

parallel application. Moreover, the application of the regular limitations, rather than the separate limitation on interest, in the case of these funding subsidiaries is particularly important now in view of their favorable impact on the balance of payments and the fact that they represent compliance with the administration's voluntary program for restraint on foreign investments.

The House bill proposes to liberalize the 10-percent ownership exception but its amendment has only limited application. Specifically, it would leave unchanged the present 10-percent rule and add a new section to make the separate limitation on interest income inapplicable to interest "received by an overseas operating funding subsidiary on obligations of a related foreign corporation." For purposes of this provision the domestic funding subsidiary is defined so as to, in effect, require that the domestic lender or its affiliated group own at least 50 percent of the voting stock of the borrowing foreign corporation. Your committee does not believe that it is necessary to the foreclosure of the tax avoidance practices at which the special limitation provision is aimed that the liberalization be limited to that provided by the House bill. Moreover, the restrictiveness of the present law and the House provision handicap the domestic corporation wishing to comply with the President's voluntary program. Therefore, your committee has amended the House bill by revising the 10-percent exception adopted in 1962. Your committee's amendment provides that the special limitation on interest from foreign corporations is not to apply with respect to interest income received by a U.S. lending corporation which directly or indirectly owns at least 10 percent of the foreign corporation from which the interest is derived. For purposes of this provision stock owned directly or indirectly by or for a foreign corporation is to be considered as owned proportionately by its shareholders.

Effective date.—The amendments made by this provision apply to interest received after December 31, 1965, in taxable years ending after that date.

g. Amendment to preserve existing law on deductions under section 931 (sec. 107 of the bill and sec. 931(d) of the code)

Under present law, U.S. citizens or domestic corporations earning income in possessions of the United States generally are taxable only on their U.S. source income (plus amounts received in the United States) if they meet certain requirements.⁵ In general, these requirements are that the citizen or corporation derive 80 percent of its gross income from sources within such a possession and 50 percent of its gross income from the active conduct of a trade or business within such a possession (both of these tests being applied with respect to income received in the prior 3 years).

A U.S. citizen or domestic corporation which qualifies for this treatment may exclude from its U.S. tax base gross income from sources without the United States (in the same way as nonresident aliens and foreign corporations not engaged in trade or business within the United States). The deductions allowed a U.S. person who qualifies for this exclusion are those which are allowable under present law to nonresident aliens and foreign corporations engaged in trade or business in

⁵ Possession for purposes of this provision does not include the Virgin Islands or, in the case of U.S. citizens does not include Puerto Rico.