(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-1967 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. 109. 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 sec-

tion 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 calender year 1967 and all calendar years thereafter.

SEC. 110. TREATY OBLIGATIONS.

No amendment made by this title 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 title shall not be deemed to be contrary to a treaty obligation of the United States.

TITLE II—OTHER AMENDMENTS TO INTERNAL REVENUE CODE

SEC. 201. APPLICATION OF INVESTMENT CREDIT TO PROPERTY USED IN POSSESSIONS OF THE UNITED STATES.

(a) PROPERTY USED BY DOMESTIC CORPORATIONS, ETC.—Section 48(a)(2)(B) (relating to property used outside the United States) is amended—

(1) by striking out "and" at the end of clause (v);

(2) by striking out the period at the end of clause (vi) and inserting in lieu thereof "; and"; and

(3) by adding at the end thereof the following new clause:

"(vii) any property which is owned by a domestic corporation (other than a corporation entitled to the benefits of section 931 or 934(b)) or by a United States citizen (other than a citizen entitled to the benefits of section 931, 932, 933, or 934(b)) and which is used predominantly in a possession of the United States by such a corporation or such a citizen, or by a corporation created or organized in, or under the law of, a possession of the United States."

(b) EFFECTIVE DATE.—The amendments made by sub-

section (a) shall apply to taxable years ending after December 31, 1965, but only with respect to property placed in service after such date. In applying section 46(b) of the Internal Revenue Code of 1954 (relating to carryback and carryover of unused credits), the amount of any investment credit carryback to any taxable year ending on or before December 31, 1965, shall be determined without regard to the amendments made by this section.

SEC. 202. DEDUCTION OF MEDICAL EXPENSES OF INDIVIDUALS AGE 65 OR OVER.

(a) REPEAL OF AMENDMENTS MADE BY SOCIAL SECURITY AMENDMENTS OF 1965.—Subsections (a) and (b) of section 106 of the Social Security Amendments of 1965 are repealed.

(b) COST OF MEDICAL INSURANCE.—Section 213(a) (relating to allowance of deduction for medical, dental, etc., expenses) is amended—

(1) by striking out "and" at the end of paragraph (1)(A);

(2) by inserting after "such expenses" in paragraph (1)(B) "(reduced by any amount deductible under subparagraph (C))";

(3) by striking out the period at the end of paragraph (1)(B) and inserting in lieu thereof ", and";

(4) by adding at the end of paragraph (1) the following new subparagraph:

"(C) an amount (not in excess of $150) equal to one-half of the expenses paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents (other than any dependent described in subparagraph (A)).";

(5) by striking out "and" at the end of paragraph (2)(B);

(6) by inserting after "such expenses" in paragraph (2)(C) "(reduced by any amount deductible under subparagraph (D))";

(7) by striking out the period at the end of paragraph (2)(C) and inserting in lieu thereof ", and"; and

(8) by adding at the end of paragraph (2) the following new subparagraph:

"(D) an amount (not in excess of $150) equal to one-half of the expenses paid during the taxable year for insurance which constitutes medical care for such dependents (other than any dependent described in paragraph (1)(A))."

(c) EFFECTIVE DATE.—The repeal and amendments

made by this section shall apply to taxable years beginning after December 31, 1966.

SEC. 203. BASIS OF PROPERTY RECEIVED ON LIQUIDATION OF SUBSIDIARY.

(a) DEFINITION OF PURCHASE.—Section 334(b)(3) (relating to definition of purchase) is amended by adding at the end thereof the following new sentence:

"Notwithstanding subparagraph (C) of this paragraph, for purposes of paragraph (2)(B), the term 'purchase' also means an acquisition of stock from a corporation when ownership of such stock would be attributed under section 318(a) to the person acquiring such stock, if the stock of such corporation by reason of which such ownership would be attributed was acquired by purchase (within the meaning of the preceding sentence)."

(b) PERIOD OF ACQUISITION.—Section 334(b)(2)(B) (relating to exception) is amended by striking out "during a period of not more than 12 months," and inserting in lieu thereof "during a 12-month period beginning with the earlier of—

"(i) the date of the first acquisition by purchase of such stock, or

"(ii) if any of such stock was acquired in

an acquisition which is a purchase within the meaning of the second sentence of paragraph (3), the date on which the distributee is first considered under section 318(a) as owning stock owned by the corporation from which such acquisition was made,".

(c) DISTRIBUTION OF INSTALLMENT OBLIGATIONS.—Section 453(d)(4)(A) (relating to distribution of installment obligations in certain liquidations) is amended to read as follows:

"(A) LIQUIDATIONS TO WHICH SECTION 332 APPLIES.—If—

"(i) an installment obligation is distributed in a liquidation to which section 332 (relating to complete liquidations of subsidiaries) applies, and

"(ii) the basis of such obligation in the hands of the distributee is determined under section 334(b)(1),

then no gain or loss with respect to the distribution of such obligation shall be recognized by the distributing corporation."

(d) EFFECTIVE DATES.—The amendment made by subsection (a) shall apply only with respect to acquisitions of stock after December 31, 1965. The amendments made by

subsections (b) and (c) shall apply only with respect to distributions made after the date of the enactment of this Act.

SEC. 204. TRANSFERS OF STOCK AND SECURITIES TO CORPORATIONS CONTROLLED BY TRANSFERORS.

(a) TRANSFERS TO INVESTMENT COMPANIES.—The first sentence of section 351(a) (relating to transfers to corporations controlled by transferor) is amended by striking out "to a corporation" and inserting in lieu thereof "to a corporation (including an investment company)".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to transfers of property whether made before, on, or after the date of the enactment of this Act.

SEC. 205. MINIMUM AMOUNT TREATED AS EARNED INCOME FOR RETIREMENT PLANS OF CERTAIN SELF-EMPLOYED INDIVIDUALS.

(a) INCREASE TO $6,600.—Section 401(c)(2)(B) (relating to earned income when both personal services and capital are material income-producing factors) is amended by striking out "$2,500" each place it appears therein and inserting in lieu thereof "$6,600".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1965.

SEC. 206. TREATMENT OF CERTAIN INCOME OF AUTHORS, INVENTORS, ETC., AS EARNED INCOME FOR RETIREMENT PLAN PURPOSES.

(a) INCOME FROM DISPOSITION OF PROPERTY CREATED BY TAXPAYER.—Section 401(c)(2) (relating to definition of earned income) is amended by adding at the end thereof the following new subparagraph:

"(C) INCOME FROM DISPOSITION OF CERTAIN PROPERTY.—For purposes of this section, the term 'earned income' includes gains (other than any gain which is treated under any provision of this chapter as gain from the sale or exchange of a capital asset) and net earnings derived from the sale or other disposition of, the transfer of any interest in, or the licensing of the use of property (other than good will) by an individual whose personal efforts created such property."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years ending after the date of the enactment of this Act.

SEC. 207. EXCLUSION OF CERTAIN RENTS FROM PERSONAL HOLDING COMPANY INCOME.

(a) RENTS FROM LEASES OF CERTAIN TANGIBLE PERSONAL PROPERTY.—Section 543(b)(3) (relating to adjusted income from rents) is amended by striking out "but does not include amounts constituting personal holding company income under subsection (a)(6), nor copyright royalties (as defined in subsection (a)(4) nor produced film rents (as defined in subsection (a)(5)(B))." and inserting in lieu thereof the following: "but such term does not include—

"(A) amounts constituting personal holding company income under subsection (a)(6),

"(B) copyright royalties (as defined in subsection (a)(4)),

"(C) produced film rents (as defined in subsection (a)(5)(B)), or

"(D) compensation, however designated, for the use of, or the right to use, any tangible personal property manufactured or produced by the taxpayer, if during the taxable year the taxpayer is engaged

in substantial manufacturing or production of tangible personal property of the same type."

(b) TECHNICAL AMENDMENTS.—

(1) Section 543(a)(2) (relating to adjusted income from rents included in personal holding company income) is amended by striking out the last sentence thereof.

(2) Section 543(b)(2) (relating to definition of adjusted ordinary gross income) is amended by adding at the end thereof the following new subparagraph:

"(D) CERTAIN EXCLUDED RENTS.—From the gross income consisting of compensation described in subparagraph (D) of paragraph (3) subtract the amount allowable as deductions for the items described in clauses (i), (ii), (iii), and (iv) of subparagraph (A) to the extent allocable, under regulations prescribed by the Secretary or his delegate, to such gross income. The amount subtracted under this subparagraph shall not exceed such gross income."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after the date of the enactment of this Act. Such amendments shall also apply, at the election of the taxpayer

(made at such time and in such manner as the Secretary or his delegate may prescribe), to taxable years beginning on or before such date and ending after December 31, 1965.

SEC. 208. PERCENTAGE DEPLETION RATE FOR CERTAIN CLAY BEARING ALUMINA.

(a) 23 PERCENT RATE.—Section 613(b) (relating to percentage depletion rates) is amended—

(1) by inserting "clay, laterite, and nephelite syenite" after "anorthosite" in paragraph (2)(B); and

(2) by striking out "if paragraph (5)(B) does not apply" in paragraph (3)(B) and inserting in lieu thereof "if neither paragraph (2)(B) nor (5)(B) applies".

(b) TREATMENT PROCESSES.—Section 613(c)(4) (relating to treatment processes considered as mining) is amended—

(1) by striking out "and" at the end of subparagraph (G),

(2) by redesignating subparagraph (H) as (I), and by inserting after subparagraph (G) the following new subparagraph:

"(H) in the case of clay, laterite, and nephelite syenite from deposits in the United States (to the

extent that alumina and aluminum compounds are extracted therefrom)—all processes applied to derive alumina or aluminum compounds therefrom; and".

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 209. PERCENTAGE DEPLETION RATE FOR CLAM AND OYSTER SHELLS.

(a) 15 PERCENT RATE.—Section 613(b) (relating to percentage depletion rates) is amended—

(1) by striking out "mollusk shells (including clam shells and oyster shells)," in paragraph (5)(A), and

(2) by inserting "mollusk shells (including clam shells and oyster shells)," after "marble," in paragraph (6).

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 210. SINTERING AND BURNING OF SHALE, CLAY, AND SLATE USED AS LIGHTWEIGHT AGGREGATES.

(a) TREATMENT PROCESSES.—Section 613(c)(4) (relating to treatment processes considered as mining) is amended by striking out "and the furnacing of quicksilver ores" in subparagraph (E) and inserting in lieu thereof

"the furnacing of quicksilver ores, and the sintering or burning of shale, clay, and slate used or sold for use as lightweight aggregates".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 211. STRADDLES.

(a) TREATMENT AS SHORT-TERM CAPITAL GAIN.—Section 1234 (relating to options) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) SPECIAL RULE FOR GRANTORS OF STRADDLES.—

"(1) GAIN ON LAPSE.—In the case of gain on lapse of an option granted by the taxpayer as part of a straddle, the gain shall be deemed to be gain from the sale or exchange of a capital asset held for not more than 6 months on the day that the option expired.

"(2) EXCEPTION.—This subsection shall not apply to any person who holds securities for sale to customers in the ordinary course of his trade or business.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) The term 'straddle' means a simultaneously granted combination of an option to buy, and

an option to sell, the same quantity of a security at the same price during the same period of time.

"(B) The term 'security' has the meaning assigned to such term by section 1236(c)."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to straddle transactions entered into after January 25, 1965, in taxable years ending after such date.

SEC. 212. TAX TREATMENT OF PER-UNIT RETAIN ALLOCATIONS.

(a) TAX TREATMENT OF COOPERATIVES.—

(1) Section 1382(a) (relating to gross income of cooperatives) is amended by striking out the period at the end thereof and inserting "or by reason of any amount paid to a patron as a per-unit retain allocation (as defined in section 1388(f))."

(2) Section 1382(b) is amended—

(A) by striking out "(b) PATRONAGE DIVIDENDS.—" and inserting in lieu thereof "(b) PATRONAGE DIVIDENDS AND PER-UNIT RETAIN ALLOCATIONS.—",

(B) by striking out "or" at the end of paragraph (1),

(C) by striking out the period at the end of

paragraph (2) and inserting a semicolon in lieu thereof,

(D) by striking out the sentence following paragraph (2) and inserting in lieu thereof the following:

"(3) as per-unit retain allocations, to the extent paid in qualified per-unit retain certificates (as defined in section 1388(h)) with respect to marketing occurring during such taxable year; or

"(4) in money or other property (except per-unit retain certificates) in redemption of a nonqualified per-unit retain certificate which was paid as a per-unit retain allocation during the payment period for the taxable year during which the marketing occurred."

"For purposes of this title, any amount not taken into account under the preceding sentence shall, in the case of an amount described in paragraph (1) or (2), be treated in the same manner as an item of gross income and as a deduction therefrom, and in the case of an amount described in paragraph (3) or (4), be treated as a deduction in arriving at gross income."

(3) Section 1382(e) is amended to read as follows:

"(e) PRODUCTS MARKETED UNDER POOLING ARRANGEMENTS.—For purposes of subsection (b), in the case

of a pooling arrangement for the marketing of products—

"(1) the patronage shall (to the extent provided in regulations prescribed by the Secretary or his delegate) be treated as patronage occurring during the taxable year in which the pool closes, and

"(2) the marketing of products shall be treated as occurring during any of the taxable years in which the pool is open."

(4) Section 1382(f) is amended by striking out "subsection (b)" and inserting in lieu thereof "paragraphs (1) and (2) of subsection (b)".

(5) The heading for section 1383 is amended by striking out the period at the end thereof and inserting ***"OR NONQUALIFIED PER-UNIT RETAIN CERTIFICATES."***

(6) Section 1383(a) is amended—

(A) by striking out "section 1382(b)(2)" and inserting in lieu thereof "section 1382(b)(2) or (4),",

(B) by striking out "nonqualified written notices of allocation" each place it appears and inserting in lieu thereof "nonqualified written notices of allocation or nonqualified per-unit retain certificates", and

(C) by striking out "qualified written notices

of allocation" and inserting in lieu thereof "qualified written notices of allocation or qualified per-unit retain certificates (as the case may be)".

(7) Section 1383(b)(2) is amended—

(A) by striking out "nonqualified written notice of allocation" and inserting in lieu thereof "nonqualified written notice of allocation or nonqualified per-unit retain certificate",

(B) by striking out "qualified written notice of allocation" and inserting in lieu thereof "qualified written notice of allocation or qualified per-unit retain certificate (as the case may be)",

(C) by striking out "such written notice of allocation" and inserting in lieu thereof "such written notice of allocation or per-unit retain certificate", and

(D) by striking out "section 1382(b)(2)" and inserting in lieu thereof "section 1382(b) (2) or (4),".

(8) The table of sections for part I of subchapter T of chapter 1 is amended by striking out—

"Sec. 1383. Computation of tax where cooperative redeems nonqualified written notices of allocation."

and inserting in lieu thereof—

"Sec. 1383. Computation of tax where cooperative redeems nonqualified written notices of allocation or nonqualified per-unit retain certificates."

(b) TAX TREATMENT BY PATRONS.—

(1) Section 1385(a) is amended by striking out "and" at the end of paragraph (1), by striking out the period at the end of paragraph (2) and inserting in lieu thereof ", and", and by adding at the end thereof the following new paragraph:

"(3) the amount of any per-unit retain allocation which is paid in qualified per-unit retain certificates and which is received by him during the taxable year from an organization described in section 1381(a)."

(2) The heading for section 1385(c) is amended by striking out "ALLOCATION" and inserting in lieu thereof "ALLOCATION AND CERTAIN NONQUALIFIED PER-UNIT RETAIN CERTIFICATES".

(3) Section 1385(c)(1) is amended to read as follows:

"(1) APPLICATION OF SUBSECTION.—This subsection shall apply to—

"(A) any nonqualified written notice of allocation which—

"(i) was paid as a patronage dividend, or

"(ii) was paid by an organization described in section 1381(a)(1) on a patronage basis with respect to earnings derived from business

or sources described in section 1382(c)(2)(A), and

"(B) any nonqualified per-unit retain certificate which was paid as a per-unit retain allocation."

(4) Section 1385(c)(2) is amended—

(A) by striking out "nonqualified written notice of allocation" and inserting in lieu thereof "nonqualified written notice of allocation or nonqualified per-unit retain certificate", and

(B) by striking out "such written notice of allocation" each place it appears and inserting in lieu thereof "such written notice of allocation or per-unit retain certificate".

(5) The table of parts for subchapter T of chapter 1 is amended by striking out—

"Part II. Tax treatment by patrons of patronage dividends."

and inserting in lieu thereof—

"Part II. Tax treatment by patrons of patronage dividends and per-unit retain allocations."

(c) DEFINITIONS.—

(1)(A) Section 1388(e)(1) is amended by striking out "allocation)" and inserting in lieu thereof "allocation or a per-unit retain certificate)".

(B) Section 1388(e)(2) is amended by striking

out "allocation" and inserting in lieu thereof "allocation or qualified per-unit retain certificate".

(2) Section 1388 is amended by adding at the end thereof the following new subsections:

"(f) PER-UNIT RETAIN ALLOCATION.—For purposes of this subchapter, the term 'per-unit retain allocation' means any allocation, by an organization to which part I of this subchapter applies, other than by payment in money or other property (except per-unit retain certificates) to a patron with respect to products marketed for him, the amount of which is fixed without reference to the net earnings of the organization pursuant to an agreement between the organization and the patron.

"(g) PER-UNIT RETAIN CERTIFICATE.—For purposes of this subchapter, the term 'per-unit retain certificate' means any written notice which discloses to the receipient the stated dollar amount of a per-unit retain allocation to him by the organization.

"(h) QUALIFIED PER-UNIT RETAIN CERTIFICATE.—

"(1) DEFINED.—For purposes of this subchapter, the term 'qualified per-unit retain certificate' means any per-unit retain certificate which the distributee has agreed, in the manner provided in paragraph (2), to take into account at its stated dollar amount as provided in section 1385(a).

"(2) MANNER OF OBTAINING AGREEMENT.—A distributee shall agree to take a per-unit retain certificate into account as provided in paragraph (1) only by—

"(A) making such agreement in writing, or

"(B) obtaining or retaining membership in the organization after—

"(i) such organization has adopted (after the date of the enactment of this subsection) a bylaw providing that membership in the organization constitutes such agreement, and

"(ii) he has received a written notification and copy of such bylaw.

"(3) PERIOD FOR WHICH AGREEMENT IS EFFECTIVE.—

"(A) GENERAL RULE.—Except as provided in subparagraph (B)—

"(i) an agreement described in paragraph (2)(A) shall be an agreement with respect to all products delivered by the distributee to the organization during the taxable year of the organization during which such agreement is made and all subsequent taxable years of the organization; and

"(ii) an agreement described in paragraph (2)(B) shall be an agreement with respect to all products delivered by the distributee to the

organization after he received the notification and copy described in paragraph (2)(B)(ii).

"(B) REVOCATION, ETC.—

"(i) Any agreement described in paragraph (2)(A) may be revoked (in writing) by the distributee at any time. Any such revocation shall be effective with respect to products delivered by the distributee on or after the first day of the first taxable year of the organization beginning after the revocation is filed with the organization; except that in the case of a pooling arrangement described in section 1382(e) a revocation made by a distributee shall not be effective as to any products which were delivered to the organization by the distributee before such revocation.

"(ii) Any agreement described in paragraph (2)(B) shall not be effective with respect to any products delivered after the distributee ceases to be a member of the organization or after the bylaws of the organization cease to contain the provision described in paragraph (2)(B)(i).

"(i) NONQUALIFIED PER-UNIT RETAIN CERTIFICATE.—For purposes of this subchapter, the term 'nonquali-

fied per-unit retain certificate' means a per-unit retain certificate which is not described in subsection (h)."

(d) INFORMATION REPORTING.—

(1) AMOUNTS SUBJECT TO REPORTING.—Section 6044(b)(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 after subparagraph (C) the following new subparagraphs:

"(D) the amount of any per-unit retain allocation (as defined in section 1388(f)) which is paid in qualified per-unit retain certificates (as defined in section 1388(h)), and

"(E) any amount described in section 1382 (b)(4) (relating to redemption of nonqualified per-unit retain certificates)."

(2) DETERMINATION OF AMOUNT PAID.—

(A) Section 6044(d)(1) is amended by striking out "allocation)" and inserting in lieu thereof "allocation or a qualified per-unit retain certificate)".

(B) Section 6044(d)(2) is amended by striking out "allocation" and inserting in lieu thereof "allocation or a qualified per-unit retain certificate".

(e) EFFECTIVE DATES.—

(1) The amendments made by subsections (a), (b), and (c) shall apply to per-unit retain allocations made during taxable years of an organization described in section 1381(a) (relating to organizations to which part I of subchapter T of chapter 1 applies) beginning after April 30, 1966, with respect to products delivered during such years.

(2) The amendments made by subsection (d) shall apply with respect to calendar years after 1966.

(f) TRANSITION RULE.—

(1) Except as provided in paragraph (2), a written agreement between a patron and a cooperative association—

(A) which clearly provides that the patron agrees to treat the stated dollar amounts of all per-unit retain certificates issued to him by the association as representing cash distributions which he has, of his own choice, reinvested in the cooperative association,

(B) which is revocable by the patron at any time after the close of the taxable year in which it was made,

(C) which was entered into after October 14,

1965, and before the date of the enactment of this Act, and

(D) which is in effect on the date of the enactment of this Act, and with respect to which a written notice of revocation has not been furnished to the cooperative association,

shall be effective (for the period prescribed in the agreement) for purposes of section 1388(h) of the Internal Revenue Code of 1954 as if entered into, pursuant to such section, after the date of the enactment of this Act.

(2) An agreement described in paragraphs (1)(A) and (C) which was included in a by-law of the cooperative association and which is in effect on the date of the enactment of this Act shall be effective for purposes of section 1388(h) of such Code only for taxable years of the association beginning before May 1, 1967.

SEC. 213. EXCISE TAX RATE ON AMBULANCES AND HEARSES.

(a) CLASSIFICATION AS AUTOMOBILES.—Section 4062 (relating to definitions applicable to the tax on motor vehicles) is amended by adding at the end thereof the following new subsection:

"(b) AMBULANCES, HEARSES, ETC.—For purposes of section 4061(a), a sale of an ambulance, hearse, or combina-

tion ambulance-hearse shall be considered to be a sale of an automobile chassis and an automobile body enumerated in subparagraph (B) of section 4061(a)(2)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to articles sold after the date of the enactment of this Act.

SEC. 214. APPLICABILITY OF EXCLUSION FROM INTEREST EQUALIZATION TAX OF CERTAIN LOANS TO ASSURE RAW MATERIALS SOURCES.

(a) EXCEPTION TO EXCLUSION.—Section 4914(d) (relating to loans to assure raw materials sources) is amended by adding at the end thereof the following new paragraph:

"(3) EXCEPTION.—The exclusion from tax provided by paragraph (1) shall not apply in any case where the acquisition of the debt obligation of the foreign corporation is made with an intent to sell, or to offer to sell, any part of such debt obligation to United States persons."

(b) TECHNICAL AMENDMENTS.—(1) Section 4914 (j)(1) (relating to loss of entitlement to exclusion in case of certain subsequent transfers) is amended—

(A) by striking out in subparagraph (A) ", or the exclusion provided by subsection (d),", and

(B) by striking out "subsection (d) or (f)" in subparagraph (D) and inserting in lieu thereof "subsection (f)".

(2) Section 4918 (relating to exemption for prior

American ownership) is amended by adding at the end thereof the following new subsection:

"(g) CERTAIN DEBT OBLIGATIONS ARISING OUT OF LOANS TO ASSURE RAW MATERIAL SOURCES.—Under regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply to the acquisition by a United States person of any debt obligation to which section 4914(d) applied where the acquisition of the debt obligation by such person is made with an intent to sell, or to offer to sell, any part of such debt obligation to United States persons. The preceding sentence shall not apply if the tax imposed by section 4911 has applied to any prior acquisition of such debt obligation."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply with respect to acquisitions of debt obligations made after the date of the enactment of this Act.

SEC. 215. EXCLUSION FROM INTEREST EQUALIZATION TAX FOR CERTAIN ACQUISITIONS BY INSURANCE COMPANIES.

(a) NEW COMPANIES AND COMPANIES OPERATING IN FORMER LESS DEVELOPED COUNTRIES.—Section 4914 (e) (relating to acquisitions by insurance companies doing business in foreign countries) is amended—

(1) by striking out "at the time of the initial designation" in the last sentence of paragraph (2);

(2) by striking out "An" in the first sentence of paragraph (3)(A)(i) and inserting in lieu thereof "Except as provided in clause (iii), an";

(3) by striking out "under this subparagraph" in paragraph (3)(A)(ii) and inserting in lieu thereof "under clause (i)";

(4) by adding after clause (ii) of paragraph (3)(A) the following new clauses:

"(iii) INITIAL DESIGNATION AFTER OCTOBER 2, 1964.—An insurance company which was not in existence on October 2, 1964, or was otherwise ineligible to establish a fund (or funds) of assets described in paragraph (2) by making an initial designation under clause (i) on or before such date, may establish (and thereafter currently maintain) such fund (or funds) of assets at any time after the enactment of this clause by designating stock of a foreign issuer or a debt obligation of a foreign obligor as a part of such fund in accordance with the provisions of clause (iv) (if applicable) and subparagraph (B)(i).

"(iv) FUNDS INVOLVING CURRENCIES OF FORMER LESS DEVELOPED COUNTRIES.—An insurance company desiring to establish a fund under clause (iii) with respect to insurance contracts payable in the currency of a country designated as a less developed country on October 2, 1964, which thereafter has such designation terminated by an Executive order issued under section 4916(b), shall designate as assets of such fund, to the extent permitted by subparagraph (E), the stock of foreign issuers or debt obligations of foreign obligors as follows: First, stock and debt obligations having a period remaining to maturity of at least 1 year (other than stock or a debt obligation described in section 4916(a)) acquired before July 19, 1963, and owned by the company on the date which the President, in accordance with section 4916 (b), communicates to Congress his intention to terminate the status of such country as a less developed country; second, stock and debt obligations having a period remaining to maturity of at least 1 year described in section 4916(a) (and owned by the company on the date of such

termination) which, at the time of acquisition, qualified for the exclusion provided in such section because of the status of such country as a less developed country; and third, such stock or debt obligations as the company may elect to designate under subparagraph (B)(i). The period remaining to maturity referred to in the preceding sentence shall be determined as of the date of the President's communication to Congress.";

(5) by striking out "TO MAINTAIN FUND" in the heading of paragraph (3)(B);

(6) by striking out "as provided in subparagraph (A)(ii)" in paragraph (3)(B)(i) and inserting in lieu thereof "under subparagraphs (A) (i) and (ii)";

(7) by inserting before the period at the end of the first sentence of paragraph (3)(C) the following: "; except that, with respect to a fund established under subparagraph (A)(iii), stock or debt obligations acquired before the establishment of such fund may not be designated as part of such fund under this subparagraph";

(8) by striking out "subparagraph (B)," in para-

graph (3)(E)(i) and inserting in lieu thereof "subparagraph (A)(iv), (B),";

(9) by striking out "subparagraph (A)" in paragraph (4)(B)(i) and inserting in lieu thereof "subparagraph (A)(i)";

(10) by striking out "paragraph (3)(A)" in paragraph (4)(B)(ii) and inserting in lieu thereof "paragraph (3)(A)(i)"; and

(11) by adding at the end of paragraph (4) the following new paragraph:

"(C) SPECIAL RULE.—For purposes of subparagraph (A), if a country designated as a less developed country on September 2, 1964, thereafter has such designation terminated by an Executive order issued under section 4916(b), all insurance contracts payable in the currency of such country which were entered into before such designation was terminated shall be treated as insurance contracts payable in the currency of a country other than a less developed country."

(b) EFFECTIVE DATE.—The amendments made by sub-

section (a) shall take effect on the day after the date of the enactment of this Act.

SEC. 216. EXCLUSION FROM INTEREST EQUALIZATION TAX OF CERTAIN ACQUISITIONS BY FOREIGN BRANCHES OF DOMESTIC BANKS.

(a) AUTHORITY FOR MODIFICATION OF EXECUTIVE ORDERS.—Section 4931(a) (relating to commercial bank loans) is amended by adding at the end thereof the following new sentence: "Clause (A) of the preceding sentence shall not prevent a modification of such Executive order (or any modification thereof) to exclude from the application of subsection (b) acquisitions by commercial banks, through branches located outside the United States, of debt obligations of foreign obligors payable in currency of the United States."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to acquisitions of debt obligations made after the date of the enactment of this Act.

TITLE III—PRESIDENTIAL ELECTION CAMPAIGN FUND ACT

SEC. 301. SHORT TITLE.

This title may be cited as the "Presidential Election Campaign Fund Act of 1966".

SEC. 302. AUTHORITY FOR DESIGNATION OF $1 OF INCOME TAX PAYMENTS TO PRESIDENTIAL ELECTION CAMPAIGN FUND.

(a) Subchapter A of chapter 61 of the Internal Revenue Code of 1954 (relating to returns and records) is amended by adding at the end thereof the following new part:

"PART VIII—DESIGNATION OF INCOME TAX PAYMENTS TO PRESIDENTIAL ELECTION CAMPAIGN FUND

"Sec. 6096. Designation by individuals.

"SEC. 6096. DESIGNATION BY INDIVIDUALS.

"(a) IN GENERAL.—Every individual (other than a nonresident alien) whose income tax liability for any taxable year is $1 or more may designate that $1 shall be paid into the Presidential Election Campaign Fund established by section 303 of the Presidential Election Campaign Fund Act of 1966.

"(b) INCOME TAX LIABILITY.—For purposes of subsection (a), the income tax liability of an individual for any taxable year is the amount of the tax imposed by chapter 1 on such individual for such taxable year (as shown on his

return), reduced by the sum of the credits (as shown in his return) allowable under sections 32(2), 33, 35, 37, and 38.

"(c) MANNER AND TIME OF DESIGNATION.—A designation under subsection (a) may be made with respect to any taxable year, in such manner as the Secretary or his delegate may prescribe by regulations—

"(1) at the time of filing the return of the tax imposed by chapter 1 for such taxable year, or

"(2) at any other time (after the time of filing the return of the tax imposed by chapter 1 for such taxable year) specified in regulations prescribed by the Secretary or his delegate."

(b) The table of parts for subchapter A of chapter 61 of such Code is amended by adding at the end thereof the following new item:

"Part VIII. Designation of income tax payments to Presidential Election Campaign Fund."

(c) The amendments made by this section shall apply with respect to income tax liability for taxable years beginning after December 31, 1966.

SEC. 303. PRESIDENTIAL ELECTION CAMPAIGN FUND.

(a) ESTABLISHMENT.—There is hereby established on the books of the Treasury of the United States a special fund to be known as the "Presidential Election Campaign Fund" (hereafter in this section referred to as the "Fund"). The

Fund shall consist of amounts transferred to it as provided in this section.

(b) TRANSFERS TO THE FUND.—The Secretary of the Treasury shall, from time to time, transfer to the Fund an amount equal to the sum of the amounts designated by individuals under section 6096 of the Internal Revenue Code of 1954 for payment into the Fund.

(c) PAYMENTS FROM FUND.—

(1) IN GENERAL.—The Secretary of the Treasury shall, with respect to each presidential campaign, pay out of the Fund, as authorized by appropriation Acts, into the treasury of each political party which has complied with the provisions of paragraph (3) an amount (subject to the limitation in paragraph (3)(B)) determined under paragraph (2).

(2) DETERMINATION OF AMOUNTS.—

(A) Each political party whose candidate for President at the preceding presidential election received 10,000,000 or more popular votes as the candidate of such political party shall be entitled to payments under paragraph (1) with respect to a presidential campaign equal to—

(i) $1 multiplied by the total number of popular votes cast in the preceding presidential

election for candidates of political parties whose candidates received 10,000,000 or more popular votes as the candidates of such political parties, divided by

(ii) the number of political parties whose candidates in the preceding presidential election received 10,000,000 or more popular votes as the candidates of such political parties.

(B) Each political party whose candidate for President at the preceding presidential election received more than 1,500,000, but less than 10,000,000, popular votes as the candidate of such political party shall be entitled to payments under paragraph (1) with respect to a presidential campaign equal to $1 multiplied by the number of popular votes in excess of 1,500,000 received by such candidate as the candidate of such political party in the preceding presidential election.

(C) Payments under paragraph (1) shall be made with respect to each presidential campaign at such times as the Secretary of the Treasury may prescribe by regulations, except that no payment with respect to any presidential campaign shall be made before September 1 of the year of the presidential election with respect to which such campaign is con-

ducted. If at the time so prescribed for any such payments, the moneys in the Fund are insufficient for the Secretary to pay into the treasury of each political party which is entitled to a payment under paragraph (1) the amount to which such party is entitled, the payment to all such parties at such time shall be reduced pro rata, and the amounts not paid at such time shall be paid when there are sufficient moneys in the Fund.

(3) LIMITATIONS.—

(A) No payment shall be made under paragraph (1) into the treasury of a political party with respect to any presidential campaign unless the treasurer of such party has certified to the Comptroller General the total amount spent or incurred (prior to the date of the certification) by such party in carrying on such presidential campaign, and has furnished such records and other information as may be requested by the Comptroller General.

(B) No payment shall be made under paragraph (1) into the treasury of a political party with respect to any presidential campaign in an amount which, when added to previous payments made to such party, exceeds the amount spent or incurred by

such party in carrying on such presidential campaign.

(4) The Comptroller General shall certify to the Secretary of the Treasury the amounts payable to any political party under paragraph (1). The Comptroller General's determination as to the popular vote received by any candidate of any political party shall be final and not subject to review. The Comptroller General is authorized to prescribe such rules and regulations, and to conduct such examinations and investigations, as he determines necessary to carry out his duties and functions under this subsection.

(5) DEFINITIONS.—For purposes of this subsection—

(A) The term "political party" means any political party which presents a candidate for election to the office of President of the United States.

(B) The term "presidential campaign" means the political campaign held every fourth year for the election of presidential and vice presidential electors.

(C) The term "presidential election" means the election of presidential electors.

(d) TRANSFERS TO GENERAL FUND.—If, after any presidential campaign and after all political parties which are entitled to payments under subsection (c) with respect

to such presidential campaign have been paid the amounts to which they are entitled under subsection (c), there are moneys remaining in the Fund, the Secretary of the Treasury shall transfer the moneys so remaining to the general fund of the Treasury.

SEC. 304. ESTABLISHMENT OF ADVISORY BOARD.

(a) There is hereby established an advisory board to be known as the Presidential Election Campaign Fund Advisory Board (hereafter in this section referred to as the "Board"). It shall be the duty and function of the Board to counsel and assist the Comptroller General in the performance of the duties imposed on him under section 303 of this Act.

(b) The Board shall be composed of two members representing each political party whose candidate for President at the last presidential election received 10,000,000 or more popular votes as the candidate of such political party, which members shall be appointed by the Comptroller General from recommendations submitted by each such political party, and of three additional members selected by the members so appointed by the Comptroller General. The term of the first members of the Board shall expire on the 60th day after the date of the first presidential election following the date of the enactment of this Act and the term of subsequent members of the Board shall begin on the 61st day after the date of a

presidential election and expire on the 60th day following the date of the subsequent presidential election. The Board shall select a Chairman from among its members.

(c) Members of the Board shall receive compensation at the rate of $75 a day for each day they are engaged in performing duties and functions as such members, including travel time, and, while away from their homes or regular places of business, shall be allowed travel expenses, including per diem in lieu of subsistence, as authorized by law for persons in the Government service employed intermittently.

(d) Service by an individual as a member of the Board shall not, for purposes of any other law of the United States, be considered as service as an officer or employee of the United States.

SEC. 305. APPROPRIATIONS AUTHORIZED.

There are authorized to be appropriated, out of the Presidential Elections Campaign Fund, such sums as may be necessary to enable the Secretary of the Treasury to make payments under section 303 of this Act.

TITLE IV—MISCELLANEOUS PROVISIONS

SEC. 401. TREASURY NOTES PAYABLE IN FOREIGN CURRENCY.

Section 16 of the Second Liberty Bond Act, as amended (31 U.S.C. 766), is amended by striking out "bonds" wher-

ever it appears therein and inserting in lieu thereof "bonds, notes,".

SEC. 402. REPORTS TO CLARIFY TO NATIONAL DEBT AND TAX STRUCTURE.

The Secretary of the Treasury shall, on or before March 31 of each year (beginning with 1967), submit to the Senate and the House of Representatives a report setting forth, as of the close of December 31 of the preceding year, the aggregate and individual amounts of the contingent liabilities and the unfunded liabilities of the Government, and of each department, agency, and instrumentality thereof, including, without limitation, trust fund liabilities, Government-sponsored corporations' liabilities, indirect liabilities not included as a part of the public debt, and liabilities of insurance and annuity programs, including their actuarial status on both a balance sheet and projected source and application of funds basis. The report shall also set forth the collateral pledged, or the assets available (or to be realized), as security for such liabilities (Government securities to be separately noted), and an analysis of their significance in terms of past experience and probable risk, and shall also set forth all other assets available to liquidate liabilities of the Government. The report shall set forth the required data in a concise form, with such explanatory material as the Secretary may determine to be necessary or desirable, and shall

include total amounts of each category according to the department, agency, or instrumentality involved.

SEC. 403. COVERAGE OF EXPENSES OF CERTAIN DRUGS UNDER SUPPLEMENTARY MEDICAL INSURANCE BENEFITS.

(a) Section 1832(a) of the Social Security Act is amended (1) by striking out "and" at the end of paragraph (1), (2) by striking out the period at the end of paragraph (2) and inserting in lieu thereof "; and", and (3) by adding at the end thereof the following new paragraph:

"(3) entitlement to be paid for allowable expenses (as defined in section 1845(a)(2)), or, if lower, actual expenses, incurred by him for the purchase of qualified drugs (as defined in subsection (a)(1) of such section)."

(b) Section 1833(a) of such Act is amended (1) by inserting "or qualified drugs" after "incurs expenses for services", (2) by striking out the period at the end of paragraph (2) and inserting in lieu thereof "; and", and (3) by adding at the end thereof the following new paragraph:

"(3) in the case of expenses covered under section 1832(a)(3)—100 per centum of such expenses."

(c) Section 1833(b) of such Act is amended by adding at the end thereof the following new sentence: "For purposes of determining amounts to be counted toward meeting

the $50 deductible imposed by the preceding sentence, there shall not be included any expenses incurred for any drug or biological which is in excess of the allowable expenses (as defined in section 1845(a)(2)) of such drug or biological."

(d) Part B of title XVIII of such Act is amended by adding at the end thereof the following new sections:

"ALLOWABLE EXPENSES FOR QUALIFIED DRUGS

"SEC. 1845. (a) For purposes of this part—

"(1) The term 'qualified drug' means a drug or biological which is included among the items approved by the Formulary Committee (established pursuant to section 1846(a)).

"(2) The term 'allowable expense', when used in connection with any quantity of a qualified drug, means the amount established with regard to such quantity of such drug by the Formulary Committee and approved by the Secretary.

"(b) Amounts to which an individual is entitled by reason of the provisions of section 1832(a)(3) shall be paid directly to such individual or, if such individual has assigned his right to receive any such amount to another person, the amount so assigned shall be paid to such other person. No individual shall be paid any amount by reason of the provisions of section 1832(a)(3) prior to the presentation by

him (or by another on his behalf) of documentary or other proof satisfactory to the Secretary establishing his entitlement thereto.

"(c) The benefits provided by reason of section 1832 (a)(3) may be paid by the Secretary or the Secretary may utilize the service of carriers for the administration of such benefits under contracts entered into between the Secretary and such carriers for such purpose. To the extent determined by the Secretary to be appropriate, the provisions relating to contracts entered into pursuant to section 1842 shall be applicable to contracts entered into pursuant to this subsection.

"FORMULARY COMMITTEE

"SEC. 1846. (a) There is hereby established a Formulary Committee to consist of the Surgeon General of the Public Health Service, the Commissioner of the Food and Drug Administration, and the Director of the National Institutes of Health.

"(b)(1) It shall be the duty of the Formulary Committee, with the advice and assistance of the Formulary Advisory Group (established pursuant to section 1847) to—

"(A) determine which drugs and biologicals shall constitute qualified drugs for purposes of the benefits provided under section 1832(a); and

"(B) determine, with the approval of the Secre-

tary, the allowable expense, for purposes of such benefits, of the various quantities of any drug determined by the Committee to constitute a qualified drug; and

"(C) publish and disseminate at least once each calendar year among individuals insured under this part, physicians, pharmacists, and other interested persons, in accordance with directives of the Secretary, an alphabetic list naming each drug or biological (by its generic name and by each other name by which it is known) which is a qualified drug together with the allowable expense of various quantities thereof, and if any such drug or biological is known by a trade name, the generic name shall also appear with such trade name.

"(2)(A) Until the Formulary Committee determines to the contrary, any drug or biological which is included in the United States Public Health Service Formulary shall be regarded as a qualified drug for purposes of the benefits provided under section 1832(a)(3). Drugs or biologicals not included in such Formulary shall be regarded as qualified drugs for such purposes upon determination of the Formulary Committee that such drugs or biologicals should be so regarded. Any drug or biological included on the list of qualified drugs shall, if listed by generic name, also be listed by its trade name or names, if any.

"(B) Drugs and biologicals shall be determined to be qualified drugs only if they can legally be obtained by the user pursuant to a prescription of a physician; except that the Formulary Committee may include certain drugs and biologicals not requiring such a prescription if it determines such drugs or biologicals to be of a lifesaving nature.

"(C) In the interest of orderly, economical, and equitable administration of the benefits provided under section 1832(a)(3), the Formulary Committee may, by regulation, provide that a drug or biological otherwise regarded as being a qualified drug shall not be so regarded when prescribed below certain minimum quantities.

"(3) In determining the allowable expense for any quantity of any qualified drug, the Formulary Committee shall give due consideration to recognized pricing guides for drugs, and of other pertinent factors, with a view to determining with respect to each qualified drug a schedule of prices for various quantities thereof which reflects the cost thereof to the ultimate dispensor of the drug plus a reasonable fee for the preparation, handling, and distribution thereof to the consumer thereof. In any case in which a drug or biological is available by generic name and one or more trade names any one of which is different from such generic name the cost of such drug or biological, for pur-

poses of the preceding sentence, shall be deemed to be the lowest cost of such drug, however named."

"ADVISORY GROUP TO FORMULARY COMMITTEE

"SEC. 1847. (a) For the purpose of assisting the Formulary Committee to carry out its duties and functions, the Secretary shall appoint an Advisory Group to the Formulary Committee (hereinafter in this section referred to as the 'Advisory Group'). The Advisory Group shall consist of seven members to be appointed by the Secretary. From time to time, the Secretary shall designate one of the members of the Advisory Group to serve as Chairman thereof. The members shall be so selected that each represents one or more of the following national organizations: an organization of physicians, an organization of manufacturers of drugs, an organization of pharmacists, an organization of persons concerned with public health, an organization of hospital pharmacists, an organization of colleges of medicine, an organization of colleges of pharmacy, and an organization of consumers. Each member shall hold office for a term of three years, except that any member appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed for the remainder of such term, and except that the terms of office of six of the members first taking office shall expire, as designated

by the Secretary at the time of appointment, two at the end of the first year, two at the end of the second year, and two at the end of the third year, after the date of appointment. A member shall not be eligible to serve continuously for more than two terms.

"(b) Members of the Advisory Group, while attending meetings or conferences thereof or otherwise serving on business of the Advisory Group, shall be entitled to receive compensation at rates to be fixed by the Secretary, but not exceeding $75 per day, including traveltime, and while so serving away from their homes or regular places of business they may be allowed travel expenses, including per diem in lieu of subsistence, as authorized by section 3109 of title 5, United States Code, for persons in the Government service employed intermittently.

"(c) The Advisory Group is authorized to engage such technical assistance as may be required to carry out its functions, and the Secretary shall, in addition, make available to the Advisory Group such secretarial, clerical, and other assistance and such pertinent data obtained and prepared by the Department of Health, Education, and Welfare as the Advisory Group may require to carry out its functions."

(e) The amendments made by this section shall become effective on whichever of the following first occurs: (1) the first day of the first month with respect to which the rate of

the monthly premium for participation is raised, pursuant to section 1839(b) of the Social Security Act, after the date of enactment of this Act, or (2) July 1, 1968.

Amend the title so as to read: "An Act to provide equitable tax treatment for foreign investment in the United States, to establish a Presidential Election Campaign Fund to assist in financing the costs of presidential election campaigns, and for other purposes."

Passed the House of Representatives June 15, 1966.

Attest: RALPH R. ROBERTS,
Clerk.

SECTION 24
COMMITTEE REPORT

1405

Calendar No. 1675

89TH CONGRESS
2d Session

SENATE

REPORT
No. 1707

FOREIGN INVESTORS TAX ACT OF 1966; PRESIDENTIAL ELECTION CAMPAIGN FUND ACT; AND OTHER AMENDMENTS

REPORT

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

TO ACCOMPANY

H.R. 13103

A BILL TO PROVIDE EQUITABLE TAX TREATMENT FOR FOREIGN INVESTMENT IN THE UNITED STATES

OCTOBER 11, 1966.—Ordered to be printed

Filed under authority of the order of the Senate of October 11, 1966

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1966

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Calendar No. 1675

89TH CONGRESS, 2d Session | SENATE | REPORT No. 1707

FOREIGN INVESTORS TAX ACT OF 1966; PRESIDENTIAL ELECTION CAMPAIGN FUND ACT; AND OTHER AMENDMENTS

OCTOBER 11, 1966.—Ordered to be printed

Filed under authority of the order of the Senate of October 11, 1966

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 13103]

The Committee on Finance, to which was referred the bill (H.R. 13103) to amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

I. SUMMARY

Your committee has accepted the House bill, the Foreign Investors Tax Act of 1966, with certain changes indicated below. In the bill as amended by your committee the Foreign Investors Tax Act provisions are referred to as title I. In addition, your committee has added to the bill certain other amendments which appear as titles II, III, and IV. These titles relate to other Internal Revenue Code amendments, the Presidential Election Campaign Fund Act, and other amendments, respectively.

A summary of the principal changes made by this bill—with your committee's amendments indicated—for the most part presented in the order in which they appear in the bill follows:

A. The Foreign Investors Tax Act

1. Interest on deposits in foreign branch banks of domestic corporations.—Interest on deposits with foreign branch banks of U.S. corporations or partnerships is to be treated as foreign source income, and

thus free of U.S. income tax when paid to nonresident aliens and foreign corporations..

2. Source rules for bank deposit interest and similar income.—After December 31, 1971, all interest on U.S. bank deposits (other than those described in No. 1 above), whether or not effectively connected with a U.S. business, is to be treated as U.S. source income (and subject to U.S. income tax) in the case of nonresident aliens and foreign corporations. Until then, this interest on bank deposits, interest paid on accounts with mutual savings banks, domestic building and loan associations, etc., and interest on amounts held by insurance companies on deposit also are to be treated as foreign source income (unless effectively connected with a U.S. business) and thereby free of U.S. income tax.

3. Rules for determining the source of dividends from foreign corporations.—The source rule with respect to dividends paid by foreign corporations is amended to provide that dividends received from a foreign corporation are to be considered as having a U.S. source only if 50 percent (House bill provided an 80-percent rule) of the corporation's gross income for the prior 3 years was effectively connected with the conduct of a trade or business in the United States.

4. Compensation for personal services.—The special source rule, providing that certain payments of compensation for services performed in the United States by a nonresident alien are treated as foreign source income (and therefore free of U.S. tax) if the services are performed for certain foreign persons or a foreign office of a U.S. corporation, is extended to services performed for a foreign office of a proprietor who is a citizen or resident of the United States or for the foreign office of a domestic partnership.

5. Trading in stocks or securities or in commodities.—Except in the case of dealers and certain investment companies, trading in stocks or securities in the United States for one's own account, whether by a foreign investor physically present in the United States, through an employee located here, or through a resident agent (whether or not the agent has discretionary authority) is not to constitute a trade or business in the United States for income tax purposes. A parallel rule is provided for those trading in commodities.

6. Income effectively connected with the conduct of a trade or business in the United States.—The benchmark to be used in determining whether income is to be subject to a flat 30-percent rate or taxed substantially the same as income earned here by a U.S. citizen or domestic corporation is whether or not the income is effectively connected with a U.S. business. In the case of investment and other fixed or determinable income and capital gains from U.S. sources the income is to be treated as effectively connected with a U.S. business if the income is derived from assets used or held for use in the conduct of a U.S. business or if the activities of the U.S. business are a material factor in the realization of the income. All other types of U.S. source income are to be considered to be effectively connected if there is a U.S. business. Income from sources without the United States will not be treated as effectively connected with a U.S. business unless the nonresident alien or foreign corporation has a fixed place of business in the United States and the income is attributable to that place of business. Moreover, in general only rents and royalties from licensing,

certain income from banking and so forth, and sales income are to be taken into account for this purpose and only to the extent the income is not "subpart F" income or income derived from a foreign corporation 50 percent owned by the nonresident alien or foreign corporation receiving the income. Your committee modified the provision of the House bill dealing with "effectively connected" foreign source income to exclude (*a*) income derived from a transaction in which the U.S. office was not a material factor, (*b*) income not derived from the usual business activities of the U.S. office, and (*c*) income not properly allocable to the U.S. office. Additionally, the definition of a U.S. office was redefined to exclude the office of certain agents. In another modification, the foreign tax credit provision was expanded to include domiciliary taxes attributable to the foreign source effectively connected income.

7. Income tax on nonresident alien individuals.—The income of nonresident aliens which is effectively connected with a U.S. business is to be taxed at the regular graduated rates applicable to individuals and all income not so connected is to be taxed at a flat 30-percent rate (or lower applicable treaty rate). U.S. source capital gains of a nonresident alien not engaged in business in the United States are to be taxed only if the alien was in the United States for 183 days or more during the year. Deductions are allowable only to the extent allocable to income which is effectively connected to a U.S. business. Also, an election is provided which allows an alien to treat income from real property as U.S. business income in order to take deductions allocable to it.

8. Expatriation to avoid income tax.—U.S. source income and the effectively connected income of a citizen received for 10 years after expatriation is, in most cases, to be taxed at the regular U.S. tax rates if a principal purpose of the expatriation was the avoidance of U.S. income, estate, or gift taxes. The House bill would have provided a 5-year rule for income taxes.

9. Withheld taxes and declarations of estimated income tax.—The Treasury Department is authorized to require payment of amounts withheld from nonresident aliens and foreign corporations on a more current basis, rather than the annual basis presently provided. Nonresident aliens who receive income which is effectively connected with the conduct of a U.S. business are to be required to file declarations of estimated tax.

10. Income tax on foreign corporations.—The regular corporate income tax is to apply to income of foreign corporations which is effectively connected with a U.S. business. U.S. source income which is not so connected is taxable at a flat 30-percent rate (or at a lower treaty rate). Foreign corporations are given an election to treat real property income as business income similar to that afforded nonresident aliens.

11. Foreign corporations carrying on insurance business in the United States.—A foreign corporation carrying on a life insurance business within the United States is to be taxed under the present special insurance company provisions on its income effectively connected with a U.S. business. The remainder of the income of this type of corporation from sources within the United States is to be taxed in the same manner as income of other corporations which is not

effectively connected; that is, at a flat 30-percent rate. An adjustment also is made to avoid double taxation which might result from the interaction of the minimum surplus provision for life insurance companies under present law and the new method of taxing foreign life insurance companies.

12. Discrimination and more burdensome taxes by foreign countries.—The House bill authorizes the President to reinstate the income, estate, or gift tax provisions in effect prior to the enactment of this bill in the case of foreigners upon a determination that the foreign country in which they are residents or were incorporated is imposing more burdensome taxes on U.S. citizens or domestic corporations on income from sources within the foreign country than the U.S. tax on similar U.S. source income of foreigners. Your committee added an amendment which provides the President with authority in the case of discrimination by a foreign government against U.S. persons, to take such action as is necessary to raise the effective rate of U.S. tax on income received by nationals or corporations of that other country to substantially the same effective rates as are applied in the other country on income of U.S. citizens or corporations.

13. Foreign community property income.—A U.S. citizen who is married to a nonresident alien and resident in foreign country with community property laws, is to have an election for post-1966 years to treat the community income of the husband and wife as income of the person who earns it or, in the case of trade or business income, as income of the husband unless the wife manages the business. Income from separate property is to be treated as income of the person owning the property. All other community income is to be governed by the applicable foreign community property law. For open pre-1967 years, an election may also be made and the rules set forth above govern except that the other community income is to be treated as the income of the person who had the greater income from the other community income categories plus separate income.

14. Foreign tax credit.—A foreign tax credit is to be allowed nonresident aliens and foreign corporations with respect to foreign taxes on foreign source income which is effectively connected to the conduct of a U.S. business. Your committee extended this provision to include income taxes paid to the foreigner's home country on grounds other than that the income was derived from sources within that country.

15. Similar income tax credit requirement.—Under present law a foreign tax credit is denied to citizens of a foreign country who are resident in the United States if the foreign country does not allow a similar credit to U.S. citizens who are resident in the foreign country. In the future the credit is to be denied only where the President finds that this is in the public interest and the foreign country refuses to grant U.S. citizens such a credit when requested to do so.

16. Separate foreign tax credit limitation.—The 10-percent exception to the separate application of the limitation on the foreign tax credit for interest income was amended by your committee so as to apply to a U.S. corporation which directly or indirectly owns 10 percent of the foreign corporation from which the interest is derived, or is a member of an affiliated group of corporations which has such ownership. The House bill contained a more limited exception which

would have provided that the separate limitation is not to apply to a domestic funding subsidiary which is formed and availed of for the principal purpose of (1) raising funds outside the United States through foreign public offerings, and (2) using these funds to finance the foreign operations of related foreign corporations.

