxes * * * are believed to be one of the most important deterrents in our tax laws to foreign investment in the United States." Accordingly, the proposed change in the situs rule with respect to bonds is directly contrary to recommendation 29 in which the elimination of U.S. estate taxes on "all intangible personal property of nonresident alien decedents" was proposed.

In view of the Treasury Department's interest in the continuing improvement of this country's balance-of-payments position, tax barriers should be removed from the path of those directly or indirectly contributing to the improvement of that position. To this end, it is urged that recommendation 29 of the task force report be effectively implemented by providing that all intangibles situated outside the United States at the date of a nonresident alien's death be excluded from such decedent's gross estate. This solution would seem to constitute the most effective and simplest method of inducing foreigners to invest here.

It is worthy of note that the estate tax rules contained in the proposed act on the situs of bonds and other securities do not apply for purposes of determining a bona fide nonresident alien's gift tax liability. In fact, under H.R. 5916 the gift tax situs rules would be liberalized with respect to stock issued by a domestic corporation to provide that the nonresident alien will never under any circumstances be subject to gift tax liability on the transfer of intangibles. It is urged that a consistent rule should apply for the purpose of subjecting a nonresident alien to estate tax, particularly in view of the close relationship between the two taxes.

In conclusion, we recommend that H.R. 5916 be revised so that exemption be granted with respect to any intangibles owned by a nonresident alien decedent at his death as provided in recommendation No. 29 of the task force report. However, if total exemption with respect to all intangibles is not considered feasible, it is suggested that the proposal contained in H.R. 5916 to amend the situs rule on debt obligations be rejected and that the present law on the subject be retained.

The Manufacturing Chemists' Association, Inc., appreciates this opportunity of presenting its views on H.R. 5916 and requests that this letter be made a part of the record of hearings on the bill.

Very truly yours,

M. F. CRASS, Jr.,
*Secretary-Treasurer.*

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NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.,
*Washington, D.C., June 25, 1965.*

Re H.R. 5916, act to remove tax barriers to foreign investment in the United States.

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means, U.S. House of Representatives, Longworth House Office Building, Washington, D.C.*

DEAR MR. MILLS: While the association does not have a formal statement to submit on H.R. 5916, we support the purposes of the bill to stimulate foreign investment in the United States by removing existing tax barriers to such investment. We believe it is a constructive approach to improve the U.S. balance-of-payments problem and and should have an overall beneficial effect on the U.S. financial community.

Very truly yours,

ROBERT W. HAACK, *President.*

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NATIONAL FOREIGN TRADE COUNCIL, INC.,
*New York, N.Y., June 24, 1965.*

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*House of Representatives, Washington, D.C.*

DEAR MR. CHAIRMAN: The National Foreign Trade Council, Inc., is pleased to respond to your invitation of June 18, 1965, to submit written statements on H.R. 5916, the act to remove tax barriers to foreign investment in the United States.

As you know, the purpose of the bill is to carry out certain legislative recommendations of a Presidential task force, headed by then Under Secretary Fowler, appointed to advise on ways in which more U.S. securities could be sold abroad to help meet the balance-of-payments problem.

The National Foreign Trade Council recommends enactment of H.R. 5916. As the report of the task force indicates, adoption of such legislation would "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." In so doing, the U.S. balance of payments would be bettered, and long-range benefits to U.S. corporations operating abroad would also result.

The council is of the opinion that the objectives of H.R. 5916 could be more fully attained if the bill were modified somewhat. A summary of our recommendations in this respect is contained in appendix I.

The task force report also contained certain other recommendations, addressed to the financial and business community, as to certain actions it could take to assist in achieving the objective. In this connection, the council earlier this year sent to a number of its members, with substantial operations outside the United States, a questionnaire concerning the recommendations in the report of the Fowler task force designated "Actions Involving U.S.-Based International Corporations." A summary of the responses is contained in appendix II for your information.

Sincerely yours,

JOSEPH B. BRADY,
*Vice President.*

APPENDIX I

SUGGESTED CHANGES TO H.R. 5916

*Taxation of estates of nonresident aliens*

The most desirable change in connection with the taxation of estates of nonresident aliens which could be added to the bill is that recommended in the report of the Fowler task force; namely, that the bill should "eliminate U.S. estate taxes on all intangilbe personal property of nonresident alien decedents." Any tax on estates of nonresident decedents, particularly those with comparatively small amounts of property in the United States, could form an obstacle to investment in U.S. securities. Even if the present provisions of the bill were enacted aliens may well be concerned that the 5-, 10,- and 15-percent rates might be increased.

If H.R. 5916 as introduced were enacted, taxes on estates of nonresident aliens could be avoided by the formation of a corporation to hold any property of such aliens. However, since the formation and maintenance of a corporation is complicated and expensive this procedure would appeal only to aliens with large amounts of property in the United States, and not to aliens with small or medium amounts of property in the United States. It is believed that the changes in the bill are intended especially to induce the latter group to invest in the United States.

*Graduated taxes—Filing of return should not be required*

Recommendation 30 of the Fowler report concerning the imposition of graduated tax on aliens has been implemented by the Treasury proposals and provisions of H.R. 5916. However the bill should contain an affirmative statement to the effect that where the nonbusiness income of a nonresident alien, not engaged in trade or business, is subject to withholding, no return need be made by the alien. Possibly the bill as introduced imples that in such a situation no return need be made. However, in order to avoid any misunder-

standing it would be desirable to have the bill so provide. A second choice would be to have a statement contained in the report of the Committee on Ways and Means to the effect that it was anticipated that regulations of the Internal Revenue Service should so provide.

*Engaged in trade or business—Dealer in securities*

Proposed section 871(c), H.R. 5916, as introduced, defines "engaged in trade or business within the United States." It provides that the term does not include "certain trading in securities or commodities" (871(c)(2)). However, there seems to be excepted from this exemption situation "where the person so trading is a dealer in securities."

This provision of the bill, as introduced, is contrary to one of the basic proposals of the report of the Fowler task force, reflected in several recommendations; namely, that foreign security dealers should be encouraged to participate in the marketing to foreigners of U.S. securities. The bill as introduced could be so interpreted as to provide a real obstacle to any activity in the United States of any foreign dealer in securities. It is urged that the Committee on Ways and Means take appropriate action to correct the provision as now contained in the bill.

## APPENDIX II

### SUMMARY OF RESPONSES TO NFTC QUESTIONNAIRE RELATING TO CERTAIN RECOMMENDATIONS IN THE FOWLER TASK FORCE REPORT

*Recommendations 3, 10, 18, 19, 22, 24*

Some of the more significant replies to this set of recommendations, all of which generally are concerned with the making available for distribution abroad of shares of U.S. corporations are set forth below.

> In the principal financial markets where investment in U.S. securities is permitted and practiced appreciably the company's shares are now readily available through either (1) current listings on foreign stock exchanges; (2) active trading on an unlisted basis; or (3) ready access to the New York markets.
>
> Company's stock is listed on Zurich Exchange where U.S. stock certificates endorsed in blank are good delivery. Company's stock was previously listed in Amsterdam and Brussels, where depositary receipts in bearer form were issued by local trust companies. Company is also contemplating issuing its annual report in several foreign languages.
>
> The company's common stock is now traded in on about eight European markets. Several foreigners are now shareowners in the company. Depository receipts for the company's stock are now offered by at least two European banking firms.
>
> Parent company shares available to local residents in all countries in which company has affiliates. Company has pointed out to government and industrial leaders in these countries that they could participate in the enterprise through the ownership of shares.

The company's shares are presently listed on four foreign exchanges (London, Paris, Toronto, and Montreal) and the company is planning to list its shares in Switzerland.

With respect to increasing foreign ownership of U.S. parent company shares, the company has long recognized that there may be benefits associated with wider ownership of its shares, such as increased sales of its products and a reduction in discrimination on the part of some countries against companies owned by foreigners. However, their experience has been that it is difficult to distinguish in the countries where the company has been listed any significant increase in sales or reduction in discriminatory practices which can be attributed solely, or even in part, to listing. Accordingly, the company has been willing to list its shares on foreign exchanges where it is possible to do so at a reasonable cost, but has been reluctant to do so where it entails significant costs as has sometimes been the situation. The company's shares are currently listed and/or traded on several foreign exchanges.

Company does collaborate with U.S. financial community in encouraging foreign ownership of its shares.

Company collaborates by listing its shares on foreign exchanges and by promoting the company abroad.

Company has collaborated with the U.S. financial community in encouraging greater foreign ownership of its shares. A large secondary offering of the company's common shares was successfully placed abroad. The company has recently made available to various representatives of the financial community, as well as others interested in this area, copies of its annual report in condensed form for distribution abroad in several foreign languages. During 1964 the company added additional foreign languages in which its report was published. Also the company has had summaries of the report printed in prominent foreign newspapers and periodicals. The company has distributed these reports to a number of other American companies and there are indications that many of them will also prepare foreign language versions.

Company has traditionally used foreign sources of debt financing. Company has also engaged in public borrowing on the Swiss capital market. Company's Swiss subsidiary issued a large debenture issue in Switzerland, which was underwritten by a Swiss banking syndicate, sold publicly and listed on several Swiss stock exchanges. Company is also on the waiting list for a new Swiss franc debenture issue but the Swiss monetary authorities are rationing long-term Swiss capital and at this time the company cannot predict when their next issue may be offered.

Parent company's shares are listed on several foreign stock exchanges. Also the company is actively investigating the possible listing of its parent company shares on other foreign stock exchanges.

Company expects its stock to be listed on two foreign stock exchanges shortly. It also expects to be listed on the French Stock Exchange unless recent proposed French legislation makes it inadvisable to do so. Company is planning to list its stock on several other foreign stock exchanges in the near future unless it develops that local regulations make it inadvisable to do so.

Company has also made inquiries regarding the possibility of listing on Australian and Brazilian exchanges; however, company has been informed that the Governments of those countries will not permit it at this time.

*Recommendation No. 23*

This recommendation concerns the specific technique of U.S. corporations offering shares to their employees in foreign countries.

Company has or is in the process of offering shares to employees in foreign countries under incentive stock purchase plan.

Shares have recently been made available for purchase by employee members of a provident fund in one foreign affiliated company.

Company has for some time offered shares to both U.S. and foreign resident employees as well as many nationals. Program is part of company's worldwide stock option plan.

Employees of subsidiary companies (excluding Canada) who are awarded bonus under parent company bonus plan receive a portion of these awards in the company's stock exactly the same as domestic employees.

Company offers its shares to employees in foreign countries through two foreign employee savings thrift plans involving parent company stock.

For many years Canadian salaried employees of company who participate in its incentive program have received shares of company's common stock as part of their awards. This program was expanded to include overseas participants in company's incentive program within the last few years and currently stock is awarded as part of their bonus awards to executives in all overseas countries, except New Zealand where exchange restrictions do not permit. Company's salaried employees in Canada have been participating for a number of years in a savings program for the purchase of common stock.

There are, of course, impediments in many countries to such a program. Company has been actively engaged for several years in studying the problems and hopes in the near future to work out methods for similar programs in some of the other countries where it has principal interests.

Company's stock purchase plan is not restricted to U.S. employees; company now has many foreign participants in the plan.

In addition, stock options are, from time to time, offered to foreign employees.

*Recommendations 25 and 26*

These recommendations which concern the instruction of senior officers to review financial operations from the standpoint of their effect on the U.S. balance of payments and also that U.S. corporations, where feasible, should finance their foreign operations in a manner which minimizes the outlay of cash, are considered together. Some of the significant responses to these questions are as follows:

A major responsibility of senior personnel is to examine all new financing proposals from the standpoint of their effect on the U.S. balance of payments. It has been the company's policy for many years for all investment abroad to be financed through foreign borrowings and earnings; this policy will be continued in the future. Recent statement by President Johnson and amplification by Secretary Connor makes it more important than ever that all American companies cooperate to the fullest extent in this effort.

Prior to February 1965 little attention was paid to the problem. Henceforth it will receive highest level attention, and maximum foreign financing will be sought for most major projects.

For a long time the company has been alert to the U.S. balance-of-payments implications of its worldwide investment program. In this respect, the company is very conscious of the significant positive contribution its overseas operations made to the U.S. balance.

The company has sought all along to maximize the contribution it can make to the American balance of payments, and has carefully reviewed its foreign financial operations with this objective in mind. The company intends to support fully the new program recently outlined by President Johnson.

Company has made a definite point of instructing all the groups in company that are involved in this decision area, both in the United States and abroad. The company has reexamined and will continue to reexamine its policies and practices controlling international transactions in an effort aggressively to do its part in solving the U.S. balance-of-payments problem.

The company is participating in the President's voluntary program to improve the U.S. balance of payments. One of the ways in which they are contributing to the program is to review carefully any new financing of overseas operations. Whenever practical, financing will be obtained abroad and every effort will be made to minimize cash outflows which would hurt the U.S. balance of payments.

Company has been cooperating fully with the President's voluntary program to reduce the U.S. balance-of-payments deficit.

Company has an internal system which produces a balance-of-payments ledger so that all transactions may be examined in light of the effect on the balance of payments. Company's estimate for the year 1965 shows that it should be able to meet the guideline improvement, in its favorable balance-of-payments contribution, suggested by the Department of Commerce.

Since the general realization of the seriousness of the American problem concerning its balance of payments and the President's appeal for industry cooperation, company has been examining, as standard procedure, all of its foreign operations requiring new investments to seek the alternates that will minimize the problem.

Company has been traditionally taking opportunities of financing to a very large extent its foreign operations from funds generated outside the United States. It has also been company's policy to invite foreign participation in its new ventures in many instances and in this way provide the additional financing required to expand its foreign operations.

Company's proposed new foreign projects do include, without exception, provision for extensive local borrowing as well as local participation in equity.

Company has earnestly tried to comply with the President's request concerning action to improve the U.S. balance-of-payments position, and, to that end, will certainly make much more serious efforts in the future to find foreign sources for capitalizing proposed foreign ventures.

Company examines opportunities to minimize the outlay of cash. In some cases, for example, the company has rented plant sites rather than purchased them. It has also endeavored to obtain "Cooley loans" without, however, ever having any success in this respect due to unwillingness of the local governments, in countries such as Brazil, to make these funds available to U.S.-owned companies.

In the past, the company has generally preferred to finance its foreign operations from retained earnings and fresh capital from the United States. Company is utilizing some local borrowing and is now considering extending local coverage.

Company's overseas affiliates normally rely heavily on their respective internally generated funds and local borrowing sources for their financial requirements.

Company noted that this recommendation has been superseded by the program of voluntary cooperation to improve the U.S. balance of payments. The company intends to comply and hopes to achieve an improvement of 15 to 20 percent over 1964 in the company's balance of payments for 1965.

As a matter of long-standing policy, the company has relied on local sources to meet the financing requirements of its overseas investments, principally by retained earnings or

by local borrowings. The company plans to continue this policy.

It has been the practice of the company, wherever practicable, to minimize the outlay of U.S. dollars and to finance foreign operations in foreign currencies.

The company follows the practice in several foreign countreis, accepting the burden of higher interest rates to make this possible. To the extent that foreign currencies are available, the company expects to continue to finance foreign operations in this manner.

The company has sought to do this in one foreign country but has not been successful. However, the company hopes to change this, and is now attempting to arrange sources of financing in the local currency.

The company noted that it has been active in connection with all recommendations of the Fowler task force. Particular emphasis, however, has been directed to the financing and ownership of foreign operations. It has always been the policy of the company to encourage local participation in the ownership of operations outside the United States and in practically all instances there is such ownership. In addition, these foreign operations are financed as largely as possible through local borrowings and the expansion of these operations has been on the basis of funds generated locally.

During 1964 company undertook to increase its overseas borrowing in the so-called developed areas by a substantial margin. In line with the recommendations of the Fowler task force and, more recently, the President's voluntary program to assist the balance of payments, the company intends for the future to make every reasonable effort to finance its overseas investments from foreign sources. A further substantial net increase in borrowing is anticipated in 1965.

Company is aware of the desirability of minimizing the outlay of cash in the financing of foreign operations. In many instances, a large amount of the fixed investment in new manufacturing plants is represented by machinery shipped from the United States. In addition, where feasible, company strives to take advantage of inducements offered by governments in the establishment of new manufacturing facilities, which will minimize the use of cash from the United States.

*Recommendation 27*

This recommendation concerns the offering in foreign markets of bonds or preferred stock of U.S. corporations convertible into common shares.

The response to this particular recommendation was comparatively unenthusiastic—typical of the replies are the following:

Recommendation does not appear practical to company at this time because conversion of securities issued by foreign

affiliates into common stock of the parent company in the United States would create serious legal and accounting problems.

Company has studied the feasibility of such a proposal in the past. There are a number of impediments which must be overcome. The company is continuing to study the matter with a view toward its eventual implementation where circumstances permit if the impediments can be satisfactorily resolved.

The company has not carried out the actions suggested in the recommendation and does not have any plans for such action in the near future. The company noted that this recommendation appears to have too many complications and possible tax disadvantages.

*Recommendation 28*

This recommendation concerns making available information concerning foreign financing to companies interested in foreign operations but less aware of foreign-financing opportunities. Some of the responses to this recommendation follow:

The company has been and will continue to assist small- or medium-sized firms by answering direct inquiries for specific information or by supplying answers to questions such as those submitted by NFTC.

Members of the company's organization have frequently been called upon by business schools, management seminars, and official conferences to share the benefit of the company's long experience in international finance with others more recently engaged in a foreign investment program. The company noted that they are happy to take part in these educational seminars.

The company has carried out this recommendation through the preparation of case studies, participation in management seminars, and is prepared to do more, if requested.

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STATEMENT OF G. KEITH FUNSTON, PRESIDENT, NEW YORK STOCK EXCHANGE, ON H.R. 5916

The New York Stock Exchange welcomes this opportunity to comment on the proposed tax legislation embodied in H.R. 5916 and entitled "An act to remove tax barriers to foreign investment in the United States." The legislation incorporates, in large part, the recommendations of the Presidential Task Force on the Balance of Payments (the Fowler committee report), of which the exchange president was a member. Adoption of this legislation would do much to stimulate the long-term flow of foreign capital to the United States, in part by removing archaic restrictions on these capital flows. The securities industry has long advocated removal of these restrictions. The exchange applauds the fact that the administration proposals will enhance the freedom of movement in the international flow of capital funds.

The legislation as written can be strengthened in several ways, though, as discussed below, and moved closer to its objective of providing greater stimulus to foreign investment. In addition, the effectiveness of a program to encourage foreign investment in U.S. securities may be enhanced by adopting several measures not included in the tax bill.

