

and loan associations or all types of deposits. Additionally, interest on similar deposits with insurance companies has not been accorded the benefits of this special rule.

Reasons for provision.—Your committee agrees with the House that it is questionable whether interest income of this type which is so clearly derived from U.S. sources, should be treated as though derived from sources without the United States and thereby escape U.S. taxation. At the same time, however, your committee realizes that an immediate alteration of the present source rule might have a substantial adverse effect on our balance of payments. To meet these two quite different problems your committee has adopted the provisions of the House bill which repeal this special foreign-source rule (exclusion from taxable U.S. income) but also postpone the effective date of the repeal until after 1971. At that time the Congress will have an opportunity to reconsider the balance-of-payments situation. In the interval your committee will have an opportunity to study the desirability of continuing the present exemption as well as considering the impact that the removal of this exemption would have on the balance-of-payments.

Your committee also agrees with the House that, as long as bank deposit interest is to be treated as foreign source income, there is no justification for denying similar treatment for interest paid by savings and loan institutions generally as well as interest earned on the proceeds of an insurance policy which are left on deposit with an insurance company. These all represent interest income received on deposits and, therefore, it is believed that the competing businesses should be treated in the same manner for tax purposes.

Explanation of provision.—For the above reasons the bill amends present law to provide that after December 31, 1971, interest on deposits with U.S. banks paid to nonresident alien individuals or foreign corporations is to be treated as income from sources within the United States. Your committee added a provision which subjects interest on deposits with U.S. branch banks of foreign corporations to these provisions. Therefore, until 1972 only bank interest received by nonresident aliens or foreign corporations which is effectively connected with the conduct of a trade or business in the United States will be subject to U.S. tax.¹ In addition, during the intervening 5-year period the bill extends the application of the foreign source rule of present law to interest (or so-called dividends) paid on deposits (or withdrawable accounts) with all chartered and supervised savings and loan associations or similar institutions, to the extent these amounts are deductible (determined without regard to section 265) in computing the taxable income of these institutions. Similar institutions for this purpose include mutual savings banks, cooperative banks, and domestic building and loan associations. Also, during this 5-year period, this special foreign source rule is to be applicable to interest on amounts held by insurance companies under an agreement to pay interest. The amounts paid by insurance companies to which this rule is extended include: (1) interest paid on policyholder dividends left with the company to accumulate; (2) interest paid on prepaid insurance premiums; (3) interest paid on proceeds

¹ The term "effectively connected" is explained subsequently in No. 2(b) below under sec. 102(d) of the bill.