17. Estate tax rates, exemptions, and returns.—A separate schedule of estate tax rates is made applicable to estates of nonresident aliens. The rates are graduated from 5 percent on the first $100,000 of a taxable estate to 25 percent on the portion which exceeds $2 million. The exemption also is raised from $2,000 to $30,000. These two measures are designed to accord approximately the same tax treatment in the case of the estate of a nonresident alien as is accorded a similar-sized estate of a citizen eligible for a marital deduction. The filing requirement for returns for the estates of these nonresident aliens also is raised from $2,000 to $30,000.

18. Situs rule for bonds.—For purposes of the tax imposed on the estates of nonresident aliens, bonds of a U.S. person, the United States, a State, or political subdivision owned by a nonresident not a citizen of the United States, are to be considered property within the United States and therefore subject to U.S. estate tax. This rule already applies in the case of other forms of debt obligations.

19. Situs rule for bank deposits.—U.S. bank deposits of nonresident aliens are to be treated as property within the United States and therefore subject to U.S. estate tax after 1971. The provisions of the House bill would have been effective immediately.

20. Situs rule for deposits in foreign branch banks.—Deposits in a foreign branch bank of a U.S. corporation or partnership are to be treated as property without the United States and therefore not includible in a foreigner's U.S. estate tax base.

24. Expatriation to avoid estate tax.—The estate of a nonresident alien is to be taxed at the regular U.S. estate tax rates if, within 10 years of his death, the alien had expatriated from the United States with a principal purpose of avoiding U.S. taxes.

22. Tax on gifts of nonresident aliens.—Transfers of intangible property by nonresident aliens are not to be subject to gift tax whether or not they are engaged in business in the United States. However, gifts of intangibles made by citizens who become expatriates within 10 years of making the gift are to be subject to gift tax if the avoidance of income, estate or gift taxes was a principal purpose for their becoming an expatriate. In the case of a person who expatriated for tax avoidance reasons, debt obligations of a U.S. person, or of the United States or a State or political subdivision, are to be treated as having a situs in the United States.

23. Treaty obligations.—No amendment made by this bill is to apply in any case where its application would be contrary to any treaty obligation of the United States. However, the granting of a benefit provided by an amendment made by this bill is not to be considered to be contrary to a treaty obligation. Thus, even though a nonresident alien or foreign corporation has a permanent establishment in the United States, income which is not effectively connected with this business is to be taxed at the applicable treaty rate rather than at the regular individual or corporate rate.

B. Other amendments to the Internal Revenue Code (added by your committee)

1. Application of the investment credit to certain property in U.S. possessions.—The investment credit is extended to property located in U.S. possessions provided the property is owned by a U.S. company or citizen, subject to U.S. tax on its income from possessions, would otherwise have qualified for the investment credit, and is not owned or used by U.S. persons who are presently exempt from U.S. tax. This amendment is effective with respect to property placed in service after December 31, 1965.

2. Medical expense deductions of persons 65 and over.—The amendment repeals the provisions with respect to a taxpayer age 65 or over, his spouse age 65 or over, and dependent mothers or fathers who are age 65 or over, which, beginning in 1967, would limit their medical deductions to medical care expenses in excess of 3 percent of adjusted gross income and define their medical care expenses to include only those medicine and drug expenses in excess of 1 percent of adjusted gross income.

3. Corporate acquisition of assets of another corporation.—(*a*) *Purchase of stock.*—Under present law, the purchase from an unrelated party by one corporation of at least 80 percent of the stock of another corporation followed by the liquidation of the acquired corporation within 2 years is treated as a purchase of the assets of the acquired corporation. These amendments expand the definition of "purchase" to include the purchase of stock from a 50-percent owned subsidiary if stock in the 50-percent owned subsidiary was also acquired by purchase. The change is to be effective with respect to acquisitions of stock made after December 31, 1965.

(*b*) *Installment notes.*—This amendment provides that when installment notes are transferred in the type of purchase and liquidation described above, gain is to be recognized to the distributing corporation in the same manner as if it had sold the notes. This amendment is to be effective with respect to distributions made after the date of enactment of this act.

4. Swap funds.—The amendment sets aside certain Treasury regulations proposing to tax the exchange of appreciated securities for shares in a mutual investment fund.

5. Self-employed persons retirement plans: minimum amount treated as earned income.—This amendment raises from $2,500 to $6,600 the minimum amount of earnings from a trade or business, in which both personal services and capital are material income-producing factors, which a self-employed person may treat as earned income regardless of the general rule that only 30 percent of the net profits of the trade or business may be treated as a self-employed person's earned income. This amendment applies to taxable years beginning after December 31, 1965.

6. Self-employed persons retirement plans: certain income of authors, inventors, and so forth.—The bill amends present law relating to self-employed individuals' retirement plans to permit authors, inventors, and so forth, to include gains (other than capital gains) from sales and other transfers of their works in their earned income base for

the purpose of computing deductions for contributions to such plans. This change will be effective for taxable years ending after the date of enactment of this act.

7. Exclusion of certain rents from personal holding company income.—This amendment provides, for taxable years beginning after the date of enactment of the act (and certain earlier years at the election of the taxpayer), that rent received from the lease of tangible personal property manufactured by a taxpayer is not to be treated as personal holding company income.

8. Percentage depletion in the case of certain clay-bearing alumina.—This amendment provides, with respect to taxable years beginning after the date of enactment, a percentage depletion rate of 23 percent for alumina and aluminum compounds extracted from domestic deposits of clay, laterite, and nephelite syenite. It further provides that in computing gross income from mining all processes applied to derive alumina or aluminum compounds from such clay, laterite, and nephelite syenite are to be treated as mining processes.

9. Percentage depletion rate for clam and oyster shells.—This amendment provides that mollusk shells (including clam and oyster shells) are to be allowed percentage depletion at the same rate (15 percent) as is applicable in the case of limestone and other calcium carbonates. This change is applicable to taxable years beginning after the date of enactment.

10. Sintering and burning of shale, clay, and slate.—This amendment provides that for purposes of percentage depletion, the sintering or burning of shale, clay, and slate used or sold for use as lightweight aggregates is to be treated as a mining process. This amendment is applicable to taxable years beginning after the date of enactment.

11. Straddles.—This amendment provides that, with respect to straddle transactions entered into after January 25, 1965, the income from the lapse of an option which originated as part of a straddle is to be treated as a short-term capital gain (instead of ordinary income). This permits it to be netted against any capital loss which may result from the exercise of the other option in the straddle while retaining what in most respects is ordinary income treatment for any excess of net short-term capital gain over net long-term capital loss.

12. The taxation of per-unit retain allocations of cooperatives.—The bill clarifies present law dealing with the taxation of cooperatives and patrons to insure that a current single tax is paid, at either the cooperative or patron level, with respect to per-unit retain certificates. In so doing, the amendment makes the treatment of these certificates generally comparable to the treatment of patronage dividends under present law.

13. The excise tax on hearses.—This bill provides that the sale of an ambulance, hearse, or combination ambulance-hearse vehicle is to be considered to be the sale of an automobile chassis or automobile body (rather than a truck chassis or body) for purposes of determining the manufacturers' excise tax on motor vehicles. This change applies with respect to articles sold after the date of enactment of this bill.

14. Interest equalization tax: raw material source loans.—Subsequent transfers of debt obligations to assure raw material sources are

to be exempt from the interest equalization tax where the indebtedness is acquired without an intent on the part of the purchaser to sell it to other U.S. persons. This change is to be effective with respect to acquisitions of debt obligations made after the date of enactment.

15. Interest equalization tax: certain acquisitions by insurance companies in developed countries.—The present exemption for reserve asset pools of U.S. insurance companies is extended to allow the establishment of reserve asset pools where a U.S. insurance company commences activities in a developed country or where a less-developed country is designated as a developed country. This amendment is to take effect on the day after the date of enactment.

16. Interest equalization tax: Euro-dollars.—The President is given the authority to exempt from the interest equalization tax U.S. dollar loans of more than 1 year made by the foreign branches of U.S. banks. This change is to apply to acquisitions of debt obligations made after the date of enactment.

C. Presidential Election Campaign Fund Act

This title provides for public support of presidential election campaign financing. Individual taxpayers are to be able to designate on their annual tax returns that $1 of their income tax liability is to be placed in a presidential election campaign fund. The amounts in the fund are to be made available to defray the expenses incurred by political parties in presenting candidates for President and Vice President. Amounts will only be paid to those political parties whose candidates received at least 1,500,000 votes in the preceding presidential election.

A major political party (one whose candidate polled 10 million votes or more in the preceding presidential election) is to be eligible to receive a payment from the fund equal to $1 times the number of votes cast for the presidential candidates of the major political parties in the preceding presidential election divided by the number of such major political parties. A minor party (one whose candidate polled more than 1,500,000 but less than 10 million votes) is to be eligible to receive a payment from the fund equal to $1 for each vote in excess of 1,500,000 votes that its candidate received in the preceding presidential election. The payment received by any political party is to be limited, however, to reimbursement of presidential campaign expenses actually incurred by the party in connection with the current presidential election.

The Comptroller General is authorized to determine the campaign expenses of the political parties and to determine the amounts which may be paid to such parties. An advisory board is established to advise and assist the Comptroller General with his duties under this act.

D. Miscellaneous provisions

1. Treasury bonds or certificates payable in foreign currency.—This amendment expands the debt management authority of the Secretary of the Treasury to permit the issuance of U.S. notes denominated in foreign currencies. This authority already exists in the case of bonds and certificates of indebtedness.

2. Reports on Federal contingent liabilities and assets.—This amendment requires the Secretary of the Treasury to submit a report to the Congress each year indicating the full contingent liabilities of the Federal Government and the assets of the Federal Government which might be made available to liquidate such liabilities. The first such report is to be submitted on or before March 31, 1967.

3. Medicare: Coverage of expenses for prescribed drugs.—This amendment authorizes payments for prescribed drugs under the Medicare Act. The estimated monthly cost of $1 per beneficiary will be shared equally by the Government and the beneficiary. Reimbursements will be made under a schedule of allowances based upon generic drug prices.

II. PURPOSE AND BACKGROUND OF FOREIGN INVESTORS TAX ACT

On October 2, 1963, the President appointed a task force on "Promoting Increased Foreign Investment in U.S. Corporate Securities and Increased Foreign Financing for U.S. Corporations Operating Abroad." On April 27, 1964, a report of this task force was released. Among the recommendations of the task force were a series of proposals designed to modify the U.S. taxation of foreign investors. The Treasury Department studied the recommendations of the task force and on March 8, 1965, submitted to the Congress proposed tax legislation designed to increase foreign investment in the United States. At the request of the administration a bill was introduced at that time designed to carry out the recommendations of the Treasury Department. Subsequently, after holding hearings on this topic, the House passed a somewhat different version of this earlier bill; namely, H.R. 13103. Your committee has held hearings on this bill and modified it somewhat. Basically, however, the objectives remain the same as in the bill as passed by the House; that is, the two objectives of improving equity in the tax treatment of nonresident aliens and foreign corporations and providing, to the extent consistent with the first objective, increased incentives for investments by these persons and corporations in the United States.

This bill represents a substantial revision of the tax treatment of foreign corporations and nonresident aliens, an area which has not been substantially revised for some 30 years.

III. REVENUE ESTIMATES

It is expected that the Foreign Investors Tax Act, as presented here, will result in a revenue gain at current income and investment levels of slightly over $1 million a year. In addition, the provision calling for quarterly payments of withheld taxes, instead of annual payments, is expected to increase collections in the fiscal year 1967 alone by $22.5 million. Table 1 shows the revenue gain or loss attributable to the various Foreign Investors Tax Act provisions in the bill to the extent this can be quantified.

TABLE 1.—*Estimated revenue changes resulting from the foreign investors tax bill*

Tax proposals	Revenue gain or loss (−)		
	Gain	Loss	Net
A. Elimination of progressive taxation of U.S. source income of nonresident alien individuals not engaged in trade or business in the United States		−$748,000	−$748,000
B. Estate tax at top rate of 25 percent on intangibles and tangibles with $30,000 exemption		−3,000,000	−3,000,000
1. Tax on excluded bank deposits	$300,000		300,000
C. Taxation of foreign life insurance company income from nontrusteed investments in the United States	3,000,000		3,000,000
D. Saving in interest cost to U.S. Government resulting from quarterly payment of withheld taxes	1,593,000		1,593,000
E. Tax on capital gains		−50,000	−50,000
Total	4,893,000	−3,798,000	1,095.000

NOTE.—Based on the most recently available withholding tax information, quarterly payment of withheld taxes will result in a revenue gain of $22,500,000 in the fiscal year 1967. Taxes will be collected for 5 quarters in the fiscal year 1967. All 1966 withholding, estimated at $90,000,000, will be collected on March 15, 1967, plus tax of $22,500,000 for the 1st quarter of 1967 on April 15, 1967.

The amendments added to the bill by your committee, other than those relating to the Foreign Investors Tax Act, are expected to result in an annual revenue loss (or expenditure increase) of slightly over $400 million. Two hundred million dollars of this is attributable to the medicare amendment making provision for drugs under the supplementary benefit program. The provision making medical expenses deductible in full with respect to most persons over age 65 is expected to result in an annual revenue loss of $180 million. An expenditure of approximately $70 million every 4 years also is expected from the Presidential Election Campaign Fund Act. The remaining provisions added by your committee are expected to result in a further revenue loss of approximately $10 million a year.

IV. GENERAL EXPLANATION

A. FOREIGN INVESTORS TAX ACT

1. INCOME TAX SOURCE RULES

a. Rules for determining source of certain interest payments (sec. 102(a)(1) of the bill and secs. 861 (a) and (c) of the code)

Present law.—Present law provides that nonresident alien individuals and foreign corporations are subject to U.S. tax only on the income they derive from sources within the United States. For purposes of determining whether the income is from within or without the United States, the code specifically enumerates types of income treated as income from sources within and as income from sources without the United States.

One of the rules under present law provides that interest on deposits paid to foreign persons not engaged in trade or business in the United States is to be treated as income from sources without the United States if the interest is paid by a bank. The Internal Revenue Service in interpreting this rule has held that, in addition to banks, the provision applies to certain deposits with some types of State-chartered savings and loan associations. However, the Service has not interpreted this provision as extending to interest paid on deposits with all savings

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.

of policies left on deposit; and (4) interest paid on overcharges of premiums.

Effective date.—Except for the provision repealing the special foreign source rule for certain interest as of December 31, 1971, these amendments are effective with respect to taxable years beginning after December 31, 1966.

b. Interest on deposits in foreign branch banks of domestic corporations (sec. 102)(a)(2) of the bill, sec. 861(a)(1)(F) of the code)

Present law.—Present law provides that interest paid to nonresident alien individuals or foreign corporations on deposits with foreign branch banks of U.S. corporations, although paid by the foreign branch situated abroad, is treated as from sources within the United States if the recipient of the interest is engaged in a trade or business in the United States. This is true whether the deposits are payable in dollars or in the currency of the foreign country where the branch is located.

Reasons for provision.—As a result of the rule described above nonresident aliens and foreign corporations often are reluctant to deposit funds with foreign branch banks of U.S. corporations since, if (for other reasons) they are considered to be engaged in a trade or business in the United States, the interest paid on their deposits in these foreign branches is subject to U.S. tax. Their reluctance is increased by the fact that foreign persons engaged in business in the United States can avoid U.S. tax on the interest their bank deposits earn by keeping their funds in a bank chartered in their own country or any other country other than the United States, rather than in the foreign branch bank of a U.S. corporation. As a result, foreign branch banks of U.S. corporations are at a serious competitive disadvantage with the banks chartered in the country where they are doing business.

Explanation of provision.—To place foreign branch banks of U.S. corporations in a competitive position with the other banks in the foreign countries where they are doing business, the bill provides that the interest on deposits paid by these branches is to be treated as foreign source income. Thus, nonresident aliens and foreign corporations will not be subject to U.S. tax on this type of interest income. Your committee has added an amendment to the House bill which would extend this provision to foreign branch banks of U.S. partnerships.

Effective date.—This amendment is effective with respect to taxable years beginning after December 31, 1966.

c. Foreign central banks and the Bank for International Settlements (sec. 102(a)(4)(A) of the bill and sec. 895 of the code)

Present law.—Under present law interest received by a foreign central bank of issue from obligations of the U.S. Government is exempt from U.S. tax unless the obligations are used by the central bank in commercial transactions. In addition foreign central banks of issue and the Bank for International Settlements are not subject to tax on interest income from their U.S. bank deposits since bank-deposit interest received by nonresident aliens and foreign corporations not engaged in a trade or business within the United States is deemed to be from sources without the United States.

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

U.S. source income and therefore subject to U.S. tax if 20 percent or more of the income of the foreign corporation paying the interest is from U.S. sources during the preceding 3-year period.

The portion of the dividend treated as being from U.S. sources, where the 50-percent test referred to above is met, is the same proportion of the dividend which the gross income of the foreign corporation during the immediately prior 3-year period, from U.S. sources, is of its gross income from all sources for that period. However, in the case of this type of interest income there is no apportionment provision and therefore all of the interest paid by a foreign corporation meeting the 20 percent rule is treated as being from U.S. sources notwithstanding the proportion of the corporation's income which is from U.S. sources.

Reasons for the provision.—Your committee agrees with the House that the application of the dividend rule described above should be restricted. In addition, your committee believes that a corresponding restriction should also be applied in the case of interest income since the investment nature of both interest and dividend income is similar. Moreover, your committee was of the opinion that the amount of interest subjected to U.S. tax (as U.S. source income) should be in proportion to the amount of the corporation's income which is effectively connected to its conduct of a trade or business in the United States. In the past, these provisions have given rise to little revenue. On the other hand, the elimination of these provisions would give an unfair advantage to foreign corporations substantially all of whose business is conducted in the United States. Consequently, your committee's bill restricts the scope of these provisions by modifying the applicable rules.

The House bill, in the case of dividends, raised the 50-percent requirement to 80 percent. Your committee has set both the dividend and interest percentage requirement at 50 percent. It is believed that this percentage when combined with the effectively connected limitation gives assurance that this second tax on investment income of foreign corporations will only be imposed where U.S. operations account for the major portion of the income being paid out. The limitation to income which is effectively connected with the conduct of a U.S. trade or business is in accord with the general concept, explained subsequently, of treating U.S. source investment income essentially the same with respect to foreign corporations whether or not they have a trade or business in the United States. As is explained further subsequently, different treatment with respect to this investment income does not appear appropriate merely on the grounds of the presence or absence in the United States of an unassociated trade or business of the foreign corporation.

Explanation of provision.—To achieve the objective set forth above your committee's bill amends the source rule with respect to dividends and interest paid by corporations to provide that no portion of the dividend or interest received from a foreign corporation is to be considered to be from U.S. sources unless 50 percent or more of the corporation's gross income for the 3-year period preceding the year in which the dividends or interest is paid, was effectively connected with the conduct of a trade or business in the United States. Also, the portion of the dividend or interest treated as being from U.S. sources

is to be the same proportion of the dividend or interest which the effectively connected income of the foreign corporation during the immediately prior 3-year period is of its gross income from all sources for that period. Thus, when compared to present law, the effect of these amendments is to decrease the amount of dividends and interest likely to remain subject to U.S. tax.

The bill also contains a transitional rule providing that, in applying the new 50-percent test, any gross income of the foreign corporation from U.S. sources, for any period before the first taxable year beginning after December 31, 1966, is treated as effectively connected income. Your committee also amended the House bill to provide a special rule for determining the source of interest or dividends paid by newly incorporated corporations.

Effective date.—These amendments are effective with respect to dividends received after December 31, 1966.

e. Compensation for personal services (secs. 102(c) and (d) of the bill and secs. 861(a)(3)(C)(ii) and 864(b)(1) of the code)

Present law.—Present law provides that payments of compensation for services performed in the United States generally are treated as U.S. source income. An exception to this rule is provided for compensation received by a nonresident alien where certain conditions are met. Thus, payments for personal services received by a nonresident alien are treated as foreign source income if (1) he was temporarily present in the United States for not over 90 days during the year; (2) the compensation does not exceed $3,000; and (3) the services are performed for a foreign employer not engaged in a trade or business in the United States or for a domestic corporation if the services are performed for an office or place of business it maintains in a foreign country or U.S. possession. Also, present law provides that the rendering of personal services in the cases described above is not to constitute engaging in a trade or business in the United States.

Reasons for provision.—Temporary personal services of the type described above on occasion may be rendered not only for a domestic corporation having an office or place of business abroad but also for a U.S. citizen, resident or for a domestic partnership where the citizen, resident or partnership has an office abroad. Your committee agrees with the House that the performance of temporary services in the United States subject to the same conditions as described above should be exempt from tax where the business abroad is that of a U.S. citizen, resident or partnership, just as it is in the case of a domestic corporation.

Explanation of provision.—For the reasons given above, the bill amends the source rule of present law relating to personal service income to provide that income from services performed by a nonresident alien temporarily present in the United States for not over 90 days in a year, if not in excess of $3,000, is to be treated as foreign source income (and not subject to U.S. tax) not only in cases where the employer is a foreign person or a domestic corporation but also where the employer is a U.S. citizen or resident or a domestic partnership. Similar changes are also made in the definition of a "trade or business within the United States" to provide that this term does not include personal services performed for employers who are U.S. citizens or

residents or for domestic partnerships where the conditions set forth above are met.

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

2. DEFINITIONS USED IN DETERMINING TAXABLE STATUS OF INCOME

a. Trading in stocks or securities or in commodities (sec. 102(d) of the bill and sec. 864(b)(2) of the code)

Present law.—Present law specifically excludes from the activities which constitute engaging in a trade or business within the United States the trading activities conducted by a nonresident alien in stocks, securities, or commodities in the United States through a resident broker, commission agent, or custodian.

This rule also applies with respect to foreign corporations. However, a question has arisen as to whether a nonresident alien or foreign corporation is to be treated as carrying on a trade or business within the United States if the foreign person grants discretionary authority to a U.S. broker or other agent to carry out transactions in the United States with respect to his stocks, securities, or commodities. Under present law, the granting of this discretionary authority may prevent a nonresident alien or foreign corporation from qualifying for this exclusion, with the result that income arising from these transactions and all other U.S. source income is subject to U.S. tax at the regular individual or corporate rates (based on a determination that such activities constitute carrying on a trade or business in the United States).

Reasons for provision.—The granting of discretionary authority to a U.S. broker or agent is thought by many foreign investors to be a desirable protective device in the event they are not in a position to give buy or sell orders at any time and, in any event, such an arrangement is frequently the most convenient method of effecting stock, security, or commodity transactions. The mere grant of this discretionary authority to a U.S. broker or agent would not appear to be significant enough to warrant treating the foreign person acting for his own account as engaging in a trade or business here. Moreover, individuals who trade in U.S. stocks and commodities are not treated as thereby being engaged in the business of buying and selling stocks and commodities, whether or not the volume of their activity is large. Also, the confusion regarding the status of a foreign investor who has granted discretionary authority to a U.S. agent may have acted to deter some foreign investment in the United States.

Explanation of provision.—For the above reasons your committee agrees with the House and has amended present law to specifically provide that the trading in stocks, securities, or commodities in the United States, for one's own account, whether by a foreign person physically present in the United States, through an employee located here, or through a resident broker, commission agent, custodian, or other agent—whether or not that agent has discretionary authority—does not constitute a trade or business in the United States. This treatment, however, does not apply to dealers in stocks, securities, or commodities or to a foreign investment corporation if it has its principal office here.

It is not intended that as a result of this provision a foreign investment company (other than a corporation which is, or but for section 542(c)(7) or 543(b)(1)(C) would be, a personal holding company) is to be permitted to locate its general business activities in the United States and avoid taxation at the regular corporate rates on its income and gains effectively connected with its business in this country. However, a foreign investment company conducting its general business activities in a foreign country (i.e., having its principal office there) can conduct trading activities in the United States through an agent with discretionary authority, without this giving rise to its being considered as conducting a trade or business in the United States.

Whether a corporation's principal office is in the United States is to be determined by comparing the activities (other than trading in securities) which the corporation conducts from an office located in the United States with the activities it conducts from offices located outside the United States. For example, a corporation which carries on most or all of its stock and securities transactions through an agent with discretionary authority in the United States but maintains a general business office outside the United States in which its management is located and from which it communicates with its shareholders and the general public, solicits sales of its own stock, and maintains its corporate records and books of account, would not be considered as having its principal office in the United States.

Although, under this provision, a dealer is specifically excluded from those who may grant discretionary authority and not be deemed to be conducting a business in the United States, he may trade in securities or commodities, for his own account, through an independent U.S. agent without being considered to be conducting a business in the United States. However, this rule does not apply if at any time during the year he has an office or place of business in the United States through which, or by the direction of which, transactions in stocks, securities, or commodities are effected.

Even though this provision does not free some dealers in stocks, securities, or commodities, and investment companies from the possibility that they may be considered as engaged in a trade or business in the United States, this does not mean that all such dealers or investment companies are so engaged. In such a situation, the question of whether a dealer or investment company is conducting a trade or business in the United States remains a question of fact to be determined under the rules of present law. Your committee has redrafted the House provision but no substantive change was intended.

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

b. Income effectively connected with the conduct of a trade or business in the United States (sec. 102(d) of the bill and sec. 864(c) of the code)

Present law.—Under present law nonresident aliens and foreign corporations are generally taxable at the regular individual or corporate rates on all their U.S. source income if they are engaged in trade or business in the United States and are taxable at a flat 30-percent rate (or lower treaty rate) on all fixed or determinable income if not so engaged. This difference in treatment applies whether or not there

is any relationship between the different types of incomes (business and investment) from the United States.

Reasons for provision.—Under the rule described above, one foreigner may be taxed on investment income at the regular individual or corporate rates while another, with an identical portfolio investment, is taxed on his investment income at the flat 30-percent (or lower treaty) rate. The difference in treatment arises from the fact that one is engaged in business in the United States and the other is not, even though the investment portfolio of the former is wholly unrelated to his U.S. business. Your committee agrees with the House that it is neither equitable nor logical for this substantial difference in tax treatment of investment income to depend on the presence or absence of an unrelated business. In addition, the Presidential Task Force on Promoting Increased Foreign Investment in U.S. Corporate Securities has pointed out that the present scheme deters foreign businessmen operating in the United States from investing in the United States, and also deters foreigners already investing in the United States from commencing a trade or business here.

The present scheme for taxing foreigners engaged in business in the United States also is defective in another respect. The interplay between the tax rules of certain foreign countries and the United States has in some cases permitted the use of the United States as a tax haven. The tax avoidance in such a case can be illustrated by a foreign corporation which is organized in a country which does not tax its domestic corporations on income derived from the conduct of a business outside the country. If such a corporation desires to sell products into countries, other than the United States or the country of its incorporation, it can, in many instances, avoid all or most taxation on the income from these sales by establishing a sales office in the United States. The income from the sales in such cases is not taxed by the United States because (under the title passage rule) it is not derived from sources within the United States. The income may not be taxed by countries where the products are sold because the corporation does not have a permanent establishment there, and the income is not taxed by the country of incorporation because the business is not conducted there. Moreover, a similar tax avoidance scheme can be utilized with respect to sales arranged in the United States concerning goods destined for use in this country. In addition, U.S. tax may be avoided in the case of rents and royalties from a licensing business and income from banking, financing or investment company businesses carried on in the United States. Your committee agrees with the House that foreign corporations carrying on substantial activities in the United States, in such cases, should not be able to cast their transactions in such a form as to avoid both all U.S. tax and most foreign taxes. Also, it is believed that foreign corporations should pay a U.S. tax on the income generated from U.S. business activities. There appears to be no national policy to be served by allowing foreign persons to operate in this country without paying their share of our governmental expenses.

To meet both types of problems described above the bill provides for the taxation of nonresident aliens and foreign corporations at the regular U.S. graduated individual rates or corporate rates on their income which is effectively connected with the conduct of a

trade or business within the United States. This effectively connected rule applies to all their income from sources within the United States and to three limited categories of foreign source income in certain situations where definite U.S. economic connections are present. The U.S. source income of nonresident aliens and foreign corporations which is not effectively connected with the conduct of a trade or business in the United States is taxed at a flat 30-percent rate (or lower treaty rate).

Explanation of provision.—As a general rule, the bill provides that income of a nonresident alien or foreign corporation will be subject to the flat 30-percent (or lower treaty) rate if it is not effectively connected with the conduct of a trade or business within the United States. The regular individual or corporate rates apply to income which is effectively connected to the conduct of a U.S. trade or business. However, the foreigner may elect to treat real property income as if it were income effectively connected with a U.S. business. This is to permit the deductions attributable to this real property income to be deducted from it. The application of the effectively connected concept to different types of income is set forth below.

(*i*) *Income from U.S. sources treated as "effectively connected."*—In determining whether periodical income such as interest, dividends, rents, wages, and capital gains is effectively connected with the conduct of a trade or business within the United States two principal factors are to be taken into account. First, is the income derived from assets used or held for use in the conduct of the trade or business in the United States? Thus, for example, are the assets being held for future, or remittant, use in the business? In this regard, particular attention will be given to the relationship between the asset and the needs of the business. Second, were the activities of the trade or business a material factor in the realization of the income? Thus, in the case of this second factor, is there an immediate relationship between the income in question and the U.S. business activities of the foreign corporation? Also to be taken into account in weighing the relationship of the investment income to the trade or business, but not to be a controlling factor by itself, is whether or not the assets or income are accounted for through the U.S. trade or business.

All other income from sources within the United States (that is, other than the periodical income and capital gains described above) is to be treated as "effectively connected" with the conduct of any trade or business within the United States.

(*ii*) *Income from sources without the United States.*—(*A*) *General Rules.*—Income from sources without the United States is not to be treated as "effectively connected" with the conduct of a trade or business within the United States unless the nonresident alien or foreign corporation has a fixed place of business in the United States and the income, gain or loss is attributable to that place of business. Also, this provision applies to only three types of income from sources without the United States. A foreign corporation which to a minimal extent, or occasionally, uses the U.S. office of a related corporation will not thereby be treated as having a fixed place of business here. Moreover, the fact that top management decisions are made in the United States will not of itself mean that the foreign corporation has an office or fixed place of business here. For example, a foreign sales

corporation which is a wholly owned subsidiary of a domestic corporation will not be considered to have a U.S. office because of the presence here of the officers of its domestic parent who are generally responsible only for its policy decisions, provided the foreign sales corporation has a managing director that conducts its day-to-day business from a foreign office. This person may or may not be an officer of the U.S. corporation. Also, in such a case, the managing director could regularly confer with the officers of the domestic parent and if necessary occasionally visit the U.S. offices of the domestic parent and, during such visits, temporarily conduct the business of the foreign subsidiary out of the domestic parent's office without thereby establishing a U.S. office.

As indicated above, this provision applies only to three specific types of income from without the United States and in no event applies with respect to income which is "subpart F" income or to dividend, interest or royalty income derived from a foreign corporation more than 50 percent owned by a nonresident alien or foreign corporation receiving the income. Of course, the subpart F income exception extends to income which is subpart F income but is excepted from its taxing provisions by the minimum distribution and export trade exceptions. The three types of income with respect to which this provision applies are:

(i) Rents and royalties derived from the active conduct of a licensing business;

(ii) Dividends, interest, or gain from stock or bond or debt obligations derived in the active conduct of a banking, financing or similar business; and

(iii) Certain sales income attributable to a U.S. sales office.

The sales income referred to above is not to be considered as "effectively connected" to a U.S. trade or business if the property is sold for use outside the United States and an office of the foreign person outside the United States contributes materially to the sale. In the case of foreign source income where the products are destined for the United States, the income will be treated as effectively connected with a U.S. business to the extent the sales activity is carried on by the U.S. office.

(*B*) *Determining Factors.*—Although your committee agrees with the general rules of the House bill, it has added certain clarifying amendments regarding what is to be considered a sufficient nexus for assertion of U.S. tax jurisdiction as well as the foreign source income to be subject to U.S. tax. In general, for purposes of determining whether a foreign corporation or nonresident alien has an office, the office or other fixed place of business of an agent is to be disregarded unless the agent is other than an independent agent operating in the ordinary course of his trade or business and either has authority (regularly exercised) to negotiate binding contracts or has a stock of merchandise from which he regularly fills orders. This agency concept regarding the degree of economic activities which will subject a foreign corporation or nonresident alien to U.S. taxation on foreign source income is substantially similar to the permanent establishment concept present in many of our existing income tax treaties. However, the interpretation of this provision is, of course, not to be limited by the judicial decisions of foreign governments regarding treaty provisions. With respect to the determination of the income to be sub-

ject to U.S. tax, the rules added by your committee provide that foreign source income will not be considered to be effectively connected with a U.S. business of a foreign corporation or nonresident alien if (*a*) a U.S. office of that business was not a material factor in the production of the income, (*b*) the income was not derived from the usual business activities of the U.S. business or (*c*) the income was not properly allocable to the activities of the U.S. business.

It is the opinion of your committee that these added rules will delimit the application of the general rules of this provision, thereby subjecting to U.S. tax only income which has its economic genesis in the United States. For purposes of this provision, the activities of the U.S. office will not be considered to constitute a "material factor" unless it provides a significant contribution to the production of the income. Thus, the activities of the U.S. office must be an essential economic element in the production of the income. Therefore, the fact that the board of directors of the foreign corporation meets in the U.S. office will not subject the worldwide sales income of that foreign corporation to U.S. taxation. Contrarily, the activities of the U.S. office need not necessarily be a major factor in the production of the income.

The requirement that the income must be derived from the usual business activities of the U.S. office, in effect, provides a de minimus exception. It is intended that this rule will exclude from U.S. tax jurisdiction all foreign income derived from casual sales. Thus, if the foreign corporation is engaged solely in a manufacturing business in the United States, the income derived by the U.S. plant as a result of an occasional foreign sale will not come within the ambit of the foreign source effectively connected rule where the sales operations for the products of the U.S. plant are located outside the United States. On the other hand, if a foreign corporation establishes a U.S. sales office to sell goods produced in Africa into the Western Hemisphere, occasional sales income derived from parts of the world other than the Western Hemisphere would not be excluded under this casual sales rule. In other words, the nature of the U.S. business would be the primary determinative factor for purposes of this exception.

The committee received considerable testimony requesting that the general foreign source effectively connected rules be modified so as to insure in all cases that only income generated in the United States would be subject to U.S. tax. It is your committee's understanding that this was the intention of the House bill and, therefore, the addition of the "properly allocable" test is considered to constitute a clarifying amendment.

(*C*) *Country of Residence Taxes.*—Your committee's bill extends the foreign tax credit provision of the House bill which applies with respect to foreign source effectively connected income (sec. 906). The House bill would not have extended the foreign tax credit provision to taxes imposed by a foreign country solely on the basis that it has jurisdiction to tax because the taxpayer is a citizen or resident of that country or a corporation created, incorporated, or domiciled in that country. Your committee's amendment extends this foreign tax credit provision to the resident country taxes on foreign source income specifically excepted by the House bill. A further discussion of this

amendment is provided in the foreign tax credit portion of this report (A–5(d)).

(D) Foreign Insurance Companies.— In the case of a foreign corporation having a life insurance business in the United States, the bill provides that income from sources without the United States will be treated as effectively connected with the conduct of the business within the United States if the income is attributable to its U.S. life insurance business. This rule merely continues the treatment which applies under existitng law which provides that income of a foreign corporation from its U.S. life insurance business is subject to tax whether the income is from sources within or without the United States.

Effective date.—This amendment applies with respect to taxable years beginning after December 31, 1966. For purposes of determining whether foreign source sales income from a binding contract, entered into on or before February 24, 1966, is attributable to a U.S. office, all the activities in the United States on or before that date, which were related to the negotiation or effectuation of the binding contract are not to be taken into account. As a result in many cases the sales income from foreign sources under binding contracts entered into before February 25, 1966, will not come within the ambit of this provision.

3. TAXATION OF NONRESIDENT ALIENS

a. Income tax on nonresident alien individuals (sec. 103(a) of the bill and sec. 871 of the code)

Present law.—Present law provides different tax treatment for nonresident alien individuals according to whether they are, or are not, engaged in a trade or business in the United States. Also, those not engaged in a trade or business in the United States are provided different treatment according to whether their income is under or over $21,200.

Nonresident alien individuals not engaged in trade or business in the United States whose annual U.S. source income of the types specified below is $21,200 or less are taxed at a flat rate of 30 percent (or lower applicable treaty rate), on certain specified items of U.S. source income. This tax is in lieu of the regular U.S. graduated rates applicable to individuals. The items of income included are interest, dividends, rents, salaries, wages, and other fixed or determinable annual or periodical gains, profits, and income. Also specifically included in the income taxable at the flat 30-percent rate are certain amounts otherwise treated in the same manner as capital gains; namely, lump-sum distributions from exempt employees' trusts (sec. 402(a)(2)); amounts paid to beneficiaries under qualified annuity plans (sec. 403(a)(2)); timber, coal, and iron ore royalties (sec. 631 (b) and (c)); and amounts received on transfers of patent rights (sec. 1235).

Nonresident alien individuals not engaged in trade or business in the United States but with an annual U.S. source income of the types indicated above, of more than $21,200, are taxed under present law (in the absence of an applicable treaty provision) at whichever of the following produces the higher total tax: the regular U.S. rates applicable to individuals, or the flat 30-percent rate. In computing the

tax at the regular graduated rates, such a nonresident alien is allowed deductions to the extent they are properly allocable to the income on which he is taxable.

Nonresident aliens not engaged in a trade or business in the United States—whether their income is over or under $21,200—are subject to tax on regular capital gains only if one of two conditions exist: (1) if they are physically present in the United States at the time the capital gain is realized or (2) if they are present in the United States for a period or periods totaling 90 days or more during the year. These capital gains are taxed at the flat 30-percent rate, if the individual's income from U.S. sources is $21,200 or less. If his income from U.S. sources exceeds this amount, the regular capital gains tax rate will apply if the regular individual income tax rates (including the capital gains tax) on all the taxpayer's U.S. source income results in a higher tax than the flat 30-percent tax.

Nonresident alien individuals engaged in trade or business in the United States are taxable at the regular U.S. graduated (and capital gains) rates on their income derived from sources within the United States. In computing the tax, an alien in this category is allowed deductions to the extent attributable to his U.S. source income.

Reasons for provision.—Your committee agrees with the House that the present tax treatment of nonresident aliens is unnecessarily complicated and also makes arbitrary distinctions based upon the size of the individual's income and whether or not the individual has a trade or business in the United States which may be wholly unrelated to the specific income in question. The bill has retained the rule of present law which provides that U.S. trade or business income of nonresident aliens is subject to the regular individual income tax rates. However, other income is to be subject to the regular rates only if it is effectively connected with the U.S. trade or business. U.S.-source fixed or determinable income of nonresident aliens which is not so connected is to be subject to a flat 30-percent rate (or lower treaty rate). This removes the arbitrary rule of present law which would vary the treatment of investment income depending upon whether the individual has an unrelated trade or business in the United States.

The flat 30-percent rate of tax in the case of certain nonresident aliens has been applied under present law, and is continued under the bill, because the United States does not have jurisdiction over all of such an individual's income. These taxpayers are not allowed the deductions that are available to U.S. citizens and the 30-percent rate is considered an appropriate effective rate in such cases. In addition, it has been found in practice that only a small amount of tax has been collected as a result of imposing the graduated rates. It is also thought that applying the uniform flat rate with respect to income not effectively connected with a trade or business in the United States would tend to encourage investment here by foreigners. To the extent this occurs, there will, of course, be an improvement in our balance of payments.

In the case of capital gain, it was the opinion of your committee and the House that the present rule that taxes a nonresident alien if present in the United States when the gain is realized is an arbitrary rule which constitutes only a trap for the unwary. Also, your committee agrees with the House view that the exclusion for nonresident aliens

not present in the United States for 90 days during a year should be extended to a period of 183 days. The 183-day period more closely parallels the general rule applied by most of the industrialized countries of the world.

Explanation of provision.—For the reasons indicated above the bill substantially revises the income tax treatment of nonresident alien individuals, dividing their income, for tax purposes, into two basic groups according to whether or not the income is effectively connected with a U.S. trade or business.

(*A*) *Income not effectively connected with the conduct of a U.S. business.*—Income of a nonresident alien individual which is fixed or determinable (substantially the same categories referred to under present law) and which is not effectively connected with the conduct of a trade or business in the United States is to be taxed at a flat 30-percent rate (or lower treaty rate).

Generally, the fixed or determinable income referred to here, as under present law, includes such income as interest, dividends, rents, salaries, annuities, and certain income accorded capital gain treatment. The House bill added two items not included in the list contained in present law and has slightly modified the language of present law so as to clarify this provision as it relates to certain amounts received from pensions or annuity plans, certain timber, iron ore, and coal royalties, and gains on certain transfers of patent rights. The two new items added to the list by the House bill are (1) gains with respect to the sale of stock of a collapsible corporation and (2) amounts received on retirement or exchange of bonds and other evidences of indebtedness issued after September 28, 1965, which are treated as gains from the sale of property which is not a capital asset. Your committee has retained this latter House provision regarding the income received on the retirement or exchange of bonds. However, your committee has deleted the collapsible corporation provision. Additionally, there was some question as to the scope of the provision in the House bill dealing with original issue discount. The reference in the bill to section 1232 refers only to original issue discount on evidences of indebtedness held by a taxpayer for more than 6 months. Also, income constituting original issue discount received on the retirement or sale or exchange of bonds is to be considered as having the same source as interest paid by the corporation issuing the bonds. As a result, if the corporation with respect to whose bonds the original issue discount arises is a domestic corporation which in the prior 3 years derives more than 80 percent of its income from foreign sources, then the original issue discount (interest) at the time of the retirement or sale or exchange of the bonds also will be considered as foreign source income.

Your committee has amended the provision of the House bill regarding gains realized on the sale of a patent or other intangible property. As amended it provides that gains realized on the sale of a patent or other intangible property, where the income from the sale is derived as a result of the use of such property in the United States, is not to be subject to U.S. tax as "fixed and determinable income" (taxed at 30 percent or lower treaty rate) unless a part of the income derived from the sale is contingent. If part of the profits from such sale are contingent, the amount subject to U.S. tax in any year would be the

contingent amount, or if this contingent amount exceeds 50 percent of the total amount paid in any 1 year, the total amount will be taxed to the extent this amount represented gain realized on the sale of the property. For or other intangible property is used. This provision is to apply to gains derived from sales made after October 4, 1966. The provisions of existing law will continue to apply to transfers of patents made prior to that date.

In the case of a nonresident alien's net U.S. source capital gains (other than those specifically included in the list as taxable at the 30-percent rate) which are not effectively connected with the conduct of a trade or business within the United States, the bill provides that no U.S. tax is to be imposed unless the nonresident alien has been present in the United States for at least 183 days during the taxable year. Present law provides a 90-day test. For purposes of applying the 183-day test an alien will be treated as being on a calendar year basis unless he has previously established a different taxable year. The requirement of present law which taxes capital gains when the alien is physically present in the United States at the time of realization is dropped entirely.

(*B*) *Income effectively connected with the conduct of U.S. business.*—Income of a nonresident alien individual that is effectively connected with the conduct of a trade or business in the United States, under your committee's bill is taxable at the regular U.S. graduated rates applicable to individuals. Thus, this income will be taxed the same as under existing law although the category itself is more limited since it only applies to income which is effectively connected to a U.S. trade or business instead of including all U.S. source income of an alien with such a trade or business. For purposes of determining whether or not income is effectively connected with the conduct of a trade or business in the United States, the rules discussed above in connection with the definition of effectively connected income (No. A-2 pt. b, above) apply.

(*C*) *Miscellaneous types of income receiving special treatment.*—Under present law certain types of income are provided special treatment. The bill as approved by your committee and the House revises and extends these categories as indicated below.

(i) *Participants in exchange programs.*—The bill retains the rule in present law which treats nonresident aliens temporarily in the United States as part of a cultural exchange or training program as engaged in a trade or business in the United States even though they are actually not so engaged. The provision is modified to provide in such cases that this type of income is effectively connected to a U.S. trade or business. The effect of treating these categories of income as effectively connected to a U.S. trade or business (or under present law as derived from a U.S. trade or business) is to impose the regular U.S. income tax on these aliens on the taxable portion of their scholarship or fellowship grants and certain other amounts incident to these grants. In this computation one exemption (except in the case of residents of contiguous countries) and the deductions allocable to this income are allowed. In the absence of this special provision, these aliens would be taxed on these grants (and amounts incident thereto) at the flat 30 percent rate. In most

cases the 30 percent tax would substantially exceed the regular tax on this income.

The types of income referred to under present law as scholarship or fellowship grants received by a nonresident alien individual temporarily present in the United States as a nonimmigrant (under subpar. (F) or (J) of sec. 101(a)(15) of the Immigration and Nationality Act) or received by a citizen or resident, are, subject to a dollar limitation, exempt from U.S. tax.

Present law (sec. 872(b)(3)) also excludes from gross income compensation paid by a foreign employer to a nonresident alien for the period he is temporarily present in the United States as a nonimmigrant for the purposes of participating in a cultural or training program. Under present law this is available where the "foreign employer" is a foreign person or a domestic corporation having an office in a foreign country or U.S. possession. The bill extends this to also cover a domestic partnership or a U.S. citizen or resident with such a foreign office.

(ii) *Income from real property.*—Under present law, it is not clear as to what situations or arrangements for the ownership by a nonresident alien of real property located in the United States will cause the nonresident alien to be considered as engaging in a trade or business within this country. This, of course, is important since the question of whether or not the alien is engaging in a trade or business in the United States determines whether his U.S. source capital gains are subject to U.S. tax and whether his other U.S. source income is taxable at the regular individual income rates, with allocable deductions, or at the flat 30-percent rate on the gross amount. Taxing income on real property at a flat 30-percent rate without the allowance of allocable deductions—which in the case of this type of income may be relatively large—may result in quite heavy tax burdens on this type of income. Your committee agrees with the House that the law in this area should be clarified and doubts whether the disallowance of deductions in such cases is appropriate. Moreover, the disallowance of deductions in such cases would tend to discourage foreign investment in U.S. realty.

The bill deals with the problem described above by providing that nonresident aliens deriving income from real property held for the production of income and located in this country, or from an interest in this type of real property located in this country, may elect to treat all the income as effectively connected to the conduct of a U.S. trade or business. This permits the nonresident alien to utilize the deductions attributable to this real estate income with the result that he is taxed on only his net income from these sources.

The election is applicable with respect to gains from the sale or exchange of real property held for the production of income (or an interest therein) and rents or royalties from mines, wells, or other natural deposits, as well as certain timber, iron ore, and coal royalties. The election is not applicable to income not specifically covered by these provisions, such as distributions by real estate investment trusts. If the election is made, it applies to all of the alien's income from U.S. real property for the taxable year which is not otherwise "effectively connected" with the conduct of a trade or business in this country. The election applies for all subsequent taxable years until

revoked and can be revoked only with the consent of the Secretary of the Treasury or his delegate.

If the election is revoked, a new election may not be made for 5 years unless the Secretary of the Treasury or his delegate consents to an earlier reelection.

(iii) *Certain pension income.*—Under present law a nonresident alien receiving pension or annuity income from a plan located in the United States is subject to U.S. tax (flat 30 percent or lower treaty rate) on the interest portion of the pension income not withstanding the fact that the services qualifying the nonresident alien for the pension were entirely rendered outside the United States. Your committee has added an amendment to this provision of the bill which would exempt from U.S. tax the type of pension income described above if 90 percent of the persons under the plan were U.S. citizens. It is the understanding of your committee that in general the regulations will provide that the plan paying the pension will be entitled to rely upon information presented by the annuitant or employer regarding the information as to whether or not the annuitant qualifies under this provision.

(iv) *Bond income of residents of the Ryukyu Islands, etc.*—At the present time the Ryukyu Islands (including Okinawa) are governed by the United States and large numbers of the individuals of these islands are in the employ of the U.S. Military Establishment. As such, their savings have frequently been invested in series E or H U.S. savings bonds. Interest income on U.S. savings bonds is, of course, U.S. source income. As a result, under present law the residents of the Ryukyu Islands, as well as the Trust Territory of the Pacific Islands, are subject to a flat 30-percent tax on the income from these bonds. Since investment in U.S. savings bonds in their case is merely a convenient way for these individuals to save a portion of their income, it is difficult for them to see why a tax should be imposed any more than would be true if they were to invest their income, in the islands, in some other type of investment. Because of this, the bill excludes from gross income subject to U.S. tax, income derived by nonresident aliens from U.S. savings bonds (series E or H) if the alien at the time of acquiring the bonds was a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands.

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

b. Deductions (sec. 103(c) of the bill and sec. 873 of the code)

Present law.—In the case of a nonresident alien individual, present law generally allows deductions to the extent they are properly allocable to income from sources within the United States but only if the alien's U.S. income is subject to the regular income tax. However, where the regular income tax applies, the deduction of losses is allowed even though they are not connected with a U.S. trade or business if they are incurred in transactions entered into for profit provided that the transaction, had it resulted in a profit, would have been subject to U.S. tax. Also allowed are property losses not connected with a trade or business arising from certain casualties or thefts if the loss is of property located within the United States.

Explanation of provision.—The bill amends present law generally to limit the allowance of deductions in case of a nonresident alien in-

dividual to deductions allocable to income which is effectively connected with the conduct of a trade or business in the United States. The allowance of deductions is limited in this manner, since it is only effectively connected income which under the bill is subject to the regular income tax.

In addition, the bill deletes the provision relating to the deduction of losses not connected with a trade or business but incurred in transactions entered into for profit since the criteria for the allowance of deductions under the bill is whether or not they are effectively connected with the conduct of a trade or business in the United States. However, the casualty loss deduction is to be available even if the property which gives rise to the loss is not effectively connected with the conduct of a trade or business in the United States if the property is located in this country. Also, the charitable contribution deduction is available even though not related to the trade or business.

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

c. Expatriation to avoid tax (sec 103(f) of the bill and new sec. 877 of the code)

Present law.—The U.S. individual income tax applies to U.S. citizens, U.S. residents, and to nonresident aliens, but in this latter case, generally only with respect to income derived from sources within the United States. Under present law, if an individual who has been a U.S. citizen gives up this citizenship and becomes a nonresident, no tax is then imposed with respect to income he derives from sources without the United States. Moreover, under present law the regular graduated rates applicable to a citizen apply in the case of an expatriate, only if he is engaged in a trade or business in the United States or his income exceeds $21,200.

Reasons for the provision.—The bill, by the elimination of progressive taxation with respect to the income of nonresident aliens which is not effectively connected with the conduct of a trade or business within the United States (as well as the reduction of the estate tax rates—described subsequently—applicable to the estates of nonresident aliens), may encourage some individuals to surrender their U.S. citizenship and move abroad. As indicated above, by doing so an expatriate would avoid the graduated tax rates on his U.S. investment income (and in certain cases, avoid some estate taxes).

Explanation of provision.—For the reasons stated above, the House bill adds a new section to the code which, in general, taxes both effectively connected income and any other U.S. source income of an expatriate at regular income tax rates, if he lost his citizenship within 5 years of the taxable year in question (and after March 8, 1965) and if one of the principal purposes of the expatriation was the avoidance of U.S. income, estate, or gift taxes. This treatment is not to apply if it results in a smaller U.S. income tax than would otherwise be imposed. Your committee's bill adopts the general rules provided in the House bill but extends the effective period during which the provisions can apply from 5 years, as provided by the House bill, to 10 years.

In addition to imposing this tax on both the expatriate's U.S. source income not effectively connected with the conduct of a U.S. trade or business and his income that is "effectively connected", regardless of its source, the new section contains special source rules to be used in de-

termining his U.S. source income. These rules provide that gains from the sale or exchange of property (other than stock or debt obligations) located in the United States, and gains on the sale or exchange of stock of a domestic corporation or debt obligations of U.S. persons or of the United States, a State or political subdivision, or the District of Columbia are to be treated as income from sources within the United States regardless of where the sale or exchange occurs or title is transferred. Deductions are to be allowed only to the extent they are properly allocable to the gross income of the expatriate, determined under the above described provisions (except that the capital loss carryover provision is not to apply).

The new section contains a special rule with respect to the burden of proving the existence or nonexistence of U.S. tax avoidance as one of the principal purposes of the expatriation. Under this provision, the Secretary of the Treasury or his delegate must first establish that it is reasonable to believe that the expatriate's loss of U.S. citizenship would (but for the application of these special provisions) result in a substantial reduction in his taxes based on the expatriate's probable income for the taxable year.

If this is established, then the expatriate must carry the burden of proving that the loss of citizenship did not have, for one of its principal purposes, the avoidance of U.S. income, estate, or gift taxes. However, the new section excepts persons whose loss of citizenship occurs under circumstances where it is unlikely that tax avoidance was a principal purpose. For example, this provision does not apply where the person acquired dual citizenship at birth and loses his U.S. citizenship by residing, for a certain period, in the foreign country of which he is also a citizen by birth.

Effective date.—This amendment applies for taxable years beginning after December 31, 1966.

d. Partial exclusion of dividends from gross income (sec. 103(g) of the bill and sec. 116(d) of the code)

Present law allows nonresident aliens the $100 dividends received exclusion only if the individual is taxable on U.S. source dividends at the regular graduated rates applicable to individuals. The bill amends this provision, effective for taxable years beginning after December 31, 1966, to conform to the effectively connected income concept by limiting the availability of the exclusion to dividends which are effectively connected with the conduct of a trade or business in the United States. The exclusion is also allowed in the case of an expatriate subject to tax under new section 877.

e. Withholding of tax on nonresident alien individuals (secs. 103(h) and (k) of the bill and secs. 1441 and 3401 of the code)

Present law.—Present law generally requires the withholding of tax in the case of a nonresident alien on U.S. source fixed or determinable income from U.S. sources (of the types previously described). The withholding is at a 30-percent rate (except in the case of certain treaty rates) and applies whether or not the flat 30-percent tax applies to the individual.[2] Thus it applies not only in the case of a nonresident alien with a gross income of $21,200 or less who is not engaged

[2] For a limited category of scholarship and fellowship income and related income the withholding rate is 14 percent.

in a trade or business in the United States but also in the case of a nonresident alien with a larger gross income and also to one who is engaged in a trade or business in the United States.

Reason for provision.—Your committee agrees with the House that withholding at the 30-percent rate should only be required in the case of income which is taxed at that rate. Therefore, income which is effectively connected with the conduct of a U.S. trade or business should not be subject to withholding tax at a 30-percent rate. This is particularly important in the case of compensation paid a nonresident alien. Unlike domestic wage withholding, this 30-percent withholding does not, in most cases, take into account the personal exemptions to which the worker would be entitled if he were a U.S. citizen. Also, since the regular graduated rates on small incomes are less than 30 percent, this rate may result in substantial overwithholding in many cases where regular income tax rates apply. Although an alien may obtain a refund of the excess withholding when he files his return at the end of the year, overwithholding in these circumstances can create a substantial hardship for the alien.

Explanation of provisions.—To meet the problem outlined above, the bill adds a new provision to the existing nonresident alien withholding provisions. Under the new provision, withholding is not required on payments to nonresident alien individuals with respect to any item of income (other than compensation for services) which is effectively connected with the conduct of a trade or business within the United States. It is the understanding of your committee that the person required to withhold will be relieved of any liability for failure to withhold if the failure was in reliance upon information as to whether or not the income was effectively connected, furnished (in accordance with regulations to be issued) by the person entitled to the receipt of the income. Your committee amended the House bill so as to specifically provide for withholding on the following types of income: (1) the contingent income derived from the sale of patents and other intangibles (see A–3(a)(A)); (2) a foreign partner's share of the U.S. income of a domestic partnership which is not effectively connected with the partnership's business; and (3) amounts received on retirement or exchange of bonds issued after September 28, 1965, which are treated as gains from the sale of property which is not a capital asset (sec. 1232).

In the case of salary and wage income, the bill also correlates the 30-percent-withholding rate applicable to nonresident aliens with the domestic graduated withholding rates. Thus, the bill amends present law to provide that the Secretary of the Treasury or his delegate may, by regulations, exempt compensation for services performed by nonresident aliens from the 30-percent withholding. Also, to permit withholding at the domestic graduated withholding rates where an exemption is granted from the 30-percent-withholding provision, the bill amends the domestic wage withholding provisions to, in effect, permit the Secretary of the Treasury or his delegate to require withholding under those provisions.

The bill also makes amendments of a technical nature to conform the language of the withholding provisions to the language used in the other taxing provisions.

Effective date.—The amendment relating to the 30-percent withholding rule applies with respect to payments made in taxable years beginning after December 31, 1966. The amendment relating to domestic wage withholding applies with respect to remuneration paid after December 31, 1966.

f. Withheld taxes and declarations of estimated income tax (secs. 103 (i) and (j) of the bill and secs. 1461 and 6015 of the code)

Under present law, persons who are required to withold on amounts paid to nonresident aliens and foreign corporations are required to file a return and remit the taxes withheld during any calendar year by March 15 of the following year. This procedure is unusual since all other withheld taxes, such as the employees' social security taxes and domestic wage withholding, are required to be remitted (together with the return) at least quarterly. As a result of the delay in the remittance of these 30-percent-withholding taxes, the witholding agents are given the use of these revenues for periods of time which are, in some cases, more than 1 year.

Your committee agrees with the House that there is no reason for not requiring the remittance of these tax revenues at a time period approximating that applicable in the case of domestic withholding. Therefore, your committee's bill amends present law to provide the Treasury Department with the authority to require more current remittance of the taxes withheld on nonresident aliens and foreign corporations. This amendment is effective with respect to payments made after December 31, 1966.

The bill also amends the provisions of present law which require individuals to file declarations of estimated tax. The amendment continues present law which includes nonresident aliens within the category of individuals required to file these declarations. However, the application of this provision to nonresident aliens is limited to those who receive income which is effectively connected with the conduct of a trade or business within the United States.

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

g. Foreign estates or trusts (sec. 103 (e) and (l) of the bill and secs. 875 and 7701a(a)(31) of the code)

Present law defines the terms "foreign trust" and "foreign estate" to mean a trust or estate, whose income from sources without the United States is not included in gross income for U.S. income tax purposes. Your committee's and the House bill amends this definition to conform it to the effectively connected concept. As amended, the terms mean an estate or trust the income from which from sources without the United States, which is not effectively connected with the conduct of a trade or business within the United States, is not included in gross income for U.S. income tax purposes. This amendment applies for taxable years beginning after December 31, 1966.

Your committee added an amendment which imputes the business activities of a trust or estates to its beneficiaries. In other words, if a trust, whether a foreign or a domestic trust, is engaged in a trade or business in the United States, its beneficiaries are deemed to also be engaged in that trade or business.

h. Citizens of possessions of the United States (sec. 103(m) of the bill and sec. 932(a) of the code)

Under present law, individuals who are citizens of possessions of the United States but not otherwise citizens of the United States, are taxed as nonresident aliens on their U.S. source income. This provision is amended by your committee's and the House bill, effective for taxable years beginning after December 31, 1966, to conform to the changes made to the taxation of nonresident aliens generally.

i. Gain from disposition of certain depreciable realty (sec. 3(j) of the House bill and sec. 1250(d) of the code)

Your committee's bill strikes the House provision which provides that the recapture rule applicable to depreciable realty is to apply to the transfer of depreciable real estate by a foreigner to a domestic corporation in a tax-free exchange for stock or securities of a domestic corporation. Your committee took this action after being advised that the relationship between the House provision and the corresponding provisions of present law affecting U.S. persons make the provision discriminatory.

4. TAXATION OF FOREIGN CORPORATIONS

a. Income tax on foreign corporations (secs. 104 (a) and (b) of the bill and secs. 881 and 882 of the code)

Present law.—Present law taxes foreign corporations not engaged in a trade or business in the United States at a flat rate of 30 percent on fixed or determinable income from sources within the United States. These items are (with a few exceptions) the same as those presently taxed at the 30-percent rate to nonresident alien individuals not engaged in a trade or business in the United States. They are interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits, and income (including certain timber, coal, and iron ore royalties).

The U.S. source income of a foreign corporation engaged in business in the United States is taxed, under present law, at the regular corporate rates. In computing the tax, deductions generally are allowed to the extent that they are properly allocable to the U.S. source income if a true and accurate return is filed by the corporation.

Reasons for provision.—Your committee's and the House bill, both in the case of nonresident aliens and in the case of foreign corporations, provides a consistent pattern of taxation. Nonresident aliens and foreign corporations will be taxed at the regular income tax rates in the case of income which is effectively connected with a U.S. trade or business. In the case of nonresident alien individuals and foreign corporations with U.S. source fixed or determinable income which is not effectively connected with a U.S. trade or business a flat 30-percent rate is applied. The reasons for differentiating the tax treatment on this basis have already been explained to a substantial extent in connection with the definition of effectively connected (No. 2(b), above) and in connection with the explanation of the taxation of nonresident aliens (No. 3(a), above).

One of the principal changes resulting from this new classification in the case of foreign corporations is that investment income which is not related to a trade or business carried on in the United States will be taxed at the flat 30-percent rate (or lower treaty rate) rather than at the regular corporate rate. This does away with the arbitrary distinction which exists under present law which makes the rate of tax, a flat 30 percent or regular rate, turn on the presence or absence of a trade or business in the United States which may be wholly unrelated to the investment income.

Under the bill all U.S. source investment income (fixed or determinable income) of foreign corporations which is not effectively connected with a trade or business in the United States will be taxed at a flat rate. However, all investment income effectively connected with a U.S. trade or business will be taxed in the same manner as other income of that trade or business, and in the same manner as similar income of a domestic corporation.

As indicated in connection with the definition of effectively connected the new rule for the taxation for foreign corporations will also prevent the use of the United States as a "tax haven" in the case of limited categories of foreign source income. However, these limited types of income do not, in any event, include "subpart F income" or, generally, income received from a foreign subsidiary.

This new rule for the taxation for foreign corporations should also tend to encourage foreign investment in the United States and thus is likely to have a favorable effect on the U.S. balance of payments.

Explanation of provision.—The bill substantially revises the income tax treatment of foreign corporations. Under the bill the income of a foreign corporation is divided into two classifications.

(A) *Income not effectively connected.*—Fixed or determinable income of a foreign corporation from sources within the United States which is not effectively connected with the conduct of a trade or business within the United States, under your committee's and the House bill, is taxable at a flat 30-percent rate (or lower treaty rate). Under your committee's bill, the types of fixed or determinable income specified are the same as under present law with the same two additions provided in the case of nonresident aliens: (1) contingent income received from the sale of patents and other intangibles, and (2) amounts of original issue discount which are treated as ordinary income received on retirement or sale or exchange of bonds or other evidences of indebtedness issued after September 28, 1965. A corresponding amendment to the House bill deleting the tax on income realized with respect to stock of a collapsible corporation was made in this provision. As indicated in the case of the taxation of nonresident aliens, the source of this original issue discount is to be determined by the same rules as those applicable to interest income. As a result, if the corporation with respect to whose bonds the original issue discount arises is a domestic corporation which for the 3-year period preceding the year of redemption derives 80 percent or more of its income from foreign sources, then the original issue discount (interest), at the time of the retirement or sale or exchange of the bonds also, will be considered as foreign source income. Moreover, the language in the nonresident alien section of this report clarifying the scope of the references in the bill to section 1232 is equally applicable with respect to this provision.

The bill has also clarified the language of present law which includes certain timber, coal, and iron ore royalties in the 30-percent list.

(B) *Income effectively connected.*—Income of a foreign corporation which is effectively connected with the conduct of a trade or business within the United States is taxable, under the bill, at the regular corporate income tax rates. In determining "taxable income" for this purpose, gross income includes only gross income which is "effectively connected" with the conduct of the trade or business within the United States.

(C) *Income from real property.*—Under present law (as explained with respect to nonresident alien individuals) it is not clear as to what situations or arrangements for the ownership by a foreign corporation of real property located in the United States will cause the foreign corporation to be considered as engaging in a trade or business within the United States. This is important to know because if a foreign corporation not engaged in a trade or business in the United States receives rents from U.S. real property, this rental income is taxable at the flat 30-percent rate (or applicable treaty rate) on the gross amount of such rents, without the allowance of any deductions attributable to the rental income. Consequently, the tax liability generated by this rental income may exceed the net rental income the corporation receives. Your committee agrees with the House that the law in this area should be clarified and doubts whether it is appropriate to tax the gross amount of this type of income.

Since the provisions of this amendment parallell the amendment provided in the case of real estate income of nonresident alien individuals, the explanation is not repeated here (see No. 3(a)(C)(ii)).

(D) *Certain interest received by banks in U.S. possessions.*—The application of the flat 30-percent rate to U.S. source income which is not effectively connected with a U.S. trade or business results in a high effective rate of tax on interest received by banks located in U.S. possessions with respect to U.S. Government obligations which they must necessarily hold to meet reserve requirements. This result is due to the fact that these banks must pay interest on the amounts invested in the U.S. Government obligations. Therefore, the net profit margin on the interest received from these U.S. Government obligations is small relative to the gross amount of interest received. It was also brought to the attention of your committee that the usual method of effecting a mitigation of the flat 30-percent rate in the case of interest—an income tax treaty providing a lower rate (0, 5, or 15)—is, of course, not possible in the case of a possession.

In view of the facts set forth above your committee has added an amendment to the House bill which provides that interest received by banks located in a U.S. possession from U.S. government obligations will be treated as effectively connected with a U.S. trade or business whether or not the bank has such a business. Consequently, the interest received by a bank in a possession from U.S. Government obligations will be taxed on a net basis—gross interest income less allocable expenses.

(E) *Deductions.*—Under the bill, deductions are allowed in computing the tax imposed at the regular corporate rates only to the extent that they are properly attributable to income which is effectively connected with the conduct of a trade or business within the United

States. The deduction for charitable contributions, however, is allowed whether or not attributable to income which is effectively connected. Generally, as under present law, deductions are permitted only if a true and accurate income tax return is filed.

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

b. Withholding of tax on foreign corporations (sec. 104(c) of the bill and sec. 1442 of the code)

Under present law, the fixed or determinable U.S. source income of a foreign corporation not engaged in trade or business in the United States, like that of a nonresident alien not engaged in a trade or business in the United States, is subject to a withholding tax of 30 percent. However, foreign corporations engaged in trade or business in the United States are not subject to the withholding tax.

The bill amends the withholding provisions of present law to conform to the effectively connected concept in the bill. Thus, under the bill a withholding tax at the 30-percent rate will apply in the case of a foreign corporation to items of fixed or determinable U.S. source income which are not effectively connected with the conduct of a trade or business in the United States. It is the understanding of your committee that the person required to withhold will be relieved of any liability for failure to withhold if the failure was in reliance upon information (as to whether or not the income was effectively connected) furnished (in accordance with regulations to be issued) by the foreign corporation entitled to the receipt of the income. The House bill provides that this 30-percent withholding provision is not applied if the Secretary of the Treasury determines that the withholding requirements impose an undue administrative burden and that the collection of the tax will not be jeopardized by an exemption. In cases like this, if the Treasury concludes that revenue will not be jeopardized (or delayed) by foregoing withholding, your committee concluded it would be desirable to do so. This amendment is applicable to taxable years beginning after December 31, 1966.

c. Deduction for dividends received from foreign corporations (sec. 104 (d) and (e) of the bill and sec. 245 (a) and (b) of the code)

Present law.—In general, present law allows corporations an 85-percent dividend-received deduction for dividends received from domestic corporations. In order for this deduction to be available in the case of dividends from a foreign corporation, it must be engaged in a trade or business in the United States for an uninterrupted period of at least 3 years and 50 percent of its gross income must be from U.S. sources during that period. Where these conditions exist, an 85-percent dividend-received deduction is available for the same proportion of the dividend as the corporation's gross income, which is from U.S. sources, is of its total gross income.

Explanation of the provision.—The House bill substantially conforms the dividends-received deduction to the effectively connected concept appearing elsewhere in the bill. Under the House bill 50 percent or more of the foreign corporation's gross income for the uninterrupted period must be from income effectively connected with the conduct of a trade or business within the United States for the deduc-

tion to be available. Also, the deduction is limited to 85 percent of the same proportion of the dividend as the foreign corporation's gross income, which is effectively connected with a U.S. trade or business, is of that corporation's total gross income from all sources.

Your committee added an amendment to the House bill which in certain situations provides a 100 percent dividends-received deduction to a domestic corporation for dividends received from a wholly owned foreign subsidiary which has a 100 percent effectively connected income. In such a situation a foreign corporation is subject to U.S. tax on all of its income, just as is a domestic corporation.

The bill also contains a transitional rule which makes it unnecessary to apply the effectively connected income concept when any of the years which is taken into account for the 50-percent test is a pre-1967 year. This rule provides that, for purposes of computing this deduction, all of a foreign corporation's U.S. source income, for any period before its first taxable year beginning after December 31, 1966, is to be considered to be effectively connected income.

Effective date.—These amendments apply for taxable years beginning after December 31, 1966.

d. Unrelated business taxable income of certain foreign charitable organizations (sec. 104(g) of the bill and sec. 512(a) of the code)

Under present law the unrelated business taxable income of foreign charities is subject to tax if it is derived from sources within the United States.

The bill conforms this provision to the effectively connected concept by providing that the unrelated business taxable income of a foreign charity is to be subject to tax only if it is effectively connected with the conduct of a trade or business in the United States.

This amendment applies for taxable years beginning after December 31, 1966.

e. Foreign corporations subject to personal holding company tax (sec. 104(h) of the bill and sec. 542(c), 543(b), and 545 (a) and (d) of the code)

Present law.—Under present law any foreign corporation with U.S. investment income, whether or not doing business here, may be taxed as a personal holding company unless all its outstanding stock is owned (directly and indirectly) by nonresident alien individuals and its U.S. source gross income is less than 50 percent of its total gross income for that year. If taxable as a personal holding company the foreign corporation is subject to a special 70-percent tax on its undistributed U.S. source personal holding company income in addition to the flat rate 30-percent tax (or possibly the regular corporate tax). Also, if a foreign corporation is determined to constitute a personal holding company and the foreign corporation has not filed a return or that which was filed was not a true and accurate return, the 70-percent personal holding company tax is assessed without allowance of the dividend paid deduction. In such cases, the combination of the regular 30-percent tax and the 70-percent personal holding company tax can constitute a tax of about 80 percent of the income of the foreign corporation.

Reason for provision.—The primary reason for applying the U.S. personal holding company tax to foreign corporations owned by non-

resident aliens has been to prevent the avoidance of the graduated rates of U.S. tax applicable to certain nonresident alien individuals by utilizing foreign holding companies as the recipients of their U.S. source investment income. Generally the graduated rates presently apply when a nonresident alien's U.S. gross income exceeds $21,200 or when he is engaged in a trade or business in the United States. However, under your committee's and the House bill nonresident aliens are not to be subject to the graduated rates of tax unless their income is effectively connected with a trade or business in the United States. In view of this the retention of the personal holding company tax would appear to serve no purpose where all of the shareholders are nonresident aliens.

Explanation of provision.—The House bill modifies the provision in present law excluding from the personal holding company definition only those foreign corporations which meet two tests; namely, where their U.S. source gross income is less than 50 percent of their total gross income and all of their stock is held directly or indirectly by nonresident aliens. In place of this the House bill substitutes a broader exemption which applies to any foreign corporation all of whose outstanding stock during the last half of its taxable year is owned by nonresident alien individuals (directly or indirectly through foreign estates, trusts, partnerships, or other foreign corporations).

Your committee has adopted three amendments in this area. The first amendment provides that the general exclusion from the personal holding company provision provided in the House bill is not to be available to a foreign corporation which is a personal holding company if it has income from personal services which is personal holding company income described in section 543(a)(7). In such a case the personal holding company tax is to be assessed on that personal service income. The second amendment provides a deminimus rule, in addition to the general exception provision provided in the House bill. Under the amendment, in the case of foreign corporations with only 10 percent or less U.S. ownership the personal holding company tax is to be assessed only on the corporation's undistributed personal holding company income attributable to the U.S. shareholders' interest. The final amendment adopted by your committee provides that a foreign corporation can claim all appropriate deductions in computing its personal holding company tax notwithstanding the general rule disallowing deductions where no return is filed. However, a 10-percent addition to taxes otherwise due is to be assessed.

Effective date.—This amendment applies with respect to taxable years beginning after December 31, 1966.

f. Foreign corporations carrying on insurance business in the United States (sec. 104(i) of the bill and secs. 819, 821, 822, 831, 832, 841 and 842 of the code)

Present law.—Present law taxes a foreign life insurance company carrying on a life insurance business in the United States on all its income attributable to that business in substantially the same manner as a domestic life insurance company.[3] Foreign insurance companies carrying on life insurance businesses in the United States gen-

[3] A foreign life insurance company that is not carrying on a life insurance business in the United States is taxable under the provisions applicable to foreign corporations generally.

erally have interpreted this as providing they were not taxable on U.S. source income which is not income of the U.S. life insurance business of the company.

As is indicated above, with respect to their life insurance company business, foreign life insurance companies are taxed, under present law, in substantially the same manner as domestic life insurance companies. However, a special rule is provided where the surplus of a foreign life insurance company held in the United States is less than a specified minimum figure. This figure is expressed as the same percent of the foreign life insurance company's liabilities on U.S. business as the average surplus of domestic corporations is of their total liabilities. The Secretary of the Treasury determines this ratio each year. If the foreign insurance company's surplus held in the United States is less than this proportion of the taxpayer's total insurance liabilities on U.S. business, then the policy and other contract liability requirements, and the required interest for computing gain from operations, are reduced by this deficiency multiplied by the rate of earnings on investments. This provision is designed to prevent foreign insurance companies doing business in the United States from avoiding tax that they would otherwise have to pay to the United States merely by not holding a sufficient amount of surplus attributable to the U.S. business.

Reason for, and explanation of provisions.—Your committee agrees with the House that foreign insurance companies—life insurance companies and other insurance companies, including both mutual and stock companies—should, in general, be taxed on their investment income in the same manner as other foreign corporations. For this reason, the bill provides that a foreign corporation carrying on an insurance business within the United States is to be taxable in the same manner as domestic companies carrying on a similar business with respect to its income which is effectively connected with the conduct of a trade or business within the United States. The remainder of the U.S. source income of this type of a corporation is to be taxed in the same manner as income of other foreign corporations which is not effectively connected with a U.S. trade or business; that is, at a flat 30 percent (or lower treaty) rate. The determination of whether a foreign insurance company qualifies for the special domestic insurance treatment is to be made by considering only the income of the corporation which is effectively connected with the conduct of its insurance business carried on in the United States. In making this change your committee intends no inferences as to the requirements of existing law with respect to investment income of foreign insurance companies.

For purposes of determining whether or not income of a foreign life insurance company is effectively connected with the conduct of its U.S. life insurance business, the annual statement of its U.S. business on the form approved by the National Association of Insurance Commissioners will usually be followed. It has been brought to the attention of your committee that certain foreign casualty insurance companies also use this form to indicate their U.S. business connected investment income. The committee does not intend to imply by negative inference that these companies will be precluded from using this form in the future. It is noted that all the income effectively connected with the foreign life insurance company's U.S. life insurance business, from whatever source derived, comes within the ambit of this provision. This a continuation of present law which subjects to U.S.

tax all the income attributable to the U.S. life insurance business from whatever source derived.

In the case of insurance companies other than life—both mutual and stock—present law provides that if these companies have income from U.S. sources but are not engaged in an insurance business here, they are taxed in the same manner as other foreign corporations. Where mutual insurance companies (other than life or marine) are carrying on an insurance company business in the United States, they are taxable on their income derived from sources within the United States in the same manner as similar domestic mutual companies. Stock casualty, fire, flood, and so forth, insurance companies carrying on an insurance business in the United States, also are taxed in the same manner as domestic stock insurance companies with respect to the portion of their taxable income from sources within the United States.

It has been pointed out that the special rule in present law referred to above with respect to foreign life insurance companies—where these companies hold a lower ratio of surplus for their U.S. business than that held by the average domestic companies—may lead to what in effect is a double tax. This results from the interaction of this provision with the effectively connected rule. Thus for example, a company may find its deductions reduced (because of the minimum surplus requirement) while, at the same time, it is taxed at a flat 30 percent (or lower treaty rate) on investment income in this country not effectively connected with the U.S. business which, in effect, also includes the income subject to the minimum surplus adjustment.

To meet the problem referred to above, your committee's and the House bill adds a paragraph to the provision described above which has the effect of reducing the income subject to the flat 30-percent tax (or lower treaty rate) by the amount by which the deductions under this special provision are reduced as the result of the application of the Secretary's ratio. This is accomplished by allowing a credit against the 30-percent tax (or lower treaty rate) for the tax levied on the hypothetical income attributed to the U.S. life insurance company business.

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

g. Subpart F income (sec. 104(j) of the bill and sec. 952(b) of the code)

Present law.—Under present law certain portions of the undistributed income of a controlled foreign corporation are taxed currently to its U.S. shareholders having a 10 percent or greater voting interest. This undistributed income so taxed is termed "subpart F income." In determining "subpart F income," there is excluded income of a foreign corporation from U.S. sources which already is taxed by the United States because the corporation is engaged in trade or business in the United States. Present law is interpreted in the income tax regulations as not excluding from "subpart F" income, income exempt from U.S. tax, or subject to a reduced rate of tax, in accordance with a treaty.

The bill modifies existing law to conform this provision with the effectively connected concept and to clarify the language of existing law with respect to income affected by treaties.

Explanation of provision.—The bill amends present law to provide that in determining "subpart F income" there is to be excluded only

those items of income effectively connected with the conduct by the foreign corporation of a trade or business within the United States. It also makes it clear that "subpart F" income includes items exempt from U.S. tax or subject to a reduced rate of tax pursuant to a treaty.

Effective date.—This amendment applies with respect to taxable years beginning after December 31, 1966.

h. Gain from certain sales or exchanges of stock in certain foreign corporations (sec. 104(k) of the bill and sec. 1248(d) of the code)

Present law.—Present law treats the gain realized by a 10-percent U.S. shareholder from the sale or exchange of stock of certain foreign corporations as a dividend, to the extent the post-1962 earnings and profits of the corporation are attributable to the shares being sold or exchanged. In determining the earnings and profits to be taken into account in determining this gain, present law excludes U.S. source income of a foreign corporation engaged in a U.S. trade or business. Consistent with the interpretation of similar language applicable to the determination of "subpart F income" explained above, these earnings and profits have been construed by the regulations as including income exempt from U.S. tax or subject to a reduced rate by treaty.

Explanation of provision.—The amendment provides that for taxable years beginning on or after January 1, 1967, the earnings and profits of the foreign corporation (for purposes of sec. 1248) is not to include income effectively connected with the conduct of a trade or business within the United States. In addition, the amendment makes it clear that the exclusion does not apply to income which is exempt from tax, or subject to a reduced rate of tax, pursuant to a treaty.

Effective date.—This amendment applies to sales or exchanges occurring after December 31, 1966.

5. MISCELLANEOUS INCOME TAX PROVISIONS, ETC.

a. Income affected by treaty (sec. 105(a) of the bill and sec. 894 of the code)

Present law.—Existing income tax treaties generally provide that the exemptions from tax, or the reduction in rates of tax, provided for in its provisions apply only to persons who do not have a permanent establishment in the United States. The "permanent establishment" concept of the treaties serves a purpose similar to the "engaged in a trade or business in the United States" concept of U.S. tax law. The effect of such a provision in a treaty, therefore, is to deny the benefits of a treaty exemption or reduced rate to a nonresident alien individual, or a foreign corporation, engaged in a trade or business in the United States through a permanent establishment.

Explanation of provision.—Under the tax treatment provided for such persons by the bill, the "engaged in trade or business in the United States" criterion is no longer the sole determinant of the method of taxing particular items of a nonresident alien individual's, or a foreign corporation's, U.S. source income. The bill seeks to tax all such persons alike on their noneffectively connected U.S. source income whether or not they also are engaged in a trade or business in the United States. This result would not be achieved under treaty provisions if some aliens or foreign corporations because of having a

permanent establishment in the United States, are denied the benefits of treaty rates or exemptions.

The bill adds to the code a new subsection providing that for purposes of applying any exemption from, or any reduced rate of, tax granted by a 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. In other words, with respect to investment income not effectively connected with a trade or business, a nonresident alien or foreign corporation will be taxed at the lower treaty rate if one is provided. This provision does not apply in computing the special tax applicable to U.S. citizens who become expatriates with a primary purpose of avoiding tax.

Effective date.—This new provision is effective for taxable years beginning after December 31, 1966.

b. Adjustment of tax on nationals, residents, and corporations of certain foreign countries (sec. 105(b) of the bill and new sec. 896 of the code)

Imposition of more burdensome taxes.—Unilaterally revising the statutory pattern of taxation of nonresident aliens and foreign corporations and granting favorable tax treatment to such persons may have the effect of making it more difficult to negotiate satisfactory tax treaties. At the same time, your committee agrees with the House that a systematic modernization of the U.S. income tax treatment of nonresident aliens and foreign corporations requires a modernization of the basic statutory provisions.

To prevent a deterioration in our position in negotiating treaties while at the same time modernizing these statutory provisions, the bill has added a provision to the tax laws which generally grants to the President the authority to apply the income tax law without regard to the amendments which this or later acts make to the provisions relating to the taxation of foreigners (including corporations) in the case of any country which imposes more burdensome taxes on U.S. citizens and corporations than the United States does on nonresident aliens and foreign corporations.

The new section gives special authority to the President where he finds that—

(1) under the laws of any foreign country, citizens of the United States (not residents of the foreign country) or U.S. corporations are being subject to more burdensome taxes on any item of income from sources within the foreign country, than those imposed by the United States on similar U.S. source income of residents or corporations of the foreign country;

(2) when asked so to do the foreign country has not acted to revise or reduce its taxes to eliminate this condition; and

(3) it is in the public interest to reimpose the pre-1967 income tax provisions.

Where these conditions exist, the President may proclaim that the tax on similar income derived from U.S. sources by residents or corporations of the foreign country for taxable years beginning after the proc-

lamation is to be determined by disregarding the amendments to the income tax law, as it relates to nonresident aliens and foreign corporations, made by this bill or by subsequent acts.

If after such a proclamation, the foreign country modifies the offending provisions of its tax law so that the President finds they are no longer more burdensome, he may proclaim that the U.S. tax on similar items of income derived from U.S. sources by residents or corporations of the foreign country, for taxable years beginning after such proclamation, is to be determined by taking into account the amendments made to the income tax provisions of the code relating to nonresident aliens and foreign corporations by this bill and later acts. Before the President makes a proclamation under this new provision, he is to give the Congress 30 days notice of his intention so to do.

Imposition of discriminatory taxes by foreign country.—It was brought to the attention of your committee that there are some foreign countries which discriminate against U.S. persons either generally or with regard to specific classes of U.S. persons. Since the present provisions of the code do not provide the President with authority to counteract discrimination by effecting substantially the same tax on the persons of the discriminating country (the present provision provides only for a doubling of the tax) it was the opinion of your committee that the ability to counteract all degrees of discrimination should be provided the President. Your committee is aware that at the present time the United Kingdom taxes dividends received by a United Kingdom permanent establishment of U.S. corporations at a higher rate than that at which it taxes its own corporations on intercorporate dividends. It is the understanding of your committee that it is situations such as this which may require action under this section.

In view of the foregoing facts your committee added a provision to the House bill granting the President the authority to take such action as is necessary to raise the effective rate of U.S. tax on income received by nationals, residents, or corporations of a discriminating country to substantially the same rates as are applied in the other country.

Effective date.—These provisions are effective for taxable years beginning after December 31, 1966.

c. Foreign community property income (sec. 105(e) of the bill and new sec. 981 of the code)

Present law.—The general income tax provisions provide, in effect, that the worldwide income of a U.S. citizen is subject to tax from whatever source derived. In a recent case,[4] it was held that an American citizen who acquired residence in a foreign country with community property laws, and who married a nonresident alien, had a sufficient interest in one-half of the marital partnership income—even though earned by the husband foreigner—to render her subject to U.S. taxation on that income.

Reasons for provision.—Your committee agrees with the House that it is undesirable to require a U.S. citizen to pay U.S. tax on income earned by a spouse who is a foreigner merely because of the attribution of one-half of the income to the U.S. citizen through the community property laws of the foreign country of residence. Although the tax is levied on the spouse who is a U.S. citizen, it is regarded by most

[4] *Katrushka J. Parsons* v. *Commissioner*, 43 T.C. 331 (1964).

foreigners as a U.S. tax on the income from the labor and property of the foreigner's spouse. In practice it appears that the revenue received from the application of this rule is limited because of the likelihood that persons subject to it are unaware of its existence. However, when a case is discovered, the tax liabilities are likely to be large because returns have not been filed.

An additional factor to be considered is that community property laws of foreign countries frequently make no difference in the source of taxable income since they often require joint returns by husbands and wives. Moreover, in many such countries it appears doubtful whether a U.S. wife under the law of that country could legally compel her foreigner husband to pay over to her amounts necessary to remit her U.S. tax liability on her community property income.

For the reasons given above, the bill provides a U.S. spouse with an election which would substantially negate the operation of the community property laws of the foreign country of residence.

Explanation of provisions.—The bill provides elections to U.S. citizens who are, during the periods involved, married to nonresident aliens. If an election is made for post-1966 years, the community income of husband and wife are to be treated as follows:

(1) Earned income (sec. 911(b)) is to be treated as income of the spouse who rendered the personal services.

(2) Trade or business income is to be treated as income of the husband unless the wife exercises substantially all the management and control over the business. Also, a partner's distributive share of income is to be wholly attributed to him (same as self-employment rules under section 1402(a)(5)).

(3) Other community income which is derived from separate property of one spouse is to be treated as income of that spouse. What is "separate property" for this purpose is to be determined under the applicable foreign community property law.

(4) All other community income is to be treated as provided in applicable foreign community property law.

Due to the uncertainty in the tax treatment of this type of community property income in prior years, the election provided for pre-1967 years, to an even greater extent, ignores community property laws of the foreign countries. For pre-1967 years the treatment of income of the types set forth in categories (1), (2), and (3) above is to be the same as described above, but the income described in category (4) above is to be treated as income of the spouse who, for the year involved, had the greater amount of income described in (1), (2), and (3) plus separate income. Thus, category (4) income is attributed to the marital partner whose earnings or property were most likely to have given rise to this income.

For purposes of this provision, the treatment of deductions is to be compatible with that accorded the income to which the deductions are attributable. In other words deductions are to follow the income they generate.

This provision provides qualified taxpayers with two elections, one for pre-1967 years and one for future years. Either election can be made for any year, at any time, so long as the year is still open. However, these elections are binding—if the election is exercised for any post-1967 year the treatment provided by this provision applies not

only to the year of election but also to all years subsequent which are open and, if made for pre-1967 years, this provision applies for all open years prior to that date. It should be noted that either election can be made separately.

Generally, the election must be made by both spouses. However, with respect to the pre-1967 election, the foreigner spouse need not join if the Secretary of the Treasury determines that (1) an election would not affect the U.S. tax liability of the foreigner spouse for any taxable year, or (2) that the foreigner spouse's U.S. tax liability for pre-1967 years cannot be ascertained and that to deny the election to the U.S. citizen would be inequitable and cause undue hardship. If either election is made, a period of 1 year is provided with respect to all open years for the making of assessments and the claiming of refunds. However, this 1-year period applies only if the deficiency or refund is attributable to the election. Also, no interest is due on a deficiency or refund resulting from the election for any period up to 1 year after the filing of the election.

d. Foreign tax credit—foreign corporations and nonresident aliens (sec. 106(a) of the bill and secs. 874, 901, and new sec. 906 of the code)

Present law.—Present law does not grant a foreign tax credit to foreign corporations or nonresident aliens since presently such persons are subject to U.S. tax only on their U.S. source income. However, the code does provide a tax credit to U.S. persons with respect to foreign taxes on foreign income subject to U.S. tax.

Reasons for provision.—As a result of the rule provided elsewhere in this bill nonresident aliens and foreign corporations, in certain types of cases, are taxable on foreign source income which is effectively connected with the conduct of a trade or business within the United States (see item 2(6)(ii) above). The country which is the source of the income may also impose a tax on this same income. Moreover, the country in which the alien is a citizen or where the foreign corporation is domiciled for tax purposes may also assert tax jurisdiction with respect to this income. In view of the fact that one of the primary reasons the foreign source income effectively connected concept is being adopted is to prevent the United States from being availed of as a "tax haven" it is the opinion of your committee that the United States should not assert tax jurisdiction in a manner which might lead to double taxation to the extent that the countries of source or residence subject the income to their tax. Therefore, your committee concluded that the policy preventing the United States from being availed as a "tax haven" would not be frustrated by providing a foreign tax credit for all foreign income taxes assessed with respect to effectively connected foreign source income.

Explanation of provision.—For the reasons indicated above the bill adds a new section to the code (sec. 906) to allow a foreign tax credit to nonresident aliens and foreign corporations with respect to foreign source income which is subject to tax in the United States because it is effectively connected with the conduct of a trade or business in the United States. However, this provision of your committee's bill differs from that provided in the House bill. Under the House bill this foreign tax credit for nonresident aliens and foreign corporations is

not to be available for taxes imposed by a country solely on the basis that it has jurisdiction to tax the individual on his worldwide income because he is a citizen or resident of that country or a corporation on its worldwide income because it is created, incorporated, or domiciled there. As indicated above it is the opinion of your committee that it is not necessary to the effectuation of the purposes of the bill that the foreign tax credit provision be limited in the manner provided in the House bill.

The credit is allowed under the existing foreign tax credit provision and is subject to the existing "per country" or "overall" limitation. The "per country" limitation restricts the credit to the proportion of the U.S. tax which the taxpayer's taxable income from sources within the particular country bears to his entire taxable income for the year. Similarly the "overall" limitation restricts the credit to the proportion of the U.S. tax which the taxpayer's taxable income, from sources without the United States, bears to his entire taxable income for the year. In determining the credit allowable to a nonresident alien individual or a foreign corporation under these limitations, the individual's or corporation's taxable income is to include only the taxable income effectively connected with the taxpayer's conduct of a trade or business within the United States. Moreover, the credit is not allowable against U.S. taxes imposed at the flat 30-percent rate on income not effectively connected with the conduct of a trade or business in the United States.

Under some circumstances, present law treats a portion of the foreign taxes paid by certain foreign subsidiaries of a domestic corporation as having been paid by the domestic corporation for purposes of computing its foreign tax credit. The bill accords this same treatment to foreign corporations, but its application is limited to income effectively connected with the conduct of a trade or business within the United States.

Effective date.—These amendments apply for taxable years beginning after December 31, 1966. In applying the foreign tax credit carryback and carryover provisions of present law to nonresident aliens and foreign corporations no amount may be carried to or from a taxable year beginning before January 1, 1967.

e. Similar credit requirement (sec. 106(b) (2) and (3) of the bill and secs. 901(c) and 2104(a) and new (h) of the code)

Present law.—Under present law, the foreign tax credit for income, etc., or death taxes are allowable to an alien who is a resident of the United States (or Puerto Rico) only if the foreign country in which the alien is a citizen or subject, in imposing its income, etc., or death taxes, allows a similar credit to citizens of the United States residing in such country.

Reason for provision.—The present law acts to deny the credit to alien residents of the United States who are citizens of countries which may be following foreign policies which are adverse to the United States. Such countries may be unconcerned as to our tax treatment of refugees from their country who become residents of the United States. The fact that the United States may deny a credit to refugees from their country, in fact, might encourage them not to provide a foreign tax credit or exemption in their laws for any residents of their country who may be U.S. citizens. Your committee agrees with the House that

the denial of the credit to such persons under these circumstances is unjustified and, therefore, has amended present law so as to allow these persons the foreign tax credit unless the President finds that so doing is not in the public interest.

Explanation of provision.—The bill modifies the provision of present law which in all cases denies a credit for citizens of a foreign country if it does not provide reciprocity for U.S. citizens residing there. Under the bill the President is given some discretion as to the disallowance of the credits in such cases. The bill provides that the President is to deny a foreign tax credit to residents who are subjects of a foreign country if he finds: (1) That a foreign country, in imposing income, war profits, and excess profits taxes or death taxes does not allow U.S. citizens residing in that country a credit for any taxes paid or accrued to the United States or any foreign country, similar to the foreign tax credit allowed by the United States to subjects of that foreign country residing in the United States; (2) that the foreign country, when requested to do so, has not acted to provide a similar credit to U.S. citizens residing in that foreign country; and (3) that it is in the public interest to allow the U.S. foreign tax credit to citizens or subjects of the foreign country who reside in the United States only if the foreign country allows such a similar credit to citizens of the United States residing in the foreign country.

The disallowance of the credit in any such case is to apply for taxable years beginning while a Presidential proclamation denying the credit is in effect.

f. Separate foreign tax credit limitation (sec. 106(c) of the bill and sec. 904(f) of the code)

Present law.—Generally, under present law the limitation on the allowable foreign tax credit, must be computed separately for all interest income and on a "per country" basis. The exceptions to this general rule are for:

(1) Interest derived from any transactions directly related to the active conduct of a trade or business in a foreign country or U.S. possession;

(2) Interest derived in the conduct of a banking, financing, or similar business (such as an insurance company business);

(3) Interest received from a corporation in which the taxpayer owns at least 10 percent of the voting stock; and

(4) Interest received on obligations acquired as the result of the disposition of a trade or business actively conducted by a taxpayer in a foreign country or as a result of a disposition of stock or obligations of a corporation in which the taxpayer owned at least 10 percent of the voting stock.

This provision was added to the code by the Revenue Act of 1962 so as to foreclose the transfer outside the United States (primarily to Canada) of short-term funds, such as bank deposits, in order to make it possible to use foreign tax credits, which otherwise could not be used, to reduce the U.S. tax on a domestic corporation's worldwide income. Interest income previously could be used in this manner because typically the foreign tax on such income was below the regular corporate tax which would apply to interest income received by a domestic corporation. Thus, if the overall limitation were used there

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

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.

the United States. In general, these deductions are: (1) Those connected with U.S. source income, (2) those allocated or apportioned under regulations with respect to deductions related to income which is partially from within and without the United States, (3) losses not connected with the trade or business but incurred in transactions entered into for profit (if the profit, had the transaction resulted in a profit, would have been taxable by the United States), (4) casualty losses (if the loss is of property within the United States), and (5) the charitable contribution deduction.

The bill does not change the tax treatment of income qualifying for the exclusion relating to income from U.S. possessions but because it allows deductions to nonresident aliens and foreign corporations engaged in a trade or business in the United States only where the deductions are allocable to income effectively connected with this trade or business, it is now necessary in this provision to specify the deductions which may be taken. The bill therefore makes applicable to U.S. citizens and domestic corporations engaged in trade or business in possessions, who qualify for the special tax treatment under existing law, the provisions of present law which allow deductions to nonresident aliens or foreign corporations engaged in trade or business in the United States.

This amendment is effective for taxable years beginning after December 31, 1966.

6. ESTATE TAX PROVISIONS

a. Estate tax rates (sec. 108(a) of the bill and sec. 2101(a) of the code)

Present law.—The estate of a nonresident alien is taxed only on the transfer of property situated or deemed to be situated in the United States at the time of his death. While the tax rates are the same as for citizens and residents of the United States, the deductions, credits, and exemptions are different: No marital deduction is allowed with respect to the estate of a nonresident alien; the specific exemption in determining the taxable estate is $2,000 instead of the $60,000 applicable in the case of U.S. citizens; no credit is allowed for foreign death taxes paid; and the expenses, losses, etc., are generally limited to the same proportion of these expenses which the alien's gross estate situated within the United States is of his entire gross estate.

Reason for provision.—The fact that a marital deduction of up to 50 percent of the adjusted gross estate is not allowed in the case of the estate tax liability of a nonresident alien, in effect nearly doubles the size of the taxable estate of many aliens over that of similarly situated citizens. The $2,000 exemption, instead of the $60,000 exemption applying to citizens, also leads to a higher estate tax base. This, of course, means that the estate of a nonresident alien is likely to pay heavier taxes on its U.S. assets than would be true in the case of the estate of a U.S. citizen of similar size. Your committee agrees with the House that this is not appropriate. In addition it has been suggested that the high U.S. estate tax on the U.S. assets of a nonresident alien tends to discourage foreign persons from investing in the United States. Any increase in foreign investment in this country which may be brought about by this change will, of course, have a favorable effect on this country's balance of payments.

In view of the considerations set forth above, your committee believes that the taxation of the U.S. estates of nonresident aliens should be reduced to more closely equate with the taxation of the estates of U.S. citizens. The bill therefore establishes a new schedule of graduated estate tax rates applicable to estate of nonresident aliens which will impose a tax on the U.S. estates of these persons in an amount which is generally equivalent to the tax imposed on an estate of similar value of a U.S. citizen with the maximum marital deduction. (As is explained subsequently the bill also increases the specific exemption available with respect to estates of nonresident aliens.)

Explanation of provision.—The new schedule of rates applicable to estates of nonresidents not citizens is as follows:

If the taxable estate is:	The tax shall be:
Not over $100,000	5 percent of the taxable estate.
Over $100,000 but not over $500,000	$5,000 plus 10 percent of excess over $100,000.
Over $500,000 but not over $1,000,000	$45,000, plus 15 percent of excess over $500,000.
Over $1,000,000 but not over $2,000,000	$120,000, plus 20 percent of excess over $1,000,000.
Over $2,000,000	$320,000, plus 25 percent of excess over $2,000,000.

Table 2 shows a comparison of the effective rates for estates of nonresident aliens provided by this new schedule with the effective rates under present law for nonresident aliens and U.S. citizens with and without a marital deduction. It will be noted that the effective rates resulting from the new schedule closely approximate those applicable in the case of the estate of a U.S. citizen with a marital deduction.

TABLE 2.—*Effective rates of U.S. tax on U.S. estates of nonresident aliens under present law and under the bill and on U.S. citizens under present law*

U.S. gross estate [1]	Effective rate of tax			
	Present treatment of nonresident alien	Tax treatment of nonresident alien provided by bill [2]	U.S. citizen	
			With marital deduction	Without marital deduction
$2,000				
$10,000	2.9			
$30,000	7.7			
$60,000	12.5	2.0		
$100,000	17.3	3.0		3.0
$500,000	25.8	7.4	8.0	22.1
$1,000,000	28.8	10.1	11.1	26.7
$5,000,000	43.0	17.8	16.9	42.3
$10,000,000	53.3	20.6	21.2	52.8

[1] For purposes of these computations it is assumed 10 percent of gross estate is deducted for funeral and other expenses both in the case of U.S. citizens and nonresident aliens.
[2] Takes into account the increase in the exemption from $2,000 to $30,000.

b. Limitation on credit for State death taxes (sec. 108(b) of the bill and sec. 2102 of the code)

Present law.—Under present law, the estate of a nonresident alien is allowed a credit against its U.S. estate tax for death taxes it pays to any of the States of the United States. The only death tax some of the States impose is a so-called pickup tax, that is, a tax equal to the maximum credit for State death taxes allowable against the Federal

estate tax. Other States impose a pickup tax in addition to their regular death taxes.

Reasons for provision.—The credit for State death taxes in the Federal statute is based on the taxes actually paid to any State. At the same time the so-called pickup taxes [6] are designed to impose a sufficiently heavy tax on property within their jurisdiction to absorb any Federal tax with respect to which credit may be obtained. A problem arises from the interrelationship of these Federal and State rules where property, such as stocks, has a situs in the United States but for State death tax purposes is not considered to have a situs in any particular State—since the nonresident alien has no residence in any State. In such cases the effect of a State pickup tax may be to impose a disproportionately heavy State death tax on what may be the minor portion of the nonresident alien decedent's gross estate located there, in order to absorb the full Federal credit which may be available with respect to property, such as stocks, which have a U.S. situs but no situs in any particular State. Since the credit for death taxes was intended to be available with respect to death taxes, imposed at a level up to the Federal credit level, by States on property within their jurisdiction, it seems inappropriate to allow a credit for a State death tax at a rate above the Federal rate on the property merely on the grounds that there is other property subject to the Federal tax outside the jurisdiction of the State.

Explanation of provisions.—The bill amends present law to provide that the maximum credit for State death taxes allowable against the Federal estate tax imposed on estates of nonresidents not citizens is to be an amount which bears the same ratio to the credit (computed without regard to this limitation) as the value of the property upon which the State death taxes are paid (and which is includible in the gross estate) bears to the total gross estate for Federal tax purposes.

Effective date.—This amendment applies with respect to estates of decedents dying after the date of the enactment of this bill.

c. Bond situs rule (sec. 108(c) of the bill and sec. 2104 of the code)

Present law.—Under present law, a nonresident alien is subject to the U.S. estate tax only with respect to property which is situated in the United States at the time of his death. The code provides so-called situs rules for determining under what conditions various types of property are to be considered as having a U.S. situs and therefore includible in the estate tax base of a decedent. Under these rules stock of a domestic corporation owned by a nonresident alien is considered to be property within the United States regardless of the location of the share certificates. In the case of bonds issued by U.S. corporations, no such statutory situs rule exists. Instead, for Federal estate tax purposes, the debt represented by a bond of a domestic corporation is considered to be situated at the location where the certificate is held. Other intangible debt obligations of U.S. obligors are treated as being situated within the United States.

Reasons for provision.—The difference in treatment for bonds is based upon the view that bonds constitute the debt itself and hence the debt is situated with the bonds, but with respect to other obliga-

[6] In addition to State pickup taxes, the problem here described may also arise where the State death tax with respect to the property located within its jurisdiction is heavier than the Federal estate tax with respect to such property.

tions the written statement of the obligation is only evidence of the existence of the debt and hence the debt is situated with the debtor. Your committee agrees with the House that this distinction is an unsatisfactory basis for exempting these bonds from the U.S. estate tax. Moreover, it sees no reason for treating bonds and stock differently in this respect.

Explanation of provision.—For the reasons given above the bill adds a new provision to the law providing that for purposes of the tax imposed on the estates of nonresidents not citizens, all debt obligations (including bonds) of a U.S. person, the United States, a State or political subdivision of a State, or of the District of Columbia owned and held by a nonresident not a citizen of the United States are to be deemed to be property situated within the United States. An exception to this rule is provided for debt obligations of U.S. corporations which have derived less than 20 percent of their gross income from U.S. sources for the 3 years prior to the nonresident's death. In such cases these debt obligations are to be considered as having a foreign situs. For purposes of this provision U.S. currency is not to be considered a debt obligation of the United States.

Additionally, a conforming change was also made by your committee with respect to the U.S. estate tax on foreigners' deposits in U.S. branch banks of foreign corporations.

Effective date.—This amendment applies with respect to estates of decedents dying after the date of enactment of this bill.

d. Deposits in U.S. banks or foreign branch banks of U.S. corporations (sec. 108(d) of the bill and sec. 2105 of the code)

Present law.—Present law provides that, for purposes of estate tax, the deposits of nonresident aliens with U.S. persons carrying on the banking business will not be considered to have a situs within the United States if the decedent was not engaged in a trade or business in the United States at the time of his death and a situs within the United States if the decedent was so engaged. This rules applies to deposits in foreign branch banks of U.S. corporations as well as to deposits in domestic branches.

Reasons for provision.—As explained above with respect to the rules for determining the source of interest payments on bank deposits with U.S. banks (see No. 1(a), above), your committee agrees with the House that it is questionable whether deposits of this type which are clearly situated in the United States should be treated as though situated without the United States and thereby allowed to escape U.S. estate taxation. On the other hand, deposits in foreign branch banks of U.S. corporations are, in fact, situated in a foreign country. Additionally, with respect to deposits in foreign branch banks of U.S. corporations, it is understood that foreign persons often have been uncertain as to whether they would be held to be "engaged in business in the United States" and that as a result they have been reluctant to deposit their funds in foreign branch banks of U.S. corporations for fear this might subject their estate to U.S. tax. As a result they are likely to place their deposits in competing foreign banks. Thus the present treatment clearly discriminates against the U.S. branches and adversely affects their ability to compete in foreign countries.

Explanation of provision.—The House bill would have immediately deleted the provision of present law which treats U.S. bank deposits

of a nonresident alien as situated without the United States. In order to conform this estate tax provision to the effective date of the income tax provision which taxes the interest derived from these deposits, your committee has amended the House bill to postpone the effective date of this provision until 1972. Your committee did not alter the provisions in the bill which also adds to the code a new provision which deems the situs of deposits by foreigners in foreign branch banks of U.S. corporations to be without the United States except to extend the same rule to foreign branch banks of U.S. partnerships. The new situs rule provides that for purposes of the U.S. estate tax on estates of nonresident aliens, deposits in a foreign branch bank of a U.S. corporation or partnership, if the branch is engaged in the commercial banking business, are not to be deemed to be property within the United States. Therefore these deposits will not be included in the foreigner's taxable U.S. estate.

Effective date.—This amendment is applicable to the estates of decedents dying after the effective date of this act.

e. Definition of taxable estate (sec. 108(e) of the bill and sec. 2106 (a) (3) of the code)

Present law.—Under present estate tax law, the estate of a citizen of the United States is entitled to a $60,000 exemption. In the case of the estate of a nonresident alien, however, present law allows only a $2,000 exemption. In the case of decedents who were residents of U.S. possessions at the time of death and are citizens of the United States solely by reason of being a citizen of the possession, or by reason of birth or residence in the possession, the exemption is the greater of $2,000, or the proportion of the $60,000 exemption granted to U.S. citizens which the value of that part of the decedent's gross estate which is situated in the United States bears to the value of his entire gross estate.

Reason for provision.—Presumably the basis for having a lower exemption for nonresident aliens than citizens and residents is that they typically have only a portion of their estate in the United States and therefore should have only a portion of the exemption allowed citizens and residents. Your committee agrees with the House that this justifies a lesser exemption for nonresident aliens but the minimal estate tax exemption presently allowed is so low as to place an unreasonable and inequitable tax burden on the estates of nonresident aliens. The exemption level your committee concluded was reasonable for nonresident aliens was $30,000, or half that allowed in the case of citizens. This is high enough to make filing of returns unnecessary in the case of relatively small investments here. This level of exemption was also selected in conjunction with the rates made applicable to nonresident aliens (see No. (a) above) to assure approximately the same level of tax burdens for a nonresident alien as in the case of citizens of the United States eligible for the marital deduction.

Explanation of provision.—The bill amends the code to provide that the estate of a nonresident not a citizen is allowed to deduct a $30,000 exemption in computing the taxable estate. The exemption which the estate of a resident of a U.S. possession to which the special rule applies is allowed, under the bill, is to be the greater of $30,000 or the proportion of the $60,000 exemption allowable under present law.

Effective date.—These amendments apply to estates of decedents dying after the effective date of this act.

f. Expatriation to avoid tax (sec. 108(f) of the bill and new sec. 2107 of the code)

Present law.—The U.S. estate tax applies to U.S. citizens and U.S. residents with respect to their estate no matter where situated. However, a foreign estate tax credit is allowable with respect to foreign death taxes paid in the case of property having a situs outside of the United States. In the case of nonresident aliens, a U.S. estate tax also applies but only with respect to property having a U.S. situs. Under present law, if an individual who has been a U.S. citizen gives up this citizenship and becomes a nonresident alien, no tax is imposed with respect to his estate to the extent the property is situated outside of the United States.

Reason for provision.—As discussed above with respect to the income tax provision of this bill, your committee and the House are concerned that the elimination of the progressive income tax rates on income of nonresident aliens which is not effectively connected with a U.S. trade or business may encourage some U.S. citizens to surrender their U.S. citizenship and move abroad. Accordingly, the bill contains a provision which generally has the effect of retaining the progressive income tax rates for a period of 10 years in case of persons who become expatriates where it appears likely that they did so for tax avoidance purposes. The same problem exists as a result of the reduction of the estate tax rates applicable to nonresident aliens. Although it is doubtful that many citizens would expatriate for this reason, your committee agrees with the House that the removal of any such incentive is desirable. In these cases the wealth of the expatriate generally would have been accumulated in the United States and therefore is properly subject to the regular U.S. estate tax rates.

Explanation of provision.—For this reason, the bill adds a new section to the code which imposes the regular U.S. estate tax rates on the U.S. estate of a nonresident alien dying within 10 years after losing U.S. citizenship if one of the principal purposes of the loss of citizenship was the avoidance of U.S. income, estate, or gift taxes. This provision is not to apply to those who lost their citizenship on or before March 8, 1965 (the date of introduction of a predecessor bill, H.R. 5916, on this topic). It also does not apply in the case of decedents dying on or before the date of enactment of this bill.

In determining the value of the gross estate of such an expatriate (as in the case of nonresident aliens generally) only property situated in the United States that was owned by him at the time of his death is included. However, the U.S. estate tax base of these expatriate decedents is expanded in certain respects to prevent him from avoiding U.S. tax on his estate by transferring assets with a U.S. situs to a foreign corporation in exchange for its stock. Such a transfer by a nonresident alien would reduce the portion of his gross estate having a U.S. situs, since the stock of a foreign corporation has a foreign situs even though the assets of the foreign corporation are situated in the United States. The new provision specifies, if certain stock ownership tests are met, that the value of the expatriate's gross U.S. estate is to include the same proportion of the value of the stock-

holdings of the expatriate in the foreign corporation as its property having a U.S. situs bears to all property.

The ownership tests that must be met for this special provision to apply are:

(i) The decedent must have owned at the time of his death 10 percent or more of the voting power of all classes of stock of the foreign corporation. Ownership for this test includes direct ownership and indirect ownership through another foreign corporation or through a foreign partnership, trust, or estate.

(ii) The decedent must have owned, at the time of his death, more than 50 percent of the total voting power of all classes of stock of the foreign corporation. Ownership for purposes of this test is ownership as described in (i) above plus ownership attributed to the expatriate under certain attribution rules of existing law (sec. 318 of the code). In general, these rules attribute to an individual ownership of stock held by members of his family, as well as by partnerships, trusts, estates, or corporations in which the individual has certain interests.

In addition, in determining whether the ownership tests are met, and in determining the portion of the U.S. situs property owned by the foreign corporation that must be included in computing the value of his gross estate, the expatriate is treated as owning the stock of a foreign corporation (at the time of his death) which he transferred during his life but which under U.S. estate tax law generally is not effective in excluding property from a gross estate. There transfers are:

(i) Transfers in contemplation of death (sec. 2035).
(ii) Transfers with retained life estate (sec. 2036).
(iii) Transfers taking effect at death (sec. 2037).
(iv) Revocable transfers (see 2038).

In computing the estate tax under this new provision the expatriate's estate is allowed the credit for State death taxes, the credit for gift tax, and the credit for tax on prior transfers.

The new section excepts from its application certain expatriates whose loss of U.S. citizenship occurs under circumstances which would make the application of the special taxing provisions inappropriate. These are the same exceptions provided with respect to the income tax expatriation provision (see No. 3(c) above).

The new provision, like the comparable income tax provision, contains a special rule dealing with the burden of proving the existence or nonexistence of U.S. tax avoidance as one of the principal purposes of the expatriation. Under this provision, the Secretary of the Treasury or his delegate must establish that it is reasonable to believe that the expatriate's loss of U.S. citizenship would (but for the application of this new provision) result in a substantial reduction in the estate, inheritance, legacy, and succession taxes.

If this is established, then the administrator of the expatriate's estate must carry the burden of proving that the loss of citizenship did not have as one of its principal purposes the avoidance of U.S. income, estate, or gift taxes.

Effective date.—This new provision is effective with respect to estates of decedents dying after the date of enactment of this bill.

It does not, in any event, apply, however, to expatriates who lost their citizenship on or before March 8, 1965.

g. Application of pre-1967 estate tax provisions (sec. 108(f) of the bill and new sec. 2108 of the code)

The unilateral reduction of estate tax rates applicable to nonresident aliens by statute may have the effect of making it more difficult to negotiate estate tax treaties. This is comparable to the similar problem arising from the revision of the income tax provisions applicable to nonresident aliens. As in the case of the income tax provisions therefore, the bill has added a new provision which gives authority to the President to apply certain provisions of the estate tax law relating to estates of nonresidents not citizens, without regard to the amendments made to these provisions by this, or any subsequent, act in the case of estates of residents of any country which imposes more burdensome death taxes with respect to estates of U.S. citizen decedents, not residents of that country, than does the United States on estates of residents of such a country, not citizens of the United States.

The new provision gives special authority to the President where he finds that:

(1) Under the laws of a foreign country a more burdensome tax is imposed on the estates of U.S. citizens, not residents of the country, than is imposed on the estates of residents of that country by the United States;

(2) The foreign country, when requested so to do, has not revised its taxes to eliminate this extra burden; and

(3) It is in the public interest to reimpose the pre-1967 estate tax provisions.

Where these conditions exist the President may proclaim that the U.S. tax on estates of residents of the foreign country is to be determined under certain provisions of U.S. estate tax laws (secs. 2101, 2102, 2106, and 6018) as in effect prior to amendment by this or any subsequent act. Such a proclamation is to apply to the estates of decedents dying after the date of the proclamation.

If after making such a proclamation the President finds that the laws of the foreign country have been revised to alleviate the excess burden on the estates of U.S. citizens he may proclaim that the tax on the estates of residents of the country is to be determined by taking into account the amendments made by this bill, and any subsequent act. Such a proclamation is to be effective with respect to estates of decedents dying after its date.

Before issuing a proclamation under the new provision the President is required to give 30 days notice of his intent so to do to the Senate and the House of Representatives.

This new section is applicable with respect to estates of decedents dying after the date of the enactment of this bill.

h. Estates tax returns (sec. 108(g) of the bill and sec. 6018 of the code)

Under present law the executor of the estate of a nonresident alien is required to file a U.S. estate tax return if the U.S. estate exceeds $2,000. The filing of returns with respect to these estates of over $2,000 is required because only a $2,000 exemption is granted to the estates of nonresident aliens under present law. Since the bill has in-

creased the $2,000 exemption to $30,000, the return filing requirement is likewise increased by the bill from $2,000 to $30,000. This amendment applies with respect to estates of decedents dying after the enactment of this bill.

7. GIFT TAX PROVISIONS

a. Tax on gifts of nonresidents not citizens (sec. 109(a) of the bill and sec. 2501 of the code)

Under present law a gift of intangible property having a U.S. situs by a nonresident alien who is engaged in trade or business in the United States is subject to U.S. gift tax.

In practice this rule has proved to be impossible to enforce, since there is no practical way for the Internal Revenue Service to find out when these gifts are made. Moreover, it does not occur to many nonresident aliens that these transfers are subject to U.S. gift tax. Thus the revenue significance of this provision is minimal.

For the above reasons the bill amends present law to provide that gifts of intangible property by nonresident aliens are not to be subject to the U.S. gift tax.

To prevent this new rule from becoming a means of tax avoidance by U.S. citizens, the bill also provides that the rule is not to apply to gifts by donors who within the 10 years immediately before the gift became expatriates of the United States with a principal purpose of avoiding U.S. income, estate, or gift taxes.

As in the case of similar amendments made by your committee with respect to the income and estate taxes, the new provision provides a special rule relating to the burden of proof. Under this rule if the Secretary of the Treasury or his delegate establishes that it is reasonable to believe that the individual's loss of U.S. citizenship will result in a substantial reduction in the gift tax payable by the donor, the burden of proving that tax avoidance was not one of the principal purposes rests with the donor. Certain types of losses of citizenship, as in the case of similar income and estate tax provisions, are not to result in the application of this provision (see No. 3(c) above).

This amendment applies with respect to the calendar year 1967 and all calendar years thereafter.

b. Situs of bonds given by expatriates (sec. 109(b) of the bill and sec. 2511 of the code)

Under present law bonds issued by U.S. persons, unlike other debt obligations, are considered to be situated where the instrument is located for purposes of the gift tax applicable to nonresident aliens. Under this rule (and in the absence of the provision added here) a citizen who becomes an expatriate with a principal purpose of avoiding U.S. taxes would continue to escape U.S. gift taxation (even under the special gift tax rules this bill makes applicable to them) on the transfer of a debt obligation of a U.S. person. To prevent this result, the bill amends the present gift tax laws to provide that debt obligations of a U.S. person, or of the United States, a State or political subdivision thereof, or the District of Columbia which are owned by such expatriates are deemed to be situated in the United States. This amendment applies with respect to the calendar year 1967 and all calendar years thereafter.

8. TREATY OBLIGATIONS

The bill provides that no amendment made by this bill is to apply in any case where its application would be contrary to any treaty obligation of the United States. However, for purposes of this provision, the granting of a benefit provided by any amendment made by this bill will not be considered to be contrary to a treaty obligation.

B. Other Amendments to the Internal Revenue Code

1. Application of investment credit to property used in U.S. possessions (sec. 201 of the bill and sec. 48(a)(2) of the code)

In general, present law provides the investment credit provisions are not available for property located outside the United States. Therefore, with limited exceptions property used in a possession is not eligible for the investment credit.

Although the investment credit provision as enacted in 1962 was intended to encourage increased investment in new plant and equipment located in the United States, there appears to be no reason to deny the benefits of this provision to U.S. possessions. It is the opinion of your committee that in view of the unique and close relationships that exist between the United States and its possessions, the economic development of these possessions should be stimulated by the same incentives that are offered to U.S. investment. However, your committee does not believe that the benefits of the investment credit should be extended to U.S. persons who already enjoy a special tax treatment sometimes accorded investment in the possessions; namely, the exemption from U.S. tax which applies to U.S. persons who derive substantially all their income from a U.S. possession.

Your committee's amendment extends the application of the investment credit provision to property used in a possession by a U.S. person or by a corporation organized in a possession provided the property would otherwise have qualified for the investment credit. This rule is not extended if the property is owned or used in the possession by U.S. persons who are presently exempt from U.S. tax due to the application of the special provisions of the code which exempt U.S. persons who derive substantially all their income from a U.S. possession (secs. 931; 932, 933, or 934(b)).

This amendment is effective with respect to taxable years ending after December 31, 1965, but only with respect to property placed in service after that date. Additionally, for purposes of computing a carryback of investment credit, the amount of any investment credit generated by this provision is to be disregarded.

2. Medical expense deductions of individuals age 65 or over (sec. 202 of the bill and sec. 213 of the code)

For taxable years beginning before January 1, 1967, existing law provides that a taxpayer age 65 or over can deduct—without regard to the 3-percent floor applicable to taxpayers under 65 years of age—all medical expenses he incurs for himself and his spouse. In addition, all amounts spent for medicines and drugs for himself and his spouse are deductible—without regard to the rule applicable to taxpayers under age 65 that amounts paid for medicines and drugs are taken into account only to the extent they exceed 1 percent of adjusted gross income.

For taxable years which begin after 1966, present law provides that a taxpayer over age 65 is subject to the same rules applicable to a taxpayer under age 65, so far as the 3-percent and 1-percent floors are concerned. That is, medical expenses will be deductible only to the extent they exceed 3 percent of adjusted gross income, and medicines and drugs will be taken into account only to the extent they exceed 1 percent of adjusted gross income.

Your committee's amendment provides that the rules applicable for 1966 to taxpayers 65 years or older shall continue to apply, and not the rules added last year by the Social Security Amendments of 1965 (Public Law 89–97) which were to take effect in 1967. The amendment also restores for future years the existing right of any taxpayer to deduct medical expenses and medicines and drugs for his dependent mother or father if age 65 or over without regard to the 3 percent and 1 percent floors otherwise applicable. The new rules for 1967 were added last year at the insistence of the House which maintained that unlimited deductions were no longer necessary after enactment of the medicare program. The Senate disagreed, and deleted the limitations on deductions for those over age 65 in its version of the medicare bill. The House insisted upon its provision in the conference, and the Senate conferees receded.

In acting to remove the limitation, the committee reaffirms its unwillingness to increase the income taxes on the aged taxpayer by placing a limitation upon the deductibility of his medical expenses or those of his spouse. It believes that the limitation is unfair to the aged taxpayer who provides for his own medical protection and to the taxpayer, even though covered under medicare, who must meet the expenses not covered under the program. For example, the medicare beneficiary has to pay a $40 deductible toward his hospital expenses, a $50 deductible toward his medical expenses, and the uncovered 20 percent of medical expenses in excess of $50. Furthermore, if he is hospitalized for more than 60 days, medicare requires that he pay $10 daily from the 61st through 90th days. If he goes to an extended care facility under medicare, he must pay $5 daily from the 21st through 100th day. And many elderly persons who are hospitalized will not receive medicare payments for their care because of a situation over which they have no control whatsoever; namely, the fact that their local hospital or hospitals may not be participating institutions under the program. In this case, these people have to come up with the cash themselves or call upon some other third-party resources.

Apart from the above reductions, limitations, and exclusions in medicare there are a number of other types of significant health expenses incurred by older citizens which must, in large part, be met out-of-pocket. Such expenses include necessary dental care, drugs, and long-term hospital or nursing home stays.

It has been estimated that medicare will cover 40 to 45 percent of the health care costs of those eligible for and who can secure its benefits. The remaining 55 to 60 percent of health costs has a serious negative impact upon those elderly struggling to maintain their independence on limited incomes. As we have in the past, it is appropriate that through sympathetic and proper tax treatment we continue to recognize the unusual and heavy health expenses incurred by our older population.

The amendment also will simplify the tax returns of the aged, because the amendment will reduce one additional calculation that they would have to make and which the Internal Revenue Service would be required to verify.

The repeal and amendments made by this section shall apply to taxable years beginning after December 31, 1966.

3. Basis of property received in the liquidation of subsidiary (sec. 203 of the bill and sec. 334 (b) (2) and (3) and sec. 453(d) of the code)

(*a*) *Purchase of stock.*—Under present law, if one corporation purchases 80 percent or more of the stock of another within a 12-month period and then causes the corporation acquired to be liquidated within 2 years of the last purchase, the basis of all the assets received is the amount paid for the stock. However, in order to prevent manipulation, stock purchased from a person related to the buyer by the attribution rules (under section 318) is not treated as stock "purchased."

Cases have been called to your committee's attention where it is necessary to acquire control of one corporation in order to obtain an 80 percent or greater stock interest in another corporation. For example, assume that one corporation desires to purchase the stock of a second corporation and does in fact purchase 45 percent of its stock directly. However, 40 percent of the stock of the second corporation is owned by a third corporation, and the third corporation does not wish to sell the stock of the second corporation. In order to acquire the stock of the second corporation, therefore, the first corporation purchases over 50 percent of the third corporation's stock and then causes this corporation to sell to it the 40 percent of the stock of second corporation owned by the third. However, since at the time of the sale, the first corporation owns more than 50 percent of the stock of the third corporation, the two corporations are classified as related under the attribution rules (sec. 318). Accordingly, under present law, the first corporation is not treated as the purchaser of more than 80 percent of the stock of the second although it acquired directly or indirectly all of this stock for cash within a 12-month period.

The amendment made by your committee eliminates the result described. It amends present law to provide that stock purchased from a related corporation (after it acquires control of it) is to be treated as purchased, if the stock of the related corporation (representing a controlling interest) was purchased within the specified period. The amendment provides that the 12-month period within which the desired stock must be acquired begins with the date of the first direct acquisition by purchase of such stock, or the date on which 50 percent of the stock of the corporation holding such stock was acquired, whichever is earlier. The new definition of purchase applies with respect to acquisitions of stock after December 31, 1965. The provision for measuring the time period of stock acquisition applies with respect to distributions made after the date of enactment of the bill.

(*b*) *Installment notes.*—When one corporation buys more than 80 percent of the stock of another within 12 months and causes the corporation acquired to be liquidated within 2 years of the last acquisition of stock, the basis of the assets acquired is the amount paid for the stock (properly allocated). In such a case, generally no gain is recognized to the distributing corporation (unless it is a corporation which

elected 341(f) treatment to avoid danger of being treated as a collapsible corporation, or unless the sections dealing with the recapture of depreciation apply).

If the property received on a liquidation of the type described above (to which sec. 334(b)(2) applies) consists of installment notes, then the gain which would normally be taxed on the sale or collection of such notes may, in part or in whole, permanently escape income taxation. This would result if the basis of such notes were raised to the amount paid for them by the acquiring corporation even though no gain were recognized to the distributing corporation.

Although existing law may be adequate to deal with certain types of situations, your committee believes that gain should generally be recognized by the distributing corporation in all cases in which the acquiring corporation receives a new basis in the installment notes. The amendment provides that installment notes transferred in a liquidation of the type described above are to be treated as "disposed of" for purposes of the installment sale provision (sec. 453(d)). As a result, gain is to be recognized to the distributing corporation, in the same manner as if it had sold the notes.

This amendment is effective with respect to distributions made after the date of enactment.

4. "Swap funds" (sec. 204 of the bill and sec. 351 of the code)

Under section 351 of the Internal Revenue Code, the transfer of property to a corporation by one or more persons in exchange for stock in the corporation is not to result in gain or loss if immediately after the exchange, the person or persons in question are in control of the corporation.

In 1960 the Internal Revenue Service issued a limited number of rulings to the effect that no tax resulted from the exchange of appreciated stock for shares in an investment fund where immediately after the exchange, the persons who transferred the stock to the corporation are in control of the corporation. Investments funds organized in this way have become known as "swap funds." It stopped issuing these rulings in 1961, however, and subsequently (in Rev. Proc. 62–32) the Service announced that this was an area in which it would not rule. Notwithstanding this change in position, new swap funds continued to be formed, relying on the advice of private tax counsel that the exchange of stock for stock in these cases was nontaxable.

On July 14, 1966, the Treasury issued a proposed regulation to the effect that this type of exchange would be taxable. At the same time it offered to enter into closing agreements with existing swap funds which would provide that section 351 would be applied to past transfers for all purposes under the code, including the determination of basis.

The effect of the amendment added to the bill by the committee is to provide that section 351 applies to corporate investment funds. This amendment is effective to transfers whenever made.

5. Minimum amount treated as earned income for retirement plans of self-employed persons (sec. 205 of the bill and sec. 401(c)(2)(B) of the code)

At present, a self-employed individual may contribute to a qualified pension or profit-sharing plan up to 10 percent of his "earned income" but not more than $2,500 in a given year. He receives an income tax

deduction for one-half of his contribution up to this amount. In the case of a person in a trade or business where both personal services and capital are material income-producing factors, not more than 30 percent of that person's share of the net profits of his trade or business may be treated as "earned income" for this purpose. However, if the person renders personal services on a full-time, or substantially full-time basis, a minimum of $2,500 of net profits from such trade or business will qualify as earned income, notwithstanding the 30-percent limitation.

This amendment permits a minimum $6,600 of earnings from a trade or business in which both personal services and capital are material income-producing factors and the taxpayer renders personal services on a full-time (or substantially full-time) basis, to be treated as "earned income." The 30-percent limitation will continue to apply as under present law, where the 30-percent rule gives rise to a greater amount of earned income than the minimum of $6,600.

This amendment permits self-employed individuals in small businesses to make more significant contributions to pension plans. This is the same amount presently treated as the maximum tax base for social security purposes.

The greatest increases in deductible pension contributions resulting from this change will be available to those persons whose net profits range between $6,600 and $8,333. Lesser additional deductions will be available to those with net profits between $2,500 and $6,600 and between $8,333 and $22,000.

It is estimated that the revenue loss from this amendment in a full fiscal year would amount to less than $1 million. This change applies to taxable years beginning after December 31, 1965.

6. Treatment of certain income of authors, inventors, and so forth, as earned income for retirement plan purposes (sec. 206 of the bill and sec. 401 (c) (2) of the code)

Present law contains provisions designed to encourage self-employed persons to establish voluntary retirement plans. Under these provisions, self-employed persons are permitted to deduct contributions (within specified limits) made to pension or profit-sharing plans for the benefit of themselves and other employees covered by the plan.

Coverage under these provisions depends on "earned income," and such income is the basis for computing deductible contributions. This term includes professional fees and other compensation for personal services from a trade or business (but does not include amounts which constitute a return on capital invested in the trade or business).

With respect to authors, the Internal Revenue Service takes the position that if an author contracts to write articles for a given period or a book for a publisher who copyrights the literary material and pays the author a stipulated amount of cash, plus a percentage of the income derived from the material, the consideration is for the author's personal services and constitutes earned income. However, where the consideration received by an author is derived either from the sale, leasing, or renting of the author's writing, the consideration is paid for the use or sale of property and is held not to constitute earned income. A similar position is taken by the Service with respect to inventors and others who create property through the application of their personal efforts.

The effect of these positions of the Internal Revenue Service is to curtail, or possibly deny entirely, the tax adantages of the self-employed individuals retirement plan provisions if the taxpayer is an author, inventor, and so forth. The intent of the Congress in adopting the "earned income" concept was to limit the applicability of these provisions to the portion of a self-employed person's income which was a result of his individual efforts as distinguished from a return on capital. Your committee does not believe that for this purpose the classification of income from an author's writing (or an inventor's invention), which is so clearly a result of his individual efforts, as "earned" or not "earned" should depend upon the terms of the contract under which the author (or inventor) is to be compensated.

For the above reasons, the bill amends the self-employed individuals retirement plan provisions to provide that "earned income" includes gains (other than capital gains) and net earnings derived from the sale or other disposition of, the transfer of any interest in, or the licensing of the use of property (other than good will) by an individual whose personal efforts created the property.

This amendment applies to taxable years ending after the date of enactment of the act.

7. Exclusion of certain rents from personal holding company income (sec. 207 of the bill and sec. 543 of the code)

Under existing law, if a company manufactures property and leases it to customers, the rents are treated as personal holding company income (unless the adjusted income from rents from all sources constitutes 50 percent or more of the adjusted ordinary gross income and unless the sum of the dividends paid during the year has reduced the other personal holding company income below 10 percent of the ordinary gross income). However, where the property manufactured by the taxpayer is sold instead of leased, the income from the sale is not treated as personal holding company income.

Your committee believes that ordinarily rental income arising from property manufactured by the taxpayers should be treated as ordinary business income rather than passive personal holding company income. It takes this position because it believes that rental income arising from property manufactured by the taxpayer, in reality, is no more passive than sales income derived from property manufactured by the taxpayer.

Accordingly, the amendment provides that compensation for the use of any tangible personal property manufactured or produced by the taxpayer is not to be treated as rental income under the personal holding company provisions if the taxpayer during the taxable year is engaged in manufacturing the same type of property from which he is receiving the rents. The effect of this is to treat this income (after it is reduced by applicable depreciation, taxes, rent, and interest paid) as ordinary business income in determining whether or not the corporation is a personal holding company. It is intended, in order for the provision to be applicable, that the manufacturing or production activity be substantial and more than minor assembly processes. (Tangible personal property here has the same meaning as in the case of the investment credit provision.)

The amendments apply to taxable years beginning after date of enactment, but taxpayers may elect to have the amendments apply to

years beginning on or before that date if ending after December 31, 1965.

8. Percentage depletion rate for certain clay bearing alumina (sec. 208 of the bill and sec. 613 of the code)

At the present time, practically all alumina—the raw material used for the production of aluminum—is obtained from bauxite. Most of the bauxite is obtained from foreign deposits, since less than 1 percent of the known world bauxite reserves are in the United States.

There are, however, large deposits of clay containing alumina in the United States from which alumina can be extracted under newly developed processes, but at a greater cost than producing alumina from bauxite. In order to spur the development of these domestic deposits and build the facilities needed to extract the alumina from them, your committee has made two changes in the existing percentage depletion provisions applicable to clay, laterite, and nephelite syenite to the extent alumina and aluminum compounds are extracted from them. (These provisions do not apply to bauxite having an aluminum oxide content of 40 percent or more.)

First, the percentage depletion rate is raised from 15 to 23 percent in the case of domestic deposits of clay, laterite, and nephelite syenite (to the extent alumina or aluminum compounds are extracted therefrom). This is the same rate of percentage depletion which is now allowed to domestic deposits of bauxite.

Second, your committee provides that in the case of domestic deposits of clay, laterite, and nephelite syenite, all processes applied to derive alumina or aluminum compounds from them are to be treated as mining processes in computing gross income from mining for depletion purposes. It is not intended to treat as mining any of the processes in the electrolytic refining of the alumina or aluminum compounds.

The amendments are applicable only to taxable years beginning after the date of the enactment of this act.

9. Percentage depletion rate for clam and oyster shells (sec. 209 of the bill and sec. 613 of the code)

Under present law, clam shells and oyster shells are allowed a percentage depletion rate of 5 percent. This rate applies even though the shells are used because of their chemical content—calcium carbonate—in the production of cement or lime. On the other hand, when other minerals, such as limestone, are used as a source of calcium carbonate, percentage depletion at the rate of 15 percent is allowed under existing law.

Clam and oyster shells are composed almost entirely of calcium carbonate and in fact, contain a much higher percentage of calcium carbonate than do limestone and marble. Your committee believes that when clam and oyster shells are used for their calcium carbonate content—such as in the making of cement or lime—they should have the same percentage depletion rate as limestone and other calcium carbonates.

Accordingly, the committee amendment provides that in the case of clam shells and oyster shells (as well as other mollusk shells), a percentage depletion rate of 15 percent generally is to apply. However, as is true under existing law in the case of limestone and other calcium

carbonates, a 5-percent rate is applicable if the shells are used, or sold for use, as riprap, ballast, road material, rubble, concrete aggregates, or for similar purposes.

The amendment is applicable to taxable years beginning after the date of enactment of the act.

10. Sintering and burning of shale, clay and slate used as lightweight aggregates (sec. 210 of the bill and sec. 613 of the code)

The courts have recently held that in computing gross income from mining for percentage depletion purposes the sintering or burning of shale, clay, or slate is not a mining process. The heat is applied for the purpose of causing the mineral to expand, or bloat, so that it can be used as a lightweight aggregate in concrete or in making building units such as cinder blocks.

Your committee believes that it is appropriate to allow the application of heat to shale, clay and slate to produce lightweight aggregates as a mining process for percentage depletion purposes. The committee amendment so provides. The amendment is applicable to taxable years beginning after the date of enactment of the act.

11. Income from lapsing of straddle options (sec. 211 of the bill and sec. 1234(c) of the code)

a. Nature of straddles.[1]—Straddles are one form of an option; namely, an offer both to purchase and to sell a specified amount of property at a stated price for a limited period of time. Options to sell securities are known as "puts"—i.e., the purchaser of the option can "put" his shares to the writer or issuer of the option at the stated price. Options to purchase are known as "calls"—i.e., the purchaser of the option can "call" the shares from the writer at the stated price. A "straddle" is a combination of a put and call, with respect to the same security, for the same quantity, at the same purchase or sale price and available for the same period of time.

Straddles are likely to be written by persons with holdings of a security who believe that in the long run, the price of the stock will not vary greatly from its present price. Their inducement for writing the straddle is the receipt of a premium. Straddles generally are granted to brokers or dealers who, in turn, customarily sell the put and call components to different purchasers. The majority of puts and calls originate in straddles. While the use of puts and calls is not a new development in the securities markets, their significance in the securities markets is relatively limited; for example, the total number of shares covered by options sold in recent years on the New York Stock Exchange has rarely exceeded 1 percent of the total shares sold.

Normally either (not both) the put or the call component of the straddle is exercised by the purchaser shortly before the end of the term for which the straddle is written. Frequently this is 6 months and 10 days after the straddle is issued. Which component of the straddle is exercised depends upon the market conditions at the time of exercise vis-a-vis market conditions at the time the straddle was written. If the market in that security has risen, the securities are likely to be "called" from the writer; if the market has fallen, the stock

[1] Much of the material prerented in this part was derived from the "Report on Put and Call Options," a report published in August 1961 by the Securities and Exchange Commission, on the basis of an extensive study by the SEC's Division of Trading and Exchanges.

is likely to be "put" to the writer. While in the great majority of the cases, one component of the straddle is exercised and the other is allowed to lapse, occasionally (perhaps 10 to 15 percent of the time) neither option is exercised and in a few other cases (less than 1 percent of the cases) both components of the straddle are exercised.

Although options are purchased for hedging and other similar purposes by some investors, their primary use probably is as a method of investing by individuals with small amounts of money.

b. Present law.—Under the 1939 code, premium income received from the writing of an option which had lapsed was treated as a short-term capital gain (sec. 117(g)(2) of the 1939 code). However, until the issuance of a revenue ruling in 1965 (Revenue Ruling 65–31) straddle writers generally allocated the entire straddle premium to the component option which was exercised, and this practice apparently was not challenged by the Internal Revenue Service prior to the issuance of the ruling. Since one component or the other of a straddle is exercised in the bulk of the cases, the fact that the premium in the case of the lapse of an option was treated as short-term capital gain was of relatively little significance. The important aspect was the treatment of the premium in connection with the portion of the straddle which was exercised.

If all of the premium is allocated to the component which is exercised and this is the "put," the premium decreases the cost or basis of the stock put to the writer of the straddle. As a result, it would increase his capital gain only when he disposed of the stock put to him. Generally, this would result in a long-term capital gain (unless he held the stock for less than 6 months). Where the call component is exercised and all of the straddle premium is allocated to it, the premium would increase the income received by the writer at the time the stock is called from (i.e., sold by) him. As a result in this case also, the total premium increases the writer's capital gain (or decreases his capital loss) and if the writer had held the stock for more than 6 months, the gain (or loss) would be long term.

The 1939 code provision treating income from the lapse of an option as a short-term capital gain was not included in the 1954 code. As a result, where both options are permitted to lapse, the total straddle premium is now reported as ordinary income. However, in the usual case where one option lapsed and the other was exercised, the treatment of allocating the straddle premium income to the side exercised in practice remained unchanged.

In the ruling (Revenue Ruling 65–31) issued on January 22, 1965, the Internal Revenue Service held that the premium for a straddle must be allocated between its put and call components on the basis of the relative market values of each. In a later technical information release, the Service announced that it would accept allocations of 55 percent of each straddle premium to the call component and 45 percent to the put component.[2]

[2] Rev. Proc. 65–29. issued on Nov. 15. 1965. This 55–45 ratio was selected because it represented a rounded approximation of relative market prices of separately written "puts" and "calls" of the same length for securities of approximately equal price. The revenue procedure concluded with the statement that "If a taxpayers does not use this method for a taxable year. then the allocation based on relative market values required by Revenue Ruling 65–31 must be used."

Under the ruling, part of the premium arising from the writing of a single straddle can result in ordinary income (the portion of the premium allocated to the lapsed component) while the remaining portion of the premium may result in either a capital gain or a capital loss, which in the usual case will be a long-term gain or loss.

c. Reasons for the changes.—The difficulty with the present tax treatment of premium income from the writing of straddles lies in the fact that by dividing the premium income into two parts, one part may be reported as ordinary income (the portion allocated to the lapsed option) while the other portion may merely decrease a capital loss. Your committee believes that it is hard to justify treating part of the transaction as resulting in ordinary income, while the other portion may give rise to a capital loss which cannot be offset (apart from the $1,000 per year deduction of net capital losses against ordinary income) against ordinary income.

The problem can be illustrated by the following example. Assume that a straddle writer issues a straddle for a stock when its price is $100 a share and this is the option price. Assume that the straddle premium is $8 per share. Assume further that the put component of the straddle is exercised by the purchaser when the price of the stock is $80 per share. As a result, the writer of the straddle must buy stock at a price of $100 per share when its market value is $80 per share. If the straddle premium allocable to the put component is $3.60 per share, the short-term capital loss for the writer of the straddle will be $16.40 per share if he disposes of the stock shortly after receipt, when the market price is still $80 per share. At the same time, the remainder of the straddle premium, $4.40 a share, is allocated to the call component, which in such a case presumably was allowed to lapse. The $4.40 per share would be ordinary income while the capital loss of $16.40 a share attributable to the put side of the option would result in a short-term capital loss, which, except to the extent of the $1,000 a year, could not be netted with the ordinary income attributable to the premium income of the other side of the straddle.

The writer of the straddle in these cases is, of course, entering the transaction in the hope of obtaining a profit; he naturally views the transaction as a single one and cannot see why he must pay ordinary income tax on a portion of the transaction while being denied full use of his capital loss attributable to the other component of the transaction (in those cases where he does not have capital gains sufficient to offset his capital losses and his losses exceed the $1,000 which may be offset against ordinary income). Moreover, the marketplace treats the straddle as a single transaction in that a smaller premium is paid for a straddle than for a separate put and call on the same stock, since the combined risk involved is less. Additionally, the writer of the straddle knows that in almost all cases, only one of the two options in the straddle will be exercised. He views this as the side for which he is being paid the premium.

Your committee agrees that it is desirable to provide for this netting of a gain or loss arising from the two components of a straddle option. Nevertheless, it appears appropriate where the transaction on a net basis results in a gain, that the premium income result in ordinary income. The netting of the two components in a straddle can be

achieved and still have any net premium gain result in what is essentially ordinary income, by treating the premium income allocated to the lapsed option as a short-term capital gain. Where this is done, any capital loss from the straddle transaction attributable to the side exercised (where the stock is disposed of in the same year in which the lapse of the option occurs) can be offset against the short-term capital gain attributable to the premium income from the side of the option which lapsed. Should the short-term capital gain in such a case exceed the capital loss, it will still be treated in essentially the same manner as ordinary income.

As a result, your committee's amendment provides that any gain on the lapse of an option granted by a taxpayer as a part of the straddle is to be treated as a short-term capital gain. This treatment is not to be available, however, in the case of persons who hold securities for sale to customers in the ordinary course of their trades or businesses. This treatment is made inapplicable in the case of such persons because their security transactions in any event are generally required to be treated as resulting in ordinary income. This treatment is applied to securities and not to commodity futures since there is no evidence that a problem has been created in this latter area.

The change made by your committee's amendment applies to all straddle transactions entered into after January 25, 1965, the effective date of the ruling which first required the allocation of the straddle premium between the put and the call components.

d. Changes made by the bill.—The amendment inserts a new subsection (c) to section 1234 of the code. The first paragraph of this new subsection provides that gain derived from the lapse of an option written as a part of a straddle (as defined in new section 1234(c)(3)) is, in effect, to be short-term capital gain, as defined in section 1222(1) of existing law. Thus, such gains will be added to any other short-term capital gains, to be netted against short-term capital losses, with the excess to be netted against any net long-term capital losses. Any remaining short-term capital gains will generally be taxed as ordinary income.

Paragraph (2) of the new section 1234(c) provides that this provision does not apply to a person who holds securities (including options to acquire or sell securities) for sale to customers in the ordinary course of his trade or business.

Paragraph (3) of the new subsection defines a "straddle" as a simultaneously granted combination of an option to buy (a "call") and an option to sell (a "put") the same quantity of a security at the same price during the same period of time.

If a person grants a multiple option (a put plus a call plus one or more additional puts or calls) it is intended that the grantor of the multiple option must identify in his records which two of the component options constitute the straddle, if it is not clear from the options themselves. It is contemplated that the method of identification will be specified in regulations issued by the Secretary of the Treasury or his delegate. If there is no identification by the writer, this provision relating to straddles is not to apply. As a result, in such a case the gain on the lapsed option (or options) would result in ordinary income.

A corporate security for purposes of the definition of a straddle is the same as defined in section 1236(c) of the code—i.e., stocks, bonds,

notes, etc. Accordingly, the term securities does not include commodity futures.

The amendments described above are to apply to straddles written after January 25, 1965, in taxable years ending after such date.

This bill is substantially identical to H.R. 11765, which was approved unanimously by the Committee on Ways and Means of the House of Representatives.

12. Tax treatment of per-unit retain allocations (sec. 212 of the bill and secs. 1382, 1383, 1385, 1388, and 6044 of the code)

Although the practices of cooperatives are not uniform in this regard, generally a per-unit retain certificate is issued by a cooperative to a patron to reflect the retention by the cooperative of a portion of the proceeds from the marketing of products for the patron. These amounts are retained pursuant to an authorization (usually in the bylaws of the cooperative) and are computed on the basis of units of products marketed.

Prior to the amendment in 1962, the Internal Revenue Code permitted cooperatives to deduct amounts paid to patrons as patronage dividends. Patronage dividends are limited by definition to amounts which are "determined with reference to the net earnings" of the cooperative. The treatment of per-unit retains, however, was not specifically dealt with in the code. The Revenue Act of 1962 substantially revised the income tax treatment of cooperatives and their patrons but the new provisions by their terms were applicable only to "patronage dividends." Because per-unit retain allocations are determined on the basis of units of products marketed for the patrons rather than with reference to net earnings, the new provisions are generally considered as not being applicable to them. By regulations issued on October 14, 1965, the Treasury Department provided for the income tax treatment of per-unit retain certificates in a manner that is substantially parallel to the treatment prescribed in the Revenue Act of 1962 with respect to patronage dividends.

The per-unit retains may be considered as contributions to capital by patrons. For this to be true they first must have been considered as paid out by the cooperative. However, because the per-unit retain certificates issued by cooperatives may have a fair market value considerably less than their face amount, and in some cases have only a negligible fair market value, some have raised questions as to whether they may be considered as paid out by the cooperatives and whether the patrons can be required to include them in their gross income. This situation bears certain similarities to the situation that caused the enactment of the provisions of the Revenue Act of 1962 dealing with patronage dividends, in that some believe that a tax may not necessarily be imposed at either level.

The patronage dividend provisions of the Revenue Act of 1962 were designed to assure that the amounts received by cooperatives in the course of their business activities with their patrons are included in computing the income tax of either the cooperative or the patron, thus subjecting these amounts to a single current tax. To accomplish this, the 1962 act provided detailed rules which specified the treatment which patronage dividends are to receive from the standpoint of both cooperatives and their patrons. It was hoped that these provisions would bring to an end the uncertainty that existed in the area

of cooperative-patron income taxation and consequently bring to a halt the litigation that the uncertainty engendered. In this regard, the Revenue Act of 1962 has not been completely successful because of the uncertainty which continues to exist with respect to per-unit retain certificates. To remove this remaining uncertainty, the bill amends the provisions of present law dealing with patronage dividends to make them applicable, generally, with respect to per-unit retain certificates. By adopting this amendment, your committee does not intend to reflect on the validity of the regulations recently issued by the Treasury Department with respect to per-unit retain certificates, nor does your committee intend to reflect on the deductibility in the past of per-unit retain certificates to cooperatives or the includability in the past of such certificates in the income of patrons.

The bill amends present law to provide tax treatment with respect to per-unit retain certificates which parallels, in general, the tax treatment applicable with respect to patronage dividends. Providing essentially the same treatment for per-unit retain certificates means, generally, that they are to be treated as income to the patron in the year in which the certificates are issued, if the patrons give their consent in writing to the inclusion of the face amount of these certificates in their income or if there is a provision in the bylaws or charter of the cooperative indicating that membership in the cooperative represents consent to such treatment. Under the amendment, the cooperative is permitted to take a deduction in arriving at gross income for a per-unit retain certificate when issued, only when the certificate qualifies for the treatment specified above at that time in the hands of the patron. Otherwise, the amount involved is deductible by the cooperative only at the time the certificate is redeemed.

Treatment of per-unit retains by cooperatives.—The amendment provides that no decrease is to be made in the gross income of a cooperative because of per-unit retain allocations to patrons except for amounts paid in "qualified per-unit retain certificates" or in redemption of "nonqualified per-unit retain certificates." (Both of these terms are explained subsequently.)[1] If a cooperative has no taxable income for the year in which it redeems nonqualifed per-unit retain certificates, the cooperative would, in effect, be permitted to carry back the deduction or exclusion to the year in which the certificate was issued.

Treatment of per-unit retains by patrons.—Under the amendment, a patron is required to include in his gross income the amount paid to him in qualified per-unit retain certificates and the amount received by him on the redemption, sale, or other disposition of nonqualified per-unit retain certificates.

Definitions and special provisions.—The amendment provides definitions of the terms used in providing for the treatment of per-unit retains. Under the first of these, the amount considered paid by a cooperative and received by a patron as a result of the issuance of a qualified per-unit retain certificate is to be the certificate's stated dollar amount. The term "per-unit retain allocation" is defined, in general, as an amount paid (except amounts paid in money or other prop-

[1] A special rule permits cooperatives to continue their existing practices with respect to the timing of the issuance of per-unit retain certificates for products marketed under a pooling arrangement and to take the tax deduction at the time the certificates are issued.

erty) to patrons with respect to products marketed for them which is fixed without regard to the net earnings of the cooperative. The term "per-unit retain certificate" is defined to mean any written notice which discloses to the recipient the stated dollar amount of a per-unit retain allocation. The term "qualified per-unit retain certificate" is defined to mean a per-unit retain certificate which the patron has agreed to include in his income at the stated dollar amount. For this purpose, a cooperative may enter into individual agreements with each of its patrons, or the agreement may be contained in a bylaw, a written notice and copy of which is given to each of the members. In general, agreements once made are effective for all subsequent years until revoked. A "nonqualified per-unit retain certificate" is defined to be any per-unit retain certificate other than one which is "qualified."

The amendment also requires the reporting by the cooperative of information with respect to per-unit retain allocations comparable to the reporting requirements with respect to patronage dividends under present law.

Effective dates and transition rule.—The amendments which relate to the substantive tax treatment of per-unit retains are to apply, generally, for taxable years of cooperatives beginning after April 30, 1966, and the information reporting provisions are to apply for calendar years after 1966.

If a cooperative has entered into individual agreements with its patrons with respect to per-unit retain allocations in compliance with the existing income tax regulations, new agreements would not be required under the amendment. Existing bylaw agreements with respect to per-unit retain allocations adopted under the Treasury regulations are to be effective for taxable years beginning before May 1, 1967. After that date a bylaw agreement which conforms to the new statutory provisions is required.

13. Excise tax rate on hearses (sec. 213 of the bill and sec. 4062 of the code)

Present law imposes a 10 percent excise tax on the sale by the manufacturer, importer, or producer of bodies and chassis of trucks, while a rate of 7 percent is imposed on automobiles.[1]

There is no statutory classification of hearses, ambulances, or combination ambulance-hearse vehicles for purposes of this excise tax. However, since 1921 the Internal Revenue Service, by administrative interpretation has classified hearses as trucks while treating ambulances and combination ambulance-hearse vehicles as automobiles for the purpose of determining the appropriate excise tax rate.

Your committee sees no reason why hearses should not be accorded the same tax treatment as ambulances—especially since the vehicles are often combined into the same unit. Moreover, ambulance and hearse manufacturers use the same basic chassis for hearses, ambulances, and combination vehicles and, further, the tax on the chassis, which is paid by the chassis manufacturer, is computed at the rate provided for automobile chassis. In addition, it is understood that the same basic body is added to the chassis by the ambulance and

[1] This 7-percent rate is scheduled for reduction to 2 percent effective Apr. 1, 1968, and to 1 percent effective Jan. 1, 1969. The 10-percent tax on trucks and hearses is a permanent rate.

hearse manufacturer without regard to whether it ultimately becomes an ambulance, hearse, or combination ambulance-hearse vehicle. Further, your committee has been informed that a rear-loading hearse can be easily converted into an ambulance or an ambulance-hearse combination vehicle by the addition of certain accessories at a cost of about half of the excise tax saving which is realized by the manufacturers as a result of the conversion. Still further evidence that it is unrealistic to classify hearses as trucks is the fact that most of the States presently license hearses as automobiles while very few States license them as trucks.

It is estimated that this bill will result in a revenue loss of approximately $100,000 a year during the period while the excise tax on trucks is 10 percent and that on automobiles is 7 percent. After April 1, 1968, when the rate on automobiles is reduced to 2 percent (and then to 1 percent on January 1, 1969) the revenue loss might actually decrease because the increased differential in rates between hearses and ambulances actually might result in fewer hearses, and more combination ambulance-hearses, being sold.

For the reasons indicated above, your committee has amended the bill to specifically classify hearses, ambulances, and combination ambulance-hearses as automobiles (and not as trucks) for purposes of the excise tax on the sale of these vehicles by the manufacturer, producer, or importer. This amendment is made effective with respect to vehicles sold after the date of enactment of this act.

14. Interest equalization tax; loans to insure raw material sources (sec. 214 of the bill and sec. 4914 of the code)

The interest equalization tax, in general, is a tax imposed on Americans with respect to the purchase of foreign securities. In the case of debt the tax rate varies with the period of time to maturity; in the case of stock the tax rate is 15 percent. The tax is designed to increase capital costs in the United States for foreigners by about 1 percent a year.

Presently there is an exemption from the interest equalization tax—as the equivalent to a direct investment—for loans made by U.S. lenders to foreign subsidiaries of U.S. corporations producing foreign ores and minerals in short supply in the United States where the financing is secured by a so-called "take or pay" contract entered into between the foreign subsidiaries and the U.S. parent. However, these loans become subject to the interest equalization tax when and if they are subsequently transferred by the lender to another U.S. person, regardless of the intent of the investor at the time of acquisition.

The amendment made by your committee provides that transfers by the original lender, subsequent to the original acquisition of the indebtedness which is exempted under this provision, would not be subject to tax where the indebtedness was originally acquired by the lender without an intent to sell the indebtedness to other U.S. persons. However, where in fact more than one sale of the indebtedness occurs after the debt is held by the initial lender, for each such sale to be exempt the indebtedness must be purchased without any intent to resell. This amendment is to be effective with respect to debt obligations acquired after the date of enactment of this act.

15. Interest equalization tax; insurance company reserve funds (sec. 215 of the bill and sec. 4914(e) of the code).

The interest equalization tax provisions presently provide a limited exception for acquisitions of otherwise taxable securities made to maintain the reserve assets of a U.S. insurance company doing an insurance business in foreign currencies abroad in developed countries. In addition, an exception for investments generally is provided with respect to those in "less developed countries." However, in order to claim the exemption with respect to developed countries, a life insurance company must "establish" a fund of assets for each developed country for which it does business. However, the establishment of such a fund can only be made during the "initial" designation period which was the 30-day period between the enactment of the act, September 2, 1964, to October 2, 1964. Therefore, no American insurance company can commence doing business in a developed country after October 2, 1964, without being subject to the interest equalization tax on its reserve assets acquisitions. The same type of problem arises when a less developed country loses its status as a less developed country by an Executive order issued after October 2, 1964. In other words, there is no opportunity to establish a fund of assets in such a situation.

Your committee adopted an amendment which would mitigate the foregoing anomalous situations. The amendment would permit a U.S. insurance company commencing activities in a developed country to establish a fund with respect to that country provided it was ineligible to make an initial designation prior to October 2, 1964. The amendment would also permit the establishment of a fund for a country if the status of that country was changed from a less developed country by an Executive order.

16. Interest equalization tax; dollar loans of foreign branches of U.S. banks (sec. 216 of the bill and sec. 4931(a) of the code)

Presently, foreign currency loans of foreign branches of U.S. banks are exempt from the application of the interest equalization tax. Additionally, loans for a term of less than 1 year are exempt not only in the case of foreign branches of U.S. banks but generally without regard to who makes the loan.

Your committee adopted an amendment which would authorize the President to exempt from the interest equalization tax U.S. dollar loans made by the foreign branches of U.S. banks (regardless of the maturities involved). To the extent that this authority is exercised, the President subsequently may withdraw or modify the exemption in the event he determines such withdrawal or modification is necessary to preserve the effectiveness of the interest equalization tax.

This amendment is to be effective with respect to acquisitions of debt obligations after the date of enactment of this act.

C. Presidential Election Campaign Fund Act

1. Background

Concern has been expressed by both the President and the Congress on the possible ramifications of the manner in which national political campaigns are presently financed. Dependence on wealthy contributors for the bulk of needed funds will tend to leave candidates

of modest means encumbered with stronger debts of loyalty to a wealthy few than to the voting public.

Soaring campaign costs have intensified this concern and made it impractical merely to restrict the size of contributions. An alternative source of financing political campaigns must be developed.

It was with an eye on developing such an alternative source of financing political campaigns that your committee in August of this year held hearings on a number of bills which would facilitate the financing of political campaigns.

As an outgrowth of these hearings and of further committee deliberations, your committee recommends the financing of presidential election campaigns based on the concept of one-man, one-vote, with each taxpayer able to share equally in the costs of such campaigns. This is brought about by the creation of a presidential election campaign fund. Each taxpayer will be permitted to designate on his annual income tax return that $1 of his tax liability is to be placed in the presidential election campaign fund. The amounts in the fund will then be made available to defray the presidential campaign expenses of those political parties whose candidates received a significant number of votes in the preceding presidential election.

Enactment of this recommendation into law will remove the cause of much of the improper influence in Government. Political parties and their presidential candidates will be assured that they need not rely on the large contributions of relatively few wealthy contributors to meet the heavy financial demands of political campaigns. Your committee's recommendation, by providing an alternative source of campaign financing, will be the most significant improvement in this regard in over a century. Under this system of campaign financing, the man elected President will be obligated equally to every taxpayer and to every voter, instead of to individual, large contributors or to corporation or union executives whose raise great sums of money. The man elected President will be in debt to all Americans, the ideal way to have it under the American system.

Your committee's recommendation, of course, relates only to the executive branch of the Government. It is most important to prevent the possibility of improper influence on the Chief Executive because of the central position which the Office of the Presidency occupies in the Federal Government. Through the manner in which the President executes the laws passed by Congress, exercises his veto power, frames the legislation which he submits, and selects his appointees to the Federal bench, the President exerts an influence over all branches of Government. Moreover, bills the President has vetoed rarely are enacted over his objection. Indeed, the present President has never had a veto overridden by Congress.

The measure recommended by your committee concerns only presidential elections, not only because of the central position of the Office of the Presidency but also because the feasibility of extending the program to cover other Federal elections should be studied in the light of the experience under this measure and because the Federal Government should not attempt to tell the States how to finance purely local elections. This measure will, nevertheless, have a favorable influence on other elections since the provision of funds for the most expensive of all campaigns will make it easier for political parties and candi-

dates in lesser elections to raise funds and will thereby make it easier for them to refuse contributions from those who might demand favors in return.

2. Designation of income tax payments to presidential election campaign fund (sec. 302 of the bill and sec. 6096 of the code)

Under your committee's bill, space is to be provided on the income tax return forms to permit each individual taxpayer (other than a nonresident alien or an estate or trust) to designate, if he so desires, that $1 be appropriated from general revenues and paid into the presidential election campaign fund. The size of the fund will thus be determined by the voluntary acts of individual taxpayers, each of whom will have the opportunity to make a financial contribution of similar size. The designation is to be permitted with respect to income tax liability for each taxable year beginning after December 31, 1966.

All taxpayers who show an income tax liability of at least $1 for the year are to be permitted to make a designation. On joint returns, both husband and wife are to be permitted to make a designation provided the tax liability shown on the return is at least $2. The designation is to be made at the time of filing the return or at such later time as may be provided in regulations (such as at the time of making a claim for refund of an overpayment of tax).

3. The presidential election campaign fund and payments therefrom (sec. 303 of the bill)

Amounts are only to be paid out of the presidential election campaign fund to reimburse certain political parties for expenses incurred in presenting candidates for President and Vice President in presidential elections. In the view of your committee, payments should be limited to expenses in presidential campaigns unless experience under the proposal proves the feasibility of extending the system to other Federal elections. To preclude any of the presidential election campaign fund from being used for other than the campaign expenses of candidates for President and Vice President, no reimbursement will be made for any item related to a candidate for any office other than President or Vice President. For example, if a Presidential or Vice Presidential candidate should make a joint political appearance with a candidate for another public office and a substantial purpose of the Presidential or Vice Presidential appearance is to further the candidacy of the other candidate, no reimbursement for such joint appearance will be allowed.

Only those political parties whose candidates for President received at least 1,500,000 votes in the preceding presidential election will be eligible to receive payments from the fund. This rule is necessary to prevent the proliferation of minor parties as a result of this bill. It insures, however, that minor parties which receive significant public backing need not become dependent on large contributors.

A political party whose candidate received more than 1,500,000 votes in the preceding presidential election but less than 10 million votes will be authorized to receive from the fund an amount equal to the lesser of its actual campaign expenses or an amount equal to $1 times the number of votes in excess of 1,500,000 that its candidate received.

A political party whose candidate for President received 10 million votes or more in the preceding presidential election is to be reimbursed

on a different basis. An amount equal to $1 for each vote received by all major parties in the last election is to be divided equally between (or among) them, with the limitation that payments to any one party cannot exceed the expenses incurred by the party in the current campaign.

The payments will be made at times to be determined by Treasury regulations, but no payment for a given presidential election campaign can be made before September 1 of the year the election is held.

The Comptroller General is charged with the responsibility for certifying to the Secretary of the Treasury the amounts payable to eligible political parties. In this certification he will take into account information supplied him by the treasurers of each political party regarding campaign expenses incurred and on the basis of the votes cast in the preceding presidential election. The Comptroller General's decisions as to the total vote received by each party are to be final.

If at the time payments are made, there are insufficient moneys in the fund to meet the amounts specified under the rules set forth, payments to all entitled parties will be reduced pro rata, and the additional amounts paid out of later additions to the fund.

If any moneys remain in the fund after all the payments authorized have been made with respect to a given presidential election, or if the fund exceeds the maximum payments which may be authorized, the amount remaining is to be returned to the general fund of the Treasury.

4. The Advisory Board (sec. 304 of the bill)

The bill establishes the Presidential Election Campaign Fund Advisory Board to advise and assist the Comptroller General in connection with his duties under this act. The board is to consist of two members from each political party whose candidate received 10 million or more votes in the last presidential election plus three additional members selected by a majority of the political party members. The first members of the board are to be appointed by the Comptroller General after the date of enactment of this bill and their term will expire 60 days after the date of the first presidential election held after the date of enactment of this bill. The next and succeeding boards will then serve 4-year terms ending 60 days after the date of each succeeding presidential election. Board members will be compensated at the rate of $75 a day for each day they serve and will receive travel expenses and a per diem in lieu of subsistence (at rates authorized for persons in intermittent Government service) when engaged in work away from their homes or regular places of business.

D. Miscellaneous Provisions

1. Treasury notes payable in foreign currency (sec. 401 of the bill)

Under present law, bonds or certificates of indebtedness may be issued by the Secretary of the Treasury payable both as to principal and interest in any foreign currency. However, presently there is no authorization for the Secretary of the Treasury to issue notes in foreign currency (31 U.S.C. 766).

Your committee's bill adds an amendment to the Second Liberty Bond Act authorizing the Secretary of the Treasury to issue notes as

well as bonds and certificates of indebtedness in foreign currencies. Notes are evidences of indebtedness issued by the Treasury Department with a maturity of from 1 to 5 years from date of issue.

Authorizing the Secretary of the Treasury to issue notes in foreign currency is designed to broaden the market for Federal securities. This is important under current market conditions when it is difficult to float long-term securities. This will enable the Secretary of the Treasury to issue notes in foreign currencies where no market exists for bonds and certificates of indebtedness in foreign currencies. To the extent a market is found in foreign currency issues of U.S. notes which would not be available for other U.S. securities, the balance of payments will be improved.

2. Reports on Government contingent liabilities and assets (sec. 402 of the bill)

In the past, it has been the practice of the Federal Government to determine its financial requirements primarily on an annual basis. This amendment does not depart from this practice. However, an annual system of budgeting does not present a complete picture of the financial condition of the United States because it fails to depict numerous categories of contingent Federal obligations and commitments. Similarly, it fails to reveal fully those situations where Congress has enacted spending authorizations, but has not specifically appropriated the moneys needed to fulfill the statutory commitment.

Moreover, under present methods, U.S. liability under many of its insurance and guarantee programs is difficult to measure and analyze. This is because sufficient information regarding these programs either is not available at all, or if it is available, is inadequately presented.

In many cases, information with respect to contingent liabilities of specific governmental programs now is available in reports of specific agencies or corporations. However, these data frequently lose much of their usefulness because they are not combined with similar data with respect to other programs. Thus, although part of this information may now be available it is not published in one place or on a uniform basis, and therefore does not aid in the overall understanding of the current financial condition of the United States.

Your committee believes that it is desirable to make available in a single, concise report, pertinent information with respect to the current status of the contingent liabilities of the Federal Government, including its long-range obligations and commitments. Indeed, the committee recognizes a responsibility to make available in such a report—as clear and complete as possible—the overall financial condition of our Government. Such a report, consolidating information now available only in part (in many diverse reports) with information which is not now available at all, will enable Congress and the public to have a better understanding of the current fiscal needs of the Federal Government.

For this reason, your committee has approved and recommends enactment of this amendment requiring the Secretary of the Treasury to submit to the Congress, by March 31 of each year a report showing the amount (both on an aggregate and on an individual basis) of the contingent liabilities and the unfunded liabilities of the Federal Gov-

ernment, determined as of December 31 of each year commencing with 1966.

The contingent liabilities referred to by the amendment include (1) liability of the Government under its various trust funds (such as the old age and survivors insurance trust fund and the highway trust fund); (2) liabilities of Government-sponsored corporations (for exemple, the Commodity Credit Corporation); (3) indirect liabilities of the Federal Government not included as part of the public debt, such as Federal Housing Administration debentures; and (4) liabilities of Federal insurance and annuity programs.

Under the amendment, data with respect to these insurance and annuity programs (which include the civil service retirement system, veterans' pension, and war risk insurance programs) are to include information regarding their actuarial status on both a balance-sheet basis and a projected source-and-application-of-funds basis.

The report is also to indicate the collateral pledged, or the assets available (or to be realized) as security for the specified liabilities, and present an analysis of their significance in terms of past experience and probable risks. Thus, for example, in the case of federally insured home mortgages the assets available on foreclosures may, under favorable circumstances, offset the potential Federal liability. But the reporting of assets is not to stop with a recording of assets related to the liabilities. Under the amendment the Secretary of the Treasury is to set forth all other assets which would be available to liquidate liabilities of the Federal Government.

In order to provide flexibility and to prevent data included in the report from being misconstrued or misleading, the amendment provides that the Secretary of the Treasury may set forth such explanatory material as he determines to be necessary or desirable. Under this provision, if he believes particular data are likely to lead to improper conclusions he may qualify that data sufficiently to negate such conclusions.

A bill identical to this section (S. 1013) was reported favorably by the committee on September 14, 1965, and passed the Senate. However, the House has not acted on that bill. A substantially identical bill was also approved by the committee in the 88th Congress. It too passed the Senate but the House did not act on it prior to the adjournment of the 88th Congress.

3. Coverage of drug expenses under supplementary medical insurance benefits (sec. 403 of the bill and secs. 1832, 1833, 1845, 1846, and 1847 of the Social Security Act)

1. BACKGROUND OF AMENDMENT

Part A of medicare is essentially designed to cover the costs of short-term institutional care provided in connection with acute illness. Part B, the supplemental medical insurance plan, while providing benefits during periods of acute illness, is also a mechanism for coping with certain of the expenses associated with chronic illness such as physician visits and home health services.

Part A of medicare pays the cost of prescribed drugs provided to a beneficiary while he is receiving covered care in a hospital or extended

care facility. No coverage, however, is available under either part A or part B toward the cost of prescribed drugs purchased by the older person who is not hospitalized or in an extended care institution.

During the debate in the Congress preceding the enactment of medicare, as well as subsequent to passage of Public Law 89–97, recognition has been given to the fact that the cost of prescribed drugs represents a significant item of medical expense to older Americans. During 1965, persons age 65 and over spent an estimated $600 million at the retail level for prescribed drugs. They spent several hundred million dollars more for nonprescribed drugs and drug sundries. Apart from the medications required as a result of acute illness, there are the recurrent and repeated costs of prescribed drugs necessary to the treatment of chronic illnesses. Some 3 million older people each spend more than $100 a year for medicine, including 600,000 persons whose drug expenses exceed $250 annually.

It appeared to your committee that part B of medicare would, therefore, be an appropriate vehicle for the provision of a benefit toward the expense of prescribed drugs which are not otherwise coverable or encompassed by the provisions of part A.

Your committee believes that this amendment represents a reasoned and economical approach toward meeting a genuine need of our older citizens. The caliber of the Formulary Committee and Advisory Group should assure responsible listing of covered drugs. The mechanism for determining allowances for each covered drug will aid in economy of operation as will the fact that coverage will be limited only to drugs requiring prescription. (Many items are prescribed by physicians which do not, by law, require prescription. Antacids and certain vitamins are prime examples. Prescriptions of this nature will not be covered. The formulary committee has authority, however, to provide coverage for a drug of a lifesaving nature such as insulin which may not require a prescription.)

The physician is enabled to prescribe by brand name if he desires and an allowance will be payable for such prescription provided that the drug is included by its generic or established name in the formulary.

2. EXPLANATION OF AMENDMENT

The committee amendment adds as a covered item of service under part B of medicare (supplemental medical insurance plan) the expense of drugs requiring a prescription. The additional benefit would become available effective July 1, 1968, or earlier if the part B premium rate is recalculated prior to that time. A formulary committee would be established consisting of the Surgeon General, the Commissioner of the Food and Drug Administration, and the Director of the National Institutes of Health. The Formulary Committee would, with the assistance of an advisory group broadly representative of those groups concerned with pharmacy, determine which drugs would be covered under the plan. The formulary committee would promulgate a schedule of allowances payable for given quantities of covered drugs. Such allowances would be based upon the lowest wholesale price of any such drug, however named, plus an increment covering the reasonable cost of distribution, handling, and compounding.

For example, the formulary committee might include tetracycline as a covered drug. They would determine the wholesale price of a given quantity of tetracycline and then add an appropriate factor covering the cost of handling, etc. That would constitute the allowance for tetracycline. The allowance thus determined would be payable on a generic basis for Achromycin, a brand name for one company's tetracycline, or for any other brands of this drug.

A drug included in the formulary under its generic or established name would also be deemed an eligible drug if prescribed under any of its proprietary or brand names and the scheduled allowance for the drug named in the formulary would also be the allowance for the proprietary or brand name version even though the wholesale costs of such proprietary or brand name items may be greater in price.

Allowances are payable to the beneficiary in the same manner as other part B benefits or he may direct payment to a third party—such as a welfare department by assignment.

The monthly cost of providing this benefit is estimated at 50 cents to the participant and 50 cents to the Federal Government. The participant's share would become part of the regular part B premium. The Federal contribution would, as is the present case with Federal participation in the costs of the part B program, come from general revenues. The cost to general revenues would be offset in part by a reduction in the amount of drug expense deductions on Federal income tax returns.

V. TECHNICAL EXPLANATION OF THE FOREIGN INVESTORS TAX ACT

For the technical explanation of this title, other than the amendments made by your committee, see the report of the Committee on Ways and Means—House Report 1450. For a discussion of the amendments made by your committee see the general explanation section of this report.

VI. CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, as reported).

SECTION 25

SENATE FLOOR DEBATE

(From the daily Congressional Record)

EQUITABLE TAX TREATMENT FOR FOREIGN INVESTMENT IN THE UNITED STATES

Mr. MANSFIELD. Mr. President, I ask unanimous consent that the Senate turn to the consideration of Calendar No. 1675, H.R. 13103.

The PRESIDING OFFICER. The bill will be stated by title.

The ASSISTANT LEGISLATIVE CLERK. A bill (H.R. 13103) to amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States.

The PRESIDING OFFICER. Is there objection to the request of the Senator from Montana?

There being no objection, the Senate proceeded to consider the bill, which had been reported from the Committee on Finance, with an amendment, to strike out all after the enacting clause and insert:

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(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, wherever in titles I, II, and III, of 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.

TITLE I—FOREIGN INVESTORS TAX ACT

SEC. 101. SHORT TITLE.

This title may be cited as the "Foreign Investors Tax Act of 1966".

SEC. 102. 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 (determined without regard to section 265) 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, 1971, subsection (a)(1)(A) and this subsection shall cease to apply."

(2) Section 861(a)(1) is amended by striking out subparagraph (B) and (C) and inserting in lieu thereof the following:

"(B) interest received from a resident alien individual 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 from all sources of such individual or such corporation has been derived from sources with in 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 individual or such corporation preceding the payment of such interest, or for such part of such period as may be applicable,

"(C) interest received from a foreign corporation (other than interest paid or credited after December 31, 1971, by a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business), when it is shown to the satisfaction of the Secretary or his delegate that less than 50 percent of the gross income from all sources of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the payment of such

interest (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,

"(D) in the case of interest received from a foreign corporation (other than interest paid or credited after December 31, 1971, by a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business) 50 percent or more of the gross income of which from all sources for the 3-year period ending with the close of its taxable year preceding the payment of such interest (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, an amount of such interest which bears the same ratio to such interest as the gross income of such foreign corporation for such period which was not effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources,

"(E) income derived by a foreign central bank, of issue from bankers' acceptances, and

"(F) interest on deposits with a foreign branch of a domestic corporation or a domestic partnership, if such branch is engaged in the commercial banking business."

(3) Section 861 (relating to income from sources within the United States) is amended by adding after subsection (c) (as added by paragraph (1)(B)) the following new subsection:

"(d) SPECIAL RULES FOR APPLICATION OF PARAGRAPHS (1)(B), (1)(C), (1)(D), AND (2)(B) OF SUBSECTION (a).—

"(1) NEW ENTRIES.—For purposes of paragraphs (1)(B), (1)(C), (1)(D), and (2)(B) of subsection (a), if the resident alien individual, domestic corporation, or foreign corporation, as the case may be, has no gross income from any source for the 3-year period (or part thereof) specified, the 20 percent test or the 50 percent test, as the case may be, shall be applied with respect to the taxable year of the payor in which payment of the interest or dividends, as the case may be, is made.

"(2) TRANSITION RULE.—For purposes of paragraphs (1)(C), (1)(D), and (2)(B) of subsection (a), the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, 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."

(4)(A) Section 895 (relating to income derived by a foreign central bank of issue from obligations of the United States) is amended to read as follows:

"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 or of any agency or instrumentality thereof (including beneficial interests, participations, and other instruments issued under section 302(c) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1717)) which are owned by such foreign central bank of issue, or derived 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."

(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.—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 50 percent of the gross income from all sources 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 was effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources; but dividends (other than dividends for which a deduction is allowable under section 245(b)) 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) 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.

"(3) TRADING IN SECURITIES OR COMMODITIES.—

"(A) STOCKS AND SECURITIES.—

"(i) IN GENERAL.—Trading in stocks or securities through a resident broker, commission agent, custodian, or other independent agent.

"(ii) TRADING FOR TAXPAYER'S OWN ACCOUNT.—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 employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in stocks or securities, or in the case of a corporation (other than a corporation which is, or but for section 542(c)(7) or 543(b)(1)(C) would be, a per-

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sonal 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.

"(B) COMMODITIES.—

"(i) IN GENERAL.—Trading in commodities through a resident broker, commission agent, custodian, or other independent agent.

"(ii) TRADING FOR TAXPAYER'S OWN ACCOUNT.—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 employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in commodities.

"(iii) LIMITATION.—Clauses (i) and (ii) shall 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)(i) and (B)(i) shall apply only if, at no time during the taxable year, the taxpayer has an office or other fixed 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.—

"(1) GENERAL RULE.—For purposes of this title—

"(A) In the case of a nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year, the rules set forth in paragraphs (2), (3), and (4) shall apply in determining the income, gain, or loss which shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(B) Except as provided in section 871(d) or sections 882(d) and (e), in the case of a nonresident alien individual or a foreign corporation not engaged in trade or business within the United States during the taxable year, no income, gain, or loss shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(2) PERIODICAL, ETC., INCOME FROM SOURCES WITHIN UNITED STATES—FACTORS.—In determining whether income from sources within the United States of the types described in section 871(a)(1) or section 881(a), or whether gain or loss from sources within the United States from the sale or exchange of capital assets, is effectively connected with the conduct of a trade or business within the United States, the factors taken into account shall include whether—

"(A) the income, gain, or loss is derived from assets used in or held for use in the conduct of such trade or business, or

"(B) the activities of such trade or business were a material factor in the realization of the income, gain, or loss.

In determining whether an asset is used in or held for use in the conduct of such trade or business or whether the activities of such trade or business were a material factor in realizing an item of income, gain, or loss, due regard shall be given to whether or not such asset or such income, gain, or loss was accounted for through such trade or business. In applying this paragraph and paragraph (4), interest referred to in section 861(a)(1)(A) shall be considered income from sources within the United States.

"(3) OTHER INCOME FROM SOURCES WITHIN UNITED STATES.—All income, gain, or loss from sources within the United States (other than income, gain, or loss to which paragraph (2) applies) shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(4) INCOME FROM SOURCES WITHOUT UNITED STATES.—

"(A) Except as provided in subparagraphs (B) and (C), no income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(B) Income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States by a nonresident alien individual or a foreign corporation if such person has an office or other fixed place of business within the United States to which such income, gain, or loss is attributable and such income, gain, or less—

"(i) consists of rents or royalties for the use of or for the privilege of using intangible property described in section 862(a)(4) (including any gain or loss realized on the sale of such property) derived in the active conduct of such trade or business;

"(ii) consists of dividends or interest, or gain or loss from the sale or exchange of stock or notes, bonds, or other evidences of indebtedness, and either is derived in the active conduct of a banking, financing, or similar business within the United States or is received by a corporation the principal business of which is trading in stocks or securities for its own account; or

"(iii) is derived from the sale (without the United States) through such office or other fixed place of business of personal property described in section 1221(1), except that this clause shall not apply if the property is sold for use, consumption, or disposi-

tion outside the United States and an office or other fixed place of business of the taxpayer outside the United States participated materially in such sale.

"(C) In the case of a foreign corporation taxable under part I of subchapter L, any income from sources without the United States which is attributable to its United States business shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(D) No income from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States if it either—

"(i) consists of dividends, interest, or royalties paid by a foreign corporation in which the taxpayer owns (within the meaning of section 958(a)), or is considered as owning (by applying the ownership rules of section 958(b)), more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or

"(ii) is subpart F income within the meaning of section 952(a).

"(5) RULES FOR APPLICATION OF PARAGRAPH (4)(B).—For purposes of subparagraph (B) of paragraph (4)—

"(A) in determining whether a nonresident alien individual or a foreign corporation has an office or other fixed place of business, an office or other fixed place of business of an agent shall be disregarded unless such agent (i) has the authority to negotiate and conclude contracts in the name of the nonresident alien individual or foreign corporation and regularly exercises that authority or has a stock of merchandise from which he regularly fills orders on behalf of such individual or foreign corporation, and (ii) is not a general commission agent, broker, or other agent of independent status acting in the ordinary course of his business,

"(B) income, gain, or loss shall not be considered as attributable to an office or other fixed place of business within the United States unless such office or fixed place of business is a material factor in the production of such income, gain, or loss and such office or fixed place of business regularly carries on activities of the type from which such income, gain, or loss is derived, and

"(C) the income, gain, or loss which shall be attributable to an office or other fixed place of business within the United States shall be the income, gain, or loss properly allocable thereto, but, in the case of a sale described in clause (iii) of such subparagraph, the income which shall be treated as attributable to an office or other fixed place of business within the United States shall not exceed the income which would be derived from sources within the United States if the sale were made in the United States."

(e) EFFECTIVE DATES.—

(1) The amendments made by subsections (a), (c), and (d) shall apply with respect to taxable years beginning after December 31, 1966; except that in applying section 864(c)(4)(B)(iii) of the Internal Revenue Code of 1954 (as added by subsection (d)) with respect to a binding contract entered into on or before February 24, 1966, activities in the United States on or before such date in negotiating or carrying out such contract shall not be taken into account.

(2) The amendments made by subsection (b) shall apply with respect to amounts received after December 31, 1966.

SEC. 103. 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 made on or before October 4, 1966,

"(C) in the case of bonds or other evidences of indebtedness issued after September 28, 1965, amounts which under section 1232 are considered as gains from the sale or exchange of property which is not a capital asset, and

"(D) gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property, or of any interest in any such property, to the extent such gains are from payments which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, or from payments which are treated as being so contingent under subsection (e),

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

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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 pargraph. 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 shall be taxable as provided in section 1 or 1201(b) on his taxable income which is effectively connected with the conduct of a trade or business within the United States.

"(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 a trade or business within the United States.

"(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 held for the production of income and located in the United States, or from any interest in such real property, including (i) gains from the sale or exchange of such 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. In such case, such income shall be taxable as provided in subsection (b)(1) whether or not such individual is engaged in trade or business within the United States during the taxable year. 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) GAINS FROM SALE OR EXCHANGE OF CERTAIN INTANGIBLE PROPERTY.—For purposes of subsection (a)(1)(D), and for purposes of sections 881(a)(4), 1441(b), and 1442(a)—

"(1) PAYMENTS TREATED AS CONTINGENT ON USE, ETC.—If more than 50 percent of the gain for any taxable year from the sale or exchange of any patent, copyright, secret process or formula, good will, trademark, trade brand, franchise, or other like property, or of any interest in any such property, is from payments which are contingent on the productivity, use, or disposition of such property or interest, all of the gain for the taxable year from the sale or exchange of such property or interest shall be treated as being from payments which are contingent on the productivity, use, or disposition of such property or interest.

"(2) SOURCE RULE.—In determining whether gains described in subsection (a)(1)(D) and section 881(a)(4) are received from sources within the United States, such gains shall be treated as rentals or royalties for the use of, or privilege of using, property or an interest in property.

"(f) CERTAIN ANNUITIES RECEIVED UNDER QUALIFIED PLANS.—For purposes of this section, gross income does not include any amount received as an annuity under a qualified annuity plan described in section 403(a)(1), or from a qualified trust described in section 401(a) which is exempt from tax under section 501(a), if—

"(1) all of the personal services by reason of which such annuity is payable were either (A) personal services performed outside the United States by an individual who, at the time of performance of such personal services, was a nonresident alien, or (B) personal services described in section 864(b)(1) performed within the United States by such individual, and

"(2) at the time the first amount is paid as such annuity under such annuity plan, or by such trust, 90 percent or more of the employees for whom contributions or benefits are provided under such annuity plan, or under the plan or plans of which such trust is a part, are citizens or residents of the United States."

"(g) 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 adjustment of tax in case of nationals or 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)."

(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 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) CERTAIN BOND INCOME 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 connected with income which is 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 connected with income which is 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)."

(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

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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) BENEFICIARIES OF ESTATE AND TRUSTS.—

(1) Section 875 (relating to partnerships) is amended to read as follows:

"SEC. 875. PARTNERSHIPS; BENEFICIARIES OF ESTATES AND TRUSTS.

"For purposes of this subtitle—

"(1) a nonresident alien individual or foreign corporation shall be considered as being engaged in a trade or business within the United States if the partnership of which such individual or corporation is a member is so engaged, and

"(2) a nonresident alien individual or foreign corporation which is a beneficiary of an estate or trust which is engaged in any trade or business within the United States shall be treated as being engaged in such trade or business within the United States."

(2) The table of sections for subpart A of part II of subchapter N of chapter 1 is amended by striking out the item relating to section 875 and inserting in lieu thereof the following:

"Sec. 875. Partnerships; beneficiaries of estates and trusts."

(f) 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 10-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 provable 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 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."

(g) 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)."

(h) WITHHOLDING OF TAX ON NONRESIDENT ALIENS.—Section 1441 (relating to withholding of tax on nonresident aliens) is amended—

(1) by striking out ", or of any partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens," in subsection (a) and inserting in lieu thereof "or of any foreign partnership";

(2) 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);

(3) 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 "gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), amounts subject to tax under section 871(a)(1)(C), gains subject to tax under section 871(a)(1)(D), and gains on transfers described in section 1235 made on or before October 4, 1966.";

(4) by adding at the end of subsection (b) the following new sentence:

"In the case of a nonresident alien individual who is a member of a domestic partnership, the items of income referred to in subsection (a) shall be treated as referring to items specified in this subsection included in his distributive share of the income of such partnership.";

(5) 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 which is included in the gross income of the recipient under section 871(b)(2) for the taxable year.";

(6) 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).";

(7) by striking out "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," in paragraph (5) of subsection (c) and inserting in lieu thereof "gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), gains subject to tax under section 871(a)(1)(D), and gains on transfers described in section 1235 made on or before October 4, 1966,", and by striking out "proceeds from such sale or exchange," in such paragraph and inserting in lieu thereof "amount payable,";

(8) by adding at the end of subsection (c) the following new paragraph:

"(7) CERTAIN ANNUITIES RECEIVED UNDER QUALIFIED PLANS.—No deduction or withholding under subsection (a) shall be required in the case of any amount received as an annuity if such amount is, under section 871(f), exempt from the tax imposed by section 871(a)."; and

(9) by redesignating subsection (d) as (e), and by inserting after subsection (c) the following new subsection:

"(d) EXEMPTION OF CERTAIN FOREIGN PARTNERSHIPS.—Subject to such terms and con-

ditions as may be provided by regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply in the case of a foreign partnership engaged in trade or business within the United States if the Secretary or his delegate determines that the requirements of subsection (a) impose an undue administrative burden and that the collection of the tax imposed by section 871(a) on the members of such partnership who are nonresident alien individuals will not be jeopardized by the exemption."

(i) 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."

(j) 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—

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"(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 (other than compensation for personal services subject to deduction and withholding under section 1441) 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."

(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) DEFINITIONS OF FOREIGN ESTATE OR TRUST.—

(1) 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,".

(2) Section 1493 (defining foreign trust for purpose of chapter 5) is repealed.

(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 possession 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 (h), (i), and (k)) shall apply with respect to taxable years beginning after December 31, 1966.

(2) The amendments made by subsection (h) shall apply with respect to payments made in taxable years of recipients beginning after December 31, 1966.

(3) The amendments made by subsection (i) shall apply with respect to payments occurring after December 31, 1966.

(4) The amendments made by subsection (k) shall apply with respect to remuneration paid after December 31, 1966.

SEC. 104. 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. TAX ON 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),

"(3) in the case of bonds or other evidences of indebtedness issued after September 28, 1965, amounts which under section 1232 are considered as gains from the sale or exchange of property which is not a capital asset, and

"(4) gains from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other like property, or of any interest in any such property, to the extent such gains are from payments which are contingent on the productivity, use, or disposition of the property or interest sold or exchanged, or from payments which are treated as being so contingent under section 871(e).

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. TAX ON INCOME OF FOREIGN CORPORATIONS CONNECTED WITH UNITED STATES BUSINESS.

"(a) NORMAL TAX AND SURTAX.—

"(1) IMPOSITION OF TAX.—A foreign cor-

poration engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 11 or 1201(a) on its taxable income which is effectively connected with the conduct of a trade or business within the United States.

"(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 a 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 connected with income which is 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 connected with income which is 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, including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. The preceding sentence shall not apply for purposes of the tax imposed by section 541 (relating to personal holding company tax), and 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 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. In such case, such income shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the United States during the taxable year. 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) INTEREST ON UNITED STATES OBLIGATIONS RECEIVED BY BANKS ORGANIZED IN POSSESSIONS.—In the case of a corporation created or organized in, or under the law of, a possession of the United States which is carrying on the banking business in a possession of the United States, interest on obligations of the United States shall—

"(1) for purposes of this subpart, be treated as income which is effectively connected with the conduct of a trade or business within the United States, and

"(2) shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the United States during the taxable year.

"(f) 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. Tax on income of foreign corporations not connected with United States business.

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"Sec. 882. Tax on income of foreign corporations connected with United States business."

(c) WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.—Section 1442 (relating to with-

holding of tax on foreign corporations) is amended to read as follows:

"SEC. 1442. WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.

"(a) GENERAL RULE.—In the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 or section 1451 a tax equal to 30 percent thereo; except that, in the case of interest described in section 1451 (relating to tax-free covenant bonds), the deduction and withholding shall be at the rate specified therein. For purposes of the preceding sentence, the references in section 1441(b) to sections 871(a)(1) (C) and (D) shall be treated as referring to sections 881 (a) (3) and (4), the reference in section 1441 (c)(1) to section 871(b)(1) shall be treated as referring to section 842 or section 882(a), as the case may be, and the reference in section 1441(c)(5) to section 871(a)(1)(D) shall be treated as referring to section 881 (a)(4).

"(b) EXEMPTION.—Subject to such terms and conditions as may be provided by regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply in the case of a foreign corporation engaged in trade or business within the United States if the Secretary or his delegate determines that the requirements of subsection (a) impose an undue administrative burden and that the collection of the tax imposed by section 881 on such corporation will not be jeopardized by the exemption."

(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, 1966, 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) DIVIDENDS RECEIVED FROM CERTAIN WHOLLY-OWNED FOREIGN SUBSIDIARIES.—

(1) Section 245 (relating to dividends received from certain foreign corporations) is amended by redesignating subsection (b) as (c), and by inserting after subsection (a) the following new subsection:

"(b) CERTAIN DIVIDENDS RECEIVED FROM WHOLLY-OWNED FOREIGN SUBSIDIARIES.—

"(1) IN GENERAL.—In the case of dividends described in paragraph (2) received from a foreign corporation by a domestic corporation which, for its taxable year in which such dividends are received, owns (directly or indirectly) all of the outstanding stock of such foreign corporation, there shall be allowed as a deduction (in lieu of the deduction provided by subsection (a)) an amount equal to 100 percent of such dividends.

"(2) ELIGIBLE DIVIDENDS.—Paragraph (1) shall apply only to dividends which are paid out of the earnings and profits of a foreign corporation for a taxable year during which—

"(A) all of its outstanding stock is owned (directly or indirectly) by the domestic corporation to which such dividends are paid; and

"(B) all of its gross income from all sources is effectively connected with the conduct of a trade or business within the United States.

"(3) EXCEPTION.—Paragraph (1) shall not apply to any dividends if an election under section 1562 is effective for either—

"(A) the taxable year of the domestic corporation in which such dividends are received, or

"(B) the taxable year of the foreign corporation out of the earnings and profits of which such dividends are paid."

(2) Subsection (a) of such section 245 is amended by adding at the end thereof (after the sentence added by subsection (d)(4)) the following new sentence: "For purposes of paragraph (2), there shall not be taken into account any taxable year within such uninterrupted period if, with respect to dividends paid out of the earnings and profits of such year, the deduction provided by subsection (b) would be allowable."

(3) Subsection (c) of such section 245 (as redesignated by paragraph (1)) is amended by striking out "subsection (a)" and inserting in lieu thereof "subsections (a) and (b)".

(f) DISTRIBUTIONS OF CERTAIN FOREIGN CORORATIONS.—Section 301(b)(1)(C) (relating to certain corporate distributees of foreign corporations) is amended—

(1) by striking out "gross income from sources within the United States" in clause (i) and inserting in lieu thereof "gross income which is effectively connected with the conduct of a trade or business within the United States";

(2) by striking out "gross income from sources without the United States" in clause (ii) and inserting in lieu thereof "gross income which is not effectively connected with the conduct of a trade or business within the United States"; and

(3) by adding at the end thereof the following new sentences: "For purposes of clause (i), the gross income of a foreign corporation for any period before its first taxable year beginning after December 31, 1966, 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. For purposes of clause (ii), the gross income of a foreign corporation for any period before its first taxable year beginning after December 31, 1966, which is not 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 without the United States."

(g) 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."

(h) CORPORATIONS SUBJECT TO PERSONAL HOLDING COMPANY TAX.—

(1) Paragraph (7) of section 542(c) (relating to corporations not subject to personal holding company tax) is amended to read as follows:

"(7) a foreign corporation (other than a corporation which has income to which section 543(a)(7) applies for the taxable year), 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;".

(2) Section 543(b)(1) (relating to definition of ordinary gross income) is amended—

(A) by striking out "and" at the end of subparagraph (A),

(B) by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", and", and

(C) by inserting after subparagraph (B) the following new subparagraph:

"(C) in the case of a foreign corporation all of the outstanding stock of which 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), all items of income which would, but for this subparagraph, constitute personal holding company income under any paragraph of subsection (a) other than paragraph (7) thereof."

(3) Section 545 (relating to definition of undistributed personal holding company income) is amended—

(A) by striking out subsection (a) and inserting in lieu thereof the following:

"(a) DEFINITION.—For purposes of this part, the term 'undistributed personal holding company income' means the taxable income of a personal holding company adjusted in the manner provided in subsections (b), (c), and (d), minus the dividends paid deduction as defined in section 561. In the case of a personal holding company which is a foreign corporation, not more than 10 percent in value of the outstanding stock of which is owned (within the meaning of section 958(a)) during the last half of the taxable year by United States persons, the term 'undistributed personal holding company income' means the amount determined by multiplying the undistributed personal holding company income (determined without regard to this sentence) by the percentage in value of its outstanding stock which is the greatest percentage in value of its outstanding stock so owned by United States persons on any one day during such period."; and

(B) by adding at the end thereof the following new subsection:

"(d) CERTAIN FOREIGN CORPORATIONS.—In the case of a foreign corporation all of the outstanding stock of which 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), the taxable income for purposes of subsection (a) shall be the income which constitutes personal holding company income under section 543(a)(7), reduced by the deductions attributable to such income, and adjusted, with respect to such income, in the manner provided in subsection (b)."

(4)(A) Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new section:

"SEC. 6683. FAILURE OF FOREIGN CORPORATION TO FILE RETURN OF PERSONAL HOLDING COMPANY TAX.

"Any foreign corporation which—

"(1) is a personal holding company for any taxable year, and

"(2) fails to file or to cause to be filed with the Secretary or his delegate a true and

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accurate return of the tax imposed by section 541,

shall, in addition to other penalties provided by law, pay a penalty equal to 10 percent of the taxes imposed by chapter 1 (including the tax imposed by section 541) on such foreign corporation for such taxable year."

(B) The table of sections for such subchapter B is amended by adding at the end thereof the following new item:

"Sec. 6683. Failure of foreign corporation to file return of personal holding company tax."

(i) 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) as 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 adding at the end of subsection (a) (as redesignated by subparagraph (A)) the following new paragraph:

"(3) REDUCTION OF SECTION 881 TAX.—In the case of any foreign corporation taxable under this part, there shall be determined—

"(A) the amount which would be subject to tax under section 881 if the amount taxable under such section were determined without regard to sections 103 and 894, and

"(B) the amount of the reduction provided by paragraph (1).

The tax under section 881 (determined without regard to this paragraph) shall be reduced (but not below zero) by an amount which is the same proportion of such tax as the amount referred to in subparagraph (B) is of the amount referred to in subparagraph (A); but such reduction in tax shall not exceed the increase in tax under this part by reason of the reduction provided by paragraph (1).",

(E) 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",

(F) by striking out "foreign life insurance company" each place it appears in such subsection (b) and inserting in lieu thereof "foreign corporation",

(G) by striking out "subsection (b)(2)(A)" each place it appears in such subsection (b) and inserting in lieu thereof "subsection (a)(2)(A)",

(H) 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

(I) 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 ameded—

(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 corporation subject to tax under this subchapter),".

(j) 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 from sources within the United States which is 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."

(k) 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, 1967, 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, 1966, 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."

(l) DECLARATION OF ESTIMATED INCOME TAX BY CORPORATIONS.—Section 6016 (relating to declarations of estimated income tax by corporations) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) CERTAIN FOREIGN CORPORATIONS.—For purposes of this section and section 6655, in the case of a foreign corporation subject to taxation under section 11 or 1201(a), or under subchapter L of chapter 1, the tax imposed by section 881 shall be treated as a tax imposed by section 11."

(m) 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 corporations carrying on an insurance business within the United States, 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 adjustment of tax in 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".

(n) EFFECTIVE DATES.—The amendments made by this section (other than subsection (k)) shall apply with respect to taxable years beginning after December 31, 1966. The amendment made by subsection (k) shall apply with respect to sales or exchanges occurring after December 31, 1966.

SEC. 105. 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 a 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) ADJUSTMENT OF TAX BECAUSE OF BURDENSOME OR DISCRIMINATORY FOREIGN TAXES.—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

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adding at the end thereof the following new section:

"SEC. 896. ADJUSTMENT OF TAX ON NATIONALS, RESIDENTS, AND CORPORATIONS OF CERTAIN FOREIGN COUNTRIES.

"(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-1967 tax provisions in accordance with the provisions of this subsection 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) IMPOSITION OF DISCRIMINATORY TAXES BY FOREIGN COUNTRY.—Whenever the President finds that—

"(1) under the laws of any foreign country, citizens of the United States or domestic corporations (or any class of such citizens or corporations) are, with respect to any item of income, being subjected to a higher effective rate of tax than are nationals, residents, or corporations of such foreign country (or a similar class of such nationals, residents, or corporations) under similar circumstances;

"(2) such foreign country, when requested by the United States to do so, has not acted to eliminate such higher effective rate of tax; and

"(3) it is in the public interest to adjust, in accordance with the provisions of this subsection, the effective rate of tax imposed by this subtitle on similar income of nationals, residents, or corporations of such foreign country (or such similar class of such nationals, residents, or corporations),

the President shall proclaim that the tax on similar income of nationals, residents, or corporations of such foreign country (or such similar class of such nationals, residents, or corporations) shall, for taxable years beginning after such proclamation, be adjusted so as to cause the effective rate of tax imposed by this subtitle on such similar income to be substantially equal to the effective rate of tax imposed by such foreign country on such item of income of citizens of the United States or domestic corporations (or such class of citizens or corporations). In implementing a proclamation made under this subsection, the effective rate of tax imposed by this subtitle on an item of income may be adjusted by the disallowance, in whole or in part, of any deduction, credit, or exemption which would otherwise be allowed with respect to that item of income or by increasing the rate of tax otherwise applicable to that item of income.

"(c) ALLEVIATION OF MORE BURDENSOME OR DISCRIMINATORY TAXES.—Whenever the President finds that—

"(1) 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 the item of income derived by such citizens or corporations from sources within such foreign country, or

"(2) the laws of any foreign country with respect to which the President has made a proclamation under subsection (b) have been modified so that citizens of the United States or domestic corporations (or any class of such citizens or corporations) are no longer subject to a higher effective rate of tax on the item of income,

he shall proclaim that the tax imposed by this subtitle on the similar income of nationals, residents, or corporations of such foreign country shall, for any taxable year

beginning after such proclamation, be determined under this subtitle without regard to such subsection.

"(d) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least thirty days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

"(e) 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. Adjustment of tax on nationals, residents, and corporations of certain foreign countries."

(d) EFFECTIVE DATE.—The amendments made by this section (other than subsections (e) and (f) shall apply with respect to taxable years beginning after December 31, 1966.

(e) ELECTIONS BY NONRESIDENT UNITED STATES CITIZENS WHO ARE SUBJECT TO FOREIGN COMMUNITY PROPERTY LAWS.—

(1) Part III of subchapter N of chapter 1 (relating to income from sources without the United States) is amended by adding at the end thereof the following new subpart:

"Subpart H—Income of Certain Nonresident United States Citizens Subject to Foreign Community Property Laws

"Sec. 981. Elections as to treatment of income subject to foreign community property laws.

"(a) GENERAL RULE.—In the case of any taxable year beginning after December 31, 1966, if—

"(1) an individual is (A) a citizen of the United States, (B) a bona fide resident of a foreign country or countries during the entire taxable year, and (C) married at the close of the taxable year to a spouse who is a nonresident alien during the entire taxable year, and

"(2) such individual and his spouse elect to have subsection (b) apply to their community income under foreign community property laws,

then subsection (b) shall apply to such income of such individual and such spouse for the taxable year and for all subsequent taxable years for which the requirements of paragraph (1) are met, unless the Secretary or his delegate consents to a termination of the election.

"(b) TREATMENT OF COMMUNITY INCOME.—For any taxable year to which an election made under subsection (a) applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as follows:

"(1) Earned income (within the meaning of the first sentence of section 911(b)), other than trade or business income and a partner's distributive share of partnership income, shall be treated as the income of the spouse who rendered the personal services.

"(2) Trade or business income, and a partner's distributive share of partnership income, shall be treated as provided in section 1402(a)(5).

"(3) Community income not described in paragraph (1) or (2) which is derived from the separate property (as determined under the applicable foreign community property law) of one spouse shall be treated as the income of such spouse.

"(4) All other such community income shall be treated as provided in the applicable foreign community property law.

"(c) ELECTION FOR PRE-1967 YEARS.—

"(1) ELECTION.—If an individual meets the requirements of subsections (a)(1)(A) and (C) for any taxable year beginning before January 1, 1967, and if such individual and the spouse referred to in subsection (a)(1)(C) elect under this subsection, then paragraph (2) of this subsection shall apply to their community income under foreign community property laws for all open taxable years beginning before January 1, 1967 (whether under this chapter, the corresponding provisions of the Internal Revenue Code of 1939, or the corresponding provisions of prior revenue laws), for which the requirements of subsection (a)(1)(A) and (C) are met.

"(2) EFFECT OF ELECTION.—For any taxable year to which an election made under this subsection applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as provided by subsection (b), except that the other community income described in paragraph (4) of subsection (b) shall be treated as the income of the spouse who, for such taxable year, had gross income under paragraphs (1), (2), and (3) of subsection (b), plus separate gross income, greater than that of the other spouse.

"(d) TIME FOR MAKING ELECTIONS; PERIOD OF LIMITATIONS; ETC.—

"(1) TIME.—An election under subsection (a) or (c) for a taxable year may be made at any time while such year is still open, and shall be made in such mnner as the Secretary or his delegate shall by regulations prescribe.

"(2) EXTENSION OF PERIOD FOR ASSESSING DEFICIENCIES AND MAKING REFUNDS.—If any taxable year to which an election under subsection (a) or (c) applies is open at the time such election is made, the period for assessing a deficiency against, and the period for filing claim for credit or refund of any overpayment by, the husband and wife for such taxable year, to the extent such deficiency or overpayment is attributable to such an election, shall not expire before 1 year after the date of such election.

"(3) ALIEN SPOUSE NEED NOT JOIN IN SUBSECTION (c) ELECTION IN CERTAIN CASES.—If the Secretary or his delegate determines—

"(A) that an election under subsection (c) would not affect the liability for Federal income tax of the spouse referred to in subsection (a)(1)(C) for any taxable year, or

"(B) that the effect on such liability for tax cannot be ascertained and that to deny the election to the citizens of the United States would be inequitable and cause undue hardship,

such spouse shall not be required to join in such election, and paragraph (2) of this subsection shall not apply with respect to such spouse.

"(4) INTEREST.—To the extent that any overpayment or deficiency for a taxable year

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is attributable to an election made under this section, no interest shall be allowed or paid for any period before the day which is 1 year after the date of such election.

"(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) DEDUCTIONS.—Deductions shall be treated in a manner consistent with the manner provided by this section for the income to which they relate.

"(2) OPEN YEARS.—A taxable year of a citizen of the United States and his spouse shall be treated as 'open' if the period for assessing a deficiency against such citizen for such year has not expired before the date of the election under subsection (a) or (c), as the case may be.

"(3) ELECTIONS IN CASE OF DECEDENTS.—If a husband or wife is deceased his election under this section may be made by his executor, administrator, or other person charged with his property.

"(4) DEATH OF SPOUSE DURING TAXABLE YEAR.—In applying subsection (a)(1)(C), and in determining under subsection (c)(2) which spouse has the greater income for a taxable year, if a husband or wife dies the taxable year of the surviving spouse shall be treated as ending on the date of such death."

(2) The table of subparts for such part III is amended by adding at the end thereof the following:

"Subpart H. Income of certain nonresident United States citizens subject to foreign community property laws."

(3) Section 911(d) (relating to earned income from sources without the United States) is amended—

(A) by striking out "For administrative" and inserting in lieu thereof the following:

"(1) For administrative"; and

(B) by adding at the end thereof the following:

"(2) For elections as to treatment of income subject to foreign community property laws, see section 981."

(f) PRESUMPTIVE DATE OF PAYMENT FOR TAX WITHHELD UNDER CHAPTER 3.—

(1) Section 6513(b) (relating to time tax is considered paid in the case of prepaid income tax) is amended to read as follows:

"(b) PREPAID INCOME TAX.—For purposes of section 6511 or 6512—

"(1) Any tax actually deducted and withheld at the source during any calendar year under chapter 24 shall, in respect of the recipient of the income, be deemed to have been paid by him on the 15th day of the fourth month following the close of his taxable year with respect to which such tax is allowable as a credit under section 31.

"(2) Any amount paid as estimated income tax for any taxable year shall be deemed to have been paid on the last day prescribed for filing the return under section 6012 for such taxable year (determined without regard to any extension of time for filing such return).

"(3) Any tax withheld at the source under chapter 3 shall, in respect of the receipient of the income, be deemed to have been paid by such receipient on the last day prescribed for filing the return under section 6012 for the taxable year (determined without regard to any extension of time for filing) with respect to which such tax is allowable as a credit under section 1452. For this purpose, any exemption granted under section 6012 from the requirement of filing a return shall be disregarded."

(2) Section 6513(c) (relating to return and payment of Social Security taxes and income tax withholding) is amended—

(A) by striking out "chapter 21 or 24" and inserting in lieu thereof "chapter 3, 21, or 24"; and

(B) by striking out "remuneration" in paragraph (2) and inserting in lieu thereof "remuneration or other amount".

(3) Section 6501(b) (relating to time returns deemed filed) is amended—

(A) by striking out "chapter 21 or 24" in paragraphs (1) and (2) and inserting in lieu thereof "chapter 3, 21, or 24"; and

(B) by inserting after "taxes" in the heading of paragraph (2) "and tax imposed by chapter 3".

(4) The amendments made by this subsection shall take effect on the date of the enactment of this Act.

SEC. 106. 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 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 a trade or business within the United States.

"(b) SPECIAL RULES.—

"(1) For 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 from sources within the United States 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 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 a 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 individuals 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 not described in section 876 and in the case of any 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, 1966. 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, 1967, 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

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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, 1966. The amendment made by paragraph (3) shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

(c) FOREIGN TAX CREDIT IN RESPECT OF INTEREST RECEIVED FROM FOREIGN SUBSIDIARIES.—

(1) Section 904(f)(2) (relating to application of limitations on foreign tax credit in case of certain interest income) is amended—

(A) by striking out subparagraph (C) and inserting in lieu thereof the following:

"(C) received from a corporation in which the taxpayer (or one or more includible corporations in an affiliated group, as defined in section 1504, of which the taxpayer is a member) owns, directly or indirectly, at least 10 percent of the voting stock,".

(B) by adding at the end thereof the following new sentence:

"For purposes of subparagraph (C), stock owned, directly or indirectly, by or for a foreign corporation shall be considered as being proportionately owned by its shareholders."

(2) The amendments made by paragraph (1) shall apply to interest received after December 31, 1965, in taxable years ending after such date.

SEC. 107. 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 ap-

portionment 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.

"(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, 1966.

SEC. 108. 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 and held by a nonresident not a citizen of the United States shall be deemed property within the United States. With respect to estates of decedents dying after December 31, 1971, deposits with a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business, shall, for purposes of this subchapter, be deemed property within the United States. This subsection shall not apply to a debt obligation to which section 2105(b) applies or to a debt obligation of a domestic corporation if any interest on such obligation, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(B) as income from sources without 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) CERTAIN BANK DEPOSITS, ETC.—For purposes of this subchapter—

"(1) amounts described in section 861(c) if any interest thereon, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(A) as income from sources without the United States, and

"(2) deposits with a foreign branch of a domestic corporation or domestic partnership, if such branch is engaged in the commercial banking business,

shall not be deemed property within the United States."

(e) DEFINITION OF TAXABLE ESTATE.—Paragraph (3) 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 METHOD 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 section 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

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amounts determined in accordance with section 2102.

"(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-1967 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-1967 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), 2106 (relating to taxable estate), 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 of 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 tables 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-1967 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. 109. 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 1967 and all calendar years thereafter.

SEC. 110. TREATY OBLIGATIONS.

No amendment made by this title 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 title shall not be deemed to be contrary to a treaty obligation of the United States.

TITLE II—OTHER AMENDMENTS TO INTERNAL REVENUE CODE

SEC. 201. APPLICATION OF INVESTMENT CREDIT TO PROPERTY USED IN POSSESSIONS OF THE UNITED STATES.

(a) PROPERTY USED BY DOMESTIC CORPORATIONS, ETC.—Section 48(a)(2)(B) (relating to property used outside the United States) is amended—

(1) by striking out "and" at the end of clause (v);

(2) by striking out the period at the end of clause (vi) and inserting in lieu thereof "; and"; and

(3) by adding at the end thereof the following new clause:

"(vii) any property which is owned by a domestic corporation (other than a corporation entitled to the benefits of section 931 or 934(b)) or by a United States citizen (other than a citizen entitled to the benefits of section 931, 932, 933, or 934(b)) and which is used predominantly in a possession of the United States by such a corporation or such a citizen, or by a corporation created or organized in, or under the law of, a possession of the United States."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years ending after December 31, 1965, but only with respect to property placed in service after such date. In applying section 46(b) of the Internal Revenue Code of 1954 (relating to carryback and carryover of unused credits), the amount of any investment credit carryback to any taxable year ending on or before December 31, 1965, shall be determined without regard to the amendments made by this section.

SEC. 202. DEDUCTION OF MEDICAL EXPENSES OF INDIVIDUALS AGE 65 OR OVER.

(a) REPEAL AMENDMENTS MADE BY SOCIAL SECURITY AMENDMENTS OF 1965.—Subsections (a) and (b) of section 106 of the Social Security Amendments of 1965 are repealed.

(b) COST OF MEDICAL INSURANCE.—Section 213(a) (relating to allowance of deduction for medical, dental, etc., expenses) is amended—

(1) by striking out "and" at the end of paragraph (1)(A);

(2) by inserting after "such expenses" in paragraph (1)(B) "(reduced by any amount deductible under subparagraph (C))";

(3) by striking out the period at the end of paragraph (1)(B) and inserting in lieu thereof ", and";

(4) by adding at the end of paragraph (1) the following new subparagraph:

"(C) an amount (not in excess of $150) equal to one-half of the expenses paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents (other than any dependent described in subparagraph (A)).";

(5) by striking out "and" at the end of paragraph (2)(B);

(6) by inserting after "such expenses" in paragraph (2)(C) "(reduced by any amount deductible under subparagraph (D))";

(7) by striking out the period at the end of paragraph (2)(C) and inserting in lieu thereof ", and"; and

(8) by adding at the end of paragraph (2) the following new subparagraph:

"(D) an amount (not in excess of $150) equal to one-half of the expenses paid during the taxable year for insurance which constitutes medical care for such dependents (other than any dependent described in paragraph (1)(A))."

(c) EFFECTIVE DATE.—The repeal and amendments made by this section shall apply to taxable years beginning after December 31, 1966.

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SEC. 203. BASIS OF PROPERTY RECEIVED ON LIQUIDATION OF SUBSIDIARY.

(a) DEFINITION OF PURCHASE.—Section 334

(b)(3) (relating to definition of purchase) is amended by adding at the end thereof the following new sentence:

"Notwithstanding subparagraph (C) of this paragraph, for purposes of paragraph (2)(B), the term 'purchase' also means an acquisition of stock from a corporation when ownership of such stock would be attributed under section 318(a) to the person acquiring such stock, if the stock of such corporation by reason of which such ownership would be attributed was acquired by purchase (within the meaning of the preceding sentence)."

(b) PERIOD OF ACQUISITION.—Section 334(b)(2)(B) (relating to exception) is amended by striking out "during a period of not more than 12 months," and inserting in lieu thereof "during a 12-month period beginning with the earlier of—

"(i) the date of the first acquisition by purchase of such stock, or

"(ii) if any of such stock was acquired in an acquisition which is a purchase within the meaning of the second sentence of paragraph (3), the date on which the distributee is first considered under section 318(a) as owning stock owned by the corporation from which such acquisition was made,".

(c) DISTRIBUTION OF INSTALLMENT OBLIGATIONS.—Section 453(d)(4)(A) (relating to distribution of installment obligations in certain liquidations) is amended to read as follows:

"(A) LIQUIDATIONS TO WHICH SECTION 332 APPLIES.—If—

"(i) an installment obligation is distributed in a liquidation to which section 332 (relating to complete liquidations of subsidiaries) applies, and

"(ii) the basis of such obligation in the hands of the distributee is determined under section 334(b)(1),

then no gain or loss with respect to the distribution of such obligation shall be recognized by the distributing corporation."

(d) EFFECTIVE DATES.—The amendment made by subsection (a) shall apply only with respect to acquisitions of stock after December 31, 1965. The amendments made by subsections (b) and (c) shall apply only with respect to distributions made after the date of the enactment of this Act.

SEC. 204. TRANSFERS OF STOCK AND SECURITIES TO CORPORATIONS CONTROLLED BY TRANSFERORS.

(a) TRANSFERS TO INVESTMENT COMPANIES.—The first sentence of section 351(a) (relating to transfers to corporations controlled by transferor) is amended by striking out "to a corporation" and inserting in lieu thereof "to a corporation (including an investment company)".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to transfers of property whether made before, on, or after the date of the enactment of this Act.

SEC. 205. MINIMUM AMOUNT TREATED AS EARNED INCOME FOR RETIREMENT PLANS OF CERTAIN SELF-EMPLOYED INDIVIDUALS.

(a) INCREASE TO $6,600.—Section 401(c)(2)(B) (relating ot earned income when both personal services and capital are material income-producing factors) is amended by striking out "$2,500" each place it appears therein and inserting in lieu thereof "$6,600".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1965.

SEC. 206. TREATMENT OF CERTAIN INCOME OF AUTHORS, INVENTORS, ETC., AS EARNED INCOME FOR RETIREMENT PLAN PURPOSES

(a) INCOME FROM DISPOSITION OF PROPERTY CREATED BY TAXPAYER.—Section 401(c)(2) (relating to definition of earned income) is amended by adding at the end thereof the following new subparagraph:

"(C) INCOME FROM DISPOSITION OF CERTAIN PROPERTY.—For purposes of this section, the term 'earned income' includes gains (other than any gain which is treated under any provision of this chapter as gain from the sale or exchange of a capital asset) and net earnings derived from the sale or other disposition of, the transfer of any interest in, or the licensing or the use of property (other than good will) by an individual whose personal efforts created such property."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years ending after the date of the enactment of this Act.

SEC. 207. EXCLUSION OF CERTAIN RENTS FROM PERSONAL HOLDING COMPANY INCOME.

(a) RENTS FROM LEASES OF CERTAIN TANGIBLE PERSONAL PROPERTY.—Section 543(b)(3) (relating to adjusted income from rents) is amended by striking out "but does not include amounts constituting personal holding company income under subsection (a)(6), nor copyright royalties (as defined in subsection (a)(4) nor produced film rents) (as defined in subsection (a)(5)(B))." and inserting in lieu thereof the following: but such term does not include—

"(A) amounts constituting personal holding company income under subsection (a)(6),

"(B) copyright royalties (as defined in subsection (a)(4)),

"(C) produced film rents (as defined in subsection (a)(5)(B)), or

"(D) compensation, however designated for the use of, or the right to use, any tangible personal property manufactured or produced by the taxpayer, if during the taxable year the taxpayer is engaged in substantial manufacturing or production of tangible personal property of the same type."

(b) TECHNICAL AMENDMENTS.—

(1) Section 543(a)(2) (relating to adjusted income from rents included in personal holding company income) is amended by striking out the last sentence thereof.

(2) Section 543(b)(2) (relating to definition of adjusted ordinary gross income) is amended by adding at the end thereof the following new subparagraph:

"(D) CERTAIN EXCLUDED RENTS.—From the gross income consisting of compensation described in subparagraph (D) of paragraph (3) subtract the amount allowable as deductions for the items described in clauses (i), (ii), (iii), and (iv) of subparagraph (A) to the extent allocable, under regulations prescribed by the Secretary or his delegate, to such gross income. The amount subtracted under this subparagraph shall not exceed such gross income."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after the date of the enactment of this Act. Such amendments shall also apply, at the election of the taxpayer (made at such time and in such manner as the Secretary or his delegate may

prescribe), to taxable years beginning on or before such date and ending after December 31, 1965.

SEC. 208. PERCENTAGE DEPLETION RATE FOR CERTAIN CLAY BEARING ALUMINA.

(a) 23 PERCENT RATE.—Section 613(b) (relating to percentage depletion rates) is amended—

(1) by inserting "clay, laterite, and nephelite syenite" after "anorthosite" in paragraph (2)(B); and

(2) by striking out "if paragraph (5)(B) does not apply" in paragraph (3)(B) and inserting in lieu thereof "if neither paragraph (2)(B) nor (5)(B) applies".

(b) TREATMENT PROCESSES.—Section 613(c)(4) (relating to treatment processes considered as mining) is amended—

(1) by striking out "and" at the end of subparagraph (G),

(2) by redesignating subparagraph (H) as (I), and by inserting after subparagraph (G) the following new subparagraph:

"(H) in the case of clay, laterite, and nephelite syenite from deposits in the United States (to the extent that alumina and aluminum compounds are extracted therefrom)—all processes applied to derive alumina or aluminum compounds therefrom; and".

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 209. PERCENTAGE DEPLETION RATE FOR CLAM AND OYSTER SHELLS.

(a) 15 PERCENT RATE.—Section 613(b) (relating to percentage depletion rates) is amended—

(1) by striking out "mollusk shells (including clam shells and oyster shells)," in paragraph (5)(A), and

(2) by inserting "mollusk shells (including clam shells and oyster shells)," after "marble," in paragraph (6).

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 210. SINTERING AND BURNING OF SHALE, CLAY, AND SLATE USED AS LIGHTWEIGHT AGGREGATES.

(a) TREATMENT PROCESSES.—Section 613(c)(4) (relating to treatment processes considered as mining) is amended by striking out "and the furnacing of quicksilver ores" in subparagraph (E) and inserting in lieu thereof "the furnacing of quicksilver ores, and the sintering or burning of shale, clay, and slate used or sold for use as lightweight aggregates".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 211. STRADDLES.

(a) TREATMENT AS SHORT-TERM CAPITAL GAIN.—Section 1234 (relating to options) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) SPECIAL RULE FOR GRANTORS OF STRADDLES.—

"(1) GAIN ON LAPSE.—In the case of gain on lapse of an option granted by the taxpayer as part of a straddle, the gain shall be deemed to be gain from the sale or exchange of a capital asset held for not more than 6 months on the day that the option expired.

"(2) EXCEPTION.—This subsection shall not apply to any person who holds securities for sale to customers in the ordinary course of his trade or business.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) The term 'straddle' means a simultaneously granted combination of an option to buy, and an option to sell, the same quantity of a security at the same price during the same period of time.

"(B) The term 'security' has the meaning assigned to such term by section 1236(c)."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to straddle transactions entered into after January 25, 1965, in taxable years ending after such date.

SEC. 212. TAX TREATMENT OF PER-UNIT RETAIN ALLOCATIONS.

(a) TAX TREATMENT OF COOPERATIVES.—

(1) Section 1382(a) (relating to gross income of cooperatives) is amended by striking out the period at the end thereof and inserting "or by reason of any amount paid to a patron as a per-unit retain allocation (as defined in section 1388(f))."

(2) Section 1382(b) is amended—

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(A) by striking out "(b) PATRONAGE DIVIDENDS.—" and inserting in lieu thereof "(b) PATRONAGE DIVIDENDS AND PER-UNIT RETAIN ALLOCATIONS.—",

(B) by striking out "or" at the end of paragraph (1),

(C) by striking out the period at the end of paragraph (2) and inserting a semicolon in lieu thereof,

(D) by striking out the sentence following paragraph (2) and inserting in lieu thereof the following:

"(3) as per-unit retain allocations, to the extent paid in qualified per-unit retain certificates (as defined in section 1388(h)) with respect to marketing occurring during such taxable year; or

"(4) in money or other property (except per-unit retain certificates) in redemption of a nonqualified per-unit retain certificate which was paid as a per-unit retain allocation during the payment period for the taxable year during which the marketing occurred."

"For purposes of this title, any amount not taken into account under the preceding sentence shall, in the case of an amount described in paragraph (1) or (2), be treated in the same manner as an item of gross income and as a deduction therefrom, and in the case of an amount described in paragraph (3) or (4), be treated as a deduction in arriving at gross income."

(3) Section 1382(e) is amended to read as follows:

"(e) PRODUCTS MARKETED UNDER POOLING ARRANGEMENTS.—For purposes of subsection (b), in the case of a pooling arrangement for the marketing of products—

"(1) the patronage shall (to the extent provided in regulations prescribed by the Secretary or his delegate) be treated as patronage occurring during the taxable year in which the pool closes, and

(2) the marketing of products shall be treated as occurring during any of the taxable years in which the pool is open."

(4) Section 1382(f) is amended by striking out "subsection (b)" and inserting in lieu thereof "paragraphs (1) and (2) of subsection (b)".

(5) The heading for section 1383 is amended by striking out the period at the end thereof and inserting "OR NONQUALIFIED PER-UNIT RETAIN CERTIFICATES."

(6) Section 1383(a) is amended—

(A) by striking out "section 1382(b)(2)" and inserting in lieu thereof "section 1382 (b) (2) or (4),",

(B) by striking out "nonqualified written notices of allocation" each place it appears and inserting in lieu thereof "nonqualified written notices of allocation or nonqualified per-unt retain certificates", and

(C) by striking out "qualified written notices of allocation" and inserting in lieu thereof "qualified written notices of allocation or qualified per-unit retain certificates (as the case may be)".

(7) Section 1383(b)(2) is amended—

(A) by striking out "nonqualified written notice of allocation" and inserting in lieu thereof "nonqualified written notice of allocation or nonqualified per-unit retain certificate",

(B) by striking out "qualified written notice of allocation" and inserting in lieu thereof "qualified written notice of allocation or qualified per-unit retain certificate (as the case may be)",

(C) by striking out "such written notice of allocation" and inserting in lieu thereof "such written notice of allocation or per-unit retain certificate", and

(D) by striking out "section 1382(b)(2)" and inserting in lieu thereof "section 1382 (b)(2) or (4),".

(8) The table of sections for part I of subchapter T of chapter 1 is amended by striking out—

"Sec. 1383. Computation of tax where cooperative redeems nonqualified written notices of allocation."

and inserting in lieu thereof—

"Sec. 1383. Computation of tax where cooperative redeems nonqualified written notices of allocation or nonqualified per-unit retain certificates."

(b) TAX TREATMENT BY PATRONS.—

(1) Section 1385(a) is amended by striking out "and" at the end of paragraph (1), by striking out the period at the end of paragraph (2) and inserting in lieu thereor ", and", and by adding at the end thereof the following new paragraph:

"(3) the amount of any per-unit retain allocation which is paid in qualified per-unit retain certificates and which is received by him during the taxable year from an organization described in section 1381(a)."

(2) The heading for section 1385(c) is amended by striking out "ALLOCATION" and inserting in lieu thereof "ALLOCATION AND CERTAIN NONQUALIFIED PER-UNIT RETAIN CERTIFICATES".

(3) Section 1385(c)(1) is amended to read as follows:

"(1) APPLICATION OF SUBSECTION.—This subsection shall apply to—

"(A) any nonqualified written notice of allocation which—

"(i) was paid as a patronage dividend, or

"(ii) was paid by an organization described in section 1381(a)(1) on a patronage basis with respect to earnings derived from business or sources described in section 1382 (c)(2)(A), and

"(B) any nonqualified per-unit retain certificate which was paid as a per-unit retain allocation."

(4) Section 1385(c)(2) is amended—

(A) by striking out "nonqualified written notice of allocation" and inserting in lieu thereof "nonqualified written notice of allocation or nonqualified per-unit retain certificate", and

(B) by striking out "such written notice of allocation or pre-unit retain certificate". inserting in lieu thereof "such written notice of allocation or per-unit retain certificate".

(5) The table of parts for subchapter T of chapter 1 is amended by striking out—

"Part II. Tax treatment by patrons of paronage dividends."

and inserting in lieu therof—

"Part II. Tax treatment by patrons of patronage dividends and per-unit retain allocations."

(c) DEFINITIONS.—

(1)(A) Section 1388(e)(1) is amended by striking out "allocation)" and inserting in lieu thereof "allocation or a per-unit retain certificate)".

(B) Section 1388(e)(2) is amended by striking out "allocation" and inserting in lieu thereof "allocation or qualified per-unit retain certificate".

(2) Section 1388 is amended by adding at the end thereof the following new subsections:

"(f) PER-UNIT RETAIN ALLOCATION.—For purposes of this subchapter, the term 'per-unit retain allocation' means any allocation, by an organization to which part I of this subchapter applies, other than by payment in money or other property (except per-unit retain certificates) to a patron with respect to products marketed for him, the amount of which is fixed without reference to the net earnings of the organization pursuant to an agreement between the organization and the patron.

"(g) PER-UNIT RETAIN CERTIFICATE.—For purposes of this subchapter, the term 'per-unit retain certificate' means any written notice which discloses to the recipient the stated dollar amount of a per-unit retain allocation to him by the organization.

"(h) QUALIFIED PER-UNIT RETAIN CERTIFICATE.—

"(1) DEFINED.—For purposes of this subchapter, the term 'qualified per-unit retain certificate' means any per-unit retain certificate which the distributee has agreed, in the manner provided in paragraph (2), to take into account at its stated dollar amount as provided in section 1385(a).

"(2) MANNER OF OBTAINING AGREEMENT.—A distributee shall agree to take a per-unit retain certificate into account as provided in paragraph (1) only by—

"(A) making such agreement in writing, or

"(B) obtaining or retaining membership in the organization after—

"(i) such organization has adopted (after the date of the enactment of this subsection) a bylaw providing that membership in the organization constitutes such agreement, and

"(ii) he has received a written notification and copy of such bylaw.

"(3) PERIOD FOR WHICH AGREEMENT IS EFFECTIVE.—

"(A) GENERAL RULE.—Except as provided in subparagraph (B)—

"(i) an agreement described in paragraph (2)(A) shall be an agreement with respect to all products delivered by the distributee to the organization during the taxable year of the organization during which such agreement is made and all subsequent taxable years of the organization; and

"(ii) an agreement described in paragraph (2)(B) shall be an agreement with respect to all products delivered by the distributee to the organization after he received the notification and copy described in paragraph (2)(B)(ii).

"(B) REVOCATION, ETC.—

"(i) Any agreement described in paragraph (2)(A) may be revoked (in writing) by the distributee at any time. Any such revocation shall be effective with respect to products delivered by the distributee on or after the first day of the first taxable year of the organization beginning after the revocation is filed with the organization; except that in the case of a pooling arrangement described in section 1382(e) a revocation made by a distributee shall not be effective as to any products which were delivered to the organization by the distributee before such revocation.

"(ii) Any agreement described in paragraph (2)(B) shall not be effective with respect to any products delivered after the distributee ceases to be a member of the organization or after the bylaws of the organization cease to contain the provision described in paragraph (2)(B)(i).

"(i) NONQUALIFIED PER-UNIT RETAIN CERTIFICATE.—For purposes of this subchapter, the term 'nonqualified per-unit retain certificate' means a per-unit retain certificate which is not described in subsection (h)."

(d) INFORMATION REPORTING.—

(1) AMOUNTS SUBJECT TO REPORTING.—Section 6044(b)(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 after subparagraph (C) the following new subparagraphs:

"(D) the amount of any per-unit retain allocation (as defined in section 1388(f)) which is paid in qualified per-unit retain certificates (as defined in section 1388(h)), and

"(E) any amount described in section 1382(b)(4) (relating to redemption of nonqualified per-unit retain certificates)."

(2) DETERMINATION OF AMOUNT PAID.—

(A) Section 6044(d)(1) is amended by striking out "allocation)" and inserting in lieu thereof "allocation or a qualified per-unit retain certificate)".

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(B) Section 6044(d)(2) is amended by striking out "allocation" and inserting in lieu thereof "allocation or a qualified per-unit retain certificate".

(e) EFFECTIVE DATES.—

(1) The amendments made by subsections (a), (b), and (c) shall apply to per-unit retain allocations made during taxable years of an organization described in section 1381(a) (relating to organizations to which part I of subchapter T of chapter 1 applies) beginning after April 30, 1966, with respect to products delivered during such years.

(2) The amendments made by subsection (d) shall apply with respect to calendar years after 1966.

(f) TRANSITION RULE.—

(1) Except as provided in paragraph (2), a written agreement between a patron and a cooperative association—

(A) which clearly provides that the patron agrees to treat the stated dollar amounts of all per-unit retain certificates issued to him by the association as representing cash distributions which he has, of his own choice, reinvested in the cooperative association,

(B) which is revocable by the patron at any time after the close of the taxable year in which it was made,

(C) which was entered into after October 14, 1965, and before the date of the enactment of this Act, and

(D) which is in effect on the date of the enactment of this Act, and with respect to which a written notice of revocation has not been furnished to the cooperative association,

shall be effective (for the period prescribed in the agreement) for purposes of section 1388(h) of the Internal Revenue Code of 1954 as if entered into, pursuant to such section, after the date of the enactment of this Act.

(2) An agreement described in paragraphs (1)(A) and (C) which was included in a by-law of the cooperative association and which is in effect on the date of the enactment of this Act shall be effective for purposes of section 1388(h) of such Code only for taxable years of the association beginning before May 1, 1967.

SEC. 213. EXCISE TAX RATE ON AMBULANCES AND HEARSES.

(a) CLASSIFICATION AS AUTOMOBILES.—Section 4062 (relating to definitions applicable to the tax on motor vehicles) is amended by adding at the end thereof the following new subsection:

"(b) AMBULANCES, HEARSES, ETC.—For purposes of section 4061(a), a sale of an ambulance, hearse, or combination ambulance-hearse shall be considered to be a sale of an automobile chassis and an automobile body enumerated in subparagraph (B) of section 4061(a)(2)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to articles sold after the date of the enactment of this Act.

SEC. 214. APPLICABILITY OF EXCLUSION FROM INTEREST EQUALIZATION TAX OF CERTAIN LOANS TO ASSURE RAW MATERIALS SOURCES.

(a) EXCEPTION TO EXCLUSION.—Section 4914(d) (relating to loans to assure raw materials sources) is amended by adding at the end thereof the following new paragraph:

"(3) EXCEPTION.—The exclusion from tax provided by paragraph (1) shall not apply in any case where the acquisition of the debt obligation of the foreign corporation is made with an intent to sell, or to offer to sell, any part of such debt obligation to United States persons."

(b) TECHNICAL AMENDMENTS.—(1) Section 4914(j)(1) (relating to loss of entitlement to exclusion in case of certain subsequent transfers) is amended—

(A) by striking out in subparagraph (A) ", or the exclusion provided by subsection (d),", and

(B) by striking out "subsection (d) or (f)" in subparagraph (D) and inserting in lieu thereof "subsection (f)".

(2) Section 4918 (relating to exemption for prior American ownership) is amended by adding at the end thereof the following new subsection:

"(g) CERTAIN DEBT OBLIGATIONS ARISING OUT OF LOANS TO ASSURE RAW MATERIAL SOURCES.—Under regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply to the acquisition by a United States person of any debt obligation to which section 4914(d) applied where the acquisition of the debt obligation by such person is

made with an intent to sell, or to offer to sell, any part of such debt obligation to United States persons. The preceding sentence shall not apply if the tax imposed by section 4911 has applied to any prior acquisition of such debt obligation."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply with respect to acquisitions of debt obligations made after the date of the enactment of this Act.

SEC. 215. EXCLUSION FROM INTEREST EQUALIZATION TAX FOR CERTAIN ACQUISITIONS BY INSURANCE COMPANIES

(a) NEW COMPANIES AND COMPANIES OPERATING IN FORMER LESS DEVELOPED COUNTRIES.—Section 4914(e) (relating to acquisitions by insurance companies doing business in foreign countries) is amended—

(1) by striking out "at the time of the initial designation" in the last sentence of paragraph (2);

(2) by striking out "An" in the first sentence of paragraph (3)(A)(i) and inserting in lieu thereof "Except as provided in clause (iii), an";

(3) by striking out "under this subparagraph" in paragraph (3)(A)(ii) and inserting in lieu thereof "under clause (i)";

(4) by adding after clause (ii) of paragraph (3)(A) the following new clauses:

"(iii) INITIAL DESIGNATION AFTER OCTOBER 2, 1964.—An insurance company which was not in existence on October 2, 1964, or was otherwise ineligible to establish a fund (or funds) of assets described in paragraph (2) by making an initial designation under clause (i) on or before such date, may establish (and thereafter currently maintain) such fund (or funds) of assets at any time after the enactment of this clause by designating stock of a foreign issuer or a debt obligation of a foreign obligor as a part of such fund in accordance with the provisions of clause (iv) (if applicable) and subparagraph (B)(i).

"(iv) FUNDS INVOLVING CURRENCIES OF FORMER LESS DEVELOPED COUNTRIES.—An insurance company desiring to establish a fund under clause (iii) with respect to insurance contracts payable in the currency of a country designated as a less developed country on October 2, 1964, which thereafter has such designation terminated by an Executive order issued under section 4916(b), shall designate as assets of such fund, to the extent permitted by subparagraph (E), the stock of foreign issuers or debt obligations of foreign obligors as follows: First, stock and debt obligations having a period remaining to maturity of at least 1 year (other than stock or a debt obligation described in section 4916(a)) acquired before July 19, 1963, and owned by the company on the date which the President, in accordance with section 4916(b), communicates to Congress his intention to terminate the status of such country as a less developed country; second, stock and debt obligations having a period remaining to maturity of at least 1 year described in section 4916(a) (and owned by the company on the date of such termination) which, at the time of acquisition, qualified for the exclusion provided in such section because of the status of such country as a less developed country; and third, such stock or debt obligations as the company may elect to designate under subparagraph (B)(i). The period remaining to maturity referred to in the preceding sentence shall be determined as of the date of the President's communication to Congress.";

(5) by striking out "TO MAINTAIN FUND" in the heading of paragraph (3)(B);

(6) by striking out "as provided in subparagraph (A)(ii)" in paragraph (3)(B)(i) and inserting in lieu thereof "under subparagraphs (A) (i) and (ii)";

(7) by inserting before the period at the end of the first sentence of paragraph (3)(C) the following: "; except that, with respect to a fund established under subparagraph (A)(iii), stock or debt obligations acquired before the establishment of such fund may not be designated as part of such fund under this subparagraph";

(8) by striking out "subparagraph (B)," in paragraph (3)(E)(i) and inserting in lieu there of "subparagraph (A)(iv), (B),";

(9) by striking out "subparagraph (A)" in paragraph (4)(B)(i) and inserting in lieu thereof "subparagraph (A)(i)";

(10) by striking out "paragraph (3)(A)" in paragraph (4)(B)(ii) and inserting in lieu thereof "paragraph (3)(A)(i)"; and

(11) by adding at the end of paragraph (4) the following new paragraph:

"(C) SPECIAL RULE.—For purposes of subparagraph (A), if a country designated as a less developed country on September 2, 1964, thereafter has such designation terminated by an Executive order issued under section 4916(b), all insurance contracts payable in the currency of such country which were entered into before such designation was terminated shall be treated as insurance contracts payable in the currency of a country other than a less developed country."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall take effect on the day after the date of the enactment of this Act.

SEC. 216. EXCLUSION FROM INTEREST EQUALIZATION TAX OF CERTAIN ACQUISITIONS BY FOREIGN BRANCHES OF DOMESTIC BANKS.

(a) AUTHORITY FOR MODIFICATION OF EXECUTIVE ORDERS.—Section 4931(a) (relating to commercial bank loans) is amended by adding at the end thereof the following new sentence: "Clause (A) of the preceding sentence shall not prevent a modification of such Executive order (or any modification thereof) to exclude from the application of subsection (b) acquisitions by commercial banks, through branches located outside the United States, of debt obligations of foreign obligors payable in currency of the United States."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to acquisitions of debt obligations made after the date of enactment of this Act.

TITLE III—PRESIDENTIAL ELECTION CAMPAIGN FUND ACT

SEC. 301. SHORT TITLE.

This title may be cited as the "Presidential Election Campaign Fund Act of 1966".

SEC. 302. AUTHORITY FOR DESIGNATION OF $1 OF INCOME TAX PAYMENTS TO PRESIDENTIAL ELECTION CAMPAIGN FUND.

(a) Subchapter A of chapter 61 of the Internal Revenue Code of 1954 (relating to returns and records) is amended by adding at the end thereof the following new part:

"PART VIII—DESIGNATION OF INCOME TAX PAYMENTS TO PRESIDENTIAL ELECTION CAMPAIGN FUND

"Sec. 6096. Designation by individuals.

"SEC. 6096. DESIGNATION BY INDIVIDUALS.

"(a) IN GENERAL.—Every individual (other than a nonresident alien) whose income tax liability for any taxable year is $1 or more may designate that $1 shall be paid into the Presidential Election Campaign Fund established by section 303 of the Presidential Election Campaign Fund Act of 1966.

"(b) INCOME TAX LIABILITY.—For purposes of subsection (a), the income tax liability of an individual for any taxable year is the amount of the tax imposed by chapter 1 on such individual for such taxable year (as shown on his return), reduced by the sum of the credits (as shown in his return) allowable under sections 32(2), 33, 35, 37, and 38.

"(c) MANNER AND TIME OF DESIGNATION.—A designation under subsection (a) may be made with respect to any taxable year, in such manner as the Secretary or his delegate may prescribe by regulations—

"(1) at the time of filing the return of the tax imposed by chapter 1 for such taxable year, or

"(2) at any other time (after the time of filing the return of the tax imposed by chapter 1 for such taxable year) specified in regulations prescribed by the Secretary or his delegate."

(b) The table of parts for subchapter A of chapter 61 of such Code is amended by adding at the end thereof the following new item:

"Part VIII. Designation of income tax payments to Presidential Election Campaign Fund."

(c) The amendments made by this section shall apply with respect to income tax liability for taxable years beginning after December 31, 1966.

SEC. 303. PRESIDENTIAL ELECTION CAMPAIGN FUND.

(a) ESTABLISHMENT.—There is hereby established on the books of the Treasury of the United States a special fund to be known as the "Presidential Election Campaign Fund" (hereafter in this section referred to as the "Fund"). The Fund shall consist of amounts transferred to it as provided in this section.

(b) TRANSFERS TO THE FUND.—The Secretary of the Treasury shall, from time to time, transfer to the Fund an amount equal to the sum of the amounts designated by individuals under section 6096 of the Internal Revenue Code of 1954 for payment into the Fund.

(c) PAYMENTS FROM FUND.—

(1) IN GENERAL.—The Secretary of the Treasury shall, with respect to each presidential campaign, pay out of the Fund, as authorized by appropriation Acts, into the treasury of each political party which has complied with the provisions of paragraph (3) an amount (subject to the limitation in paragraph (3)(B)) determined under paragraph (2).

(2) DETERMINATION OF AMOUNTS.—

(A) Each political party whose candidate for President at the preceding presidential election received 10,000,000 or more popular votes as the candidate of such political party shall be entitled to payments under paragraph (1) with respect to a presidential campaign equal to—

(i) $1 multiplied by the total number of popular votes cast in the preceding presidential election for candidates of political parties whose candidates received 10,000,000 or more popular votes as the candidates of such political parties, divided by

(ii) the number of political parties whose candidates in the preceding presidential election received 10,000,000 or more popular votes as the candidates of such political parties.

(B) Each political party whose candidate for President at the preceding presidential election received more than 1,500,000, but less than 10,000,000, popular votes as the candidate of such political party shall be entitled to payments under paragraph (1) with respect to a presidential campaign equal to $1 multiplied by the number of popular votes in excess of 1,500,000 received by such candidate as the candidate of such political party in the preceding presidential election.

(C) Payments under paragraph (1) shall be made with respect to each presidential campaign at such times as the Secretary of the Treasury may prescribe by regulations, except that no payment with respect to any presidential campaign shall be made before September 1 of the year of the presidential election with respect to which such campaign is conducted. If at the time so prescribed for any such payments, the moneys in the Fund are insufficient for the Secretary to pay into the treasury of each political party which is entitled to a payment under paragraph (1) the amount to which such party is entitled, the payment to all such parties at such time shall be reduced pro rata, and the amounts not paid at such time shall be paid when there are sufficient moneys in the Fund.

(3) LIMITATIONS.—

(A) No payment shall be made under paragraph (1) into the treasury of a poltical party with respect to any presidential campaign unless the treasurer of such party has certified to the Comptroller General the total amount spent or incurred (prior to the date of the certification) by such party in carrying on such presidential campaign, and has furnished such records and other information as may be requested by the Comptroller General.

(B) No payment shall be made under paragraph (1) into the treasury of a poltical party with respect to any presidential campaign in an amount which, when added to previous payments made to such party, exceeds the amount spent or incurred by such party in carrying on such presidential campaign.

(4) The Comptroller General shall certify to the Secretary of the Treasury the amounts payable to any political party under paragraph (1). The Comptroller General's determination as to the popular vote received by any candidate of any political party shall be final and not subject to review. The Comptroller General is authorized to prescribe such rules and regulations, and to conduct such examinations and investigations, as he determines necessary to carry out his duties and functions under this subsection.

(5) DEFINITIONS.—For purposes of this subsection—

(A) The term "political party" means any political party which presents a candidate for election to the office of President of the United States.

(B) The term "presidential campaign"

means the political campaign held every fourth year for the election of presidential and vice presidential electors.

(C) The term "presidential election" means the election of presidential electors.

(d) TRANSFERS TO GENERAL FUND.—If, after any presidential campaign and after all political parties which are entitled to payments under subsection (c) with respect to such presidential campaign have been paid the amounts to which they are entitled under subsection (c), there are moneys remaining in the Fund, the Secretary of the Treasury shall transfer the moneys so remaining to the general fund of the Treasury.

"SEC. 304. ESTABLISHMENT OF ADVISORY BOARD.

(a) There is hereby established an advisory board to be known as the Presidential Election Campaign Fund Advisory Board (hereafter in this section referred to as the "Board"). It shall be the duty and function of the Board to counsel and assist the Comptroller General in the performance of the duties imposed on him under section 303 of this Act.

(b) The Board shall be composed of two members representing each political party whose candidate for President at the last presidential election received 10,000,000 or more popular votes as the candidate of such political party, which members shall be appointed by the Comptroller General from recommendations submitted by each such political party, and of three additional members selected by the members so appointed by the Comptroller General. The term of the first members of the Board shall expire on the 60th day after the date of the first presidential election following the date of the enactment of this Act and the term of subsequent members of the Board shall begin on the 61st day after the date of a presidential election and expire on the 60th day following the date of the subsequent presidential election. The Board shall elect a Chairman from among its members.

(c) Members of the Board shall receive compensation at the rate of $75 a day for each day they are engaged in performing duties and functions as such members, including travel time, and, while away from their homes or regular places of business, shall be allowed travel expenses, including per diem in lieu of subsistence, as authorized by law for persons in the Government service employed intermittently.

(d) Service by an individual as a member of the Board shall not, for purposes of any other law of the United States, be considered as service as an officer or employee of the United States.

SEC. 305. APPROPRIATIONS AUTHORIZED.

There are authorized to be appropriated, out of the Presidential Elections Campaign Fund, such sums as may be necessary to enable the Secretary of the Treasury to make payments under section 303 of this Act.

TITLE IV—MISCELLANEOUS PROVISIONS

SEC. 401. TREASURY NOTES PAYABLE IN FOREIGN CURRENCY.

Section 16 of the Second Liberty Bond Act, as amended (31 U.S.C. 766), is amended by striking out "bonds" wherever it appears therein and inserting in lieu thereof "bonds, notes,".

SEC. 402. REPORTS TO CLARIFY TO NATIONAL DEBT AND TAX STRUCTURE.

The Secretary of the Treasury shall, on or before March 31 of each year (beginning with 1967), submit to the Senate and the House of Representatives a report setting forth, as of the close of December 31 of the preceding year, the aggregate and individual amounts of the contingent liabilities and the unfunded liabilities of the Government, and of each department, agency, and instrumentality, thereof, including, without limitation, trust fund liabilities, Government-sponsored corporations' liabilities, indirect liabilities not included as a part of the public debt, and liabilities of insurance and annuity programs, including their actuarial status on both a balance sheet and projected source and application of funds basis. The report shall also set forth the collateral pledged, or the assets available (or to be realized), as security for such liabilities (Government securities to be separately noted), and an analysis of their significance in terms of past experience and probable risk, and shall also set forth all other assets available to liquidate liabilities of the Government. The report shall set forth the required data in a concise form, with such explanatory material as the Secretary may determine to be necessary or desirable, and shall include total

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amounts of each category according to the department, agency, or instrumentality involved.

SEC. 403. COVERAGE OF EXPENSES OF CERTAIN DRUGS UNDER SUPPLEMENTARY MEDICAL INSURANCE BENEFITS.

(a) Section 1832(a) of the Social Security Act is amended (1) by striking out "and" at the end of paragraph (1), (2) by striking out the period at the end of paragraph (2) and inserting in lieu thereof "; and", and (3) by adding at the end thereof the following new paragraph:

"(3) entitlement to be paid for allowable expenses (as defined in section 1845(a)(2)), or, if lower, actual expenses, incurred by him for the purchase of qualified drugs (as defined in subsection (a)(1) of such section)."

(b) Section 1833(a) of such Act is amended (1) by inserting "or qualified drugs" after "incurs expenses for services", (2) by striking out the period at the end of paragraph (2) and inserting in lieu thereof "; and", and (3) by adding at the end thereof the following new paragraph:

"(3) in the case of expenses covered under section 1832(a)(3)—100 per centum of such expenses."

(c) Section 1833(b) of such Act is amended by adding at the end thereof the following new sentence: "For purposes of determining amounts to be counted toward meeting the $50 deductible imposed by the preceding sentence, there shall not be included any expenses incurred for any drug or biological which is in excess of the allowable expenses (as defined in section 1845(a)(2)) of such drug or biological."

(d) Part B of title XVIII of such Act is amended by adding at the end thereof the following new sections:

"ALLOWABLE EXPENSES FOR QUALIFIED DRUGS

"SEC. 1845. (a) For purposes of this part—

"(1) The term 'qualified drug' means a drug or biological which is included among the items approved by the Formulary Committee (established pursuant to section 1846(a)).

"(2) The term 'allowable expense', when

used in connection with any quantity of a qualified drug, means the amount established with regard to such quantity of such drug by the Formulary Committee and approved by the Secretary.

"(b) Amounts to which an individual is entitled by reason of the provisions of section 1832(a)(3) shall be paid directly to such individual or, if such individual has assigned his right to receive any such amount to another person, the amount so assigned shall be paid to such other person. No individual shall be paid any amount by reason of the provisions of section 1832(a)(3) prior to the presentation by him (or by another on his behalf) of documentary or other proof satisfactory to the Secretary establishing his entitlement thereto.

"(c) The benefits provided by reason of section 1832(a)(3) may be paid by the Secretary or the Secretary may utilize the service of carriers for the administration of such benefits under contracts entered into between the Secretary and such carriers for such purpose. To the extent determined by the Secretary to be appropriate, the provisions relating to contracts entered into pursuant to section 1842 shall be applicable to contracts entered into pursuant to this subsection.

"FORMULARY COMMITTEE

"SEC. 1846. (a) There is hereby established a Formulary Committee to consist of the Surgeon General of the Public Health Service, the Commissioner of the Food and Drug Administration, and the Director of the National Institutes of Health.

"(b)(1) It shall be the duty of the Formulary Committee, with the advice and assistance of the Formulary Advisory Group (established pursuant to section 1847) to—

"(A) determine which drugs and biologicals shall constitute qualified drugs for purposes of the benefits provided under section 1832(a); and

"(B) determine, with the approval of the Secretary, the allowable expense, for purposes of such benefits, of the various quantities of any drug determined by the Committee to constitute a qualified drug; and

"(C) publish and disseminate at least once each calendar year among individuals insured under this part, physicians, pharmacists, and other interested persons, in accordance with directives of the Secretary, an alphabetic list naming each drug or biological (by its generic name and by each other name by which it is known) which is a qualified drug together with the allowable expense of various quantities thereof, and if any such drug or biological is known by a trade name, the generic name shall also appear with such trade name.

"(2)(A) Until the Formulary Committee determines to the contrary, any drug or biological which is included in the United States Public Health Service Formulary shall be regarded as a qualified drug for purposes of the benefits provided under section 1832(a)(3). Drugs or biologicals not included in such Formulary shall be regarded as qualified drugs for such purposes upon determination of the Formulary Committee that such drugs or biologicals should be so regarded. Any drug or biological included on the list of qualified drugs shall, if listed by generic name, also be listed by its trade name or names, if any.

"(B) Drugs and biologicals shall be determined to be qualified drugs only if they can legally be obtained by the user pursuant to a prescription of a physician; except that the Formulary Committee may include certain drugs and biologicals not requiring such a prescription if it determines such drugs or biologicals to be of a lifesaving nature.

"(C) In the interest of orderly, economical, and equitable administration of the benefits provided under section 1832(a)(3), the Formulary Committee may, by regulation, provide that a drug or biological otherwise regarded as being a qualified drug shall not be so regarded when prescribed below certain minimum quantities.

"(3) In determining the allowable expense for any quantity of any qualified drug, the Formulary Committee shall give due consideration to recognized pricing guides for drugs, and of other pertinent factors, with a view to determining with respect to each qualified drug a schedule of prices for various quantities thereof which reflects the cost thereof to the ultimate dispenser of the drug plus a reasonable fee for the preparation, handling, and distribution thereof to the consumer thereof. In any case in which a drug or biological is available by generic name and one or more trade names any one of which is different from such generic name the cost of such drug or biological, for purposes of the preceding sentence, shall be deemed to be the lowest cost of such drug, however named."

"ADVISORY GROUP TO FORMULARY COMMITTEE

"SEC. 1847. (a) For the purpose of assisting the Formulary Committee to carry out its duties and functions, the Secretary shall appoint an Advisory Group to the Formulary Committee (hereinafter in this section referred to as the 'Advisory Group'). The Advisory Group shall consist of seven members to be appointed by the Secretary. From time to time, the Secretary shall designate one of the members of the Advisory Group to serve as Chairman thereof. The members shall be so selected that each represents one or more of the following national organizations; an organization of physicians, an organization of manufacturers of drugs, an organization of pharmacists, an organization of persons concerned with public health, an organization of hospital pharmacists, an organization of colleges of medicine, an organization of colleges of pharmacy, and an organization of consumers. Each member shall hold office for a term of three years, except that any member appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed for the remainder of such term, and except that the terms of office of six of the members first taking office shall expire, as designated by the Secretary at the time of appointment, two at the end of the first year, two at the end of the second year, and two at the end of the third year, after the date of appointment. A member shall not be eligible to serve continuously for more than two terms.

"(b) Members of the Advisory Group, while attending meetings or conferences therof or otherwise serving on business of the Advisory Group, shall be entitled to receive compensation at rates to be fixed by the Secretary, but not exceeding $75 per day, including traveltime, and while so serving away from their homes or regular places of business they may be allowed travel expenses, including per diem in lieu of subsistence, as authorized by section 3109 of title 5, United States Code, for persons in the Government service employed intermittently.

"(c) The Advisory Group is authorized to engage such technical assistance as may be required to carry out its functions, and the Secretary shall, in addition, make available to the Advisory Group such secretarial, clerical, and other assistance and such pertinent data obtained and prepared by the Department of Health, Education, and Welfare as the Advisory Group may require to carry out its functions."

(e) The amendments made by this section shall become effective on whichever of the following first occurs: (1) the first day of the month with respect to which the rate of the monthly premium for participation is raised, pursuant to section 1839(b) of the Social Security Act, after the date of enactment of this Act, or (2) July 1, 1968.

Mr. LONG of Louisiana. Mr. President, H.R. 13103 has four titles. The provisions in the first title, which make up most of the bill, revise the tax code to provide more equitable tax treatment by the United States of nonresident alien individuals and foreign corporations. The third title, which, in my view, is the most important part of the bill, establishes a presidential election campaign fund. The second and fourth titles of the bill contain a number of other provisions relating to the income tax code, medicare, and certain other matters.

Before I discuss the bill generally, I would like to point out that the provisions in titles, 2, 3, and 4 of this bill were added by the Finance Committee. As chairman of the committee, I am well aware that the Constitution provides that revenue measures must originate in the House. I do not believe, however, that this constitutional provision was intended to prevent Senators from bringing important matters before the Congress when it is clear they would not otherwise be considered. The amendments added by the Finance Committee are important, in my judgment. Furthermore, it is clear that, in most cases, there would not be an opportunity for the House to consider them in this session of Congress.

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PRESIDENTIAL ELECTION CAMPAIGN FUND ACT

For example, one of the most pressing problems facing our democracy is that of insuring that a favored few do not exert undue influence over the operations of Government at the expense of the interests of the public at large. In this regard, one of the most vulnerable aspects of the political process is the manner in which we finance political campaigns. As the Senators well know, a campaign for a major national office, particularly a campaign for the Presidency, is very expensive and cannot be financed today without the aid of welathy contributors willing to make large contributions. While in some cases these contributors seek no improper reward for their generosity, nevertheless, the opportunity remains. In other cases, frankly, it is almost impossible to distinguish between a campaign contribution and a bribe. The only way to remove this possible impediment to good government—the only way to make the one-man, one-vote principle a reality—is to broaden the base from which contributions are drawn.

The President recognizes this problem. In May, he sent a special message to the Congress outlining his proposals. Members of the Senate are aware of this problem; a number have introduced legislation dealing with it. The Finance Committee is concerned with this problem. We held hearings on various proposals advanced to deal with it in August and, as a result of these hearings and further deliberations, approved a very important proposal in this area. This proposal is, in my opinion, so important that it should be considered now.

EXPLANATION OF THE PROPOSAL

Under this proposal—the Presidential Election Campaign Fund Act, title III of the bill before us—each individual taxpayer will be able to designate on his tax return that $1 of his taxes be appropriated to a special fund. The fund will be used to defray the campaign expenses incurred in presidential elections by political parties that received a significant portion of the total vote cast.

The two major parties will receive equal amounts, determined by dividing the total vote cast for the major party candidates in the last presidential election by two. On this basis, then, each major party will receive up to roughly $37 million.

Minor parties—those whose candidates received 1,500,000 votes or more in the last presidential election, will receive $1 for every vote over 1,500,000 that their candidate receives.

These payments are to be subject to this important limitation: They cannot exceed the expenses actually incurred in the presidential campaign. Expenses will only be reimbursed, of course, if they are incurred for political purposes. Personal expenses will not be reimbursed. Furthermore, the expenses must be incurred predominantly for the purpose of furthering the candidacy of the presidential and vice-presidential nominees. The expenses incurred by these nominees predominantly to support candidates for other offices will not be reimbursed. This rule will not preclude the presidential candidate from endorsing other candidates as long as the primary purpose for his appearance is to further his own candidacy. Finally, expenses will not be reimbursed unless sufficient proof that they were actually made is supplied. The Comptroller General is charged with the responsibility for establishing the amount of expenditures which can be reimbursed.

The 1,500,000 vote restriction is necessary to avoid the proliferation of small parties interested more in publicity at public expense than in seriously offering a candidate for President. The level is low enough, however, to insure that any party which once gained significant voter support would come under the act and, if it kept this support, stay under it. Even minor party candidates would be able to refuse contributions offered on a strings-attached basis. Once a party gained 10 million or more votes in a presidential election, it would qualify as a major party and share equally with the other major parties in the major party funds made available in the next presidential election.

THE PLAN IS SUPERIOR TO A TAX DEDUCTION SCHEME

While this plan may seem novel, thoughtful consideration will show that it has many advantages over a tax deduction scheme of the type proposed by the President and several Senators, including the ranking member of the minority on the Finance Committee, the Senator from Delaware. In the first place, it would be more equitable. Every tax deduction scheme suffers from the disadvantage that it gives the rich taxpayer a larger tax saving than the poor taxpayer. For example, the President proposed a tax deduction of up to $100. The taxpayer in the highest income bracket would receive a tax saving of $70 by contributing $100 under this scheme, while the taxpayer in the bottom bracket would receive a tax saving of only $14.

I want to add, Mr. President, that you cannot gain much by making the deduction available in addition to the standard deduction. That might put standard deduction taxpayers and itemized deduction taxpayers on a par, but, as I have explained, it will not put high and low bracket taxpayers on a par. In fact, it would create more problems. By placing political contributions on a better footing than charitable contributions, it would put politicians in a more favorable category than the Almighty.

The equity consideration points out a second shortcoming in the tax deduction plan. We want to provide an incentive for low- and middle-income people to provide campaign funds, but the tax deduction plan would provide the greatest incentive to high income people. I submit that the high income people do not need any incentive. They are the ones who do the campaign financing now.

In the third place, the funds provided by the committee-approved plan would clearly be adequate to finance a presidential campaign. Thus, we would be assured that there would be no reason why a few large contributors should ever be given an opportunity to establish a basis for exerting undue influence on the President. The tax deduction plans, on the other hand, cover contributions to campaigns at all levels of government. Thus diluted, the effect of the plan is probably not strong enough to eliminate the need for large contributions in any single campaign.

And this brings up another point. If we were to approve a tax deduction for campaign contributions, we would have to authorize the Internal Revenue Service to check to make sure that the money was actually contributed and that it was actually used for political purposes. We would have to give the Internal Revenue Service the go-ahead, in other words, to investigate the political activity of every voter and the conduct of every election, Federal, State, and local. Frankly, Mr. President, I do not think we want to risk violating the sanctity of the ballot this way.

The committee plan would, of course, have an effect on other political campaigns. Since the presidential campaigns would be entirely or largely paid for through the fund, more money would be available from private contributors for campaigns for the Senate, for the House, and for State and local offices. The greater availability of funds would make it easier for a candidate to decline a contribution to which strings were attached. Moreover, if this plan works as well as I think it will, we may wish to consider extending it to cover other Federal election campaigns. It seems to me, however, that the financing of campaigns for State and local government offices is a matter which should be left to State and local governments. If we consider the Federal Government to be beyond the undue influences which occur in financing campaigns, then it would seem that State and local governments should be able to arrange their own problems.

I think it is fitting that the plan should be applied to presidential elections, at least at first, since it is most important to avoid the exercise of undue influence over the Presidency. The President influences the quality of government at all levels by, for example, the way he exercises the veto, by the nature of the legislation he introduces, by the nature of the appointments he makes, and by the way he oversees the execution of the laws passed by Congress. Congress, as I have said before, cannot get into any real mischief unless somebody in the executive branch is a party to it.

I have heard it said that this provision would not reduce the pressure for large contributions but will merely provide additional funds. I do not understand this position. It is clear to me that if the Republican and Democratic Parties are each assured of some $37 million for their next presidential campaign, they will not find it necessary to spend so much time and energy soliciting large

contributions. Nor will contributors be as likely to contribute large sums when they know that the parties already have substantial financial backing. Furthermore, this bill does not have to be the

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last word as far as presidential election campaign financing goes. It can be supplemented by laws controlling the maximum size of individual contributions—laws that have teeth in them. Such laws are difficult to pass now, however, because no alternative source of financing is available. This bill will break the chain which now binds us to the present system of campaign financing. Once we provide an alternative source of financing, laws regulating individual contributions can be tightened up.

Mr. President, I am convinced that no other bill has been voted by this committee or any other committee which would do so much to prevent the exercise of improper influence on government. That is why I consider this provision the most important title in this bill.

Mr. LAUSCHE. Mr. President, will the Senator from Louisiana yield at that point?

Mr. LONG of Louisiana. I yield.

Mr. LAUSCHE. How many taxpayers are there, as the records show?

Mr. LONG of Louisiana. Approximately 65 million returns are filed annually.

Mr. LAUSCHE. And each one would be required to pay $1?

Mr. LONG of Louisiana. Each person filing a return would be permitted to designate $1 and if a husband and wife filed a joint return they would jointly designate $2. In other words, each tax return would contain a box to be checked if the taxpayer wished to designate that $1 of tax revenues is to be paid into this election fund.

Mr. LAUSCHE. It would not be mandatory to contribute the $1; only optional?

Mr. LONG of Louisiana. It would be optional. If a taxpayer wished to designate $1 to financing both major parties equally he could. In effect he would be authorizing 50 cents to be allocated to the Republican candidate and 50 cents to the Democratic candidate, so that both sides would be adequately financed.

Mr. LAUSCHE. A party, if and when it attains 10 million votes in a general election, would be recognized as a major party and would be permitted to participate equally with the other major parties in the distribution of the funds.

Mr. LONG of Louisiana. Yes.

Mr. LAUSCHE. There are now, of course, only two major parties, so that the amount would be divided equally on a 50-percent basis; is that not correct?

Mr. LONG of Louisiana. Yes.

Mr. LAUSCHE. Will the party, or a presidential candidate, in addition to the $37 million which would go to the campaign fund, if the bill is adopted, be permitted to develop a private campaign fund to be used for campaign purposes?

Mr. LONG of Louisiana. We did not pass on that question. Of course, the Senator realizes that we really do not have jurisdiction over such a proposal, unless we claimed that because we are amending tax legislation, we do.

If the proposal becomes law, it would set the stage for passing a law to state that no private contributions could be accepted. But we do not attempt to answer that question here in this bill. It does not preclude an individual private contribution which could be made to the candidate. However, with an estimated $37 million available to each side, then Congress might very well want another law passed to say that no private contributions can be accepted. But, we do not try to answer that here.

Mr. LAUSCHE. It is my understanding, on the basis of what the Senator from Louisiana has said, that adoption of the pending bill, in and of itself, will not prohibit a candidate for the Presidency, after his campaign committee has received its share from the Federal Government, to solicit other contributions.

Mr. LONG of Louisiana. That is correct; but it would seem reasonable to believe that if the funds provided by this amendment were available there would be much less financing pressure. In the event a candidate running for President spent $50 million, let us say, it would still take the pressure off him to accept contributions which might have strings attached to them if he had received $37 million from this special fund to finance his campaign.

Mr. LAUSCHE. In other words, the only purpose of my inquiring is to get clearly in my mind the status of a candidate for the Presidency, that in addition to the receipt of moneys which would come from the bill, he could obtain further moneys to promote his campaign; and the answer to that question is yes, unless we adopt additional legislation at a later time to prohibit it; is that not correct?

Mr. LONG of Louisiana. The answer to that question is "Yes." But let me say that if Congress sees fit to enact this bill, it will undoubtedly want to think about it next year and provide a number of companion bills to go with it.

For example, we might wish to enact a fraud statute for anyone who collects money and falsifies his expense account. Also, we have had our staff prepare an amendment, which could be passed, which would make absolutely clear that none of this money would be used indirectly to help in a senatorial or a congressional campaign. Therefore, it would be crystal clear that this a presidential campaign proposal only and not a proposal to be used in campaigns for Members of Congress.

Mr. LAUSCHE. What prohibition, if at all, is contained in the bill against a candidate for the Presidency using these funds to promote the candidacy, let us say, of a Governor, or a Lieutenant Governor, or a Representative or Senator?

Mr. LONG of Louisiana. We feel that the bill as reported contains such a prohibition, that is, the presidential election campaign fund could not be used for expenses of candidates running for offices other than President and Vice President. For example, a presidential candidate cannot spend money for a television program on a candidate running for Governor.

Mr. LAUSCHE. That is, he incidentally may do that. It is not primarily for himself, but he feels he should help other candidates?

Mr. LONG of Louisiana. The test would be wether the television program or even the appearance of a presidential candidate was or was not really in his own behalf. If it was not in his own behalf, then he would be subject to receiving no disbursement from the fund.

Mr. LAUSCHE. That is, even though a goodly part of the program dealt with promoting other candidates, if the predominant part was for himself, he would be within the law?

Mr. LONG of Louisiana. If the Senator feels that the language in the bill in this regard is not tight enough, we have an amendment drawn that would make this intention clear, but I believe the language already in the bill is sufficient.

Mr. LAUSCHE. Would not there likely develop a situation where the funds solicited by the party would fall into what the Senator would call the dangerous status of present conditions, of running campaigns that would continue to have those funds used to promote senatorial and House candidates, and in a measure to promote State candidates? That fund would remain intact, to be used by them, and this fund would be used for the Presidency. Is that correct?

Mr. LONG of Louisiana. Naturally, a party will try to help finance its own senatorial, congressional, and gubernatorial candidates. Some of us who have worried about campaign financing because of the competition with presidential campaign financing. If this bill is adopted a citizen would be free to concentrate his financial support candidates in campaigns for election such as mayors, Governors, and Members of Congress.

Recently, I went to Houston, Tex., to attend a gathering of the President's Club, of which I am very proud to be a member. Each person paid $1,000 to attend a lovely dinner in honor of the President. The revenue was used to help pay off the deficit created by the last presidential campaign. When I looked around at some of the people attending that dinner who came from Louisiana, I saw some of my best potential contributors there. Some of them had their wives with them, which meant that they had to contribute $2,000.

If those contributors were not asked to contribute to presidential campaigns they would be good prospects as contributors to other campaigns. Therefore, we might be able to adequately finance congressional campaigns.

Mr. LAUSCHE. Yes; but while the passage of the Senator's recommendation might alleviate pressure that exists in the solicitation of funds, it would not guarantee an elimination of that pressure. Am I correct?

Mr. LONG of Louisiana. The Senator is correct, but it would help.

Mr. LAUSCHE. Mr. President, will the Senator yield further?

Mr. LONG of Louisiana. I yield.

Mr. LAUSCHE. I want to make the observation that, tragically, in our country, the psychology has developed that the only way one can successfully conduct a campaign is to get wagonloads of money. I have never subscribed to that philosophy, and I am rather proud to say that I was elected Governor of

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my State five times and Senator twice, and never spent more than $50,000 in getting into office, in a State of 10 million people.

Mr. LONG of Louisiana. I am very glad that the Senator was elected without spending more than $50,000.

Mr. LAUSCHE. I was elected because I was able to say that gold was not buying the election for me.

Mr. LONG of Louisiana. I have been associated with many campaigns and I have seen campaigns that cost a great deal of money.

I regret to say that in Louisiana it costs much more than the amount the Senator mentioned for a successful candidate.

I salute the Senator from Ohio. He was a great Governor of his State and he is a great Senator. I only wish we could elect Governors in Louisiana without having to raise more than $50,000, but we have not had that good fortune.

Mr. President, I should like to continue with the remainder of my discussion of the bill.

The PRESIDING OFFICER. Does the Senator wish to have the committee amendment adopted?

Mr. LONG of Louisiana. The committee amendment will remain subject to amendment. It is one amendment. Senators will be able to offer amendments to the committee amendment. I do not care to ask that it be agreed to at this moment.

I wish to continue with my statement.

THE FOREIGN INVESTORS TAX ACT

Mr. President, the first title of this bill

represents a major revision of the U.S. tax laws as they relate to the treatment of nonresident alien individuals and foreign corporations. It is the first systematic reappraisal in this area of the tax law that has been undertaken in 25 years. While this title of the bill will have only a slight effect on revenue and will not directly affect U.S. citizens, it represents a carefully considered effort to bring up to date the part of our tax law which has an important bearing on our relations with other countries.

The primary objective of this title of the bill is to establish the equitable tax treatment by this country of nonresident aliens and foreign corporations who come within the jurisdiction of our tax laws. To achieve this objective, your committee and the House Ways and Means Committee have considered all the provisions of present law which affect foreign persons. I shall not attempt to discuss every provision of this title, although I shall ask to insert a summary of them in the RECORD at the close of my remarks. I believe the major provisions of the bill can be grouped under four major headings.

TAXABLE STATUS OF INCOME

The first part of this title deals with the taxable status of income. Undoubtedly, the most important proposal from the standpoint of tax policy is the amendment which separates the U.S. investment income from the U.S. business income of a nonresident alien or foreign corporation and taxes these two types of income on different bases.

Income of a foreigner derived from a U.S. business is to be taxed substantially in the same manner as if the business income were received by a U.S. citizen or a domestic corporation—that is, at the regular individual or corporate rates with all of the appropriate deductions.

On the other hand, investment income of a nonresident alien or foreign corporation, unless it is related to a U.S. business, is to be taxed at a flat rate of 30 percent or a lesser rate applicable where we have treaties with the foreign countries involved.

Your committee believes this method of taxing nonresident aliens and foreign corporations is more equitable and reasonable than the present law which taxes these persons at the regular rates or at a flat 30 percent on their U.S. source income, depending on whether or not they are engaged in trade or business in the United States. In other words, under present law, investment income of a nonresident alien or foreign corporation is taxed at the regular rates, with the attributable deductions, if the receipient is engaged in business in the United States whether or not there is any relationship between the U.S. business and the U.S. investment income.

Attention was also directed to the fact as a result of the interplay between the tax rules of certain foreign countries and the United States, foreign corporations which carry on substantial business activities in the United States, in some cases, have been able to cast their transactions in a form which may avoid all or most United States and foreign taxes on income generated from U.S. business activities. The provisions provided by this legislation will subject certain income generated by the U.S. business activities of these foreign corporations to U.S. tax.

The benchmark used in determining whether or not income is related to a U.S. business and, therefore, taxable at regular rates rather than at the flat 30 percent rate, is whether or not the income is effectively connected with the U.S. business.

In the case of investment and other fixed or determinable income and capital gains from U.S. sources the income is to be treated as effectively connected with the U.S. business if the income is derived from assets used, or held for use, in the conduct of U.S. business or if the activities of the U.S. business were a material factor in the realization of the income. All other types of U.S. source income are to be considered to be effectively connected if there is a U.S. business.

The bill as approved by your committee adopts the general House provisions regarding the taxation of income from sources without the United States. Generally, this type of income will not be treated as effectively connected with a U.S. business and therefore subject to U.S. tax unless the nonresident alien or foreign corporation has a fixed place of business in the United States and the income is attributable to that place of business.

Moreover, even in such cases the only types of foreign source income which may be subject to U.S. tax under the bill are rents or royalties from licensing operations, income from banking and similar type operations, or certain types of sales income. An additional modification provides that neither "Subpart F" income nor dividends, interest or royalties derived from a foreign corporation more than 50 percent owned by the nonresident alien or foreign corporation will be considered effectively connected under any circumstances.

Although your committee adopted the foregoing House provisions regarding the taxation of foreign source income, your committee added certain specifying and clarifying amendments. In general, your committee's amendments provide specific rules regarding what activities of a foreign corporation are to be considered a sufficient connection for assertion of U.S. tax jurisdiction as well as the types and proportion of foreign source income to be subject to U.S. tax. Additionally, your committee amended the foreign tax credit provision of the House bill which ap-

plies with respect to foreign source effectively connected income so as to extend that credit provision to country of residence taxes.

INCOME TAX SOURCE RULES

The bill also proposes an amendment with respect to the taxation of the interest paid to nonresident aliens and foreign corporations on their U.S. bank deposits. Presently this type of interest income is subject to U.S. tax only if the foreign recipient is engaged in trade or business in the United States. Your committee adopted the provision of the House bill which, in effect, subjects all nonresident aliens and foreign corporations to U.S. tax on the interest income derived from their U.S. bank deposits after 1971. Your committee shared the House's concern that an immediate alteration of the present rule might have an adverse effect upon our balance of payments. Consequently, your committee agreed with the House that it is desirable to postpone the effective date of this provision until after 1971 at which time the Congress will have an opportunity to reconsider the then existing balance-of-payments situation. The bill also provides that as long as bank deposit interest is treated as foreign source income, similar types of interest income are to be given the same treatment.

ESTATE TAX PROVISIONS

Another major provision of the House-passed bill which was approved by your committee would modify the U.S. estate taxation of nonresident aliens. Although the U.S. estates of nonresident aliens are presently subject to the same estate tax rates as citizens or residents, the deductions, exemptions, and credit available to them are substantially less than those allowed to citizens or residents of the United States. Therefore, the estate of a nonresident alien frequently pays a heavier tax on its U.S. assets—and, in some instances, a much heavier tax—than would be true in the case of a similar estate of a U.S. citizen or resident. In an effort to more closely equate the taxation of the U.S. estates of nonresident aliens with the estates of U.S. citizens or residents, the bill establishes a

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new scale of graduated estate tax rates applicable to nonresident aliens, which would tax those estates in an amount which would be generally equivalent to the tax imposed upon an estate of similar value of a U.S. citizen entitled to a marital deduction. Also, the bill would raise the estate tax exemption of nonresident aliens from $2,000 to $30,000.

Mr. LAUSCHE. Mr. President, will the Senator yield?

Mr. LONG of Louisiana. I yield.

Mr. LAUSCHE. Will the Senator define the term "nonresident alien"?

Mr. LONG of Louisiana. That would be a person who is not a citizen of the United States and does not reside here.

The present estate tax rule, which excludes deposits in U.S. banks from the gross U.S. estate of a nonresident alien, was amended by the House bill so as to immediately include these assets in the taxable estates of such persons. In view of the fact that the provision dealing with the income taxation of the interest derived by nonresident aliens is not effective until 1972, your committee considered it appropriate to amend the House bill so as to postpone the effective date of this provision until that same date.

EXPATRIATION PROVISIONS

The bill as passed by the House and approved by your committee provides an amendment which establishes special tax treatment for U.S. citizens who expatriate in order to avoid U.S. taxes.

Your committee agrees with the House that such an amendment is necessary since—although there are undoubtedly few Americans who would avail themselves of such a maneuver—but for this provision, the bill does make such a scheme more advantageous. Therefore, we wish to foreclose the possibility that this bill would serve as an encouragement to such people. The expatriation provisions of the House bill provide that U.S. source income and the effectively connected income of a citizen received within 5 years after expatriation will be taped at the regular U.S. tax rates if a principal purpose of the expatriation was the avoidance of U.S. taxes. Your committee adopted an amendment which would extend the 5-year period in the House bill to 10 years. This was an amendment suggested by the Senator from Delaware [Mr. WILLIAMS], and I believe it is a very good amendment.

OTHER AMENDMENTS TO THE FOREIGN INVESTORS TAX ACT

The remaining amendments regarding the foreign investors tax bill, which I will not discuss in detail, do not in my opinion constitute major changes. In any event, I will ask to include in the RECORD at the conclusion of my remarks a summary of all the changes.

OTHER PROVISIONS

Mr. President, there are a number of other provisions in this bill. Many of them are, I believe, esentially of a technical nature or are relatively minor in importance. I would hope we could agree to them without much discussion.

Mr. President, I ask unanimous consent to insert at this point in the RECORD the summary of the provisions.

There being no objection, the provisions were ordered to be printed in the RECORD, as follows:

SUMMARY OF PROVISIONS

A. THE FOREIGN INVESTORS TAX ACT

1. Interest on deposits in foreign branch

banks of domestic corporations.—Interest on deposits with foreign branch banks of U.S. corporations or partnerships is to be treated as foreign source income, and thus free of U.S. income tax when paid to nonresident aliens and foreign corporations.

2. Source rules for bank deposit interest and similar income.—After December 31, 1971, all interest on U.S. bank deposits (other than those described in No. 1 above), whether or not effectively connected with a U.S. business, is to be treated as U.S. source income (and subject to U.S. income tax) in the case of nonresident aliens and foreign corporations. Until then, this interest on bank deposits, interest paid on accounts with mutual savings banks, domestic building and loan associations, etc., and interest on amounts held by insurance companies on deposit also are to be treated as foreign source income (unless effectively connected with a U.S. business) and thereby free of U.S. income tax.

3. Rules for determining the source of dividends from foreign corporations.—The source rule with respect to dividends paid by foreign corporations is amended to provide that dividends received from a foreign corporation are to be considered as having a U.S. source only if 50 percent (House bill provided an 80-percent rule) of the corporation's gross income for the prior 3 years was effectively connected with the conduct of a trade or business in the United States.

4. Compensation for personal services.—The special source rule, providing that certain payments of compensation for services performed in the United States by a nonresident alien are treated as foreign source income (and therefore free of U.S. tax) if the services are performed for certain foreign persons or a foreign office of a U.S. corporation, is extended to services performed for a foreign office of a proprietor who is a citizen or resident of the United States or for the foreign office of a domestic partnership.

5. Trading in stocks or securities or in commodities.—Except in the case of dealers and certain investment companies, trading in stocks or securities in the United States for one's own account, whether by a foreign investor physically present in the United States, through an employee located here, or through a resident agent (whether or not the agent has discretionary authority) is not to constitute a trade or business in the United States for income tax purposes. A parallel rule is provided for those trading in commodities.

6. Income effectively connected with the conduct of a trade or business in the United States.—The benchmark to be used in determining whether income is to be subject to a flat 30-percent rate or taxed substantially the same as income earned here by a U.S. citizen or domestic corporation is whether or not the income is effectively connected with a U.S. business. In the case of investment and other fixed or determinable income and capital gains from U.S. sources the income is to be treated as effectively connected with a U.S. business if the income is derived from the assets used or held for use in the conduct of a U.S. business or if the activities of the U.S. business are a material factor in the realization of the income. All other types of U.S. source income are to be considered to be effectively connected if there is a U.S. business. Income from sources without the United States will not be treated as effectively connected with a U.S. business unless the nonresident alien or foreign corporation has a fixed place of business in the United States and the income is attributable to that place of business. Moreover, in general only rents and royalties from licensing, certain income from banking and so forth, and sales income are to be taken into account for this purpose and only to the extent the income is not "subpart F" income or income derived from a foreign corporation 50 percent owned by the nonresident alien or foreign corporation receiving the income. Your committee modified the provision of the House bill dealing with "effectively connected" foreign source income to exclude (*a*) income derived from a transaction in which the U.S. office was not a material factor, (*b*) income not derived from the usual business activities of the U.S. office, and (*c*) income not properly allocable to the U.S. office. Additionally, the definition of a U.S. office was redefined to exclude the office of certain agents. In another modification, the foreign tax credit provision was expanded to include domiciliary taxes attributable to the foreign source effectively connected income.

7. Income tax on nonresident alien individuals.—The income of nonresident aliens which is effectively connected with a U.S. business is to be taxed at the regular graduated rates applicable to individuals and all income not so connected is to be taxed at a flat 30-percent rate (or lower applicable treaty rate). U.S. source capital gains of a nonresident alien not engaged in business in the United States are to be taxed only if the alien was in the United States for 183 days or more during the year. Deductions are allowable only to the extent allocable to income which is effectively connected to a U.S. business. Also, an election is provided which allows an alien to treat income from real property as U.S. business income in order to take deductions allocable to it.

8. Expatriation to avoid income tax.—U.S. source income and the effectively connected income of a citizen received for 10 years after expatriation is, in most cases, to be taxed at the regular U.S. tax rates if a principal purpose of the expatriation was the avoidance of U.S. income, estate, or gift taxes. The House bill would have provided a 5-year rule for income taxes.

9. Withheld taxes and declarations of estimated income tax.—The Treasury Department is authorized to require payment of amounts withheld from nonresident aliens and foreign corporations on a more current basis, rather than the annual basis presently provided. Nonresident aliens who receive income which is effectively connected with the conduct of a U.S. business are to be required to file declarations of estimated tax.

10. Income tax on foreign corporations.—The regular corporate income tax is to apply to income of foreign corporations which is effectively connected with a U.S. business. U.S. source income which is not so connected is taxable at a flat 30-percent rate (or at a lower treaty rate). Foreign corporations are given an election to treat real property income as business income similar to that afforded nonresident aliens.

11. Foreign corporations carrying on insurance business in the United States.—A foreign corporation carrying on a life insurance business within the United States is to be taxed under the present special insurance company provisions on its income effectively connected with a U.S. business. The remainder of the income of this type of corporation from sources within the United

States is to be taxed in the same manner as income of other corporations which is not effectively connected; that is, at a flat 30-percent rate. An adjustment also is made to avoid double taxation which might result from the interaction of the minimum surplus provision for life insurance companies under present law and the new method of taxing foreign life insurance companies.

12. Discrimination and more burdensome taxes by foreign countries.—The House bill authorizes the President to reinstate the in-

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come, estate, or gift tax provisions in effect prior to the enactment of this bill in the case of foreigners upon a determination that the foreign country in which they are residents or were incorporated is imposing more burdensome taxes on U.S. citizens or domestic corporations on income from sources within the foreign country than the U.S. tax on similar U.S. source income of foreigners. Your committee added an amendment which provides the President with authority in the case of discrimination by a foreign government against U.S. persons, to take such action as is necessary to raise the effective rate of U.S. tax on income received by nationals or corporations of that other country to substantially the same effective rates as are applied in the other country on income of U.S. citizens or corporations.

13. Foreign community property income.—A U.S. citizen who is married to a nonresident alien and resident in foreign country with community property laws is to have an election for post-1966 years to treat the community income of the husband and wife as income of the person who earns it, or in the case of trade or business income, as income of the husband unless the wife manages the business. Income from separate property is to be treated as income of the person owning the property. All other community income is to be governed by the applicable foreign community property law. For open pre-1967 years, an election may also be made and the rules set forth above govern except that the other community income is to be treated as the income of the person who had the greater income from the other community income categories plus separate income.

14. Foreign tax credit.—A foreign tax credit is to be allowed nonresident aliens and foreign corporations with respect to foreign taxes on foreign source income which is effectively connected to the conduct of a U.S. business. Your committee extended this provision to include income taxes paid to the foreigner's home country on grounds other than that the income was derived from sources within that country.

15. Similar income tax credit requirement.—Under present law a foreign tax credit is denied to citizens of a foreign country who are resident in the United States if the foreign country does not allow a similar credit to U.S. citizens who are resident in the foreign country. In the future the credit is to be denied only where the President finds that this is in the public interest and the foreign country refuses to grant U.S. citizens such a credit when requested to do so.

16. Separate foreign tax credit limitation.—The 10-percent exception to the separate application of the limitation on the foreign tax credit for interest income was amended by your committee so as to apply to a U.S. corporation which directly or indirectly owns 10 percent of the foreign corporation from which the interest is derived, or is a member of an affiliated group of corporations which has such ownership. The House bill contained a more limited exception which would have provided that the separate limitation is not to apply to a domestic funding subsidiary which is formed and availed of for the principal purpose of (1) raising funds outside the United States through foreign public offerings, and (2) using these funds to finance the foreign operations of related foreign corporations.

17. Estate tax rates, exemptions, and returns.—A separate schedule of estate tax rates is made applicable to estates of nonresident aliens. The rates are graduated from 5 percent on the first $100,000 of a taxable estate to 25 percent on the portion which exceeds $2 million. The exemption also is raised from $2,000 to $30,000. These two measures are designed to accord approximately the same tax treatment in the case of the estate of a nonresident alien as is accorded a similar-sized estate of a citizen eligible for a marital deduction. The filing requirement for returns for the estates of these nonresident aliens also is raised from $2,000 to $30,000.

18. Situs rule for bonds.—For purposes of the tax imposed on the estates of nonresident aliens, bonds of a U.S. person, the United States, a State, or political subdivision owned by a nonresident not a citizen of the United States, are to be considered property within the United States and therefore subject to U.S. estate tax. This rule already applies in the case of other forms of debt obligations.

19. Situs rule for bank deposits.—U.S. bank deposits of nonresident aliens are to be treated as property within the United States and therefore subject to U.S. estate tax after 1971. The provisions of the House bill would have been effective immediately.

20. Situs rule for deposits in foreign branch banks.—Deposits in a foreign branch bank of a U.S. corporation or partnership are to be treated as property without the United States and therefore not includable in a foreigner's U.S. estate tax base.

24. Expatriation to avoid estate tax.—The estate of a nonresident alien is to be taxed at the regular U.S. estate tax rates if, within 10 years of his death, the alien had expatriated from the United States with a principal purpose of avoiding U.S. taxes.

22. Tax on gifts of nonresident aliens.—Transfers of intangible property by nonresident aliens are not to be subject to gift tax whether or not they are engaged in business in the United States. However, gifts of intangibles made by citizens who become expatriates within 10 years of making the gift are to be subject to gift tax if the avoidance of income, estate or gift taxes was a principal purpose for their becoming an expatriate. In the case of a person who expatriated for tax avoidance reasons, debt obligations of a U.S. person, or of the United States or a State or political subdivision, are to be treated as having a situs in the United States.

23. Treaty obligations.—No amendment made by this bill is to apply in any case where its application would be contrary to any treaty obligation of the United States. However, the granting of a benefit provided by an amendment made by this bill is not to be considered to be contrary to a treaty obligation. Thus, even though a nonresident alien or foreign corporation has a permanent establishment in the United States, income

which is not effectively connected with this business is to be taxed at the applicable treaty rate rather than at the regular individual or corporate rate.

B. OTHER AMENDMENTS TO THE INTERNAL REVENUE CODE (ADDED BY YOUR COMMITTEE)

1. Application of the investment credit to certain property in U.S. possessions.—The investment credit is extended to property located in U.S. possessions provided the property is owned by a U.S. company or citizen, subject to U.S. tax on its income from possessions, would otherwise have qualified for the investment credit, and is not owned or used by U.S. persons who are presently exempt from U.S. tax. This amendment is effective with respect to property placed in service after December 31, 1965.

2. Medical expense deductions of persons 65 and over.—The amendment repeals the provisions with respect to a taxpayer age 65 or over, his spouse age 65 or over, and dependent mothers or fathers who are age 65 or over, which, beginning in 1967, would limit their medical deductions to medical care expenses in excess of 3 percent of adjusted gross income and define their medical care expenses to include only those medicine and drug expenses in excess of 1 percent of adjusted gross income.

3. Corporate acquisition of assets of another corporation.—(*a*) *Purchase of stock.*—Under present law, the purchase from an unrelated party by one corporation of at least 80 percent of the stock of another corporation followed by the liquidation of the acquired corporation within 2 years is treated as a purchase of the assets of the acquired corporation. These amendments expand the definition of "purchase" to include the purchase of stock from a 50-percent owned subsidiary if stock in the 50-percent owned subsidiary was also acquired by purchase. The change is to be effective with respect to acquisitions of stock made after December 31, 1965.

(*b*) *Installment notes.*—This amendment provides that when installment notes are transferred in the type of purchase and liquidation described above, gain is to be recognized to the distributing corporation in the same manner as if it had sold the notes. This amendment is to be effective with respect to distributions made after the date of enactment of this act.

4. Swap funds.—The amendment sets aside certain Treasury regulations proposing to tax the exchange of appreciated securities for shares in a mutual investment fund.

5. Self-employed persons retirement plans: minimum amount treated as earned income.—This amendment raises from $2,500 to $6,600 the minimum amount of earnings from a trade or business, in which both personal services and capital are material income-producing factors, which a self-employed person may treat as earned income regardless of the general rule that only 30 percent of the net profits of the trade or business may be treated as a self-employed person's earned income. This amendment applies to taxable years beginning after December 31, 1965.

6. Self-employed persons retirement plans: certain income of authors, inventors, and so forth.—The bill amends present law relating to self-employed individuals' retirement plans to permit authors, inventors, and so forth, to include gains (other than capital gains) from sales and other transfers of their works in their earned income base for the purpose of computing deductions for contributions to such plans. This change will be effective for taxable years ending after the date of enactment of this act.

7. Exclusion of certain rents from personal holding company income.—This amendment provides, for taxable years beginning after the date of enactment of the act (and certain earlier years at the election of the taxpayer), that rent received from the lease of tangible personal property manufactured by a taxpayer is not to be treated as personal holding company income.

8. Percentage depletion in the case of certain clay-bearing alumina.—This amendment provides, with respect to taxable years beginning after the date of enactment, a percentage depletion rate of 23 percent for alumina and aluminum compounds extracted from domestic deposits of clay, laterite, and nephelite syenite. It further provides that in computing gross income from mining all processes applied to derive alumina or aluminum compounds from such clay, laterite, and nephelite syenite are to be treated as mining processes.

9. Percentage depletion rate for clam and oyster shells.—This amendment provides that mollusk shells (including clam and oyster shells) are to be allowed percentage depletion at the same rate (15 percent) as is applicable in the case of limestone and other calcium carbonates. This change is applicable to taxable years beginning after the date of enactment.

10. Sintering and burning of shale, clay, and slate.—This amendment provides that for purposes of percentage depletion, the sintering or burning of shale, clay, and slate used or sold for use as lightweight aggregates is to be treated as a mining process. This amendment is applicable to taxable years beginning after the date of enactment.

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11. Straddles.—This amendment provides that, with respect to straddle transactions entered into after January 25, 1965, the income from the lapse of an option which originated as part of a straddle is to be treated as a short-term capital gain (instead of ordinary income). This permits it to be netted against any capital loss which may result from the exercise of the other option in the straddle while retaining what in most respects is ordinary income treatment for any excess of net short-term capital gain over net long-term capital loss.

12. The taxation of per-unit retain allocations of cooperatives.—The bill clarifies present law dealing with the taxation of cooperatives and patrons to insure that a current single tax is paid, at either the cooperative or patron level, with respect to per-unit retain certificates. In so doing, the amendment makes the treatment of these certificates generally comparable to the treatment of patronage dividends under present law.

13. The excise tax on hearses.—This bill provides that the sale of an ambulance, hearse, or combination ambulance-hearse vehicle is to be considered to be the sale of an automobile chassis or automobile body (rather than a truck chassis or body) for purposes of determining the manufacturers' excise tax on motor vehicles. This change applies with respect to articles sold after the date of enactment of this bill.

14. Interest equalization tax: raw material source loans.—Subsequent transfers of debt obligations to assure raw material sources are

to be exempt from the interest equalization tax where the indebtedness is acquired without an intent on the part of the purchaser to sell it to other U.S. persons. This change is to be effective with respect to acquisitions of debt obligations made after the date of enactment.

15. Interest equalization tax: certain acquisitions by insurance companies in developed countries.—The present exemption for reserve asset pools of U.S. insurance companies is extended to allow the establishment of reserve asset pools where a U.S. insurance company commences activities in a developed country or where a less-developed country is designated as a developed country. This amendment is to take effect on the day after the date of enactment.

16. Interest equalization tax: Euro-dollars.—The President is given the authority to exempt from the interest equalization tax U.S. dollar loans of more than 1 year made by the foreign branches of U.S. banks. This change is to apply to acquisitions of debt obligations made after the date of enactment.

C. PRESIDENTIAL ELECTION CAMPAIGN FUND ACT

This title provides for public support of presidential election campaign financing. Individual taxpayers are to be able to designate on their annual tax returns that $1 of their income tax liability is to be placed in a presidential election campaign fund. The amounts in the fund are to be made available to defray the expenses incurred by political parties in presenting candidates for President and Vice President. Amounts will only be paid to those political parties whose candidates received at least 1,500,000 votes in the preceding presidential election.

A major political party (one whose candidate polled 10 million votes or more in the preceding presidential election) is to be eligible to receive a payment from the fund equal to $1 times the number of votes cast for the presidential candidates of the major political parties in the preceding presidential election divided by the number of such major political parties. A minor party (one whose candidate polled more than 1,500,000 but less than 10 million votes) is to be eligible to receive a payment from the fund equal to $1 for each vote in excess of 1,500,000 votes that its candidate received in the preceding presidential election. The payment received by any political party is to be limited, however, to reimbursement of presidential campaign expenses actually incurred by the party in connection with the current presidential election.

The Comptroller General is authorized to determine the campaign expenses of the political parties and to determine the amounts which may be paid to such parties. An advisory board is established to advise and assist the Comptroller General with his duties under this act.

D. MISCELLANEOUS PROVISIONS

1. Treasury bonds or certificates payable in foreign currency.—This amendment expands the debt management authority of the Secretary of the Treasury to permit the issuance of U.S. notes denominated in foreign currencies. This authority already exists in the case of bonds and certificates of indebtedness.

2. Reports on Federal contingent liabilities and assets.—This amendment requires the Secretary of the Treasury to submit a report to the Congress each year indicating the full contingent liabilities of the Federal Government and the assets of the Federal Government which might be made available to liquidate such liabilities. The first such report is to be submitted on or before March 31, 1967.

3. Medicare: Coverage of expenses for prescribed drugs.—This amendment authorizes payments for prescribed drugs under the Medicare Act. The estimated monthly cost of $1 per beneficiary will be shared equally by the Government and the beneficiary. Reimbursements will be made under a schedule of allowances based upon generic drug prices.

Mr. LAUSCHE. Mr. President, will the Senator yield?

Mr. LONG of Louisiana. I yield.

Mr. LAUSCHE. What does the Treasury Department say about title I?

Mr. LONG of Louisiana. The Treasury thoroughly approves of title I.

Mr. LAUSCHE. Does title I's general objective contemplate removing what are supposed to be inequities imposed upon aliens, as distinguished from the tax burden placed upon nationals of the United States?

Mr. LONG of Louisiana. Yes. It proposes to tax nonresident aliens and foreign corporations upon a more equitable basis. In other words these foreign persons would be placed in a position more in line with what their tax treatment might be in other countries, where they might consider putting their money.

Mr. LAUSCHE. Then the objective is to induce foreign investors to come to the United States and invest their money here, and be assured that there will not be burdensome discriminatory taxes imposed upon them, as distinguished from the load that is placed upon our own nationals?

Mr. LONG of Louisiana. Yes. The purpose of title I is twofold as the Senator has indicated. It is, one, to provide greater tax equity to foreigners who invest their money in the United States; and, two, it is intended to encourage them to invest their money here rather than somewhere else. Additionally, the House added provisions which would actually cause some nonresident aliens and foreign corporations to pay more taxes than they paid before, in situations where we have given foreigners a better tax treatment than we give our own citizens.

Mr. LAUSCHE. By adopting a tax bill that will be an inducement to foreign investors to come to the United States, would we or would we not be lessening the burden of the outflow of our gold?

Mr. LONG of Louisiana. We would be improving our balance-of-payments situation, and we would be decreasing the outflow of gold.

Mr. LAUSCHE. Mr. President, efforts are being made to dissuade American dollars from being invested in foreign countries. This provision would be an inducement to foreign holders of our money to invest in the United States.

Mr. LONG of Louisiana. The Senator is correct.

COVERAGE OF PRESCRIBED DRUGS UNDER PART B OF MEDICARE

It is generally conceded that the major gap in medicare coverage is the failure to provide protection against the heavy costs of drugs outside of those prescribed in a hospital or extended care facility.

Older Americans spend more than $600 million a year at the retail level for prescriptions. More than 3 million people age 65 or over have annual drug costs of $100 or more, and 600,000 of these persons have drug expenses exceeding $250 a year. Obviously, these are citizens who need help, who should be helped, and who will be helped substantially by the committee's amendment.

The committee amendment represents a sensible and economical approach to meeting a serious defect in medicare. Obviously, it would have been far too costly to provide protection against all drug costs and pay for them at the usual retail prices. The amendment provides a reasonable allowance toward the cost of necessary drugs requiring prescription. The payment under the plan will come closest to paying the full cost of the prescription when the doctor prescribes on a generic basis instead of by brand name. The doctor, however, is free to prescribe by brand name, but the allowance to his patient is based upon the price of the generic version of the drug—not the brand name.

The amount involved is estimated at 50 cents a month for each aged person to be matched by 50 cents a month from the Government, or a total of $1 a month, to provide these drugs for the elderly.

One of the modern wonder drugs is Tetracycline. It is sold in some instances by that name. However, if one were to buy it from the Lederle Co., the drug is called Achromycin.

The Government, through the Defense Supply Agency, buys Tetracycline for approximately 1.5 cents to 2 cents a capsule. If one buys the same drug by brand name, the current cost is 30 cents a capsule. It used to be 50 cents a capsule.

The Government will pay under a schedule of allowances what it would cost to buy this drug under the generic name Tetracycline. We will not pay for the cost involved in simply placing a fancy brand name on the drug and charging 10, 20, or 50 times what the drug would sell for under its generic name.

The drugs for which coverage will be provided under the program would be

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determined by a high-level formulary committee consisting of the Surgeon General, the Commissioner of the Food and Drug Administration, and the Director of the National Institutes of Health. These men would be aided by an advisory group representing the major groups concerned with pharmacy.

The benefit would be added to part B of medicare effective July 1, 1968, and possibly earlier if the part B premium is recalculated prior to that date. The monthly cost is estimated at 50 cents to the beneficiary and 50 cents to the Government.

OTHER AMENDMENTS

The committee, in a related action, also approved amendments to the Internal Revenue Code which prevent the reimposition of limits on the deductible medical expenses of persons 65 and over. Right now, older persons can figure their deductible medical expenses without bothering with the 3-percent limit on general medical expenses or the 1-percent limit on expenses for medicine and drugs. One provision of the Medicare Act reimposed these limits beginning in 1967. That is, beginning in 1967, older taxpayers would only be allowed to deduct that portion of their nonreimbursed medical expenses which exceeded 3 percent of adjusted gross income and, in computing medical expenses for the purposes of the deduction, they would be required to disregard that portion of expenses for medicines and drugs which did not exceed 1 percent of adjusted gross income. In view of the fact that not all medical expenses will be covered by medicare, it is important to preserve existing income tax provisions regarding the medical expense deduction of older persons. The committee amendment would retain present law.

Mr. President, I have seen several newspaper editorials which criticize the committee because it placed about 23 amendments on the bill. About 18 of those amendments are approved by the Treasury Department. The Department says that these amendments should be agreed to, that they are appropriate and proper modifications of our tax law.

This is one amendment not approved by the Treasury Department purely because of the revenue involved.

When the committee voted on this amendment, not a single committee member wanted to vote to deny these aged people the right to deduct all of their medical expenses.

Furthermore, even though the Treasury Department is not willing to approve the amendment, I do not think any Senator would like to deny the aged people the right to deduct all of the heavy expense of drugs in the event of a costly illness.

Mr. LAUSCHE. What does the present law provide with reference to the deductibility of expenses for doctors and medical services?

Mr. LONG of Louisiana. A person under the age of 65 is presently permitted to deduct medical expenses to the extent that they exceed 3 percent of his income.

There is a further limitation which provides that such a person is allowed to

deduct the expenses of drugs only insofar as they exceed 1 percent of his income.

Under present law, if a person is over the age of 65, he is permitted to deduct the entire amount of his medical expenses without any limitations. It is well recognized that aged people have a great deal more medical expenses and less income than do people below the age of 65. It is therefore provided in the bill before us that people over the age of 65 can continue to deduct the entire amount.

Starting this coming January, the law would cause the aged people to be taxed on the same basis as people below 65. Judging from the letters we are receiving at the present time, and particularly the letters being received in the Committee on Aging, if we follow through on this provision, it would be one of the most unpopular things that we have ever done.

The committee therefore moved to continue the status of the aged people as it presently exists in the law.

Mr. LAUSCHE. Under the existing law, a person under 65 years of age cannot deduct the first 3 percent of his gross income expended for medical expenses from his tax obligation.

Mr. LONG of Louisiana. If a person is below the age of 65, he cannot deduct medical expenses unless they exceed 3 percent of his adjusted gross income. If he is over the age of 65, he can presently deduct the entire amount.

Mr. LAUSCHE. With regard to drug expenses, they must exceed 1 percent in order to be deducted.

Mr. LONG of Louisiana. The Senator is correct.

Mr. LAUSCHE. What would the pending bill do in respect to changing that law?

Mr. LONG of Louisiana. When we passed the medicare bill, in order to help cover the cost of the program, the bill contained, as one of the many items, the denial to aged people of the favorable tax treatment that they presently receive. However, the denial of this privilege that they have been receiving will not go into effect until January 1 of next year.

Having thought about the matter and knowing the tremendous protest that we will experience, especially from people who are not in a position to take full advantage of medicare—people who have sickness at home and are paying their own expenses—we decided that it would be better to let these people continue to have the favorable tax treatment they have always received and not impose this more burdensome treatment on them.

Mr. LAUSCHE. When Congress passed the medicare bill, it decided that since medicare was to be financed by the program adopted by Congress, the special benefits which persons over the age of 65 then enjoyed should be repealed.

Mr. LONG of Louisiana. The Senator is correct.

Mr. LAUSCHE. And this provision recommended by the committee reinstates those benefits which the aged have?

Mr. LONG of Louisiana. Yes. And may I say that this committee is being thoroughly consistent with what we have done before. When it passed the medicare bill in 1965, the House put in its bill the provision that would cause this tax deduction to be reduced with respect to the aged. We, in the Senate committee, struck that out, and the Senate sustained the Committee on Finance. This is one of the points on which we were compelled to yield to the House when we went to conference. So we are now doing again what we did before.

Mr. LAUSCHE. What is the dollar amount involved in this proposal?

Mr. LONG of Louisiana. About $180 million annually.

Mr. LAUSCHE. How much is involved in all of the miscellaneous items that have been added to this bill, submitted by the Treasury Department?

Mr. LONG of Louisiana. The committee amendments increase expenses in one instance, such as providing drugs, and reduce revenues in the other instance by a total of about $410 million. Most of it is in these two amendments.

Mr. LAUSCHE. Which two?

Mr. LONG of Louisiana. The one that goes into effect on January 1, to simply continue existing law on medical and drug deductions for the aged people, and the one to provide for drugs for the people under medicare.

Mr. LAUSCHE. The total is $410 million. The total, according to the Senator from Louisiana, will entail a loss of revenues of about $410 million. Is there any disagreement on that figure?

Mr. LONG of Louisiana. No, I do not think so.

Mr. WILLIAMS of Delaware. Mr. President, will the Senator yield?

Mr. LONG of Louisiana. I yield.

Mr. WILLIAMS of Delaware. Including the cost of paying for the elections out of the Treasury when all these proposals, including the depletion allowance, and so forth, become fully operative, the Treasury estimated the revenue loss will be between $500 and $600 million. That is the Treasury estimate.

Mr. LONG of Louisiana. We estimate that, every presidential year, the provision on presidential campaign costs would cost us about $70 million. We elect a President every fourth year. But that is a lot less money than it would cost if we had adopted the proposals suggested by the Senator from Delaware, who wanted to give a $100 tax deduction to everyone.

Mr. LAUSCHE. Would the approval of this particular section or title, or whatever it is, mean an abandonment of

the judgment made in 1965, when we adopted the medicare bill, that we therefore should withdraw the special tax benefits that were given the beneficiaries of the medicare bill?

Mr. LONG of Louisiana. We would be reversing the judgment of the House of Representatives. We certainly would not be reversing the judgment of the Senate.

Mr. LAUSCHE. I thank the Senator.

Mr. LONG of Louisiana. Mr. President, I should like to discuss briefly a number of other amendments. Three of these amendments involve the depletion

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allowance. The first places alumina clay on the same basis as bauxite.

This, incidentally, would involve no revenue loss at all presently; but by giving what we believe to be appropriate tax treatment to this Georgia clay and to these low-grade ores in Arkansas, we would hope that this industry could improve its position and that this Nation could become self-sufficient in the production of aluminum. As a practical matter, this might result in more revenue, in the event that these American industries are successful in processing this clay and these low-grade ores. It deals with alumina clay. It takes about twice as much of it to make a ton of aluminum as it does when bauxite is used. The provision also includes more mining processes in the base to which the percentage depletion rate applies.

The second amendment places clam and oyster shells on the same depreciation basis as other sources of calcium carbonate. The third clarifies the status of certain mining processes in the case of shale, clay and slate used in making concrete aggregates, such as cinder blocks.

Two of the amendments involve the provisions of self-employed retirement plans. One deals with the case in which a self-employed person invests both his capital and his time in a business. Under this amendment, the first $6,600 of his net profits will, in any event, be regarded as earned income, rather than only the first $2,500. Amounts in excess of the limit will continue to be allocated between personal services and capital. The second amendment treats the royalty income of authors and inventors as earned income. These amendments insure that all self-employed persons have access to the retirement provisions on a more nearly equal basis.

One final amendment I would like to call to the attention of the Senate is one that was proposed to the committee by the senior Senator from Massachusetts [Mr. SALTONSTALL]. This amendment requires the Secretary of the Treasury to submit to Congress by March 31 of each year a report showing the amount of the Federal Government's contingent liabilities and the amount of the assets available to meet these liabilities.

I am sure that that would meet with the approval of the Senator from Ohio as well; because it was felt that we should have a statement somewhere of all our contingent liabilities, and it was felt that we should have a positive statement of what assets we have available to meet those liabilities.

This provision will enable the Congress to better measure and analyze the impact of many long-range programs. Such analysis is often difficult when financial requirements are reported on an annual basis.

Mr. President, the many and separate provisions of this bill have received the committee's consideration and approval.

In this bill we have added, as I say, a number of amendments, in the effort to see that the suggestions that Senators have made—that they have been urging, that they have been studying—will receive some consideration.

I realize that revenue bills must originate in the House. The Senate does have the power to amend. Contrary to what some contend—that we only have a right to amend a revenue bill in a manner that is relevant to the bill, the Constitution provides nothing of the sort. I would hope that we never are confronted with the kind of difficulty that once confronted our Committee on Appropriations, when the committees experienced an impasse of almost a year because of quarreling about who was going to walk to meet whom and about what room the Senators were to meet in. The Constitution is clear that the right of the Senate to amend a revenue bill is unlimited. We can add any amendment, except a constitutional amendment, which of course would be contrary to the Constitution itself.

So, in effect, we urged Senators not to offer amendments that were not germane on a number of revenue bills, in order to expedite those bills. The Senator from Massachusetts [Mr. SALTONSTALL] was prevailed upon a number of times to withhold his amendment with respect to a statement of liabilities.

Eventually, Senators want their measures considered before we adjourn. We selected this very important bill on which to consider those amendments. The committee has given its best consideration to the effort. Many provisions of the bill have received careful consideration by the committee.

Mr. President, I urge the Senate to give the measure prompt consideration.

Mr. LAUSCHE. Mr. President, will the Senator yield?

Mr. LONG of Louisiana. I yield.

Mr. LAUSCHE. Since I have been in the Senate, I have listened to, and at times participated in, debates dealing with what one side claimed to be the evil of depletion allowances, and on the other side, those who argued that depletion allowances were sound.

We grant a 27.5-percent depletion allowance to the oil industry, and a 10-percent depletion allowance to the coal industry. Am I correct in my understanding that this principle of depletion allowance and special tax benefit as claimed by some is extended in this bill to three new classes?

Mr. LONG of Louisiana. No.

Mr. LAUSCHE. To how many new classes is it extended?

Mr. LONG of Louisiana. They are already eligible. They are permitted a somewhat greater depletion allowance than they had.

Mr. LAUSCHE. Is this increasing the percentage of depletion allowance?

Mr. LONG of Louisiana. In two instances, yes.

Mr. LAUSCHE. That would mean if I, as a Senator from Ohio, representing a coal State, submitted to the committee an amendment to increase the depletion allowance of 10 percent on coal to 15 or 20 percent, I would be falling within the principle of these three sections?

Mr. LONG of Louisiana. Not necessarily.

Mr. LAUSCHE. Why choose clay, clam, and oyster shells in increasing the depletion allowance and not coal?

Mr. LONG of Louisiana. Let me explain—bauxite already gets a 23-percent depletion allowance. If this Georgia clay is to compete with bauxite in the production of aluminum it would be only fair that Georgia clay get a 23-percent depletion allowance. It is a much lower grade of ore and it takes twice as much of it to produce a ton of aluminum than from bauxite. It is an inferior product for the purpose, but if it is going to compete in the production of aluminum, it should get as much depletion allowance as a superior ore.

Mr. LAUSCHE. Did the Senator give any thought to the argument of the Senator from Illinois [Mr. DOUGLAS] that the depletion allowance should be eliminated and not expanded?

Mr. LONG of Louisiana. I heard the argument, but one thing that impresses me when that argument is made is that before somebody comes in and contends for eliminating the depletion allowance, he should learn what depletion is. If he does not know what it is, he is not qualified to discuss it.

I have never been able to understand when people say there should be no depletion allowances on these items that are subject to being exhausted. I cannot understand why people want to argue there should be no depletion allowances.

Sometimes I am reminded of what happened to one of my friends who was working his way through college by flying an airplane. I financed that airplane. He was a good friend of mine. This young fellow could not afford to hire a lawyer or an accountant. He operated on a cash-in, cash-out basis. He would get a couple of dollars to take somebody up in his airplane. We would buy 5 gallons of gasoline and go back and forth. He went out every day and he made a profit. In a year he was broke. He could not figure out how it was that he was broke when he made a profit every day.

He had failed to set up a reserve for depreciation. He had failed to set up any account for his lease which had a year to run and had to be renewed. He was setting aside nothing to renew the lease. There was no reserve for depreciation, or for a number of items that would not meet the eye. After a year he was broke.

If you are in Arkansas and you are in the business of mining bauxite it will not be long before all of that bauxite is gone and you are out of business. That machinery for mining bauxite may be very good machinery but it is specialized machinery. It is useless unless you find somebody to take it off your hands.

If you are in the oil business you can figure that the oil is worth something to you, but when it is all gone the pipe, the rig, the bits, and things of that nature, the tanks that you have to contain the oil, are all worthless because you are out of the oil business.

If Senators would understand there is such a thing as depletion, then we could proceed on the basis of what would be a fair depletion allowance of products.

These three amendments simply seek to do equity between two competing prod-

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ucts and give them the same consideration.

Mr. LAUSCHE. What is the present depletion allowance on clay-bearing aluminum?

Mr. LONG of Louisiana. Presently, it would get 15 percent.

Mr. LAUSCHE. This bill would raise it to 23 percent, putting it on the same basis as bauxite?

Mr. LONG of Louisiana. The Senator is correct.

Mr. LAUSCHE. What is the present rate of the depletion allowance on clam and oyster shells?

Mr. LONG of Louisiana. Presently, it is 5 percent. I wish to explain why we raised that figure.

Mr. LAUSCHE. Did the Senator say 5 percent?

Mr. LONG of Louisiana. Let me explain this. Clams are competitive with limestone; both are calcium carbonate. If you take limestone and break it up and throw it on the ground to use as gravel, it would get a 5 percent depletion allowance, but if you crush it into powder and make it into cement, it would get 15 percent.

Here we say that if you take clam shells and put them on the ground to use

as gravel, then you would get only 5 percent, just as you would if you were using limestone. But if you were going to powder it and make chicken grit or cement out of it we would give it the same depletion allowance as limestone.

The question might be asked how we got into this situation in the first place. When we passed the law about limestone there was practically no one getting calcium carbonate out of seashells. Then, discoveries were made on the Continental Shelf whereby they could be used commercially. We would like for the people using clamshells to make cement, but they are very much at a competitive disadvantage with limestone because of the difference in depletion rates.

Mr. LAUSCHE. Where are the areas in which most of our clam and oyster shells are developed?

Mr. LONG of Louisiana. I should think there would be clam and oyster shells throughout the entire coastal areas of Florida, Louisiana, and Texas.

Mr. LAUSCHE. Louisiana is an important State in that business, is it not?

Mr. LONG of Louisiana. We are certainly interested in them. I like oysters. Of course, Virginia has oysters. That is a very fine State. I have nothing against their oysters. They are not as good as Louisiana oysters, but they are not bad.

Mr. LAUSCHE. In any event, three of the sections in the bill would expand the depletion allowance that is granted by the Federal Government to reduce the tax burden of persons engaged in refining clay-bearing aluminum, selling clam and oyster shells for various purposes, and cindering and burning of shale, clay, and slate; is that correct?

Mr. LONG of Louisiana. The Senator is correct.

Mr. LAUSCHE. Why the difference on the depletion allowance in raising it to 23 percent on clay-bearing aluminum. Why has coal been ignored?

Mr. LONG of Louisiana. Coal is not competitive with aluminum-bearing ores. The products do not compete. We do not make aluminum out of coal.

Mr. LAUSCHE. Forgetting that for a moment, why do we say 10 percent of coal, and 23 percent of alumina clay and 27.5 percent of oil? Why the difference?

Mr. LONG of Louisiana. The committee did not vote on the coal problem. If the Senator wishes to offer an amendment——

Mr. LAUSCHE. I am not going to offer any amendment because I do not believe in the depletion allowance. I think it is wrong.

Mr. MORTON. Mr. President, will the Senator from Louisiana yield?

Mr. LONG of Louisiana. I yield.

Mr. MORTON. In order to keep the RECORD straight, on this alumina- or bauxite-bearing clay, let us remember this, that today this is not a business. The Anaconda Copper Co. has worked out a process with which they think they can go into certain of the poorest areas of Georgia and take out this clay and get from it a product which would be similar to bauxite and it would get into the aluminum stream. Alcoa and Reynolds are working on the same operation in Arkansas.

However, this is not in operation today, but is something to encourage an operation in some of the areas in which we find the greatest poverty in this country, and would relieve us from the almost complete responsibility or necessity for relying on overseas sources for this vital raw material.

Mr. LONG of Louisiana. If this operation is successful, it will cause increased tax revenues to the Government. It will put many fine people to work who now live on "tobacco roads" where poverty is the worst, in Georgia, for example. They can take this Georgia clay, or the ores in Arkansas—and process them and make aluminum, and pay taxes. Yes, they will receive a depletion allowance, but so far as it goes, they will also be paying taxes. It will provide jobs, relieve unemployment, and take people off the backs of the Federal Government and enable them to pay tax to Uncle Sam.

Mr. TALMADGE. Mr. President, will the Senator from Louisiana yield?

Mr. LONG of Louisiana. I yield.

Mr. TALMADGE. The Senator is entirely correct. Aluminum is, perhaps, the second most important material in the defense of America, exceeded only by steel.

We import into the United States 85 percent of the ore from which aluminum is made. It costs the United States of America, at the present time, $150 million a year. Aluminum is increasing at the rate of doubling itself every 10 years. That means that 10 years from now the importation of ore for the manufacture of aluminum will cost $300 million instead of $150 million.

At a time when we are concerned about our dollars, our debts, and our gold drain, it never ceases to amaze me why anyone would object to developing an aluminum industry in the United States from materials located in the United States. It would save the loss of many dollars, help prevent the loss of our gold, and at the same time create jobs for our people in the United States of America.

As the able Senator has pointed out, the amendment would not be an expense to the Treasury.

Why?

It would develop a new industry in this country. That new industry, in turn, would be paying taxes to the Government of the United States.

Job opportunities will be created as a result of adoption of the amendment and the military security of this country will be enhanced from the amendment.

Why anyone could object staggers my imagination.

Now we always have someone——

Mr. LONG of Louisiana. I hope the Senator will allow me to interrupt him there long enough to say that everything the Senator has said is correct. Furthermore, as a matter of tax equity, by bringing that ore in from Jamaica, we are losing dollars, we are losing jobs and losing gold, and we are impoverishing our own people and endangering our own national security by doing it that way. If we do it this new way, it will help the gold situation, it will raise revenue for the Government, it will provide employment, and, in addition, it will do something to benefit our tax equity.

Mr. TALMADGE. It will mean more jobs in Jamaica than it will in the United States of America.

In the final analysis, anyone who objects to a depletion allowance does not have the slightest idea of economics because we are wasting a capital asset and when we waste that capital asset we must recognize that we have lost the capital that would provide new tax revenue and employment.

The amendment was offered by me in committee and was approved by the committee unanimously, as I recall—perhaps one or two dissenting votes, but virtually unanimous—and as has been pointed out, the Anaconda Copper Co. found that they could make aluminum ore from alumina in the United States of America. They have experimented with this alumina clay in several areas—in Idaho—and other sections of the country; but they have found that Georgia clay is ideal for the development of alumina and aluminum, but they have found further that it takes two tons of Georgia clay to equal one ton of bauxite to develop aluminum ore; so that the plan would not be practical unless they had a depletion allowance. If they get the depletion allowance, there is a good possibility that a vast aluminum industry can be developed in my State.

As the Senator has pointed out, it will create jobs, it will save dollars, it will save gold, and it will benefit the Treasury from the receipt of additional tax revenue.

Mr. LONG of Louisiana. The Senator is correct.

Mr. TALMADGE. I thank my friend for yielding to me to make these comments.

Mr. GORE. Mr. President, will the Senator from Louisiana yield?

Mr. LONG of Louisiana. I yield.

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Mr. GORE. I do not like to raise my voice in disagreement, but I should cite that percentage depletion in law has no relation whatsoever to wear, tear, and exhaustion or depletion of the product. It is nothing more and nothing less than a formula for tax reduction.

Mr. LONG of Louisiana. Mr. President, let the record speak for itself. Senators have varying opinions. The amendments which we have on depletion are merely based on the matter of tax equity, if nothing else.

The PRESIDING OFFICER. The Chair would like to announce that the question before the Senate is on the adoption of the committee amendment in the nature of a substitute for the bill. Both proposed language to be stricken and language to be inserted are open to amendment in two degrees, with amendments to the language to be stricken taking precedence over amendments to the language to be inserted.

Mr. WILLIAMS of Delaware. Mr. President, for the past hour and a half I have been listening to a discussion on methods of financing presidential campaigns out of the Treasury and the merits of a depletion allowance.

I thought the bill before the Senate dealt with "tax on foreign investments in this country." Would the Chair ask the clerk to state the pending business now before the Senate?

The PRESIDING OFFICER. Does the Senator mean on the bill?

Mr. WILLIAMS of Delaware. Yes; have the clerk state the bill we are discussing.

The PRESIDING OFFICER. H.R. 13103.

Mr. WILLIAMS of Delaware. That is what I thought—the Foreign Investors Tax Act, but I am somewhat confused by the discussion which has just taken place. What has the depletion allowance on clam or oyster shells or the financing of Presidential campaigns to do with that bill? Perhaps the title of the act should be amended to read "Grab Bag Act of 1966." It was very properly referred to as such in the Wall Street Journal. I think that title would be more in line with what it actually is. This bill is loaded with everything but the kitchen sink.

I have an amendment to strike out one section of the bill, which section is certainly not germane to a Foreign Investors Tax Act.

I send it to the desk and ask that it be stated.

The PRESIDING OFFICER. The amendment offered by the Senator from Delaware will be stated.

The LEGISLATIVE CLERK. It is proposed, on page 189, beginning with line 3, to strike out down to and through line 14, as follows:

SEC. 204. Transfers of stock and securities to corporations controlled by transferors.

(a) TRANSFERS TO INVESTMENT COMPANIES.—The first sentence of section 351(a) (relating to transfers to corporations controlled by transferor) is amended by striking

out "to a corporation" and inserting in lieu thereof "to a corporation (including an investment company)".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to transfers of property whether made before, on, or after the date of the enactment of this Act.

Mr. WILLIAMS of Delaware. Mr. President, this amendment would strike out section 204. This section has to do with the tax liability of transfers of stock and securities to corporations controlled by transferors. This has been referred to as the swap amendment. The Treasury has confirmed that if the amendment as set forth in the bill is agreed to by the House it will be a wide-open loophole whereby a certain group of investors may completely avoid the capital gains tax.

To cite a specific example, let us take two individuals, one of whom owns a block of General Motors stock which he bought at a very low price as compared to today's high price. Another gentleman has a sizable block of Ford Motor Co. stock which he also brought at prices much lower than today's market. They decide to diversify their holdings so that the holder of General Motors stock will have 50 percent of his holdings in Ford Motor Co. and the holder of the Ford Motor Co. stock will have 50 percent of his investment in General Motors stock.

Ordinarily they would both be subject to a capital gains tax, but under this bill they can set up a special holding company or trust, transfer those shares of stock to this new company, and accept stock of this company in exchange. Therefore, by setting up a trust or a holding company they diversify their stockholdings and in so doing are exempt from any capital gains. They would have diversified their stockholdings whereby each of them would have half of their holdings in General Motors stock and half in Ford Motor stock, as between individual A and individual B. They would therefore diversify their holdings without being subject to a capital gains tax.

This could be done by any number of stockholders with respect to stockholdings in four or five companies. These would be no limit with respect to a free stock exchange or an exchange of certificates.

The law has been that if an individual owns stock in corporation A and wishes to exchange that stock for the stock of corporation B he must pay a capital gains tax based on the value of the stock at the time of the transfer.

Representatives of the Treasury Department appeared before our committee and took a strong position against this amendment as appearing in the bill and even went so far as to indicate that the Treasury might recommend a veto if that provision were left in the bill.

Certainly this is not the time to pass a wide-open loophole in the tax laws.

I hope my amendment, which deletes that section, will be adopted.

Mr. President, I suggest the absence of a quorum.

The PRESIDING OFFICER. The clerk will call the roll.

The legislative clerk proceeded to call the roll.

Mr. LONG of Louisiana. Mr. President, I ask unanimous consent that the order for the quorum call be rescinded.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. LONG of Louisiana. Mr. President, I ask for the yeas and nays on the amendment of the Senator from Delaware.

The yeas and nays were ordered.

Mr. WILLIAMS of Delaware. Mr. President, as far as I am concerned we can proceed to vote. I have outlined the purpose of the amendment. It is to strike from the bill the section which would permit a tax-free exchange of securities through a so-called swap fund arrangement. As has been pointed out, if this provision stays in the bill, in addition to permitting securities to be exchanged tax free it would also make it possible to have a tax-free exchange of real estate for securities or securities for real estate. This is not permitted under existing law. I know of no better way to describe it than to use the words of the Treasury Department when they said that this would be a glaring loophole whereby knowledgeable investors could completely escape the capital gains tax.

I strongly urge the adoption of the amendment.

Mr. McCARTHY. Mr. President, for the sake of the RECORD, and for those Senators who were not here previously, I would argue very strongly that a loophole does not exist in the law with reference to the collection of capital gains.

However, if such a loophole did exist, I do not believe we ought to change it by allowing the Treasury to reverse a ruling which it made in 1960, and to change a situation which it allowed to stand from 1960 until 1966. If there is a loophole, the Treasury has had 5 or 6 years in which to come up here and ask us to pass legislation.

Of course, we could give up all responsibility with reference to taxation, and let the Under Secretary or the Secretary of the Treasury and the Solicitor of the Treasury Department make all our tax laws and tax rulings, but I do not believe we want that.

We examined this matter in the committee, and we decided that the ruling was arbitrary and did not seem to be sustained by law; and that if there was grave concern over the loophole, the Treasury had had 5 years to come up and ask us to close it. It appears the Treasury has decided that it has the prerogative to make such rulings whenever it wants to, without consultation with Con-

gress and without proper concern for what is in the law.

The whole question of capital gains is a very complicated one. It is my judgment that the amendment would have very little effect, although it is possible that the allowance of transfers of this kind may have the effect of freeing up investments. Insofar as we have a record, it indicates more revenue will be collected, through permitting that kind of transfer, than will be collected if we do not permit it.

All these securities can be held forever. The only possibility of collecting on them may be in estate taxes. The transfer of them to a mutual fund does

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increase the likelihood that they will be traded, that capital gains will be realized, and that taxes will be paid, more than if we do not allow the transfers. I do not concur in the argument that the proposal in the bill is such a great and powerful one it will accomplish everything that it is indicated could be accomplished, for example, by the adoption of an increased depletion allowance on minerals. I cannot claim that much for it. I do not think it will do any harm. I think it is consistent with the law, and that it is in keeping with what I consder to be the responsibility of Congress: that is, to insist that the law be rewritten, if it needs to be rewritten, by Congress itself and not interpreted, as I consider somewhat arbitrarily, by the Treasury Department of the Federal Government.

Mr. GORE. Mr. President, the majority of the committee has seen fit to load a worthwhile bill with many unworthy amendments. Perhaps the most unworthy of all is the provision now under debate. I concur in the views expressed by the senior Senator from Delaware with respect to the pending amendment. If it remains in the bill, Mr. President, it will operate as an invitation for other special interest amendments, which we shall anticipate, from the floor.

I shall not detain the Senate further. I do not claim the responsibility of being the guardian of anyone's conscience except mine, but I firmly believe this provision should be stricken from the bill.

Mr. LONG of Louisiana. Mr. President, I have no interest whatever in this amendment, one way or the other. I believe in the committee I voted against the amendment. But I do believe the RECORD should reflect what the facts are.

Until July 14 of this year, the Treasury Department interpreted the law as this amendment would have it.

If Senators will read the provision before us, I am sure that they will agree that it is consistent with the law as it is today. But now Treasury says that they think this is something of a loophole, and they want to close it by a Treasury regulation which, in the point of view of many lawyers, is contrary to existing law. It is contended that, if the law is to be changed, we ought to change it. We should look at it, we should study it, we should legislate; the Treasury does not have the job of legislating, but has the job of administering the laws.

As far as I am concerned, the Senate may do whatever it wishes to do with the provision in question, but this is how the Treasury permitted the law to be interpreted until July 14 of this year.

It is a matter of whether we want the Treasury to change the law, or whether we want to change it. To me, it is not a matter of great moment one way or the other.

But there is no doubt about the fact that most lawyers would tell you that what this amendment says is what the law actually is today. The law does not say that this particular provision applies to some transfers and not others. It makes no distinction whatsoever. But the Treasury thinks it is something of a loophole, and should be closed. The question is: Is that something upon which Congress should legislate, or something on which the Treasury should take charge itself, and proceed to change the law?

Mr. WILLIAMS of Delaware. Mr. President, what the Treasury has ruled is that the existing law does not permit the tax-free exchange of these securities. This amendment in the committee bill proposes to spell out specifically that they must allow such tax exemption. If the committee amendment is deleted the law will continue to be interpreted as not allowing a tax-free exchange, and the Treasury has so given notice. The law is clear and will be interpreted so that such taxpayers cannot get their tax exemption on such an exchange of securities.

If there be those who feel that there should be a tax-free exchange of securities let them amend the existing law. But existing law now prohibits it, and the committee amendment would legalize it. The question is very simple. As the Senator from Tennessee has pointed out, my amendment by all means should be accepted, and this section should be deleted from the bill. This would be a wide-open loophole, and I would hate to see it extended and fixed into permanent law.

Mr. GORE. Mr. President, will the Senator yield?

Mr. WILLIAMS of Delaware. I yield.

Mr. GORE. Some Senators have asked questions as to the meaning of this provision in the bill. Would the Senator be willing to state specifically that it would permit the exchange of an asset which has had great appreciation in value for another asset, and another type of asset, without recognition of the gain and without tax consequence?

Mr. WILLIAMS of Delaware. The

Senator is correct. In addition, as the Treasury Department pointed out, a man could exchange land and real estate for securities under the language of the pending bill and still escape taxes.

If a man had all of his investment in securities and another man had all of his investment in land they could exchange on a tax-exempt basis. It would completely nullify the capital gains tax in this respect.

Mr. GORE. If Senators wish to find the meaning of the amendment, they will find on page 6 of the report that it reads as follows: "These amendments expand the definition of 'purchase.' . . ."

It accomplishes its purpose by the definition of "purchase." One can do a great deal by definition of what is taxable income and what is not taxable income.

Mr. WILLIAMS of Delaware. The Senator is correct. I do not think that anyone could picture the full extent and effect of the results of agreement to this loophole.

I think it would be disastrous.

Mr. GORE. Mr. President, does the Senator agree with the senior Senator from Tennessee that the vote on his amendment would be a test as to whether the Senate wishes to use the pending bill as a grab-all for special interest amendments and that, if this provision is not stricken, we are then apt to have many other such amendments from the floor?

Mr. WILLIAMS of Delaware. If this provision is not stricken I shudder to think of what will happen to the bill before we get through, because it seems to me that our position for cleaning up this bill is stronger on this point than on any other.

That is the reason that I selected this amendment as the first.

The PRESIDING OFFICER. The question is on agreeing to amendment of the Senator from Delaware [Mr. WILLIAMS]. On this question the yeas and nays have been ordered and the clerk will call the roll.

The assistant legislative clerk called the roll.

Mr. LONG of Louisiana. I announce that the Senator from West Virginia [Mr. BYRD], the Senator from Idaho [Mr. CHURCH], the Senator from Massachusetts [Mr. KENNEDY], and the Senator from Maryland [Mr. TYDINGS], are absent on official business.

I also announce that the Senator from New Mexico [Mr. ANDERSON], the Senator from Tennessee [Mr. BASS], the Senator from Illinois [Mr. DOUGLAS], the Senator from Mississippi [Mr. EASTLAND], the Senator from Alaska [Mr. GRUENING], the Senator from Arizona [Mr. HAYDEN], the Senator from New York [Mr. KENNEDY], the Senator from Montana [Mr. METCALF], the Senator from Utah [Mr. MOSS], the Senator from Rhode Island [Mr. PELL], the Senator from West Virginia [Mr. RANDOLPH], the Senator from South Carolina [Mr. RUSSELL], the Senator from Florida [Mr. SMATHERS], and the Senator from New Jersey [Mr. WILLIAMS] are necessarily absent.

I further announce that, if present and voting, the Senator from Utah [Mr. Moss], the Senator from West Virginia [Mr. RANDOLPH], and the Senator from New Jersey [Mr. WILLIAMS] would each vote "nay."

Mr. KUCHEL. I announce that the Senator from Colorado [Mr. ALLOTT], the Senator from New Jersey [Mr. CASE], the Senator from Kentucky [Mr. COOPER], the Senator from Nebraska [Mr. CURTIS], the Senator from Iowa [Mr. HICKENLOOPER], the Senator from New York [Mr. JAVITS], the Senator from Idaho [Mr. JORDAN], the Senator from Kansas [Mr. PEARSON], and the Senator from Texas [Mr. TOWER] are necessarily absent.

The Senator from Pennsylvania [Mr. SCOTT], is detained on official business. If present and voting, the Senator from Nebraska [Mr. CURTIS], the Senator from Idaho [Mr. JORDAN], and the Senator from Kansas [Mr. PEARSON] would each vote "nay."

On this vote, the Senator from Pennsylvania [Mr. SCOTT], is paired with the Senator from Texas [Mr. TOWER]. If present and voting, the Senator from Pennsylvania would vote "nay" and the Senator from Texas would vote "yea."

The result was announced—yeas 30, nays 42, as follows:

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[No. 296 Leg.]

YEAS—30

Aiken	Kuchel	Nelson
Boggs	Lausche	Pastore
Burdick	Long, Mo.	Prouty
Clark	McClellan	Proxmire
Cotton	McIntyre	Ribicoff
Fannin	Miller	Simpson
Fulbright	Monroney	Symington
Gore	Morse	Williams, Del.
Griffin	Mundt	Yarborough
Hart	Murphy	Young, Ohio

NAYS—42

Bartlett	Harris	Mondale
Bayh	Hartke	Montoya
Bennett	Hill	Morton
Bible	Holland	Muskie
Brewster	Hruska	Neuberger
Byrd, Va.	Inouye	Robertson
Cannon	Jackson	Russell, Ga.
Carlson	Jordan, N.C.	Saltonstall
Dirksen	Long, La.	Smith
Dodd	Magnuson	Sparkman
Dominick	Mansfield	Stennis
Ellender	McCarthy	Talmadge
Ervin	McGee	Thurmond
Fong	McGovern	Young, N. Dak.

NOT VOTING—28

Allott	Gruening	Pell
Anderson	Hayden	Randolph
Bass	Hickenlooper	Russell, S.C.
Byrd, W. Va.	Javits	Scott
Case	Jordan, Idaho	Smathers
Church	Kennedy, Mass.	Tower
Cooper	Kennedy, N.Y.	Tydings
Curtis	Metcalf	Williams, N.J.
Douglas	Moss	
Eastland	Pearson	

So the amendment of Mr. WILLIAMS of Delaware was rejected.

Mr. LONG of Louisiana. I move to reconsider the vote by which the amendment was rejected.

Mr. TALMADGE. I move to lay that motion on the table.

The motion to lay on the table was agreed to.

Mr. LAUSCHE. Mr. President——

The PRESIDING OFFICER (Mr. YARBOROUGH in the chair). The Senator from Ohio is recognized.

Mr. LAUSCHE. Mr. President, will the Senator from Delaware, who is a member of the Committee on Finance, allow me to ask him a question or two?

Mr. WILLIAMS of Delaware. If I am recognized, I yield to the Senator from Ohio.

Mr. LAUSCHE. I have been recognized. Will the Senator tell me whether or not the Secretary of the Treasury made a statement before the Committee on Finance pertaining to the merits or demerits of the amendment on which we just voted?

Mr. WILLIAMS of Delaware. The representative of the Treasury Department, when he was before the Committee on Finance, described the section which we just failed to debate from this bill as being the most glaring loophole in our tax structure that had ever been proposed by the Committee on Finance.

I have been a Member of the Senate for 20 years and a member of the committee for 15 years. There is no question—this will be confirmed by the Treasury Department and our staff—that the Senate has just voted the biggest loophole in our capital gains structure that has ever been approved in the history of Congress.

For the benefit of all taxpayers who have any securities that they want to exchange and escape the capital gains tax all they would have to do is to get together, establish a special fund, and exchange their securities. This would nullify the capital gains structure.

Mr. LAUSCHE. The statement which has just been made by the Senator from Delaware [Mr. WILLIAMS] is in substance a restatement of the statement made by a representative of the Treasury Department that the adoption of this amendment would create an unprecedented loophole with respect to the ability of individuals to escape their obligation on taxes.

Mr. WILLIAMS of Delaware. There is no question about it.

Mr. LAUSCHE. Did the representative go to the point of saying that he would recommend a veto of the measure?

Mr. WILLIAMS of Delaware. The official who was there did not have that authority, but the indication was that they would recommend a veto.

I cannot conceive of the Treasury Department endorsing this bill with this amendment in it. That is a decision they will have to make.

Mr. LAUSCHE. How many amendments were added to the bill after it came from the administration?

Mr. WILLIAMS of Delaware. I understand there were around 23 of the so-called nongermane amendments, beginning with the depletion allowance on clam shells and ending up with financing elections from the Federal Treasury, plus a few other loopholes including the cutting of excise taxes on hearses. I will say that there may be some merit to the cut in the excise tax on hearses; somebody has said that they were getting ready to have a big funeral after the election to bury the Great Society.

This bill was presented to the Senate on the basis that it was a proposal to amend and adjust laws related to taxes on foreign income in this country. In the first title of the bill, the committee working with the Department had developed a good proposal; however, when we consider titles 2, 3, and 4, we find that they are not at all related. That is why this entire bill has been properly referred to as "the Grab Bag Act of 1966."

Mr. LAUSCHE. By how much will the adoption of this bill reduce the revenues of the Federal Government?

Mr. WILLIAMS of Delaware. The Treasury official before our committee as an offhand guess, estimated at the time a total loss of between $500 and $600 million a year.

Mr. LAUSCHE. That is, in spite of the fact that they have been talking about cutting down expenses so as to avoid the imposition of new taxes?

Mr. WILLIAMS of Delaware. The Senator is correct. In addition, title I of the bill, which is all the bill was supposed to embrace when it came over and which deals with foreign investors' tax credit, provided an increase in revenues of $26 million. The bill was not presented on the basis of providing revenue. But the bill as it came to the committee would provide an additional $26 million in revenue. The bill as before the Senate today would lose revenue of between $500 and $600 million when it is fully effective. That does not include what the effect of this will ultimately be with the loophole in the capital gains structure.

Mr. LAUSCHE. With respect to the loss of revenue of about $500 million. Will that inure to the general taxpayer, or are these amendments of a character that affect a particular segment of the economy?

Mr. WILLIAMS of Delaware. They are both.

Mr. LAUSCHE. Inevitably the taxpayer will benefit a bit.

Mr. WILLIAMS of Delaware. The Senator is correct.

Mr. LONG of Louisiana. Mr. President, will the Senator yield?

Mr. WILLIAMS of Delaware. I yield.

Mr. LONG of Louisiana. Mr. President, it saddens this Senator to see members of what I believe to be the finest committee in the Senate reflect on their own committee, particularly when what they say is not accurate in every respect in order to so reflect.

For example, the Senator stands on the floor and talks about this horrible bill, although he voted for all of the major amendments in the bill.

The Senator talks about losing revenue Where is revenue lost? This bill has $385 million worth of benefits for the aged people. Of that $385 million there will be $100 million paid by those people themselves.

It might be said, on balance, that this bill would provide about $285 million for those aged people. Every Senator on the committee voted for one amendment, and most Senators voted for the other.

This partcular provision says the law is what the Treasury said it was until July 14, of this year. When the Treasury got ready to change the law administratively, which they have no power to do, they proceeded to look at who had these funds being organized. They said, "We will take care of that fellow, and this fellow, and this fellow."

I voted with the Treasury on this matter because I think they have a good argument on the merits. As far as the law is concerned, they are dead wrong, and the committee thinks so too.

How do you want to change the law? Do you want Congress to legislate a change in the law or do you want the Treasury to change the law by legislative usurpation?

The whole matter is in conference and we can rewrite the provision, and this item will not cost the Treasury one penny.

I can show why it is so. Suppose someone owns stock which has been in the family for a long time, which was worth $100 a share when it was purchased. It is now worth $5,000 a share. Suppose he has a half million dollars worth of that stock. If he sells it he has to pay one-fourth of the profit on it in taxes. Therefore, he is not going to sell it. He will keep it. He would like to diversify his risk and put it into a common fund with some other stocks and have his interest in the fund and, therefore, not have as much risk in having all of his eggs in one

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basket. If he does it, does he owe a capital gains tax or does he not?

The Treasury Department until July 14, 1966, had an interpretation outstanding which said that he does not owe a tax on that transaction. If he sells his interest in the fund at such time as he disposes of it, he will pay taxes on the basis of the $100 that he began with, and everything else would be a gain. He is not going to make the transaction to dispose of the stock and pay all of the tax that he would owe if he did so.

It may be that we should legislate the way that the Treasury would like us to legislate. If that is what we want to do, we could do it in conference. As the chairman of the committee, I voted against the provision in committee. In conference, the Treasury officials will be in the room to explain this—and the Senator from Delaware [Mr. WILLIAMS] can be a conferee if he wants to be, and hear what they think and how it should be worked out. We can do anything we wish to do, from leaving the law as it is or changing it, or any point between the two. As between changing the law by administrative usurpation and changing the law by congressional act, I would prefer to see the latter.

Mr. LAUSCHE. Mr. President, will the Senator yield?

Mr. WILLIAMS of Delaware. I yield to the Senator from Ohio.

Mr. LAUSCHE. Mr. President, it is apparent to me that the Senator from Louisiana is convinced that the Treasury Department is right. He admits that by his very statement. This bill or this amendment which we adopted is intended to frustrate the legitimate and honest judgment, certified to be so by the Senator from Louisiana.

Mr. LONG of Louisiana. If the Senator will yield, the Treasury is——

Mr. LAUSCHE. The Senator stated, and the RECORD will show, that the Treasury Department is right in its agument. Now, if it is right, why have we adopted an amendment to say it is wrong?

Mr. LONG of Louisiana. The Treasury, in my judgment, has a good argument on the merits of whether such an exchange should be taxed, but as to an interpretation of what the law is at present, they are as wrong as anyone ever was, in my judgment.

Mr. LAUSCHE. That is what he has said, but the Treasury Department does not agree with him and the Senate has now found it necessary to rewrite the law. If the law is contrary to what the Treasury Department says, why do we rewrite it?

Mr. LONG of Louisiana. Well, we will tell the taxpayer what the law is and what it is not.

Mr. LAUSCHE. Surely, but, anyhow, the Senator from Louisiana concedes that the Treasury Department said that a loophole will be created and that the amendment should not be adopted, and the Senator from Louisiana voted against the amendment.

Mr. LONG of Louisiana. Treasury says this is a loophole, but only Congress can do anything about it, not the Treasury.

Mr. LAUSCHE. But there is a great inclination to open them. The Senator has created a loophole through which his eloquence may be able to move.

Mr. WILLIAMS of Delaware. Mr. President, I send to the desk a second amendment and ask that it be stated.

The PRESIDING OFFICER. The amendment will be stated for the information of the Senate.

The legislative clerk read the amendment as follows:

On page 214, beginning with line 18, strike out all down to and including line 19 on page 222, as follows:

"TITLE III—PRESIDENTIAL ELECTION CAMPAIGN FUND ACT

"SEC. 301. SHORT TITLE.

"This title may be cited as the 'Presidential Election Campaign Fund Act of 1966'.

"SEC. 302. AUTHORITY FOR DESIGNATION OF $1 OF INCOME TAX PAYMENTS TO PRESIDENTIAL ELECTION CAMPAIGN FUND.

(a) Subchapter A of chapter 61 of the Internal Revenue Code of 1954 (relating to returns and records) is amended by adding at the end thereof the following new part:

"'*Part VIII—Designation of income tax payments to presidential election campaign fund*

"'Sec. 6096. Designation by individuals.

"'(a) IN GENERAL.—Every individual (other than a nonresident alien) whose income tax liability for any taxable year is $1 or more may designate that $1 shall be paid into the Presidential Election Campaign Fund established by section 303 of the Presidential Election Campaign Fund Act of 1966.

"'(b) INCOME TAX LIABILITY.—For purposes of subsection (a), the income tax liability of an individual for any taxable year is the amount of the tax imposed by chapter 1 on such individual for such taxable year (as shown on his return), reduced by the sum of the credits (as shown in his return) allowable under sections 32(2), 33, 35, 37, and 38.

"'(c) MANNER AND TIME OF DESIGNATION.—A designation under subsection (a) may be made with respect to any taxable year, in such manner as the Secretary or his delegate may prescribe by regulations—

"'(1) at the time of filing the return of the tax imposed by chapter 1 for such taxable year, or

"'(2) at any other time (after the time of filing the return of the tax imposed by chapter 1 for such taxable year) specified in regulations prescribed by the Secretary or his delegate.'

"(b) The table of parts for subchapter A of chapter 61 of such Code is amended by adding at the end thereof the following new item:

"'Part VIII. Designation of income tax payments to Presidential Election Campaign Fund.'

"(c) The amendments made by this section shall apply with respect to income tax liability for taxable years beginning after December 31, 1966.

"SEC. 303. PRESIDENTIAL ELECTION CAMPAIGN FUND.

"(a) ESTABLISHMENT.—There is hereby established on the books of the Treasury of the United States a special fund to be known as the "Presidential Election Campaign Fund" (hereafter in this section referred to as the "Fund"). The Fund shall consist of amounts transferred to it as provided in this section.

"(b) TRANSFERS TO THE FUND.—The Secretary of the Treasury shall, from time to time, transfer to the Fund an amount equal to the sum of the amounts designated by individuals under section 6096 of the Internal Revenue Code of 1954 for payment into the Fund.

"(c) PAYMENTS FROM FUND.—

"(1) IN GENERAL.—The Secretary of the Treasury shall, with respect to each presidential campaign, pay out of the Fund, as authoriezd by appropriation Acts, into the treasury of each political party which has complied with the provisions of paragraph (3) an amount (subject to the limitation in paragraph (3)(B)) determined under paragraph (2).

"(2) DETERMINATION OF AMOUNTS.—

"(A) Each political party whose candidate for President at the preceding presidential election received 10,000,000 or more popular votes as the candidate of such political party shall be entitled to payments under paragraph (1) with respect to a presidential campaign equal to—

"(i) $1 multiplied by the total number of popular votes cast in the preceding presidential election for candidates of political parties whose candidates received 10,000,000 or more popular votes as the candidates of such political parties, divided by

"(ii) the numbef of political parties whose candidates in the preceding presidential election received 10,000,000 or more popular votes as the candidates of such political parties.

"(B) Each political party whose candidate for President at the preceding presidential election received more than 1,500,000, but less than 10,000,000, popular votes as the candidate of such political party shall be entitled to payments under paragraph (1) with respect to a presidential campaign equal to $1 multiplied by the number of popular votes in excess of 1,500,000 received by such candidate as the candidate of such political party in the preceding presidential election.

"(C) Payments under paragraph (1) shall be made with respect to each presidential campaign at such times as the Secretary of the Treasury may prescribe by regulations, except that no payment with respect to any presidential campaigns shall be made before September 1 of the year of the presidential election with respect to which such campaign is conducted. If at the time so prescribed for any such payments, the moneys in the Fund are insufficient for the Secretary to pay into the treasury of each political party which is entitled to a payment under paragraph (1) the amount to which such party is entitled, the payment to all such parties at such time shall be reduced pro rata, and the amounts not paid at such time shall be paid when there are sufficient moneys in the Fund.

"(3) LIMITATIONS.—

"(A) No payment shall be made under paragraph (1) into the treasury of a political party with respect to any presidential campaign unless the treasurer of such party has certified to the Comptroller General the total amount spent or incurred (prior to the date of the certification) by such party in carrying on such presidential campaign, and has furnished such records and other information as may be requested by the Comptroller General.

"(B) No payment shall be made under paragraph (1) into the treasury of a political party with respect to any presidential campaign in an amount which, when added to previous payments made to such party, exceeds the amount spent or incurred by such party in carrying on such presidential campaign.

"(4) The Comptroller General shall certify to the Secretary of the Treasury the amounts payable to any political party under paragraph (1). The Comptroller General's determination as to the popular vote received by any candidate of any political party shall be final and not subject to review. The Comptroller General is authorized to prescribe such

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rules and regulations, and to conduct such examinations and investigations, as he determines necessary to carry out his duties and functions under this subsection.

"(5) DEFINITIONS.—For purposes of this subsection—

"(A) The term 'political party' means any political party which presents a candidate for election to the office of President of the United States.

"(B) The term 'presidential campaign' means the political campagin held every fourth year for the election of presidential and vice presidential electors.

"(C) The term 'presidential election' means the election of presidential electors.

"(d) TRANSFERS TO GENERAL FUND.—If, after any presidential campaign and after all political parties which are entitled to payments under subsection (c) with respect to such presidential campaign have been paid the amounts to which they are entitled under subsection (c), there are moneys remaining in the Fund, the Secretary of the Treasury shall transfer the moneys so remaining to the general fund of the Treasury.

"SEC. 304. ESTABLISHMENT OF ADVISORY BOARD.

"(a) There is hereby established an advisory board to be known as the Presidential Election Campaign Fund Advisory Board (hereafter in this section referred to as the 'Board'). It shall be the duty and function of the Board to counsel and assist the Comptroller General in the performance of the duties imposed on him under section 303 of this Act.

"(b) The Board shall be composed of two members representing each political party whose candidate for President at the last presidential election received 10,000,000 or more popular votes as the candidate of such political party, which members shall be appointed by the Comptroller General from recommendations submitted by each such political party, and of three additional members selected by the members so appointed by the Comptroller General. The term of the first members of the Board shall expire on the 60th day after the date of the first presidential election following the date of the enactment of this Act and the term of subsequent members of the Board shall begin on the 61st day after the date of a presidential election and expire on the 60th day following the date of the subsequent presidential election. The Board shall select a Chairman from among its members.

"(c) Members of the Board shall receive compensation at the rate of $75 a day for each day they are engaged in performing duties and functions as such members, including travel time, and, while away from their homes or regular places of business, shall be allowed travel expenses, including per diem in lieu of subsistence, as authorized by law for persins in the Government service employed intermittently.

"(d) Service by an individual as a member of the Board shall not, for purposes of any other law of the United States, be considered as service as an officer or employee of the United States.

"SEC. 305. APPROPRIATIONS AUTHORIZED

"There are authorized to be appropriated, out of the Presidential Elections Campaign Fund, such sums as may be necessary to enable the Secretary of the Treasury to make payments under section 303 of this Act."

Mr. WILLIAMS of Delaware. Mr. President, I ask for the yeas and nays on my amendment.

The yeas and nays were ordered.

Mr. WILLIAMS of Delaware. Mr. President, this amendment would strike from the bill title III, the purpose of which is to provide for the financing of presidential campaigns out of the Federal Treasury.

There is no question that Congress should some day deal with this question in some form; however, there are too many phases of a presidential campaign, as well as a congressional campaign, which need dealing with other than just the question of financing.

For one, we should provide for a greater degree of accounting by the numerous committees formed in the States. We need more information as to how the money is now being spent. All this proposal would do now would be to make funds available out of the Treasury for a presidential campaign at the expense of the American taxpayers. At the same time it would provide no rules as to how the money would be spent or how it would be accounted for.

This proposal would provide $60 million to $70 million to finance presidential elections there is nothing that would prevent the parties from going on and raising all the money they wanted on top of that amount to be used for congressional or State races.

Certainly we recognize that there must be some different method for financing political campaigns. Some time back I joined in support of a proposal which had been endorsed by the President which would allow a tax credit for the first $100, but Congress voted that down overwhelmingly. I was sorry that I did not get the support of the President's own party at that time.

But this proposal has no place in this bill. This is not a bill in which to correct campaign abuses or provide for methods of raising campaign funds.

This bill is a foreign investors tax bill, and unless and until the Senate is ready to deal with all of the other proposals concerning the reporting as well as the financing of political campaigns I think it should be postponed.

Mr. SCOTT. Mr. President, will the Senator from Delaware yield at that point?

Mr. WILLIAMS of Delaware. I yield.

Mr. SCOTT. Let me say that I am interested in what the Senator has said about the amendment, and I agree with him in his view as to the fact that this particular amendment has no place in the bill at this point.

I do think that we need better ways to finance political campaigns, and I think that there is need for the Federal Government to consider the degree of its participation; but I also think that we need to explore the utterly prohibitive cost of television and radio time in bringing the issues of the day before the people of this country through those who seek public franchise.

However, I question that this is the time or the place, or that this is necessarily the best method.

I regret, further, that I was unable to cast a vote on the previous amendment because the usual courtesies of the Senate were lacking at that time, and I was denied that opportunity; but I want to assure those who denied me those courtesies, that I will be present on this vote and will be prepared to move the regular order in order to expedite proceedings.

Mr. COTTON. Mr. President, will the Senator from Delaware yield for a question?

Mr. WILLIAMS of Delaware. Yes, in just a moment.

The Senator from Pennsylvania has raised a valid point. There is no question that the Senate should deal with the question of equal time on television. There are so many questions which must be dealt with concerning campaigns. Under this proposal each citizen can contribute a dollar to go to the campaign fund for both parties, but the point is that we shall dip into the Federal Treasury to finance the elections.

Now I yield to the Senator from New Hampshire.

Mr. COTTON. First, Mr. President, I agree with the distinguished Senator that as intricate and difficult and complex a subject as is the control of campaign expenditures and the financing of campaigns, this subject should not be dealt with at the last minute with an amendment tucked into a bill with no more consideration than is being given or can be given it at this time.

I should like to ask the Senator a couple of general questions in order to clarify my own thinking.

Here is a bill which came from the Finance Committee of which the Senator is a distinguished member, and it is 231 pages long. It is supposedly a bill that relates to tax credits on foreign investments. It is my understanding that there are more than 20 amendments on all kinds of subjects that have been added to the bill; is that not correct?

Mr. WILLIAMS of Delaware. That is correct. It covers a great many unrelated subjects, from depletion allowances for clam and oyster shells to financing a presidential election. Some may have merit, but they have nothing whatever to do with foreign investors tax credits.

Mr. COTTON. In view of all the hodgepodge of the varying amendments and the subjects covered in the bill, and in view of the fact that this is a complicated bill, rushed into the Senate during what is supposedly and generally agreed to be almost the next-to-the-last week of the session, it would seem to me that it would be impossible to give all these amendments and the bill itself intelligent and careful attention, and that it is exceedingly poor legislation.

I should like to ask the Senator this question: Will the heavens fall or will the United States of America be severely damaged if the main subject of the bill; namely, the tax credit for foreign investments, went over until January?

Mr. WILLIAMS of Delaware. No, there would be no serious harm done, although I should like to see title 1 of the bill enacted if it could be done by deleting the other three titles, which represent nothing more than a grab bag. After the pending amendment has been voted on I shall offer another amendment to strike out titles 2, 3, and 4 and leave it just a bill dealing with foreign investment

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tax rates. This would strike out all these nongermane amendments.

Mr. COTTON. I should like to summarize by asking my distinguished friend from Delaware, who has served so long and so well on the Committee on Finance, whether, if the hodgepodge of amendments on other subjects remained in the bill, a Senator would be justified, in the opinion of the Senator from Delaware, in voting against the bill, unless it were restricted to title 1, the subject which it is supposed to cover?

Mr. WILLIAMS of Delaware. I answer the Senator in this way: I believe that title 1 is a meritorious proposal. I am in favor of it and would like to support it, but if the nongermane amendments in titles 2, 3, and 4 are not deleted and are left as they are now, I shall vote against the bill, even though I favor the bill as originally introduced. I think that answers the Senator's question.

The bill as it was originally introduced dealt only with the subject of title 1. The tax provisions on foreign investments in this country would have provided additional revenue of about $26 million, although it was not a revenue-producing measure as such—it was more of a tax adjustment act. Nevertheless, it did have the effect of producing additional revenue of $26 million.

The bill as it is now, containing all the nongermane amendments, should it

become fully applicable would result in a loss of revenue that would reach as high as $600 million. The lowest estimate I have heard is $410 million. The Treasury concedes that the loss would be between $500 and $600 million, and this is a bill which was originally designed to produce revenue.

Mr. COTTON. The Senator from New Hampshire has great respect for the Committee on Finance. He served on that committee during one session of Congress. When did the original proposal reach the Committee on Finance for consideration?

Mr. WILLIAMS of Delaware. I do not have the exact date when the original proposal was submitted, but it was about 4 or 5 weeks ago. We held hearings on it, we arrived at our decision, and we were making excellent progress until all these nongermane amendments were submitted. I think the first one related to a depletion allowance on clam shells. Anyway, once those amendments got started the dam broke, and everything went in. In fact, one Senator had an amendment, and when it came his turn to offer his amendments he said in a joking manner, "We can save a lot of time; the committee seems to be in a mood of accepting everything so I will offer my file." In fact it was almost adopted before he had a chance to get it back. That is how irresponsible the committee was acting at that particular time.

Mr. COTTON. Does the Senator from Delaware agree with the Senator from New Hampshire that, with the lateness of the time in the session, when things are being hurried through, when Members are tired and distracted with many other duties, when they are engaged in committees of conference, it would be an atrocity and extremely irresponsible to pass legislation under the conditions in which the present bill is before us?

Mr. WILLIAMS of Delaware. Personally, as I stated, I am not going to vote for the bill in its present form. I would have voted for—and I was enthusiastically in favor of—the bill as it was originally proposed. I refer to title I, the bill which dealt with taxes on foreign investors.

Mr. COTTON. I thank the Senator. He has confirmed my own doubts about the wisdom of supporting this bill in its present form.

Mr. WILLIAMS of Delaware. In conclusion, I make just one point that should not be overlooked. The argument is made that under this proposal a taxpayer can help finance the election campaigns by having the taxpayer designate in a box on his tax return that he wants $1 of his taxes to be diverted into a fund for this purpose.

But do not overlook this point—the taxpayer has no authority to designate which political party or candidate is to get his dollar.

Mr. LAUSCHE. Mr. President, may we have order? I think the Senator who is speaking is entitled to be heard. Senators who do not have the floor are talking louder than the Senator who is speaking.

The PRESIDING OFFICER. It has been necessary to call for order several times. The Chair requests the cooperation of Senators in maintaining order.

The Senator from Delaware may proceed.

Mr. WILLIAMS of Delaware. Under this proposal a taxpayer can mark in a box on his return that he wants $1 of his taxes to go into the campaign fund. The formula is designated by the committee as to how these funds are to be distributed. It is conceivable—I do not say it will happen, but it is conceivable—that 10 or 15 million taxpayers who are members of the Democratic Party or who are members of the Republican Party will designate that their dollars go into the campaign fund. They will have no control as to where that money goes. It is conceivable that all or almost all of the contributors may, for example, have been members of the Republican Party. Yet half of those funds will be distributed to a Democratic candidate. The situation may be vice versa.

We should have a proposal to encourage small contributions I think we would encourage greater participation on the part of small taxpayers by giving them a tax credit for a contribution of $2, $3, $4, or $5, but always with the right of the taxpayer to designate the political party he wishes to support.

Under the amendment in the committee bill the taxpayer has no control over whether he is financing the Democratic Party or the Republican Party. It is conceivable that all of the contributions, or an overwhelming percentage of them, may have come from members of one particular party.

It seems to me that this question should have more study. We cannot cure the problem of our present campaigns by simply providing $50 or $60 million for campaign purposes from the Public Treasury.

Mr. LONG of Louisiana. Mr. President, it would be strange to compare the Senator's argument with the one he made some time ago, when he was advancing a plan to finance presidential campaigns. A while ago we had a bill before us having to do with the debt limit. It was irrelevant to the debt limit, but the Senator proposed that a taxpayer should be allowed a deduction of up to $100 to finance presidential campaigns.

The Senator from Louisiana made the announcement at that time that if the Finance Committee were permitted to consider it, the committee would study the matter, conduct hearings, have witnesses testify, and bring something be-

fore the Senate on which the Senate could vote one way or the other. We studied the Senator's plan and came to the conclusion that it was not as good as the one the committee has proposed. We came to the conclusion that a $100 deduction was not enough of an encouragement for people to participate, except wealthy people, who would get a $70 deduction in their taxes. In the opinion of many of us, we would be giving a deduction to many people who would have put up that money anyhow. Some of those people might have strings attached to their contributions, expecting to get something out of it.

So we made another proposal. We proposed that if a taxpayer is sufficiently interested in good government, he will have an opportunity to contribute to the financing of the campaigns equally. He can mark a box on his income tax return that he is in favor of making a financial contribution to finance the campaigns of presidential candidates. The provision was worked out so that if that taxpayer is interested, he can have a dollar of his tax used to finance presidential candidates. Fifty cents of that dollar would presently go toward the Republican campaign and 50 cents of it toward the Democratic campaign. I believe that is a better way to do it, so that the candidates do not have to pad around to corporations and unions looking for money for their campaigns. They will be equally obligated to the citizens. Then we will not have to have these President's clubs or any other clubs. Once a candidate is nominated, the people take care of his financing. In effect, a citizen contributes 50 cents to both sides. The citizen makes that contribution as a matter of good government. He is not going to ask for any personal consideration. Nobody will know who he is. The $1 he has contributed will be split 50 cents for one party and 50 cents for the other; 50 cents to President Johnson, if he runs again, and 50 cents to whomever the Republican nominee may be. This will be financing good government.

The Senator from Delaware has said that this will not solve the equal time problem. It solves that problem. Television is very expensive. Both the Republican and the Democratic candidates will have plenty of time and will have money to pay for it. Splinter parties

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would not be included, unless they had votes of more than 1,500,000. So this provision solves the equal time problem which has been plaguing Congress for so long.

The provision the Senator from Delaware proposed—was studied, we had hearings on it, we had witnesses testify, we thought about it, we meditated on it, and rejected it in favor of the provision before us today. It is the judgment of the 12 members of the Finance Committee. I regret to say it is not the judgment of four members headed by the Senator who in the beginning was the ramrod of the suggestion that we do something about campaign contributions and who now suggests that we cut it out of this very bill.

Now he finds it is inconsistent, that it is not relevant to the bill. That did not bother the Senator a bit when he was offering his campaign financing proposal.

Mr. NELSON. Mr. President, will the Senator yield?

Mr. LONG of Louisiana. I yield.

Mr. NELSON. This provides that the taxpayer must mark his own tax return, indicating that it is his desire that a dollar of his tax money be allocated to both parties equally?

Mr. LONG of Louisiana. That is correct.

Mr. NELSON. Some time ago, the Senator from Louisiana, the manager of the bill here, introduced a bill which I thought was much better than this provision. I realize perhaps this is as far as he can go at this time.

The fact of the matter is that this is the only genuinely creative idea, which I consider valuable, useful, and workable, that I have seen proposed by anybody to reach the problem of financing campaigns in this country; and I congratulate the Senator on his proposal.

The amount of money being spent on campaigns in the States and across this Nation is absolutely scandalous; and the influence, or possible influence, of powerful financial and economic interests upon our legislative bodies in this country is very dangerous. I think it is time that Congress took some action to provide financing for campaigns so that there will be no question but that the people who are elected in our States and at the national level are responsive and responsible to the people of this country, and not to big, powerful economic groups, no matter what such groups might be.

Mr. LONG of Louisiana. Mr. President, a great Republican president, Theodore Roosevelt, after having been president, made the statement that presidential campaign ought to be financed with public funds, and they ought to be accounted for. That is what this measure provides. It does put every taxpayer in the position that he is encouraged to make a $1 designation for good government out of the tax he already owes. All he has to do is mark on his tax return that he wants the dollar of his tax placed in the presidential election campaign fund, to be divided equally between the two major parties. That is all there is to it. If a third party should emerge, it is provided for. If you want to say you have got to get 15 million votes rather than 10 million votes to be re-

garded as a major party, we can do that.

There has not been a serious contender among third party presidential candidates since the late Robert La Follette. But if the fate of this Nation should require a third party to emerge, the measure provides for that, too, because it provides that when they receive 1,500,000 votes, they will be entitled to be financed to the extent of $1 for every vote they received over 1,500,000.

It is a carefully considered proposition. It is the best we can do at the moment. I believe, if we pass this provision, and begin moving in that direction, that with time we can improve on it and make it a better measure. But this is a manner of saying that the President, when elected, would be equally obligated to every taxpayer who is interested in financing his campaign, and just as much to a man who voted against him as to a man who voted for him. Because, when a man marks on his tax return that he wants a dollar of his tax paid into the presidential election campaign fund he is in effect dividing his dollar between the two parties equally. He is not thereby indicating a political preference.

Mr. LAUSCHE and Mr. MURPHY addressed the Chair.

The PRESIDING OFFICER. The Senator from Ohio.

Mr. LAUSCHE. Mr. President, I yield to the Senator from California.

Mr. MURPHY. Mr. President, does the distinguished Senator mean to indicate by his last statement that the regard of the President of the United States for the individual is dependent upon a donation made for his election? I am sure the Senator did not mean that.

Mr. LONG of Louisiana. The Senator may draw his own conclusions. My remarks will speak for themselves. I am simply trying to put into effect a one-man, one-vote principle in financing the campaigns of presidential condidates and to encourage widespread participation in the process of financing presidential campaigns, something not at all inconsistent with the thinking of the President on this subject.

Mr. MURPHY. I ask the Senator another question. Having experienced, at one point in my colorful career, the receipt of a message which said that if I did not donate a dollar to a certain union of which I was a member, I would not be permitted to work, ever since then I have been sensitive about dollar donations, and whether any device may one day be found to control such dollar donations.

I am of the belief, and would like to ask the Senator if he does not agree with me, that the matter of political costs and campaign costs has increased unnecessarily. I think there is no question about that. The greatest increase comes from the use of the new medium, television. Would it not be more practical if we made an approach whereby the use of the air, which belongs to the people and not to the networks, would be divided between the candidates, for the time being? Then possibly we would not have to worry about future collections of moneys, and maybe we could begin to de-escalate this entire unnecessary expeniture that is taking place in our presidential campaigns. I ask the Senator if he does not think that would be a more practical approach.

Mr. LONG of Louisiana. Mr. President, that might be an attractive suggestion for television stations that were making a lot of money. I would hate to tell a television station that was losing money that it must give a lot of free time to put people on the air. But if the Senator wishes to offer that suggestion, I would suggest that he propose it as legislation and send it to the appropriate committee. This committee does not have jurisdiction of that matter, but I would hope that the committee that does have jurisdiction of it would study it and give it their best judgment.

Mr. MURPHY. If the Senator will forgive me, I did not expect the matter to be taken up in this bill. I had assumed that the principle of truth in packaging, which was so eloquently explained by the Senator from Michigan in this Chamber, which was designed to protect the housewives of America, would also apply to the Members of the U.S. Senate. That is why I am amazed at the number of things that turn up in a bill which I understood had to do with foreign investments.

I hope that the Senator will forgive my interruption.

Mr. LONG of Louisiana. Mr. President, I am happy to forgive the interruption, but let me say that these 23 amendments are not all the amendments of the Senator from Louisiana. As a matter of fact, I believe only 2 of the 23 are amendments by the Senator from Louisiana.

We have, among others, a very important amendment by the Senator from Massachusetts [Mr. SALTONSTALL]. That most able Senator, who is planning to retire after this year, has been working for a great number of years to pass a bill to say that, in computing what the Government owes, it should give a statement of all its contingent liabilities. My thought was, well, if it is going to do that, it is all right with me, provided that it also should give a statement of assets on the same basis.

I have been urging the Senator to hold that amendment off all through this Congress to wait for some later bill. We cannot originate revenue legislation, but, if we are going to treat the Senator fairly, we ought to let him offer his amendment; so we have put it on this bill along with the others.

The Senator from Delaware [Mr. WILLIAMS], who says we have put all this

trash in the bill, was the man who, if I recall correctly, offered the amendment on behalf of the Senator from Massachusetts [Mr. SALTONSTALL]. It is a good amendment, and I am happy to agree to it, but I regret to say it is totally irrelevant to the foreign investors' bill.

That is all right. I am not going to demand the right to have the Senator's amendment withheld from consideration forever. But the same thing is true of a great number of amendments, including some amendments by the Senator

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from Illinois [Mr. DIRKSEN] and other amendments by both Republicans and Democrats. This bill is so bipartisan that it never occurred to me to even count up to see whether there were more Republican-sponsored amendments proposed than Democratic-sponsored ones. We thought we were doing the best we could, and let it go at that.

Mr. LAUSCHE. Mr. President, will the Senator yield?

Mr. LONG of Louisiana. I yield.

Mr. LAUSCHE. Mr. President, I understand that the bill contains a provision to the effect that the maximum number of dollars to be distributed equally to the major parties shall not exceed the number of votes cast in the last national election.

Mr. LONG of Louisiana. The Senator is correct.

Mr. LAUSCHE. Does the record contain any testimony as to how much was spent by each of the presidential candidates in the last presidential election?

Mr. LONG of Louisiana. We do not have any official information on that. However, I have inquired of people who have had some contact with the presidential campaigns on both sides, Republicans and Democrats, and the judgment that they expressed to me was they thought to be a realistic figure.

Mr. LAUSCHE. What is that realistic figure—$65 million?

Mr. LONG of Louisiana. It is $1 for every vote cast, and it is to be divided equally between the two major parties. That would be a realistic figure.

Mr. LAUSCHE. It would be $32.5 million for each party.

Mr. LONG of Louisiana. There is an estimate that, in the last presidential election year, $250 million was spent. Not all of that amount was spent in the presidential campaign. Not even a major portion of it was spent in the presidential campaign. A lot of it was spent in campaigns for Senators, Representatives, and even, I suppose, for clerks of court. It is estimated that in that year over $250 million was spent in political campaigns.

Mr. LAUSCHE. There is nothing in the record to show, on the basis of the reports filed for the presidential campaign, how much was definitely spent by the presidential candidates.

Mr. LONG of Louisiana. We do not have conclusive information on that. If I do say so, I believe the people who know best would not want to tell us except on a confidential basis.

Mr. LAUSCHE. If the pending measure is passed and each of the 65 million taxpayers consent to the use of $1 of his tax money for presidential campaigns, instead of for public services, it would produce $65 million.

Mr. LONG of Louisiana. That would be for 1 year.

Mr. LAUSCHE. Would this amount accumulate so that at the end of 4 years there would be $260 million?

Mr. LONG of Louisiana. That would be the case if all of it were so designated. The money is simply transferred to the fund by the Secretary of the Treasury in the presidential year.

Mr. LAUSCHE. Instead of $260 million being available for public services and to supply public schools, the $260 million would be turned over to the political parties to promote the campaigns.

Mr. LONG of Louisiana. I regret that the Senator did not understand me.

Mr. LAUSCHE. It will accumulate for 4 years.

Mr. LONG of Louisiana. It would not accumulate. It would all go back in the general fund. If there were more dollars there than there were votes or than there were expenses, the remainder would go back to the general fund of the Treasury and would be used for the schools and all the other things in which the Senator is interested.

The amendment does provide for an accounting of every nickel of these campaign expenditures. The man in whom we have the most confidence, when it comes to checking on who spends what, happens to be the Comptroller General of the United States.

The Comptroller General of the United States would check these expenditures and be advised by a bipartisan board consisting of two Republican and two Democratic members, and three members chosen by those four members.

The Democrats would be watching every dime expended by the Republicans, and the Republicans would be watching every dime expended by the Democrats. Both sides would be watching their own parties as well. Every nickel of this money would be accounted for.

If any funds are improperly expended, there are statutes on the books to take care of that.

Mr. WILLIAMS of Delaware. The Senator mentioned the fact that I sponsored an earlier amendment dealing with campaign contributions. That is true. However, that amendment would have allowed every taxpayer to decide to whom he wished to make his contribution. He could make a contribution of up to $100 to the party of his choice and then deduct it on his tax return. Each

taxpayer would have the right to determine which political party he wanted to support.

There is no freedom of choice contained in this particular proposal.

The Senator from Louisiana is correct that hearings were held on some of these proposals. However, when this proposal was first introduced by the Senator from Louisiana and hearings were held on it, it was proposed to finance the cost entirely out of the Federal Treasury.

The method of financing has since been changed.

We should also have had hearings simultaneously with other committees to inquire into the other presidential proposal. We should require a greater degree of accountability with respect to all expenditures in presidential, congressional, and local races. That is not done under this proposal.

We will not cure the problem by taking $60 million or $70 million and pouring that much money into campaign funds with no accounting or control over the expenditures.

The Comptroller General of the United States can audit this particular fund, but he cannot make an audit with respect to the amount of money that is spent over the amount provided under this proposal.

Why not let the Comptroller General audit all campaign expenses? I think that somebody should have the power to do so.

Mr. President, I am ready to vote.

The PRESIDING OFFICER. The question is on agreeing to the amendment of the Senator from Delaware [Mr. WILLIAMS].

On this question, the yeas and nays have been ordered and the clerk will call the roll.

The legislative clerk called the roll.

Mr. LONG of Louisiana. I announce that the Senator from Idaho [Mr. CHURCH], the Senator from Massachusetts [Mr. KENNEDY], and the Senator Maryland [Mr. TYDINGS] are absent on official business.

I also announce that the Senator from New Mexico [Mr. ANDERSON], the Senator from Tennessee [Mr. BASS], the Senator from Illinois [Mr. DOUGLAS], the Senator from Mississippi [Mr. EASTLAND], the Senator from Arizona [Mr. HAYDEN], the Senator from New York [Mr. KENNEDY], the Senator from New Hampshire [Mr. MCINTYRE], the Senator from Montana [Mr. METCALF], the Senator from Utah [Mr. MOSS], the Senator from Rhode Island [Mr. PELL], the Senator from West Virginia [Mr. RANDOLPH], the Senator from Virginia [Mr. ROBERTSON], the Senator from South Carolina [Mr. RUSSELL], the Senator from Florida [Mr. SMATHERS], and the Senator from New Jersey [Mr. WILLIAMS] are necessarily absent.

I further announce that, if present and voting, the Senator from Utah [Mr. Moss], the Senator from West Virginia [Mr. RANDOLPH], and the Senator from New Jersey [Mr. WILLIAMS], would each vote "nay."

Mr. KUCHEL. I announce that the Senator from Colorado [Mr. ALLOTT], the Senator from New Jersey [Mr. CASE], the Senator from Kentucky [Mr. COOPER], the Senator from Nebraska [Mr. CURTIS], the Senator from Iowa [Mr. HICKENLOOPER], the Senator from New York [Mr. JAVITS], the Senator from Idaho [Mr. JORDAN], the Senator from Kansas [Mr. PEARSON], the Senator from Vermont [Mr. PROUTY] and the Senator from Texas [Mr. TOWER] are necessarily absent.

If present and voting, the Senator from Colorado [Mr. ALLOT], the Senator from Nebraska [Mr. CURTIS], the Senator from Iowa [Mr. HICKENLOOPER], the Senator from Idaho [Mr. JORDAN], the Senator from Kansas [Mr. PEARSON], and the Senator from Texas [Mr. TOWER] would each vote "yea."

The result was announced—yeas 33, nays 39, as follows:

[No. 297 Leg.]

YEAS—33

Aiken	Fong	Mundt
Bartlett	Gore	Murphy
Bayh	Griffin	Russell, Ga.
Bennett	Harris	Saltonstall
Boggs	Hill	Scott
Carlson	Hruska	Simpson
Cotton	Jordan, N.C.	Smith
Dirksen	Kuchel	Sparkman
Dominick	Lausche	Thurmond
Ervin	McClellan	Williams, Del.
Fannin	Miller	Young, N. Dak.

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NAYS—39

Bible	Holland	Morse
Brewster	Inouye	Morton
Burdick	Jackson	Muskie
Byrd, Va.	Long, Mo.	Nelson
Byrd, W. Va.	Long, La.	Neuberger
Cannon	Magnuson	Pastore
Clark	Mansfield	Proxmire
Dodd	McCarthy	Ribicoff
Ellender	McGee	Stennis
Fulbright	McGovern	Symington
Gruening	Mondale	Talmadge
Hart	Monroney	Yarborough
Hartke	Montoya	Young, Ohio

NOT VOTING—28

Allott	Hickenlooper	Prouty
Anderson	Javits	Randolph
Bass	Jordan, Idaho	Robertson
Case	Kennedy, Mass.	Russell, S.C.
Church	Kennedy, N.Y.	Smathers
Cooper	McIntyre	Tower
Curtis	Metcalf	Tydings
Douglas	Moss	Williams, N.J.
Eastland	Pearson	
Hayden	Pell	

So the amendment of Mr. WILLIAMS of Delaware was rejected.

Mr. LONG of Louisiana. Mr. President, I move to reconsider the vote by which the amendment was rejected.

Mr. PASTORE. I move to lay that motion on the table.

The motion to lay on the table was agreed to.

The PRESIDING OFFICER. The bill is open to further amendment.

Mr. WILLIAMS of Delaware. Mr. President, I send to the desk an amendment.

The PRESIDING OFFICER. The amendment will be stated.

The assistant legislative clerk read as follows:

The Senator from Delaware proposes on page 184, beginning with line 1, to strike out all down to and including line 3 on page 231.

Mr. WILLIAMS of Delaware. Mr. President, I ask for the yeas and nays on the amendment.

The yeas and nays were ordered.

Mr. WILLIAMS of Delaware. Mr. President, I shall be very brief in connection with this amendment.

Mr. YOUNG of Ohio. Mr. President, may we have order? Attachés are standing around the rear of the Chamber talking with each other. I suggest that if they have any work to do, they should be ordered out of here so that we can hear what is going.

Mr. President, I am pointing right at them. They are talking together and it is difficult to hear anything. I feel that they should be back in their offices doing their work instead of standing around talking together and disturbing the Senate. The Sergeant at Arms should ask them to leave unless they cease disturbing the proceedings of the Senate.

Mr. LONG of Louisiana. Mr. President, I am willing to cooperate with the Senator, but this is a very technical bill and I have to have the staff here to assist me in connection with the bill.

Mr. YOUNG of Ohio. Mr. President, they should keep quiet and not talk with each other. If they have something to say they should talk with Senators.

The PRESIDING OFFICER. If it is up to the Presiding Officer, he has been carefully observing the Senate and is sure, in all candor, that 95 percent of the talk has been between Senators. However, the Presiding Officer asks that attachés desist from discussions in the rear of the Chamber.

Mr. PASTORE. Mr. President, I agree with the observation of the Chair.

The PRESIDING OFFICER. The Senate will be in order.

Mr. WILLIAMS of Delaware. Mr. President, this bill started out to provide more equitable tax treatment for foreign investors in the United States. I feel that title I does an excellent job in taking care of the situation. I am in favor of that part of the bill, and I would like to support it.

Title I would increase revenues of the Government by $26 million, but titles II, III, and IV go far afield. As the matter now stands with all of the four titles included, when fully applicable they would cause a loss in revenues of between $500 and $600 million.

Titles II, III, and IV deal with the various provisions beginning with providing special depletion allowances for clam and oyster shells, depletion allowances for various types of clay, financing an election from the Federal Treasury, and special deductions for medical expenses. One amendment to the Medicare Act of 1965 would provide an additional $180 to $200 million for the cost of drugs.

The administration is already faced with the embarrassing fact that under title XIX of that act, as passed by Congress, there is about a $1 billion loophole. It is becoming apparent that Congress is not going to get time to deal with this before adjournment. This is indefensible on the part of the administration, which for months has known of this loophole in title XIX, and yet they did not come to the Congress to correct it. Why? Are they afraid to tell the voters before election what they will have to take away from them? This bill provides a special authority to sell FNMA certificates to foreigners abroad.

Altogether these amendments—there are 23 of them—would decrease revenues by between $500 million and $600 million.

This bill in its present form has been referred to in the Wall Street Journal as "the Grab Bag Act of 1966." I hope that this amendment will be adopted. If the amendment which I am now offering is adopted it would leave in the bill only that title dealing with foreign investment tax credit. It would save a $500 million loss in revenue at a time when everybody is talking about a tax increase soon after the votes are counted this November.

Mr. AIKEN. Mr. President, will the Senator yield?

Mr. WILLIAMS of Delaware. I yield.

Mr. AIKEN. Mr. President, I think that this Congress should have adjourned sine die last week. In the 26 years that I have been here I do not believe I have seen any time when the Senate appeared more irresponsible than it does now. We have before us a 231-page tax bill, most of which we saw for the first time at 10 o'clock this morning. There is an 80-page report accompanying the bill. I have not had the time to know what this tax bill contains.

I have noticed that many of the provisions are retroactive to last January; and that most of the other provisions take effect upon passage of the bill. To me it looks very much as if the people benefiting from the provisions of this bill are trying to nail them down before Congress knows what it is doing.

We have a war on. I understand the President wanted more revenue to pay the cost of the war. It is my understanding, and I believe it is common knowledge around town, that instead of providing funds this bill would reduce the income of the Government several hundred million dollars a year. This bill should be set aside until the time comes when we can act on it responsibly.

Mr. LONG of Louisiana. Mr. President, I thought that the purpose of making a speech on the floor of the Senate was to inform people. I thought that