First, concerning the bill itself, the exchange suggests the following adjustments:

1. *Elimination of estate tax on nonresident aliens.*—Section 8 of the bill proposes that estate tax rates be reduced to 20 to 30 percent of present levels, thereby taxing nonresident aliens at about the same rates as U.S. citizens who claim a marital deduction. This proposal stops considerably short of the Fowler committee recommendation to "eliminate U.S. estate taxes on all intangible personal property of nonresident alien decedents." Though the proposed rates would be below those imposed on resident estates in the United Kingdom, Canada, and Italy, they would be higher than those imposed in Switzerland, Germany, France, and the Netherlands. Thus, the proposal favors the residents of some countries while discriminating against those of others.

The complete elimination of estate taxes would result in a much greater stimulus to foreign investment than any partial reduction in rates. First, since even the proposed tax rates are higher than those now levied in many other countries, this deterrent to investment by residents of those countries would remain. Second, many foreigners are discouraged from investing here by the requirement to file estate tax returns. This requirement would, of course, be eliminated if the tax were removed.

Eliminating the estate tax on nonresident aliens would result in a very small loss of revenue. The tax has yielded between $3 and $5 million annually in recent years, and would probably yield only about $1 million under the proposed legislation.

Even if the rate schedule proposed in the bill is adopted, all estates of over $2,000 will apparently still be required to file a return despite an increase in the exemption from $2,000 to $30,000. Again, since the filing requirement discourages foreign investment, the exchange suggests that estates of under $30,000 be exempted from reporting.

In addition, if it is administratively feasible, section 2105 of the Internal Revenue Code should be amended so that all funds awaiting investment would not be considered property within the United States for estate tax purposes. Nonresident aliens' deposits in banks and savings and loan associations are not considered property under the proposed legislation, and this exemption might appropriately be extended to their free credit balances with brokers.

2. *Definition of "engaged in trade or business."*—The legislation proposes to amend section 871, subsection c of the Code, to (*a*) exclude from the term "engaged in trade or business within the United States," "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" and (*b*) to apply a similar exclusion to those trading in commodities for their own account.



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The New York Stock Exchange sees no reason for considering a securities or commodities dealer as engaged in business in the United States if he grants discretionary authority to an agent in a trade for his own account. The exchange recommends, therefore, that the phrase "except where the person so trading is a dealer in securities [or commodities]" be stricken from the bill.

3. *Repeal of withholding on interest and dividend payments.*—Consideration might be given to unilateral repeal of the withholding tax on interest and dividends paid to foreigners, or to the reduction of the percentage withheld. The withholding tax clearly deters investment by foreigners, and its repeal or reduction would appreciably stimulate foreign purchases of U.S. securities.

If the potential revenue loss makes unilateral action undesirable (the U.S. obtained, perhaps, $100 million from the withholding tax in 1964), the U.S. should press for mutual reductions in the withholding tax with as many foreign countries as possible. Since transactions in outstanding securities have generally produced an inflow of funds to the United States, mutual reductions in the withholding rate would probably stimulate more foreign purchases of U.S. securities than U.S. purchases of foreign securities—except for the temporary adverse effect of the interest equalization tax.

4. *Easing taxes on foreign pension trusts.*—Taxes and other restrictions imposed on foreign pension trusts and similar investors should be eased. Domestic pension funds enjoy a tax exemption on their investment income. Foreign pension funds cannot obtain this exemption without going through the difficult procedure of obtaining approval from numerous Government agencies. As a result, these investors are discouraged from investing here, especially if they are exempt from taxes in their country of domicile.

Pension funds in some foreign countries have become increasingly important in recent years. For example, the Joint Economic Committee study of European capital markets indicates that pension funds in Britain have been one of the most rapidly growing sectors in that country's financial structure, and had investments of $10 billion at the end of 1962.[1] It seems reasonable to assume, therefore, that by according foreign pension funds a tax treatment similar to that enjoyed by domestic funds, a considerable capital flow into the United States might be stimulated. Further, we assume that Treasury regulations can provide safeguards necessary to prevent any abuse of this legislation.

Consequently, taxes on the income of foreign pension funds and similar institutional investors should be eliminated by law; alternatively, these investors should be able to obtain tax exemption more readily. As a minimum step, the United States should work toward the mutual elimination of taxes on these types of investors.

The exchange believes that adoption of these amendments and additions would enhance the effectiveness of the proposed legislation considerably.

Respectfully submitted.

G. KEITH FUNSTON,
*President, New York Stock Exchange.*

[1] U.S. Congress, Joint Economic Committee, "A Description and Analysis of Certain European Capital Markets," 1964, p. 238.

NEW YORK, N.Y., *June 24, 1965.*

WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*U.S. House of Representatives,*
*Washington, D.C.:*

Concur with all provisions of H.R. 5916 on removal of tax barriers to foreign investment in the United States with the exception of limited exemption in case of taxable estate we prefer recommendation No. 29 of report of Fowler task force and strongly urge complete elimination of estate taxes on all intangible personal property of nonresident alien decedents. It is our opinion that this tax is the major deterrent to foreign investors, participation in U.S. investments.

REAL ESTATE TRADE MISSION TO EUROPE,
J. D. SAWYER, *Chairman.*

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SHEARMAN & STERLING,
*New York, June 25, 1965.*

H.R. 5916: Act to remove tax barriers to foreign investment in the United States.

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*U.S. House of Representatives, Washington 25, D.C.*

DEAR SIR: Pursuant to your request for statements with respect to the above legislation, I enclose a copy of a memorandum I submitted to Hon. Stanley S. Surrey, Assistant Secretary of the Treasury, under date of May 12, 1965. You will note that a change was suggested in H.R. 5916 to eliminate an inequity to one of our clients, Schlumberger, Ltd., a foreign corporation with its principal office in the United States. Schlumberger, Ltd., which has annual revenues in the magnitude of $300 million, is listed on the New York Stock Exchange and a check for interest equalization tax purposes established that more than 65 percent of its outstanding stock is owned of record by U.S. persons.

Historically, Schlumberger, Ltd., has never derived any benefit from the provisions of the income tax treaty between the United States and the Netherlands because it is resident in the United States. H.R. 5916 would make the provisions of the treaty applicable for the first time to Schlumberger, Ltd.'s dividend income from its U.S. subsidiaries. This would have the effect of increasing the U.S. tax rate from 7.2 to 30 percent on dividends from a U.S. holding company subsidiary owning U.S. operating subsidiaries, despite the fact that such earnings had already been subjected to U.S. income tax at ordinary rates on a consolidated return. The tax could not be avoided by including Schlumberger, Ltd., in the consolidated return because it is a foreign corporation, ineligible to be a member of an affiliated group for U.S. tax purposes.

Very truly yours,

CHARLES GOODWIN, Jr.

SHEARMAN & STERLING,
*New York, N.Y., May 12, 1965.*

Memorandum to Hon. Stanley S. Surrey, Assistant Secretary of the Treasury.

Subject: H.R. 5916 and article 7 of the Income Tax Treaty between the United States and the Netherlands.

The purpose of this memorandum is to point out an inequity in article 7 of the Income Tax Treaty between the United States and the Netherlands (the "treaty") when considered in conjunction with the proposed legislation concerning taxation of foreign investments ("H.R. 5916").

The problems arises because under section 4 of H.R. 5916 dividends paid to a Netherland-Antilles Corp. which owns the stock of a U.S. holding corporation, which in turn owns the stock of U.S. operating corporations, will be taxed at a 30 percent rate although under article 7 of the treaty the rate of such tax would be limited to 5 percent if the Netherland-Antilles Corp. owned the stock of the U.S. operating company directly.

Schlumberger, Ltd. ("SL") is a Netherland-Antilles Corp. which commenced business in 1957. At the time SL was organized an Internal Revenue Code, section 367, ruling was obtained to the effect that the exchanges involved in such organization were not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax. SL is sole stockholder of two U.S. corporations each of which has U.S. subsidiaries. Since SL is a foreign corporation, the U.S. companies have not been permitted to file a single consolidated return. For various management and business reasons and in order to permit the filing of a single consolidated return SL proposes to combine its U.S. subsidiaries into a single affiliated group under a U.S. holding company. In the absence of the proposed plan of reorganization, SL would qualify under H.R. 5916 and the United States-Netherlands Income Tax Treaty for the 5-percent tax on dividends received from its U.S. operating subsidiaries.

However, under the protocol of September 28, 1964, article 7 of the treaty (which limits the tax on dividends to 15 or 5 percent) is made inapplicable to dividends received by a Netherland-Antilles Corp. if it is receiving certain tax benefits under Netherland-Antilles law (which benefits SL is receiving) unless the payer of the dividends, that is the U.S. corporation, is owned at least 25 percent by the foreign corporation, and:

> "(a) the payer of such income is a U.S. corporation (*other than a U.S. corporation, 60 percent or more of the gross income of which is derived from* interest except to the extent derived by a corporation the principal business of which is the making of loans, *dividends,* royalties, rents from real property, or gain from the sale or other disposition of stock, securities, or real property, or gain from the sale or other disposition of stock, securities, or real property)." [Emphasis added.]

Under the proposed reorganization the new U.S. corporation as the parent of the U.S. operating companies would receive most of its income from dividends from such subsidiaries and, accordingly, under the protocol the dividends from the U.S. corporation to SL would not qualify for the treaty rate but would be taxed at a 30-percent rate under H.R. 5916.

There would appear to be no policy reason why the 5-percent rate should not apply to dividends from the new U.S. company to SL. Dividends from wholly owned operating subsidiaries are not the type of investment income against which the protocol is directed. It is submitted that the nature of the U.S. parent company's income should be determined not by looking at it individually, but by looking at the consolidated income of the entire group. To do otherwise would be to penalize the form of the U.S. organization despite the substance of the consolidated operations which generate the income from which the dividends paid to SL are derived. This argument has even greater weight when it is considered that the U.S. subsidiary of SL and its subsidiaries intend to file consolidated returns. Under the consolidated return regulations dividends received by one member of an affiliated group from another member are not treated as dividends for consolidated taxable income purposes (1.1502–31(b)(2) (ii), (v)) but are ignored.

In this connection it is most significant that in article VII of the treaty itself dividends received by a U.S. subsidiary from its subsidiary corporation are not considered the type of passive income which would cause dividends to the Netherlands parent to be taxed at a rate greater than the reduced rate. To the same effect see the U.S. tax treaties with Austria, Denmark, Finland, Ireland, Israel, Italy, Luxembourg, New Zealand, Norway, Sweden, Switzerland, and the United Kingdom.

The treaty with the Netherlands and all of the above treaties provide that dividend income "other than" dividend income from a subsidiary corporation is considered in determining whether the payer has the specific amount of passive income which will deprive it of the benefit of the reduced rate.

In addition, the draft Double Taxation Convention on Income and Capital prepared by the Organization for Economic Cooperation and Development (OECD) provides that dividends paid by a company to a resident of the other contracting state shall be taxed by the country of payment at not more than 15 percent (5 percent where the recipient is a corporation which owns 25 percent or more of the stock of the paying corporation). Thus, under the draft provision dividends received by a U.S. company from its U.S. subsidiaries and paid to a foreign parent would be taxed at a 5-percent rate.

H.R. 5916 should be amended to eliminate the above-described inequity. This could be accomplished in either of the following ways:

(1) Add a new subsection to section 11 to provide that income received by a U.S. corporation from a subsidiary corporation shall not, for the purpose of applying any treaty obligation of the United States, be considered dividend income.

(2) Add a new subsection to section 11 to provide that for purposes of applying any treaty obligation of the United States the income of a U.S. corporation, if it so elects, shall be computed on a consolidated basis.

There are probably other equally effective ways of eliminating the above inequity; for example, in the pending protocol to the treaty with the Netherlands or in the regulations under the 1964 protocol to the effect that the "other than" exception set forth in the treaty would apply as if set forth in full in the protocol.

CHARLES GOODWIN, Jr.

STATEMENT OF UNITED STATES SAVINGS & LOAN LEAGUE RE H.R. 5916

The United States Savings & Loan League enthusiastically endorses the provisions of H.R. 5916 by Chairman Mills relating to nonresident aliens not doing business in the United States.

For many years now, interest paid on the bank deposits of this special category of persons has been treated for Federal tax purposes as income not arising from sources within the United States. The result has been that interest paid on bank deposits to such persons has been exempted under the withholding requirement applicable to other income payable to such persons. This distinction carries over into the estate tax law and relieves from estate taxes the bank deposits of nonresident aliens not doing business in the United States.

These exemptions have not been applied to savings accounts in mutual savings and loan associations. On the other hand, a technical ruling does exempt the earnings on accounts of these individuals with most stock-type savings and loan associations.

This difference in treatment has resulted in mutual institutions losing many accounts of this type. Obviously some of this money has been withdrawn from the United States.

This difference in treatment between the savings accounts in commercial banks, mutual savings banks, and stock-type associations and the treatment afforded savings accounts in mutual savings associations would be corrected by H.R. 5916. It should be pointed out that elsewhere in the Internal Revenue Code earnings on savings accounts in savings and loan associations are treated in the same manner as are earnings on the savings accounts in commercial banks and mutual savings banks. For example, dividends paid by savings and loan associations are treated as interest. Also, the tax laws have not permitted any dividend deduction or credit for those dividends paid by savings and loan associations.

The Treasury Department has recommended that this distinction be eliminated, and the United States Savings & Loan League strongly concurs. The league respectfully requests that this legislation be enacted.

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UNITED STATES TRUST CO. OF NEW YORK,
*New York, N.Y., June 24, 1965.*

Hon. WILBUR D. MILLS,
*Chairman, Committee on Ways and Means,*
*House of Representatives,*
*Washington, D.C.*

DEAR MR. CHAIRMAN: I am taking the liberty of writing to you to express to you and your committee the point of view of the United States Trust Co. of New York on legislation pending before you to increase foreign investment in the United States, and particularly H.R. 5916 which you introduced on March 8, 1965.

As your committee is aware from testimony by our chairman, Mr. Hoyt Ammidon, given before you on March 20, 1963 (hearings on the tax recommendations of the President, pt. 5, p. 2725), the United States Trust Co. of New York is a banking institution which

has specialized for 110 years in trusts and investment management for individuals; members of families; and religious, educational, and charitable institutions of all kinds; and for pension and retirement funds of corporations; employee associations and labor unions; and a number of public authorities. We number among our customers many overseas financial organizations but only a very few individuals who are foreign nationals.

In this important business of the conservation and investment of funds for others, we have very close contact with individual investors abroad. From this contact we are able to say to you and your committee that it is perfectly clear to us that many foreign nationals who would like to invest in the U.S. securities markets are absolutely unwilling to do so so long as there is any estate tax on securities they may have in this country at time of death.

The problem here is not limited to the economic burden imposed on a person's estate by the U.S. estate tax, as no doubt an economic burden on the nonresident alien decedent's estate is already imposed by the inheritance and estate tax laws of his country of domicile. The thrust of the case against any U.S. estate tax is that nonresident aliens do not wish to be faced with any of the reporting and filing requirements and their related expenses to which they would become subject so long as any U.S. tax remains in effect; and, rather than face these, they prefer to avoid completely the ownership in this country of American securities.

We believe that the approach which the Treasury Department has taken in suggesting legislation to your committee which would, with respect to nonresident aliens' estates in the United States at time of death, increase the exemption and substitute for U.S. estate tax rates a lower rate schedule and would provide certain other ameliorative measures, is headed in the right direction. We applaud the Treasury objective as stated in the Department's release of March 5, 1965, entitled, "Proposed Legislation To Increase Foreign Investment in the United States," and as proposed to be carried into effect by section 8 of the bill. The only trouble is that these proposals do not go far enough to reach the goal.

We believe that the only effective measure to attract investment in the United States by nonresident foreign individuals would be to repeal the estate tax entirely. In our opinion, this is the only way by which any substantial flow of investment funds from nonresident alien individuals can be attracted to this country.

We, therefore, hope that your committee will see fit to move in the direction which the Treasury Department has pointed in its recommendation to you, but carry it through to its logical conclusion by providing for the repeal of the estate tax on nonresident alien decedents.

Although we are not in possession of the revenue figures, it is our impression that the estate tax on nonresident alien decedents does not bring any significant revenue to the Treasury at the present time. We believe that the revenue from taxes at the rates stated in your bill would likewise be insignificant. Thus, the complete repeal of these taxes would not affect the revenue in any significant way.

On the other hand, we believe that a good many hundred of millions of dollars would be invested in the U.S. securities markets by foreign

nationals if they felt that their funds would not be subject to estate tax by the U.S. Government.

Very respectfully yours,

CHARLES W. BUEK, *President.*

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COMMENTS BY HENRY S. CONSTON, OF WALTER & CONSTON, NEW YORK, N.Y., ON H.R. 5916, AN ACT TO REMOVE TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES

ESTATE TAXES

H.R. 5916 has recognized the deterrent effect which the present method of taxing nonresident alien estates has on direct foreign investment in U.S. securities by providing a limited measure of relief in this area. It is submitted that this relief in some respects is misplaced and will benefit owners of non-investment-type assets which serve to increase the outflow of gold.

TAX BASE

Present law imposes the tax on the entire gross estate which at the time of death is situated within the United States. This includes the following property (IRC sec. 2104):

(*a*) All tangibles physically located here; except certain works of art on loan for exhibition;

(*b*) Those intangibles the written evidence of which is treated as the property itself (such as bonds) if physically located here;

(*c*) Shares of stock of U.S. corporations, regardless of location;

(*d*) Moneys on deposit with banks (but only if the decedent was engaged in business in the United States); and

(*e*) Other intangibles (except insurance on decedent's life) if issued by or enforceable against a resident of the United States, a domestic corporation, or governmental unit.

Section 8 of H.R. 5916 would amend these rules as follows:

(*a*) All debt obligations, no matter where the evidence thereof is physically located, would be taxable if issued by or enforceable against U.S. citizens, residents, or entities. Other debt obligations continue to be taxable if evidence thereof is physically located here; and

(*b*) Deposits with Federal and State savings and loan associations by decedents who are not engaged in business here are excluded from the tax base.

It is submitted that these proposed amendments are far too restrictive. Instead of narrowing the tax base, the amendment would subject to tax many debt obligations which are presently not includable in the gross estate.

In order to attract foreign investment, it would appear desirable to exclude from the taxable gross estate of nonresident aliens, regardless of whether engaged in trade or business here or not, all debt obligations and shares of stock of noncontrolled corporations.

Precautionary measures should, however, be taken to reduce tax avoidance through the use of corporations to hold otherwise taxable property. At present tax avoidance by nonresident alien estates is

widespread through the use of corporations to hold U.S. investments. It would appear desirable to include in the taxable estate shares of stock and debt obligations of U.S. corporations controlled by the decedent and his family. Moreover, property located within the United States and owned by foreign corporations controlled by nonresident aliens or their families should be included in the taxable estate.

