was foreign income which was available against which could be applied excess foreign tax credits.

In general, the excepted categories, described above, present situations in which the receipt of the foreign-source interest is likely to reflect legitimate business transactions. The 10-percent exception, ((3) above) was added by the Congress in the belief that if a lender owned at least 10 percent of the voting stock of a borrowing corporation an interest-bearing loan to that corporation is not likely to be a mere tax-savings device. The Congress thereby recognized that, in practice, business reasons may often require a shareholder to provide funds to a foreign corporation in the form of loans rather than in the form of additional equity capital. However, since the Congress was at that time closing a tax avoidance device the 10-percent exception was limited to situations where the U.S. corporation directly owned at least 10 percent of the foreign debtor corporation.

Reasons for provision.—U.S. corporations, in cooperating with the President's voluntary program to aid our balance of payments by limiting the outflow of capital investment funds, have been requested to obtain a portion of their funds necessary to finance their foreign operations from the foreign capital markets rather than from sources within the United States. In this manner, the flow of dollars abroad has been curtailed and our balance-of-payments position aided. Some corporations have established subsidiaries in this country for the specific purpose of handling these foreign funding transactions. However, the use of such a subsidiary to finance these foreign operations may result in the special separate interest income limitation (described above) being applied, for purposes of computing the foreign tax credit, with respect to interest income the subsidiary derives from loaning funds to the related companies.

As indicated previously an exception is provided in those cases where the U.S. taxpayer receiving the interest directly owns 10 percent of the foreign subsidiary paying the interest. However, where the U.S. parent establishes a wholly owned domestic subsidiary to borrow the foreign funds to finance the operation of its foreign subsidiary this exception of present law may not apply. This is because the funding subsidiary does not directly own a 10-percent interest in the foreign operating subsidiary. This is true even where the domestic funding subsidiary is a wholly owned subsidiary of a corporation which, in turn, owns more than 10 percent of the foreign operating subsidiary to whom the funds are loaned. In these circumstances your committee does not see why the limitation on the foreign tax credit should not apply in the same manner whether the foreign financing is done through the parent or a domestic subsidiary of the parent.

A precedent for liberalization of this provision is found in the interest equalization tax (a provision enacted to improve our balance of payments) which provides an exemption for acquisition of stock and debt obligations of a foreign corporation in which the taxpayer owns at least 10-percent interest regardless of whether the 10-percent stock ownership belongs to the lender or another related corporation belonging to the same affiliated group. Since the interest equalization tax and this special foreign tax credit provision will have mutual application in many situations it is the opinion of your committee that, to the extent possible, these provisions should have