

The central banks of issue are generally the custodians of the banking reserves of their countries and usually carry on most of the monetary functions of their countries in much the same way as our Federal Reserve Board. The Bank for International Settlements is an international organization, in practice used primarily to aid European central banks of issue in their international financial operations, to promote cooperation among these central banks and to act as trustee in regard to certain international financial settlements. At present, all the central banks of Europe, except that of the Soviet Union, belong to the Bank for International Settlements and over 90 percent of the Bank's deposits are owned by these central banks.

*Reasons for provision.*—By reason of the present exemption of bank-deposit interest paid to certain foreigners and the exemption of interest income on their holdings of U.S. Government bonds, foreign central banks of issue have been effectively exempt from practically all U.S. tax. Presumably this was done on the grounds that these foreign central banks of issue, through their monetary activities, were for the most part carrying on essential governmental activities for their foreign governments. However, with the termination in 1971 (as provided elsewhere in this bill) of the foreign source rule for bank-deposit interest, the United States would begin taxing bank-deposit interest income of these foreign central banks and the Bank for International Settlements. Your committee agrees with the House that in the case of these foreign governmental institutions this income should continue to be exempt from U.S. tax because of the nature of the activities these banks perform for foreign governments.

*Explanation of provision.*—In view of the considerations set forth above, the bill amends the code to exempt from U.S. tax interest received by foreign central banks of issue and the Bank for International Settlements from U.S. bank deposits unless the deposits are held in connection with commercial transactions of these banks. After 1971, this will distinguish their tax treatment for interest on bank deposits from that accorded other foreign persons. Your committee added amendments which would exempt interest received by the Bank for International Settlements from U.S. Government obligations. In addition, your committee adopted an amendment extending the governmental obligation rule to include obligations of agencies or instrumentalities of the United States (including beneficial interests, participations, and other instruments issued under sec. 302(c) of the Federal National Mortgage Association Charter Act).

*Effective date.*—These amendments are effective with respect to taxable years beginning after December 31, 1966.

*d. Rules for determining the sources of dividends and interest from foreign corporations (secs. 102(a)(2), (a)(3), and (b) of the bill and secs. 861(a)(1) (B), (C), and (D), and (2) (B) of the code)*

*Present law.*—Present law provides that all, or a portion, of dividends paid by a foreign corporation to nonresident aliens or foreign corporations is considered to be from U.S. sources and therefore subject to U.S. tax, but only if 50 percent or more of the income of the foreign corporation making the distribution is derived from sources within the United States during the preceding 3-year period. A similar rule provides that all the interest paid by a foreign corporation engaged in trade or business in the United States is considered to be