EXEMPTION AND RATE OF TAX

H.R. 5916 proposes to increase the exemption for nonresident alien estates from $2,000 to $30,000 and to reduce tax rates to a maximum of 15 percent.

By excluding debt obligations and shares of stock from the tax base, the two principal media for the attraction of foreign capital would be freed from the estate tax burden. No purpose can, however, be served by permitting more advantageous tax treatment for noninvestment-type assets such as patents.

Accordingly, it is felt that property which remains includable in the gross estate be subjected to the same $60,000 exemption and be eligible for the marital deduction as are estates of U.S. citizens or residents.

RETURNS

H.R. 5916 does not coordinate the amendments relative to estate taxes with the return requirements.

Code section 6018(b) should be amended to require the filing of the return only if the gross estate exceeds the exemption.

OTHER STATUTORY DEFECTS

The amendment to code section 2102(b) as contained in section 8(b) of the bill does not make provision for estates using the alternative valuation date under code section 2032.

GIFT TAX

Under sections 2501 and 2511 of the code, nonresident aliens not engaged in trade or business in the United States are subjected to gift tax only on transfers of tangible property located here. Nonresident aliens who are engaged in business here are also subjected to taxation on gifts of intangibles located in the United States—that is, shares of stock of domestic corporations and evidences of indebtedness of domestic obligors which are physically located here.

Section 9 of H.R. 5916 proposes to exempt gifts of intangibles by nonresident aliens from gift tax whether or not the donor is engaged in business here.

Certainly, the abolition of the distinction between persons doing business in the United States and those not so engaged should be endorsed. However, tax avoidance could be prevented only if the tax base for gift tax purposes were changed so as to be identical to the estate tax base. In accordance with the recommendation herein contained, shares of stock and evidences of indebtedness of noncontrolled corporations would be excluded. However, there appears to be no reason why assets which serve to bolster the outflow of gold, such as patents, should be tax exempt.

ADDITIONAL RECOMMENDATIONS

*(1) Interest income of nonresident aliens*

Many domestic corporations wishing to invest in foreign countries are forced to borrow U.S. funds for this purpose because foreign lenders are unwilling to allow interest payments to be reduced by U.S. withholding taxes. The most practical approach to this problem would be to exempt interest completely from gross income of nonresident aliens. If this approach were considered to be too radical, an amendment to section 861(a)(1) pursuant to which interest paid on loans, the proceeds of which are used exclusively outside the United States, would be considered to be income from sources outside the United States could remedy this situation.

*(2) Tax base*

The tax base used for nonresident aliens not engaged in trade or business here (sec. 871(a)) and nonresident foreign corporations (sec. 881(a)) should be broadened. The term "fixed or determinable annual or periodical income" was first incorporated into the code in 1936. It has undergone little change since that time. As a result, such loophole closing sections as 341 (collapsible corporations), 1245 and 1250 (depreciation recapture) and 306 (preferred stock bail outs) create loopholes for nonresident aliens since gain from the sale of noncapital assets is not taxable to nonresident aliens. It would perhaps be preferable to broaden the tax base of nonresident aliens not engaged in business here and nonresident foreign corporations to include all U.S. source income with the exception of interest as stated above, certain capital gains and income from the sale of property which is includable in inventory or which is used in the taxpayer's trade or business.

*(3) Capital gains*

While the liberalization of the taxation of capital gains of nonresident alien individuals is endorsed, there appears to be no reason to exempt from taxation proceeds from the sale of patents (not qualifying under IRC sec. 1235), copyrights, trademarks or other similar rights. These should be excluded from the liberalized capital gains rules.

In the event that a nonresident alien is subjected to taxation on capital gains by virtue of his presence in the United States for 183 days or more, the tax rate thereon should not exceed the 25 percent applicable to U.S. citizens. Moreover, such persons should be allowed to take advantage of the 5 year capital loss carryover.

*(4) Certificates of compliance*

An unreasonable administrative requirement is set forth in IRC section 6851(d) under which nonresident aliens, subject to certain exceptions, must secure certificates of compliance with the income tax laws prior to departure from the United States. In practice, this rule is not strictly enforced. Nevertheless, the fact that it is on the books presents an annoyance and a form of discrimination against foreigners which should be abolished.

*(5) Accumulated earnings tax*

Under section 531, a corporation becomes subject to the penalty tax for failure to distribute unreasonably accumulated surplus. In cases where domestic corporations are controlled by nonresident aliens, this provision requires the remittance of dollars to foreign countries. It would be desirable to remove this stimulus to the outflow of gold by specifying that the accumulated earnings tax shall not apply to corporations which are controlled by nonresident aliens.

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ARMONK, N.Y., *June 24, 1965.*

Hon. WILBUR D. MILLS,
*House of Representatives, Washington, D.C.:*

Having been a member of the Fowler committee I would like to urge your favorable consideration of the tax bill, H.R. 5916, relating to the committee's recommendations. Having just read the National Foreign Trade Council statement on H.R. 5916 I believe that this merits your consideration also.

Thank you.

ARTHUR K. WATSON.

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WOOL ASSOCIATES OF THE NEW YORK
COTTON EXCHANGE, INC.,
*New York, N.Y.*

COMMITTEE ON WAYS AND MEANS,
*House of Representatives,*
*Longworth House Office Building, Washington, D.C.*

GENTLEMEN: The Wool Associates of the New York Cotton Exchange, Inc., favors the princples of H.R. 5916, the act to remove tax barriers to foreign investment in the United States. This organization, however, believes that the new tax on foreign dealers in commodities proposed in the bill will prevent the attainment of its objectives.

It is the opinion of the wool associates that the bill will—

(1) Decrease certain foreign investments in the United States; and

(2) Add to the gold deficit.

DECREASE CERTAIN FOREIGN INVESTMENTS IN THE UNITED STATES

The Wool Associates of the New York Cotton Exchange, Inc., provides a marketplace for trading in wool top and grease wool for future delivery. Many of the orders executed on the exchange originate in foreign lands. Should the bill be adopted in its present form, an additional tax barrier will be erected. This barrier will divert such orders to similar exchanges in foreign lands. Hence, foreign investments in wool top and grease wool futures in the United States will be drastically decreased.

ADD TO THE GOLD DEFICIT

Member firms of the Wool Associates of the New York Cotton Exchange, Inc., require the accounts of their customers to be protected by deposits of cash margins. Overseas customers, who will be subjected to a tax which does not presently exist, will close their accounts in the United States. Cash margin deposits will be withdrawn to finance transaction in foreign futures exchanges. The effect on the gold deficit will be twofold: (*a*) Gold currently in the United States will be withdrawn; and (*b*) a potential inflow of gold will be diverted to foreign nations.

For these reasons the Wool Associates of the New York Cotton Exchange, Inc., believes that current provisions of the bill fail to achieve the desired result. The wool associates earnestly urges the committee to exempt foreign dealers in commodities from the proposed tax embodied in H.R. 5916.

On behalf of the Wool Associates of the New York Cotton Exchange, Inc., I thank the committee for the opportunity to present these views.

Sincerely,

CHARLES R. RUDD,
*Executive Committee.*

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NEW YORK, N.Y.,
*June 25, 1965.*

Hon. WILBUR D. MILLS,
*Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.:*

As a member of the Presidental task force on promoting increased foreign investment in U.S. corporate securities and as a general partner in the firm of Morgan Stanley & Co., 2 Wall Street, New York, I urge strongly that H.R. 5916 be given prompt and favorable consideration by your committee. I have also reviewed the proposed letter and memorandum to you from Robert McKinney and from Messrs. Andre Meyer and Frederick M. Eaton and confirmed in general my agreement with the suggestions of proposed changes in H.R. 5916 recommended by Messrs. Meyer and Eaton.

Respectfully submitted.

JOHN M. YOUNG.

# SUMMARY OF RECOMMENDATIONS FOR REVISIONS GIVEN IN STATEMENTS TO THE COMMITTEE ON WAYS AND MEANS

**Prepared by the staff of the Joint Committee on Internal Revenue Taxation**

## PART ONE. SUMMARY OF COMMENTS ON PRINCIPAL PROVISIONS OF THE BILL

*I. Source rules*

*A. Section 2(a) of the bill.*—Under present law, some interest paid by savings institutions to nonresident aliens is income from U.S. sources and is subject to tax. The bill would amend code section 861(a)(1) to provide that all such interest is not included in U.S. source income, so that it would not be taxable income to nonresident aliens.

*Comments*

*American Life Insurance Co. and the United States Life Insurance Co. in the City of New York*

A similar exemption should be provided by statute for the interest or earnings element paid to nonresident aliens under life insurance company contracts. This will improve the U.S. balance of payments, will increase the taxable income of U.S. life insurance companies and, finally and most important, will put nonresident alien investors in American life insurance in the same position as similar persons investing in U.S. savings institutions.

*American Life Convention and Life Insurance Association of America*

Strongly urges that similar exemption be provided for interest paid to nonresident aliens on life insurance.

*United States Savings and Loan League*

Strongly supports enactment of this provision.

*Henry S. Conston, New York attorney*

Exempt interest income from the gross income of nonresident aliens. Alternatively, treat interest on loans, proceeds of which are used exclusively outside the United States, as income from sources outside the United States.

*B. Section 2(b) of the bill.*—Under present law, a pro rata portion of dividend income from a foreign corporation is considered U.S. source income if more than 50 percent of the corporation's gross income is derived from U.S. sources. It is proposed to amend code section 861(a)(2)(B) to include in U.S. source income dividends from foreign corporations, but only if such corporations are engaged in trade or business within the United States. If more than 80 percent of the gross business income of such a corporation was U.S. source income, then a fraction (the gross business income of the corporation from U.S. sources divided by its gross income from all sources) of the dividend income from such corporation would be included in U.S.

source income. Thus distributions by a foreign corporation doing business here of amounts originally received by it as dividends from U.S. corporations will not result in the imposition of any American income tax a second time if less than 80 percent of the gross business income of the corporation is from sources in the United States.

*Comments*

*Association of the Bar of the City of New York, Committee on Taxation*

A *de minimis* rule should be adopted providing that code section 861(a)(2)(B) not be applicable unless at least 25 percent of the foreign corporation's entire income constitutes "gross business income" under code section 882(a)(3).

*II. Taxation of nonresident alien individuals (sec. 3 of the bill)*

Under present law, a nonresident alien individual engaged in business in the United States is taxed on all his U.S. source income in the same manner as a resident would be taxed. The bill would amend code section 871 to tax the business income of nonresident alien individuals engaged in business in the United States separately from the nonbusiness income of these individuals. The nonbusiness income would be taxed in the same manner as such income is taxed in the case of nonresident alien individuals who are not engaged in business in the United States.

*Comments*

*S. B. Bledsoe of Salvage & Lee, representing the Board of Trade of the City of Chicago*

The board of trade is concerned with the definition of the term "engaged in business within the United States." It fears that the language will exclude foreign commodity traders from the benefits of the bill and that as a result business will be diverted to foreign commodity markets.

*G. Keith Funston (a member of the task force), representing the New York Stock Exchange*

Expand the exclusion from "engaged in trade or business within the United States" to cover foreign securities and commodities dealers trading for their own accounts, whether or not these dealers grant discretionary authority to agents in the United States.

Repeal or reduce the withholding tax on interest and dividends paid to foreigners.

*Charles R. Rudd, representing the Wool Association of the New York Cotton Exchange, Inc.*

The bill imposes an unjust tax on foreign dealers in commodities and in this respect is objectionable.

*Joseph B. Brady, representing the National Foreign Trade Council, Inc.*

Securities dealers should be encouraged to participate in the marketing of U.S. securities to foreigners by including such dealers in the securities trading exemption from the definition of "engaged in trade or business within the United States."

Returns should not be required in those situations where the nonbusiness income of nonresident aliens not engaged in trade or business in the United States is subject to withholding.

*Frederick M. Eaton, representing the Fowler Task Force*

A foreign dealer or underwriter should not be deemed to be engaged in a trade or business in the United States by reason of participation in an underwriting group having a U.S. manager. H.R. 5916 provides that the term "engaged in a trade or business within the United States" does not include trading in securities for one's own account whether the transactions are effected directly or indirectly except where a person "so trading is a dealer in securities, whether or not any such agent has discretionary authority to make decisions affecting such transactions." He suggests that this amendment can be interpreted as implying that a dealer in the type of case cited above is engaged in a trade or business here.

*American Institute of Certified Public Accountants, Committee on Federal Taxation*

Employees of foreign offices of domestic partnerships, U.S. citizens, and resident aliens should have the same exemption as that provided for employees of domestic corporations under present law, in code section 871(c).

*Henry S. Conston, New York attorney*

Broaden the income tax base from "fixed or determinable annual or periodical gains, profits, and income" to include all U.S. source income except interest, certain capital gains, and income from the sale of inventory or items used in the taxpayer's trade or business.

There is no reason to give preferred capital gains treatment to proceeds from the sale of patents (other than sales to which sec. 1235 is applicable), copyrights, trademarks, or similar rights.

Nonresident aliens subject to the tax on capital gains should have the benefits of the same 25-percent maximum tax rate and capital loss carryover provisions as U.S. citizens enjoy.

*Association of the Bar of the City of New York, Committee on Taxation*

The penalties for expatriation should not be eliminated as to those who acquired dual nationality at birth, and subsequently voluntarily chose other than U.S. nationality. Section 350 of the Immigration and Nationality Act.

The proposed code section 871(c)(2) should explicity state that the volume of securities or commodities transactions is not material in the determination of whether an investor is engaged in trade or business within the United States.

The proposed code section 871(f) permits a nonresident alien individual to elect to be taxed on a net basis with respect to certain types of income. This election should also be available to income from the disposition of timber, but only in those cases where an election under code section 631(a) is not made.

The term "taxable year" is ambiguous both under present law and under the bill. The ambiguity should be eliminated, in

view of the fact that it often results in a variation of tax treatment depending upon the particular authority that is interpreting the term in the particular case.

The expatriation proposals in sections 3, 8, and 9 of the bill are too harsh. They introduce many complexities not warranted by the problem of U.S. expatriates.

The bill provides that dividends and gains from the sale of stock are excluded from the category of business income. There should also be excluded interest (other than interest earned in the conduct of a banking business) and gains from the sale of other securities.

Consideration should be given to excluding from the definition of business income those capital gains which are not derived from sales or exchanges, such as distributions under section 301(c)(3)(A).

The proposed code section 871(b)(3) would exclude from "business income" gains from the sale or exchange of stock by securities dealers. The association urges a policy review of this provision to determine whether this exclusion is intended.

*III. Taxation of foreign corporations (sec. 4 of the bill)*

Under present law, a foreign corporation engaged in business in the United States is taxed on all its U.S. source income in the same manner as a domestic corporation and gets a dividends received deduction for dividends from domestic corporations (resulting in a maximum effective tax rate of 7.2 percent on such dividends). Under the bill, code section 882 would be amended to include dividends in "nonbusiness income" of such a corporation, and would tax such income at a 30-percent rate or the lower applicable treaty rate.

*Comments*

*Association of the Bar of the City of New York*

Code section 542(c)(7) excludes from the definition of "personal holding company" certain foreign corporations whose stock is wholly owned by nonresident alien individuals, directly or through other foreign corporations. The indirect ownership provision should be expanded to include stock owned through foreign trusts, estates, and partnerships, all of the beneficiaries or partners of which are nonresident aliens.

The present requirement that a foreign corporation derive at least 50 percent of its gross income from sources within the United States in order to have that corporation's dividends be eligible for the dividends-received deduction, should be increased to 80 percent.

Section 4(b) of the bill, amending section 882 of the code, has the effect of denying to resident foreign corporations the dividends-received deduction presently allowed to them. This would seem to run counter to the purpose of the bill to encourage foreign investment in the United States.

The bill provides that dividends and gains from the sale of stock are excluded from the category of business income. There should also be excluded interest (other than interest earned in the conduct of a banking business) and gains from the sale of other securities.

Consideration should be given to excluding from the definition of "business income" those capital gains which are not derived from sales or exchanges, such as distributions under code section 301(c)(3)(A).

The proposed code section 882(a)(3) would exclude from "business income" gains from the sale or exchange of stock by securities dealers. A policy review should be made to determine whether this exclusion is intended.

*Ira T. Wender, Michael Waris, Jr., and Peter L. Briger of Baker, McKenzie & Hightower*

Foreign corporations that are actively engaged in business in the United States and that have made substantial, permanent type investments in domestic corporations (at least a 10-percent equity interest) should be permitted to elect either—

(1) The treatment provided under existing law for resident foreign corporations (the availability of the intercorporate dividends received deduction, but a tax on capital gains realized in connection with U.S. stock investments); or

(2) The tax treatment provided in the proposed amendment (no intercorporate dividends received deduction, but exemption from tax on capital gains on U.S. stock investments).

*Frederick M. Eaton, representing the Fowler Task Force*

Under the proposed definitions of business and nonbusiness income, capital gains realized by a foreign corporation would be excluded from business and nonbusiness income, and therefore totally exempt from U.S. tax. This would make it possible for U.S. persons to finance and operate a securities dealer business in the United States through the medium of a resident foreign corporation, thereby accumulating profits from trading in corporate stock substantially free of tax at the corporate level. To prevent this unintended result, he would amend the definition of business income to provide that this term is to include net gains from the sale or exchange of stock in corporations if such stock is held by the taxpayer primarily for sale to customers ordinarily in the course of its trade or business.

*American Institute of Certified Public Accountants, Committee on Federal Taxation*

There should be a reduction in the present 30-percent tax rate on investment income of foreign corporations not engaged in business in the United States.

Present law and the proposed section 882(c)(1) should be amended to soften the provision disallowing all deductions in the event of unexcused failure to file returns.

*Henry S. Conston, New York attorney*

The accumulated earnings tax should not apply to corporations controlled by nonresident aliens, since such application encourages transmission of U.S. dollars abroad.

*Cleary, Gottlieb, Steen & Hamilton*

Under present law, a foreign corporation engaged in trade or business in the United States pays the full 48 percent U.S. cor-

porate tax rate on interest received by it on debt securities it owns. The bill proposes to give special treatment to the dividend income received by foreign corporations engaged in business in the United States, but makes no special provision for interest income received by such corporations. Thus, the present method of taxation of interest income would continue, and foreign corporations would be discouraged from investing in debt securities. This would keep foreign corporations engaged in business here from investing in debt securities here and would, in other cases, result in "unnecessarily complex arrangements for foreign portfolios containing investments in U.S. securities." Therefore interest received by a foreign corporation doing business in the United States should be treated as nonbusiness income (like dividends). Such avoidance possibilities as may appear should be dealt with directly and specifically.

