

We urge that in your deliberations, you carefully weigh the evidence submitted by the aircraft, airline, travel industry and other interested parties which, collectively, seeks to indicate that with the cooperation of all concerned, alternative and far more desirable measures could be adopted to overcome the problem of the so-called travel gap.

Our services are at your disposal and we thank you for the opportunity to submit our opinion on this important subject.

Very truly yours,

KARL L. LEWIN, *President.*

New York, N.Y., February 12, 1968.

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DEAR SIR: It is our understanding that hearings are about to be conducted by the House Ways and Means Committee in connection with the Direct Foreign Investment Program and the Regulations which have been issued thereunder. As you know, the Regulations contain a provision which requires that a specified share of total annual earnings from affiliated foreign ventures must be repatriated at least once each year. Published reports have stated that legislation is being sought which will provide Federal income tax incentives for such repatriation. The purpose of this letter is to set forth a suggested Federal income tax incentive in a particular area.

The suggestion herein is that the shareholders of a Subchapter S corporation be granted a foreign tax credit with respect to dividends received by the Subchapter S corporation from foreign subsidiaries.

Domestic corporations are allowed a foreign tax credit against their U.S. income tax for the following:

1. Income taxes of foreign countries imposed on the domestic corporation itself (Sec. 901(a), Int. Rev. Code).

2. Income taxes of foreign countries imposed on a foreign corporation subsidiary of the domestic parent, in tax years in which the subsidiary distributes a dividend to the parent. This credit also extends to foreign income taxes paid by a sub-subsidiary. Thus, in tax years, where there are dividends through the chain from the foreign sub-subsidiary to foreign subsidiary to domestic parent, the latter is deemed to have paid an appropriate portion of foreign income taxes actually incurred by the foreign subsidiary and sub-subsidiary (Sec. 902(a) & (b), Int. Rev. Code).

In a great many cases, the foregoing credits will completely eliminate any U.S. income tax on foreign corporation dividend income.

However, the benefit of the foregoing credits is denied to the shareholders of a Subchapter S corporation, i.e., one which elects not to be subject to Federal income tax pursuant to rules stated in Code sections 1371-8. Income taxes of foreign countries imposed on the Subchapter S corporation itself will result in tax benefit to the shareholders of the Subchapter S corporation only as a deduction. The "deemed paid" foreign tax credit granted to a taxpayer corporation under Sec. 902(a) & (b) is completely lost under a Subchapter S election. Thus, under present law, such foreign corporation dividend income will be fully taxed to the shareholders of the Subchapter S corporation without benefit of any foreign tax credit whatever. This loss of foreign tax credits creates a disincentive to repatriation of earnings from foreign first and second tier subsidiaries where the domestic parent is a Subchapter S corporation.

We respectfully request that legislation along the following rough outlines be considered:

(a) The shareholders of the Subchapter S corporation would be deemed to have paid the foreign income taxes paid and deemed paid by the Subchapter S corporation, computed as if the corporation were a taxpayer corporation. The foreign tax credit "pass-through" might be allocated pro-rata to shareholders at the end of the tax year of the Subchapter S corporation.

(b) In computing the taxable income of the Subchapter S corporation, dividend income from foreign corporations would be "grossed up" by the amount of the "deemed paid" foreign tax credit as if the Subchapter S corporation were a taxpayer corporation.

(c) For purposes of computing the limitation on the foreign tax credit under Section 904, there would be an appropriate "pass-through" of the Sub-