*Shearman & Sterling*

Schlumberger, Ltd. (SL) is a foreign corporation with its principal office in the United States. It has two wholly owned domestic subsidiaries, each of which own a number of domestic operating subsidiaries. (It presently plans to merge the two domestic subsidiaries into a single domestic holding company.) Under H.R. 5916, SL would pay a 30-percent tax on the dividends from its subsidiary or subsidiaries. It would pay a lower rate of tax (5 percent) if it could qualify for the special treatment in the Netherlands Antilles Treaty. However, it cannot qualify for that treatment because the income of its subsidiary will be dividend income. Accordingly, H.R. 5916 should be amended to provide that dividend income received by a U.S. corporation from a subsidiary corporation shall not be treated as "dividend income" for certain treaty purposes. Alternatively, for purposes of qualifying for the special treaty treatment, the U.S. holding companies should be permitted to compute their income on a consolidated basis as if all operations were owned directly by a single entity.

*G. Keith Funston (a member of the task force), representing the New York Stock Exchange*

Repeal or reduce the withholding tax on interest and dividends paid to foreign corporations.

*IV. Estate tax on nonresident aliens (sec. 8 of the bill)*

The bill would amend the law to increase from $2,000 to $30,000 the exemption from estate tax for nonresident aliens. In addition, the rates at which the estate whould be taxed would be greatly lowered the tax beginning at 5 percent on the first $100,000 and never going over a 15 percent rate.

*Comments*

*Association of the Bar of the City of New York, Committee on Taxation*

The expatriation proposals in sections 3, 8, and 9 of the bill are too harsh. They introduce many complexities not warranted by the problem of U.S. expatriates.

The penalties for expatriation should not be eliminated as to those who acquired dual nationality at birth and subsequently voluntarily chose other than U.S. nationality. Section 350 of the Immigration and Nationality Act.

Code section 2107(b), providing special rules for determing the value of the gross estate of an expatriate under certain circumstances, should be eliminated since it adds too much complexity to warrant the limited revenue benefits of the provision.

The bill would authorize the President under certain circumstances to set aside, in the case of an estate of a foreign resident, estate tax amendments made by this bill or later acts. Since we do not know what amendments will be made in the future, it would seem advisable to limit this authority to the setting aside of the amendments made by the pending bill.

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Eliminate the estate tax on estates of nonresident aliens. Alternatively, exempt estates of under $30,000 from the requirement of filing estate tax returns and also exclude from taxable estates all funds awaiting investments, such as brokers' free credit balances.

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Section 8 of the bill should be amended to eliminate the estate tax on estates of nonresident alien decedents. This tax can be avoided by the formation of corporations under other sections of the bill. That vehicle would be resorted to by those with large amounts of property in the United States. Elimination of the tax would encourage the holders of small amounts of property to invest in the United States.

*Henry S. Conston, New York attorney*

Section 8 of the bill should be amended to exclude from the taxable estates of nonresident aliens all debt obligations and stock of noncontrolled corporations. In order to reduce tax avoidance, there should be included in the gross estates of such persons debt obligations and stock of controlled U.S. corporations and also U.S. property owned by controlled foreign corporations.

If the above proposal is agreed to, then it is not necessary to further relieve such estates from tax. It would then be proper to return to existing law on the taxable estate.

*Dorsey Richardson, president, Investment Company Institute and member of the Fowler Task Force*

He expresses approval in general of the bill, although pointing out that it does not go as far as the task force recommendation eliminating U.S. estate tax on intangible personal property of nonresident decedents. He states, however, that he understands there are technical reasons for not recommending the complete elimination and therefore apparently endorses the bill as presented.

*American Institute of Certified Public Accountants, Committee on Federal Taxation*

The proposed code section 2107 excludes certain expatriates from the beneficial estate tax rates provided by the bill. In the case of expatriation of a naturalized citizen who loses his U.S. citizenship upon returning to his native country, this exclusion should apply only to that proportionate part of the gross estate situated in the United States which is equal to the ratio of that part of the gross estate going to U.S. heirs, over the total gross estate.

*Reese H. Harris, Jr., representing the Trust Division, American Bankers Association*

No estate tax should be imposed on estates of nonresident aliens. Alternatively the Fowler Task Force recommendation should be adopted to eliminate U.S. estate taxes on all intangible personal property of nonresident alien decedents.

*Manufacturing Chemist's Association, Inc.*

Under present law, bonds owned by a nonresident alien are subject to the U.S. estate tax only if the actual paper instruments are physically in the United States. The bill would change this rule to provide that bonds of U.S. corporations would be subject to U.S. estate tax regardless of where the pieces of paper were located. The organization states that some of its members have followed the President's recommendations and the suggestions of the Fowler Task Force in raising capital for foreign operations. In order to minimize the outlay of U.S. dollars, some members of the association have sold bonds of U.S. obligors in foreign capital markets to raise funds needed abroad. The buyers of these bonds are not subject to U.S. estate tax under existing law unless the bonds are located in the United States. However, these individuals would become subject to the U.S. estate tax as to these bonds under the situs rule proposed by the bill. Accordingly, the bill should be amended to provide that intangibles owned by nonresident aliens be exempted from the estate tax altogether. Alternatively, the present situs rules should be retained.

*Frederick M. Eaton, representing the Fowler Task Force*

It is better to eliminate all estate taxes on intangible property of nonresident alien decedents, rather than reduce the estate tax rate from 5 percent to 15 percent and increase the exemption from $2,000 to $30,000. From a psychological standpoint, it is important to eliminate the tax. Since the present revenue of all U.S. estate taxes paid by foreigners on U.S. property is between $3 and $6 million. the loss from complete elimination cannot be great, in view of the fact that most of the $3 to $6 million would be lost anyway, under the lower rates proposed by the Treasury.

*U.S. Trust Co.*

The bill moves in the right direction in lessening the estate tax on nonresident aliens but it does not go far enough. In order to really encourage foreign investment in the United States, the estate tax on nonresident aliens should be eliminated altogether

so that they would be encouraged to freely buy in the U.S. securities markets.

In addition to the financial question, the need for reporting and giving information discourages many potential foreign investors.

*Real Estate Trade Mission to Europe, J. D. Sawyer, chairman*

Urges complete elimination of estate tax on intangible property of nonresident alien decedents.

*Fulton C. Underhay of Herrick, Smith, Donald & Ketchum, attorneys*

Suggests modifications in expatriation provisions dealing with the estate tax.

Urges complete elimination of an estate tax on intangible personal property owned by nonresident aliens.

## PART TWO. SUMMARY OF OTHER COMMENTS ON THE BILL

*Henry S. Conston, New York attorney*

Equalize the gift tax treatment of nonresident aliens engaged in trade or business here and those not so engaged. Make the tax base for the gift tax the same as that for the estate tax. (See recommendations of Henry S. Conston in Part One, IV, above.)

Abolish the code section 6851(d) certification of compliance requirement for nonresident aliens seeking to depart the United States. The requirement is not strictly enforced and constitutes an annoyance for and discrimination against foreigners.

*Association of the Bar of the City of New York, Committee on Taxation*

A resident alien should have the right to protest a Presidential determination that a foreign country does not satisy the "similar credit" requirement for allowance of the foreign tax credit.

Domestic fiduciaries should be permitted to administer estates and trusts for the exclusive benefit of foreign beneficiaries and remaindermen without being subject to capital gains tax on the sale of portfolio securities.

Consideration also should be given to abolishing the present requirement that a visiting alien, before departing from the United States, must secure a tax clearance and sailing permit. Present procedures in this regard are harassing and annoying to visiting aliens and do not produce a significant amount of revenue.

The gift tax penalties for expatriation should not be eliminated as to those who acquired dual nationality at birth and subsequently voluntarily chose other than U.S. nationality. Section 350 of the Immigration and Nationality Act.

The expatriation proposals in sections 3, 8, and 9 of the bill are too harsh. They introduce many complexities not warranted by the problem of U.S. expatriates.

*G. Keith Funston (a member of the task force), representing the New York Stock Exchange*

Eliminate or ease taxes and other restrictions imposed on foreign pension trusts and similar institutional investors.

*Support Group for Progressive Banking and First National City Bank, Walter B. Wriston, executive vice president*

The interest paid by a foreign branch of a U.S. bank to a foreign depositor should be exempt from U.S. income tax whether or not the foreign depositor is deemed to be "doing business in the United States." If the deposits were in a foreign bank they would not be subject to U.S. tax even though the foreign depositor was engaged in a trade or business here.

*American Institute of Certified Public Accountants, Committee on Federal Taxation*

Nonresident alien individuals and foreign corporations who do not engage in trade or business in the United States should have the same exemption from the "permanent establishment" provisions as is given by section 11(b) of the bill to such persons who do engage in trade or business within the United States.

The proposed code sections 2501 and 2511 exclude certain expatriates from the beneficial gift tax rates provided by the bill. In the case of expatriation of a naturalized citizen who loses his U.S. citizenship upon returning to his native country, this exclusion should apply only to gifts to U.S. citizens.

*Robert McKinney, member of task force*

Submits a summary of some of the actions taken by the so-called private sector to implement those recommendations of the Fowler task force directed toward it.

States that the private sector has made substantial contributions to the general effort to improve the balance-of-payments situation.

Adds that help given by Chairman Cohen and his staff at the SEC and by Assistant Secretary Surrey and his staff at the Treasury has been extremely encouraging.

Urges favorable consideration of H.R. 5916.

*William Engstrom*

Disagrees with philosophy of the bill. Believes it will tend to debilitate the program of investment in less developed areas.

*Association of Stocks Exchange Firms*

Expresses "enthusiastic approval" of the bill. Agrees with statements of Mr. Funston representing New York Stock Exchange.

*Arthur K. Watson, International Business Machines*

Supports bill and approves statement of National Foreign Trade Council.

*Investors League, Inc., William Jackman, president*

Supports the bill and agrees with position taken by G. Keith Funston representing the New York Stock Exchange.

*George F. James, Socony Mobil Oil Co., member of task force*

Supports the bill and agrees with suggestions of Andre Meyer and Frederick M. Eaton.

*Real Estate Trade Mission to Europe, J. D. Sawyer, chairman*

Supports the bill generally.

*National Association of Securities Dealers, Inc., Robert W. Haack*

Supports the bill.

*John M. Young, member of task force*

Strongly supports bill. Agrees with recommendations made by Andre Meyer and Frederick Eaton.

NOTE.—The persons named made many additional comments of a technical nature not involving policy questions. These comments will be carefully considered in work on the bill by the draftsmen and the staff members.

# SECTION 8

# SUMMARY OF RECOMMENDATIONS FOR REVISIONS GIVEN IN STATEMENTS PRESENTED TO THE COMMITTEE ON WAYS AND MEANS

# ACT TO REMOVE TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES

(Fowler Task Force Report)

(H.R. 5916)

## SUMMARY OF RECOMMENDATIONS FOR REVISIONS GIVEN IN STATEMENTS

PRESENTED TO THE

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

JULY 6, 1965

Prepared by the staff of the Joint Committee on Internal Revenue Taxation

U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1965 JCS-9-65

# DIGEST OF STATEMENTS SUBMITTED ON H.R. 5916, "ACT TO REMOVE TAX BARRIERS TO FOREIGN INVESTMENT IN THE UNITED STATES"

## PART ONE. SUMMARY OF COMMENTS ON PRINCIPAL PROVISIONS OF THE BILL

*I. Source rules*

*A. Section 2(a) of the bill.*—Under present law, some interest paid by savings institutions to nonresident aliens is income from U.S. sources and is subject to tax. The bill would amend code section 861(a)(1) to provide that all such interest is not included in U.S. source income, so that it would not be taxable income to nonresident aliens.

*Comments*

*American Life Insurance Co. and the United States Life Insurance Co. in the City of New York*

A similar exemption should be provided by statute for the interest or earnings element paid to nonresident aliens under life insurance company contracts. This will improve the U.S. balance of payments, will increase the taxable income of U.S. life insurance companies and, finally and most important, will put nonresident alien investors in American life insurance in the same position as similar persons investing in U.S. savings institutions.

*American Life Convention and Life Insurance Association of America*

Strongly urges that similar exemption be provided for interest paid to nonresident aliens on life insurance.

*United States Savings and Loan League*

Strongly supports enactment of this provision.

*Henry S. Conston, New York attorney*

Exempt interest income from the gross income of nonresident aliens. Alternatively, treat interest on loans, proceeds of which are used exclusively outside the United States, as income from sources outside the United States.

*B. Section 2(b) of the bill.*—Under present law, a pro rata portion of dividend income from a foreign corporation is considered U.S. source income if more than 50 percent of the corporation's gross income is derived from U.S. sources. It is proposed to amend code section 861(a)(2)(B) to include in U.S. source income dividends from foreign corporations, but only if such corporations are engaged in trade or business within the United States. If more than 80 percent of the gross business income of such a corporation was U.S. source income, then a fraction (the gross business income of the corporation from U.S. sources divided by its gross income from all sources) of the dividend income from such corporation would be included in U.S.

source income. Thus distributions by a foreign corporation doing business here of amounts originally received by it as dividends from U.S. corporations will not result in the imposition of any American income tax a second time if less than 80 percent of the gross business income of the corporation is from sources in the United States.

*Comments*

*Association of the Bar of the City of New York, Committee on Taxation*

A *de minimis* rule should be adopted providing that code section 861(a)(2)(B) not be applicable unless at least 25 percent of the foreign corporation's entire income constitutes "gross business income" under code section 882(a)(3).

*II. Taxation of nonresident alien individuals (sec. 3 of the bill)*

Under present law, a nonresident alien individual engaged in business in the United States is taxed on all his U.S. source income in the same manner as a resident would be taxed. The bill would amend code section 871 to tax the business income of nonresident alien individuals engaged in business in the United States separately from the nonbusiness income of these individuals. The nonbusiness income would be taxed in the same manner as such income is taxed in the case of nonresident alien individuals who are not engaged in business in the United States.

*Comments*

*S. B. Bledsoe of Salvage & Lee, representing the Board of Trade of the City of Chicago*

The board of trade is concerned with the definition of the term "engaged in business within the United States." It fears that the language will exclude foreign commodity traders from the benefits of the bill and that as a result business will be diverted to foreign commodity markets.

*G. Keith Funston (a member of the task force), representing the New York Stock Exchange*

Expand the exclusion from "engaged in trade or business within the United States" to cover foreign securities and commodities dealers trading for their own accounts, whether or not these dealers grant discretionary authority to agents in the United States.

Repeal or reduce the withholding tax on interest and dividends paid to foreigners.

*Charles R. Rudd, representing the Wool Association of the New York Cotton Exchange, Inc.*

The bill imposes an unjust tax on foreign dealers in commodities and in this respect is objectionable.

*Joseph B. Brady, representing the National Foreign Trade Council, Inc.*

Securities dealers should be encouraged to participate in the marketing of U.S. securities to foreigners by including such dealers in the securities trading exemption from the definition of "engaged in trade or business within the United States."

Returns should not be required in those situations where the nonbusiness income of nonresident aliens not engaged in trade or business in the United States is subject to withholding.

*Frederick M. Eaton, representing the Fowler Task Force*

A foreign dealer or underwriter should not be deemed to be engaged in a trade or business in the United States by reason of participation in an underwriting group having a U.S. manager. H.R. 5916 provides that the term "engaged in a trade or business within the United States" does not include trading in securities for one's own account whether the transactions are effected directly or indirectly except where a person "so trading is a dealer in securities, whether or not any such agent has discretionary authority to make decisions affecting such transactions." He suggests that this amendment can be interpreted as implying that a dealer in the type of case cited above is engaged in a trade or business here.

*American Institute of Certified Public Accountants, Committee on Federal Taxation*

Employees of foreign offices of domestic partnerships, U.S. citizens, and resident aliens should have the same exemption as that provided for employees of domestic corporations under present law, in code section 871(c).

*Henry S. Conston, New York attorney*

Broaden the income tax base from "fixed or determinable annual or periodical gains, profits, and income" to include all U.S. source income except interest, certain capital gains, and income from the sale of inventory or items used in the taxpayer's trade or business.

There is no reason to give preferred capital gains treatment to proceeds from the sale of patents (other than sales to which sec. 1235 is applicable), copyrights, trademarks, or similar rights.

Nonresident aliens subject to the tax on capital gains should have the benefits of the same 25-percent maximum tax rate and capital loss carryover provisions as U.S. citizens enjoy.

*Association of the Bar of the City of New York, Committee on Taxation*

The penalties for expatriation should not be eliminated as to those who acquired dual nationality at birth, and subsequently voluntarily chose other than U.S. nationality. Section 350 of the Immigration and Nationality Act.

The proposed code section 871(c)(2) should explicity state that the volume of securities or commodities transactions is not material in the determination of whether an investor is engaged in trade or business within the United States.

The proposed code section 871(f) permits a nonresident alien individual to elect to be taxed on a net basis with respect to certain types of income. This election should also be available to income from the disposition of timber, but only in those cases where an election under code section 631(a) is not made.

The term "taxable year" is ambiguous both under present law and under the bill. The ambiguity should be eliminated, in

view of the fact that it often results in a variation of tax treatment depending upon the particular authority that is interpreting the term in the particular case.

The expatriation proposals in sections 3, 8, and 9 of the bill are too harsh. They introduce many complexities not warranted by the problem of U.S. expatriates.

The bill provides that dividends and gains from the sale of stock are excluded from the category of business income. There should also be excluded interest (other than interest earned in the conduct of a banking business) and gains from the sale of other securities.

Consideration should be given to excluding from the definition of business income those capital gains which are not derived from sales or exchanges, such as distributions under section 301(c)(3)(A).

The proposed code section 871(b)(3) would exclude from "business income" gains from the sale or exchange of stock by securities dealers. The association urges a policy review of this provision to determine whether this exclusion is intended.

*III. Taxation of foreign corporations (sec. 4 of the bill)*

Under present law, a foreign corporation engaged in business in the United States is taxed on all its U.S. source income in the same manner as a domestic corporation and gets a dividends received deduction for dividends from domestic corporations (resulting in a maximum effective tax rate of 7.2 percent on such dividends). Under the bill, code section 882 would be amended to include dividends in "nonbusiness income" of such a corporation, and would tax such income at a 30-percent rate or the lower applicable treaty rate.

*Comments*

*Association of the Bar of the City of New York*

Code section 542(c)(7) excludes from the definition of "personal holding company" certain foreign corporations whose stock is wholly owned by nonresident alien individuals, directly or through other foreign corporations. The indirect ownership provision should be expanded to include stock owned through foreign trusts, estates, and partnerships, all of the beneficiaries or partners of which are nonresident aliens.

The present requirement that a foreign corporation derive at least 50 percent of its gross income from sources within the United States in order to have that corporation's dividends be eligible for the dividends-received deduction, should be increased to 80 percent.

Section 4(b) of the bill, amending section 882 of the code, has the effect of denying to resident foreign corporations the dividends-received deduction presently allowed to them. This would seem to run counter to the purpose of the bill to encourage foreign investment in the United States.

The bill provides that dividends and gains from the sale of stock are excluded from the category of business income. There should also be excluded interest (other than interest earned in the conduct of a banking business) and gains from the sale of other securities.

Consideration should be given to excluding from the definition of "business income" those capital gains which are not derived from sales or exchanges, such as distributions under code section 301(c)(3)(A).

The proposed code section 882(a)(3) would exclude from "business income" gains from the sale or exchange of stock by securities dealers. A policy review should be made to determine whether this exclusion is intended.

*Ira T. Wender, Michael Waris, Jr., and Peter L. Briger of Baker, McKenzie & Hightower*

Foreign corporations that are actively engaged in business in the United States and that have made substantial, permanent type investments in domestic corporations (at least a 10-percent equity interest) should be permitted to elect either—

(1) The treatment provided under existing law for resident foreign corporations (the availability of the intercorporate dividends received deduction, but a tax on capital gains realized in connection with U.S. stock investments); or

(2) The tax treatment provided in the proposed amendment (no intercorporate dividends received deduction, but exemption from tax on capital gains on U.S. stock investments).

*Frederick M. Eaton, representing the Fowler Task Force*

Under the proposed definitions of business and nonbusiness income, capital gains realized by a foreign corporation would be excluded from business and nonbusiness income, and therefore totally exempt from U.S. tax. This would make it possible for U.S. persons to finance and operate a securities dealer business in the United States through the medium of a resident foreign corporation, thereby accumulating profits from trading in corporate stock substantially free of tax at the corporate level. To prevent this unintended result, he would amend the definition of business income to provide that this term is to include net gains from the sale or exchange of stock in corporations if such stock is held by the taxpayer primarily for sale to customers ordinarily in the course of its trade or business.

*American Institute of Certified Public Accountants, Committee on Federal Taxation*

There should be a reduction in the present 30-percent tax rate on investment income of foreign corporations not engaged in business in the United States.

Present law and the proposed section 882(c)(1) should be amended to soften the provision disallowing all deductions in the event of unexcused failure to file returns.

*Henry S. Conston, New York attorney*

The accumulated earnings tax should not apply to corporations controlled by nonresident aliens, since such application encourages transmission of U.S. dollars abroad.

*Cleary, Gottlieb, Steen & Hamilton*

Under present law, a foreign corporation engaged in trade or business in the United States pays the full 48 percent U.S. cor-

porate tax rate on interest received by it on debt securities it owns. The bill proposes to give special treatment to the dividend income received by foreign corporations engaged in business in the United States, but makes no special provision for interest income received by such corporations. Thus, the present method of taxation of interest income would continue, and foreign corporations would be discouraged from investing in debt securities. This would keep foreign corporations engaged in business here from investing in debt securities here and would, in other cases, result in "unnecessarily complex arrangements for foreign portfolios containing investments in U.S. securities." Therefore interest received by a foreign corporation doing business in the United States should be treated as nonbusiness income (like dividends). Such avoidance possibilities as may appear should be dealt with directly and specifically.

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*G. Keith Funston (a member of the task force), representing the New York Stock Exchange*

Repeal or reduce the withholding tax on interest and dividends paid to foreign corporations.

*IV. Estate tax on nonresident aliens (sec. 8 of the bill)*

The bill would amend the law to increase from $2,000 to $30,000 the exemption from estate tax for nonresident aliens. In addition, the rates at which the estate whould be taxed would be greatly lowered the tax beginning at 5 percent on the first $100,000 and never going over a 15 percent rate.

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*Reese H. Harris, Jr., representing the Trust Division, American Bankers Association*

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*U.S. Trust Co.*

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so that they would be encouraged to freely buy in the U.S. securities markets.

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## PART TWO. SUMMARY OF OTHER COMMENTS ON THE BILL

*Henry S. Conston, New York attorney*

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Abolish the code section 6851(d) certification of compliance requirement for nonresident aliens seeking to depart the United States. The requirement is not strictly enforced and constitutes an annoyance for and discrimination against foreigners.

*Association of the Bar of the City of New York, Committee on Taxation*

A resident alien should have the right to protest a Presidential determination that a foreign country does not satisy the "similar credit" requirement for allowance of the foreign tax credit.

Domestic fiduciaries should be permitted to administer estates and trusts for the exclusive benefit of foreign beneficiaries and remaindermen without being subject to capital gains tax on the sale of portfolio securities.

Consideration also should be given to abolishing the present requirement that a visiting alien, before departing from the United States, must secure a tax clearance and sailing permit. Present procedures in this regard are harassing and annoying to visiting aliens and do not produce a significant amount of revenue.

The gift tax penalties for expatriation should not be eliminated as to those who acquired dual nationality at birth and subsequently voluntarily chose other than U.S. nationality. Section 350 of the Immigration and Nationality Act.

The expatriation proposals in sections 3, 8, and 9 of the bill are too harsh. They introduce many complexities not warranted by the problem of U.S. expatriates.

*G. Keith Funston (a member of the task force), representing the New York Stock Exchange*

Eliminate or ease taxes and other restrictions imposed on foreign pension trusts and similar institutional investors.

*Support Group for Progressive Banking*

The interest paid by a foreign branch of a U.S. bank to a foreign depositor should be exempt from U.S. income tax whether or not the foreign depositor is deemed to be "doing business in the United States." If the deposits were in a foreign bank they would not be subject to U.S. tax even though the foreign depositor was engaged in a trade or business here.

*American Institute of Certified Public Accountants, Committee on Federal Taxation*

Nonresident alien individuals and foreign corporations who do not engage in trade or business in the United States should have the same exemption from the "permanent establishment" provisions as is given by section 11(b) of the bill to such persons who do engage in trade or business within the United States.

The proposed code sections 2501 and 2511 exclude certain expatriates from the beneficial gift tax rates provided by the bill. In the case of expatriation of a naturalized citizen who loses his U.S. citizenship upon returning to his native country, this exclusion should apply only to gifts to U.S. citizens.

*Robert McKinney, member of task force*

Submits a summary of some of the actions taken by the so-called private sector to implement those recommendations of the Fowler task force directed toward it.

States that the private sector has made substantial contributions to the general effort to improve the balance-of-payments situation.

Adds that help given by Chairman Cohen and his staff at the SEC and by Assistant Secretary Surrey and his staff at the Treasury has been extremely encouraging.

Urges favorable consideration of H.R. 5916.

*William Engstrom*

Disagrees with philosophy of the bill. Believes it will tend to debilitate the program of investment in less developed areas.

*Association of Stocks Exchange Firms*

Expresses "enthusiastic approval" of the bill. Agrees with statements of Mr. Funston representing New York Stock Exchange.

*Arthur K. Watson, International Business Machines*

Supports bill and approves statement of National Foreign Trade Council.

*Investors League, Inc., William Jackman, president*

Supports the bill and agrees with position taken by G. Keith Funston representing the New York Stock Exchange.

*George F. James, Socony Mobil Oil Co., member of task force*

Supports the bill and agrees with suggestions of Andre Meyer and Frederick M. Eaton.

*Real Estate Trade Mission to Europe, J. D. Sawyer, chairman*

Supports the bill generally.

*National Association of Securities Dealers, Inc., Robert W. Haack*

Supports the bill.

*John M. Young, member of task force*

Strongly supports bill. Agrees with recommendations made by Andre Meyer and Frederick Eaton.

NOTE.—The persons named made many additional comments of a technical nature not involving policy questions. These comments will be carefully considered in work on the bill by the draftsmen and the staff members.

## SECTION 9

## H.R. 11297 AS INTRODUCED IN THE HOUSE OF REPRESENTATIVES

**(See Section 11 of this document, page 319)**

## SECTION 10

## H.R. 11297 THE "FOREIGN INVESTORS TAX ACT OF 1965" 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

**(See Section 11 of this document, page 319)**

## SECTION 11

## WRITTEN STATEMENTS BY INTERESTED INDIVIDUALS AND ORGANIZATIONS ON H.R. 11297 SUBMITTED TO THE COMMITTEE ON WAYS AND MEANS

# WRITTEN STATEMENTS

BY

# INTERESTED INDIVIDUALS AND ORGANIZATIONS

ON

## H.R. 11297

## THE FOREIGN INVESTORS TAX ACT OF 1965

SUBMITTED TO

COMMITTEE ON WAYS AND MEANS

EIGHTY-NINTH CONGRESS

SECOND SESSION

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1966

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WILLIAM H. QUEALY, *Minority Counsel*

II

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71-297 O-67-pt. 1—21

89th Congress
1st Session

COMMITTEE PRINT

# H.R. 11297

# THE "FOREIGN INVESTORS TAX ACT OF 1965"

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

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## COMMITTEE ON WAYS AND MEANS
U.S. House of Representatives

NOTE: This document is not a committee report. It is being printed for informational purposes only

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Printed for the use of the Committee on Ways and Means

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II

# CONTENTS

## H.R. 11297, THE FOREIGN INVESTORS TAX ACT OF 1965

This document contains three parts: I, H.R. 11297, the Foreign Investors Tax Act of 1965, as introduced in the House of Representatives on September 28, 1965; II, a summary of the principal provisions of H.R. 11297; and III, a comparative print showing the changes which would be made in existing law by H.R. 11297.

The bill was introduced by Chairman Wilbur D. Mills at the instruction of the Committee on Ways and Means in order to make it available for the information of the general public. Comments received will be reviewed by the committee before the bill is reported to the House in the next session of the Congress. It is a modified version of H.R. 5916, which was an administration proposal originating from the recommendations of the so-called Fowler task force. H.R. 11297 contains the essential elements of the predecessor bill (H.R. 5916), but with certain modifications.

1

I.

89TH CONGRESS
1ST SESSION

# H.R. 11297

## IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 28, 1965
Mr. MILLS introduced the following bill; which was referred to the Committee on Ways and Means

## A BILL

To amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States.

*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 "Foreign Investors Tax Act of 1965".

(b) TABLE OF CONTENTS.—

(c) 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 is to a section or other provision of the Internal Revenue Code of 1954.

**SEC. 2. 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:

"(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 deductible under section 591 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, 1970, subsection (a)(1)(A) and this subsection shall cease to apply."

(2) Section 861(a)(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 at the end thereof the following new subparagraph:

"(D) interest on deposits with a foreign branch of a domestic corporation, if such branch is engaged in the commercial banking business and if such deposits are payable only in foreign currency."

(3(A) Section 895 (relating to income derived by a foreign central bank of issue from obligations of the United States) is amended—

(i) by striking out "shall not be included" and inserting

in lieu thereof ", or from interest on deposits with persons carrying on the banking business, shall not be included";

(ii) by striking out "such obligations" and inserting in lieu thereof "such obligations or deposits";

(iii) by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, the Bank for International Settlements shall be treated as a foreign central bank of issue with respect to interest on deposits with persons carrying on the banking business."; and

(iv) by striking out the heading 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) 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.—

(1) 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 unless less than 80 percent of the gross 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 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 is effectively connected with the conduct of a trade or business 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 (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".

(2) Section 861(a)(2) is amended by adding after subparagraph (C) the following:

"For purposes of subparagraph (B), the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1965, 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."

(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."

(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) Except in the case of a dealer in stocks or securities, 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 agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a corporation (other than a corporation which is, or but for section 542(c)(7) 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.

"(ii) In the case of a person who is a dealer in stocks or securities, trading in stocks or securities for his own account through a resident broker, commission agent, custodian, or other independent agent.

"(B) COMMODITIES.—

"(i) Except in the case of a dealer in commodities, 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 agent has discretionary authority to make decisions in effecting the transactions.

"(ii) In the case of a person who is a dealer in commodities, trading in commodities for his own account through a resident broker, commission agent, custodian, or other independent agent.

"(iii) Clauses (i) and (ii) 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) LIMITATIONS.—Subparagraphs (A) (ii) and (B) (ii) shall apply only if, at no time during the taxable year, the taxpayer has an office or 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.—For purposes of this title, factors to be taken into account in determining whether gains, profits, and income or loss shall be treated as 'effectively connected' with the conduct of a trade or business within the United States by a nonresident alien individual or foreign corporation include whether—

"(1) the gains, profits, and income or loss are derived from assets used in or held for use in the conduct of such trade or business,

"(2) the gains, profits, and income or loss are accounted for through such trade or business, or

"(3) the activities of the trade or business were a material factor in the realization of the gains, profits, and income or loss."

(e) EFFECTIVE DATES.—

(1) The amendments made by subsections (a) and (b) shall apply with respect to payments occurring after December 31, 1965.

(2) The amendments made by subsections (c) and (d) shall apply with respect to taxable years beginning after December 31, 1965.

**SEC. 3. 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:

**"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, and

"(C) amounts which under section 341, or under section 1232 (in the case of bonds or other evidences of indebtedness issued after September 28, 1965), are treated as gains from the sale or exchange of property which is not a capital asset,

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.

"(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 (or during any preceding taxable year beginning after December 31, 1965) shall be taxable as provided in section 1 or 1201 (b) on his taxable income which is effectively connected with the conduct of such trade or business.

"(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 the trade or business within the United States.

"(c) PARTICIPANTS IN CERTAIN EXCHANGE OF 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.

"(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 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

"(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. 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) 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 reinstatement of pre-1966 income tax provisions in the case of 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).**

**"(7) For taxation of gains realized upon certain transfers to domestic corporations, see section 1250(d)(3)."**

(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(b) or 877."

(b) GROSS INCOME.—

(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."

(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) BOND INTEREST 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.—

(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 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 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.

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

"(3) PERSONAL EXEMPTIONS.—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.

"(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:

**"(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:

"(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."

(e) 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:

**"SEC. 877. EXPATRIATION TO AVOID TAX.**

"(a) IN GENERAL.—Every nonresident alien individual who at any time after March 8, 1965, and within the 5-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.

"(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—

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

"(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.

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.

"(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).

"(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."

(2) The table of sections for subpart A of part II of subchapter N of chapter 1 (relating to nonresident alien individuals) 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."

(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—

"(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

"(2) in determining the tax imposed for the taxable year pursuant to section 877(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 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 "and gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), and gains on transfers described in section 1235.";

(3) 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 on which a tax is imposed for the taxable year pursuant to section 871(b)(1).";

(4) by amending paragraph (4) of subsection (c) to read as follows:

"(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)."; and

(5) by striking out "amounts 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 of exchange of capital assets," in paragraph (5) and of subsection (c) and inserting in lieu thereof "gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), and gains on tranfers described in section 1235,", and by striking out "proceeds from such sale or exchange," in such paragraph and inserting in lieu thereof "amount payable,".

(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—";

(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—

"(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 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."

(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 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) 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) DEFINITION OF FOREIGN ESTATE OR TRUST.—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,".

(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 posssession 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."

(n) EFFECTIVE DATES.—

(1) The amendments made by this section (other than the amendments made by subsections (g), (h), and (k)) shall apply with respect to taxable years beginning after December 31, 1965.

(2) The amendments made by subsections (g) and (h) shall apply with respect to payments occurring after December 31, 1965.

(3) The amendments made by subsection (k) shall apply with respect to remuneration paid after December 31, 1965.

**SEC. 4. 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:

**"SEC. 881. 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, permiums, 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), and

"(3) amounts which under section 341, or under section 1232 (in the case of bonds or other evidences of indebtedness issued after September 28, 1965), are treated as gains from the sale or exchange of property which is not a capital asset,

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:

**"SEC. 882. 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 (or during any preceding taxable year beginning after December 31, 1965) shall be taxable as provided in section 11 or 1201(a) on its taxable income which is effectively connected with the conduct of such trade or business.

"(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 the 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 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) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts provided by section 170 shall be allowed whether or not 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, incldluing therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. This paragraph 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.

"(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.

"(4) CROSS REFERENCES.—

**"For rule that certain foreign taxes are not to be taken into account in determining deductions or credits, 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) grains described in section 631 (b) or (c), and

"(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. 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).

"(e) 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."

(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).

(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."

(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. Income of foreign corporations not connected with United States business.**

**"Sec. 882. 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 by striking out "not engaged in trade or business within the United States", and by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, the reference in section 1441(c)(1) to section 871(b)(1) shall be treated as referring to section 882(a)."

(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—

(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, 1965, 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) 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."

(f) 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 foreign estates, foreign trusts, foreign partnerships, or other foreign corporations;".

(g) 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:

"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."

(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—

(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 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",

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

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

(G) 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

(H) 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."**

(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."**

(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).

(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."**

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

(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 insurance company),".

(h) 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 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."

(i) 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, 1966, 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, 1965, 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."

(j) TECHNICAL AMENDMENTS.—

(1) Section 884 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 insuance companies, 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 reinstatement of pre-1966 income tax provisions in the 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)".

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

(k) EFFECTIVE DATES.—The amendments made by this section (other than subsections (c) and (i)) shall apply with respect to taxable years beginning after December 31, 1965. The amendments made by subsection (c) shall apply with respect to payments occurring after December 31, 1965. The amendment made by subsection (i) shall apply with respect to sales or exchanges occurring after December 31, 1965.

SEC. 5. SPECIAL TAX PROVISIONS.

(a) INCOME AFFECTED BY TREATY.—Section 894 (relating to income exempt under treaties) is amended to read as follows:

"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 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)."

(b) APPLICATION OF PRE-1966 INCOME 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 INCOME 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 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,

"(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 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.

"(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 citizens of the United States not residents of such foreign country or domestic corporations 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 or corporations of such foreign country shall, for any taxable year beginning after such proclamation, be determined under this subtitle 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 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. Application of pre-1966 income tax provisions."

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

(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 (or during any preceding taxable year beginning after December 31, 1965) 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 the trade or business within the United States.

"(b) SPECIAL RULES.—

"(1) or 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 which would not be taxed by such foreign country or possession but for the fact that—

"(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 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 the trade or business within the United States.

"(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).

"(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."

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

(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:

"(4) NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.—In the case of any nonresident alien individual or a foreign corporation, the amount determined pursuant to section 906; and".

(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, 1965. 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, 1966, 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."

(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, 1965. The amendment made by paragraph (3) shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

**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 Statets 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.

"(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.—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:

| "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." |

(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, 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)."

(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 of—

"(1) a United States person, or

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

owned by a nonresident not a citizen of the United States shall be deemed property within the United States."

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

"(b) DEPOSITS IN CERTAIN FOREIGN BRANCHES.—For purposes of this subchapter, deposits in a foreign branch of a domestic corporation, if such branch is engaged in the commercial banking business and if such deposits are payable only in foreign currency, shall not be deemed property within the United States."

(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 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 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.

"(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)), 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 sec-tion 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.

"(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), as modified by section 2102(b).

"(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).

"(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-1966 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-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 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), and 6018 (relating to estate tax returns) 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 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."

(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-1966 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. 9. TAX ON GIFTS 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 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 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

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

"(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."

(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 nonresident not a citizen of the United States who is excepted from the application of section 2501(a)(2)—

"(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 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 calendar year 1966 and all calendar years thereafter.

**SEC. 10. TREATY OBLIGATIONS.**

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. For purposes of the preceding sentence, the extension of a benefit provided by any amendment made by this Act shall not be deemed to be contrary to a treaty obligation of the United States.

## II. SUMMARY OF PRINCIPAL PROVISIONS

The bill modifies the income, estate, and gift tax treatment of nonresident aliens and the income tax treatment of foreign corporations.

The purposes of the bill are to modernize the present U.S. tax treatment of foreigners and to encourage foreign investment in the United States—thereby beneficially affecting the U.S. balance of payments—by removing tax barriers to such investment.

The bill restructures the income tax treatment of foreigners to make them taxable at the regular U.S. graduated rates on their income which is "effectively connected" with the conduct by them of a trade or business in the United States. The U.S. source income of foreigners that is not so connected is to be taxable at a flat rate of 30 percent (or a lesser applicable treaty rate) regardless of whether the foreigner is engaged in trade or business in the United States.

The bill also provides a new lower schedule of estate tax rates applicable to the estates of nonresident aliens and increases the exemption for such estates from $2,000 to $30,000. Under the bill, nonresident aliens engaged in business in the United States will no longer be subject to the gift tax on transfers of intangible property.

The following is a listing of the principal changes made by the bill in the order in which they appear in the bill:

1. *Source rule for interest on bank deposits.*—Present law makes interest on U.S. bank deposits foreign source income when paid to persons not engaged in business in the United States. The bill amends this source rule, effective January 1, 1971, to conform it to the source rule generally applicable to other forms of interest. Thus, from that time on this interest will constitute U.S. source income.

2. *Source rule for interest on deposits with savings and loan associations or insurance companies.*—The bill extends the above exception (for the next 5 years) to interest on deposits or withdrawable accounts with savings and loan associations and to interest on amounts left on deposit with insurance companies.

3. *Source rule for interest on deposits with foreign banking branches of U.S. corporations.*—The bill provides that the interest on foreign currency deposits with foreign banking branches of U.S. corporations is to be classified as income from sources without the United States regardless of whether the depositor is engaged in business in the United States.

4. *Exemption for interest on bank deposits of foreign central banks of issue or of the Bank for International Settlements.*—The bill provides that the interest on bank deposits of a foreign central bank of issue or of the Bank for International Settlements is to be exempt from U.S. tax unless the deposits are held for use in connection with the conduct of commercial banking functions or other commercial activities.

5. *Source rule for dividends paid by foreign corporations ("second dividend" tax).*—The bill provides that a portion of the dividends paid by a foreign corporation are to be treated as U.S. source income

only if 80 percent or more of the gross income of the corporation for the preceding 3 years was effectively connected with the conduct of a trade or business in the United States. The portion considered to be from sources in the United States equals the portion of the foreign corporation's income for that period which is effectively connected to such trade or business. Under present law, a portion of a foreign corporation's dividends are considered to be from U.S. sources if 50 percent or more of its income for the 3 preceding years was from U.S. sources.

6. *Compensation for certain personal services.*—The bill adds the foreign office or place of business of a citizen or resident of the United States or of a domestic partnership to the list of foreign employers whose payments of compensation to nonresident alien employees for services rendered in the United States is to be treated as having a source without the United States. Similarly, the bill provides that the performance of services in the United States for a foreign office or place of business of such U.S. employers does not constitute engaging in a trade or business in the United States by such employees. As under present law, these special rules apply only if the alien is temporarily present in the United States for not more than 90 days in the taxable year and the compensation does not exceed $3,000.

7. *Trading in stock or securities or in commodities.*—The bill excludes from the term "engaged in trade or business in the United States" trading in stocks or securities or in commodities in the United States by nonresident aliens or foreign corporations (other than dealers) in person or through an agent who has discretion to carry on such trading activities. However, a foreign investment company whose principal office is in the United States will be considered engaged in trade or business here. The exclusion of present law only applies if the trading is done through a resident independent agent not having discretion. This rule continues to apply to foreign dealers.

8. *Income "effectively connected" with the conduct of a trade or business in the United States.*—The bill prescribes factors to be taken into account in determining whether an item of income is "effectively connected" with the conduct of a trade or business in the United States. Among the factors to be considered are whether—

(1) the gains, profits, and income or loss are derived from assets used in or held for use in the conduct of such trade or business,

(2) the gains, profits, and income or loss are accounted for through such trade or business, or

(3) the activities of the trade or business were a material factor in the realization of the gains, profits, and income or loss.

Under this rule, income may be "effectively connected" to a branch office in the United States even though the income itself is from foreign sources (a foreign tax credit is allowed under appropriate circumstances in such cases).

9. *Tax on ordinary income of nonresident alien individuals.*—The bill provides for the taxation of the income of nonresident alien individuals which is "effectively connected" with the conduct of a trade or business in the United States at the regular graduated rates applicable to individuals, and for the taxation of income not so connected at a flat 30-percent rate (or the lower applicable treaty rate).

Under present law, if individuals are engaged in a trade or business in the United States or if their income exceeds $21,200, they are taxed at the graduated rates (in the case of incomes above $21,200, a flat rate applies under present law if it results in a larger tax).

10. *Treatment of capital gains of nonresident alien individuals.*—The bill provides for the taxation of the U.S. capital gains of a nonresident alien individual which are not effectively connected with a U.S. business only if the alien was in the United States for 183 days or more during a taxable year. The present rule taxed the U.S. capital gains of an alien who is not engaged in business in the United States if he was present in the United States for 90 days or more and, in any event, if the gains occurred during the alien's presence in the United States.

11. *Income from real property.*—The bill permits a foreigner to elect to treat income from U.S. real property as income which is effectively connected with the conduct of a trade or business in the United States (in cases in which this is not, in fact, true). This enables such a taxpayer to receive the benefits of the deductions connected with this income and to be taxable at the regular graduated rates on it.

12. *U.S. savings bond interest of residents of the Ryukyu Islands or the Pacific Trust Territories.*—The bill exempts from U.S. income tax interest derived by nonresident aliens from series E or H savings bonds if they were acquired while the alien was a resident of the Ryukyu Islands (includes Okinawa) or of the Trust Territory of the Pacific Islands.

13. *Income tax: Expatriation to avoid tax.*—The bill provides for imposition (for 5 years after loss of citizenship) of income tax at the regular graduated rates on the gross income (generally U.S. source income) of a citizen who has expatriated with one of his principal purposes being the avoidance of U.S. taxes. (However, the Government must establish the probability that the expatriate substantially reduced his income taxes.)

14. *Withholding of tax on nonresident aliens.*—The bill provides that withholding is not required with respect to income which is "effectively connected" with the conduct of a trade or business in the United States. It also permits the Treasury Department to exempt compensation for personal services from nonresident alien withholding (generally at 30 percent) and instead to require domestic wage withholding (14 percent) on such compensation.

15. *Liability for withheld tax.*—The bill provides, in effect, for the quarterly filing of returns and the quarterly remittance of the taxes withheld in the case of payments to foreigners, in the same manner as the code provides generally, instead of the present annual filing of returns and remittances of tax in these cases.

16. *Gain from disposition of certain depreciable real property.*—The bill removes, in the case of a foreigner, the limitation on the real estate depreciation "recapture" provision which presently limits the amount to be "recaptured" in an exchange of real property for the stock of a controlled corporation.

17. *Income tax on foreign corporations.*—The bill imposes the income tax at the regular corporate rates on the income of a foreign corporation which is "effectively connected" with the conduct of a trade or business in the United States and at a flat 30-percent rate (or applicable treaty rate) on the U.S. source income of such a corporation

which is not so connected. Under present law, if a foreign corporation has a trade or business in the United States, all of its income from U.S. sources is taxed at the regular corporate rates. Only if the foreign corporation is not engaged in a trade or business here, does the flat 30-percent rate (or applicable treaty rate) apply to its income from U.S. sources.

18. *Income from real property.*—The bill permits a foreign corporation to elect to treat income from United States real property as income which is effectively connected with the conduct of a trade or business in the United States (in cases in which this is not, in fact, true). This enables such a corporation to receive the benefits of the deductions connected with this income and to be taxable at the regular corporate income tax rates on it.

19. *Withholding of tax on foreign corporations.*—The bill requires withholding at a 30-percent rate (or lower applicable treaty rate) on payments to a foreign corporation of income which is not effectively connected with the conduct of a trade or business in the United States irrespective of whether the corporation is engaged in business in the United States. Under present law withholding is required only if the corporation is not engaged in a trade or business within the United States.

20. *Deduction for dividends received from foreign corporations.*—The bill conforms the 85-percent dividends received deduction provision applicable to dividends received from foreign corporations to the "effectively connected income" concept. Instead of providing this deduction where 50 percent or more of its gross income is from U.S. sources, the bill makes the deduction available only where 50 percent of its gross income is effectively connected with the conduct of a U.S. trade or business.

21. *Corporations subject to personal holding company tax.*—The bill exempts from the personal holding company tax a foreign corporation if all of its stock outstanding during the last half of its taxable year is owned by foreigners whether held by them directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations. Under present law this exemption applies only if the foreign corporation derives less than 50 percent of its income from U.S. sources.

22. *Foreign corporations carrying on insurance business in the United States.*—The bill provides that foreign insurance companies are to be taxed in the same manner as domestic insurance companies on their income which is effectively connected with the conduct of a trade or business within the United States. Income which is not so connected (even though the company is engaged in an insurance business here) is to be taxed in the same manner as foreign corporations generally; i.e., at a flat 30-percent rate (or at the lower applicable treaty rate).

23. *Income affected by treaty.*—The bill provides that in the case of income which is not effectively connected with the conduct of a trade or business within the United States, any reduced rate of tax under a treaty (or exemption from tax) applicable where there is no permanent establishment in the United States is also to be applicable to such income even though there is a permanent establishment in the United States.

24. *Application of pre-1966 income tax provisions.*—The bill, in certain circumstances, permits the President to reinstate the income tax provisions of the code in effect prior to the enactment of this bill with

respect to the income tax applicable to residents or corporations of a specified foreign country. The President may reinstate these taxes if the laws of the foreign country in question impose upon the income of U.S. nonresident citizens or U.S. corporations more burdensome taxes with respect to any item of income than the taxes imposed by the United States on similar income derived from sources within the United States by residents or corporations of such foreign country. The provisions are to be reinstated, however, only where the foreign country has been requested by the United States to correct the situation and has not done so, and the President finds it is in the public interest to apply the pre-1966 tax provisions.

25. *Foreign tax credit.*—The bill allows a foreign tax credit to nonresident aliens and foreign corporations with respect to income from sources without the United States, which is effectively connected with the conduct of a trade or business within the United States. No credit or deduction will be allowed for taxes paid to a country solely by reason of the foreigners being domiciled there for tax purposes.

26. *Similar income tax credit requirement.*—Present law provides for the disallowance of the foreign tax credit to foreigners who are resident in the United States if the foreign country of which they are nationals does not allow a similar credit to U.S. citizens who are resident in the foreign country. The bill provides that the credit is to be disallowed in such cases only where the President has requested the allowance of such credit to U.S. citizens resident there, and his request having been turned down, he finds that the disallowance of the credit to the foreigners is in the public interest.

27. *Similar estate tax credit requirement.*—Present law provides in certain cases for the disallowance of the estate tax credit for foreign death taxes paid by the estate of an alien decedent who dies a resident in the United States where the country of which the decedent was a national does not allow a similar credit for U.S. citizens. The bill modifies this provision in the same way as described above in the case of the foreign tax credit under the income tax provisions.

28. *Estate tax rates.*—The bill provides a new schedule of estate tax rates applicable to estates of nonresident aliens. The rates are as follows:

| *Taxable estate* | *Tax rate on described portion of taxable estate (percent)* |
|---|---|
| 1st $100,000 | 5 |
| From $100,000 to $500,000 | 10 |
| From $500,000 to $1,000,000 | 15 |
| From $1,000,000 to $2,000,000 | 20 |
| Over $2,000,000 | 25 |

These rates are designed to accord approximately the same treatment as that applicable to U.S. citizen decedents eligible for the maximum marital deduction (taking into account the change in exemptions described in No. 33 below).

29. *Credit for State death taxes paid.*—The bill limits the credit for State death taxes allowable to the estate of a nonresident alien to the same proportion of the Federal taxes which the value of the property upon which the State death taxes are imposed bears to the total gross estate.

30. *Property within the United States.*—The bill provides that for purposes of determining the tax on estates of nonresident aliens, debt obligations (including bonds) of a U.S. person, the United States, a

State or political subdivision of a State, or the District of Columbia owned by the decedent are deemed to be property within the United States. This has the effect of including bonds of U.S. corporations in the U.S. estate tax base of nonresident alien decedents even though physically located outside the United States.

31. *Property without the United States.*—The bill deletes the rule of present law that provides that bank deposits of nonresident aliens who were not engaged in business in the United States are property without the United States for purposes of computing the estate tax of such an alien. Thus, such bank deposits in the future will be in their U.S. estate tax base.

32. *Deposits in foreign banking branches of U.S. corporations.*—The bill provides that deposits in a foreign branch of a U.S. corporation which is engaged in a commercial banking business are to be treated as property without the United States if the deposits are payable only in foreign currency. Thus such amounts will not be included in the U.S. estate tax base of a nonresident alien decedent.

33. *Estate tax exemption for nonresident aliens.*—The bill increases the exemption from U.S. estate tax in the case of estates of nonresident aliens from $2,000 to $30,000.

34. *Estate tax: Expatriation to avoid tax.*—The bill provides for the taxation of the U.S. assets of an estate of a nonresident alien at the regular estate tax rates if within 10 years of his death the alien had expatriated from the United States with one of the principal purposes being the avoidance of U.S. taxes. (However, the Government must establish the probability that the expatriation substantially reduced his death taxes.)

35. *Application of pre-1966 estate tax provisions.*—The bill, in certain circumstances, permits the President to reinstate certain estate tax provisions of the code in effect prior to the enactment of this bill with respect to the estate taxes applicable to residents of a specified foreign country. The President may reinstate these taxes if the laws of the foreign country in question impose upon the death of U.S. nonresident citizens with estates in such country more burdensome taxes than the taxes imposed by the United States on similar estates situated within the United States of nonresident alien individuals of such foreign country. The provisions are to be reinstated, however, only where the foreign country has been requested by the United States to correct the situation and has not done so and the President finds it is in the public interest to apply the pre-1966 tax provisions.

36. *Estate tax returns.*—The bill provides that the estate of a nonresident alien is required to file an estate tax return only if its U.S. gross estate exceeds $30,000, instead of $2,000 as under present law.

37. *Tax on gifts of nonresident aliens.*—The bill excludes from the gift tax transfers of intangible property by nonresident aliens whether or not they are engaged in business in the United States (but not in the case of expatriates for a period of up to 10 years).

38. *Treaty obligations.*—The bill provides that the amendments made by this bill are not to apply where their application would be contrary to any treaty obligation of the United States. (However, the extension of a tax benefit provided by this bill is not to be deemed to be contrary of a treaty obligation.)

## III. CHANGES IN EXISTING LAW WHICH WOULD BE MADE BY H.R. 11297, AS INTRODUCED

Changes in existing law which would be made by H.R. 11297, 89th Congress (a bill to amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States), as introduced, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in *italic*, existing law in which no change is proposed is shown in roman):

# Subtitle A—Income Taxes

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## CHAPTER 1—NORMAL TAXES AND SURTAXES

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## Subchapter A—Determination of Tax Liability

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### PART I—TAX ON INDIVIDUALS

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**SEC. 1. TAX IMPOSED.**

(a) RATES OF TAX ON INDIVIDUALS.—

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*(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(b) or 877.*

[(d)] *(e)* CROSS REFERENCE.—

**For definition of taxable income, see section 63.**

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### PART II—TAX ON CORPORATIONS



**SEC. 11. TAX IMPOSED.**

(a) CORPORATIONS IN GENERAL.—A tax is hereby imposed for each taxable year on the taxable income of every corporation. The tax shall consist of a normal tax computed under subsection (b) and a surtax computed under subsection (c).

(b) NORMAL TAX.—The normal tax is equal to the following percentage of the taxable income:

(1) 30 percent, in the case of a taxable year beginning before January 1, 1964, and

(2) 22 percent, in the case of a taxable year beginning after December 31, 1963.

(c) SURTAX.—The surtax is equal to the following percentage of the amount by which the taxable income exceeds the surtax exemption for the taxable year:

(1) 22 percent, in the case of a taxable year beginning before January 1, 1964.

(2) 28 percent, in the case of a taxable year beginning after December 31, 1963, and before January 1, 1965, and

(3) 26 percent, in the case of a taxable year beginning after December 31, 1964.

(d) SURTAX EXEMPTION.—For purposes of this subtitle, the surtax exemption for any taxable year is $25,000, except that, with respect to a corporation to which section 1561 (relating to surtax exemptions in case of certain controlled corporations) applies for the taxable year, the surtax exemption for the taxable year is the amount determined under such section.

(e) EXCEPTIONS.—Subsection (a) shall not apply to a corporation subject to a tax imposed by—

(1) section 594 (relating to mutual savings banks conducting life insurance business),

(2) subchapter L (sec. 801 and following, relating to insurance companies), *or*

(3) subchapter M (sec. 851 and following, relating to regulated investment companies and real estate investment trusts)[, or].

[(4) section 881(a) (relating to foreign corporations not engaged in business in United States).]

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

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## Subchapter B—Computation of Taxable Income

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## PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

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### SEC. 116. PARTIAL EXCLUSION OF DIVIDENDS RECEIVED BY INDIVIDUALS.

(a) EXCLUSION FROM GROSS INCOME.—Effective with respect to any taxable year ending after July 31, 1954, gross income does not include

amounts received by an individual as dividends from domestic corporations, to the extent that the dividends do not exceed $100. If the dividends received in a taxable year exceed $100, the exclusion provided by the preceding sentence shall apply to the dividends first received in such year.

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(d) CERTAIN NONRESIDENT ALIENS INELIGIBLE FOR EXCLUSION.—[Subsection (a) does not apply to a nonresident alien individual with respect to whom a tax is imposed for the taxable year under section 871(a)] *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*

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

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**SEC. 154. CROSS REFERENCES.**

**(1) For definitions of "husband" and "wife", as used in section 152 (b)(4), see section 7701(a)(17).**

**(2) For deductions of estates and trusts, in lieu of the exemptions under section 151, see section 642(b).**

**(3) For exemptions of nonresident aliens, see section [873(d)] *873(b)(3)*.**

**(4) For exemptions of citizens deriving income mainly from sources within possessions of the United States, see section 931(e).**

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## PART VIII—SPECIAL DEDUCTIONS FOR CORPORATIONS

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**SEC. 245. DIVIDENDS RECEIVED FROM CERTAIN FOREIGN CORPORATIONS.**

(a) GENERAL RULE.—In the case of dividends received from a foreign corporation (other than a foreign personal holding company) which is subject to taxation under this chapter, if, for an uninterrupted period of not less than 36 months ending with the close of such foreign corporation's taxable year in which such dividends are paid (or, if the corporation has not been in existence for 36 months at the close of such taxable year, for the period the foreign corporation has been in existence as of the close of such taxable year) such foreign corporation has been engaged in trade or business within the United States [and has derived 50 percent or more of its gross income from sources within the United States,] *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*, there shall be allowed as a deduction in the case of a corporation—

(1) An amount equal to the percent (specified in section 243 for the taxable year) of the dividends received out of its earnings and profits specified in paragraph (2) of the first sentence of section 316(a), but such amount shall not exceed an amount which bears the same ratio to such percent of such dividends received out of such earnings and profits as the gross income of such foreign corporation for the taxable year [from sources within the United States] *which is effectively connected with the conduct of a trade or business within the United States* bears to its gross income from all sources for such taxable year, and

(2) An amount equal to the percent (specified in section 243 for the taxable year) of the dividends received out of that part of its earnings and profits specified in paragraph (1) of the first sentence of section 316(a) accumulated after the beginning of such uninterrupted period, but such amount shall not exceed an amount which bears the same ratio to such percent of such dividends received out of such accumulated earnings and profits as the gross income of such foreign corporation [from sources within the United States], *which is effectively connected with the conduct of a trade or business within the United States*, for the portion of such uninterrupted period ending at the beginning of such taxable year bears to its gross income from all sources for such portion of such uninterrupted period.

*For purposes of this subsection, the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1965, 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.*

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## Subchapter F—Exempt Organizations

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## PART II—TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

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**SEC. 512. UNRELATED BUSINESS TAXABLE INCOME.**

(a) DEFINITION.—The term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the exceptions, additions, and limitations provided in sub-

section (b). 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 [derived from sources within the United States determined under subchapter N (sec. 861 and following, relating to tax based on income from sources within or without the United States)] *which is effectively connected with the conduct of a trade or business within the United States.*

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## Subchapter G—Corporations Used To Avoid Income Tax on Shareholders

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### PART II—PERSONAL HOLDING COMPANIES

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**SEC. 542. DEFINITION OF PERSONAL HOLDING COMPANY.**

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(c) EXCEPTIONS.—The term "personal holding company" as defined in subsection (a) does not include—

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[(7) a foreign corporation if—

[(A) its gross income from sources within the United States for the period specified in section 861(a)(2)(B) is less than 50 percent of its total gross income from all sources, and

[(B) 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;]

*(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 foreign estates, foreign trusts, foreign partnerships, or other foreign corporations;*

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## Subchapter L—Insurance Companies

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## PART I—LIFE INSURANCE COMPANIES

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### Subpart E—Miscellaneous provisions

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**SEC. 819. FOREIGN LIFE INSURANCE COMPANIES.**

[(a) CARRYING ON UNITED STATES INSURANCE BUSINESS.—A foreign life insurance company carrying on a life insurance business within the United States, if with respect to its United States business it would qualify as a life insurance company under section 801, shall be taxable on the United States business of such company in the same manner as a domestic life insurance company.]

[(b)] (*a*) ADJUSTMENT WHERE SURPLUS HELD IN UNITED STATES IS LESS THAN SPECIFIED MINIMUM.—

(1) IN GENERAL.—In the case of any [company described in subsection (a)] *foreign corporation taxable under this part,* if the minimum figure determined under paragraph (2) exceeds the surplus held in the United States, then—

(A) the amount of the policy and other contract liability requirements (determined under section 805 without regard to this subsection), and

(B) the amount of the required interest (determined under section 809(a)(2) without regard to this subsection),

shall each be reduced by an amount determined by multiplying such excess by the current earnings rate (as defined in section 805(b)(2)).

(2) DEFINITIONS.—For purposes of paragraph (1)—

(A) The minimum figure is the amount determined by multiplying the taxpayer's total insurance liabilities on United States business by—

(i) in the case of a taxable year beginning before January 1, 1959, 9 percent, and

(ii) in the case of a taxable year beginning after December 31, 1958, a percentage for such year to be determined and proclaimed by the Secretary or his delegate.

The percentage determined and proclaimed by the Secretary or his delegate under clause (ii) shall be based on such data with respect to domestic life insurance companies for the preceding taxable year as the Secretary or his delegate considers representative. Such percentage shall be computed on the basis of a ratio the numerator of which is the excess

of the assets over the total insurance liabilities, and the denominator of which is the total insurance liabilities,

(B) The surplus held in the United States is the excess of the assets held in the United States over the total insurance liabilities on United States business.

For purposes of this paragraph and subsection [(c)] *(b)*, the term "total insurance liabilities" means the sum of the total reserves (as defined in section 801(c)) plus (to the extent not included in total reserves) the items referred to in paragraphs (3), (4), and (5) of section 810(c).

[(c)] *(b)* DISTRIBUTIONS TO SHAREHOLDERS.—

(1) IN GENERAL.—In applying sections 802(b)(3) and 815 [for purposes of subsection (a)], *with respect to a foreign corporation* the amount of the distributions to shareholders shall be determined by multiplying the total amount of the distributions to shareholders (within the meaning of section 815) of the foreign [life insurance company] *corporation* by whichever of the following percentages is selected by the taxpayer for the taxable year:

(A) the percentage which the minimum figure for the taxable year (determined under subsection [(b)] *(a)*(2)(A)) is of the excess of the assets of the company over the total insurance liabilities; or

(B) the percentage which the total insurance liabilities on United States business for the taxable year is of the company's total insurance liabilities.

(2) DISTRIBUTIONS PURSUANT TO CERTAIN MUTUALIZATIONS.—In applying section 815(e) [for purposes of subsection (a)] *with respect to a foreign corporation*—

(A) the paid-in capital and paid-in surplus referred to in section 815(e)(1)(A) of a foreign [life insurance company] *corporation* is the portion of such capital and surplus determined by multiplying such capital and surplus by the percentage selected for the taxable year under paragraph (1); and

(B) the excess referred to in section 815(e)(2)(A)(i) (without the adjustment provided by section 815(e)(2)(B)) is whichever of the following is the greater:

(i) the minimum figure for 1958 determined under subsection [(b)] *(a)*(2)(A), or

(ii) the surplus described in subsection [(b)] *(a)*(2)(B) (determined as of December 31, 1958).

[(d) No UNITED STATES INSURANCE BUSINESS.—Foreign life insurance companies not carrying on an insurance business within the United States shall not be taxable under this part but shall be taxable as other foreign corporations.]

(c) *CROSS REFERENCE.*—

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

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## PART II—MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE AND CERTAIN MARINE INSURANCE COMPANIES AND OTHER THAN FIRE OR FLOOD INSURANCE COMPANIES WHICH OPERATE ON BASIS OF PERPETUAL POLICIES OR PREMIUM DEPOSITS)

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### SEC. 821. TAX ON MUTUAL INSURANCE COMPANIES TO WHICH PART II APPLIES.

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[(e) NO UNITED STATES INSURANCE BUSINESS.—Foreign mutual insurance companies (other than a life insurance company and other than a fire, flood, or marine insurance company subject to the tax imposed by section 831) not carrying on an insurance business within the United States shall not be subject to this part but shall be taxable as other foreign corporations.]

[(f)] (*e*) SPECIAL TRANSITIONAL UNDERWRITING LOSS.—

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[(g)] (*f*) CROSS REFERENCES.—

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**(1) For exemption from tax of certain mutual insurance companies, see section 501(c)(15).**

**(2) For alternative tax in case of capital gains, see section 1201(a).**

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

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### SEC. 822. DETERMINATION OF TAXABLE INVESTMENT INCOME.

(a) DEFINITIONS.—For purposes of this part—

(1) The term "taxable investment income" means the gross investment income, minus the deductions provided in subsection (c).

(2) The term "investment loss" means the amount by which the deductions provided in subsection (c) exceed the gross investment income.

(b) GROSS INVESTMENT INCOME.—For purposes of subsection (a), the term "gross investment income" means the sum of the following:

(1) The gross amount of income during the taxable year from—

(A) interest, dividends, rents, and royalties,

(B) the entering into of any lease, mortgage, or other instrument or agreement from which the insurance company derives interest, rents, or royalties,

(C) the alteration or termination of any instrument or agreement described in subparagraph (B), and

(D) gains from sales or exchanges of capital assets to the extent provided in subchapter P (sec. 1201 and following, relating to capital gains and losses).

(2) The gross income during the taxable year from any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1).

(c) DEDUCTIONS.—In computing taxable investment income, the following deductions shall be allowed:

(1) TAX-FREE INTEREST.—The amount of interest which under section 103 is excluded for the taxable year from gross income.

(2) INVESTMENT EXPENSES.—Investment expenses paid or accrued during the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 percent of the mean of the book value of the invested assets held at the beginning and end of the taxable year plus one-fourth of the amount by which taxable investment income (computed without any deduction for investment expenses allowed by this paragraph, for tax-free interest allowed by paragraph (1), or for partially tax-exempt interest and dividends received allowed by paragraph (7)), exceeds 3¾ percent of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

(3) REAL ESTATE EXPENSES.—Taxes (as provided in section 164), and other expenses, paid or accrued during the taxable year exclusively on or with respect to the real estate owned by the company. No deduction shall be allowed under this paragraph for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property.

(4) DEPRECIATION.—The depreciation deduction allowed by section 167.

(5) INTEREST PAID OR ACCRUED.—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest on which is wholly exempt from taxation under this subtitle.

(6) CAPITAL LOSSES.—Capital losses to the extent provided in subchapter P (sec. 1201 and following) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, losses paid, and expenses paid over the sum of the items described in subsection (b) (other than paragraph (1)(D) thereof) and net premiums received. In the application of section 1212 for purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(A) the taxable investment income (computed without regard to gains or losses from sales or exchanges of capital assets or to the deduction provided in section 242 for partially tax-exempt interest); or

(B) losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

(7) SPECIAL DEDUCTIONS.—The special deductions allowed by part VIII (except section 248) of subchapter B (sec. 241 and following, relating to partially tax-exempt interest and to dividends received). In applying section 246(b) (relating to limital tion on aggregate amount of deductions for dividends received) for purposes of this paragraph, the reference in such section to "taxable income" shall be treated as a reference to "taxabe-investment income."

(8) TRADE OR BUSINESS DEDUCTIONS.—The deductions allowed by this subtitle (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner; except that for purposes of this paragraph—

(A) any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account, and

(B) the deduction for net operating losses provided in section 172 shall not be allowed.

(9) DEPLETION.—The deduction allowed by section 611 (relating to depletion).

(d) OTHER APPLICABLE RULES.—

(1) RENTAL VALUE OF REAL ESTATE.—The deduction under subsection (c) (3) or (4) on account of any real estate owned and occupied in whole or in part by a mutual insurance company subject to the tax imposed by section 821 shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this paragraph) as the rental value of the space not so occupied bears to the rental value of the entire property.

(2) AMORTIZATION OF PREMIUM AND ACCRUAL OF DISCOUNT.—The gross amount of income during the taxable year from interest, the deduction provided in subsection (c)(1), and the deduction allowed by section 242 (relating to partially tax-exempt interest) shall each be decreased to reflect the appropriate amortization of premium and increased to reflect the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 821. Such amortization and accrual shall be determined—

(A) in accordance with the method regularly employed by such company, if such method is reasonable, and

(B) in all other cases, in accordance with regulations prescribed by the Secretary or his delegate.

For taxable years beginning after December 31, 1962, no accrual of discount shall be required under this paragraph on any bond (as defined in section 171(d)).

(3) DOUBLE DEDUCTIONS.—Nothing in this part shall permit the same item to be deducted more than once.

[(e) FOREIGN MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE.—In the case of a foreign mutual insurance company (other than a life or marine insurance company or a fire insurance company subject to the tax imposed by section 831), the taxable investment income shall be the taxable income from sources within the United States (computed without regard to the deductions allowed by subsection (c)(7)), and the gross amount of income from the items described in subsection (b) (other than paragraph (1)(D) thereof) and net premiums shall be the amount of such income from sources within the United States. In the case of a company to which the preceding sentence applies, the deductions allowed in this section shall be allowed to the extent provided in subpart B of part II of subchapter N (sec. 881 and following) in the case of a foreign corporation engaged in trade or business within the United States.]

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[(f)] (e) DEFINITIONS.—For purposes of this part—

(1) NET PREMIUMS.—The term "net premiums" means gross premiums (including deposits and assessments) written or received on insurance contracts during the taxable year less return premiums and premiums paid or incurred for reinsurance. Amounts returned where the amount is not fixed in the insurance contract but depends on the experience of the company or the discretion of the management shall not be included in return premiums but shall be treated as dividends to policyholders under paragraph (2).

(2) DIVIDENDS TO POLICYHOLDERS.—The term "dividends to policyholders" means dividends and similar distributions paid or declared to policyholders. For purposes of the preceding sentence, the term "paid or declared" shall be construed according to the method regularly employed in keeping the books of the insurance company.

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## PART III—OTHER INSURANCE COMPANIES



### SEC. 831. TAX ON INSURANCE COMPANIES (OTHER THAN LIFE OR MUTUAL), MUTUAL MARINE INSURANCE COMPANIES, AND CERTAIN MUTUAL FIRE OR FLOOD INSURANCE COMPANIES.

(a) IMPOSITION OF TAX.—Taxes computed as provided in sectino 11 shall be imposed for each taxable year on the taxable income of—

(1) every insurance company (other than a life or mutual insurance company),

(2) every mutual marine insurance company, and

(3) every mutual fire or flood insurance company—

(A) exclusively issuing perpetual policies, or

(B) whose principal business is the issuance of policies for which the premium deposits are the same, regardless of the length of the term for which the policies are written, if the unabsorbed portion of such premium deposits not required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy.

[(b) NO UNITED STATES INSURANCE BUSINESS.—Foreign insurance companies (other than a life or mutual insurance company), foreign mutual marine insurance companies, and foreign mutual fire insurance companies described in subsection (a), not carrying on an insurance

business within the United States, shall not be subject to this part but shall be taxable as other foreign corporations.]

[(c)] (*b*) ELECTION FOR MULTIPLE LINE COMPANY TO BE TAXED ON TOTAL INCOME.—

(1) IN GENERAL.—Any mutual insurance company engaged in writing marine, fire, and casualty insurance which for any 5-year period beginning after December 31, 1941, and ending before January 1, 1962, was subject to the tax imposed by section 831 (or the tax imposed by corresponding provisions of prior law) may elect, in such manner and at such time as the Secretary or his delegate may by regulations prescribe, to be subject to the tax imposed by section 831, whether or not marine insurance is its predominant source of premium income.

(2) EFFECT OF ELECTION.—If an election is made under paragraph (1), the electing company shall (in lieu of being subject to the tax imposed by section 821) be subject to the tax imposed by this section for taxable years beginning after December 31, 1961. Such election shall not be revoked except with the consent of the Secretary or his delegate.

[(d) ALTERNATIVE TAX ON CAPITAL GAINS.—

**[For alternative tax in case of capital gains, see section 1201(a).]**

(*c*) *CROSS REFERENCE.*—

***(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.***

**SEC. 832. INSURANCE COMPANY TAXABLE INCOME.**

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[(d) TAXABLE INCOME OF FOREIGN INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL AND FOREIGN MUTUAL MARINE.—In the case of a foreign insurance company (other than a life or mutual insurance company), a foreign mutual marine insurance company, and a foreign mutual fire insurance company described in section 831 (a), the taxable income shall be the taxable income from sources within the United States. In the case of a company to which the preceding sentence applies, the deductions allowed in this section shall be allowed to the extent provided in subpart B of part II of subchapter N (sec. 881 and following) in the case of a foreign corporation engaged in trade or business within the United States.]

[(e)] (*d*) DOUBLE DEDUCTIONS.—Nothing in this section shall permit the same item to be deducted more than once.

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## PART IV—PROVISIONS OF GENERAL APPLICATION



**SEC. 841. CREDIT FOR FOREIGN TAXES.**

The taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of a domestic insurance company subject to the tax imposed by section 802, 821, or 831, to the extent provided in the case of a domestic corporation in section 901 (relating to foreign tax credit). For purposes of the preceding sentence (*and for purposes of applying section 906 with respect to a foreign insurance company*), the term "taxable income" as used in section 904 means—

(1) in the case of the tax imposed by section 802, the life insurance company taxable income (as defined in section 802(b)),

(2) in the case of the tax imposed by section 821(a), the mutual insurance company taxable income (as defined in section 821(b)); and in the case of the tax imposed by section 821(c), the taxable investment income (as defined in section 822(a)), and

(3) in the case of the tax imposed by section 831, the taxable income (as defined in section 832(a)).

**[SEC. 842. COMPUTATION OF GROSS INCOME.**

[The gross income of insurance companies subject to the tax imposed by section 802 or 831 shall not be determined in the manner provided in part I of subchapter N (relating to determination of sources of income).]

***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.*

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# Subchapter N—Tax Based on Income From Sources Within or Without the United States



## PART I—DETERMINATION OF SOURCES OF INCOME



### SEC. 861. INCOME FROM SOURCES WITHIN THE UNITED STATES.

(a) GROSS INCOME FROM SOURCES WITHIN UNITED STATES.—The following items of gross income shall be treated as income from sources within the United States:

(1) INTEREST.—Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including—

[(A) interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States,]

*(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) interest received from a resident alien individual, a resident foreign corporation, 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 of such resident payor or domestic 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 payor preceding the payment of such interest, or for such part of such period as may be applicable, [and]

(C) income derived by a foreign central bank of issue from bankers' acceptances[.], *and*

*(D) interest on deposits with a foreign branch of a domestic corporation, if such branch is engaged in the commercial banking business and if such deposits are payable only in foreign currency.*

(2) DIVIDENDS.—The amount received as dividends—

(A) from a domestic corporation other than a corporation entitled to the benefits of section 931, and other than a corporation less than 20 percent of whose gross income is shown to the satisfaction of the Secretary or his delegate to have 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 corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence), or

(B) from a foreign corporation unless less than [50] *80* percent of the gross 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] *effectively connected with the conduct of a trade or business* 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 income of the corporation for such period [derived from sources] *which is effectively connected with the conduct of a trade or business* 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 (*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

(C) from a foreign corporation to the extent that such amount is required by section 243(d) (relating to certain dividends from foreign corporations) to be treated as dividends from a domestic corporation which is subject to taxation under this chapter, and to such extent subparagraph (B) shall not apply to such amount.

*For purposes of subparagraph (B), the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1965, 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.*

(3) PERSONAL SERVICES.—Compensation for labor or personal services performed in the United States; except that compensation for labor or services performed in the United States shall not be

deemed to be income from sources within the United States if—

(A) the labor or services are performed 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,

(B) such compensation does not exceed $3,000 in the aggregate, and

(C) the compensation is for labor or services performed as an employee of or under a contract with—

(i) a nonresident alien, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

(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.

(4) RENTALS AND ROYALTIES.—Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the Unired States patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property.

(5) SALE OF REAL PROPERTY.—Gains, profits, and income from the sale of real property located in the United States.

(6) SALE OF PERSONAL PROPERTY.—Gains, profits, and income derived from the purchase of personal property without the United States (other than within a possession of the United States) and its sale within the United States.

(b) TAXABLE INCOME FROM SOURCES WITHIN UNITED STATES.—From the items of gross income specified in subsection (a) as being income from sources within the United States there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as taxable income from sources within the United States.

*(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 deductible under section 591 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, 1970, subsection (a)(1)(A) and this subsection shall cease to apply.*

**SEC. 862. INCOME FROM SOURCES WITHOUT THE UNITED STATES.**

(a) GROSS INCOME FROM SOURCES WITHOUT UNITED STATES.—The following items of gross income shall be treated as income from sources without the United States:

(1) interest other than that derived from sources within the United States as provided in section 861(a)(1);

(2) dividends other than those derived from sources within the United States as provided in section 861(a)(2);

(3) compensation for labor or personal services performed without the United States;

(4) rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like properties;

(5) gains, profits, and income from the sale of real property located without the United States; and

(6) gains, profits, and income derived from the purchase of personal property within the United States and its sale without the United States.

(b) TAXABLE INCOME FROM SOURCES WITHOUT UNITED STATES.—From the items of gross income specified in subsection (a) there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be treated in full as taxable income from sources without the United States.

**SEC. 863. ITEMS NOT SPECIFIED IN SECTION 861 OR 862.**

(a) ALLOCATION UNDER REGULATIONS.—Items of gross income, expenses, losses, and deductions, other than those specified in sections 861(a) and 862(a), shall be allocated or apportioned to sources within or without the United States, under regulations prescribed by the Secretary or his delegate. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the taxable income therefrom) the expenses, losses, and other deductions properly apportioned or allo-

cated thereto and a ratable part of other expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as taxable income from sources within the United States.

(b) INCOME PARTLY FROM WITHIN AND PARTLY FROM WITHOUT THE UNITED STATES.—In the case of gross income derived from sources partly within and partly without the United States, the taxable income may first be computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income; and the portion of such taxable income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Secretary or his delegate. Gains, profits, and income—

(1) from transportation or other services rendered partly within and partly without the United States,

(2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced (in whole or in part) by the taxpayer without and sold within the United States, or

(3) derived from the purchase of personal property within a possession of the United States and its sale within the United States,

shall be treated as derived partly from sources within and partly from sources without the United States.

**SEC. 864. DEFINITIONS.**

(a) *SALE, ETC.*—For purposes of this part, the word "sale" includes "exchange"; the word "sold" includes "exchanged"; and the word "produced" includes "created", "fabricated", "manufactured", "extracted", "processed", "cured", or "aged".

*(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) Except in the case of a dealer in stocks or securities, 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 agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a corporation (other than a corporation which is, or but for section 542(c)(7) 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.*

*(ii) In the case of a person who is a dealer in stocks or securities, trading in stocks or securities for his own account, through a resident broker, commission agent, custodian, or other independent agent.*

*(B) COMMODITIES.—*

*(i) Except in the case of a dealer in commodities, 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 agent has discretionary authority to make decisions in effecting the transactions.*

*(ii) In the case of a person who is a dealer in commodities, trading in commodities for his own account through a resident broker, commission agent, custodian, or other independent agent.*

*(iii) Clauses (i) and (ii) 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)(ii) and (B)(ii) shall apply only if, at no time during the taxable year, the taxpayer has an office or 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.—For purposes of this title, factors to be taken into account in determining whether gains, profits, and income or loss shall be treated as "effectively connected" with the*

*conduct of a trade or business within the United States by a nonresident alien individual or foreign corporation include whether—*

*(1) the gains, profits, and income or loss are derived from assets used in or held for use in the conduct of such trade or business,*

*(2) the gains, profits, and income or loss are accounted for through such trade or business, or*

*(3) the activities of the trade or business were a material factor in the realization of the gains, profits, and income or loss.*

## PART II—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS



### Subpart A—Nonresident Alien Individuals



**SEC. 871. TAX ON NONRESIDENT ALIEN INDIVIDUALS.**

[(a) NO UNITED STATES BUSINESS—30 PERCENT TAX.—

[(1) IMPOSITION OF TAX.—Except as otherwise provided in subsection (b) 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 (except interest on deposits with persons carrying on the banking business), 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.

[(2) CAPITAL GAINS OF ALIENS TEMPORARILY PRESENT IN THE UNITED STATES.—In the case of a nonresident alien individual not engaged in trade or business in the United States, there is hereby imposed for each taxable year, in addition to the tax imposed by paragraph (1)—

[(A) if he is present in the United States for a period or periods aggregating less than 90 days during such taxable year—a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from sales or exchanges of capital assets effected during his presence in the United States exceed his losses, allocable to sources within the United States, from such sales or exchanges effected during such presence; or

[(B) if he is present in the United States for a period or periods aggregating 90 days or more during such taxable year—a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from sales or exchanges of capital assets effected at any time during such year exceed his losses, allocable to sources within the United States, from such sales or exchanges effected at any time during such year.

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 individual were engaged in trade or business in the United States, except that such gains and losses shall be computed 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.]

*(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, and*

*(C) amounts which under section 341, or under section 1232 (in the case of bonds or other evidences of indebtedness issued after_____), are treated as gains from the sale or exchange of property which is not a capital asset,*

*but only to the extent the amounts 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.*

[(b) NO UNITED STATES BUSINESS—REGULAR TAX.—A nonresident alien individual not engaged in trade or business within the United States shall be taxable without regard to subsection (a) if during the taxable year the sum of the aggregate amount received from the sources specified in subsection (a)(1), plus the amount by which gains from sales or exchanges of capital assets exceed losses from such sales or exchanges (determined in accordance with subsection (a)(2)) is more than $19,000 in the case of a taxable year beginning in 1964 or more than $21,200 in the case of a taxable year beginning after 1964, except that—

[(1) the gross income shall include only income from the sources specified in subsection (a) (1) plus any gain (to the extent provided in subchapter P; sec. 1201 and following, relating to capital gains and losses) from a sale or exchange of a capital asset if such gain would be taken into account were the tax being determined under subsection (a)(2);

[(2) the deductions (other than the deduction for charitable contributions and gifts provided in section 873(c)) shall be allowed only if and to the extent that they are properly allocable to the gross income from the sources specified in subsection (a), except that any loss from the sale or exchange of a capital asset shall be allowed (to the extent provided in subchapter P without the benefit of the capital loss carryover provided in section 1212) if such loss would be taken into account were the tax being determined under subsection (a)(2).

[If (without regard to this sentence) the amount of the taxes imposed in the case of such an individual under section 1 or under section 1201(b), minus the credit under section 35, is an amount which is less than 30 percent of the sum of—

[(A) the aggregate amount received from the sources specified in subsection (a)(1), plus.

[(B) the amount, determined under subsection (a)(2), by which gains from sales or exchanges of capital assets exceed losses from such sales or exchanges,

then this subsection shall not apply and subsection (a) shall apply. For purposes of this subsection, the term "aggregate amount received from the sources specified in subsection (a)(1)" shall be applied without any exclusion under section 116.

[(c) UNITED STATES BUSINESS.—A nonresident alien individual engaged in trade or business within the United States shall be taxable without regard to subsection (a). For purposes of part I, 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 the performance of personal services—

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

[(2) 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. Such term does not include the effecting, through a resident broker, commission agent, or custodian, of transactions in the United States in stocks or securities, or in commodities (if of a kind customarily dealt in on an organized commodity exchange, if the transaction is of the kind customarily consummated at such place, and if the alien, partnership, or corporation has no office or place of business in the United States at any time during the taxable year through which or by the direction of which such transactions in commodities are effected).]

*(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 (or during any preceding taxable year beginning after December 31, 1965) shall be taxable as provided in section 1 or*

*1201(b) on his taxable income which is effectively connected with the conduct of such trade or business.*

*(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 the trade or business within the United States.*

[(d)] *(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.*

*(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 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*

*(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. 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) CROSS REFERENCES.—

**[(2)] (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.***

**[(1)] (3) For doubling of tax on citizens of certain foreign countries, see section 891.**

***(4) For reinstatement of pre-1966 income tax provisions in the case of 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).***

***(7) For taxation of gains realized upon certain transfers to domestic corporations, see section 1250(d)(3).***

**SEC. 872. GROSS INCOME.**

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

(1) [the] 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.*

(b) EXCLUSIONS.—The following items shall not be included in gross income of a nonresident alien individual, and shall be exempt from taxation under this subtitle:

(1) SHIPS UNDER FOREIGN FLAG.—Earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(2) AIRCRAFT OF FOREIGN REGISTRY.—Earnings derived from the operation of aircraft registered under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(3) COMPENSATION OF PARTICIPANTS IN CERTAIN EXCHANGE OR TRAINING PROGRAMS.—Compensation paid by a foreign employer to a nonresident alien individual for the period he 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. For purposes of this paragraph, the term "foreign employer" means—

(A) a nonresident alien individual, foreign partnership, or foreign corporation, or

(B) an office or place of business maintained in a foreign country or in a possession of the United States by a domestic

[corporation] *corporation, a domestic partnership, or an individual who is a citizen or resident of the United States.*

*(4) BOND INTEREST 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.*

**SEC. 873. DEDUCTIONS.**

[(a) GENERAL RULE.—In the case of a nonresident alien individual 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.

[(b) LOSSES.—

[(1) 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) (relating to losses) shall be allowed whether or not connected with income from sources within the United States, but only if the profit, if such transaction had resulted in a profit, would be taxable under this subtitle.

[(2) 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), shall be allowed whether or not connected with income from sources within the United States, but only if the loss is of property within the United States.

[(c) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts provided by section 170 shall be allowed whether or not connected with income from sources within the United States, but only as to contributions or gifts made to domestic corporations, or to community chests, funds, or foundations, created in the United States.

[(d) PERSONAL EXEMPTION.—In the case of a nonresident alien individual who is not a resident of a contiguous country, only one exemption under section 151 shall be allowed as a deduction.

[(e) STANDARD DEDUCTION.—

[For disallowance of standard deduction, see section 142(b)(1).]

*(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 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 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.*

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

*(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).***

**SEC. 874. ALLOWANCE OF DEDUCTIONS AND CREDITS.**

(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 [of his total income received from all sources in the United States], 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 [the] source or the credit provided by section 39 for certain uses of gasoline and lubricating oil.

(b) TAX WITHHELD AT SOURCE.—The benefit of the deduction for exemptions under section 151 may, in the discretion of the Secretary or his delegate, and under regulations prescribed by the Secretary or his delegate, be received by a nonresident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

(c) [FOREIGN TAX CREDIT NOT ALLOWED.—A nonresident] *FOREIGN TAX CREDIT.—Except as provided in section 906, a nonresident* alien individual shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

**SEC. 875. PARTNERSHIPS.**

For purposes of this subtitle, a nonresident alien individual shall be considered as being engaged in a trade or business within the United States if the partnership of which he is a member is so engaged.

**SEC. 876. ALIEN RESIDENTS OF PUERTO RICO.**

(a) NO APPLICATION TO CERTAIN ALIEN RESIDENTS OF PUERTO RICO.—This subpart shall not apply to an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, and such alien shall be subject to the tax imposed by section 1.

(b) CROSS REFERENCE.—

For exclusion from gross income of income derived from sources within Puerto Rico, see section 933.

***SEC. 877. EXPATRIATION TO AVOID TAX.***

*(a) IN GENERAL.—Every nonresident alien individual who at any time after March 8, 1965, and within the 5-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.*

*(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—*

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

*(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.*

*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.*

*(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).*

*(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.*

**SEC. [877] *878.* FOREIGN EDUCATIONAL, CHARITABLE, AND CERTAIN OTHER EXEMPT ORGANIZATIONS.**

**For special provisions relating to unrelated business income of foreign educational, charitable, and other exempt trusts, see section 512(a).**

## Subpart B—Foreign Corporations



**[SEC. 881. TAX ON FOREIGN CORPORATIONS NOT ENGAGED IN BUSINESS IN UNITED STATES.**

[(a) IMPOSITION OF TAX.—In the case of every foreign corporation not engaged in trade or business within the United States, there is hereby imposed for each taxable year, in lieu of the taxes imposed by section 11, a tax of 30 percent of the amount received from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), 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 631 (b) and (c) which are considered to be gains from the sale or exchange of capital assets).]

***SEC. 881. 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), and*

*(3) amounts which under section 341, or under section 1232 (in the case of bonds or other evidences of indebtedness issued after ————————), are treated as gains from the sale or exchange of property which is not a capital asset,*

*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.**

**SEC. 882. [TAX ON RESIDENT FOREIGN CORPORATIONS.] *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 (or during any preceding taxable year beginning after December 31, 1965)* shall be taxable as provided in section 11 *or 1201(a) on its taxable income which is effectively connected with the conduct of such trade or business.*

*(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 the trade or business within the United States.*

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

*(1)* [the] 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.—

[(2)] *(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 *effectively* connected with [income

from sources] *the conduct of a trade or business* within the United States; and the proper apportionment and allocation of the deductions [with respect to sources within and without the United States] *for this purpose* shall be determined as provided in [part I, under] regulations prescribed by the Secretary or his delegate.

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

[(1)] (*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 [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 *and credits. This paragraph 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.*

[(4)] (*3*) FOREIGN TAX CREDIT.—[Foreign] *Except as provided by section 906, foreign* corporations shall not be allowed the [credits] *credit* against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

(*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*

*(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. 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).*

[(d)] *(e)* 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.

**SEC. 883. EXCLUSIONS FROM GROSS INCOME.**

The following items shall not be included in gross income of a foreign corporation, and shall be exempt from taxation under this subtitle:

(1) SHIPS UNDER FOREIGN FLAG.—Earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(2) AIRCRAFT OF FOREIGN REGISTRY.—Earnings derived from the operation of aircraft registered under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

**SEC. 884. CROSS REFERENCES.**

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

**[(3)] *(2)* For special provisions relating to foreign insurance companies, see [subchapter L (sec. 801 and following)] *section 842.***

**[(2)] *(3)* For rules applicable in determining whether any foreign corporation is engaged in trade or business within the United States, see section [871(c)] *864(b).***

***(4) For reinstatement of pre-1966 income tax provisions in the 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.***

**[(1)] *(6)* For withholding at source of tax on income of foreign corporations, see section 1442.**

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## Subpart C—Miscellaneous Provisions



### SEC. 891. DOUBLING OF RATES OF TAX ON CITIZENS AND CORPORATIONS OF CERTAIN FOREIGN COUNTRIES.

Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax imposed by sections 1, 3, 11, 802, 821, 831, 852, 871, and 881 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country; but the tax at such doubled rate shall be considered as imposed by such sections as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 percent of the taxable income of the taxpayer (computed without regard to the deductions allowable under section 151 and under part VIII of subchapter B). Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under the preceding provisions of this section have been modified so that discriminatory and extraterritorial taxes applicable to citizens and corporations of the United States have been removed, he shall so proclaim, and the provisions of this section providing for doubled rates of tax shall not apply to any citizen or corporation of such foreign country with respect to any taxable year beginning after such proclamation is made.

### SEC. 892. INCOME OF FOREIGN GOVERNMENTS AND OF INTERNATIONAL ORGANIZATIONS.

The income of foreign governments or international organizations received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments or by international organizations, or from interest on deposits in banks in the United States of moneys belonging to such foreign governments or international organizations, or from any other source within the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

**SEC. 893. COMPENSATION OF EMPLOYEES OF FOREIGN GOVERNMENTS OR INTERNATIONAL ORGANIZATIONS.**

(a) RULE FOR EXCLUSION.—Wages, fees, or salary of any employee of a foreign government or of an international organization (including a consular or other officer, or a nondiplomatic representative), received as compensation for official services to such government or international organization shall not be included in gross income and shall be exempt from taxation under this subtitle if—

(1) such employee is not a citizen of the United States, or is a citizen of the Republic of the Philippines (whether or not a citizen of the United States); and

(2) in the case of an employee of a foreign government, the services are of a character similar to those performed by employees of the Government of the United States in foreign countries; and

(3) in the case of an employee of a foreign government, the foreign government grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country.

(b) CERTIFICATE BY SECRETARY OF STATE.—The Secretary of State shall certify to the Secretary of the Treasury the names of the foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by employees of the Government of the United States in foreign countries.

**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 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).*

**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 owned by such foreign central bank of issue, *or 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 with respect to interest on deposits with persons carrying on the banking business.*

***SEC. 896. APPLICATION OF PRE-1966 INCOME 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 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.*

*(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 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.*

*(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 citizens of the United States not residents of such foreign country or domestic corporations 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 or corporations of such foreign country shall, for any taxable year beginning after such proclamation, be determined under this subtitle 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 he deems necessary or appropriate to implement this section.*

## PART III—INCOME FROM SOURCES WITHOUT THE UNITED STATES



### Subpart A—Foreign Tax Credit



**SEC. 901. TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.**

(a) ALLOWANCE OF CREDIT.—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the applicable limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1333 (relating to war loss recoveries), or against the personal holding company tax imposed by section 541.

(b) AMOUNT ALLOWED.—Subject to the applicable limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) CITIZENS AND DOMESTIC CORPORATIONS.—In the case of a citizen of the United States and 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) RESIDENT OF THE UNITED STATES OR PUERTO RICO.—In the case of a resident of the United States and in the case of an

individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid or accrued during the taxable year to any possession of the United States; and

(3) ALIEN RESIDENT OF THE UNITED STATES OR PUERTO RICO.—In the case of an alien resident of the United States and in the case of an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid or accrued during the taxable year to any foreign country[, 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]; and

*(4) NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.—In the case of any nonresident alien individual or a foreign corporation, the amount determined pursuant to section 906; and*

[(4)](5) PARTNERSHIPS AND ESTATES.—In the case of any individual described in paragraph (1), (2), [or (3),] *(3), or (4),* who is a member of a partnership or a beneficiary of an estate or trust, the amount of his 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.

*(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.*

[(c)] *(d)* CORPORATIONS TREATED AS FOREIGN.—For purposes of this subpart, the following corporations shall be treated as foreign corporations: