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L.B. Rist: Interest Equalization Tax

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88TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
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INTEREST EQUALIZATION TAX ACT OF 1963

DECEMBER 16, 1963.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. MILLS, from the Committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 8000]

The Committee on Ways and Means to whom was referred the bill (H.R. 8000) to amend the Internal Revenue Code of 1954 to impose a tax on acquisitions of certain foreign securities in order to equalize costs of longer term financing in the United States and in markets abroad, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment appears in italic type in the bill herewith reported to the House.

I. SUMMARY

H.R. 8000, as reported, provides an interest equalization tax designed to bring the cost of capital raised in the U.S. market by foreign persons more closely into alinement with the costs prevailing in markets in other industrial countries. The tax is designed to aid our balance-of-payments position by restraining the heavy and accelerated demand on our capital market from other industrialized countries. The interest equalization tax is a temporary excise tax effective for the period July 19, 1963 (August 17, for listed securities) through December 31, 1965.

The bill imposes the tax on the acquisition by a U.S. person of a debt obligation of a foreign obligor, or stock of a foreign issuer, which is acquired from a foreign person. The tax on the transfer of stock is 15 percent of the actual value of the stock at the time of the transfer. The tax on the transfer of debt obligations varies from 15 percent on obligations with a maturity of 28½ years or more down to 2.75 percent for those with a maturity of 3 to 3½ years. For debt obligations with a shorter maturity, no tax is imposed.

99-006—63——1

These tax rates are designed to reduce the net rate of return to the U.S. buyer on the foreign securities involved by about 1 percent per annum, in order to decrease the volume of foreign securities sold in the U.S. market. It is anticipated that this may well improve the U.S. balance of payments by from $1.25 to $1.5 billion a year relative to the rate in the first 6 months of 1963. It is expected to increase revenues by up to $30 million a year.

The principal exclusions in the bill relate to—

(1) Securities acquired from a prior American owner;

(2) Securities received in connection with a wide range of export transactions;

(3) Debt obligations received by commercial banks in the course of their commercial banking business;

(4) Direct investments in 10-percent-owned corporations;

(5) Securities of "less-developed-country corporations" and obligations of less-developed countries;

(6) New security issues which the President exempts in the interest of international monetary stability, presumably new Canadian securities;

(7) Reserves maintained by insurance companies doing busineww in foreign countries; and

(8) Investments of foreign membership dues by labor unions and other exempt organizations.

The administration has strongly urged the adoption of this bill as an essential part of the overall program to reduce the balance-of-payments deficit.

II. REASONS FOR THE BILL

As indicated in table 1, the U.S. balance of payments has consistently been in a deficit position since 1957, and with the exception of the year 1957, has been in a deficit position since 1949. The deficits attributable to the last 6 years have given rise to a depletion of the U.S. gold reserve of over $7 billion.

TABLE 1.—*U.S. balance of payments annually for the period 1949–62, and quarterly for 1962 and 1963 to date*

[In millions of dollars; quarterly figures seasonally adjusted annual rates]

1949	175	1961	−2,370
1950	−3,580	1962	−2,186
1951	−305	1962:	
1952	−1,046	I	−2,340
1953	−2,152	II	−1,808
1954	−1,550	III	−1,424
1955	−1,145	IV	−3,172
1956	−935	1963:[1]	
1957	520	I	−3,460
1958	−3,529	II	−4,956
1959	−3,743	III	−1,024
1960	−3,881		

[1] Excludes receipts from sales of nonmarketable, medium-term convertible Government securities.

Source: U.S. Department of Commerce.

Thus, on an annual basis the peak deficit in the overall U.S. balance of payments of $3.9 billion was reached in 1960. Since that time, the overall deficit has gradually declined to a level of $2.2 billion in 1962. However, late in 1962 the deficit in the balance of payments started to rise again and this trend continued through the first half of 1963.

As indicated in table 1, the overall deficit in the balance of payments in the fourth quarter of 1962 was $3.2 billion and in the first quarter of 1963 was $3.5 billion (both figures are seasonally adjusted annual rates). Then in the second quarter of 1963, this increased to $5 billion on an annual rate basis. This worsening of the balance-of-payments position occurred despite arrangements for the advance payment of debt owed the United States by various foreign countries, despite progress in reducing net Government outlays of dollars abroad and also despite efforts over that period by the administration to bring upward pressures on short-term interest rates and thus encourage the retention of funds seeking short-term investment in this country.

The trend in the balance of payments in recent years can more accurately be seen by examining the balance on regular transactions.[1] These data are shown in table 2. They indicate that the deficit on regular transactions in 1962 was in excess of $3.5 billion, or more than

[1] This includes all regular reoccurring transactions, including those involving the Government, but does not include nonscheduled repayments of Government loans, advances from other countries on military exports, and other special measures taken to reduce the financial burden of the deficit, such as medium-term borrowings.

$500 million above the deficit in 1961. Moreover, the deficits of $973 million and $1,258 million in the first two quarters of 1963, respectively, when converted to an annual rate, suggest a deficit in these regular transactions of approximately $4.5 billion for the first 6 months of the year. Table 2 indicates that the major factor in this worsening of the balance-of-payments position is the outflow of private long-term capital. The net outflow of this capital increased over $300 million from 1961 to 1962. Moreover, the experience of the first two quarters of 1963 suggests that private long-term capital outflows could be expected to reach an annual rate of $3.5 to $4 billion, further increasing the outflow of long-term capital more than $1.25 billion above the 1961 level.

TABLE 2.—*U.S. balance of payments, 1960 through 3d quarter 1963*

[In millions of dollars]

	1960	1961	1962	1963 [1]		
				1st quarter	2d quarter	3d quarter
Commercial trade balance	2, 817	3, 179	1, 989	402	497	530
Commercial services balance	1, 458	2, 130	2, 322	615	481	585
Balance on commercial goods and services [2]	4, 275	5, 309	4, 311	1, 017	978	1, 115
Military expenditures	−3, 048	−2, 934	−3, 028	−748	−725	−707
Military cash receipts [3]	336	393	673	184	197	171
Government grants and capital-dollar payments to foreign countries and international institutions	−1, 107	−1, 116	−1, 070	−241	−267	−179
Government capital receipts, excluding debt prepayments, borrowings, and fundings [4]	538	533	513	102	120	166
Remittances and pensions	−672	−705	−736	−212	−209	−193
Private capital:						
Long-term	−2, 114	−2, 143	−2, 495	−1, 022	−901	−482
Short-term	−1, 438	−1, 475	−716	69	−593	31
Unrecorded transactions	−683	−905	−1, 025	−122	142	−334
Balance on regular transactions	−3, 913	−3, 043	−3, 573	−973	−1, 258	−412
Special Government transactions [5]	32	673	1, 387	458	171	331
Overall deficit	−3, 881	−2, 370	−2, 186	−515	−1, 087	−81

[1] Seasonally adjusted but not annual rates.
[2] Nonmilitary merchandise and service transactions less those financed by Government grants and capital.
[3] Excluding advances on military exports.
[4] Includes small changes in miscellaneous Government nonliquid liabilities.
[5] Not seasonally adjusted. Includes nonscheduled receipts on Government loans, advances on military exports, and sales of nonmarketable medium-term securities, including $350,000,000 of nonmarketable medium-term convertible securities in the 1st quarter of 1963, $152,000,000 in the 2d quarter of 1963 and $175,000,000 in the third quarter.

Source: Survey of Current Business.

One of the major factors in the increase in long-term private capital outflow has been the very substantial rise in new issues of foreign securities purchased by U.S. residents. As indicated in table 3, these new issues of foreign securities purchased by U.S. residents increased from $523 million in 1961 to $1,076 million in 1962, an increase of over $550 million. Moreover, the experience in the first two quarters of 1963 would suggest purchases of these securities at an annual rate of about $2 billion. Thus, in this period since 1961 the rate of purchases of these new issues of foreign securities doubled relative to the volume of purchases in the prior year. As indicated by table 3, the great bulk of these new securities issues originated in Canada, Western Europe, and Japan.

TABLE 3.—*New issues of foreign securities purchased by U.S. residents, 1961 to 3d quarter, 1963* [1]

[In millions of dollars]

	Total 1961	1962					1963		
		I	II	III	IV	Total	I	II [2]	III [3]
Canada	237	10	112	41	294	457	368	264	79
Western Europe	57	35	138	15	7	195	65	154	14
Japan	61	11	17	48	25	101	42	65	52
Latin American Republics	18	(4)	19	(4)	[5] 83	[5] 102	12		23
Other developed countries	43	(6)	(6)	(6)	(6)	60		17	
Other less developed countries	95	(6)	(6)	(6)	(6)	77	19	17	11
International institutions and unallocated	12	80	1	3		84			
Total new issues	523	170	312	133	461	1, 076	506	518	179

[1] Not seasonally adjusted.
[2] Revised.
[3] Preliminary.
[4] Less than $500,000.
[5] Includes $75,000,000 issue by Inter-American Development Bank.
[6] Not available.

Source: Survey of Current Business and Department of Commerce.

In addition to new foreign securities floated in the United States, the large volume of outstanding foreign securities sold in the United States also has been an important factor in accounting for the deficit in the balance of payments. United States net purchases of outstanding foreign securities in recent years, and by quarters (not enlarged to annual rates) for 1963, are as follows:

Net purchases of outstanding foreign securities

[In millions of dollars]

1959	−140
1960	−177
1961	−353
1962	−55
1963 (1st quarter)	−48
1963 (2d quarter)	−64
1963 (3d quarter)	+51

The substantial improvement suggested by these figures for 1962, before the announcement of the tax, was centered in transactions in foreign stocks, as shown by table 4. In good part, this appears to have reflected some temporary factors. The available data do not permit a precise analysis of the transactions of U.S. persons with foreigners since the figures are collected only for purchases and sales of foreign securities in the U.S. market, whether or not the transactions are with Americans or other foreigners. But it appears that despite the relatively small net sales of foreign stock in the U.S. market in 1962, Americans remained large buyers of some foreign stock, while apparently increasing their sales to foreigners of foreign stock purchased at an earlier time. The size of these gross purchases and sales is suggested by table 4. The tax should substantially reduce gross sales by foreigners to U.S. purchasers without at the same time affecting incentives to sell other foreign securities, already held by Americans, to foreigners. This could have a substantial favorable effect on the balance of payments, turning what could otherwise be a major net minus factor in the balance of payments to a plus factor, as happened in the third quarter of 1963.

In addition to the direct improvement in the balance of payments anticipated from including within the tax base outstanding foreign securities, it is believed essential to cover these securities in any provision which taxes new foreign issues. If these issues are not subject to the tax, it could be expected that much of the improvement in the balance of payments brought about by taxing acquisitions of new issues would be offset by much larger acquisitions by U.S. persons of outstanding foreign issues. To the extent that sales of outstanding issues are diverted to the United States, the opportunity for selling new issues in the foreign market is improved, thereby achieving much the same result as if the new issues were initially sold in the United States.

TABLE 4.—*Gross transactions in outstanding foreign bonds and stocks, 1960 through 1st half 1963*

[In millions of dollars]

Period	Outstanding foreign bonds			Outstanding foreign stocks		
	Gross sales by foreigners [1]	Gross purchases by foreigners [2]	Net purchases by Americans (−)	Gross sales by foreigners [1]	Gross purchases by foreigners	Net purchases by Americans (−)
1960	−771	669	−102	−575	500	−75
1961	−624	597	−27	−919	593	−326
1962	−782	753	−29	−721	695	−26
1963:						
1st quarter	−175	126	−49	−166	167	1
2d quarter	−175	117	−58	−197	191	−6
1st half	−350	243	−107	−363	358	−5
3d quarter	−248	282	34	−116	133	17

[1] Excludes new issues sold by foreigners to U.S. residents or other foreigners, and adjustment for direct investment transactions.
[2] Excludes redemptions of bond issues held by U.S. residents and other minor differences between security-transaction and balance-of-payments data.

Source: Unpublished balance-of-payments data from Commerce Department.

In the third quarter of 1963—most of which followed the announcement of the tax—table 4 indicates that the net purchases of foreign stocks and bonds result in a favorable balance of $51 million, which converts to an annual rate of $204 million. This can be contrasted to the unfavorable balance in 1962 of $55 million, a difference in the balance-of-payments position of $259 million. The comparable gain from the second quarter to the third was an improvement at an annual rate of more than $450 million.

There are no signs that the flood of new securities issues which occurred up through the second quarter of 1963 would of its own accord fall back to the more sustainable levels of earlier years. Similarly, there is no indication that the purchases of outstanding issues by Americans could be expected to decline in the absence of legislation in this area. Foreign businessmen and foreign local governments are becoming more aware of the efficient marketing facilities and also the relatively low rates of interest available here, and are learning how to place securities in the U.S. market. Moreover, as production costs rise in the European market, business firms are finding it more difficult to finance their growth from retained earnings. Thus they can be expected to be in the market for increased funds.

The European markets still are not adequately organized to efficiently supply business needs or the borrowing requirements of their governments from the growing savings of their own people, and as a result, foreign enterprises and governments, in the absence of a change in capital costs, can be expected to look toward the United States for these funds.

Similarly, U.S. underwriters are becoming more familiar with foreign securities. Moreover, American investors have become more interested in foreign issues because of the large volume of these securities now being offered in this country, and because the rate of return on these securities, relative to the domestic investment outlets, makes them highly attractive. The unfortunate experience of the 1920's and 1930's, which in the past has restrained the demand for foreign securities, now appears to have been largely forgotten. In addition, the more ready convertibility of currencies in recent years has lessened the fear of difficulty in obtaining payment in the United States of income and principal on these securities.

This bill deals with this problem of excess sales of foreign securities here in the United States by imposing a tax, called the interest equalization tax, on the acquisition by a U.S. person of a foreign security from a foreign person. In the case of stocks, this tax is 15 percent of the actual value. In the case of bonds, the tax is graduated by the remaining length of time to the maturity of the bond, varying from 2.75 percent for bonds with a period of maturity of 3 to 3½ years (those with a period of less than 3 years are exempt) to the same 15 percent rate applicable to stocks in the case of bonds with a period to maturity of 28½ years or more. The schedule of rates applicable to bonds is calculated to be the equivalent to raising the interest rate in the U.S. market by 1 percent. Since the sale of stock is, of course, an alternative way of raising capital for foreign corporations, the tax is applied to equities in a manner which will have a comparable effect on the costs of raising capital by this means.

Looked at from the standpoint of an American contemplating the purchase of an outstanding security from a foreign person, the interest equalization tax will reduce the yield of that security by about 1 percent, making the yields available on alternative domestic investment relatively more attractive. Looked at from the standpoint of foreign persons raising new money, the interest equalization tax will raise the cost of obtaining capital in the U.S. market by approximately this same 1 percent.

The interest equalization tax is expected to raise the cost of obtaining capital in the U.S. market to more nearly the cost prevailing in most of the industrialized countries abroad. In only two countries, Switzerland and the Netherlands, are long-term interest rates below, or comparable with, those presently prevailing in the United States. However, these countries limit by direct controls the amount of foreign borrowing which can occur in their markets. This is also true of the United Kingdom, which has the largest of the foreign markets. The United Kingdom until quite recently confined its lending almost entirely to Commonwealth countries in the sterling area. This is true even though in the United Kingdom the prevailing interest rate already is 1 percent or more above the rate prevailing in the United States.

The higher cost to foreign persons of obtaining funds in the United States as a result of this tax will not prevent the floating of new issues, or the sale of outstanding issues in this country. With the tax in effect normal market factors will continue to determine which issues will be marketed in the United States. However, the bill will stop the drain of funds from this country by foreign borrowers who are motivated merely by the fact that long-term funds may be obtained here at a slightly lesser interest rate than generally prevails abroad.

Of course, much the same results could be obtained by raising the long-term interest rate by 1 percent or more in the United States. To achieve such a rise of long-term rates in a market which characteristically supplies many times as much capital for domestic uses as for foreign, would under present circumstances not only be very difficult but also unwise. Long-term interest rates have remained relatively steady over the past 3 years, despite rising demands for funds, because of the substantial ability of this Nation to generate liquid savings. In this environment, monetary policy or the use of other powers of the Government evolving within free markets would not be capable of bringing about a change in interest rates of sufficient size to effect a substantial reduction in the flow of funds abroad. Certainly, attempts to achieve this result would have a restrictive effect on new domestic investments at the very time additional investments are required in this country to bring about a higher rate of growth.

This tax is imposed as a temporary tax effective only through 1965. It is a part of the broader attack on the balance-of-payments problem, which includes both short- and long-run measures dealing with all items affecting the balance of payments. On one hand, it is is anticipated that the profitability and attractiveness of domestic investment will be improved as a result of the tax reduction program already passed by the House; and, on the other hand, it is anticipated that as the capital markets in other industrialized countries abroad become more efficient and are freed of controls, they will supply a larger share of the world's capital requirements. The termination of the tax at the end of 1965 will give Congress an opportunity to review all of the relevant considerations at that time, when it is hoped these readjustments in savings and investment patterns and improvements in the U.S. balance of payments will make it unnecessary to continue this tax.

The tax is effective with respect to transactions occurring on or after July 19, 1963, which was the day after the administration proposed the tax, and the date on which it was recommended that the bill become effective. Your committee believes that it is necessary to make the tax effective as of that date. To do otherwise, would have invited a flood of transactions in foreign securities after the announcement of the proposal, but before the effective date. This, of course, would have substantially worsened the balance-of-payments position. However, for securities listed on national exchanges the effective date was made August 17, 1963, in order to give the exchanges an opportunity to adjust to the new procedures.

As a result of this announcement's effect, the interest equalization tax has already played an important part in reducing the outflow of capital and in improving our overall balance-of-payments position.

As indicated by table 2, the outflow of U.S. capital in the form of new issues of foreign securities decreased from levels of $506 million and $518 million consecutively in the first two quarters of 1963 to $179 million in the third quarter. The experience in outstanding

foreign stocks and bonds purchased by Americans in this period is similar (see table 4). In the first half of 1963, net purchases by Americans of outstanding foreign stocks and bonds amounted to $112 million. On an annual rate basis this represents an unfavorable balance of $224 million. In the third quarter, there was a favorable net balance of $51 million, or, on an annual rate basis, a favorable net balance of $204 million. This is a change from the experience in the first half of over $400 million.

This dramatic improvement in the balance of payments is a concrete demonstration of the effect that this bill can be expected to have. The Treasury Department has estimated that this bill will result in an improvement in the balance of payments of $1¼ to $1½ billion from the rate in the first 6 months of 1963. This is suggested from the changing pattern of U.S. transactions in foreign securities in the third quarter relative to the first half of this year. Table 5, which shows selected capital movements in 1962 and in the first three quarters of 1963 on an annual rate basis, demonstrates the basis for this expectation. This table shows that the purchase of new issues of foreign securities in the third quarter of 1963 was at an annual rate of approximately $1.1 billion below the level of purchases of these securities in the first half of the year. In addition, the table shows that net U.S. purchases of outstanding foreign securities have between the first half and the third quarter of 1963 changed from an unfavorable balance of $224 million to a favorable balance of $204 million. This is an overall change in the balance-of-payments position of over $400 million. The combined savings in the balance of payments for these two categories, therefore, is $1.5 billion. While it is recognized, of course, that uncertainties related to the imposition of the tax may have restrained new lending during the third quarter, it should also be noted that the sizable volume of new issues reaching the market during that period reflected a working off of the large backlog of new issues for which commitments had been made prior to the announcement.

TABLE 5.—*U.S. balance of payments—Selected capital movements and deficit on regular transactions, 1962 to 3d quarter 1963*

[Seasonally adjusted annual rates; in millions of dollars]

	Full year 1962	1963		
		1st half	2d quarter	3d quarter [1]
Selected capital movements:				
U.S. transactions in foreign securities:				
New issues	−1,076	−1,922	−1,944	[2] −852
Redemptions	170	166	208	96
Other U.S. purchases (−) or sales (+)	−55	−224	−256	204
Total foreign securities	−961	−1,980	−1,992	−552
Bank credits to foreigners:				
Long-term	−117	−318	−708	−572
Short-term	−277	−772	−1,960	8
Total bank credit	−394	−1,090	−2,668	−564
Foreign purchases (+) or sales (−) of U.S. securities	+134	+294	+532	+144
Total securities and bank credit	−1,221	−2,776	−4,128	−972
Balance-of-payments deficit on regular transactions	−3,573	−4,462	−5,032	−1,648

[1] Preliminary.
[2] Reflects almost entirely commitments made before July 18.

Source: Commerce Department.

The period which elapsed after July 18 and before your committee acted to report this bill has made it possible to observe the effects this tax could be expected to have on various groups in the United States. This has demonstrated areas in which the original recommendation of the Treasury Department would have created hardships and inequalities. This period of approximately 4 months has made it possible for your committee to make adjustments to the originally proposed bill to alleviate these hardships and inequalities while at the same time maintaining the basic concepts of the bill as recommended by the administration. The various exemptions provided, including those for export paper, commercial bank loans, and short-term paper, will assure that our export effort and the normal recurring financing of international business will not be hampered. These exemptions are explained in the general explanation which follows.

III. GENERAL EXPLANATION

a. Imposition of tax

This bill, subject to specified exemptions, imposes a tax on the acquisition by U.S. persons of foreign securities from a foreign person. It does not apply to purchases of foreign securities by U.S. persons from other U.S. persons. To the extent practicable, the application of the tax is limited to the area of long-term investment, which in recent years has had an adverse effect on the U.S. balance of payments.

1. *Rate of tax.*—A tax of 15 percent of the actual value is applied to the acquisition by a U.S. person of stock of a foreign issuer. In the case of the acquisition of a debt obligation of a foreign obligor, the tax is determined on the basis of the length of time remaining to maturity of the obligation at the time acquired by a U.S. person in a taxable transaction. The tax rate increases as the period remaining to maturity of an obligation increases. No tax is imposed where the period to maturity is less than 3 years. The tax rates applied are designed to have the effect of increasing a foreigner's cost of raising capital in the United States by approximately 1 percent a year. The schedule of rates is as follows:

If the period remaining to maturity is—	The tax, as a percentage of actual value, is—
At least 3 years, but less than 3½ years	2.75 percent.
At least 3½ years, but less than 4½ years	3.55 percent.
At least 4½ years, but less than 5½ years	4.35 percent.
At least 5½ years, but less than 6½ years	5.10 percent.
At least 6½ years, but less than 7½ years	5.80 percent.
At least 7½ years, but less than 8½ years	6.50 percent.
At least 8½ years, but less than 9½ years	7.10 percent.
At least 9½ years, but less than 10½ years	7.70 percent.
At least 10½ years, but less than 11½ years	8.30 percent.
At least 11½ years, but less than 13½ years	9.10 percent.
At least 13½ years, but less than 16½ years	10.30 percent.
At least 16½ years, but less than 18½ years	11.35 percent.
At least 18½ years, but less than 21½ years	12.25 percent.
At least 21½ years, but less than 23½ years	13.05 percent.
At least 23½ years, but less than 26½ years	13.75 percent.
At least 26½ years, but less than 28½ years	14.35 percent.
28½ years or more	15.00 percent.

The equivalence of the tax to an interest rate increase of 1 percent for foreign borrowers can be illustrated by the following example. Assume that prior to the imposition of the tax a foreign borrower and a U.S. borrower could each obtain $100,000 in the United States for a 10-year period at an interest rate of 5 percent payable annually. Thus, each would pay $50,000 in interest spread over the life of the loan for use of the $100,000. Under the bill, the domestic borrower could continue to borrow on the same basis. However, since the American purchasing the debt obligation from the foreign borrower would also have to pay a tax of $7,700 (7.7 percent rate for debt with a maturity of 9½ to 10½ years), presumably the foreign borrowers in order to raise funds in competition with American borrowers would have to reimburse the lender for the tax. One way of doing this would be to ask the borrower to pay a higher interest rate. Had he been required to pay a 1-percent higher interest rate, spread over the 10-year period, he would have paid $10,000 additional. The $7,700 in tax, all of which would have to be paid at the beginning of the 10-year period, is approximately the present value of ten $1,000 payments spread over the period of the life of the obligation when discounted at about the prevailing rate for foreign securities. The tax passed onto the borrower, therefore is about the equivalent of an increase in the interest rate of about 1 percent.

The bill provides no tax on the acquisition of debt obligations having less than 3 years remaining to maturity from the date of acquisition. Interest rates for short-term loans in the United States can more readily be influenced by monetary policy, when appropriate, and have been brought into closer alinement with those prevailing in most important industrialized countries abroad. Moreover, this exemption will permit the wide variety of transactions relating to international trade to proceed unhampered. Although your committee is aware of the fact that the exclusion of short-term loans from tax could shift foreign long-term borrowers into the short-term money market, it appears unlikely that this effect will occur to an important extent.

Under the bill, debt obligations which are convertible into stock over more than a 5-year period will initially be taxed as debt obligations. However, at the time they are converted into stock, they will be subject to an additional tax equal to the full 15-percent rate which would have been paid if they initially had been stock, reduced by the tax previously paid by the person making the conversion. Where the debt instrument may be converted into stock only within 5 years of the date of issuance, the instrument is treated under the bill as initially being stock and at that time subject to the 15-percent tax.

Your committee concluded that a debt obligation which could be converted into stock over an extended period of time (more than 5 years) should be basically treated as a debt obligation for purposes of the interest equalization tax. Since the interest equalization tax is imposed only for a short period (namely, through December 31, 1965) it was believed that these obligations would in all likelihood be acquired primarily for their debt features. However, your committee recognized that the treatment of all convertible instruments as debt obligations would create a possibility of avoidance whereby foreign persons could issue short-term debt instruments whose principal attraction would be the combination of a low tax rate with favorable conversion features that would be exercised shortly after the termination date of the interest equalization tax. Therefore, your committee's bill treats those obligations which must be converted over a relatively short period of time into stock in the same manner as if they initially were stock issues. On the other hand, longer term convertible debt obligations are so treated only if actually converted during the period of time when the tax is in effect.

2. *Persons liable for tax.*—The person acquiring the obligation of a foreign issuer or obligor is subject to tax if this person is a "U.S. person;" i.e., a citizen or resident of the United States, a domestic partnership, a U.S. estate or trust, or a domestic corporation. Acquisitions made by a State of the United States or by an agency, instrumentality, or political subdivision of a State, are also subject to tax. In addition, corporations created or organized under the laws of the Commonwealth of Puerto Rico or the Virgin Islands or other possessions of the United States are treated as U.S. persons. Thus, for example, acquisition of foreign stock or debt obligations by Puerto Rican corporations will be subject to tax, but acquisitions of the stock or debt obligations of Puerto Rican corporations by citizens or residents of the United States will be exempt.

3. *General application of tax.*—In general, the tax applies whenever a U.S. person acquires ownership of stock or debt obligations of a foreign issuer or obligor from a foreign person. Under this general rule, transfers which are not considered to represent a real change in ownership are not to result in the imposition of the tax. For example, transfers between a person and his nominee, custodian, or agent are exempt from tax, as are transfers from a decedent to his executor or administrator. In addition, transfers to a survivor upon the death of a joint tenant, from a minor to his guardian, and other similar transfers by operation of law, are exempt from tax. The bill also provides that the receipt of stock or debt obligations of a foreign issuer or obligor by an individual citizen or resident of the United States as a gift is not subject to tax. Your committee also provided that acquisitions resulting from corporate distributions, liquidations, and reorganizations would generally be exempt from tax since such transfers generally involve neither a substantial change of position nor an outflow of U.S. dollars. Finally, the receipt of a stock option or similar right by a U.S. person for any reason connected with his employment by a foreign corporation will not be subject to tax if the right is nontransferable, otherwise than by will or the laws of descent and distribution, and is exercisable during the optionee's lifetime only by him.

4. *Limitations on amount of tax.*—The bill contains a special rule for the computation of tax where stock or a debt obligation is acquired as the result of the surrender of another debt obligation, the extension or renewal of a debt obligation by action by the obligee, or the exercise of an option or right to acquire stock or debt obligations. In general, the tax in these cases is equal to the regular tax reduced by the tax which would have been payable had the option, right, or debt surrendered, exercised, extended, or renewed been taxed at that time. In these cases the option, right, or debt obligation involved represents a value the American already had. Where a foreign corporation issues rights to its shareholders which permit the shareholders to subscribe to additional shares of the corporation, the tax is based upon the subscription price.

b. Exemptions from the tax

The bill provides for exemptions for various transactions in order to avoid creating unnecessary hardship and imparing normal commercial transactions, as well as to avoid conflicting with other important national objectives such as the promotion of our export trade and our assistance to the less developed countries of the free world. The principal exemptions provided are described below.

1. *International monetary stability.*—Your committee believes that it is desirable to enable the President of the United States to exempt new security issues of a foreign country from tax where he determines that application of tax to such securities imperils, or threatens to imperil, the stability of the international monetary system. This is in accordance with the treaty obligation of the United States to the Interna-

tional Monetary Fund. This obligation requires the United States "* * * to collaborate with the fund to promote exchange stability * * *."[1]

Your committee has received assurances from the Secretary of the Treasury that, under present circumstances, new issues of Canadian issuers and obligors are the only securities which he would recommend that the President exempt from tax. Moreover, it is the intent of your committee that the exemption of Canadian securities should be contingent upon Canadian borrowings returning to their historical levels and that the exemption should be revoked or limited if Canadian borrowings exceed amounts required to maintain their international reserves and reach the abnormal levels attained in 1962 and the first 6 months of 1963. It is understood that the Canadian Government, through its own interest rate policy or otherwise, will maintain borrowings by Canadians in the United States only to the extent necessary to permit Canada to attain an equilibrium in its reserve position. Therefore, should the Canadian balance-of-payments position improve as a result of recent Government policies to increase exports, it is expected that the need for Canadian borrowing in the United States will be reduced. Your committee has also been assured that the administration will follow the volume of Canadian borrowing in U.S. markets closely. Should the total of such borrowing exceed prudent limits, the President will have discretionary authority to impose a limitation on the volume of such exempt borrowings. This discretionary power to limit the size of any exemption gives assurance that the Canadian exemption will not undermine the purpose of this tax. Your committee believes that the Canadian-United States relationship with respect to the close integration of their capital markets and its implications for the Canadian balance of payments is unique, and that exemption of new issues of Canadian securities under this discretionary provision should not under normal circumstances be extended to securities of other countries.

The bill provides that the exclusion is to apply only to original or new issues. A debt obligation is treated as part of an original or new issue for this purpose only when it is acquired during the first 60 days after interest begins to accrue on the obligation. Stock is treated as part of an original or new issue only when it is acquired from the issuer by the U.S. person claiming the exclusion.

If the President by Executive order limits the amount of issues which may be exempt, or limits the period during which the issues may be exempt, the exclusion is to apply to those as to which notice of acquisition is filed first with the Secretary of the Treasury.

2. *Less developed countries.*—The bill provides that the tax is not to apply to acquisitions by U.S. persons of (1) debt obligations issued or guaranteed by a national or local government of a less developed country, (2) stock or debt obligations of a "less developed country corporation," or (3) a debt obligation issued by an individual or partnership resident in a less developed country in return for property which is used, consumed, or disposed of wholly within one or more less developed countries.

This exclusion is designed to avoid cutting down the flow of private capital to those nations with chronic capital shortages, urgent development needs, and limited capability for foreign borrowing on normal commercial terms. The United States has long recognized a responsibility for assisting these nations in their struggle to achieve improved standards of living, and the application of the tax to issues of these countries would work against that objective. Furthermore, the outflow of portfolio capital to these areas has been limited, never exceeding $200 million during recent years, and usually running closer to $100 million.

[1] Articles of agreement between the United States of America and other powers respecting the International Monetary Fund, Bretton Woods Agreement, art. IV, sec. 4(a).

The bill permits the President to designate any country other than the following as less developed countries:

Australia	Monaco
Austria	Netherlands
Belgium	New Zealand
Canada	Norway
Denmark	Republic of South Africa
France	San Marino
Germany (Federal Republic)	Spain
Hong Kong	Sweden
Italy	Switzerland
Japan	United Kingdom
Liechtenstein	Countries within the Sino-Soviet bloc
Luxembourg	

The President may designate an overseas territory, department, province, or possession of any foreign country as a separate economically less developed country. Until the President designates countries as being economically less developed for purposes of this tax, all countries, other than those listed above, are to be treated as economically less developed and all overseas territories, departments, provinces, and possessions of any foreign country outside the Sino-Soviet bloc are considered to be separate less developed countries. Once the President initially designates a foreign country as being economically less developed for purposes of this tax, he may not terminate such designation without notifying the Congress of his intention to do so.

3. *Direct investments.*—The bill provides that the tax is not applicable to direct investments. Direct investment implies active participation in the management of the foreign corporation. Decisions to make investments of this type largely are concerned with questions of market position and long-range profitability rather than interest-rate differentials. Your committee believes that application of this bill, which is intended to equalize costs as between capital markets, is not appropriate in that area.

The bill defines as direct investments exempt from tax those acquisitions by a U.S. person of stock or debt obligations of a foreign issuer or obligor where immediately after the acquisition (or at the end of that year) the U.S. person owns 10 percent or more of the combined voting power of all classes of stock of the foreign corporation. In determining whether or not a person owns 10 percent of the voting stock, he is considered to own stock owned by corporations in an affiliated group of corporations as well as the stock owned directly.

The bill also defines as direct investments exempt from tax the acquisition of an interest in, or a debt obligation of, a foreign partnership by a general partner if such partner is entitled to a 10-percent or greater interest in the profits of the partnership immediately following the acquisition.

In general, the 10-percent ownership requirement exempts all transactions which would normally be considered business investments. However, your committee's attention was directed to the fact that in certain foreign countries U.S. persons are prevented by government regulation from acquiring as much as a 10-percent interest in certain corporations even though the business of the foreign corporation is directly related to the business of the U.S. person. In such cases (and in similar cases involving general partnership interests) the bill provides for exemption from the tax even though the U.S. person owns less than 10 percent of the voting stock of the foreign corporation (or less than a 10-percent interest in the profits of a partnership).

The "direct investment" exception is not to apply if the foreign corporation or partnership is formed or availed of for the principal purpose of acquiring stock or debt obligations of foreign issuers or obligors in a case where the 10-percent owner would be subject to tax upon acquisition had the stock or debt obligations been acquired directly by him. Thus, U.S. persons will not be allowed to form "closely held" holding companies for the purpose of acquiring securities which would be taxed if acquired directly. Moreover, if a U.S. person acquires stock or debt obligations of a foreign corporation in which he owns a 10-percent or greater stock interest, for the purpose of selling, or offering for sale, any part of the stock or debt obligations to U.S. persons, the exemption will not apply.

4. *Commercial bank loans.*—The bill provides an exclusion from tax for the acquisition of debt obligations by a commercial bank in the making of loans in the ordinary course of its commercial banking business. In part, this is attributable to the fact that the great bulk of commercial bank loans fall within the less than 3-year maturity range and therefore would in any event not be subject to tax. However, this exclusion also recognizes the special role played by banks in support of normal, recurring financing of the international business of American firms. Also, it permits the banks to continue freely their role in financing U.S. exports and their conduct of banking operations in foreign countries through branches. In this latter case, their activities normally consist of receiving deposits in foreign currencies and making loans in such currencies. These transactions, of course, have no effect on the U.S. balance-of-payments position.

Your committee is aware that a generalized exclusion of this type could be abused. Although that is not expected, your committee does consider it necessary to provide specific authority in the bill for the collection of detailed and timely information on the nature of, and trends in, bank lending to foreign persons. The information collected under these reporting requirements will provide a basis both for determining whether a general exclusion of this character should be continued and, if not, for indicating the specific ways in which the general exclusion should then be modified.

The possible need for and practicability of amending this legislation with respect to loans of commercial banks will be reviewed by your committee should this evidence suggest that bank lending to industrialized countries abroad, whose borrowing will otherwise be subject to tax, is rising in amounts out of proportion to a general expansion in the banking business or amounts related to the normal recurring

needs of international trade. A sizable increase in bank lending that appeared to be related to a diversion of credit demands from channels subject to the tax would be a source of particular concern to your committee.

5. *Export financing.*—One of the best ways of reducing the deficit in the U.S. balance of payments is to increase exports from this country. American business has had an excellent record in this regard and to maintain and improve this record it is essential that American firms have the ability to offer credit facilities to their foreign customers, whether for short- or long-term loans. Therefore, your committee has provided for a series of exemptions for stock and debt obligations of foreign issuers or obligors which are acquired as a result of export transactions. These are listed below:

A. *Guarantees by Export-Import Bank.*—The bill provides that the acquisition of debt obligations which are guaranteed or insured in whole or in part by the Export-Import Bank (or other U.S. Government agencies or instrumentalities) are to be exempt from tax. This exemption is based on the fact that the Export-Import Bank guarantees or insures a loan only if, and to the extent, the debt obligation received by the U.S. exporter is attributable to the sale of goods produced in the United States. This exemption applies without regard to the relationship of the exporter to the producer of the goods.

B. *Goods produced in United States.*—If a U.S. person acquires a debt obligation in the course of his trade or business as a result of the sale of property manufactured, produced, grown, or extracted in the United States, the bill provides that the acquisition of the debt obligation is to be exempt from tax if 85 percent or more of the purchase price in the transaction is attributable to the sale of such property, and to the performance of services, by the U.S. person. However, the initial acquisition will in most cases, in effect becomes subject to tax if the U.S. producer transfers the debt obligation to a U.S. person other than a commercial bank which acquires it in the ordinary course of its commercial banking business or other than to an agency or instrumentality of the United States. This restriction on transferability is designed to prevent avoidance of tax by introduction of the exporter into a market transaction normally financed by unrelated financial institutions.

C. *U.S. contractors and suppliers.*—The bill provides that tax is not to apply to the acquisition of stock or debt obligations if 30 percent or more of the purchase price is attributable to the sale of property manufactured, produced, grown, or extracted in the United States by, and services performed by, the person who acquires the stock or debt obligation. However, this is to be true only if 50 percent or more of the purchase price is attributable to the sale of property manufactured, produced, grown, or extracted in the United States, and services performed, by all U.S. persons. This is designed to provide for a problem called to your committee's attention in its public hearings on H.R. 8000. It was pointed out that U.S. persons often bid on an entire foreign project and, as a condition to obtaining the business, are required to take part of the contract price in the form of stock or debt obligations of a foreign issuer or obligor. In many of these contracts, a portion, but not all, of the contract price is attributable to the sale of U.S.-produced goods. In the contracts referred to, the foreign stock or debt obligations are required to be taken by the principal contractor, even though some of the U.S.-produced goods which are furnished in connection with the project may be supplied by U.S. subcontractors. Your committee believes that imposition of tax on acquisitions of this type might impede U.S. contractors and suppliers when competing for foreign projects. As in the case of debt obligations acquired in simple export transactions, tax would generally apply at the time of transfer (based upon the initial acquisition price) if the debt obligation is later transferred to a U.S. person other than a commerical bank which acquires it in the ordinary course of its commercial banking business or other than to an agency or instrumentality of the United States. Similarly, the tax will in effect apply to the initial acquisition of stock if the stock is transferred to any U.S. person before January 1, 1966.

D. *Export-related loans.*—The bill provides that the acquisition of a debt obligation is to be exempt from tax if the U.S. person making the loan and receiving the debt obligation can show that the proceeds of the loan will be used for the storage, handling, transportation, processing, packaging, or servicing of property produced by him in the United States. This is designed to cover cases where U.S. producers, in an effort to distribute their products abroad, are required to finance the construction of foreign fabricating, distribution, and marketing facilities which are necessary if U.S. exports of supplier products are to be increased or maintained. Since the exporter-producer generally would not transfer the debt obligation acquired in a transaction of this kind, the bill provides that tax will, in most cases, attach at the time of the transfer (based upon the initial acquisition price) if the U.S. person transfers the debt obligation to a U.S. person other than a commercial bank which acquires it in the ordinary course of its commercial banking business or other than to an agency or instrumentality of the United States. As in the case of debt obligations acquired by an exporter in payment for exported goods, and in the case of contractors financing entire foreigh projects, tax is not payable if the debt obligation is transferred to a foreign person, since the acquisition and transfer of a debt obligation under such circumstances does not have an adverse effect on the balance of payments.

6. *Other exemptions provided.*—Your committee's bill also provides a series of additional exemptions, described below, designed to deal with specific types of situations. Some of these relate to businesses which, because of their nature deal in foreign securities. Others are related to natural resource or raw material sources outside of the United States. The other exemptions are for various other factors. In general, these exemptions have one factor in common, however: the acquisition of the foreign securities is due to factors other than the interest rate differential between American and foreign security markets. The exemptions are as follows:

A. *Insurance companies with foreign business.*—In general, the bill permits insurance companies to elect to acquire stock and debt obligations of foreign issuers and obligors tax free in an amount equal to 110 percent of their reserves against foreign risks. If such an election is made, the company must designate stock of foreign issuers, and debt obligations of foreign obligors having a period remaining to maturity of 3 years or more, which it owned on December 10, 1963, as part of such fund. It also is to designate stock and debt obligations acquired after December 10, 1963, which it wants to consider as part of the fund. Once a foreign security is designated as part of one of these exempt reserve funds, if the insurance company sells the security to a U.S. person, the U.S. purchaser will pay tax on the security as if he acquired it from a foreign person. Of course, if it sells the security to a foreign person, no tax would have to be paid by it or the foreign purchaser. In addition to this exemption, insurance companies, like other U.S. persons, may acquire securities tax free under other sections of the bill. The reason for this exemption can be explained as follows: Domestic insurance companies often engage in business in foreign countries through branch operations. In the conduct of this business, they collect premiums in a foreign currency, reinvest the premiums in stock and debt obligations payable in that foreign currency, and must pay liabilities arising under the insurance contract in the same currency as that in which the premiums are collected. These transactions do not, of course, affect the balance-of-payments accounts of the United States. Moreover, an imposition of a tax on such transactions would impose an unreasonable burden on such companies by requiring them, in order to avoid the tax, to invest their reserves in U.S. securities and thereby expose themselves to a foreign exchange risk between the time of investment of premiums and the time claims under the policy were payable.

B. *Underwriters and dealers.*—In the case of underwriters and dealers of foreign securities, the bill provides a procedure which in effect permits them to purchase these securities from foreign issuers and obligors and sell them to other foreign persons without tax effect. Under the provision in the bill, the underwriter is subject to tax when he buys a security from a foreign person without regard to the person to whom he intends to sell it. However, if he or a member of the same distributing group sells it to a foreign person, he may claim a credit or refund for the tax previously paid. In addition, a dealer in foreign bonds is exempted from tax on acquisitions made in the ordinary course of his business if the bonds are resold to foreign persons within a specified period. A refund of tax is provided for the dealer or underwriter in such cases since these transactions do not adversely affect the balance-of-payments position of the United States and assist in maintaining effective international capital market facilities.

C. *Labor unions, etc.*—The bill provides an exemption from tax for a tax-exempt organization (described in sec. 501(c)) operating in a foreign country through a local organization to the extent the acquisitions result from the investment of contributions or membership fees paid in the currency of the foreign country by individuals who are members of the local organization if the securities acquired are held exclusively for the benefit of the local organization. Representatives of labor organizations which appeared before your committee stated that their unions collect dues in foreign currency from their members who are residents in the foreign country. The unions invest these dues in stock or debt obligations arising in the foreign country. Subsequently, they dispose of these securities as necessary to meet their foreign obligations. Your committee believes that transactions of this type, like the insurance company reserve provisions described above, should be exempt from tax since they do not affect the U.S. balance of payments and would unnecessarily expose them to an exchange risk. Moreover, investments of this type are not made in response to interest rate differentials.

D. *Ores and minerals with inadequate U.S. supply.*—The bill contains an exemption for loans by U.S. persons to a foreign corporation if 50 percent or more of the total combined voting power of all classes of stock of the foreign corporation is owned by U.S. persons and the foreign corporation extracts or processes ores or minerals. This exemption is only available, however, if the available deposits in the United States of the ore or, mineral, involved are inadequate to satisfy the needs of domestic producers. In addition, a U.S. person owning the voting stock of the corporation must agree to pay an amount sufficient to amortize a portion of the loan under a so-called "take-or-pay" contract by which it agrees either to purchase a part of the production of the foreign corporation or to pay a portion of its costs of operation. Usually, a U.S. corporation's commitment to finance a foreign supplier of this type is satisfied through a direct loan from the U.S. shareholder. Such a loan would be exempt under the "direct investment" exemption. This exemption, therefore, will be of limited application but is desirable as a way of providing shareholders flexibility in the manner in which they finance the acquisition of foreign ores and minerals such as bauxite, which cannot be acquired in sufficient quantities in the United States.

E. *Ores and minerals extracted and sold outside the United States.*—The bill provides an exemption for debt obligations acquired by a U.S. person as a result of the sale by him of ores or minerals (or derivatives of the ores or minerals) extracted outside the United States if the foreign purchaser agrees to purchase such ores or minerals for a period of 3 years or more. Provision is also made in the bill to permit these companies to acquire debt obligations of foreign obligors tax free if the proceeds of the loan are to be used by the borrower to install, maintain, or improve facilities for the storage, handling, transportation, processing, or servicing of ores or minerals extracted outside the United States. Acquisitions of debt obligations made as the result of the sale of domestic ores and minerals, or the financing of facilities for their distribution will, of course, be exempt under the general provision relating to export loans. Since, however, the ores and minerals available to U.S. companies may be located in other parts of the world, this provision extends the exclusion to transactions involving foreign ores and minerals. If a U.S. person acquires a debt obligation tax free under this provision and transfers it (before January 1, 1966) to a U.S. person, other than a commercial bank receiving it in the normal course of its commercial banking business, or to an agency or instrumentality of the United States, he will in most cases be subject to tax in the same manner as if the original acquisition were taxable.

F. *Acquisition required by foreign law.*—The bill provides an exemption from tax in the case of securities acquired by a U.S. person doing business in a foreign country to the extent these acquisitions are reasonably necessary to satisfy minimum requirements relating to the holding of foreign securities imposed by the laws of the foreign country. Insurance companies, with respect to their insurance reserves, in effect are allowed to apply this exemption or the special tax exemption with respect to foreign reserves, whichever results in the greater holdings of foreign securities. This exemption is provided because some foreign countries require foreign businesses engaged in business locally to investment a portion of their assets in securities of that country as a condition to doing business there. Usually restrictions of this type exist in the case of less developed countries with shortages of local investment funds and with serious exchange problems. However, most foreign countries impose restrictions of this type on regulated industries such as commercial banks, insurance companies, etc. Since these acquisitions of foreign securities arise from business necessity and are not influenced by interest rate differentials, the bill provides an exemption in these cases. If a U.S. person claims an exemption with respect to foreign securities under this provision and then subsequently disposes of these securities, he is treated as a foreign person with respect to this transfer. Thus if he transfers the securities to a U.S. person, this person will generally be subject to tax on this acquisition.

G. *Foreign corporations controlled by Ar ericans and traded here.*—The bill treats as a domestic corporation for purposes of this tax certain foreign corporations other than investment companies. The effect of this is to exempt purchases of their stock from the interest equalization tax. The foreign corporations qualifying for this treatment are those whose stock is traded on a national securities exchange or exchanges registered with the Securities and Exchange Commission if the trading on these U.S. exchanges represented the principal market for their stock during 1962 and if more than 50 percent of the stock was held by U.S. persons (on the latest record date before July 19, 1963).

c. Administrative provisions

1. *Certification procedure.*—As indicated previously, the interest equalization tax does not apply where foreign securities are purchased from a U.S. person. To distinguish taxable from nontaxable transactions, the bill provides for the use of a certification procedure. Under this procedure, receipt of a certificate of American ownership in connection with the acquisition of a foreign security is considered as conclusive proof of prior American ownership unless the person receiving it has actual knowledge that the certificate is false.

A substitute procedure is available in the case of securities purchased on a registered national securities exchange, if the exchange has adopted rules under which transactions will be permitted in the "regular market" only where the seller is a U.S. person. Other transactions through these exchanges would be treated as "special contracts." If a broker provides the purchaser with a written confirmation that the security obtained for him was acquired in the "regular market," this will be considered the equivalent of receiving a certificate of American ownership by the purchaser. The broker will also provide written confirmation in the case of "special contracts" which will indicate that the security was not purchased in the regular market and, therefore, may be subject to tax. A U.S. person selling on such an exchange may file individual certificates of American ownership with his broker with respect to each transaction. Alternatively, he may file a blanket certificate of American ownership with the broker which will qualify all his subsequent sales through the same account. Essentially the same treatment is available in the case of over-the-counter trading which is subject to similar rules promulgated by the National Association of Securities Dealers.

The bill provides a penalty equal to 125 percent of the applicable tax in the case of a person who willfully executes a certificate of American ownership or a blanket certificate of American ownership which is false in any material respect. The penalty also applies in the case of false reports of sales to foreign persons. The penalty is an assessable one, which means that it may be collected in the same manner as the tax. This is provided to discourage persons from executing false certificates. Similar penalties are provided in case false confirmations are furnished by members of either registered national securities exchanges or the National Association of Securities Dealers. Unless the person acquiring the stock or debt obligation had actual knowledge that the certificate involved is false in any material respect, the penalty applicable in the case of false certification is in lieu of, rather than in addition to, any interest equalization tax.

The bill also provides criminal penalties for the willful execution of individual and blanket certificates of American ownership or sales to foreign persons which are false in any material respect. The criminal penalty in this case makes the willful execution of a false certificate a misdemeanor and provides for a fine of not more than $1,000, or imprisonment for not more than 1 year, or both.

2. *Filing returns.*—Tax liability in the case of the interest equalization tax is to be reported by the filing on a calendar quarter basis of returns covering all of the taxable and certain other transactions occurring within the calendar quarter. The returns must be filed on or before the last day of the first month following the period for which the return is made. (However, the first return period commences July 19, 1963, and ends at the close of the calendar quarter in which this bill is enacted.)

Returns must be filed and reporting must be made on the return both with respect to taxable transactions and also nontaxable transactions where exemption certificates were received. However, in the case of nontaxable transactions, where the purchaser has received written confirmation from members of a registered national securities exchange or the National Association of Security Dealers, the transactions need not be reported on these quarterly returns. If required returns are not filed, a civil penalty of 5 percent of the amount of the tax is provided, except that the penalty in no event may be less than $10 or more than $1,000. The penalty does not apply where the failure to file can be shown to be due to reasonable cause.

3. *Nondeductibility of tax.*—The bill provides that for income tax purposes, deductions may not as a general rule be taken for the interest equalization tax by persons acquiring foreign securities. However, this amount may be capitalized by the person and, therefore, treated as an amount paid by him for the security. If the interest equalization tax paid by the U.S. person when added to the cost of a debt obligation creates bond premium, this premium will be amortizable, and deductible, in the same manner as other bond premium under existing law; namerly, rateably over the life of the bond. If the foreign seller of the bond reimburses the U.S. person who buys the bond for part or all of the tax paid by him, this amount is treated as an item of income to the purchaser at that time. However, in such cases he also receives a deduction for the tax in a like amount and to that extent does not add the tax to his basis for the bond.

d. Effective Date

The bill generally is effective with respect to acquisitions by U.S. persons of foreign securities made on or after July 19, 1963. This is 1 day after the date Congress received the President's special message to the Congress on the balance of payments and the public announcement of the principal features proposed by the administration for this bill. However, a special effective date is provided for acquisitions of foreign securities acquired on a national securities exchange registered with the Securities and Exchange Commission. For these acquisitions the effective date is August 17, 1963. This later effective date permitted uninterrupted trading in foreign securities on the exchanges, while they were adjusting their trading rules and procedures to the requirements of the proposed bill.

Your committee recognized, however, that the application of the tax to acquisitions resulting from transactions which were in advanced stages of negotiation on July 18, 1963, would have created serious hardships. For that reason, the bill provides that acquisitions made after July 18, 1963, are exempt from tax in various situations such as the four following types of situations:

(1) The acquisition was made pursuant to an obligation which was unconditional on July 18, 1963 (or was subject only to conditions contained in a formal contract under which partial performance had occurred);

(2) The acquisition was made by a person who had taken every action, on or before July 18, 1963, necessary to signify approval of the acquisition under the procedures ordinarily employed by him in similar transactions and had sent the foreign issuer or obligor a commitment letter in which he set forth the principal terms of the acquisition;

(3) The acquisition was made by a U.S. person (exempt under sec. 4915 except for subsec. (c)) who had applied for, and received from a foreign government, on or before July 18, 1963, authorization to make the acquisition, if this authorization was required in order for it to be made; and

(4) If the acquisition was made before September 17, 1963, of stock or a debt obligation covered by a registration statement filed with the Securities and Exchange Commission on July 18, 1963, or within 90 days prior, and the registration statement had not been amended after July 18, 1963, and before the acquisition, in a manner to increase the number of shares of stock or the aggregate face amount of the debt obligations covered by the registration statement.

The bill also provides that tax is not applicable to the acquisition of foreign stock made pursuant to the exercise of an option or similar right held on July 18, 1963, by the acquiring person (or by a decedent from whom he acquired the option or right). U.S. persons who held employees' stock options on July 18, 1963, may exercise their options without tax, and persons who held convertible debentures on July 18, 1963, may convert their debentures to stock without tax.

e. Revenue effect

It is estimated that this bill will result in an annual revenue gain of up to $30 million in a full year of operation.

IV. TECHNICAL EXPLANATION OF THE BILL

SECTION 1. SHORT TITLE, ETC.

(*a*) *Short title.*—Subsection (a) of section 1 of the bill provides that the bill may be cited as the "Interest Equalization Tax Act of 1963."

(*b*) *Amendment of 1954 code.*—Subsection (b) of section 1 of the bill provides that whenever in the bill an amendment is expressed in terms of an amendment to a section or other provision, the reference is considered to be made to a section or other provision of the Internal Revenue Code of 1954.

SECTION 2. INTEREST EQUALIZATION TAX

(*a*) *Imposition of tax.*—Subsection (a) of section 2 of the bill adds to subtitle D of the code (relating to miscellaneous excise taxes) a new chapter 41, imposing an interest equalization tax and consisting of sections 4911 through 4920.

SECTION 4911. IMPOSITION OF TAX

(*a*) *In general.*—Section 4911(a) imposes a tax on each acquisition by a U.S. person of stock of a foreign issuer, or of a debt obligation of a foreign obligor if such obligation has a period remaining to maturity of 3 years or more. The amount of tax imposed on each such acquisition is determined under section 4911(b). The term "acquisition" is defined in section 4912(a); the terms "United States person," "stock," "foreign issuer," "debt obligation," "foreign obligor," and "period remaining to maturity" are defined in section 4920.

(*b*) *Amount of tax.*—Paragraph (1) of section 4911(b) provides that the tax imposed on the acquisition of stock of a foreign issuer is equal to 15 percent of the actual value of the stock.

Paragraph (2) of section 4911(b) provides that the tax imposed on the acquisition of a debt obligation of a foreign obligor is equal to a percentage of the actual value of the debt obligation measured by the period remaining to its maturity, determined in accordance with the following table:

If the period remaining to maturity is—	The tax, as a percentage of actual value, is—
At least 3 years, but less than 3½ years	2.75
At least 3½ years, but less than 4½ years	3.55
At least 4½ years, but less than 5½ years	4.35
At least 5½ years, but less than 6½ years	5.10
At least 6½ years, but less than 7½ years	5.80
At least 7½ years, but less than 8½ years	6.50
At least 8½ years, but less than 9½ years	7.10
At least 9½ years, but less than 10½ years	7.70
At least 10½ years, but less than 11½ years	8.30
At least 11½ years, but less than 13½ years	9.10
At least 13½ years, but less than 16½ years	10.30
At least 16½ years, but less than 18½ years	11.35
At least 18½ years, but less than 21½ years	12.25
At least 21½ years, but less than 23½ years	13.05
At least 23½ years, but less than 26½ years	13.75
At least 26½ years, but less than 28½ years	14.35
28½ years or more	15.00

In general, actual value is determined by the consideration paid by a purchaser in an arm's length transaction. In no event will the actual value of any stock or debt obligation acquired be considered to be less than the actual value of the money or other property paid for such stock or debt obligation.

(*c*) *Persons liable for tax.*—Section 4911(c) provides (in par. (1)) that the tax imposed by section 4911(a) is to be paid by the person acquiring the stock or debt obligation involved. In general, the person who (immediately prior to a transaction constituting an acquisition under ch. 41) owns the money or other property transferred as the consideration for the stock or debt obligation acquired is considered the person who makes the acquisition and is liable for the tax. The fact that some other person is the registered owner of the stock or obligee of the debt obligation does not make such person liable for the tax, or relieve the transferor of the property of liability, if such other person is not in fact the owner. A nominee, custodian, or agent who purchases stock or a debt obligation on behalf of his principal is not considered as having made an acquisition of such stock or debt obligation; the person for whom the stock or debt obligation has been purchased is treated as having made the acquisition. For example, a broker who purchases stock of a foreign issuer in his capacity as broker is not considered as having obtained ownership of such stock even if it is registered in the broker's name pursuant to the instructions of the person for whom the broker is acting; the person for whom the broker is acting is treated as having made the acquisition of the stock.

Section 4911(c) also contains (in par. (2)) a cross reference to section 6681 of the code (added by sec. 5(a) of the bill), which provides for the imposition of a penalty on the maker of a false interest equalization tax certificate. Such penalty may be in lieu of or in addition to the tax.

(*d*) *Termination of tax.*—Section 4911(d) provides that the tax imposed by section 4911(a) will not apply to any acquisition made after December 31, 1965.

SECTION 4912. ACQUISITIONS

(*a*) *In general.*—Section 4912(a) defines the term "acquisition" as any purchase, transfer, distribution, exchange, or other transaction (whether occurring within or outside the United States) by virtue of which ownership is obtained either directly or through a nominee, custodian, or agent.

As a general rule, an acquisition is considered as having been made on the date the consideration is paid for the stock or debt obligation acquired. Where a U.S. person enters into an agreement to make a series of loans to a foreign person over a period of time, each particular loan is treated as a separate acquisition of a debt obligation of a foreign obligor, occurring as of the date the loan is made. In the case of an acquisition of stock subject to the rules of a national securities exchange or national securities association registered with the Securities and Exchange Commission, the acquisition will normally be deemed to occur on the settlement date provided in such rules (whether or not payment is actually made on that date), although the actual value of the stock will normally be fixed as of the trade date by reference to the price at which the purchase was effected. The application of these rules is illustrated by the following examples:

Example (1).—On December 27, 1963, A, a U.S. person, places an order with his broker to purchase, pursuant to a special contract, 100 shares of the stock of foreign corporation M from a nonresident alien; the stock is traded on the New York Stock Exchange. The order is executed on that date at a price of $10 per share. A gives his check for $1,000 to his broker on December 31, 1963. Pursuant to the rules of the exchange, settlement is not due to be made until 4 business days after the trade date. Because of an intervening Saturday and Sunday (December 28 and 29, 1963) and holiday (January 1, 1964), the settlement date with respect to A's acquisition falls on January 3, 1964. A is considered to acquire the M stock on January 3, 1964. The actual value of the M stock is $1,000, and A is liable to pay a tax of $150 with his return covering the first calendar quarter of 1964.

Example (2).—B, a U.S. person, enters into an agreement to make a series of loans to foreign corporation N. Pursuant to the terms of the agreement, B transfers $10,000 to N on January 1, 1964, $10,000 on March 30, 1964, and $10,000 on June 1, 1965. All of the loans mature on September 10, 1968. B acquires on January 1, 1964, a debt obligation of a foreign obligor having a period remaining to maturity of between 4½ and 5½ years. B acquires on March 30, 1964, a debt obligation of a foreign obligor having a period remaining to maturity of between 3½ and 4½ years. B acquires on June 1, 1965, a debt obligation of a foreign obligor having a period remaining to maturity of between 3 and 3½ years.

Section 4912(a) also provides that a U.S. person acting as a fiscal agent in connection with the redemption or purchase for retirement of stock or debt obligations is not considered to obtain ownership of such stock or debt obligations, even though such person acts in a capacity which technically may be that of a trustee. The person on whose behalf the fiscal agent is acting is considered as having made the acquisitions involved.

In addition, section 4912(a) provides that the exercise of a right to convert a debt obligation (as defined in sec. 4920(a)(1)) into stock is deemed an acquisition of stock from the foreign issuer by the person exercising such right. Thus, if a U.S. person acquires such a debt obligation (whether or not from the foreign obligor) and then exercises the right to convert, the stock so acquired is considered as having been acquired from the foreign issuer of the stock at the time of exercise. (Sec. 4913(a)(3)(A) contains a special limitation on the amount of tax that is imposed in certain cases when stock is acquired pursuant to the exercise of the right to convert a debt obligation into stock; and sec. 2(c)(6) of the bill contains a provision excluding from the tax the exercise of certain rights to convert debt obligations which were held on July 18, 1963.)

Finally, section 4912(a) provides that any extension or renewal of an existing debt obligation requiring affirmative action of the obligee is considered the acquisition of a new debt obligation. (Sec. 4913(a)(2) provides a limitation on the tax imposed on an acquisition of this kind; and sec. 4920(a)(7)(B)(ii) provides a rule for the treatment of the acquisition of a debt obligation which is renewable without affirmative action by the obligee.)

(*b*) *Special rules*.—Section 4912(b) contains special rules under which certain types of transactions are deemed to constitute acquisitions for purposes of the new chapter 41.

Certain transfers to foreign trusts

Paragraph (1) of section 4912(b) provides that any transfer (other than in a sale or exchange for full and adequate consideration) of money or other property to a foreign trust is deemed an acquisition by the transferor of stock of a foreign issuer in an amount equal to the actual value of the money or property transferred, but only to the extent that such trust acquires stock or debt obligations which would, if acquired directly by the transferor, be subject to the interest equalization tax. If any stock or debt obligation acquired by the foreign trust would not have been taxable had the acquisition been made directly by the transferor, then such stock or debt obligation is not taken into account under this paragraph. This rule is applicable without regard to whether the transferor is a beneficiary of, or otherwise interested in, the trust. As a general rule, the owner of property immediately before its transfer is considered the "transferor" for these purposes. (Sec. 4913(b) provides a limitation on the tax in the case of a transfer, deemed to be an acquisition under this paragraph, which is otherwise taxable under ch. 41.)

The special rule contained in section 4912(b)(1) does not apply to transfers made to a foreign trust in a sale or exchange for full and adequate consideration. If, however, the consideration received by the U.S. person consists of stock of a foreign issuer or debt obligations of a foreign obligor with a period remaining to maturity of 3 years or more, the acquisition of such stock or debt obligations is taxable to the extent otherwise provided in chapter 41. Transfers by a U.S. person to a foreign trust of which he is a beneficiary are not considered, simply by reason of his beneficial interest, to be for full and adequate consideration. The exception to the special rule relating to a sale or exchange for full and adequate consideration does not cover loans; loans are not considered sales or exchanges for this purpose.

One additional exception is provided to the coverage of the special rule contained in section 4912(b)(1). Contributions to a foreign pension or profit-sharing trust established by an employer, made by an employee who performs personal services on a full-time basis in a foreign country (and is not an owner-employee as defined in sec. 401(c)(3) of the code) are not deemed acquisitions of stock of a foreign issuer. Thus, such an employee can contribute money to a foreign pension or profit-sharing trust established by his employer, and his contributions will not be deemed acquisitions of stock of a foreign issuer even if the trust acquires foreign stock or debt obligations which would be subject to the tax had the employee acquired them directly. The exception is not applicable to contributions by an employer.

The application of section 4912(b)(1) is illustrated by the following examples:

Example (1).—On July 25, 1964, A, a U.S. person, transfers $1,000 to X, a foreign trust, and X acquires voting stock of Y, a foreign corporation, for $800, on September 3, 1964. The direct acquisition by A of the Y stock would have been taxable to him. A is considered to have acquired stock of a foreign issuer on July 25, 1964, in the amount of $800 and incurs a tax of $120 (15 percent of $800).

Example (2).—The facts are the same as in example (1). A makes no further transfers to foreign trust X but on December 1, 1964, X acquires from B, a nonresident alien individual, debt obligations of Z, a foreign corporation, with a period remaining to maturity of 10 years. The direct acquisition by A of the Z debt obligations would have been taxable to him. The purchase price of these debt obligations is $300. A is considered to have acquired (as of July 25, 1964) stock of a foreign issuer—not a debt obligation of a foreign obligor—in an additional amount of $200, representing the balance of the $1,000 transferred to X which remains after the application of $800 to the earlier acquisition. A therefore incurs an additional tax of $30 (15 percent of $200).

Example (3).—The facts are the same as in example (2), except that B is a U.S. person. A incurs no additional tax by reason of the purchase by the trust of the Z debt obligations. The same result would follow if B were a nonresident alien individual but Z were a less-developed country corporation.

Certain transfers to foreign corporations and partnerships

Paragraph (2) of section 4912(b) provides that any transfer of money or other property to a foreign corporation or foreign partnership, either (A) as a contribution to the capital of such corporation or partnership, or (B) in exchange for one or more debt obligations of such corporation or partnership if it is a foreign corporation or partnership formed or availed of by the transferor to acquire (through such corporation or partnership) stock or debt obligations the direct acquisition of which by the transferor would be subject to the tax imposed by section 4911, is deemed an acquisition by such transferor of stock of such foreign corporation or partnership in an amount equal to the actual value of the money or property transferred. Amounts paid to satisfy stock assessments are considered to be contributions to capital.

The application of section 4912(b)(2) is illustrated by the following examples:

Example (1).—A, a U.S. person, transfers $1,000 to foreign corporation M as a contribution to its capital. A is considered to have acquired stock of M in the amount of $1,000 and the acquisition (if not otherwise excluded under ch. 41) is subject to tax in the amount of $150.

Example (2).—A, a U.S. person, owns 10 percent of the voting stock of foreign corporation M, all of which he acquired before July 18, 1963. On April 9, 1964, A transfers $5,000 to M in exchange for a 2-year promissory note of M. On June 1, 1965, M is availed of by A for the principal purpose of acquiring, for $3,500, stock of foreign corporation N. Because of section 4915(c)(1) the exclusion for direct investments cannot apply to A's acquisition of M's promissory note; and because A's acquisition is deemed to be an acquisition of stock the exemption for debt obligations of less than 3 years' maturity does not apply. Accordingly, the acquisition (if not otherwise excluded under ch. 41) is subject to tax in the amount of $750 (15 percent of $5,000).

Acquisitions from domestic corporation or partnership formed or availed of to obtain funds for foreign issuer or obligor

Paragraph (3) of section 4912(b) provides that the acquisition of stock or a debt obligation of a domestic corporation (other than a domestic corporation described in sec. 4920(a)(3)(B)), or a domestic partnership, formed or availed of for the principal purpose of obtaining funds, whether directly or indirectly, for a foreign issuer or obligor, is deemed an acquisition from such foreign issuer or obligor of its stock or debt obligation. The effect of this provision is to treat the stock or debt obligation of such a domestic corporation or partnership as that of a foreign issuer or obligor and, therefore, subject to the interest equalization tax unless it is otherwise excluded (as, for example, under sec. 4915, 4916, or 4917) because of the status of (or the relationship of the acquiring person to) the foreign issuer or obligor; the status of (or relationship to) the domestic corporation or partnership will not serve to provide (or prevent) such an exclusion. On the other hand, this rule is not applicable to a domestic corporation or partnership which obtains capital to be used by it in the active conduct of its own business, or the active conduct of a business by it as a participant in a joint venture, even though the corporation or partnership may be wholly owned by a foreign issuer or obligor. The acquisition and holding of investments is not the active conduct of a trade or business for this purpose.

Reorganization exchanges

Paragraph (4) of section 4912(b) provides that an acquisition of stock or debt obligations of a foreign issuer or obligor by a U.S. person in an exchange to which section 354, 355, or 356 of the code applies (or would apply but for sec. 367) is considered an acquisition from the foreign issuer or obligor in exchange for its stock or debt obligations. Under this rule, stock distributed in a reorganization is deemed to have been acquired from the foreign issuer even though actually received from another corporation which is a party to the reorganization. As a result, a U.S. person receiving stock of the foreign issuer in such an exchange for stock of another corporation will qualify for the exclusion provided by section 4914(a)(4). The rule also treats any stock or debt obligations surrendered in the exchange as stock or debt obligations of the foreign issuer or obligor. As a result, a U.S. person acquiring debt obligations of the foreign obligor in such an exchange for stock or debt obligations of another corporation will be entitled to apply the limitation on tax provided by section 4913(a)(2). Although this special rule does not apply to a domestic corporation acquiring stock or debt obligations of a foreign issuer or obligor as a party to a reorganization, such an acquisition may be excluded by some other provision of chapter 41 (as, for example, sec. 4914(a)(5) or 4915(a)).

The application of section 4912(b)(4) is illustrated by the following examples:

Example (1).—A, a U.S. person, owns stock of X, a domestic corporation. On July 30, 1964, X transfers a portion of its assets to Y, a foreign corporation, in exchange for 80 percent of the voting stock of Y. X then distributes the stock of Y to its shareholders in exchange for X stock. The transaction is one to which section 355 of the code would apply, although no prior ruling under section 367 is obtained.

A is considered (for purposes of ch. 41) to have acquired Y stock in a distribution by Y in exchange for its stock.

Example (2).—B, a U.S. person, owns stock of M, a foreign corporation. On July 30, 1964, B surrenders his M stock to N, another foreign corporation, in exchange for voting stock of N. The transaction is one to which section 354 of the code would apply. B is considered (for purposes of ch. 41) to have acquired the N stock in a distribution by N in exchange for its stock.

SECTION 4913. LIMITATION ON TAX ON CERTAIN ACQUISITIONS

(*a*) *Certain surrenders, extensions, renewals, and exercises.*—Section 4913(a) provides limitations on the amount of the interest equalization tax otherwise applicable in the case of certain specified types of acquisitions.

General rule

Paragraph (1) of section 4913(a) provides that the limitations set forth in such section are applicable to acquisitions of stock or debt obligations of foreign issuers or obligors in cases where the acquisition involved results from—

(A) the surrender to the foreign obligor, for cancellation, of a debt obligation of such obligor;

(B) the extension or renewal of an existing debt obligation requiring affirmative action of the obligee; or

(C) the exercise of an option or similar right to acquire such stock or debt obligation (or a right to convert a debt obligation into stock).

By reason of the rule set forth in section 4912(b)(4), transactions described in subparagraph (A) of this paragraph include certain transactions in which stock or debt obligations of the foreign issuer or obligor are received upon surrender of a debt obligation of another corporation which is a party to a reorganization.

General limitation

Paragraph (2) of section 4913(a) provides that the tax imposed upon any acquisition referred to in paragraph (1) of such section, except in cases to which paragraph (3) applies, will not exceed the amount of tax imposed by section 4911 less the amount of tax that would have been imposed if the debt obligation (or the option or right) which was surrendered, extended, renewed, or exercised had been acquired in a transaction subject to such tax immediately prior to the surrender, extension, renewal, or exercise. For this purpose, a defaulted debt obligation of a foreign government or subdivision (or an agency or instrumentality thereof) which has been in default as to payment of principal for at least 10 years and which is surrendered in exchange for another debt obligation of that government or subdivision (or agency or instrumentality) is deemed to have an actual value and period remaining to maturity equal to that of the debt obligation acquired. For purposes of paragraph (2), the term "option or right" does not include the right to convert a debt obligation (as defined in sec. 4920(a)(1)) into stock; the limitation on tax upon the exercise of such a conversion privilege is separately treated in paragraph (3). (The exercise of certain rights of shareholders and employees to acquire stock is also subject to the special rules in par. (3).)

The application of section 4913(a)(2) is illustrated by the following examples (in which none of the exclusions or exemptions provided by ch. 41 is applicable):

Example (1).—A is a U.S. person, and M corporation is a foreign corporation. A surrenders a debt obligation of M, having at the time a period remaining to maturity of 5½ years and an actual value of $900, in exchange for a debt obligation of M having a period remaining to maturity of 10½ years and an actual value of $950. A incurs a tax of $32.95, representing the amount of tax imposed on the actual value of the debt obligation acquired (8.3 percent of $950, or $78.85) less the amount of tax that would have been imposed if the debt obligation which was surrendered had been acquired in a transaction subject to tax immediately prior to its surrender (5.1 percent of $900, or $45.90).

Example (2).—B is a U.S. person, and N is a foreign corporation. B acquires a debt obligation of N which will mature in 30 days, and the instrument provides that the obligation will become payable at maturity unless within the 30-day period prior to maturity the parties agree to extend the obligation on the same terms for an additional 5-year period. The parties so agree. The actual value of the debt obligation before and after the extension is $1,000. B incurs a tax of $43.50, representing the amount of tax imposed on the actual value of the debt obligation acquired (4.35 percent of $1,000, or $43.50) less the amount of tax that would have been imposed if the debt obligation which was extended had been acquired in a transaction subject to the tax immediately prior to its extension (no tax, since the debt obligation would have had a maturity of less than 3 years).

Example (3).—On August 5, 1964, C, a U.S. person, acquires for $100 from X, a nonresident alien, an option to purchase for $100 per share 10 shares of stock of O, a foreign corporation. C exercises the option on January 2, 1965, at which time the option has an actual value of $500 and the O stock has an actual value of $150 per share. C incurs a tax upon the acquisition of the option of $15 (15 percent of $100). In addition, C incurs a tax on the exercise of the option of $150, representing the amount of tax imposed on the actual value of the stock acquired (15 percent of $1,500, or $225) less the amount of tax that would have been imposed if the option had been acquired in a transaction subject to tax immediately prior to its exercise (15 percent of $500, or $75).

Example (4).—D, a U.S. person owning stock of P, a foreign corporation, receives from P, as a distribution with respect to such stock, rights to purchase 100 additional shares of P stock at a price of $20 per share. The rights are valid for a period of 1 year from the date of distribution to the shareholder. D incurs no tax on the distribution of the rights. D exercises such rights at a time when the actual value of P stock is $30 per share and the actual value of such rights equals $10 per share. D incurs a tax of $300, representing the amount of tax imposed on the actual value of the stock acquired (15 percent of $3,000, or $450) less the amount of tax that would have been imposed if the rights had been acquired in a transaction subject to tax immediately prior to their exercise (15 percent of $1,000 or $150).

Special limitations

Paragraph (3) of section 4913(a) provides special limitations on the amount of tax imposed on certain types of acquisitions.

Conversion of debt obligations into stock

Paragraph (3)(A) of section 4913(a) provides a limitation on the tax imposed on the acquisition of stock pursuant to the exercise of a right to convert a debt obligation (as defined in sec 4920(a)(1)) into stock, where the person exercising such right (or, in certain cases, a decedent) was liable for tax on his acquisition of the debt obligation. The tax imposed upon such an acquisition is limited to the amount of tax which would have been imposed under section 4911 if the debt obligation had been treated as stock at the time of its acquisition by the person exercising the right (or by a decedent from whom such person acquired the right by bequest or inheritance or by reason of such decendent's death), less the amount of tax paid by the person (or such decedent) exercising the right as a result of the acquisition of the debt obligation. (The third sentence of sec. 4912(a) treats the exercise of a right to convert a debt obligation into stock as an acquisition of stock from the foreign issuer.)

The application of section 4913(a)(3)(A) is illustrated by the following example:

Example.—On January 2, 1964, A, a U.S. person, purchases from nonresident alien X a debt obligation of foreign corporation N. The debt obligation has a period remaining to maturity of 10 years at the time of its acquisition by A and has a conversion privilege which is effective for the full 10-year period. A pays $1,000 for this debt obligation and also pays an interest equalization tax of $77 (7.70 percent of $1,000). In June 1964, A exercises the conversion privilege and exchanges the debt obligation for 200 shares of stock of N. At the time of the conversion, 200 shares of the stock of N have an actual value of $1,500. Under the special rule of section 4913(a)(3)(A), A is liable for an additional tax of $73 (15 percent of $1,000, less the $77 already paid).

Exercise of certain shareholders' rights

Paragraph (3)(B) of section 4913(a) states the special rule that the tax imposed by section 4911 upon the acquisition of foreign stock or debt obligations as a result of the exercise of certain rights of a shareholder in a foreign corporation to subscribe for additional shares of its stock or debt obligations is limited to the amount of tax which would be imposed by section 4911 if the price paid upon exercise of such option or right were the actual value of the stock or debt obligation acquired. The rights covered under paragraph (3)(B) are those which are distributed to a shareholder with respect to his stock and which by their terms must expire or terminate within a period not exceeding 90 days from the date on which the rights are so distributed. (The general rule and general limitation set forth in pars. (1) and (2) of sec. 4913(a) are applicable if the right involved is exercised by a person other than the shareholder to whom it was distributed, or if the right by its terms need not expire or terminate within the 90-day period.)

The application of section 4913(a)(3)(B) is illustrated by the following example:

Example.—A, a U.S. person, receives in a distribution with respect to 100 shares of stock he owns in N, a foreign corporation, the right to subscribe for 1 new share of the stock of N for each 5 shares he owns. The right by its terms expires on the 60th day after distribution. A exercises the right and acquires 20 new shares of N stock at a purchase price of $200. Under the special rule of paragraph (3)(B), A incurs a tax of $30 (15 percent of the $200 paid for the new stock).

Certain employee stock options

Paragraph (3)(C) of section 4913(a) provides that the tax imposed by section 4911 upon an acquisition of stock of a foreign issuer by a U.S. person pursuant to the exercise of an option or similar right described in section 4914(a)(7) is limited to the amount of tax which would have been imposed under section 4911 if the price paid for such stock were its actual value. Thus, the tax imposed upon the exercise of an employee's stock option described in section 4914 (a)(7) is based on the option price.

(*b*) *Certain transfers which are deemed acquisitions.*—Section 4913(b) provides a limitation on the amount of tax imposed in a transfer to which either section 4912(b) (1) or (2) applies. The amount of tax thus imposed as a result of the transfer of property to a foreign trust, corporation, or partnership, as the case may be, is limited to that imposed by section 4911, less the amount of tax paid by the transferor as a result of the transfer being otherwise taxable as an acquisition under chapter 41. The application of this rule is illustrated by the following example:

Example.—A, a U.S. person, transfers $1,000 to a foreign trust in exchange for a 5-year debt obligation of such trust. A pays an interest equalization tax of $43.50 (4.35 percent of $1,000) as a result of the acquisition of such debt obligation. Thereafter, the trust acquires for $1,000 stock of foreign corporation N, the direct acquisition of which by A would have been subject to tax under section 4911. The additional tax for which A is liable is limited to $106.50 (15 percent of $1,000 less the $43.50 already paid).

SECTION 4914. EXCLUSION FOR CERTAIN ACQUISITIONS

(*a*) *Transactions not considered acquisitions.*—Section 4914(a) enumerates certain transactions which are not included in the term "acquisition" for purposes of the interest equalization tax.

Paragraph (1) excludes any transfer between a person and his nominee, custodian, or agent. Thus, the term "acquisition" does not include a transfer of stock or a debt obligation by any person to his broker, or by a broker to his customer, where the broker is not acting for his own account.

Paragraph (2) excludes any transfer described in section 4343(a) of the code, relating to certain transfers by operation of law from decedents, minors, incompetents, financial institutions, bankrupts, successors, foreign governments and aliens, trustees, and survivors.

Paragraph (3) excludes any transfer by legacy, bequest, or inheritance to a U.S. person, as well as any transfer by gift to a U.S. person who is an individual. Inter vivos transfers to trusts or other entities are not excluded.

Paragraph (4) excludes any distribution by a corporation of its stock or debt obligations to a shareholder with respect to or in exchange for its stock. Thus, a stock dividend, distribution of rights, or any other distribution to a stockholder of the distributing corporation's stock or debt obligations—in connection with a reorganization, liquidation, or redemption, or otherwise—is a transfer which is not considered an acquisition, whether or not it is subject to Federal income tax. This rule is illustrated by the following examples:

Example (1).—A, a U.S. person, is a shareholder in M, a foreign corporation. M distributes to A as a dividend, with respect to its stock, the right to purchase its debt obligations. A is liable for Federal income tax on the distribution. The receipt by A of the right to purchase the debt obligations of M is not an acquisition for purposes of the interest equalization tax.

Example (2).—The facts are the same as in example (1), except that A receives a further distribution by M (with respect to its stock) of debt obligations of foreign corporations N and O. The acquisition by A of the debt obligations of N and O is not excluded under section 4914(a)(4), since the debt obligations are not those of M.

Example (3).—B, a U.S. person, is a stockholder in P, a domestic corporation. In a transaction to which section 354 applies, B surrenders to P his stock in P in exchange for voting stock of R, a foreign corporation. Under the special rule of section 4912(b)(4), B is deemed to have acquired the R stock in a distribution by R to B in exchange for stock of R. The acquisition by B is not considered to be a taxable acquisition.

Paragraph (5) of section 4914(a) excludes any exchange to which section 361 applies (or would apply but for section 367), where the transferor corporation was a domestic corporation engaged in the active conduct of a trade or business, other than as a dealer in stock or securities, immediately before the date on which the assets involved are transferred to the acquiring corporation. The application of paragraph (5) is illustrated by the following examples:

Example (1).—On September 3, 1964, X, a domestic corporation which is engaged in the active conduct of a manufacturing business, transfers all of its assets to M, a foreign corporation, in exchange for voting stock of M. Immediately following the transaction, X owns 7 percent of such voting stock. Although no section 367 ruling is obtained, the transaction is one described in section 361. X is not considered as having made an acquisition of the stock of M for purposes of the interest equalization tax.

Example (2).—On October 6, 1964, N, a foreign corporation, transfers substantially all of its assets to Y, a domestic corporation, in exchange for voting stock in Y. The transaction is one described in section 361, and the Commissioner of Internal Revenue prior to the transaction has ruled under section 367 that avoidance of Federal income taxes was not one of its principal purposes. Included in the assets transferred by N are stock and debt obligations of foreign corporations O, P, and R, none of which is a party to the reorganization. The receipt by Y of the stock and debt obligations of O, P, and R is not excluded under section 4914(a)(5) since N, the transferor corporation, is not a domestic corporation.

Paragraph (6) of section 4914(a) excludes any exercise of a right to convert an indebtedness, pursuant to its terms, into stock, if such indebtedness was treated as stock pursuant to the provisions of section 4920(a)(2)(D). Thus, if a convertible debt obligation is one which is classified as stock in accordance with the special rule of section 4920(a)(2)(D), no tax under chapter 41 will be imposed upon the exercise of the conversion right. (For the treatment under ch. 41 of stock acquired as the result of the exercise of the right to convert a debt obligation (as defined) into stock, see sections 4912(a) and 4913(a)(3).)

Paragraph (7) of section 4914(a) excludes the grant of a stock option or similar right to a U.S. person who is an individual, for any reason connected with his employment by a corporation, if such option or right (A) is granted by the employer corporation, or by its parent or subsidiary corporation, to purchase stock of any of such corporations, and (B) by its terms is not transferable by such U.S. person otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him. This paragraph does not apply to any option or right other than the employee stock options described. The tax imposed on the exercise of an employee stock option or similar right so acquired is determined under section 4913(a)(3)(C). For an exclusion from the tax of acquisitions occurring upon the exercise of certain options or similar rights held on July 18, 1963, see section 2(c)(6) of the bill.

(*b*) *Excluded acquisitions*.—Section 4914(b) enumerates certain acquisitions to which the interest equalization tax does not apply.

Paragraph (1) of section 4914(b) excludes acquisitions of stock or debt obligations by any agency or wholly-owned instrumentality of the United States. For example, acquisitions by the Export-Import Bank are excluded.

Paragraph (2)(A) of section 4914(b) excludes acquisitions of debt obligations by a commercial bank if the bank acquires the debt obligations in the ordinary course of its commercial banking business. Paragraph (2)(B) excludes acquisitions of stock or debt obligations by a commercial bank through foreclosure, where such stock or debt obligations were held as security for loans made in the ordinary course of its commercial banking business. The exclusion provided by paragraph (2) does not extend to trust companies or other financial institutions not regularly engaged in accepting deposits from customers and performing other functions related to the commercial banking business, or to acquisitions by a commercial bank for its investment portfolio; however, if a person is engaged both in the commercial banking business and in other businesses or activities, those acquisitions related solely to the commercial banking business (but no others) are excluded. A corporation organized under section 25(a) of the Federal Reserve Act (commonly known as the Edge Act), or a State-chartered corporation operating under an agreement with the Federal Reserve Board under section 25 of the Federal Reserve Act, will be considered a commercial bank for this purpose if it is regularly engaged in accepting deposits from customers.

Loans made in the ordinary course of a commercial banking business may take a wide variety of forms and may be made for a multitude of purposes. While past practices are not necessarily determinative, the conduct of the business of a commercial bank in the past, as well as the ordinary course of business by other banks similarly situated, is indicative of what will constitute loans made in the ordinary course of a commercial banking business.

Paragraph (3) of section 4914(b) excludes any acquisition of stock or debt obligations by a U.S. person doing business in a foreign country to the extent that such acquisition is reasonably necessary to satisfy minimum requirements relating to holdings of stock or debt obligations of foreign issuers or obligors imposed by the laws of such foreign country. This will exclude from the tax acquisitions by insurance companies (except as limited in the manner discussed below), banks, and others who are required to make deposits of, or otherwise hold, stock or debt obligations of foreign issuers or obligors in connection with business carried on by their foreign branches. The exclusion applies to acquisitions in amounts reasonably required to comply with legal requirements, whether such requirements are expressly set forth by statute or are imposed by administrative action under applicable laws. It is limited in amount to holdings of foreign securities required by the laws or administrative regulations in force at the time of the acquisition involved.

If any of the requirements imposed by foreign laws relates to the holding of insurance reserves, the exclusion otherwise allowable under section 4914(b)(3) with respect to acquisitions by an insurance company during any calendar year is reduced by the maximum amount of the exclusion which could be allowed under section 4914(e) (discussed below) with respect to acquisitions made by the insurance company during that year, or by the amount of the insurance reserves which must be held in order to satisfy such requirements, whichever is less. The application of this rule is illustrated by the following example:

Example.—R, a U.S. person, is an insurance company subject to taxation under section 831 of the Code. R insures risks relating to property located in foreign country X, which is the only foreign country in which it is doing business. Pursuant to the laws of X, R is required to acquire and hold foreign securities sufficient to maintain insurance reserves equal to 120 percent of the unearned premiums and unpaid losses with respect to its insurance and reinsurance of risks located in X. Accordingly, R makes acquisitions of foreign stock and debt obligations during the calendar year 1964 in sufficient amounts so that it holds foreign securities at all times during the year equal to 120 percent of the insurance reserves required by X. Since, under section 4914(e), R would be entitled to exclude up to 110 percent of its allowable insurance reserve determined under that section with respect to the insurance of X risks, only the additional acquisitions of foreign securities required to be made in order to comply with X's laws are excludable under section 4914(b)(3).

Paragraphs (4) through (7) of section 4914(b) contain references to the exclusions provided by section 4914(c) through (f) (discussed below).

(c) *Export credit, etc., transactions.*—Section 4914(c) excludes from the interest equalization tax certain acquisitions of stock and debt obligations arising from the sale of property or services by U.S. persons.

In general

Paragraph (1) of section 4914(c) provides that the acquisition by a U.S. person of a debt obligation arising out of the sale to a foreign obligor of tangible personal property or services (or both) is excluded from tax if—

(A) payment of the obligation is guaranteed or insured, in whole or in part, by an agency or wholly-owned instrumentality of the United States; or

(B) such U.S. person makes the sale in the ordinary course of his trade or business and at least 85 percent of the purchase price is attributable to the sale of property manufactured, produced, grown, or extracted in the United States, or to the performance of services by such U.S. person (or by one or more includible corporations in an affiliated group, as defined in sec. 1504 of the code, of which such person is a member) or to both.

The acquisition of a debt obligation, payment of which is guaranteed or insured in whole or in part by the Export-Import Bank (or any other agency or wholly-owned instrumentality of the United States) is excluded from tax under paragraph (1)(A). Paragraph (1)(B) provides an exclusion from tax for the ordinary business operations of U.S. merchant exporters. The acquisition of stock of a foreign issuer may not be excluded under paragraph (1).

The term "services," as used in section 4914(c) (1) and (2), is not construed to include functions performed as an underwriter.

The application of section 4914(c)(1) is illustrated by the following examples:

Example (1).—A, a domestic corporation, sells machinery to foreign corporation P for $200,000 (in a transaction otherwise taxable under ch. 41), receiving as payment $50,000 in cash and $150,000 in P's 5-year promissory notes. Payment of the notes is guaranteed by the Export-Import Bank. Acquisition of the notes by A is excluded from tax.

Example (2).—M, a domestic corporation, sells an airplane manufactured in the United States to X, a foreign corporation, for a total price of $1 million (in a transaction otherwise taxable under ch. 41), receiving as payment $100,000 in cash and $900,000 in X's 10-year promissory notes. The acquisition by M is excluded from tax.

Example (3).—N, a U.S. person, is engaged in business as a merchant exporter. In the ordinary course of such business N sells equipment to foreign corporation Y, for $100,000 (in a transaction otherwise taxable under ch. 41), receiving as payment $30,000 in cash and $70,000 in Y's 5-year notes. Of the $100,000 purchase price, $90,000 represents the fair market value of the equipment, which was manufactured in the United States, and $10,000 is attributable to assembly and installation operations performed at the destination by a local contractor on behalf of N. The acquisition of the notes by N is excluded from tax.

Alternate rule for producing exporters

Paragraph (2) of section 4914(c) provides that the acquisition by a U.S. person from a foreign issuer or obligor of its stock or debt obligation is excluded from tax if the stock is received in payment for, or the debt obligation arises out of, the sale of tangible personal property or services (or both) to such issuer or obligor and if—

(A) at least 30 percent of the purchase price in the transaction is attributable to the sale of property manufactured, produced, grown, or extracted in the United States by such U.S. person (or by one or more includible corporations in an affiliated group, as defined in section 1504 of the code, of which such person is a member), or to the performance of services by such U.S. person (or by one or more such corporations), or to both, and

(B) at least 50 percent of the purchase price is attributable to the sale of property manufactured, produced, grown, or extracted in the United States, or the performance of services by U.S. persons, or both.

Goods and services sold by the U.S. person acquiring the stock or debt obligation involved are counted in meeting the 50 percent requirement (as well as the 30 percent test) and U.S. goods and services provided by others are also counted. Where a U.S. person, such as a construction engineer, acts as contractor for the performance of services, amounts attributable to services performed by such person or employees of such person (whether or not within the United States) are included in determining whether the 30 percent and 50 percent tests are met; but amounts attributable to services performed by subcontractors who are not U.S. persons are not counted.

The application of section 4914(c)(2) is illustrated by the following examples:

Example (1).—A, a domestic corporation, is in the business of manufacturing electrical equipment in the United States. Corporation A contracts to sell such equipment to foreign corporation P and to arrange for the construction of a plant to house the equipment. P agrees to pay A a total purchase price of $1 million—$200,000 in cash and $800,000 in P's 5-year promissory notes. The value of the electrical equipment sold by A is $250,000 and services provided by a wholly owned domestic subsidiary of A are valued at $100,000. B, a domestic corporation, supplies construction materials manufactured in the United States and valued at $100,000 and services valued at $50,000. The acquisition by A of the notes of P is excluded from tax.

Example (2).—B, a domestic corporation, is a construction engineering firm. B contracts with foreign corporation R for the construction of a plant for $100,000, receiving as payment $30,000 in cash, $50,000 in R's 5-year promissory notes, and $20,000 in R's stock. B subcontracts to foreign corporation S the performance of services in connection with the construction of a road leading to the plant; these services have a value of $20,000. The acquisition by B of the debt obligations and stock of R is excluded from tax.

Export-related loans

Paragraph (3) of section 4914(c) provides that the acquisition of a debt obligation by a U.S. person from a foreign obligor is excluded from tax if the obligation arises out of a loan to increase or maintain sales of tangible personal property manufactured, produced, grown, or extracted in the United States by such U.S. person (or by one or more includible corporations in an affiliated group, as defined in section 1504 of the code, of which such person is a member), and if the proceeds of the loan will be used by the obligor for the installation, maintenance, or improvement of facilities outside the United States which will be used for the storage, handling, transportation, processing, packaging, or servicing of property a substantial portion of which is the tangible personal property referred to above. A loan will not qualify for this exclusion unless the foreign obligor is committed to invest the proceeds of the loan for the stated purpose. Whether property sold by a U.S. person (or an includible corporation) constitutes a "substantial portion" of all of the property with respect to which a facility is used will depend on the percentage which the property so sold is of the total of all of such property, and not on the absolute dollar amount of such sales. The determination will be made by reference to the reasonably anticipated use to be made of the facility over the period during which the loan to be excluded will be outstanding.

The application of section 4914(c)(3) is illustrated by the following example:

Example.—A, a domestic corporation, is engaged in the business of producing steel in the United States. Over a period of several years A has sold to foreign corporation X approximately 40 percent of the steel fabricated by X in its plant in foreign country Q, and reasonably anticipates that this relationship will continue indefinitely. In the interest of increasing or maintaining these sales, A agrees to lend X $500,000, and X agrees to use the proceeds to construct new steel fabricating facilities at such plant. A receives 10-year promissory notes from X in return for the loan. The acquisition of these notes is excluded from the tax.

Other loans related to certain sales by U.S. persons

Paragraph (4) of section 4914(c) provides that an acquisition by a U.S. person of a debt obligation from a foreign obligor is excluded from tax if the debt obligation—

(A) was received by the U.S. person as all or part of the purchase price provided in a contract under which the foreign obligor agrees to purchase for 3 years or more ores or minerals (or derivatives thereof) extracted outside the United States by the U.S. person, by one or more includible corporations in an affiliated group (as defined in sec. 48(c)(3)(C) of the code) of which such person is a member, or by a corporation at least 10 percent of whose voting stock is owned by such U.S. person (but only if at least 50 percent of such voting stock is owned by U.S. persons each of whom owns at least 10 percent); or

(B) arises out of a loan, made by the U.S. person to the foreign obligor, the proceeds of which will be used by the obligor for the installation, maintenance, or improvement of facilities outside the United States which will be used for the storage, handling, transportation, processing, or servicing of ores or minerals (or derivatives thereof) a substantial portion of which is extracted outside the United States by any of the persons or corporations described in subparagraph (A).

Paragraph (4)(A) of section 4914(c) is applicable to credit extended in connection with supply contracts of the type described, but not to any cash loan which may be made in connection with such a contract. Paragraph (4)(B) is applicable to cash loans, but only when the proceeds are used for the stated purpose. With respect to paragraph (4)(B), whether property sold by any person constitutes a "substantial portion" of all of the property with respect to which a facility is used will depend on the percentage which the property so sold is of the total of all of such property, and not on the absolute dollar amount of such sales. The determination will be made by reference to the reasonably anticipated use to be made of the facility over the period during which the loan to be excluded will be outstanding.

Neither paragraph (4)(A) nor (4)(B) applies to the acquisition of stock of the foreign person involved or of debt obligations of any other person.

The application of section 4914(c)(4) is illustrated by the following examples:

Example (1).—A is a domestic corporation engaged in the business of selling crude and refined oil. A enters into an agreement under which it sells heating oil to foreign corporation M over a period of 10 years for a total consideration of $5 million. In partial payment of the contract price, A receives M's 10-year promissory notes in the amount of $2,500,000. The oil is extracted outside the United States by a corporation of which A owns 30 percent of the combined voting power of all classes of stock and U.S. person B owns an additional 20 percent. The acquisition by A of the notes is excluded from the tax.

Example (2).—The facts are the same as in example (1), except that A also agrees to make to foreign corporation M a $1 million loan, the proceeds of which M agrees to use for construction of a refinery. In return, A receives M's 10-year promissory notes. During the period in which the loan is to be outstanding, 35 percent of the oil refined in the facility which M constructs is to be supplied by A under the contract referred to in example (1). The acquisition by A of the notes is excluded from the tax.

Cross reference

Paragraph (5) of section 4914(c) contains a cross reference to section 4914(g), which provides in effect that (except for the exclusion contained in sec. 4914(c)(1)(A), relating to loans guaranteed or insured by an agency or wholly-owned instrumentality of the U.S. Government) any of the exclusions allowed under section 4914(c) may be lost as a result of certain subsequent transfers.

(*d*) *Loans to assure raw materials sources.*—Section 4914(d) excludes from tax the acquisition of debt obligations where the borrowing foreign corporation extracts or processes certain ores or minerals and where the loan made by the U.S. person will be amortized under so-called "take or pay" contracts entered into by the shareholders of the foreign corporation.

General rule

Paragraph (1) of section 4914(d) requires, in order for the exclusion to apply, that the foreign obligor extract or process ores or minerals the available deposits of which in the United States are inadequate to satisfy the needs of domestic producers, and that U.S. persons directly own at least 50 percent of the total combined voting power of all classes of stock of the foreign corporation at the time of the acquisition involved. It further requires that the loan be amortizable under a contract or contracts in which stockholders of the foreign corporation (including at least one U.S. person) agree to pay during the period remaining to maturity of the obligation, by purchasing a part of the production of such corporation or otherwise, a portion of the corporation's costs of operation and costs of amortizing outstanding loans.

Limitation

Paragraph (2) of section 4914(d) limits the total exclusions allowable under section 4914(d)(1) to the amount by which the "applicable percentage" of the aggregate actual value of the debt obligation acquired and all other debt obligations representing loans theretofore made to the foreign corporation (by both U.S. and foreign persons) during the same calendar year which are amortizable under "take or pay" contracts exceeds the actual value of similar debt obligations the acquisition of which by any U.S. person has been excluded from tax under section 4914(d) during the same calendar year. For this purpose the term "applicable percentage" means the lesser of (A) the percentage of the total combined voting power of all classes of stock of the foreign corporation which is owned by U.S. persons at the time of the acquisition involved, or (B) the percentage of the corporation's operating and amortization costs for the calendar year which all such U.S. persons have agreed to pay. The application of section 4914(d) is illustrated by the following example:

Example.—A, a domestic corporation, owns 60 percent of the only class of the outstanding stock of foreign corporation M. The remaining stock of M is owned by other foreign corporations. M is engaged in foreign country X in the processing of bauxite into alumina. The deposits of bauxite in the United States are inadequate to supply the needs of U.S. producers of aluminum for alumina.

A enters into a "take or pay" contract with M under which A agrees (subject to a clause permitting termination of payments in case of intervening *force majeure*) to purchase 60 percent of M's alumina production, or in lieu thereof to pay 60 percent of an amount equal to M's costs of operation and costs of amortizing outstanding loans. Similar contracts are entered into by the other shareholders of M. The following loans are made to M:

Lender	Amount	Date
Foreign corporation B	$500,000	Dec. 15, 1964
Foreign corporation C	1,000,000	Jan. 15, 1965
Domestic corporation D	2,000,000	Feb. 1, 1965
Domestic corporation E	1,000,000	Feb. 15, 1965

All of these loans are amortizable under the "take or pay" contracts described above. All are repayable on December 31, 1974, except the loan made by D, which is repayable on December 31, 1979. The lenders acquire promissory notes of M in the amounts set forth above, and the notes have an actual value equal to their face value. None of the other exclusions provided by chapter 41 is applicable.

D may exclude its acquisition from tax under the provisions of section 4914(d) only to the extent of $1,800,000 (60 percent of $3 million). D is liable for a tax of $20,600 (10.30 percent of $200,000).

E may exclude its acquisition from tax under such provisions only to the extent of $600,000 (60 percent of $4 million, or $2,400,000, less the $1,800,000 previously excluded by D). E is liable for a tax of $30,800 (7.70 percent of $400,000).

The exclusion allowed by section 4914(d) may in effect be lost as a result of certain subsequent transfers. The conditions under which the exclusion may be lost are set forth in section 4914(g).

(e) Acquisitions by insurance companies doing business in foreign countries.—Section 4914(e) excludes from tax the acquisition of certain stock and debt obligations by insurance companies doing business in foreign countries.

In general

Paragraph (1) of section 4914(e) states the general rule that the tax imposed by section 4911 does not apply to the acquisition of stock or a debt obligation by a U.S. person which is an insurance company subject to income taxation under section 802, 821, or 831 of the code if it meets the conditions and requirements set forth in section 4914(e). In general, the tax will not apply to an acquisition if—

> (A) the stock or debt obligation acquired is designated as part of a fund of assets established and maintained by the insurance company with respect to foreign risks insured or reinsured by such company under contracts (including annuity contracts) which, by their terms, provide that the proceeds will be payable only in the currency of a foreign country; and
>
> (B) the actual value of all of the assets held in such fund immediately after the stock or debt obligation has been designated as a part thereof does not exceed 110 percent of the applicable allowable reserve of such company.

The term "foreign risks," for purposes of section 4914(e), means risks in connection with property outside, or liability arising out of activity outside, or in connection with the lives or health of residents of countries other than, the United States.

Establishment and maintenance of fund of assets

Paragraph (2) of section 4914(e) provides that an insurance company which desires to obtain the benefit of exclusions under such section shall, as a condition of entitlement to any such exclusion, establish and maintain a fund (or funds) of assets. A life insurance company (as defined in sec. 801(a) of the code) must establish a fund of assets separately for each foreign currency (other than the currency of a country which qualifies as a less developed country) in which the proceeds of its insurance contracts are payable and for which insurance reserves are maintained by such company, and with respect to which it desires to obtain the benefits of such exclusions. Each such fund must separately meet the requirements of section 4914(e). An insurance company other than a life insurance company (as so defined) must establish a single fund of assets for all foreign currencies (other than currencies of countries which qualify as less developed countries at the time of the initial designation) in which the proceeds of its insurance contracts are payable and for which insurance reserves are maintained by such company, if it desires to obtain the benefits of exclusions under section 4914(e).

Designation of assets

Paragraph (3) of section 4914(e) contains three subparagraphs; subparagraph (A) provides rules for the initial designation of assets constituting a fund, subparagraph (B) provides rules for additional designations of assets after the initial designation, and subparagraph

(C) provides a limitation on the designations permitted. (Under sec. 4914(g)(2), if an insurance company designates (or is required to designate) stock or a debt obligation under sec. 4914(e), it will not thereafter be considered a U.S. person with respect to that stock or debt obligation.)

Initial designation

Paragraph (3)(A) requires that an insurance company desiring to establish a fund (or funds) of assets under paragraph (2) must initially designate, as part or all of such fund (or funds), stock of foreign issuers, or debt obligations of foreign obligors having a period remaining to maturity (as of December 10, 1963) of 3 years or more, or both, which it owned on December 10, 1963, to the extent that such stock and debt obligations had an actual value as of such date not in excess (in the case of any such fund) of 110 percent of the applicable allowable reserve as determined in accordance with paragraph (4)(A). The designation or designations which an insurance company is thus required to make must be made first from stock and debt obligations which were acquired by such company on or before July 18, 1963, and must not include any stock or debt obligation described in section 4916(a) (relating to less developed countries, less developed country corporations, etc.). Any initial designation which an insurance company is required to make under paragraph (3)(A) must be made on or before the 30th day after the date of the enactment of the new chapter 41 (or at such later time as the Secretary of the Treasury or his delegate may by regulations prescribe) by the segregation on the books of such company of the stock or debt obligations (or both) designated.

Designations to maintain fund

Paragraph (3)(B) provides that, to the extent permitted by paragraph (3)(C), an insurance company may claim an exclusion under section 4914(e) with respect to the acquisition of stock or a debt obligation of a foreign issuer or obligor after December 10, 1963, if such company designates such stock or debt obligation as part of a fund of assets described in paragraph (2) before the expiration of 30 days after the date of such acquisition (and continues to own it until the time the designation is made); except that any such stock or debt obligation acquired before the initial designation of assets to the fund is actually made by segregating such assets on the books of the company as described above may be designated under paragraph (3)(B) at the time of such initial designation without regard to the 30-day and continued ownership requirements.

Limitation

Paragraph (3)(C) provides that no designation of stock or a debt obligation as a part of a fund of assets may be made under paragraph (3) (A) or (B) to the extent that, immediately thereafter, the actual value of all of the assets held in such fund would exceed 110 percent of the applicable allowable reserve determined in accordance with paragraph (4).

Determination of reserves

Paragraph (4)(A) of section 4914(e) provides that, for purposes of section 4914(e), the term "allowable reserve" means—

(1) in the case of a life insurance company (as defined in sec. 801(a) of the code), the items taken into account under section 810(c) of the code arising out of contracts of insurance and reinsurance (including annuity contracts) which relate to foreign risks and the proceeds of which are payable in a single foreign currency (other than the currency of a less developed country); and

(2) in the case of an insurance company other than a life insurance company (as so defined), the amount of its unearned premiums and unpaid losses which relate to foreign risks insured or reinsured under contracts providing for payment in foreign currencies (other than currencies of less developed countries), and which are taken into account in computing taxable income under section 832(b) (4) and (5) of the code (for such purpose treating underwriting income of an insurance company subject to taxation under sec. 821 of the code as taxable income under sec. 832).

The determination of an allowable reserve of an insurance company for any calendar year is made as of the close of the previous calendar year, except as provided in paragraph (4)(B).

Paragraph (4)(B) provides that an insurance company which has established a fund of assets under section 4914(e) may elect, in such manner and form as the Secretary of the Treasury or his delegate shall prescribe in regulations and on or before the date that such company is required under section 6076 of the code to file its return for the period in which the last day of any calendar year occurs, to make the determination of the allowable reserve with respect to such year as of the close of such year. At the time of making such election, the company may (if the allowable reserve as so determined is higher than as determined under par. (4)(A)) designate additional stock or debt obligations (or both) as part of such fund, so long as the company still owns such stock or debt obligations at the time of designation and the actual value of all of the assets held in such fund is not increased to more than 110 percent of the allowable reserve applicable to such fund as determined under paragraph (4)(B). In the case of a life insurance company (as defined in sec. 801(a) of the code), the election under paragraph (4)(B) is made separately with respect to each fund of assets established as provided in section 4914(e)(2). Any tax paid by the company under section 4911 on the acquisition of the additional stock or debt obligations so designated will constitute an overpayment of tax; and, under regulations prescribed by the Secretary of the Treasury or his delegate, credit or refund (without interest) will be allowed or made with respect to such overpayment.

Nonrecognition of artificial increases in allowable reserve

Paragraph (5) of section 4914(e) provides that an insurance or reinsurance contract which is entered into or acquired by an insurance company for the principal purpose of artificially increasing the amount determined as an allowable reserve as provided in paragraph (4) of such section will not be recognized in computing whether an acquisition of stock or a debt obligation of a foreign issuer or obligor can be excluded under section 4914(e). The facts and circumstances of each case will be considered in determining whether the principal purpose was to artificially increase the amount of an allowable reserve.

The operation of section 4914(e) is illustrated by the following examples:

Example (1).—R is a domestic insurance company subject to income taxation under section 802 of the code. R insures the lives of residents of foreign country X, under contracts the proceeds of which are payable only in the currency of that country. As of the close of calendar year 1962, $500,000 was the amount of R's allowable reserve, computed in accordance with paragraph (4)(A) of section 4914(e), with respect to such contracts. R also insures the lives of residents of foreign country Y under contracts the proceeds of which are payable only in its currency. As of the same date, $200,000 was the amount of the allowable reserve, similarly computed, with respect to such contracts.

On December 10, 1963, R owned the following foreign securities, each having as of that date the period remaining to maturity and the actual value indicated:

Security	Period to maturity (years)	Actual value
(1) Bonds of foreign corporation A	10	$200,000
(2) Notes of foreign country X	2	50,000
(3) Bonds of foreign corporation B	15	100,000
(4) Stock of foreign corporation C	----------	125,000

All of such securities had been acquired by R on or before July 18, 1963.

During the period from July 19, 1963, through December 10, 1963, R engaged in the following transactions:

(*a*) On July 24, 1963, R acquired a 5-year debt obligation of foreign corporation D, having an actual value on that date of $2,000; and on September 10, 1963, R sold that debt obligation.

(*b*) On July 29, 1963, R acquired a debt obligation of foreign corporation E, maturing on November 30, 1966, and having an actual value when acquired of $5,000.

(*c*) On August 27, 1963, R acquired 500 shares of stock of foreign corporation F having an actual value on that date of $18,000 and an actual value on December 10, 1963, of $20,000.

(*d*) On September 2, 1963, R acquired 10-year bonds of foreign government Y having an actual value of $100,000 both at the time of acquisition and on December 10, 1963.

R desires to obtain the benefit of exclusions under section 4914(e) and therefore on December 31, 1963, establishes two funds of assets, one with respect to the risks insured in foreign country X and the other with respect to the risks insured in foreign country Y, by segregating on its books (in accordance with sec. 4914(e)(3)(A)(i)) the assets which are required to be designated as part of each fund. (None of the other exclusions or exemptions provided by ch. 41 is applicable.)

Before it may designate any other assets, R must designate the bonds of foreign corporation A, the bonds of foreign corporation B and the stock of foreign corporation C. R may not designate the notes of foreign country X, since they had a period remaining to maturity of less then 3 years on December 10, 1963. R makes the following designations:

	Currency X fund	Currency Y fund
Allowable reserve	$550,000	$220,000
Initial designation:		
(1) Bonds of foreign corporation A	200,000	----------
(2) Bonds of foreign corporation B	----------	100,000
(3) Stock of foreign corporation C	50,000	75,000
Total	250,000	175,000
Amount remaining to be designated	300,000	45,000

In making further designations, R is not permitted to designate the 5-year debt obligation of foreign corporation D, since it was not owned by R on December 10, 1963. It is also not permitted to designate the debt obligation of foreign corporation E, since on December 10, 1963, the debt obligation had a period remaining to maturity of less than 3 years. R must designate the 500 shares of stock of corporation F and the bonds of foreign country Y. R makes the following designations:

	Currency X fund	Currency Y fund
(1) Stock of foreign corporation F	$20,000	----------
(2) Bonds of foreign country Y	55,000	$45,000
Total, initial designation	325,000	220,000

Example (2).—The facts are the same as in example (1), and R has made the initial designations described therein. R now desires to designate additional foreign stock and debt obligations which it has acquired after December 10, 1963. R engaged in the following foreign security transactions after December 10, 1963, and prior to January 1, 1964:

(*a*) On December 21, 1963, R acquired a 5-year debt obligation of foreign corporation H, which had an actual value of $10,000; this was sold on December 27, 1963.

(*b*) On December 24, 1963, R acquired stock in foreign corporation J, which had an actual value of $20,000.

(*c*) On December 26, 1963, R acquired a 15-year debt obligation of foreign corporation K, which had an actual value of $5,000.

Under section 4914(e)(3)(B), R may maintain the funds it has established by designating additional assets as part of the funds to the extent allowed under section 4914(e). The 5-year debt obligation of H, which was sold on December 27, 1963, may be designated by R despite the fact it is not owned by R on December 31, 1963, if such designation is made on December 31, 1963, at the time of the initial designation of assets. The stock acquired by R on December 24, 1963, and the debt obligation acquired by R on December 26, 1963, may also be designated by R as part of a fund on December 31, 1963, or on any date thereafter (up to 30 days after the date of acquisition) on which they are owned by R. Accordingly, R designates the debt obligation of H, the stock of J, and the debt obligation of K as part

of the fund established with respect to risks insured in foreign country X.

Example (3).—The facts are the same as in example (1). R, after making the initial designation of assets in the funds established for currency X and currency Y, makes other acquisitions of foreign securities during the calendar year 1964. As of the close of the calendar year 1963, $600,000 is the allowable reserve with respect to risks payable in the currency of foreign country X.

On June 10, 1964, R acquires a 10-year debt obligation of foreign corporation P, having an actual value of $10,000. At the time of such acquisition the actual values of the assets in the X currency fund and the Y currency fund are such that the designation of the P debt obligation would bring the total actual value of the assets of each such fund to an amount greater than 110 percent of their respective allowable reserves. Accordingly, R is not able to designate the P debt obligation as part of a fund of assets under section 4914(e). R thus is required to (and does) pay an interest equalization tax of $770 (7.70 percent of $10,000) with respect to its acquisition of the debt obligation of P.

However, R continues to hold the P debt obligation and on January 25, 1965, files its return with respect to transactions which occurred during the last quarter of the calendar year 1964. At such time R determines that the amount of its allowable reserve as of the close of the calendar year 1964 with respect to currency X risks was $620,000. The actual value of the P debt obligation on January 25, 1965, was $12,000, and the actual value of all assets held in the X fund on that date was $640,000. Under the special election provided in section 4914(e)(4)(B), R may designate the P debt obligation as an asset of the X fund since such designation would not raise the total actual value of the X fund assets on January 25 above $682,000 (110 percent of $620,000). Pursuant to regulations prescribed by the Secretary of the Treasury or his delegate, R is permitted to obtain a refund or credit of the $770 tax paid on the acquisition of the debt obligation of P.

(*f*) *Acquisitions by certain tax-exempt labor, fraternal, and similar organizations having foreign branches or chapters.*—Section 4914(f) provides that the tax imposed by section 4911 does not apply to the acquisition of stock or debt obligations by a U.S. person which is described in section 501(c) of the code, is exempt from taxation under subtitle A of the code, and operates in a foreign country through a local organization or organizations, to the extent that such acquisition results from the investment or reinvestment of contributions or membership fees paid in the currency of such country by individuals who are members of the local organization or organizations, and the stock or debt obligations acquired are held exclusively for the benefit of the members of any of such local organizations. The term "local organizations" includes all branches, chapters, and similar entities, located and operating in a foreign country, which are chartered by, or affiliated or associated with, the parent or central organization, and subject to the general supervision of, and examination by, such parent or central organization. The term "membership fees" covers dues, fees, and assessments which are paid by the local membership; however, premiums (including deposits and assessments) paid to a mutual insurance company or association referred to in section 501(c)(15) of the code are not considered membership fees or contributions. A

U.S. person will meet the exclusive holding requirements of section 4914(f) if the stock or debt obligations involved are held exclusively for the benefit of the members of any or all of the local organizations in the particular foreign country.

An exclusion allowed under section 4914(f) may, in effect, be lost as a result of certain subsequent transfers. The conditions under which the exclusion may be lost are set forth in section 4914(g).

(*g*) *Loss of entitlement to exclusion in case of certain subsequent transfers.*—Section 4914(g) provides in effect for the loss by U.S. persons of the benefits of certain exclusions previously allowed under section 4914 upon subsequent transfers of the stock or debt obligations involved.

In general

Paragraph (1) of section 4914(g) sets forth provisions relating to the loss of the exclusions provided in section 4914 (c), (d), and (f) upon the subsequent transfer of the debt obligation or stock involved.

In the case of the exclusion of a debt obligation from tax under the provisions of section 4914(c) (relating to export credit, etc., transactions), other than paragraph (1)(A) thereof (relating to debt obligations guaranteed or insured by an agency or instrumentality of the United States), or under the provisions of section 4914(d) (relating to loans to assure raw materials sources), the acquiring person becomes liable for tax under section 4911 if the debt obligation is subsequently transferred by him before the termination of the tax to any U.S. person otherwise than—

(A) to an agency or wholly-owned instrumentality of the United States;

(B) to a commercial bank acquiring the obligation in the ordinary course of its commercial banking business; or

(C) in a transaction described in section 4914(a)(1) (transfers between a person and his nominee, custodian, or agent), a transaction described in section 4914(a)(2) (certain transfers by operation of law as enumerated in sec. 4343(a) of the code), or a transaction (other than a transfer by gift) described in section 4914(a)(3) (transfers by legacy, bequest, or inheritance).

A debt obligation the acquisition of which is excluded from tax under section 4914(c)(1)(A) (because guaranteed or insured by an agency or instrumentality of the United States) may be transferred to any person without loss of the exclusion.

In the case of the exclusion of stock from tax under the provisions of section 4914(c)(2) (alternate rule for producing exporters), the acquiring person becomes liable for tax under section 4911 if the stock is subsequently transferred by him before the termination of the tax to a U.S. person otherwise than in a transaction described in section 4914(a)(1), a transaction described in section 4914(a)(2), or a transaction (other than a transfer by gift) described in section 4914(a)(3).

In the case of the exclusion of stock or a debt obligation from tax under the provisions of section 4914(f) (relating to acquisitions by certain tax-exempt labor, fraternal, and similar organizations having foreign branches or chapters), the acquiring person becomes liable for tax under section 4911 if the stock or debt obligation is subsequently transferred by it before the termination of the tax to any U.S. person.

Where an exclusion is lost under the provisions of section 4914(g)(1) and liability for the tax is incurred by the transferor with respect to the stock or debt obligation involved, such liability is incurred at the time of the subsequent transfer. The amount of the tax due is equal to the amount of tax for which the transferor would have been liable had the exclusion not originally applied with respect to the acquisition. No liability is imposed under section 4914(g)(1) upon the transferee.

The application of section 4914(g)(1) is illustrated by the following examples:

Example (*1*).—M, a domestic corporation, on June 15, 1964, sells an airplane manufactured in the United States to X, a foreign corporation, for a total price of $1 million, receiving as payment $100,000 in cash and X's 10-year promissory note having an actual value of $900,000. At that time, the acquisition by M is excluded from tax under section 4914(c)(1)(B). On July 1, 1965, M sells the note to P, a domestic corporation which is not a commercial bank, for $800,000. M incurs liability on July 1, 1965, for tax in the amount of $69,300 (7.7 percent of $900,000).

Example (*2*).—B, a domestic corporation, is a construction engineering firm. On September 1, 1964, B sells its services to foreign corporation R for the construction of a plant for $100,000, receiving as payment $80,000 in cash and stock of R having an actual value of $20,000. At that time, the acquisition by B is excluded from tax under section 4914(c)(2). On February 15, 1965, B sells the stock to P, a domestic corporation which is a commercial bank, for $18,000. B incurs liability on February 15, 1965, for tax in the amount of $3,000 (15 percent of $20,000).

U.S. person treated as foreign person on disposition of certain securities

Paragraph (2) of subsection 4914(g) sets forth a special rule with respect to the disposition by a U.S. person of stock or a debt obligation the acquisition of which by such person was excluded from tax under section 4914(b)(3), or which was designated (or required to be designated) under section 4914(e). If a U.S. person, after December 10, 1963, sells or otherwise disposes of stock or a debt obligation which was so excluded or designated (or required to be designated), such person is not, with respect to that stock or debt obligation, considered a U.S. person. Accordingly, the acquisition of such stock or debt obligation by any other U.S. person is not excluded from tax under section 4918 (relating to prior American ownership).

In cases to which paragraph (2) applies, no liability for tax is imposed upon the U.S. person making the sale or other disposition. Since such person is not considered a U.S. person for this purpose, however, such person may become subject to penalty under section 6681 or 7241 of the code if he executes a certificate of American ownership with respect to such stock or debt obligation or sells such stock or debt obligation under the coverage of a blanket certificate of American ownership.

The application of section 4914(g)(2) is illustrated by the following examples:

Example (*1*).—R, a life insurance company, establishes a fund of assets with respect to foreign currency X. Under paragraph (3)(A) of section 4914(e), R is required, as part of its initial designation of assets with respect to such fund, to designate 100 shares of P corporation stock which it owns. However, the shares are not at any time so designated. In June 1964, R sells the P stock to a U.S. person.

Under the special rule of section 4914(g)(2), R is treated as a foreign person with respect to such stock and is not able to execute a certificate of American ownership with respect thereto.

Example (2).—B, a U.S. company doing business in foreign country X, is required by the laws of that country to place a deposit of $5,000 in local securities with that government during the time B continues to do business in X. B purchases two 10-year debt obligations of foreign corporation N having a total actual value of $5,000, and deposits these with X. B has an exclusion under section 4914(b)(3) with respect to these two acquisitions. In January 1965, B sells one of the debt obligations to a U.S. person. B cannot give a certificate of American ownership to the purchaser. The U.S. person who acquires the debt obligation of N from B is subject to the provisions of chapter 41 to the same extent as if B were a foreign person.

SECTION 4915. EXCLUSION FOR DIRECT INVESTMENTS

(*a*) *In general*.—Section 4915(a) provides that the tax imposed by section 4911 does not apply to the acquisition of stock or a debt obligation of a foreign corporation or foreign partnership where the acquiring person is investing in a foreign corporation or foreign partnership in which he has a substantial ownership interest.

Excluded acquisitions

Paragraph (1) of section 4915(a) states the general rule that an acquisition by a U.S. person of stock or debt obligations of a foreign corporation or foreign partnership is not subject to the interest equalization tax if immediately after the acquisition such person (or one or more includible corporations in an affiliated group, as defined in sec. 1504 of the code, of which such person is a member) owns (directly or indirectly) 10 percent or more of the total combined voting power of all classes of stock of such foreign corporation, or if such person owns (directly or indirectly) 10 percent or more of the profits interest of such foreign partnership. (Under sec. 4920(a)(2), any interest of a partner in a partnership is included within the definition of the term "stock.") Stock owned, directly or indirectly, by or for a foreign corporation or foreign partnership is considered as being owned proportionately by its shareholders or partners. The exclusion for direct investments applies to acquisitions from the corporation or partnership or from third parties, and to contributions of capital to the foreign corporation or foreign partnership by a person holding at least 10 percent of the voting power of all classes of stock of the corporation, or at least 10 percent of the profits interest of the partnership, immediately after making such capital contribution.

The application of section 4915(a)(1) is illustrated by the following examples:

Example (1).—On March 31, 1964, A, a U.S. person, acquires 100 shares of the only class of stock of foreign corporation N from the corporation, which immediately thereafter has a total of 1,000 shares outstanding. A's acquisition of the 100 shares of N stock is excluded from tax as the acquisition of a direct investment.

Example (2).—The facts are the same as in example (1), except that later in 1964 A lends N $100,000, taking a 5-year promissory note in return. A's acquisition of the indebtedness of N is excluded from tax as the acquisition of a direct investment.

Example (3).—The facts are the same as in example (1), except that later in 1964 A purchases from R, a nonresident alien, an additional 50 shares of the stock of N. A's acquisition of the 50 shares of stock of N is exempt from tax as the acquisition of a direct investment.

Example (4).—On April 15, 1964, A, a U.S. person, acquires a 10 percent interest in the profits of foreign partnership M. M acquires 100 percent of the voting stock of foreign corporation O. Subsequently, A lends O $100,000, taking a 5-year promissory note in return. A's acquisition of the indebtedness of O is excluded from tax as the acquisition of a direct investment since A is considered to own 10 percent of the stock of O.

Overpayment with respect to certain taxable acquisitions

Paragraph (2) of section 4915(a) provides that the tax paid on the acquisition of stock of a foreign corporation or foreign partnership by a U.S. person will constitute an overpayment if such person continuously holds such stock from the time of its acquisition to the last day of the calendar year in which the acquisition was made and as of such last day owns 10 percent or more of the total combined voting power of all classes of stock of the corporation or 10 percent or more of the profits interest of the partnership. Paragraph (2) further provides that under regulations prescribed by the Secretary of the Treasury or his delegate, credit or refund (without interest) will be allowed or made with respect to such overpayment. This provision permits a credit or refund on acquisitions of stock if the acquiring U.S. person is unable to meet the direct investment requirements of section 4915(a)(1) in a single acquisition but does meet such requirements through a series of acquisitions in the same year. The exclusion does not apply to the acquisition of a debt obligation by the U.S. person prior to his acquisition of the requisite 10-percent interest in a foreign corporation or foreign partnership.

The application of section 4915(a)(2) is illustrated by the following example:

Example.—On each of September 1, October 1, November 1, and December 1, 1964, A, a U.S. person, acquires from S, a foreign corporation, 2,500 shares of the only class of stock of foreign corporation N, which has a total of 100,000 shares outstanding. On September 15, 1964, A lends N $10,000, taking a 5-year promissory note in return. On December 15, 1964, A lends N an additional $10,000 on the same terms. On December 31, 1964, A holds all 10,000 shares of stock so acquired. A is entitled to a refund (without interest) of the tax paid on the acquisition made on September 1, and a credit (without interest) against the tax applicable to the acquisitions made on October 1 and November 1. The acquisition of stock made on December 1 is excluded from tax under section 4915(a)(1) as a direct investment. A incurs a tax of $435 (4.35 percent of $10,000) on the acquisition of the 5-year promissory note of N on September 15, 1964; but the acquisition of the similar debt obligation of N on December 15, 1964, is excluded from tax as a direct investment.

(*b*) *Special rule for Government-controlled enterprises*.—Section 4915 (b) provides that a U.S. person will be considered to meet the direct investment ownership requirement of section 4915(a)(1) with respect to a foreign corporation or foreign partnership if (A) the government of a foreign country or any political subdivision thereof (or an agency or instrumentality of such a government), directly or indirectly, restricts to less than 10 percent the percentage of the total combined voting power of all classes of stock of such corporation or the percentage of the profits interest in such partnership which may be owned by such U.S. person; (B) such U.S. person owns at least 5 percent of the total combined voting power of so much of such stock, or at least 5 percent of so much of such profits interest, as is not owned by such foreign government, subdivision, agency, or instrumentality; (C) a trade or business actively conducted in one or more foreign countries by such U.S. person (or by one or more corporations in an affiliated group, as defined in sec. 48(c)(3)(C) of the code, of which such person is a member) is directly related to the business carried on by such foreign corportion or partnership; and (D) such person, and one or more other U.S. persons each of whom satisfies (B) and (C), together meet the 10 percent direct investment requirement.

The application of section 4915(b) is illustrated by the following example:

Example.—Corporation A, corporation B, and corporation C are U.S. corporations. Each has a wholly-owned foreign subsidiary which is actively engaged in selling petroleum products in foreign country M. Country M permits foreign corporation F to be formed to construct and operate an oil pipeline in country M. An agency of country M acquires 50 percent of the only class of stock of F, and the remaining 50 percent is allocated by country M among the oil companies doing business in that country. Under this allocation, A acquires 9 percent, B acquires 7 percent, and C acquires 3 percent of the stock of F (constituting 18, 14, and 6 percent, respectively, of the stock not owned by the agency of M). All three acquisitions are excluded from tax as direct investments.

(c) *Exception for foreign corporations or partnerships formed or availed of for tax avoidance.*—Section 4915(c) prevents the application of the exclusion for direct investments in certain cases.

In general

Paragraph (1) of section 4915(c) provides that the exclusion for direct investments under section 4915(a) does not apply if the foreign corporation or foreign partnership involved is formed or availed of by the U.S. person for the principal purpose of acquiring, through the foreign corporation or foreign partnership, an interest in stock or debt obligations the acquisition of which would, if made directly by the U.S. person, be subject to the interest equalization tax.

Thus, if A, a U.S. person, acquires 10 percent of the stock of N, a foreign corporation engaged primarily in the business of investing, reinvesting, or trading in foreign securities the direct acquisition of which by A would be subject to interest equalization tax, the acquisition is not excluded under section 4915. Moreover, even if M is not engaged in such activity at the time of the acquisition by A, the acquisition would not be excluded under such section if M is later availed of by A (prior to the termination of the tax) principally for the purpose of acquiring for A an interest in a portfolio of foreign securities. On the other hand, if M actively engages in the conduct of a business other than a securities business and acquires debt obligations as an incident of such business, it is not considered to be availed of for the proscribed purpose.

Commercial banks, underwriters, and required holdings

Paragraph (2) of section 4915(c) provides that the "formed or availed of" exception to the exclusion from tax for direct investments in foreign corporations and foreign partnerships is not operative in cases where the foreign corporation or partnership is principally acquiring foreign stock or debt obligations because of legal requirements imposed as a condition to doing business in a foreign country or, in the case of a foreign corporation or partnership engaged in business as an underwriter (within the meaning of sec. 4919(c)(1)) or in the business of commercial banking, where transactions are made in the ordinary course of such business.

Thus, the fact that a U.S. person acquires stock or debt obligations of a foreign corporation or partnership which in turn acquires stock and debt obligations of other foreign issuers and obligors—

(A) in making loans in the ordinary course of its business as a commercial bank,

(B) in the ordinary course of its business of underwriting and distributing securities issued by other persons, or

(C) to satisfy minimum requirements relating to holdings of stock or debt obligations of foreign issuers or obligors imposed by the laws of foreign countries where such foreign corporation or partnership is doing business,

will not, standing alone, be considered an acquisition of an interest in stock or debt obligations of foreign issuers or obligors by the U.S. person for purposes of the exclusion under section 4915.

Loss of entitlement to exclusion or refund where foreign corporation or partnership is availed of for tax avoidance

Paragraph (3) of section 4915(c) provides that where an acquisition is excluded from tax as a direct investment under section 4915(a)(1), or a credit or refund of tax has been received under section 4915(a)(2) with respect to acquisitions made during a calendar year, but the foreign corporation or foreign partnership is availed of by the acquiring person (after the acquisition or calendar year involved but before the termination of the tax) for the principal purpose of tax avoidance as described in paragraph (1) of such section, such person will incur liability for the tax under section 4911 at the time the foreign corporation or partnership is availed of for such purpose; and the amount of such tax will be equal to the amount of the tax which would have applied under section 4911 if the direct investment had not previously been excluded, or (in a case involving a credit or refund under sec. 4915(a)(2)) to the aggregate amount of tax for which such person was liable under section 4911 upon his acquisitions of the stock or debt obligations involved.

(d) *Exception for acquisitions ade with intent to sell to U.S. persons.*—Section 4915(d) provides that the direct invest ients exclusion is inapplicable if stock or debt obligations of a foreign issuer or obligor are acquired by a U.S. person with an intent to sell, or to offer to sell, any part thereof to U.S. persons. Thus, if a U.S. underwriter acquires 10 percent or more of the stock of a foreign corporation with a view to the distribution of any part of such stock to U.S. persons through resale, the acquisition is not excludable under section

4915(a). (However, if all or part of the stock acquired is sold to persons other than U.S. persons, a credit or refund of the interest equalization tax imposed may be allowed with respect to these sales under sec. 4919.) On the other hand, if a domestic corporation, solely to carry out a plan for expanding its markets abroad, acquires 10 percent or more of the stock of a foreign corporation but later, for sound business reasons, disposes of its interest to a U.S. person, such acquisition will not be considered to have been made with an intent to sell, or to offer to sell, such stock to U.S. persons, and it will be excluded under section 4915 from the tax.

SECTION 4916. EXCLUSION FOR INVESTMENTS IN LESS DEVELOPED COUNTRIES

(*a*) *General rule.*—Section 4916(a) provides an exclusion from the interest equalization tax for investments by U.S. persons (in stock or debt obligations of foreign issuers or obligors) which constitute investments in a less developed country. These investments are—

(1) a debt obligation issued or guaranteed by the government of a less developed country, by a political subdivision of such a country, or by an agency or instrumentality of such a government;

(2) stock or a debt obligation of a less developed country corporation; and

(3) a debt obligation issued by an individual or partnership resident in a less developed country in return for property which is used, consumed, or disposed of wholly within one or more less developed countries.

A debt obligation otherwise qualifying for this exclusion will not be disqualified because it is guaranteed by a person other than one described in section 4916(a) or because it is repayable in the currency of a country which is not considered less developed.

(*b*) *Less developed country defined.*—Section 4916(b) defines the term "less developed country." Except for certain countries and areas (specified in such section) which may not be designated as less developed countries, the designation of countries to be considered economically less developed for this purpose is left to Executive order. For the interim period prior to the issuance of an Executive order under the new chapter 41, all countries designated as less developed (under sec. 955(c)(3) of the code) by Executive Order No. 11071, dated December 27, 1962 (designating certain areas as economically less developed countries for purposes of subpts. A and F of pt. III of subch. N, and sec. 1248 of ch. 1 of the code), will be considered to be less developed for purposes of the interest equalization tax. This includes all countries, and overseas territories, departments, provinces, and possessions of countries (other than areas within the Sino-Soviet bloc), except those specified. The countries designated as less developed for purposes of section 4916 need not (except for the interim period referred to above) be the same as those designated as less developed in any Executive order under section 955(c)(3) of the code. The designation of a country as a less developed country under section 4916 can be terminated (after such interim period) only by a further Executive order after 30 days' notice to the Congress. Any such termination will not affect the treatment of acquisitions occurring prior to the issuance of the terminating Executive order.

(*c*) *Less developed country corporation defined.*—Section 4916(c) defines the term "less developed country corporation."

In general

Paragraph (1) of section 4916(c) defines a less developed country corporation as one which (for the applicable periods described in par. (2)) (A) meets the requirements of section 955(c) (1) or (2) of the code; or (B) has gross income 80 percent or more of which is derived from sources within less developed countries, and assets 80 percent or more in value of which consists of property described in clauses (iii), (iv), and (v) of section 955(c)(1)(B) of the code. For this purpose, the determination of whether a foreign country is a less developed country is to be made in accordance with section 4916(b).

Section 955(c)(1) of the code provides that a corporation will qualify as a less developed country corporation if it conducts one or more active trades or businesses in one or more less developed countries, derives 80 percent or more of its gross income from less developed countries, and has 80 percent or more in value of its assets consisting of—

(A) property used in such trades or businesses and located in less developed countries;

(B) money and deposits with persons carrying on the banking business;

(C) stock, and obligations which at the time of their acquisition have at least a 1-year maturity, of any other less developed country corporation;

(D) obligations of a less developed country;

(E) investments required because of restrictions imposed by a less developed country; and

(F) property described in section 956(b)(2) of the code, relating to exceptions from the term "United States property."

For purposes of section 955(c)(1), whether income is derived from sources within less developed countries is determined under regulations prescribed by the Secretary of the Treasury or his delegate.

Section 955(c)(2) of the code provides that the term "less developed country corporation" also includes a foreign corporation 80 percent or more of the assets of which consists of assets used, or held for use, for or in connection with production of income described below and property described in section 956(b)(2), relating to exceptions from the term "United States property", and 80 percent or more of the gross income of which consists of—

(A) gross income derived from, or in connection with, the using (or hiring or leasing for use) in foreign commerce of aircraft or vessels registered under the laws of a less developed country, or from, or in connection with, the performance of services directly related to use of such aircraft or vessels, or from the sale or exchange of such aircraft or vessels, and

(B) dividends and interest received from foreign corporations which are less developed country corporations within the meaning of such section 955(c)(2) and 10 percent or more of the total combined voting power of all classes of stock of which is owned by the foreign corporation, and gain from the sale or exchange of stock or obligations of foreign corporations which are such less developed country corporations.

Under paragraph (1)(B) of the new section 4916(c), a foreign corporation will be regarded as a less developed country corporation even if it is not engaged in the active conduct of one or more trades or businesses in less developed countries, if it has 80 percent or more of its income from sources within less developed countries and has 80 percent or more in value of its assets in—

(A) stock, and debt obligations which at the time of their acquisition have at least a 1-year maturity, of any less developed country corporation;

(B) obligations of a less developed country; and

(C) investments which are required because of restrictions imposed by a less developed country.

For purposes of paragraph (1)(B) of section 4916(c), whether income is derived from sources within less developed countries is to be determined under the same rules as those applicable under section 955(c)(1) of the code.

Applicable periods

Paragraph (2) of section 4916(c) sets forth the applicable periods for which a corporation must meet the requirements contained in paragraph (1) of such section in order to qualify as a less developed country corporation. These periods are—

(A) the annual accounting period of the foreign corporation immediately preceding the one in which the acquisition involved is made, if it had such an accounting period;

(B) the annual accounting period in which the acquisition is made; and

(C) the next succeeding annual accounting period.

If an acquisition is made in the first annual accounting period of a newly-formed foreign corporation, the acquisition will be excluded from the tax if the foreign corporation meets the applicable requirements for that accounting period and the next succeeding accounting period. If an acquisition is made in the final accounting period of a foreign corporation, the acquisition will not be excluded, unless the special rules of section 4916(c)(3) are applicable.

Special rules for treatment of corporations as less developed country corporations

Paragraph (3) of section 4916(c) provides that a foreign corporation will be deemed to be a less developed country corporation with respect to any acquisition if it is established to the satisfaction of the Secretary of the Treasury or his delegate before the acquisition occurs (or, in the case of an acquisition occurring before or within 60 days after the date of the enactment of the bill, pursuant to application made within such period following enactment as may be prescribed by the Secretary of the Treasury or his delegate in regulations) that the foreign corporation met the applicable requirements of section 4916(c)(1) for the annual accounting period (if any) immediately preceding the accounting period in which the acquisition is made, and may reasonably be expected to satisfy such requirements for the annual accounting period in which the acquisition is made and the next succeeding annual accounting period. In the case of an acquisition occurring on or before December 10, 1963, a foreign corporation will be treated as a less developed country corporation if the requirements of section 4916(c)(1) are met for the annual accounting period

immediately preceding the annual accounting period in which the acquisition occurred.

The elective ruling procedure provided for in section 4916(c)(3) is available for both new and outstanding issues. A ruling may be issued even if the foreign corporation is newly organized and has had no accounting period referred to in section 4916(c)(2)(A). A ruling may not be issued, however, if the foreign corporation had an accounting period referred to in section 4916(c)(2)(A) but did not qualify as a less developed country corporation for such period. If a ruling is issued by the Secretary of the Treasury or his delegate under section 4916(c)(3), the foreign corporation's subsequent failure to meet the requirements of section 4916(c)(1) for the annual accounting period in which the acquisition is made or the next succeeding annual accounting period will not result in loss of the exclusion.

Treatment of corporations as less developed country corporations in other cases

Paragraph (4) of section 4916(c) permits a U.S. person to treat a foreign corporation as a less developed country corporation for purposes of section 4916, even though no ruling under section 4916(c)(3) has been obtained, if such corporation has met the applicable requirements of section 4916(c)(1) for the annual accounting period (if any) immediately preceding the accounting period in which the acquisition involved is made and such person reasonably believes that such corporation will satisfy such requirements for the current and next succeeding annual accounting periods; but a person relying upon this paragraph is subject to possible subsequent liability for tax as provided in section 4916(d)(1).

(*d*) *Subsequent liability for tax in certain cases.*—Section 4916(d) provides in effect for the loss of exclusions previously allowed under section 4916(a) upon the happening of certain subsequent events.

Stock and debt obligations of certain corporations

Paragraph (1) of section 4916(d) provides that if a ruling is not obtained from the Secretary of the Treasury or his delegate with respect to an acquisition of stock or a debt obligation of a foreign corporation under section 4916(c)(3), and such corporation is treated under section 4916(c)(4) as meeting the applicable requirements of section 4916(c)(1) but fails to meet such requirements either for the annual accounting period in which the acquisition involved is made or for the next succeeding annual accounting period, the U.S. person making the acquisition involved will incur liability for the interest equalization tax on the last day of the accounting period of the foreign corporation with respect to which such failure occurs (prior to termination of the tax), in an amount equal to the tax which would have been payable under section 4911 if the exclusion had not applied at the time of the acquisition. This rule is illustrated by the following example:

Example.—On April 1, 1964, A, a U.S. person, acquires for $10,000 from B, a nonresident alien, bonds of foreign corporation M maturing on June 30, 1967. The annual accounting period of M immediately preceding the acquisition ends on December 31, 1963, and for that period M satisfies the requirements set forth in section 4916(c)(1). M fails to satisfy these requirements for its annual accounting period ending December 31, 1964. A ruling has not been obtained from the

Secretary of the Treasury or his delegate with respect to M under section 4916(c)(3). A incurs liability for the tax on December 31, 1964 (although the period remaining to maturity of the bonds at that time is less than 3 years), and the amount of the tax, computed on the basis of the period remaining to maturity of the bonds on April 1, 1964, is equal to 2.75 percent of $10,000, or $275.

Debt obligations issued in return for certain property

Paragraph (2) of section 4916(d) provides that if an exclusion is allowed under section 4916(a)(3) with respect to the acquisition of a debt obligation issued in return for property described in such section, but part or all of such property is used, consumed, or disposed of (before the termination of the tax) otherwise than wholly within one or more less developed countries, the acquiring person will incur liability for the tax under section 4911 as of the time the property is first so used, consumed, or disposed of, in an amount equal to the tax which would have been payable under section 4911 if the exclusion had not applied at the time of the acquisition.

SECTION 4917. EXCLUSION FOR ORIGINAL OR NEW ISSUES WHERE REQUIRED FOR INTERNATIONAL MONETARY STABILITY

(*a*) *In general.*—Section 4917(a) provides that the interest equalization tax will not be applicable to certain acquisitions which may be covered by an Executive order issued by the President. If the President determines that the application of this tax will have such consequences for a foreign country as to imperil or threaten to imperil the stability of the international monetary system, he may by such an Executive order exclude from the tax acquisitions of stock or debt obligations of the government of the foreign country or a political subdivision thereof, any agency or instrumentality of such a government, any corporation, partnership, or trust (other than a company registered under the Investment Company Act of 1940) organized under its laws, or any individual resident therein, including acquisitions of debt obligations secured by mortgages. The order will in any event be applicable only to acquisitions made as part of an original or new issue of stock or debt obligations as to which notice of acquisition is filed in accordance with regulations prescribed by the Secretary of the Treasury or his delegate. In the case of acquisitions made during the period from July 19, 1963, through the date of the enactment of the bill, notice of acquisition may be filed within such period following such date of enactment as is prescribed in regulations by the Secretary of the Treasury or his delegate.

The regulations under this section may permit or require filing of the prescribed notice to be made either before or after the acquisition occurs. Such notice may be required to set forth all the principal terms of the transaction involved and such other information as may be prescribed in such regulations.

It is contemplated that the regulations will not permit the filing of a notice of acquisition in connection with a private placement until the material terms of the transaction are agreed upon by the parties, or in connection with a public offering which is registered with the Securities and Exchange Commission until a registration statement has been filed with the Commission.

(*b*) *Applicability of Executive order.*—Section 4917(b) provides that an Executive order described in section 4917(a) may be applicable to all such original or new issues, or only to an aggregate amount or classification thereof, as stated in the order. If the order is applicable to a limited aggregate amount of such issues it will apply under regulations prescribed by the Secretary of the Treasury or his delegate to those acquisitions as to which notice of acquisition was first filed, provided in any given case that the acquisition described in the notice is made before or within 90 days after the date of filing. If the acquisition is not made within this period, the notice will have no effect. If a new notice is filed upon expiration of the 90-day period, the date on which this notice is filed will govern the applicability of the order to the acquisition. An Executive order described in section 4917(a) may be terminated in whole or in part at any time by an Executive order issued for that purpose, and the termination will be effective from the date the order is issued or from such later date as is specified in such order.

(*c*) *Original or new issue.*—Section 4917(c) provides (for purposes of sec. 4917) that a debt obligation is treated as part of an original or new issue only if acquired not later than 60 days after the date on which interest begins to accrue on such obligation, and that stock is treated as part of an original or new issue only when it is acquired from the issuer by the U.S. person claiming the exclusion. Stock is considered an original or new issue only if it is previously unissued; treasury stock will not be so considered. A debt obligation may be acquired from a person other than the obligor within the 60-day period and still be regarded as part of an original or new issue.

SECTION 4918. EXEMPTION FOR PRIOR AMERICAN OWNERSHIP

(*a*) *General rule.*—Section 4918(a) states the general rule that the interest equalization tax is inapplicable to an acquisition of stock or a debt obligation of a foreign issuer or obligor if it is established by clear and convincing evidence that the person from whom such stock or debt obligation was acquired was a U.S. person throughout the period of his ownership or continuously since July 18, 1963. The effect of this exemption for prior American ownership is to assure that only one tax will be paid on stock or debt obligations acquired after July 18, 1963, and that no tax will be paid on those acquired prior to that date, so long as continuous American ownership is maintained. A person who has not maintained his status as a U.S. person during the entire period of his ownership of stock or a debt obligation (or continuously since July 18, 1963) will not be permitted to transfer it free of the tax to other Americans.

Under section 4914(g)(2), neither a person making an acquisition excluded from the tax under section 4914(b)(3) nor an insurance company acquiring stock or a debt obligation which it designates (or is required to designate) under section 4914(e) is considered a U.S. person for purposes of section 4918 with respect to the stock or debt obligation so acquired. Section 4920(a)(4)(C) provides that an investment company which has elected under section 4920(a)(3)(B) to be treated as a foreign issuer or obligor is not considered a U.S. person. While one or more classes of a foreign corporation's stock may be treated under section 4920(a)(3) as not being the stock of a foreign issuer, the foreign corporation is not considered a U.S. person for any of the purposes of chapter 41.

The clear and convincing evidence required by section 4918(a) may be supplied through certificates of American ownership as described in section 4918(b), or through the use of individual or blanket certificates of American ownership and the furnishing of confirmations by members of national securities exchanges and national securities associations in accordance with the requirements described in section 4918 (c) and (d).

(*b*) *Certificate of American ownership.*—Section 4918(b) provides that, for purposes of the exemption under section 4918(a), a certificate of American ownership executed and filed as provided in section 4918(e), and received in connection with an acquisition, is conclusive proof of prior American ownership unless the person making such acquisition has actual knowledge that the certificate is false in any material respect.

(*c*) *Trading on certain national securities exchanges.*—Section 4918(c) provides that, for purposes of the exemption under section 4918(a), a written confirmation received from a member or member firm of a registered national securities exchange stating that an acquisition was made in the regular market on the exchange and not subject to a special contract will be conclusive proof of prior American ownership (unless the acquiring person has actual knowledge that the confirmation is false in any material respect) if the exchange has in effect at the time of the acquisition rules providing in substance that (A) a member or member firm can effect a sale as broker (of stock or debt obligations subject to the tax) in the regular market on the exchange only if the member or member firm has in his or its possession a certificate of American ownership with respect to the stock or debt obligation sold or a blanket certificate of American ownership with respect to the seller's account, and (B) a member or member firm effecting a purchase as broker of such stock or debt obligations other than in the regular market and subject to a special contract must furnish the acquiring person a written confirmation stating that the acquisition was made subject to such special contract. A written confirmation furnished to a custodian, nominee, or agent acting for the purchaser is deemed to have been furnished to the purchaser.

In cases where stock or a debt obligation subject to tax under chapter 41 is traded on an exchange having the rules described above, a U.S. person selling such stock or debt obligation executes and files with the member or member firm acting as his broker either an individual or blanket certificate of American ownership. The member or member firm, not having actual knowledge that the certificate is false in any material respect, may effect the sale in the regular market on the exchange and the member or member firm acting on behalf of the buyer can assume the seller is a U.S. person since the transaction occurred in the regular market. The buyer will receive a confirmation from the member or member firm effecting the purchase on his behalf stating that the acquisition was made in the regular market and not subject to a special contract. This confirmation is regarded for purposes of this exemption as conclusive proof of prior American ownership.

If the seller is not a U.S. person entitled to furnish an individual or blanket certificate of American ownership, the member or member firm acting on his behalf may not effect the sale in the regular market on the exchange and must make the sale subject to a special contract. In such a case, the member or member firm acting on behalf of the buyer must furnish the buyer a written confirmation stating that the acquisition was made subject to such special contract, and, of course, such confirmation is not regarded as proof of prior American ownership.

(*d*) *Trading in the over-the-counter market.*—Section 4918(d) provides that, for purposes of the exemption under section 4918(a), a written confirmation received from a member or member firm of a registered national securities association in connection with an acquisition made in the U.S. over-the-counter market is regarded as conclusive proof of prior American ownership, unless the confirmation states that the acquisition was made from a person who has not executed and filed a certificate of American ownership with respect to the stock or debt obligation sold or a blanket certificate of American ownership with respect to the seller's account (or the acquiring person has actual knowledge that the confirmation is false in any material respect), if the association has in effect at the time of the acquisition rules providing in substance that a member or member firm effecting a sale as broker, in the over-the-counter market, of any stock or debt obligation subject to the tax but for this exemption, must (A) have an individual or blanket certificate in his possession, or (B) furnish the person acquiring such stock or debt obligation a written confirmation stating that the acquisition was made from a person who has not executed and filed such a certificate. A written confirmation furnished to a custodian, nominee, or agent acting for the purchaser is deemed to have been furnished to the purchaser. Section 4918(d) also provides that a member or member firm who makes an acquisition for his or its own account in the over-the-counter market may treat a blanket certificate of American ownership with respect to the seller's account as conclusive proof for purposes of this exemption of prior American ownership unless such member or member firm has actual knowledge that the certificate is false in any material respect.

In cases where stock or a debt obligation subject to tax under chapter 41 is sold in the over-the-counter market and a member or member firm of the National Association of Securities Dealers (if such association has adopted rules as described in sec. 4918(d)) is acting as broker for the seller or acquiring for his or its own account, the U.S. person selling such stock or debt obligation executes and files with the member or member firm either an individual or blanket certificate of American ownership. Unless such member or member firm has actual knowledge that the certificate is false in any material respect, a written confirmation can be furnished by the member or member firm which does not specify whether or not the seller executed and filed a certificate. Such a confirmation is regarded for purposes of this section as conclusive proof of prior American ownership. If the seller is not a U.S. person entitled to furnish an individual or blanket certificate of American ownership, the member or member firm acting as broker on his behalf must furnish the acquiring person a written confirmation stating that the acquisition was made from a person who has not executed and filed an individual or blanket certificate of American ownership, and, of course, such confirmation is not regarded as proof of prior American ownership.

(*e*) *Execution, filing, and contents of certificate.*—Section 4918(e) provides that a certificate of American ownership or a blanket certificate of American ownership under section 4918 must be executed and filed in such manner and set forth such information as the Secretary of the Treasury or his delegate prescribes by regulations. It is contemplated that such regulations will provide, among other things, in connection with certificates of American ownership, that such a certificate may be executed either by a former owner or by a U.S. person acting as the nominee of the former owner and that the signature must be guaranteed by a U.S. bank, a member of the National Association of Securities Dealers, or a member firm of a national securities exchange registered with the Securities and Exchange Commission. Where the certificate is executed by a nominee, it will not be necessary to reveal the name of the actual owner to the purchaser; but the nominee will be required to maintain adequate records to identify the U.S. person for whose account the securities were held and to establish such owner's U.S. citizenship, residence, or incorporation during his period of ownership. With respect to blanket certificates of American ownership, the regulations are expected to provide that the owner of an account must certify that he is the actual owner of all securities sold through the account and that he has been a U.S. person continuously since July 18, 1963. If such person ceases to be a U.S. person, he will be required to certify that he will notify the member or member firm of the change and will make no sale through the account until such notice has been received. Blanket certificates of American ownership will be permitted to be executed by nominees subject to requirements such as those described for individual certificates of American ownership.

SECTION 4919. SALES BY UNDERWRITERS AND DEALERS TO FOREIGN PERSONS

(*a*) *Credit or refund.*—Section 4919(a) provides that a credit against, or refund of, the tax paid under section 4911 upon the acquisition of stock or debt obligations of a foreign issuer or obligor may be allowed or made if the stock or debt obligations (1) are acquired by an underwriter from the foreign issuer or obligor (or from a person or persons controlling, controlled by, or under common control with such issuer or obligor) and are resold directly to persons other than U.S. persons in connection with a private placement, (2) are acquired by an underwriter in connection with a public offering by a foreign issuer or obligor (or by a person or persons controlling, controlled by, or under common control with such issuer or obligor) and are resold to persons other than U.S. persons, or (3) consist of debt obligations acquired by a dealer in the ordinary course of his business from persons other than U.S. persons and resold to persons other than U.S. persons within 90 days after (or, in the case of short sales, within 90 days before) their acquisition. Control with respect to an issuer or obligor has the same meaning for these purposes (and for purposes of the definition in sec. 4919(c)(1)) as under the Securities Act of 1933.

For purposes of section 4919(a) it is immaterial whether the acquisition or resale by the underwriter or dealer takes place in the United States. The tax paid with respect to any such acquisition will constitute an overpayment of tax only if it is clearly established that the stock or debt obligations involved were resold to persons other than U.S. persons. Where stock or debt obligations are resold as part of a public offering, the underwriter may claim a credit or refund not only for its own sales to persons other than U.S. persons but also for any such sales made by other U.S. persons participating in the distribution of the stock or debt obligations acquired by the underwriter.

The credit or refund (without interest) is to be allowed to an underwriter or dealer under regulations prescribed by the Secretary of the Treasury or his delegate. Where an acquisition by an underwriter is concerned, if the underwriter sells all or part of the stock or debt obligations acquired to persons other than U.S. persons during the same return period in which the acquisition of such stock or debt obligations is made, the acquisition will be subject to the tax imposed by section 4911 and an offsetting tax credit for such sales will be allowed under section 4919. If the sales by the underwriter to persons other than U.S. persons occur in a return period subsequent to the return period in which the acquisition by the underwriter is made, the tax imposed by section 4911 on the acquisition will be paid with the interest equalization tax return filed for the prior period and a credit or refund of tax will be allowed or made under section 4919 upon the filing of a claim therefor. It is contemplated that a tax credit may also be allowed to the underwriter, if claimed, for sales to persons other than U.S. persons which take place after the reporting period during which the acquisition occurred but before the return for that period is due. The credit or refund arising from the resale of debt obligations by dealers will be claimed and allowed in a similar manner.

(*b*) *Evidence to support credit or refund.*—Section 4919(b) provides that an underwriter or dealer claiming a credit or refund under such section with respect to the interest equalization tax must file with the return required under section 6011(d) of the code such information pertaining to his claim for credit or refund as the Secretary of the Treasury or his delegate may prescribe by regulations. It is contemplated that the type of information required from an underwriter with respect to a private placement or public offering may include the following:

(A) The name and address of the foreign issuer or obligor (or the person or persons related in control) whose stock or debt obligations were acquired and the date of acquisition;

(B) The consideration paid or to be paid by the underwriter for the stock or debt obligations acquired;

(C) The total number of shares of stock or the total face amount of debt obligations acquired and a brief description thereof; and

(D) (i) In the case of private placements: The total sold; the total sold directly by the underwriter to persons other than U.S. persons; the dates of sale and the names and addresses of the persons to whom sold; and a copy or description of any agreement or agreements governing the acquisition or sale of the stock or debt obligations by the underwriter; or

(ii) In the case of public offerings: The total sold; the total sold to persons other than U.S. persons; the total sold by U.S. persons participating in the distribution; and a copy of any prospectus or offering circular used in effectuating any of the sales.

It is contemplated that the type of information required from a dealer claiming the credit or refund may include a description of the debt obligations involved, the names and addresses of the persons to whom they were sold, and the date or dates of sale.

The claim for credit or refund by an underwriter will not be allowed with respect to stock or debt obligations sold by a U.S. person (other than the underwriter) participating, in connection with a public offering, in the distribution of the stock or debt obligations acquired by the underwriter unless the underwriter establishes by clear and convincing evidence that the stock or debt obligations were sold to persons other than U.S. persons. A certificate of sales to foreign persons executed by a U.S. person (other than the underwriter) and relied upon by the underwriter will be regarded as conclusive proof that the sales were made to foreign persons unless the underwriter has actual knowledge that the certificate is false in any material respect. The requirements for filing such a certificate, the information to be set forth therein, and the manner in which it is to be executed will be prescribed by the Secretary of the Treasury or his delegate by regulations.

In any case where two or more underwriters form a group for the purpose of purchasing and distributing (through resale) stock or debt obligations of a single foreign issuer or obligor, the filing of a certificate of sales to foreign persons by any one of such underwriters may, to the extent provided by regulations prescribed by the Secretary of the Treasury or his delegate, constitute the filing of such certificate on behalf of all of such underwriters. Normally, in such cases all certificates of sales to foreign persons would be permitted to be filed with the interest equalization tax return filed by the managing underwriter of the purchasing and selling group.

(*c*) *Definitions.*—Paragraph (1) of section 4919(c) defines the term "underwriter" to mean any person who has purchased stock or debt obligations from the issuer or obligor thereof (or from a person controlling, controlled by, or under common control with such issuer or obligor), or from another underwriter, with a view to the distribution through resale of such stock or debt obligations. Paragraph (2) defines a "dealer" as any person who is a member of the National Association of Securities Dealers and who is regularly engaged, as a merchant, in purchasing stock or debt obligations and selling them to customers with a view to the gains and profits which may be derived therefrom.

SECTION 4920. DEFINITIONS

(*a*) *In general.*—Section 4920(a) contains definitions of basic terms used in chapter 41.

Debt obligation

Paragraph (1) of section 4920(a) provides that, in general, the term "debt obligation" means any indebtedness, whether or not represented by a bond, debenture, note, certificate, or other writing, and whether or not bearing interest. The term also means any interest in, or any option or similar right to acquire, a debt obligation described in the preceding sentence, whether or not such interest, option, or right is in writing. It does not refer to the obligations (other than obligations to pay) of parties to executory contracts nor does it refer to the obligation of an insurer to pay under a contract of insurance or an annuity contract.

The term "debt obligation" does not include any obligation which—

(A) is convertible by its terms into stock of the obligor, if it is so convertible only within a period of 5 years or less from the date on which interest begins to accrue thereon; or

(B) arises out of the divorce, separate maintenance, or support of an individual who is a U.S. person.

Stock

Paragraph (2) of section 4920(a) provides that the term "stock" means any stock, share, or other capital interest in a corporation; any interest of a partner (whether general or limited) in a partnership; any interest in an investment trust; any indebtedness which is convertible by its terms into stock of the obligor if it is so convertible only within a period of 5 years or less from the date on which interest begins to accrue; and any interest in, or option or similar right to acquire, any of the interests described in this sentence.

Foreign issuer or obligor

Paragraph (3) of section 4920(a) defines the terms "foreign issuer," "foreign obligor," and "foreign issuer or obligor."

Under paragraph (3)(A) such terms mean any issuer of stock or obligor of a debt obligation which is an international organization of which the United States is not a member; the government of a foreign country or a political subdivision thereof, or an agency or instrumentality of such a government; a corporation, partnership, or estate or trust which is not a U.S. person as defined in paragraph (4); or a nonresident alien individual.

Paragraph (3)(B) provides that such terms also include a domestic corporation which, as of July 18, 1963, was a management company registered under the Investment Company Act of 1940 if (i) at least 80 percent of the value of the stock and debt obligations owned by the corporation on July 18, 1963, and at the end of every calendar quarter thereafter consists of stock or debt obligations of foreign issuers or obligors and of other debt obligations having an original period to maturity of 90 days or less; (ii) the corporation elects to be treated as a foreign issuer or obligor for purposes of chapter 41; and (iii) during the period from July 18, 1963, to the date the election is made the corporation does not materially increase its assets by borrowing or by issuing or selling its stock (other than stock issued or sold on or before September 16, 1963, as part of a public offering with respect to which a registration statement was first filed with the Securities and Exchange Commission on July 18, 1963, or within 90 days prior thereto). The election must be made on or before the 60th day after the date of the enactment of the bill and must be made under regulations prescribed by the Secretary of the Treasury or his delegate. The election will be effective as of the date specified by the corporation, which may be before the date of the enactment of the bill but not later than the date on which the election is made. Such an election remains in effect until revoked. If, at the close of any succeeding calendar quarter, the company ceases to meet the 80-percent requirement described above, the election is deemed revoked as of the close of that quarter. If an election is revoked, no further election is permitted. In general, the effect of this provision is to permit a management company which elects to be treated as a foreign issuer or obligor to manage its portfolio of foreign securities without incurring the interest equalization tax which would normally be incurred on acquisitions of such foreign securities. In addition, the provision has the effect of imposing the interest equalization tax on the acquisition by a U.S. person of any shares of the company which are newly issued or not owned by U.S. persons prior to acquisition.

If the assets of a foreign corporation are acquired by a domestic corporation in a reorganization described in subparagraph (D) or (F) of section 368(a)(1) of the code, both corporations are considered a single domestic corporation for purposes of section 4920(a)(3)(B). The election provided by section 4920(a)(3)(B) may be made by the foreign corporation in anticipation of its becoming a domestic corporation for these purposes.

Paragraph (3) of section 4920(a) also provides that a foreign corporation other than a company registered under the Investment Company Act of 1940 is not considered a foreign issuer with respect to any class of its stock which is traded on one or more national securities exchanges registered with the Securities and Exchange Commission, if the trading on such exchanges constituted the principal market for such class during the calendar year 1962 and more than 50 percent of such class was held of record by U.S. persons as of the latest record date before July 19, 1963. The latest date as of which record ownership of the stock of the foreign corporation was determined by the foreign corporation, whether for the declaration of dividends or other corporate purposes, governs. This provision has the effect of permitting U.S. persons to acquire free of the interest equalization tax a particular class of stock of a foreign issuer, the principal market for which is on such U.S. exchanges and more than 50 percent of which is owned of record by U.S. persons. The exclusion applies separately to each class of stock, but the acquisition need not be made on an exchange if the requirements of the provision have been satisfied.

A foreign corporation is not considered a U.S. person for purposes of chapter 41, even though this provision applies to one or more classes of its stock.

U.S. person

Paragraph (4) of section 4920(a) defines the term "U.S. person" to mean—

(A) a citizen or resident of the United States;

(B) a domestic partnership;

(C) a domestic corporation other than a corporation described in section 4920(a)(3)(B);

(D) an agency or wholly owned instrumentality of the United States;

(E) a State or political subdivision, or any agency or instrumentality thereof; and

(F) any estate or trust—

(i) the income of which from sources without the United States is includible in gross income under subtitle A of the code or would be so includible if not exempt from tax under section 501(a), 521(a), or 584(b) of the code; or

(ii) which is situated in the Commonwealth of Puerto Rico or a possession of the United States.

A foreign corporation engaged in trade or business within the United States is not regarded as a resident of the United States. The term "U.S. person" includes organizations exempt from Federal income tax.

Domestic corporation; domestic partnership

Paragraph (5) of section 4920(a) defines the term "domestic corporation" to mean a corporation created or organized in the United States or under the laws of the United States or any State; the definition of "corporation" appearing in section 7701(a)(3) of the code is applicable to chapter 41. This paragraph also defines the term "domestic partnership" to mean a partnership created or organized in the United States or under the laws of the United States or any State; the definition of "partnership" appearing in section 7701(a)(2) of the code is applicable to chapter 41.

United States; State

Paragraph (6) of section 4920(a) provides that the term "United States" in a geographical sense includes the States, the District of Columbia, the Commonwealth of Puerto Rico, and the possessions of the United States; and the term "State" includes the District of Columbia, the Commonwealth of Puerto Rico, and the possessions of the United States. The term "possessions" includes the Virgin Islands and other territories of the United States.

Period remaining to maturity

Paragraph (7)(A) of section 4920(a) states the general rule that the period remaining to maturity of a debt obligation is the period beginning on the date of its acquisition and ending on the fixed or determinable date when, according to its terms, the payment of principal becomes due. For this purpose each installment of a debt obligation payable in installments is deemed to have a separate period remaining to maturity. (For the time when an acquisition is considered to be made, see sec. 4912(a) (discussed above).) This rule is illustrated by the following examples:

Example (1).—On May 31, 1964, A, a U.S. person, purchases from B, a nonresident alien, 20-year bonds of X, a foreign government. The bonds mature on December 31, 1974, and therefore have a remaining period to maturity of 10 years and 7 months.

Example (2).—On June 30, 1964, C, a U.S. person, acquires for $10,000 from D, a nonresident alien, a serial promissory note due in five equal annual installments of $2,000 commencing on August 1, 1966. The debt obligation has a period remaining to maturity of 2 years and 1 month with respect to $2,000, 3 years and 1 month with respect to $2,000, 4 years and 1 month with respect to $2,000, 5 years and 1 month with respect to $2,000, and 6 years and 1 month with respect to $2,000.

Paragraph (7)(B) of section 4920(a) sets forth in clauses (i) through (v) the modifications in the general rule which are to be made in determining the period remaining to maturity in certain special cases.

Clause (i) of paragraph (7)(B) provides that the period remaining to maturity of any interest in or option or similar right to acquire any debt obligation is the period remaining to maturity of the debt obligation at the time the interest, option, or right is acquired. This rule is illustrated by the following examples:

Example (1).—On July 31, 1964, A, a U.S. person, acquired from B, a nonresident alien, a depositary receipt which constitutes evidence of an interest in certain bonds of a foreign corporation which are held by a foreign bank and which mature on June 30, 1979. The depositary receipt has a period remaining to maturity of 14 years and 11 months.

Example (2).—On September 1, 1964, A, a U.S. person, acquires from M, a foreign corporation, an option to acquire 15-year bonds of M when such bonds are issued. The period remaining to maturity of the option is considered to be 15 years.

Clause (ii) of paragraph (7)(B) provides that the period remaining to maturity of any debt obligation which is renewable without affirmative action by the obligee, or of any interest in or option or similar right to acquire such a debt obligation, ends on the last day of the final renewal period. This rule is illustrated by the following example:

Example.—On June 1, 1964, A, a U.S. person, acquires from B, a nonresident alien, 20-year bonds of M, a foreign corporation. Such bonds are payable on December 31, 1974, except that, under the terms of the bonds, the obligation is automatically renewable for an additional period of 10 years if the holder does not demand payment within 30 days following the lapse of the initial term. The period to maturity is deemed to include the renewal period of 10 years.

Clause (iii) of paragraph (7)(B) provides that the period remaining to maturity of any debt obligation which has no fixed or determinable date when the payment of principal becomes due is considered to be 28½ years. This rule is illustrated by the following example:

Example.—On October 1, 1964, A, a U.S. person, acquires from B, a nonresident alien, bonds of F, a foreign government. The bonds are callable by the obligor at any time after 5 years; but they provide for payment of principal only upon such call or upon default by the issuer in payment of interest. The period remaining to maturity is deemed to be 28½ years.

Clause (iv) of paragraph (7)(B) provides that the period remaining to maturity of any debt obligation which is payable on the demand of the obligee is considered to be less than 3 years. This rule applies to a debt obligation as to which payment of principal is due or overdue at the time of its acquisition.

Clause (v) of paragraph (7)(B) provides that the period remaining to maturity of a debt obligation which is subject to retirement prior to its maturity through operation of a mandatory sinking fund will be determined under regulations prescribed by the Secretary of the Treasury or his delegate. It is contemplated that these regulations will generally determine the period remaining to maturity on the basis of the average life of the debt obligations involved.

(*b*) *Cross reference.*—Section 4920 (b) contains a cross reference to the definition of the term "acquisition" in section 4912.

SECTION 2. INTEREST EQUALIZATION TAX—Continued

(*b*) *Technical amendment.*—Subsection (b) of section 2 of the bill amends the table of chapters for subtitle D of the code to reflect the new chapter 41 (added by subsec. (a) of sec. 2 of the bill).

(c) *Effective date.*—Subsection (c) of section 2 of the bill contains the effective date provisions applicable to the new chapter 41.

General rule

Paragraph (1) of section 2(c) of the bill sets forth the general rule that, except as provided by paragraphs (2), (3), (4), (5), (6), and (7), the amendments made by section 2 apply only with respect to acquisitions of stock and debt obligations made after July 18, 1963.

Preexisting commitments

Paragraph (2) of section 2(c) of the bill provides that the interest equalization tax does not apply to an acquisition—

(A) made pursuant to an obligation to acquire stock or debt obligations which on July 18, 1963, was unconditional or was subject only to conditions contained in a formal contract under which partial performance had occurred;

(B) as to which on or before July 18, 1963, the acquiring U.S. person (or, in a case where two or more U.S. persons are acquiring as part of a single transaction, a majority in interest of such persons) had taken every action to signify approval under the procedures ordinarily employed by such person (or persons) in similar transactions and had sent or deposited for delivery to the foreign issuer or obligor written evidence of such approval in the form of a commitment letter or other signed document setting forth the principal terms of the acquisition, subject only to the execution of formal documents evidencing the acquisition and to customary closing conditions; or

(C) which would be excluded from tax under section 4915 (relating to direct investments) but for section 4915(c), if (i) on or before July 18, 1963, the acquiring person received from a foreign government (or an agency or instrumentality thereof) authorization to make the acquisition involved (and approval of the amount thereof), and (ii) such authorization was required in order for the acquisition to be made.

In order to qualify under the requirements of subparagraph (B) above, the acquiring U.S. person must have both approved the acquisition and sent or deposited the requisite commitment letter or similar document on or before July 18, 1963. If two or more U.S. persons are acquiring as part of a single transaction, those persons acquiring more than 50 percent of the actual value of the stock or debt obligations which are the subject of the transaction must have taken these actions on or before July 18, 1963. A person who had entered into a short sale contract on or before July 18, 1963, generally will be considered subject to a preexisting commitment because, in effect, such person is unconditionally obligated to make an acquisition to cover the short sale.

Public offering

Paragraph (3) of section 2(c) of the bill provides that the tax does not apply to an acquisition made on or before September 16, 1963, if—

(A) a registration statement (within the meaning of the Securities Act of 1933) was in effect with respect to the stock or debt obligation acquired at the time of its acquisition;

(B) the registration statement was first filed with the Securities and Exchange Commission on July 18, 1963, or within 90 days prior thereto; and

(C) no amendment was filed with the Securities and Exchange Commission after July 18, 1963, and before the acquisition which had the effect of increasing the number of shares of stock or the aggregate face amount of the debt obligations covered by the registration statement.

Investment of proceeds of subscription offering

Paragraph (4) of section 2(c) of the bill provides that the tax does not apply to acquisitions of stock or debt obligations by a corporation electing to be treated as a foreign issuer or obligor under section 4920(a)(3)(B), to the extent that the amount of consideration paid for all such stock and debt obligations does not exceed the proceeds received by such corporation from a subscription offering, completed on or before September 16, 1963, as to which a registration statement was filed with the Securities and Exchange Commission on July 18, 1963, or within 90 days prior thereto.

Listed securities

Paragraph (5) of section 2(c) of the bill provides that the tax does not apply to an acquisition made on or before August 16, 1963, if the stock or debt obligation involved was acquired on a national securities exchange registered with the Securities and Exchange Commission. This provision applies to acquisitions made on such an exchange without regard to whether the acquired security is listed on the exchange, but it does not apply to acquisitions of listed securities which are not made through the exchange.

Options and foreclosures

Paragraph (6) of section 2(c) of the bill provides that the tax does not apply to an acquisition—

(A) of stock pursuant to the exercise of an option or similar right, or of a right to convert a debt obligation into stock of the same issuer, if such option or right was held on July 18, 1963, by the person making the acquisition or by a decedent from whom such person acquired the right to exercise such option or right by bequest or inheritance or by reason of such decedent's death; or

(B) of stock or debt obligations as a result of a foreclosure by a creditor pursuant to the terms of an instrument held by such creditor on July 18, 1963.

Domestication

Paragraph (7) of section 2(c) of the bill provides that the tax does not apply to the acquisition by a domestic corporation of the assets of a foreign corporation pursuant to a reorganization described in section 368(a)(1) (D) or (F) of the code if the acquisition occurs on or before the 180th day after the date of the enactment of the bill and the foreign corporation is a management company registered under the Investment Company Act of 1940 from July 18, 1963, until the time of the acquisition. The effect of this provision is to prevent foreign investment companies reincorporating as domestic investment companies from being subject to the interest equalization tax on the portfolio of foreign securities held at the time of reincorporation.

Meaning of terms

Paragraph (8) of section 2(c) of the bill provides that terms used in section 2(c) of the bill (except as specifically otherwise provided) have the same meaning as when used in the new chapter 41 of the code.

SECTION 3. RETURNS

(*a*) *Making of returns.*—Subsection (a) of section 3 of the bill amends section 6011 of the code (relating to general requirement of return, statement, or list) by redesignating subsection (d) as subsection (e) and by adding a new subsection (d).

SECTION 6011(d). INTEREST EQUALIZATION TAX RETURNS

In general

Paragraph (1) of section 6011(d) provides for the filing, on a calendar quarter basis, of returns of the interest equalization tax imposed by section 4911. A return must be filed by each person who incurs liability for the tax during the calendar quarter, and, in general, by each person who makes acquisitions during the calendar quarter which are nontaxable by reason of the exemption provided in section 4918 for stock or debt obligations acquired from a U.S. person. However, a return need not be filed in connection with an acquisition as to which a written confirmation, furnished in accordance with the requirements described in section 4918 (c) or (d), is treated as conclusive proof of American ownership, nor must such an acquisition be listed in any return made under this paragraph.

In the case of a person incurring liability for interest equalization tax, the return must disclose the taxable acquisitions and the amount of tax incurred, and must have attached a list of transactions during the quarter (other than acquisitions as to which written confirmations are furnished in accordance with the requirements described in sec. 4918 (c) or (d)) in respect of which no liability for payment of tax is incurred by reason of the provisions of section 4918. The list must be accompanied by clear and convincing evidence that these acquisitions are ones to which the provisions of section 4918 apply. A certificate of American ownership described in section 4918(e) will, of course, constitute clear and convincing evidence for this purpose.

In the case of a person who does not incur liability for the interest equalization tax during the calendar quarter but who makes acquisitions to which the provisions of section 4918 apply (other than acquisitions as to which written confirmations are furnished in accordance with the requirements described in sec. 4918 (c) or (d)), the return must have a list of such acquisitions attached and must be accompanied by the requisite evidence showing that the acquisitions are ones to which the provisions of section 4918 apply.

A person who receives a written confirmation in connection with an acquisition from a member or member firm of a national securities exchange or national securities association which is treated under the provisions of section 4918 (c) or (d) as conclusive proof of prior American ownership is not required to submit a return or accompanying evidence as to such acquisition. If such person is required to file a return because liability is incurred in connection with other transactions, acquisitions as to which such a written confirmation is received need not be listed on the return.

Information returns of commercial banks

Paragraph (2) of section 6011(d) provides that every U.S. person which is a commercial bank must file a return with respect to loans and commitments to foreign obligors at such times, in such manner, and setting forth such information as the Secretary of the Treasury or his delegate may prescribe by forms and regulations. (Debt obligations acquired by a commercial bank in making loans in the ordinary course of its commercial banking business are excluded from the interest equalization tax under sec. 4914(b)(2)(A).) It is contemplated that returns may include (in addition to any information on aggregate lending activity) information concerning the purpose of each loan, the type of borrower, and the principal terms of the transaction.

Reporting requirements for members of exchanges and associations

Paragraph (3) of section 6011(d) provides that members and member firms of national securities exchanges and national securities associations which are registered with the Securities and Exchange Commission (and which have adopted rules of the type described in sec. 4918 (c) or (d)) must keep such records and file such information as the Secretary of the Treasury or his delegate may prescribe by regulations in connection with sales effected by such members and member firms as brokers, and acquisitions made for their own accounts, of stock or debt obligations as to which a certificate of American ownership or blanket certificate of American ownership is executed and filed as described in section 4918(e).

(*b*) *Time for filing returns.*—Subsection (b) of section 3 of the bill amends part V of subchapter A of chapter 61 of the code (relating to time for filing returns and other documents) by adding at the end thereof a new section 6076, which provides that each return of interest equalization tax must be filed on or before the last day of the first month following the period for which the return is made.

(*c*) *Publicity of returns.*—Subsection (c) of section 3 of the bill amends section 6103(a)(2) of the code (relating to public record and inspection) to provide in effect that interest equalization tax returns will be open to public examination and inspection only on the same basis as other returns.

(*d*) *Clerical amendment.*—Subsection (d) of section 3 of the bill amends the table of sections for part V of subchapter A of chapter 61 of the code to reflect the new section 6076 (added by subsec. (b) of sec. 3 of the bill).

(*e*) *First return period.*—Subsection (e) of section 3 of the bill contains one exception to the rule provided in section 6011(d) of the code (as added by subsec. (a) of sec. 3 of the bill) for the making of returns on a calendar-quarter basis. Under this exception the first period for which an interest equalization tax return is to be made is the period commencing July 19, 1963, and ending at the close of the calendar quarter in which the bill is enacted.

SECTION 4. DISALLOWANCE OF DEDUCTION FOR AMOUNT PAID AS INTEREST EQUALIZATION TAX

Section 4 of the bill adds to section 263(a) of the code (relating to capital expenditures) a new paragraph (3). The new paragraph would deny, for income tax purposes, any deduction for interest equalization tax paid by a person under section 4911 on his acquisitions of foreign stock and debt obligations, except to the extent that any amount attributable to the amount paid as such tax is included in gross income for the taxable year.

At the present time section 164(b)(3) of the code denies, for income tax purposes, a deduction for the amount of certain Federal excise taxes (which would include the new interest equalization tax), with a provision, however, that section 164(b)(3) will not prevent these taxes from being deducted under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income).

The effect of paragraph (3) of section 263(a), in generally denying a deduction for income tax purposes of interest equalization tax, is to require the acquiring person to capitalize the amount paid by him as interest equalization tax. If an amount paid by a U.S. person as interest equalization tax on the acquisition of a debt obligation, when added to the basis of such debt obligation, creates bond premium (as defined in sec. 171(b) of the code), such bond premium will be amortizable in accordance with section 171.

The exception provided from the general rule denying a deduction for income tax purposes of the interest equalization tax applies in a case where the interest equalization tax itself, or a portion thereof, is included in gross income. An illustration of this is a situation where a bond having a 30-year maturity is sold by a foreign underwriter for $1,000, on which an American purchaser must pay a tax of $150. At the time of his acquisition, the purchaser demands $150 from the underwriter as reimbursement for the tax which he must pay. If the purchaser accepts $100 in satisfaction of his demand, the $100 is included in the purchaser's gross income, and he will be allowed a deduction of $100 from gross income for the tax paid by him.

SECTION 5. PENALTIES

Section 5 of the bill adds to the code three new sections imposing civil and criminal penalties in certain cases.

(*a*) *Assessable penalties.*—Subsection (a) of section 5 of the bill amends subchapter B of chapter 68 of the code (relating to assessable penalties) by adding at the end thereof two new sections—section 6680, providing a civil penalty for failure to file an interest equalization tax return in certain situations where no tax is due, and section 6681, imposing civil penalties for executing false equalization tax certificates and for acting in disregard of the rules of national securities exchanges and national securities associations.

SECTION 6680. FAILURE TO FILE INTEREST EQUALIZATION TAX RETURNS

Section 6011(d) of the code, as added by section 3 of the bill, requires a person to file an interest equalization tax return even though he incurred no liability for the tax if he would have incurred such liability but for the prior American ownership exemption of section 4918 of the code (except in connection with an acquisition with respect to which a written confirmation, furnished in accordance with the requirements described in sec. 4918 (c) or (d), is treated as conclusive proof of prior American ownership). Except for the criminal penalty provided in section 7203, these persons would incur no liability if they failed to file a return. The new section 6680 imposes on such persons a civil penalty of 5 percent of the amount of tax they would have been required to pay but for the provisions of section 4918. However, the penalty cannot be less than $10 nor more than $1,000. The penalty does not apply if it is shown that the failure to file is due to reasonable cause.

SECTION 6681. FALSE EQUALIZATION TAX CERTIFICATES

(*a*) *False certificate of American ownership.*—Section 4918(a) of the code exempts from the interest equalization tax those acquisitions which are made from another American person. Section 4918(b) provides that a certificate that the prior owner was an American person during the applicable period of his ownership is conclusive proof of American ownership for this purpose unless the person making the acquisition has actual knowledge that the certificate is false in any material respect. Under section 4918 (c) and (d) a blanket certificate of American ownership may be treated as conclusive proof of prior American ownership by members and member firms of national securities exchanges and national securities associations in specified circumstances, unless the member or member firm has actual knowledge that the certificate is false in any material respect. The effect of section 4918 is to relieve the person acquiring stock or a debt obligation covered by an individual or blanket certificate, even though the certificate is false, from payment of the tax unless he has actual knowledge of the falseness of the certificate.

Subsection (a) of the new section 6681 imposes on a person willfully executing a certificate of American ownership or a blanket certificate of American ownership which is false in any material respect a penalty equal to 125 percent of the tax (imposed by sec. 4911 of the code on the acquisition of the stock or debt obligation involved) which, but for the provisions of section 4918, would be payable by the person making the acquisition. The penalty is an assessable one and, when imposed, will enable the Government to collect the tax which was lost by reason of the execution of the false certificate, plus an extra amount to discourage persons from executing false certificates.

(*b*) *Liability of members of national securities exchanges and associations.*—Section 4918 (c) and (d) of the code set forth procedures under which receipt of a written confirmation from a member or member firm of a national securities exchange or national securities association will be treated as conclusive proof of prior American ownership in connection with an acquisition made on such exchange or in the over-the-counter market.

Subsection (b) of the new section 6681 provides a penalty for such members equal to 125 percent of the tax (imposed by sec. 4911 of the code on the acquisition of the stock or debt obligation involved in a transaction subject to the rules of such exchange or association as described in sec. 4918 (c) or (d)) which, but for the provisions of section 4918, would be payable by the person acquiring the stock or debt obligation, if such member (A) willfully effects the sale of such stock or debt obligation or furnishes a written confirmation with respect to the purchase or sale of such stock or debt obligation other than in accordance with the requirements described in section 4918 (c) or (d); or (B) has actual knowledge that the individual or blanket certificate of American ownership in his possession is false in any material respect, or that the person who executed and filed the blanket certificate of American ownership in his possession was not a U.S. person at the time of the sale. The penalty is an assessable one and, when imposed, will enable the Government to collect the tax which was lost by the willful failure of the member or member firm to comply with the requirements described in section 4918 (c) or (d), plus an extra amount to discourage members and member firms from such willful failures to comply.

(*c*) *False certificates of sales to foreign persons.*—Subsection (c) of section 6681 imposes, on a person willfully executing a false certificate of sales to a foreign person described in section 4919(b) of the code, a similar penalty of 125 percent of the tax which is imposed by section 4911 on the acquisition of the stock or debt obligation involved and which, but for the application of the conclusive presumption provided in section 4919(b) and the reliance on the correctness of the certificate by the underwriter receiving the certificate, would be payable by the underwriter.

(*d*) *Penalty to be in lieu of tax in certain cases.*—Subsection (d) of section 6681 provides that unless the person acquiring the stock or debt obligation had actual knowledge that the certificate involved was false in any material respect, the penalty under subsection (a) or (c) of section 6681 will be in lieu of any tax on the acquisition of such stock or debt obligation under section 4911.

SECTION 5. PENALTIES—Continued

(*b*) *Criminal penalty.*—Subsection (b) of section 5 of the bill amends part II of subchapter A of chapter 75 of the code (relating to penalties applicable to certain taxes) by adding at the end thereof a new section 7241, providing criminal penalties for the willful execution of individual or blanket certificates of American ownership, or certificates of sales to foreign persons, which are false in any material respect. The criminal penalty is in addition to the assessable civil penalty provided in section 6681, discussed above. Section 7241 makes the offense of willfully executing a false certificate a misdemeanor and provides for a fine of not more than $1,000 or imprisonment for not more than 1 year, or both.

(*c*) *Clerical amendments.*—Subsection (c) of section 5 of the bill amends the table of sections for subchapter B of chapter 68 of the code, and the table of sections for part II of subchapter A of chapter 75 of the code, to reflect the new sections added to the code by subsections (a) and (b) of section 5 of the bill.

V. SEPARATE VIEWS OF REPUBLICANS ON H.R. 8000

GENERAL STATEMENT

H.R. 8000 is intended to restrict the flow of U.S. private investment capital abroad as a means of alleviating the balance of payments problem. As such, it is misdirected. The deficit in our balance of payments, which has persisted for the past several years, is not attributable to private investment abroad. In fact, in the private sector the amounts repatriated, either as a return on prior investment or as a repayment of prior loans, exceed the amounts reinvested.

The United States necessarily depends to a large degree upon private investment abroad, with the offsetting flow of funds to the United States as a return on that investment, or as a payment of prior advances, to provide a favorable balance in its foreign exchange accounts. In recognition of this, there was widespread opposition to the concept embodied in the bill on the part of the banking and business community. Even the Secretary of the Treasury was forced to admit that the long-term effect of this legislation will be adverse to our balance of payments. In fact, this was cited as the reason for making the legislation "temporary."

While H.R. 8000 is proposed as a "temporary" measure, there is no assurance that the administration will undertake to deal with the underlying causes which have brought about the deficit in the U.S. balance of payments. In fact, there is little likelihood that these basic causes will be remedied prior to December 31, 1965, which is the stated expiration date of H.R. 8000. For that reason it is wholly unrealistic to consider the bill as "temporary." If enacted, H.R. 8000 will become a permanent tax or penalty on certain types of U.S. private investment abroad, the threat of which will be used as a means of exercising control over all such investment.

We are not unmindful of the strain placed upon our balance of payments by foreign borrowers seeking advantageous U.S. long-term interest rates. However, the bill is not specifically directed at that type of transaction. The bill adopts a "shotgun" approach, with "built in" loopholes for "favored" U.S. lenders or foreign borrowers. In the final analysis, the Treasury is relying primarily upon so-called voluntary restraints rather than upon the legislation itself. While disclaiming any intention to invoke direct exchange controls, the results sought to be achieved by this bill depend more upon a "control" over the transactions which are exempt, than upon a tax on the transactions which are nonexempt. The Congress is in fact being called upon to enact this bill as a "club" for the Treasury to hold over certain segments of the financial community, both at home and abroad, in order to obtain from those who are exempt from the tax voluntary compliance with a program of control over capital outflow which will be left to the sole discretion of the President and the Treasury Department.

Since the bill is relied upon largely for its "psychological" effect—for the induced controls over investment abroad—there has been no

effort made on the part of the administration to press for the speedy enactment of this legislation. On the contrary, because of the threat of retroactivity in the bill, the Treasury has had almost absolute control over all U.S. investments and loans abroad since July 18, 1963. In the interim, there has been a sharp reduction in the outflow of U.S. capital. This should not be relied upon as an indication of what will happen when the bill becomes law. The uncertainty which exists today is a greater deterrent than the tax itself. Since the legislation was proposed on July 18, 1963, the only major transactions being consummated are those for which there have been reliable assurances of exemption. Once the bill becomes law, there may well be a substantial demand for U.S. capital abroad on the part of borrowers who will be willing, if necessary, to absorb the interest equalization tax.

DISCUSSION

H.R. 8000 is more significant for the transactions it exempts than for the transactions it purports to tax

The Ways and Means Committee was advised by the Secretary of the Treasury that the immediate need for this legislation was the strain placed upon our balance of payments by foreign borrowers seeking to take advantage of the low long-term interest rates in the United States. For that reason, the proposed bill was entitled an "interest equalization tax" bill. Yet we find that the bill exempts much of the long-term borrowing which supposedly created the problem and, at the same time, in the guise of an "interest equalization tax," taxes investment in foreign equity securities where there is no interest factor and no balance-of-payments problem.

In the course of the consideration of this bill, the Treasury Department submitted a schedule showing the outflow of private U.S. capital for the years 1960 to 1962, inclusive, and for three calendar quarters of the year 1963.

TABLE 1.—*Outflow of private U.S. capital to abroad after deducting inflow of private U.S. capital from abroad, 1960 to 3d quarter 1963*

[In millions of dollars; negative figures indicate excess of outflow over inflow]

	1960	1961	1962	1963 [1]			Total [2]
				I	II [3]	III [3]	
Direct foreign investments, net	−1,694	−1,598	−1,557	−501	−452	−161	−5,963
Short-term capital, net	−1,348	−1,541	−507	61	−508	123	−3,720
Long-term foreign loans by institutions	−200	−258	−248	−11	−131	−115	−963
New foreign bonds, after deducting redemptions	−459	−364	−832	−450	−461	−134	−2,700
Outstanding foreign bonds, U.S. purchases less sales	−102	−27	−29	−49	−47	34	−220
New foreign stocks	−14	−36	−74	−25	−7	−21	−177
Outstanding foreign stocks, U.S. purchases less sales	−75	−326	−26	1	−5	17	−414
Total	−3,892	−4,150	−3,273	−974	−1,611	−257	−14,157
Of which long-term portfolio capital (all above items except direct foreign investments and short-term capital)	−850	−1,011	−1,209	−534	−651	−219	−4,474

[1] Not seasonally adjusted; 2d quarter unrevised.
[2] 45 months.
[3] Preliminary.

Source: Treasury Department, Dec. 4, 1963.

It will be noted from the above table that there were substantial increases in the first and second quarters of the year 1963 in long-term foreign loans and new foreign bonds purchased in the United States. Other types of foreign investments do not reflect any appreciable increase. Nevertheless, H.R. 8000 purports to exempt a substantial portion of both long-term foreign loans and foreign bonds sales.

First, pursuant to the terms of H.R. 8000, direct foreign investments, amounting to a net outflow of $1.557 billion for the year 1962, will be exempt. In addition, special exemptions have been provided for investments which did not qualify under the exemption for "direct" foreign investments. Unquestionably, an undetermined amount of the long-term foreign loans will fall within these special exemptions.

Secondly, H.R. 8000 exempts all loans for a term of less than 3 years. This provision will serve to exempt short-term capital outflow, which amounted to a net of $507 million in the year 1962, together with an undetermined amount which might have been borrowed for a longer term, but will be placed on a shorter term exempt basis.

Thirdly, H.R. 8000 exempts all bank loans irrespective of term. It is understood that approximately one-half of the long-term foreign loans by institutions, amounting to $248 million for the year 1962, will fall within this exemption. In addition, a substantial amount of the loans, which might otherwise be represented by foreign bonds, may be placed with the banks free of tax. In fact, since the announcements of the proposed tax on July 18, 1963, it is reported that the city of Vienna changed its plan for financing in the United States, from a proposed bond issue to a direct loan from the banks.

Finally, irrespective of category, an exemption has been granted to Canada. Approximately one-half of the foreign securities purchased by U.S. residents come from Canada.

TABLE 2.—*New issues of foreign securities purchased by U.S. residents, 1961 to 3d quarter 1963*[1]

[In millions of dollars]

	Total 1961	1962					1963		
		I	II	III	IV	Total	I	II[2]	III[3]
Canada	237	10	112	41	294	457	368	264	79
Western Europe	57	35	138	15	7	195	65	154	14
Japan	61	11	17	48	25	101	42	65	52
Latin American Republics	18	(4)	19	(4)	[5] 83	[5] 102	12	------	23
Other developed countries	43	(6)	(6)	(6)	(6)	60	------	17	------
Other less developed countries	95	(6)	(6)	(6)	(6)	77	19	17	11
International institutions and unallocated	12	80	1	3	------	84	------	------	------
Total, new issues	523	170	312	133	461	1,076	506	518	179

1 Not seasonally adjusted.
2 Revised.
3 Preliminary.
4 Less than $500,000.
5 Includes $75 million issue by Inter-American Development Bank.
6 Not available.

Source: Survey of Current Business and Department of Commerce, as supplied by Treasury Department, Dec. 3, 1963.

Accordingly, on its face, H.R. 8000 will accomplish very little. The exemptions provided for in the bill serve to exclude from tax the major areas of capital outflow, taxing only relatively insignificant transactions, such as the purchase of foreign stocks and the purchase of new foreign bonds (other than Canadian) where the borrower is precluded from obtaining the funds from a bank. Since most lending abroad, and for the most part foreign bonds, are purchased by institutional investors such as banks, insurance companies, and the like, the net effect is to permit the bank to lend money abroad tax free, but to deny to the other institutional investors the same right. The foreign borrower is "funneled" into the bank loan route.

In accounting for the seeming lack of scope of the bill, the Secretary of the Treasury was forced to disclose the real effect of the bill—not as a tax—but as a regulatory measure. Recognizing that the bill exempts much more than it taxes, the Secretary nevertheless stated that the Treasury does not anticipate any problem with respect to the exempt transactions. Why? Because, according to the Secretary, Canada will cooperate to limit the amount of the exemption which is to be granted for Canadian borrowings. And, what is more significant, the U.S. banks will "cooperate" so as to limit the amount loaned abroad by these banks. Thus, while the bank loan exemption admittedly constitutes a possible "loophole," the threat of taking away the exemption will be counted on to prevent the U.S. banks and the foreign borrowers from taking advantage of that loophole without the consent of the Treasury.

H.R. 8000 deals with a symptom, not the underlying causes of a balance-of-payments problem

Unquestionably, there has been an accelerated outflow of U.S. private capital in the form of long-term foreign loans and the purchase of foreign bonds. However, the bill is not specifically directed at these transactions, and actually exempts a substantial portion of foreign borrowing. The real purpose of the bill is to exert pressure against all forms of U.S. investment abroad. This ignores the underlying causes of the balance-of-payments problem.

There has been a growing lack of confidence in the ability of the United States to continue military and other foreign aid at existing levels. The United States has undertaken to guarantee, practically singlehandedly, not only the security of Western Europe but containment of the expansion of 700 million Communist Chinese. In addition to this tremendous burden, we may ultimately be faced with even greater financial burdens in Latin America. Our expenditures abroad for both military and nonmilitary aid have been running at the rate of about $4 billion annually. Unless and until we find a means of reducing this outflow of $4 billion annually, we will never solve the balance-of-payments problem.

TABLE 3.—*U.S. balance of payments, 1960— to 2d quarter 1963*

[In millions of dollars]

	1960	1961	1962	1963 [1] 1st quarter	1963 [1] 2d quarter
Commercial trade balance	2,817	3,179	1,989	420	502
Commercial services balance	1,458	2,130	2,322	614	486
Balance on commercial goods and services [2]	4,275	5,309	4,311	1,034	988
Military expenditures	−3,048	−2,934	−3,028	−748	−717
Military cash receipts [3]	336	393	673	184	199
Government grants and capital-dollar payments to foreign countries and international institutions	−1,107	−1,116	−1,070	−235	−261
Government capital receipts excluding debt prepayments, borrowings, and fundings [4]	538	533	513	104	121
Remittances and pensions	−672	−705	−736	−212	−207
Private capital:					
Long term	−2,114	−2,143	−2,495	−1,022	−895
Short term	−1,438	−1,475	−716	58	−577
Unrecorded transactions	−683	−905	−1,025	−122	68
Balance on regular transactions	−3,913	−3,043	−3,573	−959	−1,281
Special Government transactions [5]	32	673	1,387	458	171
Overall deficit	−3,881	−2,370	−2,186	−501	−1,110

[1] Seasonally adjusted.

[2] Nonmilitary merchandise and service transactions less those financed by Government grants and capital.

[3] Excluding advances on military exports.

[4] Includes small changes in miscellaneous Government nonliquid liabilities.

[5] Not seasonally adjusted. Includes nonscheduled receipts on Government loans, advances on military exports, and sales of nonmarketable medium-term securities, including $350 million of nonmarketable medium-term convertible securities in the 1st quarter of 1963, and $152 million in the 2d quarter of 1963.

Source: Survey of Current Business, as supplied by Treasury Department, Dec. 3, 1963.

For the past 2 years, the administration attempted to conceal the seriousness of the problem through a series of "gimmicks." For the first time, in the consideration of this bill, the administration has set out separately these so-called special Government transactions in table 3 above.

These so-called special Government transactions were a temporary expedient—just as is H.R. 8000—designed to "buy time," and thereby to avoid facing the problem. First, the Western European nations were called upon to anticipate the payment of their debt obligations to the United States and to pay an advance for military supplies purchased from the United States. While these transactions resulted in a decrease in the net balance of payments, the underlying causes of the deficit were ignored. Secondly, when the possibility for advance payments from the Western European nations was exhausted, another expedient was resorted to to bring about an "improvement" on paper in our balance of payments. The Treasury borrowed funds abroad which, at the option of the lenders, were repayable at a fixed rate of exchange in the foreign currency. It is reported that approximately $500 million of these obligations were issued during the 6 months ending June 30, 1963. This form of financing solved nothing.

There is unquestionably a "tight" world money market. Any action taken to restrict funds in the United States from going into that market in particular types of transactions will necessarily be reflected in offsetting pressures elsewhere. For example, the sale abroad of U.S. Government obligations (either repayable in foreign funds or convertible into such funds) was resorted to as a means of offsetting

the demand against U.S. gold stocks. The withdrawal of such capital by the United States was immediately offset by an increase in long-term borrowing by foreign borrowers in the U.S. capital market. From the standpoint of our balance of payments, the net result was the same as if the Treasury had not resorted to these bonds as a substitute for meeting the demands on the U.S. gold.

Faced with this dilemma, the Treasury proposes to establish independent capital markets outside of the United States. The committee was told that the U.S. capital market—headquartered in New York City—could no longer meet the world needs for capital. Therefore, it was hoped that the effect of this legislation might lead to the establishment of competing capital markets elsewhere. We challenge the desirability of that result, even if it could be achieved—which we doubt. It is isolationism on the part of a nation which has undertaken as a major objective the promotion of free trade. The result will be detrimental to the position of the United States as leader of the free world in the economic struggle against the Communist bloc. Instead of compromising our position of financial leadership of the free world by curtailing private outflow of capital, we should reappraise our governmental expenditures abroad. Governmental expenditures should be reduced before private investment.

H.R. 8000 will adversely affect balance of payments by restricting U.S. investment abroad

In proposing to control or tax U.S. investment abroad as a means of improving the balance-of-payments deficit, the administration has elected to sacrifice the long-range benefits which flow from such investment in order to gain a dubious short-range advantage. In fact, any advantage is predicated upon the doubtful assumptions (1) that there will not be an offsetting decrease in foreign investment in the United States and foreign purchases of U.S. products, and (2) that the curtailment of U.S. investment abroad will be "temporary." The administration claims that the Trade Expansion Act of 1962 and the pending tax reduction bill ultimately will bring about a sufficient increase in exports to offset the existing deficit in our balance of payments. These assumptions completely overlook the changes which are taking place in the world about us.

All of the nations are today striving toward industrialization. Canada proposes to put severe restrictions on the imports of automotive parts from the United States to be used in the assembly of automobiles in Canada. Similar restrictions have been imposed by other nations where U.S. automotive manufacturers have assembly plants. India seeks U.S. aid in order to expand its capacity for steelmaking. The U.S. commercial trade balance cannot achieve any long-range growth in the face of such pressures. In fact, as compared with the 1960–61 average, this balance shows a decline of more than $1 billion in the calendar year 1962 and promises a similar decline in the calendar year 1963. The only real "bright spot" in our balance of payments is reflected in the growth of private investment income. Private investment income has increased from approximately $2.9 billion for the year 1960 to an estimated $4 billion for the calendar year 1963. A breakdown of the items making up the commercial surplus in our balance of payments is set forth in the table which follows:

TABLE 4.—*U.S. balance of payments—Commercial surplus on goods and services, 1960 to June 1963*

[In millions of dollars]

	1960	1961	1962	Change, 1960–62 (improvement +)	January to June 1963, seasonally adjusted
1. Nonmilitary merchandise exports	+19,459	+19,913	+20,479	+1,020	+10,454
2. Less exports financed by Government grants and capital	+1,919	+2,237	+2,345	+426	+1,427
3. Commercial merchandise exports (1–2)	+17,540	+17,676	+18,134	+594	+9,027
4. Nonmilitary merchandise imports	−14,723	−14,497	−16,145	−1,422	−8,105
5. Commercial trade balance	+2,817	+3,179	+1,989	−828	+922
6. Private investment income	+2,873	+3,464	+3,850	+977	+2,005
7. Other nonmilitary service receipts	+4,307	+4,532	+4,801	+494	+2,490
8. Less services financed by Government grants and capital	+288	+430	+538	+250	+339
9. Commercial service exports (6+7−8)	+6,892	+7,566	+8,133	+1,221	+4,156
10. Nonmilitary service imports	−5,434	−5,436	−5,791	−357	−3,056
11. Commercial services balance	+1,458	+2,130	+2,322	+862	+1,100
12. Commercial surplus	+4,275	+5,309	+4,311	+36	+2,022

Source: Treasury Department, Dec. 3, 1963.

Commercial goods and services sold abroad already produce a favorable trade balance. Unquestionably, some exports can be increased. Such increases will, however, be slow and hard won. The industrial capacity of our major world customers to supply themselves has been expanded, largely with U.S. aid. Our former customers all strive towards self-sufficiency. Every nation, no matter how small or how weak economically, seeks to establish productive facilities in order to avoid having to import steel, chemicals, oil, and even manufactured goods such as automobiles and parts, and household appliances. This trend will make difficult any dramatic expansion of U.S. exports.

The tax rate reductions in the proposed Revenue Act of 1963, now pending before the Senate Finance Committee, are relied upon to bring about a substantial increase in consumer purchasing power in the United States. Such an increase will inevitably result in a corresponding increase in merchandise imports (table 4, item 4). Tax reduction will produce no offsetting increase in merchandise exports (table 4, item 3). As a net result, the U.S. commercial trade balance may be reduced. To counteract this effect it is necessary to encourage investment abroad, with the accompanying increased return on such investment. This bill is a backward step toward the solution of the problem. Instead, we should be striving to increase U.S. ownership of foreign income-producing assets.

CONCLUSION

For the reasons stated, the undersigned Republican members of the Ways and Means Committee are opposed to the enactment of this legislation.

H.R. 8000 is another effort to "cover up" the underlying causes which have brought about recurring deficits in our balance of payments. Even its proponents concede that the legislation is undesirable as a long-term measure. On the other hand, we have seen no program advanced by the administration which would serve permanently to meet the problem. In fact, the recent reduction by the Congress in foreign aid appropriations was bitterly opposed by the administration spokesmen.

No one should be deceived by this bill. The administration disclaims any desire to control foreign exchange. Except for its induced effect as a "control" on all U.S. investment abroad, the bill would accomplish little. We would be opposed to direct control over U.S. investment abroad, and are equally opposed to the attempt by this bill to achieve that result indirectly.

If the United States is to maintain its position as leader of the free world in the cold war with the Communist bloc, and particularly in the economic confrontation, we must maintain our position as the financial leader of the free world. That position can be maintained only so long as we provide a free capital market. Our position of leadership imposes upon us that burden. Indeed, to be banker to the world is a profitable occupation. This bill would seek to destroy that position. It reflects a "defeatist" attitude which we cannot accept.

John W. Byrnes.
Thomas B. Curtis.
Victor A. Knox.
James B. Utt.
Jackson E. Betts.
Bruce Alger.
Steven B. Derounian.

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Public Law 89-809
89th Congress, H. R. 13103
November 13, 1966

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.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Foreign Investors Tax Act of 1966 and Presidential Election Campaign Fund Act of 1966.

SECTION 1. TABLE OF CONTENTS, ETC.

(a) TABLE OF CONTENTS.—

Sec. 1. Table of contents, etc.
(a) Table of contents.
(b) Amendment of 1954 Code.

TITLE I—FOREIGN INVESTORS TAX ACT

Sec. 102. Source of income.
(a) Interest.
(b) Dividends.
(c) Personal services.
(d) Definitions.
(e) Effective dates.
Sec. 103. Nonresident alien individuals.
(a) Tax on nonresident alien individuals.
(b) Gross income.
(c) Deductions.
(d) Allowance of deductions and credits.
(e) Beneficiaries of estates and trusts.
(f) Expatriation to avoid tax.
(g) Partial exclusion of dividends.
(h) Withholding of tax on nonresident aliens.
(i) Liability for withheld tax.
(j) Declaration of estimated income tax by individuals.
(k) Collection of income tax at source on wages.
(l) Definitions of foreign estate or trust.
(m) Conforming amendment.
(n) Effective dates.
Sec. 104. Foreign corporations.
(a) Tax on income not connected with United States business.
(b) Tax on income connected with United States business.
(c) Withholding of tax on foreign corporations.
(d) Dividends received from certain foreign corporations.
(e) Dividends received from certain wholly-owned foreign subsidiaries.
(f) Distributions of certain foreign corporations.
(g) Unrelated business taxable income.
(h) Corporations subject to personal holding company tax.
(i) Amendments with respect to foreign corporations carrying on insurance business in United States.
(j) Subpart F income.
(k) Gain from certain sales or exchanges of stock in certain foreign corporations.
(l) Declaration of estimated income tax by corporations.
(m) Technical amendments.
(n) Effective dates.
Sec. 105. Special tax provisions.
(a) Income affected by treaty.
(b) Adjustment of tax because of burdensome or discriminatory foreign taxes.
(c) Clerical amendments.
(d) Effective date.
(e) Elections by nonresident United States citizens who are subject to foreign community property laws.
(f) Presumptive date of payment for tax withheld under chapter 3.
Sec. 106. Foreign tax credit.
(a) Allowance of credit to certain nonresident aliens and foreign corporations.
(b) Alien residents of the United States or Puerto Rico.
(c) Foreign tax credit in respect of interest received from foreign subsidiaries.
Sec. 107. Amendments to preserve existing law on deductions under section 931.
(a) Deductions.
(b) Effective date.

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TITLE I—FOREIGN INVESTORS TAX ACT—Continued

Sec. 108. Estates of nonresidents not citizens.
(a) Rate of tax.
(b) Credits against tax.
(c) Property within the United States.
(d) Property without the United States.
(e) Definition of taxable estate.
(f) Special methods of computing tax.
(g) Estate tax returns.
(h) Clerical amendment.
(i) Effective date.
Sec. 109. Tax on gifts of nonresidents not citizens.
(a) Imposition of tax.
(b) Transfers in general.
(c) Effective date.
Sec. 110. Treaty obligations.

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.
(b) Effective date.
Sec. 202. Basis of property received on liquidation of subsidiary.
(a) Definition of purchase.
(b) Period of acquisition.
(c) Distribution of installment obligations.
(d) Effective dates.
Sec. 203. Transfers of property to investment companies controlled by transferors.
(a) Transfers to investment companies.
(b) Investment companies required to file registration statement with S.E.C.
(c) Effective date.
Sec. 204. Removal of special limitations with respect to deductibility of contributions to pension plans by self-employed individuals.
(a) Removal of special limitations.
(b) Conforming amendments.
(c) Definition of earned income.
(d) Effective date.
Sec. 205. Treatment of certain income of authors, inventors, etc., as earned income for retirement plan purposes.
(a) Income from disposition of property created by taxpayer.
(b) Effective date.
Sec. 206. Exclusion of certain rents from personal holding company income.
(a) Rents from leases of certain tangible personal property.
(b) Technical amendments.
(c) Effective date.
Sec. 207. Percentage depletion rate for certain clay bearing alumina.
(a) 23 percent rate.
(b) Treatment processes.
(c) Effective date.
Sec. 208. Percentage depletion rate for clam and oyster shells.
(a) 15 percent rate.
(b) Effective date.
Sec. 209. Percentage depletion rate for certain clay, shale, and slate.
(a) 7½-percent rate.
(b) Conforming amendment.
(c) Effective date.
Sec. 210. Straddles.
(a) Treatment as short-term capital gain.
(b) Effective date.
Sec. 211. Tax treatment of per-unit retain allocations.
(a) Tax treatment of cooperatives.
(b) Tax treatment by patrons.
(c) Definitions.
(d) Information reporting.
(e) Effective dates.
(f) Transition rule.
Sec. 212. Excise tax rate on ambulances and hearses.
(a) Classification as automobiles.
(b) Effective date.

TITLE II—OTHER AMENDMENTS TO INTERNAL REVENUE CODE—Continued

Sec. 213. Applicability of exclusion from interest equalization tax of certain loans to assure raw materials sources.
(a) Exception to exclusion.
(b) Technical amendments.
(c) Effective date.
Sec. 214. Exclusion from interest equalization tax for certain acquisitions by insurance companies.
(a) New companies and companies operating in former less developed countries.
(b) Effective date.
Sec. 215. Exclusion from interest equalization tax of certain acquisitions by foreign branches of domestic banks.
(a) Authority for modification of executive orders.
(b) Effective date.

TITLE III—PRESIDENTIAL ELECTION CAMPAIGN FUND ACT

Sec. 301. Short title.
Sec. 302. Authority for designation of $1 of income tax payments to presidential election campaign fund.
Sec. 303. Presidential election campaign fund.
(a) Establishment.
(b) Transfers to the fund.
(c) Payments from fund.
(d) Transfers to general fund.
Sec. 304. Establishment of advisory board.
Sec. 305. Appropriations authorized.

TITLE IV—MISCELLANEOUS PROVISIONS

Sec. 401. Treasury notes payable in foreign currency.
Sec. 402. Reports to clarify the national debt and tax structure.

(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: 68A Stat. 275. 26 USC 861.

"(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 deducti-

68A Stat. 78, 204. 26 USC 265, 591.

ble 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, 1972, subsection (a)(1)(A) and this subsection shall cease to apply."

26 USC 861.

(2) Section 861(a)(1) is amended by striking out subparagraphs (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 within 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, 1972, 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, 1972, 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 ENTITIES.—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: 75 Stat. 64. 26 USC 895.

"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." 78 Stat. 800; Ante, p. 164.

(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: 68A Stat. 275. 26 USC 861.

"(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". Post, p. 1558. 26 USC 901-905; Post, p. 1568.

(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."

68A Stat. 278. 26 USC 864.

(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.

"(2) 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 personal 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.

Post, p. 1559.

"(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.

Post, pp. 1547, 1555.

"(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.

Ante, p. 1541.

"(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 loss—

68A Stat. 277.
26 USC 862.

"(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

26 USC 1221.

"(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 disposition 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.

73 Stat. 112.
26 USC 801-820.

"(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—

76 Stat. 1018.
26 USC 958.

"(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

26 USC 952.

"(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 property 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: 68A Stat. 278. 26 USC 871.

"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, 26 USC 402, 403, 631, 1235.

"(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 26 USC 1232.

"(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

71-048 (719) O - 66 - 2

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 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 paragraph. 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.

68A Stat. 320.
26 USC 1202.
26 USC 1212.

"(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.

26 USC 1, 1201;
Post, p. 1550.

"(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.

66 Stat. 168;
75 Stat. 534.
75 Stat. 536.
26 USC 1441.

"(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

68A Stat. 213.
26 USC 631.

"(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)—

68A Stat. 357.
26 USC 1441.
Post, pp. 1555, 1557.

"(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—

72 Stat. 1622.
26 USC 403.
26 USC 401, 501.

"(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

Ante, p. 1544.

"(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)."

68A Stat. 7.
26 USC 1.

(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."

Ante, p. 1547; Post, p. 1551.

(b) GROSS INCOME.—

26 USC 872.

(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."

75 Stat. 536.

(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.—

26 USC 873.

(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:

78 Stat. 43.
26 USC 165.

"(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.

68A Stat. 58.
26 USC 170.

"(2) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts allowed by section 170.

26 USC 151.

"(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: 68A Stat. 45. 26 USC 154.

"(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: 26 USC 874.

"(a) RETURN PREREQUISITE TO ALLOWANCE.—A nonresident alien individual shall receive the benefit of the deductions and 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." 26 USC 31, 32. 79 Stat. 167. 26 USC 39.

(e) BENEFICIARIES OF ESTATES AND TRUSTS.—

(1) Section 875 (relating to partnerships) is amended to read as follows: 68A Stat. 281. 26 USC 875.

"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: 26 USC 877.

"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. 26 USC 1-2524. Ante, p. 1547.

"(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— 26 USC 1, 1201; Ante, p. 1550.

"(1) the gross income shall include only the gross income described in section 872(a) (as modified by subsection (c) of this section), and Ante, p. 1550.

"(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. 78 Stat. 99. 26 USC 1212.

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. Ante, p. 1550. 68A Stat. 49. 26 USC 165.

"(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). 66 Stat. 236.

"(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 probable 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." 26 USC 1-2524.

(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: 26 USC 116.

"(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 Ante, p. 1547.

"(2) in determining the tax imposed for the taxable year pursuant to section 877(b)." Ante, p. 1551.

(h) WITHHOLDING OF TAX ON NONRESIDENT ALIENS.—Section 1441 (relating to withholding of tax on nonresident aliens) is amended— 68A Stat. 357. 26 USC 1441.

(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."; 26 USC 402, 403, 631, 1235, Ante, p. 1547.

(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: 75 Stat. 536.

"(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: 70 Stat. 563.

"(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 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 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." Ante, p. 1547.

68A Stat. 360. 26 USC 1461. (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.

26 USC 1441-1465. "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."

74 Stat. 1000. 26 USC 6015. (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—

26 USC 3401-3404. "(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.—

76 Stat. 988. 26 USC 7701. (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,".

Repeal. 68A Stat. 365. 26 USC 1493. (2) Section 1493 (defining foreign trust for purposes of chapter 5) is repealed.

26 USC 932. (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." 26 USC 1-1563.

(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: 68A Stat. 282. 26 USC 881.

"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), 26 USC 631.

"(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 26 USC 1232.

"(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), Ante, p. 1547.

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: 26 USC 882.

"SEC. 882. TAX ON INCOME OF FOREIGN CORPORATIONS CONNECTED WITH UNITED STATES BUSINESS.

"(a) NORMAL TAX AND SURTAX.—

"(1) IMPOSITION OF TAX.—A foreign corporation 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. 78 Stat. 25; Post, p. 1557. 26 USC 11. 26 USC 1201.

"(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.

68A Stat. 58. 26 USC 170.

"(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.

26 USC 6001-7852.

26 USC 541.

26 USC 32. 79 Stat. 167. 26 USC 39. Post, p. 1568.

"(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.

26 USC 901; Post, p. 1569.

"(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—

26 USC 631.

"(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.

Ante, p. 1547.

"(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.

68A Stat. 732. 26 USC 6012.

"(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."

78 Stat. 25. 26 USC 11.

(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:

Ante, p. 1555.

"(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.

"Sec. 882. Tax on income of foreign corporations connected with United States business."

68A Stat. 358. 26 USC 1442.

(c) WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.—Section 1442 (relating to withholding of tax on foreign corporations) is amended to read as follows:

"SEC. 1442. WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.

26 USC 1-1563.

26 USC 1441, 1451; Ante, p. 1553.

Ante, p. 1555.

Post, p. 1561.

"(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 thereof; 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)(2) shall be treated as referring to section 842 or section 882(a)(2), 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). Ante, pp. 1547, 1553, 1555.

"(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— 68A Stat. 73; 76 Stat. 977. 26 USC 245.

(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— 78 Stat. 117. 26 USC 1562.

"(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." Ante, p. 1558.

(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 CORPORATIONS.—Section 301(b)(1)(C) (relating to certain corporate distributees of foreign corporations) is amended— 76 Stat. 977. 26 USC 301.

(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." 68A Stat. 170. 26 USC 512. 26 USC 511.

(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: 68A Stat. 186; 78 Stat. 79. 26 USC 542.

"(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;". 78 Stat. 81. 26 USC 543.

(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:"

68A Stat. 189. 26 USC 545.

(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

26 USC 561.

76 Stat. 1018. 26 USC 958.

(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)."

78 Stat. 81. 26 USC 543.

26 USC 6671-6881. Ante, p. 61.

(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 accurate return of the tax imposed by section 541,

26 USC 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."

26 USC 1-1388.

(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:

68A Stat. 267. 26 USC 842.

"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."

26 USC 801-832.

Ante, p. 1555.

(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) is amended—

73 Stat. 136. 26 USC 819.

(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).

68A Stat. 29. 26 USC 103. Post, p. 1563.

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."

76 Stat. 989. 26 USC 821. (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."

68A Stat. 263; 76 Stat. 992. 26 USC 822. (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).

26 USC 831. (6) Section 831 (relating to tax on certain other insurance companies) is amended—

(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."

26 USC 832. (7) Section 832 (relating to insurance company taxable income) is amended by striking out subsection (d) and by redesignating subsection (e) as subsection (d).

26 USC 841. (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),". Post, p. 1568.

76 Stat. 1008. 26 USC 952. (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."

76 Stat. 1041. 26 USC 1248. (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: 68A Stat. 738; 78 Stat. 29. 26 USC 6016.

"(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." 26 USC 6655. 26 USC 11, 801-843, 1201. Ante, pp. 1555, 1557.

(m) TECHNICAL AMENDMENTS.—

(1) Section 884 is amended to read as follows: 26 USC 884.

"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)". 76 Stat. 1009. 26 USC 953.

(3) Section 1249(a) is amended by striking out "Except as provided in subsection (c), gain" and inserting in lieu thereof "Gain". 76 Stat. 1045. 26 USC 1249.

(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: 68A Stat. 284. 26 USC 894.

"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)." Ante, p. 1551.

(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 26 USC 891-895.

aliens and foreign corporations) is amended by 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,

68A Stat. 4.
26 USC 1-1563.

"(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.

26 USC 861-972, 1441-1465.

"(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.

68A Stat. 4.
26 USC 1-1563.

"(d) 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.

"(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:

68A Stat. 285;
76 Stat. 1006.
26 USC 901-972.

"Subpart H—Income of Certain Nonresident United States Citizens Subject to Foreign Community Property Laws

"Sec. 981. Election as to treatment of income subject to foreign community property laws.

"SEC. 981. ELECTION 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. 76 Stat. 1004. 26 USC 911.

"(2) Trade or business income, and a partner's distributive share of partnership income, shall be treated as provided in section 1402(a)(5). 68A Stat. 354; 68 Stat. 1087. 26 USC 1402.

"(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. 53 Stat. 1.

"(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 manner 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 citizen 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 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— 76 Stat. 1005. 26 USC 911.

(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: 68A Stat. 812. 26 USC 6513.

"(b) PREPAID INCOME TAX.—For purposes of section 6511 or 6512— 26 USC 6511, 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. 26 USC 3401-3404. 26 USC 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). 68A Stat. 732. 26 USC 6012.

"(3) Any tax withheld at the source under chapter 3 shall, in respect of the recipient of the income, be deemed to have been paid by such recipient 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 1462. For this purpose, any exemption granted under section 6012 from the requirement of filing a return shall be disregarded." 26 USC 1441-1465.

(2) Section 6513(c) (relating to return and payment of Social Security taxes and income tax withholding) is amended— 26 USC 6513.

(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— 26 USC 6501.

(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: 26 USC 901-905.

"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. 76 Stat. 999.

"(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— Ante, pp. 1550, 1555.

"(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. 68A Stat. 287. 26 USC 904.

"(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 individual not connected with United States business) or 881 (relating to income of foreign corporations not connected with United States business). Ante, p. 1547. Ante, p. 1555.

"(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." 76 Stat. 999, 1001. 26 USC 78, 902.

(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 68A Stat. 281. 26 USC 874.

"(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". Ante, p. 1568.

(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: 26 USC 901.

"(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". 26 USC 876.

(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."

68A Stat. 378. 26 USC 2014.

(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 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.—

76 Stat. 1002. 26 USC 904.

(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:

68A Stat. 369. 26 USC 1504.

"(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: 68A Stat. 291. 26 USC 931.

"(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 apportionment 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. 26 USC 861-864.

"(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. 26 USC 165.

"(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. 78 Stat. 43.

"(C) The deduction for charitable contributions and gifts allowed by section 170. 26 USC 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: 26 USC 2101.

"(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: Post, p.1573. 26 USC 2106.

"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."

68A Stat. 397.
26 USC 2102.

(b) CREDITS AGAINST TAX.—Section 2102 (relating to credits allowed against estate tax) is amended to read as follows:

"SEC. 2102. CREDITS AGAINST TAX.

Ante, p. 1571.

26 USC 2011-2013.

"(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)."

26 USC 2103.

(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:

26 USC 2104.

"(c) DEBT OBLIGATIONS.—For purposes of this subchapter, debt obligations of—

26 USC 2101-2106.
Post, p. 1573.

"(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, 1972, 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."

Ante, p. 1542.

(d) PROPERTY WITHOUT THE UNITED STATES.—Subsection (b) of section 2105 (relating to bank deposits) is amended to read as follows:

26 USC 2105.

"(b) CERTAIN BANK DEPOSITS, ETC.—For purposes of this subchapter—

Ante, p. 1541.

"(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."

74 Stat. 1000.
26 USC 2106.

(e) DEFINITION OF TAXABLE ESTATE.—Paragraph (3) of 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

74 Stat. 999.
26 USC 2209.
68A Stat. 389.
26 USC 2052.

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 METHODS 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: 68A Stat. 397. 26 USC 2101-2106.

"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. 26 USC 2001.

"(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 76 Stat. 1018. 26 USC 958.

"(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. 26 USC 2035-2038.

"(c) CREDITS.—The tax imposed by subsection (a) shall be credited with the amounts determined in accordance with section 2102. Ante, p. 1572.

"(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). 66 Stat. 236.

"(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.

Ante, pp. 1571, 1572.

"(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 or his delegate shall prescribe such regulations as may be necessary or appropriate to implement this section."

68A Stat. 739. 26 USC 6018.

(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.

26 USC 2501.

(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.

26 USC 2502.

"(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

66 Stat. 236.

"(B) such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

68A Stat. 4. 26 USC 1-2524.

"(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:

26 USC 2511.

"(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)—

Ante, p. 1574.

"(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 and held 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—

76 Stat. 967. 26 USC 48.

(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(c)) 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." 68A Stat. 291; 74 Stat. 998. 26 USC 931-934.

(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. 76 Stat. 963. 26 USC 46.

SEC. 202. 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: 26 USC 334.

"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)." 26 USC 318.

(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: 26 USC 453.

"(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 26 USC 332.

"(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. 203. TRANSFERS OF PROPERTY TO INVESTMENT COMPANIES CONTROLLED BY TRANSFERORS.

(a) TRANSFERS TO INVESTMENT COMPANIES.—The first sentence of section 351(a) (relating to transfer to corporation controlled by the transferor) is amended by striking out "to a corporation" and inserting in lieu thereof "to a corporation (including, in the case of transfers made on or before June 30, 1967, an investment company)". 68A Stat. 111. 26 USC 351.

(b) INVESTMENT COMPANIES REQUIRED TO FILE REGISTRATION STATEMENT WITH THE S.E.C.—Section 351 is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) APPLICATION OF JUNE 30, 1967, DATE.—For purposes of this section, if, in connection with the transaction, a registration statement is required to be filed with the Securities and Exchange Commission, a transfer of property to an investment company shall be treated as made on or before June 30, 1967, only if—

"(1) such transfer is made on or before such date,

"(2) the registration statement was filed with the Securities and Exchange Commission before January 1, 1967, and the aggregate issue price of the stock and securities of the investment company which are issued in the transaction does not exceed the aggregate amount therefor specified in the registration statement as of the close of December 31, 1966, and

"(3) the transfer of property to the investment company in the transaction includes only property deposited before May 1, 1967."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply with respect to transfers of property to investment companies whether made before, on, or after the date of the enactment of this Act.

SEC. 204. REMOVAL OF SPECIAL LIMITATIONS WITH RESPECT TO DEDUCTIBILITY OF CONTRIBUTIONS TO PENSION PLANS BY SELF-EMPLOYED INDIVIDUALS.

(a) REMOVAL OF SPECIAL LIMITATIONS.—Paragraph (10) of section 404(a) (relating to special limitation on amount allowed as deduction for self-employed individuals for contributions to certain pension, etc., plans) is repealed. Repeal. 76 Stat. 820. 26 USC 404.

(b) CONFORMING AMENDMENTS.—

(1) Each of the following provisions of section 401 is amended by striking out "(determined without regard to section 404(a)(10))" each place it appears: 26 USC 401.

(A) Subsection (a)(10)(A)(ii).

(B) Subparagraphs (A) and (B) of subsection (d)(5).

(C) Subparagraph (A) of subsection (d)(6).

(D) Subparagraphs (A) and (B)(i) of subsection (e)(1).

(E) Subparagraphs (B) and (C) and the last sentence of subsection (e)(3).

(2) Subparagraph (A) of section 404(e)(2) is amended by striking out "(determined without regard to subsection (a)(10))".

(3) Paragraph (1) and subparagraph (B) of paragraph (2) of section 404(e) are each amended by striking out "(determined without regard to paragraph (10) thereof)".

(c) DEFINITION OF EARNED INCOME.—Section 401(c)(2) (relating to definition of earned income for certain pension and profit-sharing plans) is amended by striking out subparagraphs (A) and (B) and inserting in lieu thereof the following: 76 Stat. 811.

"(A) In general.—The term 'earned income' means the net earnings from self-employment (as defined in section 1402(a)), but such net earnings shall be determined— 68A Stat. 353. 26 USC 1402.

"(i) only with respect to a trade or business in which personal services of the taxpayer are a material income-producing factor,

"(ii) without regard to paragraphs (4) and (5) of section 1402(c), 79 Stat. 381.

"(iii) in the case of any individual who is treated as an employee under sections 3121(d)(3) (A), (C), or (D), without regard to paragraph (2) of section 1402(c), and 26 USC 3121. 74 Stat. 945.

"(iv) without regard to items which are not included in gross income for purposes of this chapter, and the deductions properly allocable to or chargeable against such items.

For purposes of this subparagraph, section 1402, as in effect for a taxable year ending on December 31, 1962, shall be treated as having been in effect for all taxable years ending before such date."

(d) Effective Date.—The amendments made by subsections (a) and (b) shall apply with respect to taxable years beginning after December 31, 1967.

SEC. 205. 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: *Ante*, p. 1577.

"(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. 206. 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— 78 Stat. 84. 26 USC 543.

"(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 manu-

factured 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. 78 Stat. 81. 26 USC 543.

(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. 207. PERCENTAGE DEPLETION RATE FOR CERTAIN CLAY BEARING ALUMINA.

(a) 23 Percent Rate.—Section 613(b) (relating to percentage depletion rates) is amended— 68A Stat. 208; 74 Stat. 291. 26 USC 613.

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

SEC. 208. 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. 209. PERCENTAGE DEPLETION RATE FOR CERTAIN CLAY, SHALE, AND SLATE.

(a) 7½ Percent Rate.—Section 613(b) (relating to percentage depletion rates) is amended—

(1) by renumbering paragraphs (5) and (6) as (6) and (7), respectively, and by inserting after paragraph (4) the following new paragraph:

"(5) 7½ percent—clay and shale used or sold for use in the manufacture of sewer pipe or brick, and clay, shale, and slate used or sold for use as sintered or burned lightweight aggregates.";

(2) by striking out in paragraph (3)(B) (as amended by section 207(a)(2)) "if neither paragraph (2)(B) nor (5)(B) applies" and inserting in lieu thereof "if neither paragraph (2)(B), (5), or (6)(B) applies";

(3) by striking out in paragraph (6) (as renumbered by paragraph (1)) "shale, and stone, except stone described in paragraph (6)" and inserting in lieu thereof "shale (except shale described in paragraph (5)), and stone (except stone described in paragraph (7))";

(4) by striking out, in subparagraph (B) of paragraph (6) (as so renumbered), "building or paving brick," and by striking out "sewer pipe,"; and

(5) by inserting after "any such other mineral" in paragraph (7) (as so renumbered) "(other than slate to which paragraph (5) applies)".

74 Stat. 293. 26 USC 613. (b) CONFORMING AMENDMENT.—Section 613(c)(4)(G) (relating to treatment processes) is amended by striking out "paragraph (5)(B)" and inserting in lieu thereof "paragraph (5) or (6)(B)".

(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. 210. STRADDLES.

72 Stat. 1644. 26 USC 1234. (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.

68A Stat. 330. 26 USC 1236. "(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. 211. TAX TREATMENT OF PER-UNIT RETAIN ALLOCATIONS.

(a) TAX TREATMENT OF COOPERATIVES.—

76 Stat. 1046. 26 USC 1382. (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))."

26 USC 1388.

(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 Post, p. 1583.

"(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: 76 Stat. 1047.

"(e) PRODUCTS MARKETED UNDER POOLING ARRANGEMENTS.—For purposes of subsection (b), in the case of a pooling arrangement for the marketing of products— 26 USC 1382.

"(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."** 26 USC 1383.

(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.—

76 Stat. 1048. 26 USC 1385. (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)." 26 USC 1381.

(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 26 USC 1382.

"(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.—

26 USC 1388. (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). 76 Stat. 1048. 26 USC 1385.

"(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. 76 Stat. 1046. 26 USC 1382.

"(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.—

76 Stat. 1054. 26 USC 6044.

(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:

Ante, p. 1582.

"(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

Ante, p. 1581.

"(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.

76 Stat. 1045. 26 USC 1381.

(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. 212. 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: 68A Stat. 482; 78 Stat. 1086. 26 USC 4062.

"(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)." 26 USC 4061. 79 Stat. 136.

(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. 213. 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: 78 Stat. 813. 26 USC 4914.

"(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: 78 Stat. 831. 26 USC 4918.

"(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." 78 Stat. 809. 26 USC 4911.

(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. 214. 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."; 78 Stat. 827. 26 USC 4916.

(5) by striking out "TO MAINTAIN FUND" in the heading of paragraph (3) (B); 79 Stat. 959. 26 USC 4914.

(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"; 78 Stat. 819.

(8) by striking out "subparagraph (B)," in paragraph (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: 78 Stat. 820. 26 USC 4914.

"(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." 78 Stat. 827. 26 USC 4916.

(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. 215. 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." 78 Stat. 839. 26 USC 4931.

(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: 68A Stat. 731. 26 USC 6001-6091.

"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. 26 USC 1-1388. 76 Stat. 962.

"(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—

80 STAT. 1587
80 STAT. 1588

"(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."

68A Stat. 4.
26 USC 1-1388.

(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.

Ante, p. 1587.

(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 15,000,000 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 the excess over $5,000,000 of—

(i) $1 multiplied by the total number of popular votes cast in the preceding presidential election for candidates of political parties whose candidates received 15,000,000 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 15,000,000 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 5,000,000, but less than 15,000,000, 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 5,000,000 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.

80 STAT. 1588
80 STAT. 1589

(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— Definitions.

(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.

80 STAT. 1589

80 STAT. 1590

Membership.

(b) The Board shall be composed of two members representing each political party whose candidate for President at the last presidential election received 15,000,000 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.

Term of office.

Compensation.

(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.

40 Stat. 505.

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 THE NATIONAL DEBT AND TAX STRUCTURE.

The Secretary of the Treasury shall, on the first day of each regular session of the Congress, submit to the Senate and the House of Representatives a report setting forth, as of the close of the preceding June 30 (beginning with the report as of June 30, 1967), 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, so far as practicable, trust fund liabilities, Government corporations' liabilities, indirect liabilities not included as a part of the public debt, and liabilities of insurance and annuity programs, including their actuarial status. 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 shall also set forth all other assets specifically available to

liquidate such liabilities of the Government. The report shall set forth the required data in a concise form, with such explanatory material (including such analysis of the significance of the liabilities in terms of past experience and probable risk) 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.

Approved November 13, 1966.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 1450 (Comm. on Ways and Means) and No. 2327 (Comm. of Conference).
SENATE REPORT No. 1707 (Comm. on Finance).
CONGRESSIONAL RECORD, Vol. 112 (1966):
June 15: Considered and passed House.
Oct. 12: Considered in Senate.
Oct. 13: Considered and passed Senate, amended.
Oct. 20: House agreed to conference report.
Oct. 22: Senate agreed to conference report.

Public Law 89-243
89th Congress, H. R. 4750
October 9, 1965

An Act

79 STAT. 954

To provide an extension of the interest equalization tax, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Interest Equalization Tax Extension Act of 1965.

SECTION 1. SHORT TITLE, ETC.

(a) Short Title.—This Act may be cited as the "Interest Equalization Tax Extension Act of 1965".

(b) Amendment of 1954 Code.—Except as otherwise expressly provided, whenever in this Act an amendment is expressed in terms of an amendment to a section or other provision, the reference is to a section or other provision of the Internal Revenue Code of 1954.

SEC. 2. EXTENSION OF INTEREST EQUALIZATION TAX.

Section 4911(d) is amended by striking out "December 31, 1965" and inserting in lieu thereof "July 31, 1967". 78 Stat. 810. 26 USC 4911.

SEC. 3. IMPOSITION OF TAX WITH RESPECT TO DEBT OBLIGATIONS HAVING MATURITY OF 1 TO 3 YEARS.

(a) Imposition of Tax.—The following provisions are amended by striking out "3 years" each place it appears and inserting in lieu thereof "1 year"—

(1) section 4911(a);
(2) section 4914(e)(3)(D); 26 USC 4914.
(3) section 4914(e)(3)(E)(ii); and
(4) section 4920(a)(7)(B)(iv). 26 USC 4920.

(b) Amount of Tax.—Section 4911(b)(2) is amended by striking from the table the line reading

"At least 3 years, but less than 3½ years........ 2.75 percent"

and inserting in lieu thereof the following:

"At least 1 year, but less than 1¼ years	1.05 percent
At least 1¼ years, but less than 1½ years	1.30 percent
At least 1½ years, but less than 1¾ years	1.50 percent
At least 1¾ years, but less than 2¼ years	1.85 percent
At least 2¼ years, but less than 2¾ years	2.30 percent
At least 2¾ years, but less than 3½ years	2.75 percent".

(c) Effective Date.—

(1) General rule.—Except as provided by paragraphs (2), (3), and (4), the amendments made by subsections (a) and (b) shall apply with respect to acquisitions of debt obligations, and designations described in section 4914(e)(3)(D) or 4914(e)(3)(E)(ii) of the Internal Revenue Code of 1954, made after February 10, 1965.

(2) Preexisting commitments.—Such amendments shall not apply to an acquisition—

(A) made pursuant to an obligation to acquire which on February 10, 1965—

(i) was unconditional, or

(ii) was subject only to conditions contained in a formal contract under which partial performance had occurred; or

(B) as to which on or before February 10, 1965, the acquiring United States person (or, in a case where 2 or more United States persons are making acquisitions as part of a single transaction, a majority in interest of such persons) had taken every action to signify approval of the acquisition under the procedures ordinarily employed by such person (or persons) in similar transactions and had sent or deposited for delivery to the foreign person from whom the acquisition was made written evidence of such approval in the form of a commitment letter, memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the foreign person from whom the acquisition was made which set forth, the principal terms of such acquisition, subject only to the execution of formal documents evidencing the acquisition and to customary closing conditions.

(3) PUBLIC OFFERINGS.—Such amendments shall not apply to an acquisition of debt obligations made on or before April 12, 1965, if—

48 Stat. 74. 15 USC 77a.

(A) a registration statement (within the meaning of the Securities Act of 1933) was in effect with respect to the debt obligation acquired at the time of its acquisition;

(B) the registration statement was first filed with the Securities and Exchange Commission on February 10, 1965, or within 90 days before that date; and

(C) no amendment was filed with the Securities and Exchange Commission after February 10, 1965, and before the acquisition which had the effect of increasing the aggregate face amount of the debt obligations covered by the registration statement.

(4) FORECLOSURES.—Such amendments shall not apply to an acquisition of debt obligations as a result of a foreclosure by a creditor pursuant to the terms of an instrument held by such creditor on February 10, 1965.

(d) RETURNS.—

78 Stat. 843. 26 USC 6011.

(1) FIRST RETURN PERIOD.—Notwithstanding any provision of section 6011(d)(1) of the Internal Revenue Code of 1954, the first period for which returns shall be made under such section 6011 (d)(1) with respect to acquisitions made subject to tax by this section shall be the period commencing February 11, 1965, and ending at the close of the calendar quarter in which the enactment of this Act occurs.

26 USC 6076.

(2) TIME FOR FILING FIRST RETURNS.—Notwithstanding any provision of section 6076 of the Internal Revenue Code of 1954, the first return with respect to acquisitions made subject to tax by this section shall be filed on or before the last day of the first month following the close of the calendar quarter in which the enactment of this Act occurs, or at such later time as may be provided in regulations prescribed by the Secretary or his delegate.

(e) CONFORMING AMENDMENTS.—

26 USC 4931.

(1) Effective as provided in paragraph (2), section 4931 is amended—

(A) by striking out subsection (c) and redesignating subsections (d) and (e) as subsections (c) and (d), respectively;

(B) by striking out "subsection (b) or (c)" each place it appears in subsection (a) and inserting in lieu thereof "subsection (b)";

(C) by striking out ", and the tax imposed under subsection (c)," each place it appears in the subsection herein redesignated as subsection (c); and

(D) by striking out "3 YEARS" in the heading to subsection (b) and inserting in lieu thereof "1 YEAR".

30 F. R. 1929.

(2) Executive Order 11198, issued February 10, 1965, shall not be affected by the amendments made by this section and shall continue to apply as though such amendments had not been made.

The amendments made by this subsection shall take effect only at such time as may be provided in a modification hereafter made (in accordance with section 4931 of the Internal Revenue Code of 1954) in such Executive order. 78 Stat. 839. 26 USC 4931.

SEC. 4. OTHER AMENDMENTS.

(a) CERTAIN EXPORT LEASES.—

(1) Section 4914(c) is amended by redesignating paragraph (6) as paragraph (7) and by inserting after paragraph (5) the following new paragraph: 26 USC 4914.

"(6) CERTAIN EXPORT LEASES.—The tax imposed by section 4911 shall not apply to the acquisition from a foreign obligor by a United States person of a debt obligation of such obligor arising out of a lease of personal property to such obligor by such United States person if— 26 USC 4911.

"(A) at least 30 percent of the value of the property subject to the lease, or 60 percent of the actual value of the debt obligation arising out of such lease, is attributable to the use of tangible personal property which was manufactured, produced, grown, or extracted in the United States by such United States person (or by one or more includible corporations in an affiliated group, as defined in section 1504, of which such person is a member), or to the performance of services pursuant to the terms of the lease by such United States person (or by one or more such corporations) with respect to such personal property, or to both, and 68A Stat. 369. 26 USC 1504.

"(B) at least 50 percent of the value of the property subject to lease, or 100 percent of the actual value of the debt obligation arising out of such lease, is attributable to the use of tangible personal property which was manufactured, produced, grown, or extracted in the United States, or to the performance of services pursuant to the terms of the lease by United States persons, or to both."

(2) Section 4914(b)(6) is amended by inserting "or lease" after "sale".

(3) Section 4914(j)(1) is amended—

(A) by striking out "or (5)" in subparagraph (A) and inserting in lieu thereof "(5), or (6)";

(B) by striking out "or (5)" in subparagraph (D) and inserting in lieu thereof "(5), or (6)"; and

(C) by striking out "or (3)" in clause (iii) in subparagraph (A) and inserting in lieu thereof "(3), or (6)" and by inserting after the word "sale" in such clause the words "or lease".

(4) Paragraph (1) of the subsection of section 4931 redesignated as subsection (c) by section 3(e) of this Act is amended—

(A) by inserting "or lease" after "sale" each place it appears;

(B) by inserting after "loan" in subparagraph (A) the following: ", amount paid, or other consideration given to acquire such debt obligation";

(C) by inserting "or leasing" after "selling" in subparagraph (B); and

(D) by adding at the end of such paragraph (after and below subparagraph (B)) the following new sentence:

"For purposes of the preceding sentence, the acquisition by a wholly-owned subsidiary of a commercial bank of a debt obligation arising out of a lease made by such subsidiary shall be treated as the acquisition of a debt obligation by a commercial bank."

(b) SALES OF FOREIGN BRANCHES.—

78 Stat. 813. 26 USC 4914.

(1) Section 4914(g)(1) is amended—

(A) by striking out "or" at the end of subparagraph (A);

(B) by striking out the period at the end of subparagraph (B) and inserting in lieu thereof "; or"; and

(C) by adding at the end thereof the following new subparagraph:

"(C) as part or all of the purchase price in a sale by such United States person of substantially all of the assets of a branch of such United States person located outside the United States."

(2) Section 4914(g)(2) is amended to read as follows:

"(2) LIMITATIONS.—Subparagraphs (A) and (B) of paragraph (1) shall not apply to the acquisition of a debt obligation if any of the stock sold or surrendered in connection with its acquisition was originally acquired with the intent to sell or surrender. Subparagraph (C) of paragraph (1) shall not apply to the acquisition of a debt obligation if any of the assets sold had been transferred to the branch for the purpose of sale (other than sale in the ordinary course of its trade or business)."

(3) The heading of section 4914(g) is amended by inserting "OR SALE OF FOREIGN BRANCH" after "SUBSIDIARY".

(4) Section 4914(b)(10) is amended to read as follows:

"(10) ACQUISITIONS OF DEBT OBLIGATIONS ON SALE OR LIQUIDATION OF WHOLLY OWNED FOREIGN SUBSIDIARIES OR SALE OF FOREIGN BRANCHES.—Of debt obligations acquired in connection with the sale or liquidation of a wholly owned foreign corporation or the sale of a foreign branch, to the extent provided in subsection (g)."

(c) CONSTRUCTION LOANS.—

(1) Section 4914(h) is amended to read as follows:

"(h) CERTAIN DEBT OBLIGATIONS SECURED BY UNITED STATES MORTGAGES, ETC.—

26 USC 4911.

"(1) IN GENERAL.—The tax imposed by section 4911 shall not apply to the acquisition from a foreign obligor by a United States person of—

"(A) a debt obligation of such foreign obligor which is secured by real property located in the United States, to the extent that such debt obligation—

"(i) is a part of the purchase price of such real property (or of such real property and related personal property), or

"(ii) arises out of a loan made by such United States person to the foreign obligor the proceeds of which are concurrently used as part of the purchase price of such real property (or of such real property and related personal property); or

"(B) a debt obligation of such foreign obligor which is secured by real property located in the United States on which improvements are under construction by the obligor, if such debt obligation arises out of a loan made by such United States person all the proceeds of which are used—

"(i) to finance the construction of such improvements, or

"(ii) to repay all or any part of a loan made to finance such construction, if the construction loan has qualified (or would have qualified) under paragraph (2)(B) and such repayment occurs within 5 years after such construction loan is made.

"(2) LIMITATIONS.—Paragraph (1) shall apply to the acquisition of a debt obligation only if—

"(A) in the case of the sale of property referred to in paragraph (1)(A)—

"(i) the seller is a United States person, and

"(ii) at least 25 percent of the purchase price of the property sold is, at the time of such sale, paid in United States currency to such United States person by the foreign obligor from funds not obtained from United States persons for the purpose of purchasing such property; or

"(B) in the case of the construction of improvements referred to in paragraph (1)(B)—

"(i) at the time any proceeds of the loan out of which such debt obligation arises are advanced, an amount equal to at least one-third of the amount of such advance, plus one-third of the amount of any previous advances of such proceeds, has been expended for such construction by the foreign obligor in United States currency from funds not obtained from United States persons for the purpose of financing such construction, and

"(ii) not less than 85 percent of the cost of such construction attributable to property or services is attributable to property grown, extracted, manufactured, or produced in the United States, or to services performed by United States persons, or to both.

"(3) RELATED PERSONAL PROPERTY.—For purposes of paragraph (1)(A), the term 'related personal property' means personal property which is sold in connection with the sale of real property for use in the operation of such real property."

(2) Section 4914(b)(11) is amended to read as follows: 78 Stat. 813.

"(11) ACQUISITIONS OF CERTAIN DEBT OBLIGATIONS SECURED BY REAL PROPERTY IN THE UNITED STATES.—Of debt obligations secured by real property in the United States, to the extent provided in subsection (h)." 26 USC 4914.

(d) STUDENT LOANS.—Section 4914(b) is amended by adding at the end thereof the following new paragraph:

"(13) STUDENT LOANS.—Of debt obligations which arise out of loans to a foreign obligor registered as a full-time student at an educational institution (as defined in section 151(e)(4)) in the United States, to the extent that the acquisition by the acquiring person of such debt obligations with a period remaining to maturity of 1 year or more from such obligor in any calendar year does not exceed $2,500." 68A Stat. 42. 26 USC 151.

(e) TANGIBLE PROPERTY HELD FOR PERSONAL USE.—Section 4914(b) is amended by adding at the end thereof (after the new paragraph added by subsection (d) of this section) the following new paragraph:

"(14) TANGIBLE PROPERTY HELD FOR PERSONAL USE.—Of debt obligations arising out of the sale of tangible property located outside the United States which was held for his personal use by the person acquiring such obligation."

(f) CERTAIN FOREIGN BRANCHES ENGAGED IN THE COMMERCIAL BANKING BUSINESS WHICH ARE MEMBERS OF FOREIGN STOCK EXCHANGES.—

(1) Section 4914(b)(2) is amended by adding at the end thereof (after and below subparagraph (B)) the following new sentence:

"Stock or debt obligations acquired by a foreign branch of a corporation, in connection with its banking business, shall be considered debt obligations described in subparagraph (A) of the preceding sentence if—

"(i) such branch is engaged in the commercial banking business and is also a member of a foreign stock exchange all the members of which on June 29, 1965, were banks,

"(ii) on July 18, 1963, such branch was so engaged and was such a member,

"(iii) such stock or debt obligations would not (but for this sentence) be excludable under the preceding sentence, and

"(iv) at the time of such acquisition, such branch does not hold stock and debt obligations described in clause (iii) which have an adjusted basis in excess of 3 percent of the deposits of the customers (other than deposits of United States persons engaged in the commercial banking business and members of an affiliated group (determined under section 48(c)(3)(C)) of which such a United States person is a member) of such branch payable in the currency of the country in which such branch is located."

76 Stat. 969. 26 USC 48.

78 Stat. 813. 26 USC 4914.

(2) Section 4914(j)(2) is amended by adding at the end thereof the following new sentence: "For purposes of this chapter, if, after July 18, 1963, a United States person sells or otherwise disposes of stock or a debt obligation to the acquisition of which the last sentence of subsection (b)(2) applied, such person shall not, with respect to that stock or debt obligation, be considered a United States person."

(3) The amendments made by this subsection shall apply to acquisitions made after July 18, 1963.

(g) Certain Current Designations by Insurance Companies.—Section 4914(e)(3)(B) is amended to read as follows:

"(B) Current designations to maintain fund.—

"(i) In general.—To the extent permitted by subparagraph (E), stock of a foreign issuer or a debt obligation of a foreign obligor acquired by an insurance company after July 18, 1963, may be designated as part of a fund of assets described in paragraph (2), if such designation is made before the expiration of 30 days after the date of such acquisition and the company continues to own the stock or debt obligation until the time the designation is made; except that any such stock or debt obligation acquired before the initial designation of assets to the fund is actually made as provided in subparagraph (A)(ii) may be designated under this clause at the time of such initial designation without regard to such 30-day and continued ownership requirements.

"(ii) Certain debt obligations having maturity of less than 3 years.—A debt obligation having a period remaining to maturity (on the date of acquisition) of at least 1 year but less than 3 years, which is acquired during the period beginning February 11, 1965, and ending on the date of the enactment of the Interest Equalization Tax Extension Act of 1965, may be designated as part of a fund of assets described in paragraph (2) on or before the 30th day after the date of such enactment (or at such later time as the Secretary or his delegate may by regulations prescribe) without regard to the 30-day and continued ownership requirements provided in clause (i)."

(h) Acquisitions by Certain Tax-Exempt Organizations.—

(1) Section 4914(f) is amended by adding at the end thereof (after and below paragraph (2)) the following new sentence: 78 Stat. 813. 26 USC 4914.
"For purposes of this subsection, stock or debt obligations acquired as a result of the investment or reinvestment of such contributions or fees which consist of insurance premiums (other than premiums paid to a mutual insurance company or association described in section 501(c)(15)) paid by the members of such local organizations shall be treated as held exclusively for the benefit of such members if primarily so held, notwithstanding that such stock or debt obligations may, under certain contingencies, be used for the benefit of other members of such United States person." 68A Stat. 165. 26 USC 501.

(2) The amendment made by paragraph (1) shall apply with respect to acquisitions of stock and debt obligations made after July 18, 1963.

(i) Exclusion for Investments in Less Developed Country Partnerships.—Section 4916(c)(1) is amended by adding at the end thereof the following new sentence: "A foreign partnership, as defined in section 7701(a)(2) and (5), the assets and gross income of which, for the applicable periods set forth in paragraph (3), satisfy the requirements of subparagraph (A) or (B) of the first sentence of this paragraph, shall be treated as a less developed country corporation for purposes of this section." 26 USC 4916. 68A Stat. 913.

(j) Notice of Acquisition for Exclusion of Original or New Issues.—Section 4917 is amended— 26 USC 4917.

(1) by adding at the end of subsection (a) the following new sentence: "In the case of acquisitions of debt obligations having a period remaining to maturity of 1 year or more but less than 3 years made during the period beginning February 11, 1965, and ending with the date of the enactment of the Interest Equalization Tax Extension Act of 1965, the notice of acquisition may be filed within such period following the date of such enactment as the Secretary or his delegate may prescribe by regulations."; and

(2) by adding at the end of such section the following new subsection:

"(d) Reduction of Exclusion in Case of Late Filing of Certain Notices of Acquisition.—If, with respect to an acquisition after the date of the enactment of the Interest Equalization Tax Extension Act of 1965 of stock or a debt obligation which is all or part of an original or new issue to which an Executive order issued under subsection (a) is applicable (other than an Executive order which is applicable to a limited aggregate amount of such issues), the notice of acquisition required by subsection (a) is not filed on or before the last day (including extensions of time) specified in the regulations prescribed by the Secretary or his delegate under such subsection, the exclusion provided by such Executive order shall not apply to 5 percent of such acquisition for each 30-day period or fraction thereof after such last day during which such failure continues, except that in no event shall such exclusion be reduced under this subsection by more than 25 percent of such acquisition."

(k) Consideration of Treaty Violations in Connection With Exclusion for Original or New Issues.—Section 4917 is amended by adding after subsection (d) (as added by subsection (j) of this section) the following new subsection:

"(e) Fulfillment of Treaty Obligations.—In determining whether to issue an Executive order under subsection (a) with respect to a foreign country, and in determining whether to revoke or modify an Executive order issued under subsection (a) with respect to a foreign country (whether issued before or after the enactment of this subsection), the President may take into account whether such foreign country is according privileges to United States persons in conformity with treaties of friendship, commerce, and navigation between the United States and such foreign country."

(l) CREDIT OR REFUND FOR SALES OF STOCK BY DEALERS TO FOREIGN PERSONS.—

78 Stat. 833. 26 USC 4919.

(1) Section 4919(a)(3) is amended to read as follows:

"(3) CERTAIN STOCK.—Consist of stock—

"(A) acquired by a dealer in the ordinary course of his business and sold by him on the day of purchase or on either of the two succeeding business days to—

"(i) persons other than United States persons, or

"(ii) another dealer who resells it on the same or the next business day to persons other than United States persons; or

"(B) acquired by a dealer in the ordinary course of his business to cover short sales made by him on the day of purchase or on either of the two preceding business days to—

"(i) persons other than United States persons, or

"(ii) another dealer who resold it on the same or the next business day to persons other than United States persons."

(2) Section 4919(b)(3) is amended by striking out the heading and inserting in lieu thereof "CERTAIN SALES BY DEALERS.—".

(3) Section 4919(b)(3)(B) is amended—

(A) by striking out "with respect to a debt obligation sold in a transaction" and inserting in lieu thereof "with respect to a sale";

(B) by striking out "a debt obligation" each place it appears in clauses (i) and (ii) and in the matter which follows and inserting in lieu thereof "stock or a debt obligation";

(C) by striking out "such debt obligation" each place it appears in the matter which follows clause (ii) and inserting in lieu thereof "such stock or debt obligation"; and

(D) by inserting "or (a)(3)" after "subsection (a)(2)" each place it appears.

(m) COMMERCIAL FINANCING.—

26 USC 4920.

(1) Section 4920(a) is amended by inserting after paragraph (5) the following new paragraph:

"(5A) CERTAIN COMMERCIAL FINANCING BRANCHES NOT TREATED AS DOMESTIC CORPORATIONS.—The term 'domestic corporation' does not include a branch office of such a corporation located outside the United States if—

76 Stat. 969. 26 USC 48.

"(A) such corporation is primarily engaged in the trade or business of acquiring debt obligations (i) arising out of the sale of tangible personal property produced, manufactured, or assembled by one or more includible corporations in an affiliated group (determined under section 48(c)(3)(C) except that clause (i) of such section shall not apply) of which such acquiring corporation is a member and (ii) arising out of the sale of tangible personal property received as part or all of the consideration in sales of tangible personal property described in clause (i);

"(B) such office is primarily engaged in the trade or business of acquiring debt obligations described in subparagraph (A) which are repayable exclusively in one or more currencies other than United States currency;

"(C) such office was located outside the United States on February 10, 1965, and was regularly engaged in the trade or business of acquiring debt obligations described in subparagraph (B) for a period of not less than 12 consecutive months before February 10, 1965;

"(D) such office maintains separate books and records reasonably reflecting the assets and liabilities properly attributable to such office; and

"(E) there is in effect an election that such branch office be treated as a foreign corporation for purposes of this chapter.

For purposes of this paragraph, a corporation or a branch office shall be treated as primarily engaged in the trade or business described in subparagraph (A) during the taxable year if at least 90 percent of the face amount of the debt obligations acquired by such corporation or branch office during such taxable year consists of debt obligations described in subparagraph (A) and if throughout such taxable year such corporation or branch office is exclusively engaged in the trade or business of acquiring debt obligations (whether or not described in subparagraph (A)) and servicing debt obligations arising out of sales of tangible personal property described in subparagraph (A). The election under this paragraph shall be made by such corporation in accordance with regulations prescribed by the Secretary or his delegate. A separate election may be made with respect to each branch office of such corporation except that, for purposes of this paragraph, all branch offices of such corporation located in a country shall be treated as a single branch office. Such election shall be effective as of February 10, 1965, and shall remain in effect until revoked in accordance with such regulations. If, at any time, such corporation ceases to meet the requirements of subparagraph (A), all elections made by such corporation under this paragraph shall be deemed revoked. If, at any time, a branch office (within the meaning of this paragraph) ceases to meet the requirements of subparagraph (B) or (D), the election with respect to such office shall thereupon be deemed revoked. When an election is revoked, a new election under subparagraph (E) may be made subject to such conditions and limitations as may be prescribed by the Secretary or his delegate."

(2)(A) Section 4920(a)(5) is amended by adding at the end thereof the following new sentence: "A corporation or partnership making an election under this paragraph or paragraph (5A) with respect to a branch office located outside the United States shall not, at any time, execute a certificate of American ownership (within the meaning of section 4918) either with respect to stock or a debt obligation of a foreign issuer or obligor held by such branch office at the time the election is made with respect to such branch office or with respect to stock or a debt obligation of a foreign issuer or obligor acquired by such branch office while the election with respect to such branch office is in effect." 78 Stat. 835. 26 USC 4920. 26 USC 4918.

(B) The amendment made by subparagraph (A)—

78 Stat. 835. 26 USC 4920. (i) insofar as it relates to elections made under section 4920(a)(5), shall apply to dispositions made after June 28, 1965; and

(ii) insofar as it relates to elections made under section 4920(a)(5A), shall apply to dispositions made after February 10, 1965.

26 USC 4912. (3) Section 4912(b)(2)(B) is amended—

(A) by striking out "section 4920(a)(5)(E)" and inserting in lieu thereof "paragraph (5) or (5A) of section 4920 (a)"; and

(B) by inserting "(including, in the case of a transfer to a branch office described in section 4920(a)(5A), a transfer made for consideration)" after "money or other property" where it first appears.

(n) FOREIGN STOCK ISSUES TREATED AS DOMESTIC.—Section 4920 is amended—

(1) by striking out paragraph (8) of subsection (a),

(2) by redesignating subsections (b) and (c) as subsections (c) and (d), respectively, and

(3) by inserting after subsection (a) the following new subsection:

"(b) FOREIGN STOCK ISSUES TREATED AS DOMESTIC.—

"(1) IN GENERAL.—For purposes of this chapter, a foreign corporation (other than a company registered under the Invest-

54 Stat. 789. ment Company Act of 1940) shall not be considered a foreign

15 USC 80a-51. issuer with respect to any class of its stock if—

"(A) as of the corporation's latest record date before July 19, 1963, more than 65 percent of such class of stock was held of record by United States persons, or

"(B) the class of stock had its principal market during the calendar year 1962 on one or more national securities exchanges registered with the Securities and Exchange Commission, and, as of the corporation's latest record date before July 19, 1963, more than 50 percent of such class of stock was held of record by United States persons.

"(2) CLASS OF STOCK DEFINED.—For purposes of this subsection, the term 'class of stock' means all shares of stock of a corporation issued and outstanding as of the corporation's latest record date before July 19, 1963, which are identical with respect to the rights and interest such shares represent in the control, profits, and assets of the corporation. Such term also includes additional shares possessing rights and interests identical with the rights and interests of shares described in the preceding sentence if such additional shares shall have been—

"(A) issued on or before November 10, 1964;

"(B) issued after November 10, 1964, pursuant to a written commitment made by such corporation on or before such date;

"(C) issued after November 10, 1964, to a shareholder with respect to or in exchange solely for shares described in this paragraph; or

"(D) issued after November 10, 1964, and if—

"(i) such corporation was actively engaged in a trade or business on July 19, 1963;

"(ii) shares of such class were held of record by more than 250 shareholders on the corporation's latest record date before July 19, 1963;

"(iii) the percentage of shares of such class held of record by United States persons as of the corporation's latest record date before the issuance of such additional shares is not less than the percentage required to be held by United States persons as of the latest record date before July 19, 1963, in order for the class of stock to qualify under paragraph (1);

"(iv) all such additional shares are shares which, if acquired by United States persons at the time of original issuance, would have been excluded from the tax imposed by section 4911 by reason of section 4914(a)(6), 4916, 78 Stat. 809.

or 4917, or are shares exchanged in a reorganization 26 USC 4911,

described in section 368(a)(1)(B) for shares of a domes- 4914, 4916,

tic corporation which was engaged in the active conduct 4917.

of a trade or business (other than as a dealer in securities) 68A Stat. 120.

immediately before the date of such exchange; and 26 USC 368.

"(v) at least 15 days before the date such additional shares are issued (or, in the case of an issue occurring on or before the 60th day after the date of the enactment of this sentence, within such period as may be prescribed by the Secretary or his delegate by regulations), the issuing corporation files (in accordance with regulations prescribed by the Secretary or his delegate) a notice of intent to issue such shares.

For purposes of subparagraph (D), the issuance of an option or similar right to acquire stock, or of any debt obligation convertible into stock, shall be treated as the issuance of the stock which may be obtained on the exercise of such option or similar right or the conversion of such debt obligation."

(o) COMMERCIAL BANK LOANS.—

(1) Paragraph (2) of the subsection of section 4931 redesignated as subsection (c) by section 3(e) of this Act is amended by Ante, p.955.

striking out "(other than banks)" each place it appears and inserting in lieu thereof "(other than United States persons engaged in the commercial banking business and members of an affiliated group (determined under section 48(c)(3)(C)) of 76 Stat. 969.

which such a United States person is a member)". 26 USC 48.

(2) The last sentence of section 4931(c) (as enacted on September 2, 1964) is amended by striking out ", except that, for 78 Stat. 839.

such purposes, the provisions of section 4918 shall not apply". 26 USC 4918.

(p) DEDUCTIBILITY OF INTEREST EQUALIZATION TAX.—

(1) Section 263(a)(3) is amended to read as follows:

"(3) Except as provided in subsection (d), any amount paid 78 Stat. 845.

as tax under section 4911 (relating to imposition of interest 26 USC 263.

equalization tax)."

(2) Section 263 is amended by adding at the end thereof the following new subsection:

"(d) REIMBURSEMENT OF INTEREST EQUALIZATION TAX.—The deduction allowed by section 162(a) or 212 (whichever is appropriate) 68A Stat.45,69.

shall include any amount paid or accrued in the taxable year or a 26 USC 162.

preceding taxable year as tax under section 4911 (relating to imposi- 26 USC 212.

tion of interest equalization tax) to the extent that any amount attributable to the amount paid or accrued as tax is included in gross income for the taxable year. Under regulations prescribed by the Secretary or his delegate, the preceding sentence shall not apply with respect to any amount attributable to that part of the tax so paid or accrued which is attributable to an amount for which a deduction has been claimed for the taxable year or a preceding taxable year under section 171 (relating to amortization of bond premium)."

68A Stat. 61. 26 USC 171.

(3) The amendments made by this subsection shall apply to taxable years ending after September 2, 1964.

(q) EFFECTIVE DATE.—Except as otherwise specifically provided in this section and in the amendments made by this section, such amendments shall apply with respect to acquisitions of stock and debt obligations made after February 10, 1965. Executive Order 11198, issued February 10, 1965, to the extent it is inconsistent with the amendments made by this section, shall be deemed modified by such amendments.

30 F. R. 1929.

SEC. 5. PREEXISTING COMMITMENTS.

(a) CERTAIN COMMITMENTS EXISTING ON OR BEFORE JULY 18, 1963.—Section 2(c)(2)(B) of the Interest Equalization Tax Act is amended to read as follows:

78 Stat. 841. 26 USC 4911 note.

"(B) as to which on or before July 18, 1963, the acquiring United States person (or, in a case where 2 or more United States persons are making acquisitions as part of a single transaction, a majority in interest of such persons) had taken every action to signify approval of the acquisition under the procedures ordinarily employed by such person (or persons) in similar transactions, subject only to the execution of formal documents evidencing the acquisition and to customary closing conditions, and the acquiring United States person (or persons)—

"(i) had sent or deposited for delivery to the foreign person from whom the acquisition was made written evidence of such approval in the form of a commitment letter, memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the foreign person from whom the acquisition was made which set forth, the principal terms of such acquisition, or

"(ii) had received from the foreign person from whom the acquisition was made a memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the acquiring United States person (or persons) which set forth, the principal terms of such acquisition;".

(b) CERTAIN DEBT OBLIGATIONS OF FORMER LESS DEVELOPED COUNTRIES.—The tax imposed by section 4911 of the Internal Revenue Code of 1954 shall not apply to the acquisition by a United States person of a debt obligation issued by the government of a foreign country which has been designated as an economically less developed country under an Executive order of the President in effect for purposes of the tax imposed by section 4911, but with respect to which such designation has been terminated before the enactment of this Act, if, prior to such acquisition, the Secretary of State has certified to the Secretary of the Treasury or his delegate that—

78 Stat. 809. 26 USC 4911.

(1) the government of such foreign country had, on or before April 6, 1965, communicated to the United States Department of State its intention to issue such debt obligation;

(2) the government of such foreign country had, on or before April 6, 1965, commenced negotiations with United States persons relative to the issuance of such debt obligation; and

(3) exemption from the tax imposed by section 4911 of the Internal Revenue Code of 1954 on the acquisition of such debt obligation by a United States person is in the best interests of the United States.

78 Stat. 809. 26 USC 4911.

SEC. 6. USE OF FOREIGN CURRENCIES OWNED BY THE UNITED STATES.

(a) Under the direction of the President, the Secretary of the Treasury shall periodically ascertain, by country, the amount of funds required by the United States Government to pay its obligations in foreign countries, including obligations payable in foreign currencies.

(b) Every international agreement (other than an agreement entered into pursuant to title I of the Agricultural Trade Development and Assistance Act of 1954, as amended (Public Law 480, 83d Congress)) hereafter entered into, or hereafter amended or extended, between the United States and any foreign country under which currency of such country accrues or will accrue for the use of the United States shall include provisions that such currency may be used for paying United States obligations in such country which may be paid in such currency, and if not needed for such purpose may be used, or converted to other foreign currencies or to dollars for use, in paying United States obligations in any foreign country, in such amounts as the Secretary of the Treasury considers necessary for the requirements of the United States.

68 Stat. 454. 7 USC 1701-1709.

(c) The Secretary of the Treasury shall submit a report annually to the Senate Committee on Finance and the House Committee on Ways and Means which shows, by executive agencies and by countries, (1) the expenditures in dollars and in foreign currencies made during the preceding fiscal year in paying the obligations of the United States in foreign countries, (2) the amounts of foreign currencies available for the use of the United States at the close of such year, and (3) the amounts of foreign currencies convertible to other foreign currencies or to dollars at the close of such year.

Report to congressional committees.

(d) This section shall terminate at the time when the tax imposed by section 4911 of the Internal Revenue Code of 1954 terminates.

Approved October 9, 1965, 6:25 a.m.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 602 (Comm. on Ways & Means) and No. 988 (Comm. of Conference).
SENATE REPORT No. 621 (Comm. on Finance).
CONGRESSIONAL RECORD, Vol. 111 (1965):
Aug. 5: Considered and passed House.
Aug. 24: Considered and passed Senate, amended.
Sept. 16: House agreed to conference report.
Sept. 20: Senate agreed to conference report.

DIGEST OF TESTIMONY PRESENTED AND STATEMENTS SUBMITTED TO THE COMMITTEE ON WAYS AND MEANS WITH RESPECT TO H.R. 8000

("INTEREST EQUALIZATION TAX ACT OF 1963")

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

BY THE STAFF OF

THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

OCTOBER 21, 1963

U.S. GOVERNMENT PRINTING OFFICE

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INTRODUCTION

On August 20, 21, 22, and 23, 1963, the Committee on Ways and Means held public hearings on H.R. 8000, the "Interest Equalization Tax Act of 1963."

This digest attempts to summarize the arguments advanced for and against the bill. In general, the arguments advanced for the bill are summarized in section I, and the arguments advanced against the bill are summarized in section II. Recommendations for basic modification of the bill are summarized in section III, while more specific recommendations are set forth in a section-by-section analysis in section IV. Finally, specific alternative recommendations made by witnesses are summarized in section V.

An attempt has been made to summarize generally all arguments and recommendations; however, if some testimony has been omitted, it was unintentional. For detailed statements presented by witnesses and by those whose statements were submitted for the record, it is necessary to refer to the printed hearings.

CONTENTS

		Page
I.	Summary of testimony recommending enactment of H.R. 8000	1
II.	Summary of testimony against enactment of H.R. 8000	4
III.	Summary of testimony recommending basic modifications of H.R. 8000	8
	A. Acquisitions which have no adverse effect on the U.S. balance-of-payments positions should be exempt from tax	8
	B. H.R. 8000 should not apply to purchases of outstanding securities	10
	C. H.R. 8000 should not apply to new issues of stock	12
	D. H.R. 8000 should not apply to Canadian securities	13
	E. Any transaction which is directly related to the active conduct of a trade or business abroad should be exempt from tax	13
IV.	Section-by-section arrangement of comments	14
V.	Alternative proposals	29

I. SUMMARY OF TESTIMONY RECOMMENDING ENACTMENT OF H.R. 8000

Comments	Name of witness
A. Reasons for imposition of an interest equalization tax: (1) Imposition of the tax will reduce the immediate strains placed on the U.S. balance-of-payments position by an increased outflow of long-term portfolio capital from this country. (*a*) In recent years there has been an increase in the U.S. balance-of-payments deficit position on regular transactions.	Treasury Department. American Federation of Labor and Congress of Industrial Organizations. Smith, Kline & French Overseas Co.

Year	Deficit on "regular transactions" (approximate amount in billions)
1961	\$3
1962	3½
1963 (annualized)	4

(*b*) The increased deficit on regular transactions is due almost entirely to the accelerating outflow of long-term portfolio capital into new issues of foreign securities.

Year	Increase in U.S. purchases of new foreign securities over preceding year (millions)
1962	\$553
1963 (annualized)	[1] 875

[1] Estimated.

Comments	Name of witness
(2) The tax should bring the cost of capital raised by foreigners in the U.S. market into closer alinement with costs prevailing in the markets of most other industrialized countries.	
(a) The major reason foreigners have increased their borrowings in New York has been the ready availability of funds at a relatively low interest rate, rather than a pressing need for capital from outside the borrower's own country.	
(b) Foreign governments have recently been borrowing substantially more in the United States than they did in earlier years. Moreover, there has been a sudden rise in sales of new issues by foreign corporations.	
(3) Imposition of the tax will give the United States time to make fundamental adjustments in other areas.	
(a) Action has been taken to reduce the rate of Government oversea spending by $1 billion within the next 18 months.	
(b) The tax program (H.R. 8363) will not be immediately effective in reducing the U.S. balance-of-payments deficit.	
(4) Imposition of the tax will encourage other industrialized countries to develop their own capital markets.	
B. Reasons for principal exemptions and exclusions from tax.	
(1) Short-term capital:	
(a) Imposition of the tax on short-term capital could impede the normal flow of commerce.	
(b) Shifts of short-term funds in response to interest rate differentials cannot readily be distinguished from other commercial transactions.	
(2) Direct investments in 10-percent-owned subsidiaries:	
(a) In making such investments, questions of market position and long-range profitability outweigh any concern over interest rate differentials.	
(3) Investments in less-developed countries:	

Comments	Name of witness
(a) There should be no impediment to the flow of private capital to nations with capital shortages and urgent development needs.	
(4) Authorization to exclude certain new issues:	
(a) The President's authority under this provision should be exercised only in response to highly unusual circumstances.	Department of State.
(b) Under existing cirsumstances, the exemption should apply only in the case of Canada. However, the provision should not be amended by specifically enumerating the countries to be eligible for the exclusion or by limiting more narrowly the President's discretion to grant the exclusion.	
(5) Export credit	
(a) Imposition of the tax should not adversely affect U.S. exports. However, consideration should be given to the effect of the tax on Webb-Pomerene-type associations, export merchants, and "turnkey" arrangements.	Department of Commerce.
C. Reasons for rejecting alternative proposals.	
(1) A sharp rise in long-term interest rates would reduce both domestic and foreign borrowing. Such a proposal would increase domestic unemployment and jeopardize the prospects for restoring lasting balance in our international accounts.	
(2) The balance-of-payments problem cannot be met simply by exercising the moral force of Government leadership and persuasion. Firm legal guidelines and discipline of market forces are required to reinforce these efforts.	
(3) The effectiveness of the tax would be sharply reduced if outstanding securities were excepted from the tax.	
(a) In 6 of the past 10 years there has been a drain on the U.S. balance-of-payments position from the purchases of outstanding foreign stocks by U.S. persons. The drain amounted to $326 million in 1961.	
(4) Exemption of new issues of stocks from tax would impair the effectiveness of the tax.	
(a) Bonds and stocks represent alternative sources of funds and it would be inconsistent to tax foreign access to one market and not the other.	

II. SUMMARY OF TESTIMONY AGAINST ENACTMENT OF H.R. 8000

Comments	Name of witness or association
H.R. 8000 should not be enacted in any form for the following reasons:	
(1) Private foreign investment improves the overall asset position of the United States. This will, in the future, aid the U.S. balance-of-payments position as a result of receipt of interest, dividends, and return of capital.	Investment Bankers Association of America. Morgan Stanley & Co. National Association of Security Dealers, Inc. Smith, Barney & Co.

Summary of recent capital flows resulting from previous foreign investments

Year	Net outflow for new investment by U.S. persons (millions)	Income from all foreign private investment (millions)
1958–62	$16,626	$15,419
1962	3,273	3,850

Source: Testimony of Investment Bankers Association, p. 220.

Comments	Name of witness or association
(2) The fundamental cause of the U.S. balance-of-payments deficit position is the expenditure of U.S. military and foreign aid abroad.	International Economic Policy Association. Investment Bankers Association. Paul D. Seghers. Robert G. Strachan.
(a) The military account in Europe is running at a deficit of probably $800 to $900 million annually. Total foreign military outpayments total approximately $2.4 billion annually.	International Economic Policy Association.
(3) Security transactions, particularly with Western Europe, result in nominal balance-of-payments leakage.	International Investment Analysts. Investment Bankers Association. Investors Diversified Services.

Summary of recent capital transactions with Europe

Year	Excess of European purchases of U.S. securities over U.S. purchases of European securities (millions)
1958–62	$280
1963 (5 months)	(23)

Source: Testimony of Investment Bankers Association, pp. 221, 222.

Comments	Name of witness or association
(4) H.R. 8000 will not make a significant contribution toward reduction of the U.S. balance-of-payments deficit.	Burnham & Co. Investment Bankers Association. Investors League, Inc. Model, Roland & Co. Morgan Stanley & Co. International Bond & Share, Inc. International Investment Analysts. Smith, Barney & Co.
(a) Because of various exceptions and exclusions, H.R. 8000 would, at a maximum, effect a reduction of approximately $300,000,000 annually in the U.S. balance-of-payments deficit:	

Net recorded purchases of foreign securities by U.S. institutions, citizens, and residents

(Millions)

	1958	1959	1960	1961	1962	1963 (5 months)
Total purchases of stocks and bonds	$1,362.5	$749.7	$644.7	$830.4	$1,047.9	$585.9
Exclusion for international institutions		156.6	147.0	1.3	165.3	119.4
Total		593.1	497.7	831.7	882.6	466.5
Other exclusions and exemptions			381.2	519.7	583.5	370.0
Amount subject to tax			116.5	312.0	299.1	96.5

Source: Testimony of International Investment Analysts, p. 297.

II. SUMMARY OF TESTIMONY AGAINST ENACTMENT OF H.R. 8000—Continued

Comments	Name of witness or association
H.R. 8000, etc.—Continued	
(b) Foreign borrowers may switch from long-term debt and equity financing to short-term or bank-loan financing as a means of avoiding the tax.	Burnham & Co. International Bond & Share, Inc. International Investment Analysts. Investment Bankers Association. Model, Roland & Co. Morgan Stanley & Co. B. F. Pitman, Jr. Smith, Barney & Co. Stein Roe & Farnham.
(c) Due to the fact interest rate differentials between countries are not uniform, some foreign borrowers will find it cheaper to borrow in the United States and pay the interest equalization tax than pay the interest rates applicable to loans made in foreign countries.	Hon. John A. Burns, Governor of the State of Hawaii. Machinery & Allied Products Institute. B. F. Pitman, Jr. United States Trust Co. of New York.
(d) If an investment decision is based upon current rate of return, the bill may have some effect; however, if the motive is to participate in growth situations, the tax will have no appreciable influence on investment decisions.	International Economic Policy Association.
(5) Enactment of H.R. 8000 may cause an increase in the U.S. balance-of-payments deficit.	Bache & Co. Carl Marks & Co. International Bond & Share, Inc. Madison Fund, Inc. Wertheim & Co.
(a) Enactment of H.R. 8000 will lessen confidence in the dollar— (i) Foreigners may sell their holdings of U.S. securities.	Burnham & Co. International Investment Analysts. Investment Bankers Association. Investors Diversified Services. Model, Roland & Co. Morgan Stanley & Co. National Association of Security Dealers, Inc.

	New York Chamber of Commerce. Smith, Barney & Co. J. R. Timmins & Co. United States Trust Co. of New York.
(ii) Long-term borrowers who seek to make loans in a weak currency will be encouraged to make U.S. dollar loans. Investors fearing devaluation of the dollar will continue to invest in foreign securities.	International Economic Policy Association. B. F. Pitman, Jr.
(iii) A dual price structure on securities will indicate a weakness of the dollar.	Investment Bankers Association. Investors Diversified Services. Smith, Barney & Co. Stein Roe & Farnham.
(b) U.S. exports which are tied to U.S. borrowings will decline.	American Life Convention & Life Insurance Association of America. Bank of Hawaii. Investment Bankers Association. Investors Diversified Services. Japan Bond Underwriters Association. Japan Federation of Securities Dealers' Association. Kidder, Peabody & Co. Morgan Stanley & Co. National Association of Manufacturers. Raymond Rodgers. Smith, Barney & Co. United States Trust Co. of New York.
(c) Foreign countries may retaliate. For example, Japan may impose restrictions on importation of U.S. goods and limit foreign travel of its citizens.	American Life Convention & Life Insurance Association of America. Bank of Hawaii. Hon. John A. Burns, Governor of the State of Hawaii. First National Bank of Hawaii, Henry J. Clay. Hon. Hiram J. Fong, U.S. Senator from the State of Hawaii. Machinery & Allied Products Institute. Madison Fund, Inc. New York Chamber of Commerce. Pineapple Growers Association of Hawaii. Raymond Rodgers. J. R. Timmins & Co.

Comments	Name of witness or association
A. Acquisitions which have no adverse effect on the U.S. balance-of-payments position should be exempt from tax.	Cravath, Swaine & Moore. Morgan Stanley & Co. J. R. Timmins & Co.
(1) U.S. persons who own foreign securities should be permitted to switch from one foreign security to another foreign security without imposition of a tax.	
(a) Provision should be made to permit dollar amounts received from the sale of foreign securities by U.S. persons to foreign persons to be reinvested in foreign securities by the U.S. person making the sale or any other U.S. person without imposition of a tax. Such transactions have no net effect on the U.S. balance-of-payments position.	American Institute of Certified Public Accountants. Carl Marks & Co. Henry J. Clay. International Investors, Inc. National Association of Security Dealers, Inc.
(b) Allowance should be made to permit a U.S. person to switch his investment in foreign securities from one investment to another without imposition of a tax.	Burnham & Co. Investment Company Institute. Morgan Stanley & Co. National Association of Manufacturers. J. R. Timmins & Co. Wertheim & Co.
(i) Switching in this manner would have no net effect on the U.S. balance-of-payments position.	Burham & Co.
(ii) By limiting the switch privilege to the person selling a security, the exemption would not be interpreted as a form of devaluation of the dollar for the following reasons: (a) The switch transactions would primarily be accomplished in foreign currencies; therefore, the U.S. dollar would not be affected. (b) By prohibiting the transfer of "investment dollars," the approach would be consistent with that followed by Japan when, until Apr. 1, 1963, it required that proceeds from the sale of securities acquired with a permit from the Japanese authorities be retained in Japan. Limitation of the switch privilege to the person who sold a foreign security would avoid the creation and marketability of "investment dollars". Multiple rate situations occurred in the United Kingdom, Germany, France, and the Netherlands only because a form of investment dollar was freely transferable.	Burnham & Co.
(2) Security transactions resulting in the financing of exports should be exempted.	Investment Bankers Association. Kidder, Peabody & Co. Smith, Barney & Co. Morgan Stanley & Co.
(a) The Treasury figures for the first half of 1963 show U.S. purchases of Western European securities amounting to $205 million. During this period, Morgan Stanley & Co. managed or comanaged Western European issues totaling $172.5 million. Approximately, $160 million of the proceeds of these financings were spent in the United States and did not affect the U.S. balance of payments. A simple procedure could be established to insure that such funds do not leave the United States, in which case such transactions should be exempt from tax.	
(3) Domestic insurance companies operating abroad should be allowed to invest premiums collected abroad in foreign securities without payment of the tax.	American Life Convention & Life Insurance Association of America.
(*a*) Premiums must be invested in the currency of the country in which collected, since it is generally unsound to force an insurance company to assume the exchange risk of converting premiums to dollars for investment purposes and then back to a foreign currency for payment purposes.	
(4) Labor unions operating abroad should be allowed to invest union dues collected abroad in foreign securities without payment of the tax.	American Federation of Labor & Congress of Industrial Organizations. Brotherhood of Railroad Trainmen.
(5) Purchase of foreign securities by U.S. citizens abroad should be exempt from tax.	U.S. Council of the International Chamber of Commerce, Inc.
(*a*) Purchase of stock by an employee under an employer-sponsored purchase plan should be exempt.	Standard Oil Co. (New Jersey). U.S. Chamber of Commerce.
(*b*) Exemption could be limited to persons who are bona fide residents abroad.	Canadian Husky Oil, Ltd. Standard Oil Co. (New Jersey).
(*c*) Acquisition of stock options, or acquisition of stock pursuant to the exercise of a stock option, by a U.S. person who is an employee of the issuing corporation, its parent or its subsidiaries, should be exempt from tax if the option is acquired in connection with his employment and the stock is acquired without an intent of offering the stock for sale to a U.S. person.	Canadian Husky Oil, Ltd. Roberts & Holland.

Comments	Name of witness or association
Acquisition, etc.—Continued	
(6) Foreign subsidiaries of U.S. parent corporations should be permitted to borrow U.S. dollars free of tax if the proceeds of the loan are to be returned to the United States through the retirement of an outstanding loan with the U.S. parent.	B. F. Goodrich Co.
(7) Investments in foreign corporations having 80 percent or more of their assets invested in U.S. property should be fully exempt from tax.	Roberts & Holland.
(8) Acquisition of foreign securities by domestic corporations whose stock is more than two-thirds owned by foreigners should be exempt from tax due to the fact— (i) there is no dollar drain since the funds invested were originally derived from foreign sources; (ii) the exemption would apply only to reinvestment of proceeds of sales of foreign securities; and (iii) the United States would lose the 30 percent withholding tax and tax on capital gains if the domestic corporation reincorporated as a foreign corporation.	International Holdings Co.
(9) Trading in stock of a foreign corporation should be exempt from tax so long as the foreign corporation invests an amount in the United States equal to the dollar value of its stock held by Americans.	Carling Brewing Co.
(10) Arbitrage transactions should be permitted without imposition of tax if the proceeds are reinvested by the arbitrageur within a stated period of time.	Smith, Barney & Co.
B. H.R. 8000 should not apply to purchases of outstanding securities.	Carl Marks & Co. New York Stock Exchange. Smith, Barney & Co. United States Council of the International Chamber of Commerce, Inc. Wertheim & Co.

Comments	Name of witness or association
(1) For 1962 and for the 1st half of 1963, acquisitions of outstanding foreign securities by U.S. persons has been approximately offset by acquisition of U.S. securities by foreigners. (2) Since 1950, foreigners have purchased more U.S. corporate securities than U.S. persons have purchased outstanding foreign securities:	Burnham & Co. International Investment Analysts. Investment Bankers Association. Madison Fund, Inc. Model, Roland & Co. Morgan Stanley & Co. National Association of Security Dealers, Inc. Stein Roe & Farnham. United States Trust Co. of New York. New York Stock Exchange.

Year	Net inflow of dollars to the United States (excluding net foreign purchases of U.S. governments) (millions)
1950	$(319)
1951	159
1952	171
1953	293
1954	120
1955	140
1956	181
1957	153
1958	(380)
1959	310
1960	105
1961	(8)
1962	79
1963 (1st quarter)	(19)
Total	935

1 Estimated.

Source: Testimony of New York Stock Exchange, p. 438.

III. SUMMARY OF TESTIMONY RECOMMENDING BASIC MODIFICATIONS OF H.R. 8000—Continued

Comments	Name of witness or association
B. H.R. 8000, etc.—Continued	
(3) Exemption for outstanding securities would not result in a switching of investments by U.S. persons from new to outstanding issues:	
(a) Unregistered securities may not be resold in the United States until foreign distribution has been completed.	Investment Bankers Association.
(b) Different type investors buy new as compared with outstanding issues. Institutional investors generally buy new issues while smaller investors generally buy outstanding issues.	Model, Roland & Co.
C. H.R. 8000 should not apply to new issues of stock.	Morgan, Stanley & Co.
(1) Dollar outflow from sales of new foreign stock issues has been a relatively small amount when compared with the outflow resulting from sales of bonds:	Stein Roe & Farnham.

[Millions]

	1960	1961	1962	1st quarter, 1963
Long-term loans by institutions	$200	$258	$248	($14)
New foreign bonds after deducting redemptions	459	364	832	456
New foreign stocks	14	36	74	25

Comments	Name of witness or association
(2) Exemption of stocks from the tax should not result in a switch of investment from bonds to stock for two reasons. First, many institutional investors who buy foreign debt obligations do not typically buy foreign equity securities and, second, many large foreign issuers have been public or quasi-public bodies which do not issue common stocks.	Do.

Comments	Name of witness or association
D. H.R. 8000 should not apply to Canadian securities.	
(1) The bill should not apply to acquisition of stock in foreign corporations which are 50 percent owned by U.S. persons if the stock is listed on a national stock exchange since trading in such stock does not adversely affect the U.S. balance-of-payments position.	International Nickel Corp.
(2) Acquisitions of all Canadian securities listed on a national stock exchange should be exempt from tax.	Do.
(a) This provision would add seven Canadian companies to those covered by item (1).	
(b) Trading of these shares since 1961 has resulted in a net inflow of dollars to the United States.	
(3) Acquisition of any Canadian security should be exempt from tax.	
(a) Canada has an unfavorable trade balance with the United States. For the years 1958–62, this deficit totaled just under $3 billion.	Investors League, Inc.
(b) For 1962 and the first 5 months of 1963, Canadians have been net purchasers of outstanding stock:	A. E. Ames & Co. Grace Canadian Securities, Inc. J. R. Timmins & Co.

	1962 (millions)	5 months, 1963 (millions)
Purchases by Canada from the United States	$554.7	$191.5
Sales by Canada to the United States	543.1	136.1
Total	11.6	55.4

Comments	Name of witness or association
E. Any transaction which is directly related to the active conduct of a trade or business abroad should be exempt from tax.	National Association of Manufacturers. National Foreign Trade Council, Inc. Raymond Rodgers. Standard Oil Co. (New Jersey). United States Council of the International Chamber of Commerce.
(1) Business loans are generally made as a result of competition with foreign companies and not because of interest return or other purely financial considerations.	

IV. SECTION-BY-SECTION ARRANGEMENT OF COMMENTS

Section 4911. Imposition of Tax

Subsection (a) imposes a tax on the acquisition by U.S. persons of debt obligations of foreign obligors. The rate of tax increases from 2.75 percent of actual value for obligations with maturities of at least 3 years but less than 3½ years to 15 percent for obligations with maturities exceeding 28½ years. The tax does not apply to debt obligations having a maturity of less than 3 years.

COMMENTS

See sections II and III.

* * * * *

The principle of interest equalization should be applied to U.S. controlled Euro-dollars.—Bache & Co.

* * * * *

A refund procedure should be available when a note is prepaid.—Association of the Bar of the City of New York.

* * * * *

The tax should not apply to an interest bearing note received by a U.S. person upon sales of assets by him to a foreigner under a deferred payment contract.—Martin D. Ginsburg.

* * * * *

Under certain circumstances it may be impossible to determine the duration of a loan at the time it is made. For example, if repayment is dependent upon percentage payments out of the proceeds of a banana crop, it is impossible to tell when a note will be paid.—United Fruit Co.

Subsection (b) imposes a tax on the acquisition of stock of a foreign issuer by a U.S. person. The tax is equal to 15 percent of the actual value of the stock.

COMMENTS

See sections II and III.

Subsection (c) provides that the person acquiring the security shall pay the tax.

NO COMMENTS

Subsection (d) provides that the tax shall not apply to acquisitions made after December 31, 1965.

NO COMMENTS

Section 4912. Acquisitions

Subsection (a), in general, defines the term "acquisition" to mean any purchase, transfer, distribution, exchange, or other transaction by virtue of which ownership of a foreign security is obtained by a U.S. person. An extension or renewal of an existing debt obligation is treated as a new obligation.

COMMENTS

The period remaining to maturity of a debt obligation should be measured from the date the loan is actually made rather than from the date the obligation becomes unconditionally binding on the parties.—National Association of Manufacturers.

* * * * *

Imposition of tax and maturity of a debt obligation should depend on the date funds are transferred rather than on the date the loan agreement becomes binding on the parties.—American Institute of Certified Public Accountants.

* * * * *

If an outstanding loan has a history of being renewed, or the parties to the loan contemplated that the agreement would be renewed at the time it was made, the tax should not be imposed if it is renewed.—National Foreign Trade Council, Inc.

Subsection (b) provides special rules.

Paragraph (1) of subsection (b) provides that transfers of money or other property to a foreign trust, partnership, or estate is taxable to the extent the foreign entity acquires stock or debt obligations of a foreign issuer or obliger.

COMMENTS

The tax should be based on the U.S. person's percentage share of the foreign obligations acquired by the foreign trust, partnership or estate rather than the total amount acquired. For example, if a foreign partnership invested $1,000 if its $10,000 capital in stock of a foreign corporation, and $9,000 in a manufacturing plant, the amount subject to tax in the hands of a 10 percent partner should be $100, not $1,000.—Association of the Bar of the City of New York.

* * * * *

The exemptions applicable to direct investments in 10 percent owned subsidiaries and investments in less developed country corporations should apply to U.S. persons taxed under this section in the same manner as if the investments were made directly.—Association of the Bar of the City of New York.

Paragraph (2) of subsection (b) provides that a transfer to capital of a corporation is to be treated as an acquisition of stock.

NO COMMENTS

Paragraph (3) of subsection (b) provides that acquisitions of foreign securities in connection with corporate reorganizations or distributions are considered as being acquired from the issuer or obligor of the foreign security.

COMMENTS

Exemption under this provision should not depend on receipt of a tax-free ruling under section 367 of the Internal Revenue Code as is implied from the Treasury Department technical explanation of the bill—Association of the Bar of the City of New York.

Section 4913. Limitation on Tax on Certain Acquisitions

Subsection (a) provides that tax at the time of the exercise of an option, or the extension or renewal of a debt obligation, is to be limited as provided in subsection (b).

COMMENTS

Exchanges in bankruptcy or insolvency situations should be exempt from tax.—Association of the Bar of the City of New York.

Subsection (b) provides that the tax on the exercise of an option, or extension or renewal of a debt obligation, is to be determined by reducing the tax payable under the general rule by the tax which would have been payable had the option or security surrendered been subject to tax immediately before the time of exercise, renewal, etc. In the case of certain defaulted Government obligations, the bill provides for their tax-free exchange.

NO COMMENTS

Section 4914. Exclusion for Certain Acquisitions

Subsection (a) provides, in general, that the tax shall not apply to the following transactions:

1. Transfers between a person and his nominee, custodian, or agent;
2. Certain transfers by operation of law;
3. Gifts and inheritances;
4. Distributions and exchanges of stock by a corporation to or with its shareholders; or
5. Conversion of debentures into stock.

COMMENTS

Provision should be made to exempt acquisitions by an existing shareholder under a subscription solely for the purpose of maintaining his proportionate equity.—Westinghouse Electric Corp.

Subsection (b) provides that the following U.S. persons are not subject to tax.

(1) Agencies and instrumentalities of the United States.

NO COMMENTS

(2) Commercial banks making loans in the ordinary course of their commercial banking business.

COMMENTS

Exemption should be limited to strictly commercial credit transactions or to the financing of specific export transactions.—Smith, Barney & Co.

* * * * *

The statute should specifically provide for exemption of foreign securities acquired by Edge Act corporations.—New York Clearing House.

(3) Exporters of U.S. goods are exempt from tax if the goods exported were manufactured, produced, extracted, or grown in the United States by the exporter or a related corporation. However, this exemption applies only if the debt obligation is held to maturity by the exporter or is transferred by him to a commercial bank or agency or instrumentality of the United States.

COMMENTS

Proceeds from the sale of any security should be exempt to the extent used to purchase goods or services from U.S. persons—Investment Bankers Association.

* * * * *

Exemption should apply to export transactions dealing wholly or in part with services since such services are almost inevitably a part of a transaction involving the sale of products—Machinery & Allied Products Institute.

* * * * *

Provision should be made to exclude debt obligations of a foreign issuer received by a foreign branch of a domestic corporation as a result of the sale of goods produced abroad by the foreign branch—Association of the Bar of the City of New York.

* * * * *

A U.S. exporter who undertakes to provide a purchaser with a complete operating facility should be allowed to receive debt obligations of the foreign issuer free of tax. Failure to provide exemption will place U.S. companies at a price disadvantage. Moreover, allocation of a portion of the purchase price of such contracts to U.S. manufactured goods could become hopelessly involved—Westinghouse Electric Corp.

* * * * *

"Turnkey" contracts (contracts where a U.S. manufacturer assumes responsibility for an entire project of which his equipment is only part) should be excepted from the tax—National Association of Manufacturers.

* * * * *

In order to be competitive with foreign contractors, the bill should be amended to exclude from tax debt obligations and stock received as compensation for services, material, machinery, equipment, construction, or any combination of them, performed, furnished, procured, or supplied by the U.S. person or his subcontractor—National Constructors Association.

* * * * *

Provision should be made to permit dispositions because of factors beyond the control of the exporter, for example reorganizations, bankruptcy, etc.—National Association of Manufacturers.

* * * * *

A U.S. person should be permitted to transfer a debt obligation to a controlled foreign corporation which qualifies as an export trade corporation.—Westinghouse Electric Corp.

(4) Any U.S. person is exempt from tax to the extent acquisition of foreign securities is reasonably necessary to satisfy minimum requirements imposed upon him by foreign law. Foreign law requirements are, in effect, frozen as of July 18, 1963.

COMMENTS

Test should be whether the stock or debt obligation was acquired "in accordance with good business practice" in a foreign country.—National Foreign Trade Council, Inc.

* * * * *

The exemption for investments required by foreign law should permit all investments made pursuant to any legal requirement so long as it is not discriminatory against American corporations. U.S. banks operating foreign branches have no choice but to comply with laws of the countries in which they operate.—New York Clearing House.

* * * * *

It is customary for insurance companies to invest premiums collected abroad in securities of the foreign country in which collected. Therefore, investments in excess of legal requirements are a matter of business necessity, even though not compelled by law. It is also unrealistic and unfair to restrict investments to those required by foreign insurance laws as they existed on July 18, 1963—Association of Casualty & Surety Companies and the National Board of Fire Underwriters.

* * * * *

Some countries do not require investment in the securities of that country but the need to keep money in the country of origin nevertheless exists. Moreover, due to market fluctuations, it is not possible to maintain a level of investment exactly equal to that required (some life insurance companies keep a surplus of not more than 10 percent)—American Life Convention and Life Insurance Association of America.

* * * * *

Restriction of investments to a required reserve is too narrow. Provision should also be made to allow for changes in requirements imposed by foreign governments—American Foreign Insurance Association.

Section 4915. Exclusion for Direct Investments

Subsection (a) provides, in general, that the tax does not apply to acquisitions by U.S. persons of securities of a foreign corporation in which they own, directly or indirectly, a 10-percent or greater stock interest.

COMMENTS

The 10-percent figure is too high. The exemption should turn on whether the foreign corporation whose stock is acquired is engaged in operations similar or related to those of the investor—Chamber of Commerce of the United States.

* * * * *

The 10-percent figure is too high. The exemption should apply to investments in corporations in a related business—Standard Oil Co. (New Jersey).

* * * * *

The 10-percent ownership requirement is too high to provide an adequate basis for distinction between portfolio investments and direct investments. Investments of lesser amounts should be exempt if made in corporations engaged in operations similar or related to those of the investor—United States Council of International Chamber of Commerce, Inc.

* * * * *

Broader stock attribution rules than those provided should be adopted for purposes of determining if a person owns 10 percent of the stock of a foreign corporation—Association of the Bar of the City of New York.

* * * * *

Exemption should be provided in cases where a U.S. contractor, in order to comply with the terms of a bid on a construction contract, obtains less than a 10-percent interest in a foreign corporation. Such bid requirements have recently been imposed by some foreign purchasers of large-scale projects to insure that major contractors retain an interest in the project after performance has been completed.—Westinghouse Electric Corp.

* * * * *

Provision should be made to grant refund of tax paid with respect to acquisitions while owning less than 10 percent of the stock of the foreign corporation if the U.S. person subsequently acquires a 10-percent interest in the corporation.—National Association of Manufacturers.

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Provision should be made to exempt investments made through partnerships or other forms of business organizations.—National Association of Manufacturers.

* * * * *

Provision should be made to provide that any member of an affiliated group can make loans to foreign subsidiaries in those cases where the foreign subsidiary is 10 percent owned by a U.S. corporate member of the affiliated group.—United Fruit Co.

* * * * *

Provision should be made to allow U.S. persons generally to make tax-free loans to 10-percent-owned foreign subsidiaries of domestic corporations—Kaiser Aluminum & Chemical Corp.

* * * * *

If the U.S. persons who own a domestic corporation also own a foreign corporation, the domestic corporation should be permitted to make tax-free loans to the foreign corporation.—Stephen S. Ziegler.

* * * * *

Committee report should make it clear that a 10-percent interest need not be acquired at one time for the exception to apply.—United States Gypsum Co.

Subsection (b) provides that the direct investment rule of subsection (a) does not apply to corporations which are formed or availed of for the purpose of acquiring securities of a foreign corporation, which if acquired directly, would be subject to tax. However, this provision does not apply to corporations formed or availed of to hold foreign securities if the securities acquired are necessary to meet minimum requirements of local law, or are derived in the ordinary course of an underwriting, brokerage, or commercial banking business.

COMMENTS

Acquisitions made in connection with business transactions with a person in a foreign country should be exempt even though such person is not technically doing business in the foreign country.—National Association of Manufacturers.

* * * * *

Acquisitions by an "investment bank" should be exempt in the same manner as acquisitions made by commercial banks. Moreover, the statutory prohibition should be against foreign corporations formed or availed of for the primary purpose of avoiding the interest equalization tax rather than being formed or availed of for the purpose of acquiring securities of a foreign corporation.—Baker, McKenzie & Hightower.

* * * * *

Exemption should apply to "dealers" rather than "brokers" since brokers do not acquire securities.—Investment Bankers Association of America.

Subsection (c) provides that the direct investment rule of subsection (a) does not apply if the 10-percent shareholder of the foreign corporation intends to sell the securities he acquires to U.S. persons.

NO COMMENTS

Section 4916. Exclusion for investments in less developed countries

Subsection (a), in general, provides that the tax shall not apply to the acquisition by U.S. persons of—

(1) debt obligations of a less developed country; or
(2) stock or debt obligations of less developed country corporations.

COMMENTS

In addition to the provision relating to investments in less developed country corporations, provision should be made to exclude investments made in a less developed country in an individual capacity or through a partnership, trust, etc.—National Association of Manufacturers.

* * * * *

Should exempt all investments or loans, whether or not with a corporation, made in any less developed country for activities within such countries.—Standard Oil Co. (New Jersey).

* * * * *

An exclusion should be provided for debt obligations of individuals and partnerships of a less developed country.—United Fruit Co.

* * * * *

Exemption should apply to obligations acquired from partnerships and other noncorporate organizations.—American Institute of Certified Public Accountants.

* * * * *

Exemption should apply to obligations of individuals and partnerships as well as to investments in holding companies.—United States Council of the International Chamber of Commerce, Inc.

Subsection (b) provides that the President of the United States shall designate which countries are to be treated as being less developed for purposes of the bill.

NO COMMENTS

Subsection (c) defines the term "less developed country corporation."

COMMENTS

Provision should be made to exempt investment in a company which holds the stock of various operating companies which themselves qualify as less developed country corporations. This amendment would make the definition of a less developed country corporation consistent with the definition used for foreign tax credit purposes.—Deltec Panamerica S.A.

* * * * *

The definition of a less-developed country corporation used for foreign tax credit purposes should be used.—Liberian Iron Ore, Ltd.

* * * * *

The definition of a less-developed country corporation used for foreign tax credit purposes should be used.—Association of the Bar of the City of New York.

* * * * *

A holding company for a less developed country corporation should qualify—American Institute of Certified Public Accountants.

* * * * *

In the case of new issues distributed before enactment of the bill, provision should be made to permit post acquisition approved by the Treasury Department of the issue as being an issue of a less developed country corporation—American Institute of Certified Public Accountants.

* * * * *

Income from sources within the United States, and assets located in the United States, should be treated as less developed country income, and assets, for purposes of determining qualification of a corporation as a less developed country corporation—American Institute of Certified Public Accountants.

Section 4917. Exclusion for New Issues Where Required for International Monetary Stability

This section permits the President of the United States to exempt from tax certain new issues of foreign securities. The exemption may be limited in dollar amount and/or for a specified period. If the exclusion is limited, it applies to those securities to which registration statements first become effective or to which notification first occurs.

COMMENTS

Exemption should be broadened to permit exemption statement with the Securities and Exchange Commission rather than on the time the registration statement becomes effective—Investment Bankers Association of America.

* * * * *

It would seem more equitable for the exemption to apply to those issues as to which registration statements or notifications were first filed.—Association of the Bar of the City of New York.

* * * * *

Exemption should be broadened to permit exemption for outstanding issues.—United States Council of the International Chamber of Commerce, Inc.

Section 4918. Exemption for Prior American Ownership

Subsection (a) provides that the tax shall not apply to a person who acquires a foreign security from a person who was a U.S. person throughout the period of his ownership of the security or continuously since July 18, 1963.

COMMENTS

Exemption should also apply in cases where a U.S. person sells securities after immigrating to the United States after July 18, 1963.—Kramer, Marx, Greenlee & Backus.

Subsection (b) provides that receipt of a certificate of American ownership shall be conclusive proof that the purchaser is exempt from tax unless the purchaser knew the certificate was false in a material respect.

COMMENTS

The use of blanket certificates of American ownership as proof of the purchaser's exemption from tax, presently authorized for national security exchange transactions, should be authorized with respect to over-the-counter transactions—Association of Stock Exchange Firms.

* * * * *

The procedure worked out by the Treasury Department and the New York Stock Exchange whereby no certificate of American ownership need accompany a certificate of stock traded on the exchange should be codified—New York Stock Exchange.

Section 4919. Sales by Underwriters and Dealers to Foreign Persons

Subsection (a) provides exemption from tax for—

(1) underwriters to the extent they sell foreign securities to non-U.S. persons in connection with private placements or public offerings registered with the Securities and Exchange Commission; and

(2) dealers in dollar bonds if the dollar bonds are sold to non-U.S. persons within 30 days after their acquisition.

COMMENTS

The requirement that an offering must be registered with the Securities and Exchange Commission in order to be exempt should be deleted since offerings of less than $300,000 and offerings sold entirely to foreigners are exempt from registration—Cahill, Gordon, Reindel & Ohl.

* * * * *

Provision should be expanded to cover all public offerings regardless of whether registration is required—Association of the Bar of the City of New York.

Subsection (b) sets forth the general procedure to be followed by a person claiming an exemption as an underwriter or dealer.

NO COMMENTS

Subsection (c) defines the terms "underwriter," "dealer," and "foreign dollar bonds."

NO COMMENTS

Section 4920. Definitions

Paragraph (1), in general, defines the term "debt obligation" to include any indebtedness, whether or not in writing and whether or not bearing interest. It also includes any interest, option, or right in a debt obligation. The definition excludes convertible debentures, notes received as compensation for services, and obligations arising out of divorce.

COMMENTS

Convertible debentures should be taxed as debt obligations. A 15-percent tax should be paid upon conversion and a credit given at that time for the tax paid on the bond—Smith, Barney & Co.

* * * * *

The exclusion authorized for debt obligations received as compensation for services should be extended to exclude *stock* received as compensation for services rendered—National Constructors Association.

* * * * *

Exemption should be made for *stock* received as compensation—American Institute of Certified Public Accountants.

* * * * *

The bill should not apply to debt obligations received by a U.S. person as a result of services performed by a 50-percent-owned foreign subsidiary of the U.S. person—Chicago Bridge & Iron Co.

Paragraph (2) defines the term stock to include stock or shares of a corporation, the partnership interest of a limited partner, and options or rights to acquire stock.

NO COMMENTS

Paragraph (3) defines the term "foreign issuer or obligor." Subparagraph (A) of paragraph (3) sets forth the general rule that a foreign issuer or obligor includes—

(i) an international organization of which the United States is not a member;

(ii) a government of a foreign country; and

(iii) foreign corporations, partnerships, trusts, estates, associations, insurance companies, or joint-stock companies.

NO COMMENTS

Subparagraph (B) of paragraph (3) treats as a foreign obligor any domestic corporation which is formed or availed of for the principal purpose of acquiring capital for a foreign person.

NO COMMENTS

Subparagraph (C) of paragraph (3) permits a domestic regulated investment company which has 80 percent of its assets in foreign securities to elect to be treated as a foreign corporation. Such a corporation may not, however, borrow or issue new stock after July 18, 1963, and before its election; except for issues registered with the Securities and Exchange Commission before July 18, 1963, and sold before September 15, 1963. Elections under this provision must be made within 30 days after enactment of this provision. The effective date of an election is to be determined by the electing corporation.

COMMENTS

A regulated investment company making an election under this provision should be permitted to make the election with respect to its investments retroactive to July 18, 1963; but, shares in the fund should not be treated as shares of a foreign corporation with respect to transfers by shareholders until after the date of enactment of the bill—Japan Fund, Inc.

* * * * *

Electing funds should be permitted to switch their foreign investments tax free during the period July 18, 1963, to the date of their election. Moreover, purchasers of stock in the fund should also be exempt from tax for this interim period. Failure to adopt this provision would be unfair and inequitable since purchasers of stock in a fund during the interim period might not have foreseen a retroactive election by the fund—Eurofund, Inc.

Paragraph (4) defines the term "United States person."

NO COMMENTS

Paragraph (5) defines the term "period remaining to maturity."

COMMENTS

Provision should be made to permit refund of a tax if a loan is prepaid—New York Clearing House.

* * * * *

The definition should be amended to exclude demand deposits, for example, demand deposits in a foreign bank—Connor, Winters, Randolph & Ballaine.

EFFECTIVE DATES

In General

The tax is, in general, applicable to acquisitions of foreign securities by U.S. persons after July 18, 1963.

COMMENTS

The bill should be made effective on the date of enactment—Association of Stock Exchange Firms.

Exemption for preexisting commitments

The bill does not apply to acquisitions made after July 18, 1963, pursuant to an obligation which on July 18, 1963 was—

1. unconditional; or
2. subject only to conditions contained in a formal contract under which partial performance had occurred.

COMMENTS

The bill should exempt contracts which on July 18, 1963, were subject only to the satisfaction of conditions which were not within the purchasers' control—Investment Bankers Association.

* * * * *

Acquisitions made after July 18, 1963, should be exempt if, prior to such date, the acquisition was subject to a firm purchase agreement or had reached a stage where none of the important terms or conditions were under the buyers control. The buyer should be required to provide satisfactory evidence of the agreement and the stage of negotiations on July 18, 1963—Keystone Custodian Funds, Inc.

* * * * *

The bill should exclude transactions which had progressed to the point where a memorandum of terms or a commitment letter had been exchanged prior to July 18, 1963—Henry J. Clay.

* * * * *

Exemption should be made for commitments evidenced by a commitment letter signed on or before July 18, 1963—Morgan Stanley & Co.

* * * * *

The bill should not apply to an obligation, understanding, or plan which was in existence on July 18, 1963, and under which partial performance or execution, such as obtaining foreign exchange control permits or organization of a foreign corporation, had occurred as of such date—Baker, McKenzie & Hightower.

* * * * *

Acquisitions made after July 18, 1963, should be exempt if the purchase, or commitment to purchase, had been formally approved before July 18, 1963, by a finance or investment committee of an insurance company, pension trust, educational or charitable institution, or similar institutional investor—Breed, Abbott & Morgan.

* * * * *

As a practical matter, life insurance companies consider themselves obligated to complete a transaction after reaching an understanding with the other party even though certain customary conditions remain to be fulfilled before the company is legally committed. Transactions in this state on July 18, 1963, should be exempt—American Life Convention and Life Insurance Association of America.

Exemption for public offerings registered with the Securities and Exchange Commission

The bill does not apply to acquisitions made on or before September 15, 1963 if—

1. a registration statement with respect to the security was in effect at the time of the acquisition,
2. the registration statement was filed with the Securities and Exchange Commission in the 90-day period prior to July 18, 1963; and
3. no material amendments to the registration statement had been filed after July 18, 1963.

COMMENTS

The exemption should be extended to the private placement of foreign securities in all cases where within 90 days prior to July 18, 1963, a placing banker had received firm authorization from a foreign issuer to proceed with the private placement on specified terms as to amount, maturity, and interest rate—R.W. Pressprich & Co.

* * * * *

The exemption should be amended to apply to acquisitions made on September 16, 1963, in order to conform the statute to public announcements made by the Treasury Department on July 18, 1963, relating to the effective date of the tax.—Cahill, Gordon, Reindel & Ohl.

Exemption for listed securities

The bill does not apply to acquisitions of foreign securities by a U.S. person if the foreign security was acquired on a national stock exchange before August 17, 1963.

NO COMMENTS

Exemptions for the exercise of options and the acquisition of securities as a result of foreclosure

The bill does not apply to acquisitions made pursuant to an option acquired before July 19, 1963, or to acquisitions made as a result of a foreclosure.

COMMENTS

The bill should also exclude stock acquired as a result of the exercise of an option by the estate, heir, or legatee of a person whose acquisition would not have resulted in tax.—Association of the Bar of the City of New York.

RETURN AND PENALTY REQUIREMENTS

The bill provides for—

1. Quarterly returns by persons incurring liability for tax and by persons who would be liable for tax except for the fact the security acquired carried with it a certificate of American ownership.
2. A civil penalty of the greater of $10 or 5 percent of the amount of tax that would be due (but computed without regard to the exemptions for certificates of American ownership or sales to foreigners by underwriters, etc.) had a return been filed. The maximum penalty shall not exceed $1,000.
3. A civil penalty of 125 percent of the tax that would otherwise have been paid by the purchaser if a person executes a false certificate of American ownership or certificate of sale to foreign persons. In addition, criminal penalties of $1,000 and imprisonment for not more than 1 year may also be imposed for the willful execution of a fraudulent certificate.

NO COMMENTS

DENIAL OF DEDUCTION FOR TAX PAID

The bill, in general, denies a deduction for tax paid by a U.S. person in connection with the acquisition of a foreign security and provides that the tax shall be added to the basis of the security acquired. However, a deduction is allowable if the U.S. person is reimbursed for the tax by a foreign issuer or obligor and is required to include such reimbursement in income.

COMMENTS

> Deduction for the tax should be allowed even though a reimbursement is includible in income in a taxable year which differs from the one in which the tax was paid.—National Association of Manufacturers.

* * * * *

> Provision should be made in the case of original issue discount obligations to permit the tax to be treated as an additional price paid for the obligation. Provision should also be made to permit amortization of the tax over the period of the indebtedness.—Association of the Bar of the City of New York.

V. ALTERNATIVE PROPOSALS

Public witnesses recommended consideration of the following alternatives to enactment of H.R. 8000:

The solution to the U.S. balance-of-payments deficit position must be found in top-level political agreement among the leaders of the free world. Such agreement must define the mutual obligations of the parties with respect to the budgetary and foreign exchange costs of defending Europe and containing Communist China in the Far East.

Reduce non-asset-creating expenditures abroad.

Increase longer term interest rates.

Arrange a major drawing on the International Monetary Fund.

Remove the 25-percent gold cover on U.S. currency.

Issue special certificates and bonds denominated in currencies of foreign countries.

Establish a new international monetary mechanism with ability to expand credit to provide an effective means of financing world trade.

Seek voluntary restraints on the making of foreign investments by large institutional investors.

Create a capital issues committee to screen all foreign demands on the U.S. capital markets.

Adopt a program of tax incentives for persons who increase their export of U.S. manufactured goods.

Impose temporary direct restrictions on investments of American companies in industrial foreign countries.

Restrict or place a tax on foreign travel by U.S. persons.

Encourage investment in the United States by—

(a) reducing or eliminating the withholding tax on dividends and interest paid foreign investors; and

(b) increasing the estate tax exemption of nonresident aliens from $2,000 to $60,000.

Discourage foreign investment by U.S. persons through repeal of the foreign tax credit.

Require that tax-exempt organizations pay tax on their foreign source income.

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Calendar No. 1203

88TH CONGRESS *2d Session*	SENATE	REPORT No. 1267

INTEREST EQUALIZATION TAX ACT

JULY 30, 1964.—Ordered to be printed
Filed under authority of the order of the Senate of July 30, 1964

Mr. BYRD of Virginia, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 8000]

The Committee on Finance, to whom was referred the bill (H.R. 8000) to amend the Internal Revenue Code of 1954 to impose a tax on acquisitions of certain foreign securities in order to equalize costs of longer term financing in the United States and in markets abroad, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill, as amended, do pass.

I. SUMMARY

Although your committee has made an extensive series of amendments to the House-passed bill, they are of a relatively technical nature perfecting the intent of the provisions as passed by the House.

H.R. 8000 provides an interest equalization tax designed to bring the cost of capital raised in the U.S. market by foreign persons more closely into alinement with the costs prevailing in markets in other industrial countries. The tax is designed to aid our balance-of-payments position by restraining the heavy and accelerated demand on our capital market from other industrialized countries. The interest equalization tax is a temporary excise tax effective for the period July 19, 1963 (August 17, for listed securities), through December 31, 1965.

The bill imposes the tax on the acquisition by a U.S. person of a debt obligation of a foreign obligor, or stock of a foreign issuer, which is acquired from a foreign person. The tax on the transfer of stock is 15 percent of the actual value of the stock at the time of the transfer. The tax on the transfer of debt obligations varies from 15 percent on obligations with a maturity of 28½ years or more down to 2.75 percent for those with a maturity of 3 to 3½ years. For debt obligations with a shorter maturity, no tax is imposed.

These tax rates are designed to reduce the net rate of return on the foreign securities by about 1 percent per annum. Much of the burden of the tax is likely to be shifted to the foreign seller with a resulting decrease in the volume of foreign securities sold in the U.S. Market. It is anticipated that this may well improve the U.S. balance of payments by from $1.25 to $1.5 billion a year relative to the rate which would exist in the absence of this tax. It is expected to increase revenues by up to $30 million a year.

The principal exclusions in the bill relate to—

(1) Securities acquired from a prior American owner;

(2) Securities received in connection with a wide range of export transactions;

(3) Debt obligations received by commercial banks in the course of their commercial banking business;

(4) Direct investments in corporations or partnerships owned 10 percent or more by the investor;

(5) Securities of "less-developed-country corporations" and obligations of less-developed countries;

(6) New security issues which the President exempts in the interest of international monetary stability, presumably new Canadian securities;

(7) Reserves maintained by insurance companies doing business in foreign countries; and

(8) Investments of foreign membership dues by labor unions and other exempt organizations.

The administration has strongly urged the adoption of this bill as an essential part of the overall program to reduce the balance-of-payments deficit.

II. REASONS FOR THE BILL

As indicated in table 1, the U.S. balance of payments has consistently been in a deficit position since 1957, and with the exception of the year 1957, has been in a deficit position since 1949. The deficits attributable to the last 6 years have given rise to a depletion of the U.S. gold reserve of over $7 billion.

TABLE 1.—*U.S. balance of payments annually for the period 1949–62, and quarterly for 1962, 1963, and the 1st quarter of 1964*

[In millions of dollars; quarterly figures seasonally adjusted annual rates]

1949	175	1962	−2,203
1950	−3,580	1963 [1]	−1,942
1951	−305	1962:	
1952	−1,046	I	−2,992
1953	−2,152	II	−1,760
1954	−1,550	III	−1,336
1955	−1,145	IV	−2,724
1956	−935	1963: [1]	
1957	520	I	−2,838
1958	−3,529	II	−4,592
1959	−3,743	III	−172
1960	−3,881	IV	−460
1961	−2,370	1964: I	−168

[1] Includes receipts from sales of nonmarketable, medium-term convertible Government securities.

Source: U.S. Department of Commerce.

On an annual basis the peak deficit in the overall U.S. balance of payments of $3.9 billion was reached in 1960. However, late in 1962 the deficit in the balance of payments started to rise again and this trend continued through the first half of 1963.

As indicated in table 1, the overall deficit in the balance of payments in the fourth quarter of 1962 was $2.7 billion and in the first quarter of 1963 was $2.9 billion (both figures are seasonally adjusted annual rates). Then in the second quarter of 1963, this increased to $4.6 billion on an annual rate basis. This worsening of the balance-of-payments position occurred despite arrangements for the advance payment of debt owed the United States by various foreign countries, despite progress in reducing net Government outlays of dollars abroad and also despite efforts over that period by the administration to bring upward pressures on short-term interest rates and thus encourage the retention of funds seeking short-term investment in this country.

The trend in the balance of payments in recent years can more accurately be seen by examining the balance on regular transactions.[1] These data are shown in table 2. They indicate that the deficit on regular transactions in 1962 was $3.6 billion, or more than $500 million above the deficit in 1961. Moreover, the deficits of $1,180 million and $1,319 million in the first two quarters of 1963, respectively, when converted to an annual rate, suggest a deficit in these regular transactions of approximately $5 billion based on the experience of the first 6 months of the year. Table 2 indicates that the major factor in this worsening of the balance-of-payments position is the outflow of private long-term capital. The net outflow of this capital increased over $400 million from 1961 to 1962. Moreover, the experience of the first two quarters of 1963 suggested that private long-term capital outflows in the absence of this legislation could be expected to reach an annual rate of $3.5 to $4 billion, further increasing the outflow of long-term capital to a level more than $1.25 billion above the 1961 level.

[1] This includes all regular reoccurring transactions, including those involving the Government but does not include nonscheduled repayments of Government loans, advances from other countries on military exports, and other special measures taken to reduce the financial burden of the deficit, such as medium-term borrowings.

TABLE 2.—*U.S. balance of payments, 1960 through 1st quarter 1964*

[In millions of dollars]

	1960	1961	1962	1963 [1]					1964 [1]
				Total	1st quarter	2d quarter	3d quarter	4th quarter	1st quarter
Commercial trade balance	2,822	3,196	2,079	2,287	388	447	611	841	1,123
Commercial services balance	1,528	2,288	2,477	2,168	572	460	565	571	817
Balance on commercial goods and services [2]	4,350	5,484	4,556	4,455	960	907	1,176	1,412	1,940
Military expenditures	−3,048	−2,954	−3,044	−2,897	−747	−731	−711	−708	−720
Military cash receipts [3]	336	394	669	623	184	200	88	151	223
Government grants and capital-dollar payments to foreign countries and international institutions	−1,110	−1,139	−1,077	−886	−251	−254	−192	−189	−140
Government capital receipts, excluding debt prepayments, borrowings, and fundings [4]	543	516	501	445	99	95	163	88	135
Remittances and pensions	−672	−705	−738	−826	−213	−219	−203	−191	−202
Private capital:									
Long-term	−2,107	−2,177	−2,609	−3,188	−1,103	−845	−470	−770	−677
Short-term	−1,438	−1,492	−752	−726	15	−514	43	−270	−632
Unrecorded transactions	−772	−998	−1,111	−286	−124	42	−277	73	−108
Balance on regular transactions	−3,918	−3,071	−3,605	−3,286	−1,180	−1,319	−383	−404	−181
Special Government transactions [5]	37	701	1,402	1,344	458	171	426	289	139
Overall deficit	−3,881	−2,370	−2,203	−1,942	−722	−1,148	+43	−115	−42

[1] Seasonally adjusted but not annual rates.
[2] Nonmilitary merchandise and service transactions less those financed by Government grants and capital.
[3] Excluding advances on military exports.
[4] Includes small changes in miscellaneous Government nonliquid liabilities.
[5] Not seasonally adjusted. Includes nonscheduled receipts on Government loans, advances on military exports, and sales of nonmarketable medium-term securities, including \$350,000,000 of nonmarketable medium-term convertible securities in the 1st quarter of 1963, \$152,000,000 in the 2d quarter of 1963 and \$175,000,000 in the 3rd quarter, \$25,000,000 in the 4th quarter.

Source: Survey of Current Business.

New issues.—One of the major factors in the increase in long-term private capital outflow has been the very substantial rise in new issues of foreign securities purchased by U.S. residents. As indicated in table 3, new issues of foreign securities purchased by U.S. residents doubled between 1961 and 1962. Moreover, the experience in the first two quarters of 1963 suggested purchases of these securities at an annual rate of about \$2 billion or almost double the already high 1962 volume. With the announcement of the proposed interest equalization tax on July 18, 1963, the volume of new foreign issues purchased by U.S. residents dropped sharply. As indicated by table 3, the great bulk of these new securities issues originated in Canada, Western Europe, and Japan.

TABLE 3.—*New issues of foreign securities purchased by U.S. residents, by area, 1961 through 1st quarter 1964 (not seasonally adjusted)*

[In millions of dollars]

	Total 1961	1962					1963					1964
		I	II	III	IV	Total	I	II	III	IV	Total	I
Canada	237	10	112	41	294	457	368	264	79	26	737	91
Western Europe	57	35	138	15	7	195	65	154	19	34	272	----
Japan	61	11	17	48	25	101	17	66	52	5	140	----
Other developed countries [1]	43	(2)	(2)	(2)	(2)	60	----	17	----	----	17	----
Latin American Republics	18	(3)	19	(3)	[4] 83	[4] 102	13	----	23	----	36	13
Other less developed countries	95	(2)	(2)	(2)	(2)	77	18	17	10	22	67	24
International institutions	12	80	1	3	----	84	----	----	----	----	----	4
Total, new issues	523	170	312	133	461	1,076	481	518	183	87	1,269	132

[1] Australia, New Zealand, South Africa.
[2] Not available.
[3] Less than \$500,000.
[4] Includes \$75,000,000 issue by Inter-American Development Bank.

Source: Survey of Current Business and Department of Commerce.

Outstanding issues.—In addition to new foreign securities floated in the United States, the large volume of outstanding foreign securities sold in the United States also has been an important factor in accounting for the deficit in the balance of payments. U.S. net purchases of outstanding foreign securities in recent years, and by quarters (not enlarged to annual rates) for 1963 and the first quarter of 1964, are as follows:

Net purchases of outstanding foreign securities (minus indicates net purchases)

[In millions of dollars]

1959	−140
1960	−309
1961	−387
1962	−96
1963	−6
1963 (1st quarter)	−59
1963 (2d quarter)	−68
1963 (3d quarter)	+32
1963 (4th quarter)	+89
1964 (1st quarter)	+99

The substantial improvement suggested by these figures for 1962, before the announcement of the tax, was centered in transactions in foreign stocks, as shown by table 4. In good part, this appears to have reflected some temporary factors. The available data do not permit a precise analysis of the transactions of U.S. persons with foreigners since the figures are collected only for purchases and sales of foreign securities in the U.S. market, whether or not the transactions are with Americans or other foreigners. But it appears that despite the relatively small net sales of foreign stock in the U.S. market in 1962, Americans remained large buyers of some foreign stock, while apparently increasing their sales to foreigners of foreign stock purchased at an earlier time. The size of these gross purchases and sales is suggested by table 4. The tax should substantially reduce gross sales by foreigners to U.S. purchasers without affecting incentives of U.S. persons to sell part of their security holdings to foreigners. This could have a substantial favorable effect on the balance of payments, turning what could otherwise be a major net minus factor in the balance of payments to a plus factor, as happened in the last half of 1963 and first quarter of 1964.

In addition to the direct improvement in the balance of payments from applying the proposed tax to outstanding foreign securities, it is believed that there are other reasons which make it essential to cover these securities in any provision which taxes new foreign issues. If these issues are not subject to the tax, it could be expected that much of the improvement in the balance of payments brought about by taxing acquisitions of new issues would be offset by increased acquisitions by U.S. persons of outstanding foreign issues.

TABLE 4.—*Gross transactions in outstanding foreign bonds and stocks, 1960 through 1st quarter 1964*

[In millions of dollars]

Period	Outstanding foreign bonds			Outstanding foreign stocks		
	Gross sales by foreigners [1]	Gross purchases by foreigners [2]	Net purchases by Americans (−)	Gross sales by foreigners [1]	Gross purchases by foreigners	Net purchases by Americans (−)
1960	−786	559	−227	−566	484	−82
1961	−614	552	−62	−923	598	−325
1962	−782	711	−71	−721	696	−25
1963	−672	553	−119	576	689	113
1963:						
1st half	−352	228	−124	−366	363	−3
2d half	−320	325	5	−210	326	116
1964: 1st quarter	−79	88	9	−115	205	90

[1] Excludes new issues sold by foreigners to U.S. residents or other foreigners, and adjustment for direct investment transactions.
[2] Excludes redemptions of bond issues held by U.S. residents and other minor differences between security transaction and balance-of-payments data.

Source: Unpublished balance-of-payments data from Commerce Department.

In the second half of 1963, as table 4 indicates, net purchases of foreign stocks and bonds resulted in a favorable balance of $121 million, which converts to an annual rate of $242 million. This can be contrasted to the unfavorable balance in the first half of $254 million (on an annual rate basis). The improvement during this period therefore amounted to $496 million on an annual rate basis.

Continued need for tax.—The flood of new securities issues which occurred up through the second quarter of 1963 would not of its own accord have fallen back to the more sustainable levels of earlier years.

Similarly, purchases of outstanding foreign issues by Americans certainly would not decline more than temporarily in the absence of legislation in this area. Foreign businessmen and foreign local governments are becoming more aware of the efficient marketing facilities and also the relatively low rates of interest available here, and are learning how to place securities in the U.S. market. Moreover, as production costs rise in the European market, business firms are finding it more difficult to finance their growth from retained earnings. Thus they can be expected to be in the market for increased funds. The European markets still are not adequately organized to efficiently supply business needs or the borrowing requirements of their governments from the growing savings of their own people, and as a result, foreign enterprises and governments, in the absence of a change in capital costs, can be expected to look toward the United States for these funds.

Similarly, U.S. underwriters are becoming more familiar with foreign securities. Moreover, American investors—particularly institutional investors—have become more interested in foreign issues because of the desire for diversification, and because the rate of return on these securities, relative to domestic investment outlets, makes many of them highly attractive. The unfortunate experience of the 1920's and 1930's, which in the past has restrained the demand for foreign securities, now appears to have been largely forgotten. In addition, the more ready convertibility of currencies in recent years has lessened the fear of difficulty in obtaining payment in the United States of income and principal on these securities.

Some have suggested that the improvement in the balance of payments since the first half of 1963, and particularly the small deficit in the first quarter of 1964, make the interest equalization tax no longer necessary. However, this ignores the fact that much of the visible gains have been due to the imminence of this tax. Certainly other factors, such as price stability, and an improving balance of trade, have contributed to the improvement in the balance of payments, but certainly the major factor has been the realization of most prospective purchasers of stock or debt obligations that Congress was likely to enact this tax effective as of July 19, 1963.

Moreover, incomplete data now available for the entire first half of 1964 suggests a deficit in regular transactions at an annual rate of roughly $1.8 billion—instead of the $700 million suggested by the first quarter of 1964. The Treasury has suggested that we cannot count on a deficit in the balance of payments (regular transactions) of less than $2 billion for the year as a whole on the assumption that the interest equalization tax is enacted. While these figures represent a substantial improvement over the $5 billion annual deficit rate that arose before the interest equalization tax was proposed, they do not suggest that we can afford to abandon measures such as the interest equalization tax that are likely to have the most significant effect in bringing about a balance in our payments. The failure to enact the interest equalization tax would face the country with the possibility of a repetition of our experience in early 1963 with the gain in our payments in sectors other than that in long-term capital flows being overbalanced by the worsening of our position with respect to long-term capital outflows.

Nature of the tax.—This bill deals with this problem of excess sales of foreign securities here in the United States by imposing a tax, called the interest equalization tax, on the acquisition by a U.S. person of a foreign security from a foreign person. In the case of stocks, this tax is 15 percent of the actual value. In the case of bonds, the tax is graduated by the remaining length of time to the maturity of the bond, varying from 2.75 percent for bonds with a period of maturity of 3 to 3½ years (those with a period of less than 3 years are exempt) to the same 15 percent rate applicable to stocks in the case of bonds with a period to maturity of 28½ years or more. The schedule of rates applicable to bonds is calculated to be the equivalent to raising the interest rate in the U.S. market by 1 percent. Since the sale of stock is, of course, an alternative way of raising capital for foreign corporations, the tax is applied to equities in a manner which will have a comparable effect on the costs of raising capital by this means.

Looked at from the standpoint of foreign persons raising new money, the interest equalization tax will raise the cost of obtaining capital in the U.S. market by approximately 1 percent and thus bring it near the cost prevailing in most of the industrialized countries abroad. In only two countries, Switzerland and the Netherlands, are long-term interest rates below, or comparable with, those presently prevailing in the United States. However, these countries limit by direct controls the amount of foreign borrowing which can occur in their markets. This is also true of the United Kingdom, which has the largest of the foreign markets. The United Kingdom until quite recently confined its lending almost entirely to Commonwealth countries in the sterling area. This is true even though in the United Kingdom the prevailing interest rate already is 1 percent or more above the rate prevailing in the United States.

The higher cost to foreign persons of obtaining funds in the United States as a result of this tax will not prevent the floating of new issues, or the sale of outstanding issues in this country. With the tax in effect normal market factors will continue to determine which issues will be marketed in the United States. However, the bill will stop the drain of funds from this country by foreign borrowers who are motivated merely by the fact that long-term funds may be obtained here at a slightly lesser interest rate than generally prevails abroad.

Alternatives to the tax.—Of course, much the same results could be obtained by raising the long-term interest rate by 1 percent or more in the United States. To achieve such a rise of long-term rates, in a market which characteristically supplies many times as much capital for domestic uses as for foreign, would under present circumstances not only be very difficult but also unwise. Long-term interest rates have remained relatively steady over the past 3 years, despite rising demands for funds, because of the substantial ability of this Nation to generate liquid savings. In this environment, monetary policy or the use of other powers of the Government evolving within free markets would not be capable of bringing about a change in interest rates of sufficient size to effect a substantial reduction in the flow of funds abroad. Certainly, attempts to achieve this result would have a restrictive effect on new domestic investments at the very time additional investments are required in this country to bring about a higher rate of growth.

One suggestion sometimes made is that a capital issues committee be used to limit sales of foreign securities in the United States rather than an interest equalization tax. Your committee has rejected such an alternative because it departs from the concept of allowing

the marketplace to determine what foreign issues are to be sold here. Instead it would substitute the arbitrary judgment of a board as to which issues could be floated here and which could not. There is no reason to believe that the judgment of such a board would be superior to the determination in the marketplace under this tax. It should also be clear that such a board would be faced with difficult decisions in deciding among issues of different countries and also among different types of businesses. Moreover, such a board could not be used to limit outstanding issues.

Temporary character of the tax.—This tax is imposed as a temporary tax effective only through the end of 1965. It is a part of the broader attack on the balance-of-payments problem, which includes both short- and long-run measures dealing with all items affecting the balance of payments. On one hand, it is anticipated that the profitability and attractiveness of domestic investment will be improved as a result of the tax reduction program enacted earlier this year and, on the other hand, it is anticipated that as the capital markets in other industrialized countries abroad become more efficient and are freed of controls, they will supply a larger share of the world's capital requirements. The provisions of this bill terminating the tax at the end of 1965 will give Congress an opportunity to review all of the relevant considerations at that time, when it is hoped these readjustments in savings and investment patterns and improvements in the U.S. balance of payments will make it unnecessary to continue this tax.

Effective date.—The tax is effective with respect to transactions occurring on or after July 19, 1963, which was the day after the administration proposed the tax, and the date on which it was recommended that the bill become effective. Your committee believes that it is necessary to make the tax effective as of that date. To do otherwise, would have invited a flood of transactions in foreign securities after the announcement of the proposal, but before the effective date. This, of course, would have substantially worsened the balance-of-payments position. However, for securities listed on national exchanges the effective date was made August 17, 1963, in order to give the exchanges an opportunity to adjust to the new procedures.

As a result of this announcement's effect, the proposed interest equalization tax has already played an important part in reducing the outflow of capital and in improving our overall balance-of-payments position.

As indicated by table 3, the outflow of U.S. capital in the form of new issues of foreign securities decreased from levels of $481 million and $518 million, respectively, in the first two quarters of 1963 to $183 million in the third quarter, $87 million in the fourth quarter, and $132 million in the first quarter of 1964. The reversal from net purchases to net sales of outstanding foreign stocks and bonds in this period is also notable (see table 4).

Effectiveness of bill.—The dramatic improvement in the balance of payments is a concrete demonstration of the effect that this bill can be expected to have. The Treasury Department has estimated that this bill will result in an improvement in the balance of payments of $1¼ to $1½ billion from the rate in the first 6 months of 1963. This is suggested from the changing pattern of U.S. transactions in foreign securities since the middle of 1963. Table 5, which shows selected capital movements in 1962, 1963, and the first quarter of 1964 on an annual rate basis, demonstrates the basis for this expectation. This table shows that the purchase of new issues of foreign securities in the last half of 1963 and the first quarter of 1964 was at an annual rate of $1.3 billion below the rate of purchases of these securities in the first half of the year; and net U.S. transactions in outstanding foreign securities swung from an annual rate of outflow of about $250 million to an annual rate of inflow of almost $300 million. The combined savings in the balance of payments for these two categories, therefore, is at an annual rate of about $1.8 billion to date. While it is recognized, of course, that uncertainties related to the imposition of the tax may have restrained new lending since July of 1963, it should also be noted that the sizable volume of new issues reaching the market during part of the period reflected a working off of the large backlog of new issues for which commitments had been made prior to the announcement.

TABLE 5.—*U.S. balance of payments—Selected capital movements and deficit on regular transactions, 1962 through 1st quarter 1964*

[Seasonally adjusted annual rates; in millions of dollars]

	1962	1963				1964, 1st quarter [1]
		1st half	2d quarter	3d quarter	4th quarter	
Selected capital movements:						
U.S. transactions in foreign securities:						
New issues	−1,076	−1,858	−1,932	[2] −1,012	−348	−388
Redemptions	203	186	200	208	200	176
Other U.S. purchases (−) or sales (+)	−96	−254	−272	128	356	396
Total foreign securities	−969	−1,926	−2,004	−676	208	184
Bank credits to foreigners:						
Long-term	−127	−320	−588	−536	−1,632	−1,220
Short-term	−324	−860	−1,968	76	−1,088	−1,744
Total bank credit	−451	−1,180	−2,556	−460	−2,720	−2,964
Foreign purchases (+) or sales (−) of U.S. securities	+134	+256	+456	+204	+292	−168
Total securities and bank credit	−1,286	−2,850	−4,104	−932	−2,220	−2,948
Balance-of-payments deficit on regular transactions	−3,605	−4,998	−5,276	−1,532	−1,616	−724

[1] Preliminary.
[2] Reflects almost entirely commitments made before July 18.

Source: Commerce Department.

III. GENERAL EXPLANATION

The principal amendments made by your committee are set forth in (e) below. In addition, where they have a major impact on the discussion they are noted elsewhere.

a. Imposition of tax

This bill, subject to specified exemptions, imposes a tax on the acquisition by U.S. persons of foreign securities from a foreign person. It does not apply to purchases of foreign securities by U.S. persons from other U.S. persons. To the extent practicable, the application of the tax is limited to the area of long-term investment, which in recent years has had an adverse effect on the U.S. balance of payments.

1. *Rate of tax.*—A tax of 15 percent of the actual value is applied to the acquisition by a U.S. person of stock of a foreign issuer. In the case of the acquisition of a debt obligation of a foreign obligor, the tax is determined on the basis of the length of time remaining to maturity of the obligation at the time acquired by a U.S. person in a taxable transaction. The tax rate increases as the period remaining to maturity of an obligation increases. No tax is imposed where the period to maturity is less than 3 years. The tax rates applied are designed to have the effect of increasing a foreigner's cost of raising capital in the United States by approximately 1 percent a year. The schedule of rates is as follows:

If the period remaining to maturity is—	The tax, as a percentage of actual value, is—
At least 3 years, but less than 3½ years	2.75 percent.
At least 3½ years, but less than 4½ years	3.55 percent.
At least 4½ years, but less than 5½ years	4.35 percent.
At least 5½ years, but less than 6½ years	5.10 percent.
At least 6½ years, but less than 7½ years	5.80 percent.
At least 7½ years, but less than 8½ years	6.50 percent.
At least 8½ years, but less than 9½ years	7.10 percent.
At least 9½ years, but less than 10½ years	7.70 percent.
At least 10½ years, but less than 11½ years	8.30 percent.
At least 11½ years, but less than 13½ years	9.10 percent.
At least 13½ years, but less than 16½ years	10.30 percent.
At least 16½ years, but less than 18½ years	11.35 percent.
At least 18½ years, but less than 21½ years	12.25 percent.
At least 21½ years, but less than 23½ years	13.05 percent.
At least 23½ years, but less than 26½ years	13.75 percent.
At least 26½ years, but less than 28½ years	14.35 percent.
28½ years or more	15.00 percent.

The equivalence of the tax to an interest rate increase of 1 percent for foreign borrowers can be illustrated by the following example. Assume that prior to the imposition of the tax a foreign borrower and a U.S. borrower could each obtain $100,000 in the United States for a 10-year period at an interest rate of 5 percent payable annually. Thus, each would pay $50,000 in interest spread over the life of the loan for use of the $100,000. Under the bill, the domestic borrower could continue to borrow on the same basis. However, since the American purchasing the debt obligation from the foreign borrower would also have pay a tax of $7,700 (7.7 percent rate for debt with a maturity of 9½ to 10½ years), presumably the foreign borrowers in order to raise funds in competition with American borrowers would have to reimburse the lender for the tax. One way of doing this would be to ask the borrower to pay a higher interest rate. Had he been required to pay a 1-percent higher interest rate, spread over the 10-year period, he would have paid $10,000 additional. The $7,700 in tax, all of which would have to be paid at the beginning of the 10-year period, is approximately the present value of ten $1,000 payments spread over the period of the life of the obligation when discounted at about the prevailing rate for foreign securities. The tax passed onto the borrower, therefore, is about the equivalent of an increase in the interest rate of about 1 percent.

The bill provides no tax on the acquisition of debt obligations having less than 3 years remaining to maturity from the date of acquisition. Interest rates for short-term loans in the United States can more readily be influenced by monetary policy, when appropriate, and have been brought into closer alinement with those prevailing in most important industralized countries abroad. Moreover, this exemption will permit the wide variety of short-term transactions relating to international trade to proceed unhampered. Your committee is aware of the fact that the exclusion of short-term loans from tax could shift foreign long-term borrowers into the short-term money market. However, it is not clear that this effect will occur to am important extent.

Under the bill, debt obligations which are convertible into stock over more than a 5-year period will initially be taxed as debt obligations. However, at the time they are converted into stock, they will be subject to an additional tax equal to the full 15-percent rate which would have been paid if they initially had been stock, reduced by the tax previously paid by the person making the conversion (or by the tax which would have been paid by this person had his purchase been taxable). Where the debt instrument may be converted into stock only within 5 years of the date of issuance, the instrument is treated under the bill as initially being stock and at that time subject to the 15-percent tax.

Your committee concluded that a debt obligation which could be converted into stock over an extended period of time (more than 5 years) should be basically treated as a debt obligation for purposes of the interest equalization tax. Since the interest equalization tax is imposed only for a short period (namely, through December 31, 1965) it was believed that these obligations would in all likelihood be acquired primarily for their debt features. However, your committee recognized that the treatment of all convertible instruments as debt obligations would create a possibility of avoidance whereby foreign persons could issue short-term debt instruments whose principal attraction would be the combination of a low tax rate with favorable conversion features that would be exercised shortly after the termination date of the interest equalization tax. Therefore, the bill treats those obligations which must be converted over a relatively short period of time into stock in the same manner as if they initially were stock issues. On the other hand, longer term convertible debt obligations are so treated only if actually converted during the period of time when the tax is in effect.

2. *Persons liable for tax.*—The person acquiring the obligation of a foreign issuer or obligor is subject to tax if this person is a "U.S. person"; i.e., a citizen or resident of the United States, a domestic partnership, a U.S. estate or trust, or a domestic corporation. Acquisitions made by a State of the United States or by an agency, instrumentality, or political subdivision of a State, are also subject to tax. In addition, corporations created or organized under the laws of the Commonwealth of Puerto Rico or the Virgin Islands or other possessions of the United States are treated as U.S. persons. Thus, for example, acquisition of foreign stock or debt obligations by Puerto Rican corporations will be subject to tax, but acquisitions of the stock or debt obligations of Puerto Rican corporations by citizens or residents of the United States will be exempt.

3. *General application of tax.*—In general, the tax applies whenever a U.S. person acquires ownership of stock or debt obligations of a foreign issuer or obligor from a foreign person. Under this general rule, transfers which are not considered to represent a real change in ownership are not to result in the imposition of the tax. For example, transfers between a person and his nominee, custodian, or agent are exempt from tax, as are transfers from a decedent to his executor or administrator. In addition, transfers to a survivor upon the death of a joint tenant, from a minor to his guardian, and other similar transfers by operation of law, are exempt from tax. The bill also provides that the receipt of stock or debt obligations of a foreign issuer or obligor by an individual citizen or resident of the United States as a gift is not subject to tax. The bill also provides that acquisitions resulting from corporate distributions and reorganizations would generally be exempt from tax since such transfers generally involve neither a substantial change of position nor an outflow of U.S. dollars (as indicated subsequently, your committee has adopted amendments liberalizing the exemptions in the case of liquidations, reorganizations, etc.). Finally, the receipt of a stock option or similar right by a U.S. person for any reason connected with his employment by a foreign corporation will not be subject to tax if the right is nontransferable, otherwise than by will or the laws of descent and distribution, and is exercisable during the optionee's lifetime only by him.

4. *Limitations on amount of tax.*—The bill contains a special rule for the computation of tax where stock or a debt obligation is acquired as the result of the surrender of another debt obligation, the extension or renewal of a debt obligation by action by the obligee, or the exercise of an option or right to acquire stock or debt obligations. In general, the tax in these cases is equal to the regular tax reduced by the tax which would have been payable had the option, right, or debt surrendered, exercised, extended, or renewed been taxed at that time. In these cases the option, right, or debt obligation involved represents a value the American already had. Where a foreign corporation issues rights to its shareholders which permit the shareholders (and subsequent holders) to subscribe to additional shares of the corporation, the tax is based upon the subscription price.

b. Exemptions from the tax

The bill provides for exemptions for various transactions in order to avoid creating unnecessary hardship and impairing normal commercial transactions, as well as to avoid conflicting with other important national objectives such as the promotion of our export trade and our assistance to the less-developed countries of the free world. The principal exemptions provided are described below.

1. *International monetary stability.*—Your committee believes that it is desirable to enable the President of the United States to exempt new security issues of a foreign country from tax where he determines that application of tax to such securities imperils, or threatens to imperil, the stability of the international monetary system. This is in accordance with the treaty obligation of the United States to the International Monetary Fund. This obligation requires the United States "* * * to collaborate with the fund to promote exchange stability * * *."[1]

Your committee has received assurances from the Secretary of the Treasury that, under present circumstances, new issues of Canadian issuers and obligors are the only securities which he would recommend that the President exempt from tax. Moreover, it is the intent of

[1] Articles of agreement between the United States of America and other powers respecting the International Monetary Fund, Bretton Woods Agreement, art. IV, sec. 4(a).

your committee that the exemption of Canadian securities should be contingent upon Canadian borrowings returning to their historical levels and that the exemption should be revoked or limited if Canadian borrowings exceed amounts required to maintain their international reserves and reach the abnormal levels attained in 1962 and the first 6 months of 1963. It is understood that the Canadian Government, through its own interest rate policy or otherwise, will maintain borrowings by Canadians in the United States only to the extent necessary to permit Canada to attain an equilibrium in its reserve position. Therefore, should the Canadian balance-of-payments position improve as a result of recent Government policies to increase exports, it is expected that the need for Canadian borrowing in the United States will be reduced. Your committee has also been assured that the administration will follow the volume of Canadian borrowing in U.S. markets closely. Should the total of such borrowing exceed prudent limits, the President will have discretionary authority to impose a limitation on the volume of such exempt borrowings. This discretionary power to limit the size of any exemption gives assurance that the Canadian exemption will not undermine the purpose of this tax. Your committee believes that the Canadian-United States relationship with respect to the close integration of their capital markets and its implications for the Canadian balance of payments is unique, and that exemption of new issues of Canadian securities under this discretionary provision should not under normal circumstances be extended to securities of other countries.

The bill provides that the exclusion is to apply only to original or new issues. A debt obligation is treated as part of an original or new issue for this purpose only when it is acquired during the first 90 days (60 days under the House bill) after interest begins to accrue on the obligation. Stock is treated as part of an original or new issue only when it is acquired from the issuer by the U.S. person claiming the exclusion.

If the President by Executive order limits the aggregate amount of issues (rather than a classification of issues) which may be exempt, or limits the period during which the issues may be exempt, the exclusion is to apply to those as to which notice of acquisition is filed first with the Treasury Department.

2. *Less developed countries.*—The bill provides that the tax is not to apply to acquisitions by U.S. persons of (1) debt obligations issued or guaranteed by a national or local government of a less developed country, (2) stock or debt obligations of a "less developed country corporation," or (3) a debt obligation issued by an individual or partnership resident in a less developed country in return for money or property which is used, consumed, or disposed of wholly within one or more less developed countries. (Your committee has also amended the bill to exclude certain stock or debt obligations acquired as a result of contracts between U.S. persons and less developed countries. The exclusion in such cases will apply where property of the U.S. person is subject to actual or threatened expropriation and the amounts received from this property are required to be reinvested.)

This exclusion is designed to avoid cutting down the flow of private capital to those nations with chronic capital shortages, urgent development needs, and limited capability for foreign borrowing on normal commercial terms. The United States has long recognized a responsibility for assisting these nations in their struggle to achieve improved standards of living, and the application of the tax to issues of these countries would work against that objective. Furthermore, the outflow of portfolio capital to these areas has been limited, never exceeding $200 million during recent years, and usually running closer to $100 million.

The bill permits the President to designate any countries other than the following as less developed countries:

Australia	Monaco
Austria	Netherlands
Belgium	New Zealand
Canada	Norway
Denmark	Republic of South Africa
France	San Marino
Germany (Federal Republic)	Spain
Hong Kong	Sweden
Italy	Switzerland
Japan	United Kingdom
Liechtenstein	Countries within the Sino-Soviet bloc
Luxembourg	

The President may designate an overseas territory, department, province, or possession of any foreign country as a separate economically less developed country. Until the President designates countries as being economically less developed for purposes of this tax, all countries, territories, etc., designated in Executive Order No. 11071, dated December 27, 1962, are to be treated as less developed countries for such purposes. Once the President initially designates a foreign country as being economically less developed for purposes of this tax, he may not terminate such designation without notifying the Congress of his intentoin to do so. (See committee amendment and statement relating to treatment of income and assets from U.S. possessions, from the United States, and from mandated territories.)

3. *Direct investments.*—The bill provides that the tax is not applicable to direct investments. Direct investment implies active participation in the management of the foreign corporation. Decisions to make investments of this type largely are concerned with questions of market position and long-range profitability rather than interest-rate differentials. Your committee believes that application of this bill, which is intended to equalize costs as between capital markets, is not appropriate in that area.

The bill defines as direct investments exempt from tax those acquisitions by a U.S. person of stock or debt obligations of a foreign issuer or obligor where immediately after the acquisition (or within 12 months thereafter) the U.S. person owns 10 percent or more of the combined voting power of all classes of stock of the foreign corporation. In determining whether or not a person owns 10 percent of the voting stock, he is considered to own stock owned by corporations in an affiliated group of corporations as well as the stock owned directly. (Your committee amendments also exempt debt obligations which a 10-percent-owned subsidiary receives in its regular business and passes on to the U.S. parent corporation.)

The bill also defines as direct investments exempt from tax the acquisition of an interest in, or a debt obligation of, a foreign partnership by a general partner if such partner is entitled to a 10-percent or greater interest in the profits of the partnership immediately following the acquisition.

In general, the 10-percent ownership requirement exempts all transactions which would normally be considered business investments. However, in certain foreign countries U.S. persons are prevented by government regulation from acquiring as much as a 10-percent interest in certain corporations even though the business of the foreign corporation is directly related to the business of the U.S. person. In such cases (and in similar cases involving general partnership interests) the bill provides for exemption from the tax even though the U.S. person owns less than 10 percent of the voting stock of the foreign corporation (or less than a 10-percent interest in the profits of a partnership).

The "direct investment" exception is not to apply if the foreign corporation or partnership is formed or availed of for the principal purpose of acquiring stock or debt obligations of foreign issuers or obligors in a case where the 10-percent owner would be subject to tax upon acquisition had the stock or debt obligations been acquired directly by him. Thus, U.S. persons will not be allowed to form "closely held" holding companies for the purpose of acquiring securities which would be taxed if acquired directly. Moreover, if a U.S. person acquires stock or debt obligations of a foreign corporation in which he owns a 10-percent or greater stock interest, for the purpose of selling, or offering for sale, any part of the stock or debt obligations to U.S. persons, the exemption will not apply. (See committee amendment relating to exception for certain foreign banks.)

4. *Commercial bank loans.*—The bill provides an exclusion from tax for the acquisition of debt obligations by a commercial bank in the making of loans in the ordinary course of its commercial banking business. (See committee statement with respect to foreign branches.) In part, this is attributable to the fact that the great bulk of commercial bank loans fall within the less than 3-year maturity range and therefore would in any event not be subject to tax. However, this exclusion also recognizes the special role played by banks in support of normal, recurring financing of the international business of American firms. Also, it permits the banks to continue freely their role in financing U.S. exports and their conduct of banking operations in foreign countries through branches. In this latter case, their activities normally consist of receiving deposits in foreign currencies and making loans in such currencies. These transactions, of course, have no effect on the U.S. balance-of-payments position.

Your committee is aware that a generalized exclusion of this type could be abused. Although that is not expected, your committee does consider it necessary to provide specific authority in the bill for the collection of detailed and timely information on the nature of, and trends in, bank lending to foreign persons. The information collected under these reporting requirements will provide a basis both for determining whether a general exclusion of this character should be continued and, if not, for indicating the specific ways in which the general exclusion should then be modified.

The possible need for and practicability of amending this legislation with respect to loans of commercial banks will be reviewed by your committee should this evidence suggest that bank lending to industrialized countries abroad, whose borrowing will otherwise be subject to tax, is rising in amounts out of proportion to a general expansion in the banking business or amounts related to the normal recurring needs of international trade. A sizable increase in bank lending that appeared to be related to a diversion of credit demands from channels subject to the tax would be a source of particular concern to your committee.

5. *Export financing.*—One of the best ways of reducing the deficit in the U.S. balance of payments is to increase exports from this country. American business has had an excellent record in this regard and to maintain and improve this record it is essential that American firms have the ability to offer credit facilities to their foreign customers, whether for short- or long-term loans. Therefore, the bill provides a series of exemptions for stock and debt obligations of foreign issuers or obligors which are acquired as a result of export transactions. These are listed below:

A. *Guarantees by Export-Import Bank.*—The bill provides that the acquisition of debt obligations which are guaranteed or insured in whole or in part by the Export-Import Bank (or other U.S. Government agencies or instrumentalities) are to be exempt from tax. This exemption is based on the fact that the Export-Import Bank guarantees or insures a loan only if, and to the extent, the debt obligation received by the U.S. exporter is attributable to the sale of goods produced in the United States. This exemption applies without regard to the relationship of the exporter to the producer of the goods.

B. *Goods produced in United States.*—If a U.S. person acquires a debt obligation in the course of his trade or business as a result of the sale of property manufactured, produced, grown, or extracted in the United States, the bill provides that the acquisition of the debt obligation is to be exempt from tax if 85 percent or more of the purchase price in the transaction is attributable to the sale of such property, and to the performance of services, by the U.S. person. The initial acquisition will become subject to tax if the U.S. producer transfers the debt obligation to a U.S. person other than a commercial bank which acquires it in the ordinary course of its commercial banking business or other than to an agency or instrumentality of the United States. Your committee has added an amendment permitting the paper to be transferred where the credit was necessary to the sale and the terms of the credit reasonable. (An exemption for debt and stock arising from the sale or licensing of patents, copyrights, and other intangible property also is provided by your committee.)

C. *U.S. contractors and suppliers.*—The bill provides that the tax is not to apply to the acquisition of stock or debt obligations if 30 percent or more of the purchase price is attributable to the sale of property manufactured, produced, grown, or extracted in the United States by, and services performed by, the person who acquires the stock or debt obligation. However, this is to be true only if 50 percent or more of the purchase price is attributable to the sale of property manufactured, produced, grown, or extracted in the United States, and services performed, by all U.S. persons. Your committee has added an amendment to provide that as an alternative the debt or stock can be equal to 100 percent of all U.S. production, provided the person receiving the stock or debt obligation contributed U.S. production or services equal to at least 60 percent of the value of the securities received. It was pointed out that U.S. persons often bid on an entire foreign project and, as a condition to obtaining the business, are required to take part of the contract price in the form of stock or debt obligations of a foreign issuer or obligor. In many of these contracts, a portion, but not all, of the contract price is attributable to the sale of U.S.-produced goods. In the contracts referred to, the foreign stock or debt obligations are required to be taken by the principal contractor, even though some of the U.S.-produced goods which are furnished in connection with the project may be supplied by U.S. subcontractors. Your committee believes that imposition of tax on acquisitions of this type might impede U.S. contractors and suppliers when competing for foreign projects. As in the case of debt obligations acquired in simple export transactions, tax would generally apply at the time of transfer (based upon the initial acquisition price) if the debt obligation is later transferred to a U.S. person other than a commercial bank which acquires it in the ordinary course of its commercial banking business or other than to an agency or instrumentality of the United States. (However, your committee has amended this to permit the passing on of the debt to anyone where credit was necessary to the sale and the terms of credit were reasonable.) Similarly, the tax will in effect apply to the initial acquisition of stock if the stock is transferred to any U.S. person before January 1, 1966.

D. *Export-related loans.*—The bill provides that the acquisition of a debt obligation is to be exempt from tax if the U.S. person making the loan and receiving the debt obligation can show that the proceeds of the loan will be used for the storage, handling, transportation, processing, packaging, or servicing of property produced by him in the United States. This is designed to cover cases where U.S. producers, in an effort to distribute their products abroad, are required to finance the construction of foreign fabricating, distribution, and marketing facilities which are necessary if U.S. exports of supplier products are to be increased or maintained. Since the exporter-producer generally would not transfer the debt obligation acquired in a transaction of this kind, the bill provides that tax will, in most cases, attach at the time of the transfer (based upon the initial acquisition price) if the U.S. person transfers the debt obligation to a U.S. person other than a commercial bank which acquires it in the ordinary course of its commercial banking business or other than to an agency or instrumentality of the United States. As in the case of debt obligations acquired by an exporter in payment for exported goods, and in the case of contractors financing entire foreign projects, tax is not payable if the debt obligation is transferred to a foreign person, since the acquisition and transfer of a debt obligation under such circumstances does not have an adverse effect on the balance of payments.

6. *Other exemptions provided.*—The bill also provides a series of additional exemptions, described below, designed to deal with specific types of situations. Some of these relate to businesses which, because of their nature, deal in foreign securities. Others are related to natural resource or raw material sources outside of the United States. The other exemptions are for various other factors. In general, these exemptions have one factor in common, however: the acquisition of the foreign securities is due to factors other than the interest rate

differential between American and foreign security markets. The exemptions are as follows:

A. *Insurance companies with foreign business.*—In general, the bill permits insurance companies to elect to acquire stock and debt obligations of foreign issuers and obligors tax free in an amount equal to 110 percent of their reserves against foreign risks. (Your committee has made a series of perfecting amendments in the operation of an insurance company's exempt fund of assets.) If such an election is made, the company must designate stock of foreign issuers, and debt obligations of foreign obligors, which it owned on July 18, 1963, as part of such fund. Once a foreign security is designated as part of one of these exempt reserve funds, if the insurance company sells the security to a U.S. person, the U.S. purchaser will pay tax on the security as if he acquired it from a foreign person. Of course, if it sells the security to a foreign person, no tax would have to be paid by it or the foreign purchaser. In addition to this exemption, insurance companies, like other U.S. persons, may acquire securities tax free under other sections of the bill. The reason for this exemption can be explained as follows: Domestic insurance companies often engage in business in foreign countries through branch operations. In the conduct of this business, they collect premiums in a foreign currency, reinvest the premiums in stock and debt obligations payable in that foreign currency, and must pay liabilities arising under the insurance contract in the same currency as that in which the premiums are collected. These transactions do not, of course, affect the balance-of-payments accounts of the United States. Moreover, an imposition of a tax on such transactions would impose an unreasonable burden on such companies by requiring them, in order to avoid the tax, to invest their reserves in U.S. securities and thereby expose themselves to a foreign exchange risk between the time of investment of premiums and the time claims under the policy were payable.

B. *Underwriters and dealers.*—In the case of underwriters and dealers in foreign securities, the bill provides a procedure which in effect permits them to purchase these securities from foreign issuers and obligors and sell them to other foreign persons without tax effect. Under the provision in the bill, the underwriter is subject to tax when he buys a security from a foreign person without regard to the person to whom he intends to sell it. However, if he or a member of the same distributing group sells it to a foreign person, he may claim a credit or refund for the tax previously paid. In addition, a dealer in foreign bonds is in effect exempted from tax on acquisitions made in the ordinary course of his business if the bonds are resold to foreign persons within 90 days, and your committee has added a provision permitting arbitrage in stocks within a 3-day period. A refund of tax is provided for the dealer or underwriter in such cases since these transactions do not adversely affect the balance-of-payments position of the United States and assist in maintaining effective international capital market facilities.

C. *Labor unions, etc.*—The bill provides an exemption from tax for a tax-exempt organization (described in sec. 501(c)) operating in a foreign country through a local organization to the extent the acquisitions result from the investment of contributions or membership fees paid in the currency of the foreign country by individuals who are members of the local organization if the securities acquired are held exclusively for the benefit of the local organization. Unions collect dues in foreign currency from their members who are residents in the foreign country. The unions invest these dues in stock or debt obligations arising in the foreign country. Subsequently, they dispose of these securities as necessary to meet their foreign obligations. Your committee believes that transactions of this type, like the insurance company reserve provisions described above, should be exempt from tax since they do not affect the U.S. balance of payments and would unnecessarily expose them to an exchange risk. Moreover, investments of this type are not made in response to interest rate differentials.

D. *Ores and minerals with inadequate U.S. supply.*—The bill contains an exemption for loans by U.S. persons to a foreign corporation if 50 percent or more of the total combined voting power of all classes of stock of the foreign corporation is owned by U.S. persons and the foreign corporation extracts or processes ores or minerals. This exemption is only available, however, if the available deposits in the United States of the ore or mineral involved are inadequate to satisfy the needs of domestic producers. In addition, a U.S. person owning the voting stock of the corporation must agree to pay an amount sufficient to amortize a portion of the loan under a so-called take-or-pay contract by which it agrees either to purchase a part of the production of the foreign corporation or to pay a portion of its costs of operation. Usually, a U.S. corporation's commitment to finance a foreign supplier of this type is satisfied through a direct loan from the U.S. corporation. Such a loan would be exempt under the "direct investment" exemption. This exemption, therefore, will be of limited application but is desirable as a way of providing shareholders flexibility in the manner in which they finance the acquisition of foreign ores and minerals, such as bauxite, which cannot be acquired in sufficient quantities in the United States.

E. *Ores and minerals extracted and sold outside the United States.*—The bill provides an exemption for debt obligations acquired by a U.S. person as a result of the sale by him of ores or minerals (or derivatives of the ores or minerals) extracted outside the United States if the foreign purchaser agrees to purchase such ores or minerals for a period of 3 years or more. Provision is also made in the bill to permit these companies to acquire debt obligations of foreign obligors tax free if the proceeds of the loan are to be used by the borrower to install, maintain, or improve facilities for the storage, handling, transportation, processing, or servicing of ores or minerals extracted outside the United States. (Your committee in general has extended this provision to qualify ores or minerals in which the U.S. person has a substantial economic interest.) Acquisitions of debt obligations made as the result of the sale of domestic ores and minerals, or the financing of facilities for their distribution will, of course, be exempt under the general provision relating to export loans. Since, however, the ores and minerals available to U.S. companies may be located in other parts of the world, this provision extends the exclusion to transactions involving foreign ores and minerals.

F. *Acquisition required by foreign law.*—The bill provides an exemption from tax in the case of securities acquired by a U.S. person doing business in a foreign country to the extent these acquisitions are reasonably necessary to satisfy minimum requirements relating to the holding of foreign securities imposed by the laws of the foreign country. Insurance companies, with respect to their insurance reserves, in effect are allowed to apply this exemption or the special tax exemption with respect to foreign reserves, whichever results in the greater holdings of foreign securities. This exemption is provided because some foreign countries require foreign businesses engaged in business locally to invest a portion of their assets in securities of that country as a condition to doing business there. Usually restrictions of this type exist in the case of less developed countries with shortages of local investment funds and with serious exchange problems. However, most foreign countries impose restrictions of this type on regulated industries such as commercial banks, insurance companies, etc. Since these acquisitions of foreign securities arise from business necessity and are not influenced by interest rate differentials, the bill provides an exemption in these cases. If a U.S. person claims an exemption with respect to foreign securities under this provision and then subsequently disposes of these securities, he is treated as a foreign person with respect to this transfer. Thus if he transfers the securities to a U.S. person, this person will generally be subject to tax on this acquisition.

G. *Foreign corporations controlled by Americans and traded here.*—The bill treats as a domestic corporation for purposes of this tax certain foreign corporations other than investment companies. The effect of this is to exempt purchases of their stock from the interest equalization tax. The foreign corporations qualifying for this treatment are those whose stock is traded on a national securities exchange or exchanges registered with the Securities and Exchange Commission if the trading on these U.S. exchanges represented the principal market for their stock during 1962 and if more than 50 percent of the stock was held by U.S. persons (on the latest record date before July 19, 1963). Your committee has added a provision qualifying a foreign corporation for this treatment if 65 percent of its stock was owned by Americans on the latest record date before July 18, 1963.

c. Administrative provisions

1. *Certification procedure.*—As indicated previously, the interest equalization tax does not apply where foreign securities are purchased from a U.S. person. To distinguish taxable from nontaxable transactions, the bill provides for the use of a certification procedure. Under this procedure, receipt of a certificate of American ownership in connection with the acquisition of a foreign security is considered as conclusive proof of prior American ownership unless the person receiving it has actual knowledge that the certificate is false.

A substitute procedure is available in the case of securities purchased on a registered national securities exchange, if the exchange has adopted rules under which transactions will be permitted in the "regular market" only where the seller is a U.S. person. Other transactions through these exchanges would be treated as "special contracts." In effect, if a broker provides the purchaser with a written confirmation that the security obtained for him was acquired in the "regular market," this will be considered the equivalent of receiving a certificate of American ownership by the purchaser. The broker will also provide written confirmation in the case of "special contracts" which will indicate that the security was not purchased in the regular market and, therefore, may be subject to tax. A U.S. person selling on such an exchange may file individual certificates of American ownership with his broker with respect to each transaction. Alternatively, he may file a blanket certificate of American ownership with the broker which will qualify all his subsequent sales through the same account. Essentially the same treatment is available in the case of over-the-counter trading which is subject to similar rules promulgated by a national securities association registered with the Securities and Exchange Commission.

The bill provides a penalty equal to 125 percent of the applicable tax in the case of a person who willfully executes a certificate of American ownership or a blanket certificate of American ownership which is false in any material respect. The penalty also applies in the case of false reports of sales to foreign persons. The penalty is an assessable one, which means that it may be collected in the same manner as the tax. This is provided to discourage persons from executing false certificates. Similar penalties are provided in case false confirmations are furnished by members of either registered national securities exchanges or a registered national securities association. Unless the person acquiring the stock or debt obligation had actual knowledge that the certificate involved is false in any material respect, the penalty applicable in the case of false certification is in lieu of, rather than in addition to, any interest equalization tax.

The bill also provides criminal penalties for the willful execution of individual and blanket certificates of American ownership or sales to foreign persons which are false in any material respect. The criminal penalty in this case makes the willful execution of a false certificate a misdemeanor and provides for a fine of not more than $1,000, or imprisonment for not more than 1 year, or both.

2. *Filing returns.*—Tax liability in the case of the interest equalization tax is to be reported by the filing on a calendar quarter basis of returns covering all of the taxable and certain other transactions occurring within the calendar quarter. The returns must be filed on or before the last day of the first month following the period for which the return is made. (However, the first return period commences July 19, 1963, and ends at the close of the calendar quarter in which this bill is enacted.)

Returns must be filed and reporting must be made on the return both with respect to taxable transactions and also nontaxable transactions where exemption certificates were received. However, in the case of nontaxable transactions, where the purchaser has received written confirmation from members of a registered national securities exchange or a registered national securities association, the transactions need not be reported on these quarterly returns. If required returns are not filed, a civil penalty of 5 percent of the amount of the tax is provided, except that the penalty in no event may be less than $10 or more than $1,000. The penalty does not apply where the failure to file can be shown to be due to reasonable cause. (Your committee has also added an amendment authorizing information returns from the purchasers' brokers.)

3. *Nondeductibility of tax.*—The bill provides that for income tax purposes, deductions may not as a general rule be taken for the interest equalization tax by persons acquiring foreign securities. However, this amount may be capitalized by the person and, therefore, treated as an amount paid by him for the security. If the interest equalization tax paid by the U.S. person when added to the cost of a debt obligation creates bond premium, this premium will be amortizable, and deductible, in the same manner as other bond premium under existing law; namely, rateably over the life of the bond. If the foreign seller of the bond reimburses the U.S. person who buys the bond for part or all of the tax paid by him, this amount is treated as an item of income to the purchaser at that time. However, in such cases he also receives a deduction for the tax in a like amount and to that extent does not add the tax to his basis for the bond.

d. Effective date

The bill generally is effective with respect to acquisitions by U.S. persons of foreign securities made on or after July 19, 1963. This is 1 day after the date Congress received the President's special message to the Congress on the balance of payments and the public announcement of the principal features proposed by the administration for this bill. However, a special effective date is provided for acquisitions of foreign securities acquired on a national securities exchange registered with the Securities and Exchange Commission. For these acquisitions the effective date is August 17, 1963. This later effective date permitted uninterrupted trading in foreign securities on the exchanges, while they were adjusting their trading rules and procedures to the requirements of the proposed bill.

Your committee recognized, however, that the application of the tax to acquisitions resulting from transactions which were in advanced stages of negotiation on July 18, 1963, would have created serious hardships. For that reason, the bill provides that acquisitions made after July 18, 1963, are exempt from tax in various situations such as the four following types of situations:

(1) The acquisition was made pursuant to an obligation which was unconditional on July 18, 1963 (or was subject only to conditions contained in a formal contract under which partial performance had occurred);

(2) The acqusition was made by a person who had taken every action, on or before July 18, 1963, necessary to signify approval of the acquisition under the procedures ordinarily employed by him in similar transactions and had sent the foreign person from whom the acquisition was made a commitment letter (or other document) in which he set forth the principal terms of the acquisition;

(3) The acquisition was made by a U.S. person (exempt under sec. 4915 except for subsec. (c)) who had applied for, and received from a foreign government, on or before July 18, 1963, authorization to make the acquisition, if this authorization was required in order for it to be made; and

(4) If the acquisition was made before September 17, 1963, of stock or a debt obligation covered by a registration statement filed with the Securities and Exchange Commission on July 18, 1963, or within 90 days prior, and the registration statement had not been amended after July 18, 1963, and before the acquisition, in a manner to increase the number of shares of stock or the aggregate face amount of the debt obligations covered by the registration statement.

The bill also provides that tax is not applicable to the acquisition of foreign stock made pursuant to the exercise of an option or similar right held on July 18, 1963, by the acquiring person (or by a decedent from whom he acquired the option or right). U.S. persons who held employees' stock options on July 18, 1963, may exercise their options without tax, and persons who held convertible debentures on July 18, 1963, may convert their debentures to stock without tax.

e. Finance Committee amendments

Your committee has added a series of amendments to the House-passed bill which for the most part are technical in nature and intended primarily to perfect the intent of the provisions of this bill as passed by the House. The more important of these provisions are listed below:

1. The House bill provides that contributions to a foreign pension or profit-sharing trust made by an employee who performs services, for the business involved, on a full-time basis in a foreign country (and who is not an owner-employee) are not to be subject to tax with respect to these contributions. Your committee has amended the bill to extend this exemption to contributions made by an employer to a foreign pension or profit-sharing trust established for the exclusive benefit of employees (who are not owner-employees) who perform personal services for the business on a full-time basis in a foreign country. Exemptions of this type are desirable because they relate to normal business transactions where the contributions can be expected to be made in foreign currency since the benefits are payable to retired employees in foreign currency. It would be inappropriate to subject such trusts to the risk of exchange fluctuations which would be the case were a domestic trust and domestic investments used in such a case (sec. 4912(b)(1)). It should be understood that obligations of a pension or profit-sharing trust to make payments for a specified period or for the life of a beneficiary are not "debt obligations" within the meaning of the bill.

2. The House bill provides that tax is not to apply to acquisitions of foreign stocks or debt obligations in a tax-free reorganization (in the case of exchanges to which sec. 354, 355, or 356 apply, or would apply but for sec. 367). Your committee's amendments provide that the tax also is not to apply in those cases which would be tax-free except for the fact that money (or other property) in addition to stock of the foreign person is received by the U.S. person. Since the receipt of money (or other property) in such a case will benefit the U.S. balance of payments, your committee saw no reason why this should result in the imposition of tax (sec. 4912(b)(4)).

3. The House bill provides an exclusion from tax for the acquisition of debt obligations by a commercial bank in making loans in the ordinary course of its commercial banking business. In this connection your committee does not intend that the interest equalization tax apply to loans or investments in foreign currencies made by foreign branches of U.S. banks to the extent of foreign currency deposits acquired in the ordinary course of their business . Loans or investments will be considered as made in the ordinary course of a branch's commercial banking business if the loans or investments would be considered to be in the ordinary course of commercial banking business either in the United States or in the foreign countries in which the U.S. bank has foreign branches (sec. 4914(b)(2)).

4. Under the bill as passed by the House, tax does not apply to any distribution by a corporation of its own stock or debt obligations. Your committee's amendments would also exclude from tax a distribution in complete or partial liquidation of a corporation of stock or debt obligations owned by the corporation on July 18, 1963 (the general effective date of the bill). However, such a distribution is to be free of tax only to the extent the shareholder involved owned his stock on July 18, 1963, or acquired his stock in a transaction other than one excluded from tax under sections 4914(b), 4915, 4916, or 4917. Provision for distribution of securities held on July 18, 1963, free of this tax seemed appropriate to your committee since the tax does not apply to acquisitions before this date (sec. 4914(a)(5)).

5. Your committee has added an amendment excluding from tax stock or debt obligations acquired by U.S. persons doing business in a foreign country to the extent the acquisition was a substitute for the payment of tax to the foreign country. This exemption was provided because it was obvious that the acquisition of the stock or debt in such cases was not attributable to variations in rates of return in the United States and foreign countries (sec. 4914(b)(4)).

6. Your committee has added an amendment excluding from tax stock of a foreign corporation entitling the holder to occupy for dwelling purposes a house or apartment owned or leased by the corporation. Since purchases of dwellings to be occupied by the purchaser are not generally subject to the interest equalization tax, your committee saw no reason for subjecting to tax what is the equivalent type of ownership in the case of cooperative housing (sec. 4914(b)(5)).

7. The House bill in the case of exporters contains a rule providing that the tax is not to apply to foreign stock or debt arising out of the sale of tangible personal property or services if 30 percent of the purchase price of the property or services is attributable to property produced in the United States by the exporter and at least 50 percent of this property (or services) is produced in the United States by U.S. persons. Your committee has provided alternate rules in this case which relate these requirements to the stock or debt to be acquired rather than to the purchase price of the property or services. Thus, your committee's amendment provides an exemption for the stock or debt if 60 percent of the value of the stock or debt acquired is attributable to production in the United States (or services) by the exporter and if 100 percent of the stock or debt acquired is attributable to property produced in the United States (or services rendered by U.S. persons). This alternate rule is intended primarily as a way of liberalizing the House rule in the case of construction projects outside the United States (sec. 4914(c)(2)).

8. Your committee has added an exemption for stock or debt acquired as a result of the sale or licensing to a foreign person of patents, inventions, or similar property, if 85 percent of the purchase price, or license fee, is attributable to the sale or license of patents, inventions, etc., produced or developed in the United States by the U.S. person who receives the stock or debt obligation. This exemption was provided on the grounds that such sales or licensing have substantially the same effect on the balance of payments as export sales for which a similar exemption is available under the House bill (sec. 4914(c)(3)).

9. The House bill provides an exemption for debt obligations acquired by a U.S. person as a result of the sale by him of ores or minerals extracted outside the United States if the foreign purchaser agrees to purchase these ores or minerals for a period of 3 years or more. Under the House bill, the ores or minerals could have been extracted (1) by the U.S. person himself; (2) by a corporation included in the same affiliated group (50 percent ownership test applied); or (3) by a corporation 10 percent of which is owned by the U.S. person in question and at least 50 percent of which is owned by U.S. persons having 10 percent or greater interests. Your committee's amendments liberalize this House provision by making this exclusion from tax available where the mineral is extracted by a corporation in which the U.S. person (or its 50-percent shareholder or subsidiary) has a 10-percent interest, whether or not there are five U.S. persons having 10-percent interests (a modification of rule (3) above.) In addition, your committee's amendments make this exclusion available where the ores or minerals are obtained under a contract which was entered into on or before July 18, 1963, or where the ore or mineral extracted outside of the United States was exchanged for similar ores or minerals with respect to which the stock or debt was obtained (sec. 4914(c)(5)).

10. Your committee has made a series of perfecting amendments in the exclusion provided by the House bill which allows insurance companies to elect to acquire stock and debt obligations of foreign persons tax free in an amount equal to 110 percent of their reserves against foreign risks. Under the modifications, insurance companies will estimate the size of their reserves without waiting until the end of the calendar years (sec. 4914(e)).

11. Your committee has added an exclusion to provide that a U.S. shareholder may acquire foreign debt obligations tax free in connection with the sale of the stock of a wholly owned foreign subsidiary or as a result of a liquidation of a wholly owned foreign subsidiary following the sale of its assets for a foreign debt obligation. Your committee considered it appropriate to provide exclusions in such cases because acquisitions of this character are not made in response to interest rate differentials (sec. 4914(g)).

12. Your committee has added an exemption for acquisitions by a U.S. person of a debt obligation of a foreign person in connection with the purchase from a U.S. owner of real property located in the United States, where 25 percent of the purchase price is paid in dollars to the U.S. seller. Such transactions are beneficial to our balance of payments (sec. 4914(h)).

13. Your committee has made an exclusion available in certain cases where the assets of a foreign issuer are invested almost exclusively in U.S. securities. In this case, your committee had in mind, primarily, cases where foreign investment companies invest almost exclusively in U.S. securities and sell most of the stock of the company to other than U.S. persons. In such cases, your committee concluded that the stock sales were beneficial to the U.S. balance of payments and, therefore, should not be discouraged by imposing a tax upon minor sales to U.S. persons who are abroad. The tax-free sales to U.S. persons in such cases, however, will only be available to those who are bona fide residents of foreign countries or perform personal services on a full-time basis in a foreign country. In addition the sales will be tax free only to the extent of acquisitions in any year not in excess of $5,000. To qualify for this treatment, less than 25 percent of the stock of the foreign fund must be held by U.S. persons; money and deposits of the foreign fund, other than deposits with U.S. banks, must represent less than 5 percent of the fund's assets; and all other assets of the fund from June 30, 1963, on (or any period thereafter in which the fund is in existence) must be in stocks and debt obligations of U.S. corporations, in U.S. governmental bonds, or in debt obligations of U.S. persons (sec. 4914(i)).

14. Under the House bill, debt obligations exempted from tax under the export provision generally became taxable if the debt was subsequently transferred by the exporter to other than an agency of the United States or a commercial bank. Your committee has amended this provision to permit the transfer of the debt obligation in such cases by the exporter, without tax, where the exporter shows that the extension of credit was reasonably necessary to obtain the sale of property or services and that the terms of the debt obligation were not unreasonable in light of credit practices prevailing in the exporter's business. The standard to be applied under this provision is intended to be flexible, so as to permit U.S. exporters to meet the competitive conditions existing in their respective industries by extending the credit necessary to sell their products and services to foreign customers (sec. 4914(j)(1)(A)(iii)).

15. The House bill contains a general exclusion for direct (as distinct from portfolio) investments by U.S. persons in foreign corporations. Generally, direct investments are considered to be those where the U.S. person owns 10 percent or more of the voting stock of the foreign corporation. Your committee has amended this exclusion to extend it to debt obligations of other foreign persons obtained by the American person from the 10-percent-owned foreign corporation where it, in turn, obtained the debt obligation in the ordinary course of its business, as a result of the sale or rental of products produced by it or for the performance of services by it. Since much the same result could be achieved by direct loans to the 10-percent-owned foreign corporation, your committee saw no reason why the foreign companies should not obtain the funds directly by transferring debt obligations to the U.S. person which it acquired in its business with foreigners (sec. 4915(a)(1)).

16. Under the House bill, the 10-percent-ownership test required in the case of a series of acquisitions that the direct investment standard had to be met on the last day of the calendar year in which the stock purchase was made. Your committee has provided that this ownership requirement can be satisfied by obtaining the 10-percent ownership at any time within 12 months after the acquisition, and has also provided that debt obligations can qualify under this provision. Your committee saw no reason for requiring the satisfaction of the 10-percent requirement at the end of a calendar year rather than at the end of a 12-month period (sec. 4915(a)(2)).

17. In the case of the exclusion for direct investments, the House bill imposes a limitation to the effect that this exclusion is not to be available where the 10-percent-owned foreign corporation is formed or availed of by the U.S. person for the purpose of acquiring stock or debt which, if it were acquired directly, would be subject to the interest equalization tax. In this connection, it is made clear in the House bill that the acquisition by a U.S. person of stock in a foreign

corporation which acquires stock or debt of foreign persons in making loans in the ordinary course of its business as a commercial bank is not to be considered as resulting in the denial of the exclusion to the U.S. person under the direct investment provision. Your committee has amended this provison to provide that for this purpose, the term "commercial bank" is to include any foreign corporation or partnership which is primarily engaged in the business of accepting deposits from customers and receiving other borrowed funds in foreign currencies and making loans in these currencies. Your committee sees no reason why in such cases even though the institutions are not technically considered as "commercial banks" any other test should be applied than that applicable to such banks (sec. 4915(c)(2)).

18. The House-passed bill provides an exemption from tax for acquisitions by U.S. persons of (1) debt obligations of governments of less developed countries; (2) of stock or debt obligations of "less developed country corporations"; or (3) of debt obligations issued by individual residents in less developed countries. To qualify as a less developed country corporation, in general, 80 percent of the corporation's income and 80 percent of its assets must, with certain exceptions, originate in, or be located in, less developed countries. The attention of your committee has been called to cases where the property of corporations located in less developed countries is being nationalized (or taken in action which has the effect of nationalization) and the property is being paid for by the less developed country involved with the requirement that the funds so obtained be invested in that country. In such cases, the corporations involved have had difficulties in obtaining sufficient information with respect to their reinvestments to provide assurance that the corporations in which they invested constitute less developed country corporations (by meeting the two 80-percent tests). In such cases, there appears to be little doubt that the less developed country corporation test could be met if the necessary information could be obtained. Moreover, because of the fact that the reinvestments within the country are required by the country itself, it appears to your committee that no further tests need be imposed by the United States in such cases (sec. 4916(a)(4)).

19. The definition of a less developed country for purposes of the exclusion for less developed country corporations and investments is to be designated by the President except that certain countries listed in the bill are considered as not being less developed countries. The fact, however, that only "foreign countries" can be so designated makes it impossible for a possession of the United States to qualify for this purpose as a less developed country. To prevent discrimination in this regard against investments in such U.S. possessions as Puerto Rico, your committee has amended the definition of less developed countries to include not only foreign countries but also possessions of the United States. In the past, in designating less developed countries, the President by Executive order has made it clear that trusteed areas are considered as separate foreign countries and, therefore, may qualify as less developed countries even though the country to whom they are trusteed under United Nations agreement may not so qualify. Your committee believes that there should be included in the same category as trusteed countries those which were mandated by the League of Nations whether or not subsequently trusteed by the United Nations (sec. 4916(b)).

20. In determining whether or not 80 percent of a corporation's income is derived from a less developed country and 80 percent or more of its assets comes from such countries, your committee has amended the House bill to provide that income or assets located in the United States are not generally to be taken into account. Thus, while such income or assets will not aid a corporation in meeting the 80-percent tests, nevertheless, the presence of income or assets in the United States will not prevent a corporation from otherwise qualifying (sec. 4916(c)(2)).

21. Under the House bill, the interest equalization tax does not apply if a U.S. purchaser establishes by clear and convincing evidence that he purchased a foreign security from another American. Your committee has modified this to provide that he must prove that he purchased the foreign security from an American either by (1) a certificate of American ownership from an American eligible to execute such a certificate, or (2) a confirmation that the purchase was made on the regular market of a registered stock exchange or from a member of a national securities association with respect to an exempt over-the-counter transaction. This prevents an individual from obtaining an exemption from tax where he purchases a foreign security from another American who under the bill is in effect treated in the same manner as a foreigner (e.g., an insurance company with respect to its exempt fund of assets). (Secs. 4918 (a) and (f).)

22. Under the House bill, where an underwriter obtains foreign securities from a foreigner and then resells these securities to foreigners, a credit or refund on the tax initially paid may be claimed. In addition, an exemption is allowed under the House bill for debt obligations acquired by a dealer and within 90 days sold by him to foreigners. In the case of stock, under the House provision, no exclusion was available to a dealer for resales to foreigners. Your committee has provided an exclusion in such cases where the dealer resells the stock to foreigners either on the day of purchase or on either of the 2 succeeding business days. This is designed primarily as a means of exempting dealers whose principal business is engaging in arbitrage in different markets with respect to foreign securities. (Sec. 4919 (a)(3).)

23. Your committee has amended the definition of "domestic corporation" and "domestic partnership" to permit a foreign branch of a dealer in securities to be treated as a foreign corporation or partnership if (1) the branch was located outside the United States on July 18, 1963, and was regularly engaged as a merchant in securities for at least 12 months prior to that date, (2) all purchases by the branch of stock and debt obligations are in the ordinary course of its business, and (3) the branch maintains separate books and records properly reflecting its assets and liabilities. If an election of this type is made, any transfers by the domestic corporation or partnership to the foreign branch, or borrowings by the branch from U.S. banks, are subject to the tax. Your committee believed this amendment is desirable, because it places foreign branches of U.S. securities firms, which were in operation for a substantial period of time prior to the announcement of the tax, in a comparable position with foreign subsidiaries of other U.S. securities firms (sec. 4920(a)(5)).

24. Under the House bill, a class of stock of a foreign corporation is treated as the stock of a domestic corporation if registered national

securities exchanges constituted the principal market for the stock during the calendar year 1962 and as of the latest record date before July 19, 1963, more than 50 percent of that class of stock was owned by U.S. persons. Your committee's bill also treats a class of stock of a foreign corporation as domestic for purposes of the interest equalization tax if more than 65 percent of the stock was held by Americans on the last record date before July 19, 1963. Treatment of foreign corporations which are substantially owned by Americans as domestic corporations, without regard to the market in which their stock is traded, removes the distinction that existed under the House bill between listed stocks and those traded over the counter (sec. 4920(a)(8)).

25. Your committee has provided an exclusion in certain cases from tax for the acquisition of stock in the initial capitalization of a foreign corporation which would be excluded under the direct investment provision but for the requirement that the 10-percent foreign-owned corporation may not invest in assets which would be taxable to the U.S. person if acquired directly. The exclusion is available if at least 75 percent in interest of the U.S. persons in the initial capitalization had appropriately signified before July 18, 1963 their intention to invest in such a corporation. (Bill sec. 2(c)(2)(E).)

26. Your committee has added new broker reporting requirements to the bill. Under the House bill, only the broker for the seller of the stock or debt was required to maintain records to show that the seller had supplied him with a certificate of American ownership or that he had a blanket certificate on file with respect to the seller. Your committee amended the bill to also require the broker for the purchaser to maintain records where the purchaser is potentially liable for tax; that is, in all cases other than where the purchase was made in the regular market on an exchange or in an over-the-counter transaction where the seller's broker represented to the purchaser's broker that the seller had filed with him a certificate of American ownership. (Bill sec. 3(a)(3).)

27. Your committee has provided that the criminal provision in the bill which penalizes the willful execution of false certificates is to be made applicable only to false certificates executed on or after the date of enactment of the bill. This is in conformity with the constitutional prohibition against criminal penalties applying to acts occurring before the date of enactment of the legislation involved. However, this change does not affect the applicability of the provisions in present law (sec. 1001 of title 18, United States Code) which provide criminal penalties for false representations made to a department or agency of the United States on a matter within its jurisdiction (bill sec. 6(b)).

f. Revenue effect

It is estimated that this bill will result in a revenue gain of up to $30 million in a full year of operation.

IV. TECHNICAL EXPLANATION OF THE BILL

SECTION 1. SHORT TITLE, ETC.

(*a*) *Short title.*—As amended, subsection (a) of section 1 of the bill provides that the bill may be cited as the "Interest Equalization Tax Act."

(*b*) *Amendment of 1954 code.*—Subsection (b) of section 1 of the bill provides that whenever in the bill an amendment is expressed in terms of an amendment to a section or other provision, the reference is considered to be made to a section or other provision of the Internal Revenue Code of 1954.

SECTION 2. INTEREST EQUALIZATION TAX

(*a*) *Imposition of tax.*—Subsection (a) of section 2 of the bill adds to subtitle D of the code (relating to miscellaneous excise taxes) a new chapter 41, imposing an interest equalization tax and consisting of sections 4911 through 4920.

SECTION 4911. IMPOSITION OF TAX

This section has been approved by your committee without change. For a technical explanation of section 4911, see pages 24 and 25 of the report of the Committee on Ways and Means on the bill (H. Rept. 1046, 88th Cong., 1st sess.)

SECTION 4912. ACQUISITIONS

Section 4912 as passed by the House defines the term "acquisition" for purposes of the bill.

Your committee has amended paragraphs (1), (2), and (4) of section 4912(b). In all other respects, this section is approved by your committee without change.

For a technical explanation of section 4912 (other than your committee's amendments) see pages 25 through 30 of the report of the Committee on Ways and Means on the bill.

Paragraph (1) of section 4912(b), as amended

Paragraph (1) of section 4912(b) is amended to exempt from tax contributions made by an employer to a foreign pension or profit-sharing trust which it establishes for the exclusive benefit of employees (who are not owner-employees within the meaning of sec. 401(c)(3)) who perform personal services for it on a full-time basis in a foreign country.

Paragraph (2) of section 4912 (b), as amended

Section 4912(b)(2) has been amended by combining subparagraphs (A) and(B) into a new subparagraph (A) and by adding a new subparagraph (B). Under new subparagraph (B), if a domestic corporation or partnership transfers money or other property to, or applies money or other property for the benefit of, a branch office of such corporation or partnership as to which there is in effect an election under new section 4920(a)(5)(E), or if funds are borrowed by such branch from a bank defined in section 581 (other than a branch of such bank located outside the United States lending such funds in the ordinary course of its business), such domestic corporation or partnership shall be deemed to have acquired stock of a foreign corporation or partnership in an amount equal to the actual value of the money or property transferred or applied, or the funds borrowed.

The application of this amendment is illustrated by the following examples:

Example (1).—A, a domestic corporation engaged in business in the United States as a dealer in securities, elects under section 4920(a)(5)(E) to treat F, its branch located in Paris, as a foreign corporation. On December 1, 1964, while the election is still effective, A transfers to F stock of P, a domestic corporation, valued at $200,000. A incurs a tax of $30,000 (15 percent of $200,000), since it is deemed to have acquired stock of a foreign corporation in an amount equal to the actual value of the property transferred.

Example (2).—The facts are the same as in example (1), except that on February 1, 1965, while the election is still effective, A pays $100,000 to employees of F as their salaries for the month of January 1965. A incurs a tax of $15,000 (15 percent of $100,000), since it is deemed to have acquired stock of a foreign corporation in an amount equal to the actual value of the money applied for the benefit of the branch.

Example (3).—The facts are the same as in example (1), except that on March 1, 1965, while the election is still effective, F borrows $300,000 from the New York City office of R, a commercial bank incorporated under the laws of the State of New York. F agrees to repay the loan within 6 months. A incurs a tax of $45,000 (15 percent of $300,000), since it is deemed to have acquired stock of a foreign corporation in an amount equal to the actual value of the funds borrowed by the branch.

Paragraph (4) of section 4912(b), as amended

Paragraph (4) of section 4912(b) as passed by the House provided that an acquisition of stock or debt obligations of a foreign issuer or obligor by a U.S. person in an exchange to which section 354, 355, or 356 applies (or would apply but for sec. 367) is deemed to be an acquisition from the foreign issuer or obligor in exchange for its stock or for its debt obligations.

Your committee's amendment extends the coverage of this paragraph to an acquisition which does not qualify as an exchange under section 354, 355, or 356 in cases where a U.S. person receives money or other property, in addition to voting stock, in exchange for the stock surrendered by such U.S. person.

In addition, an exchange of stock by a U.S. person prior to December 31, 1963, in a taxable year ending before that date, solely for voting stock of a foreign corporation which is in control (as defined in sec. 368(c)) of the acquiring corporation is deemed to take place on the date of enactment of this chapter, so as to qualify as an exchange under section 354 or 356 pursuant to a reorganization under section 368(a)(1)(B), as amended by the Revenue Act of 1964.

The application of this amendment is illustrated by the following example:

Example.—A, a U.S. person, owns all of the stock of M, a domestic corporation. On October 1, 1963, A transfers all of the stock of M to Y, a foreign corporation, in exchange for 10,000 shares of the voting stock of Z, a foreign corporation which controls Y (within the meaning of sec. 368(c)), and $50,000. After the exchange, A owns 4 percent of the voting stock of Z. A's acquisition of Z stock is not subject to tax.

SECTION 4913. LIMITATION ON TAX ON CERTAIN ACQUISITIONS

Subparagraphs (A) and (B) of section 4913(a)(3) have been modified and a new subsection (c) has been added to section 4913. In all other respects, section 4913 remains unchanged.

For a technical explanation of section 4913 (other than the amendments incorporated by your committee) see pages 30 through 33 of the report of the Committee on Ways and Means on the bill.

Subparagraph (A) of section 4913(a)(3), as amended

Under the bill as passed by the House, the tax imposed on the acquisition of stock from a foreign issuer pursuant to the exercise of the right to convert a debt obligation is limited to the amount of tax which would have applied if the debt obligation had been treated as stock at the time of its acquisition (either by the person exercising the right or by a decedent from whom such person acquired the right by reason of death), less any tax actually paid by the person exercising the right (or such decedent) as the result of the acquisition of the convertible obligation.

However, under the bill as passed by the House, only U.S. persons who actually pay tax on the acquisition of a convertible debt obligation have the benefit of the limitation. U.S. persons who acquire convertible debt obligations of foreign obligors in tax-free transactions, for example, from prior American owners (including U.S. underwriters distributing new foreign issues), would pay a 15-percent tax upon conversion of the debt obligation into stock even though the prior American owner may have paid a tax upon his acquisition of the debt obligation. Your committee's amendment limits the tax on conversion in all cases to the amount which would have been due if the acquisition of the debt obligation had been treated as an acquisition of stock from a foreign seller, less the amount of tax actually paid by the person exercising the right (or his decedent) upon acquisition of the convertible, or, if the debt acquisition was not subject to interest equalization tax, the amount of tax which would have been imposed if the debt acquisition had been subject to tax.

The application of this amendment is illustrated by the following examples:

Example 1.—M, a U.S. person, owns convertible debt obligations of Z, a foreign corporation, in the face amount of $5,000 maturing December 31, 1971. M acquired these debt obligations at par value on January 15, 1964 from a prior American owner. Each $1,000 in face amount of the debt obligations is convertible for the life of the obligation into 20 shares of Z. On July 1, 1964, M converts his debt obligations into 100 shares of Z stock. M is liable for tax in the amount of $425 (15 percent of $5,000 ($750) less 6.50 percent of $5,000 ($325)).

Example 2.—On September 1, 1964, P, a U.S. person, acquires at par $10,000 in face amount of a new issue of the convertible obligations of J, a foreign corporation. These debt obligations mature on January 15, 1979. Each $1,000 in face amount is convertible for the life of the obligation into 10 shares of J common stock. On January 4, 1965, P sells these convertibles to Q, another U.S. person, for $13,000. On March 1, 1965, Q converts his holdings of J's debt obligations into 100 shares of J stock. Q is liable for interest equalization tax in the amount of $611, in connection with the conversion (15 percent of $13,000 (or $1,950) less 10.30 percent of $13,000 (or $1,339)).

Subparagraph (B) of section 4913(a)(3), as amended

The bill as passed by the House limits the tax imposed on the acquisition by a shareholder of stock or debt obligations from foreign issuers or obligors pursuant to the exercise of shareholder subscription rights to the exercise price specified in the subscription offer, rather than the difference between the market value of the securities acquired at the time of exercise and the value of the rights exercised if the offering by its terms expires within 90 days from the date that the rights are distributed.

Your committee has expanded the scope of this limitation on tax to make it available to subsequent purchasers of such rights. Your committee has also extended the limitation to anyone who in fact exercises a subscription right within 90 days from the date of its distribution by the corporation, whether or not any termination date is specified in the offering.

The application of this amendment is illustrated by the following examples:

Example 1.—R, a foreign corporation, offers to its stockholders of record July 1, 1964, the right to subscribe to 1 share of stock at $35 per share for each 10 shares held on that date. Rights that are not exercised on or before September 28, 1964, expire automatically. R distributes these rights to its shareholders on the record date. On July 15, 1964, G, a U.S. person who owns 100 shares of R stock, sells his subscription rights to H, another U.S. person, for $100. H exercises the rights on September 1, 1964 (when R's shares are selling for $47 per share), and acquires 10 shares of R stock from the corporation at $35 per share. H is liable for tax in the amount of $52.50 (15 percent of $350).

Example 2.—The facts are the same as in example 1, except that on September 25 corporation R announces that it will extend its subscription offer through October 2, 1964, and all rights exercised through the latter date will be honored. Although the total subscription period has now been extended beyond 90 days, H's tax liability is still limited to $52.50 since he exercised his rights within 90 days of distribution.

New section 4913(c)

Section 4912(b)(3) imposes the tax on the acquisition by U.S. persons of stock or debt obligations of domestic corporations or partnerships which are formed or availed of for the principal purpose of channeling the proceeds of or capital contributions to foreign borrowers. In effect, the American making the acquisition is taxed as if he were acquiring his debt obligation directly from the foreign borrower.

Section 4911 also imposes a tax on the domestic intermediary at the time it transfers the funds to the foreign borrower, in the event that the domestic entity acquires stock or a debt obligation with a maturity of 3 years or more in connection with the transfer.

In order to preclude the imposition of two taxes on such transactions, your committee added a new subsection 4913(c) which would reduce the tax which is payable by the domestic intermediary by the amount of tax paid by the original U.S. lender by virtue of the application of section 4912(b)(3).

The application of this amendment is illustrated by the following example:

Example.—F, a foreign corporation, desires to obtain a long-term loan from L, a U.S. corporation, in order to finance an expansion of its plant. F organizes D, a Delaware corporation, which borrows $1 million from L on a 20-year bond guaranteed by F. D relends the full proceeds of its loan from L to F, in exchange for F's unsecured 20-year note. L is liable for tax in the amount of $122,500 (12.25 percent of $1 million) on its acquisition of D's bond, since D was formed for the principal purpose of obtaining funds for F. D is not liable for tax on its acquisition of F's debt obligation since its tax is limited to the tax otherwise due, $122,500, less the tax paid by L, $122,500.

SECTION 4914. EXCLUSION FOR CERTAIN ACQUISITIONS

Your committee has made several changes in section 4914 and has added several new provisions to this section. The principal additions relate to tax exemptions in the case of—

(1) the receipt in connection with the complete or partial liquidation of a foreign corporation of foreign securities held by the foreign corporation on July 18, 1963;

(2) the acquisition of debt obligations of a foreign obligor when received by a U.S. person in lieu of the payment of a foreign tax;

(3) acquisition by U.S. persons of stock in foreign cooperative housing corporations;

(4) the receipt of foreign debt obligations in connection with the sale or liquidation of a wholly owned subsidiary;

(5) the acquisition of the debt obligation of a foreign obligor in connection with the sale of real property located in the United States, if 25 percent of the purchase price is paid by the foreign purchaser with funds not borrowed directly or indirectly from U.S. persons;

(6) an exemption of not more than $5,000 per year in the case of U.S. citizens resident in a foreign country, or employed on a full-time basis in a foreign country, for investments in foreign corporations substantially all of whose assets consist of U.S. investments; and

(7) the receipt of foreign stock or debt obligations by a U.S. person in connection with the sale or licensing of patents, know-how, etc., which he produced in the United States.

The principal changes relate to—

(1) the rules applicable to investment of reserves maintained by U.S. insurance companies with respect to their foreign insurance business;

(2) the relationship that must exist between a U.S. person acquiring a debt obligation of a foreign obligor in connection with the sale of ores or minerals extracted outside the United States and the person who extracts the ore or minerals sold;

(3) in cases where foreign stock or debt obligations are received in partial payment of a contract, the value of goods sold, or of

services furnished, which must be domestically produced or furnished by U.S. persons; and

(4) a provision which permits the transferability of debt obligations acquired in connection with the export of U.S.-produced property to persons other than an agency or instrumentality of the United States or a commercial bank if the extension of the credit was necessary in order to accomplish the sale and was reasonable in light of competitive conditions.

For the technical explanation of section 4914 of the bill (other than the amendments made by your committee), see pages 33 through 50 of the report of the Committee on Ways and Means on the bill.

New paragraph (5) of section 4914(a)

This is a new paragraph added by your committee to the bill as it was passed by the House. Former paragraph (5) of this subsection is renumbered (6), and subsequent paragraphs are renumbered accordingly.

Under subsection 4914(a)(4), as passed by the House, distributions by a foreign corporation to a U.S. shareholder, with respect to or in exchange for its own stock, would be excluded from tax only if made in the form of stock or debt obligations of the distributing corporation. Your committee's amendment provides an exclusion with respect to acquisitions by a U.S. person as a result of the distribution to such person by a foreign corporation (of which he is a shareholder), in complete or partial liquidation, of any stock or debt obligations which were owned by such corporation on July 18, 1963, provided that the U.S. person acquired the shares with respect to which the liquidating distribution is made prior to July 18, 1963, in a taxable transaction after that date, or in a transaction after that date which was excluded from tax under a section other than sections 4914 (b), 4915, 4916, or 4917.

The application of this amendment is illustrated by the following example:

Example.—X, a U.S. person, owns 100 shares of C, a Canadian company, which he acquired in 1962. On February 5, 1964, X acquires 50 shares of C from Y, another U.S. person, at $10 per share. On February 6, 1964, X acquires 50 shares of C from Z, a Canadian individual, at $9 per share in a transaction subject to tax under section 4911. On July 1, 1964, C distributes all of its securities holdings to its stockholders in a distribution which qualifies as a partial liquidation under section 346. As a result of the liquidating distributions made by C, X receives a $1,000 debenture of P corporation, a Canadian corporation, maturing in 1969, which was acquired by C in 1961, and 100 shares of the common stock of Q, a French corporation, having an actual value of $10 per share at the time of C's liquidating distribution, which were acquired by C in September 1963. X is not liable for tax on the distribution of the debentures of P corporation, but is liable for tax with respect to the distribution of Q stock in the amount of $150 (15 percent of $1,000).

New paragraph (4) of section 4914(b)

This new paragraph excludes from tax acquisitions of foreign stock or debt obligations by a U.S. person doing business in a foreign country to the extent that such acquisitions are made, in conformity with the laws of such foreign country, as a substitute for the payment of

tax imposed by that country. Such acquisitions would not qualify for exclusion under paragraph (3) of this subsection, as passed by the House, as they are merely permitted, rather than required, by the laws of the foreign country.

New paragraph (5) of section 4914(b)

This new paragraph permits a U.S. person to acquire stock of a foreign corporation without tax if ownership of the stock entitles the holder, solely by reason of such ownership, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation.

Paragraph (1) of section 4914 (c), as amended

Subparagraph (A) of this paragraph, as passed by the House, has been amended by your committee to make clear that if payment of any part of a loan to a foreign obligor arising out of a sale of tangible personal property or services is guaranteed or insured by an agency or wholly owned instrumentality of the United States, such as the Export-Import Bank, the acquisition of any related debt obligation arising out of the sale (including any separate debt obligation covering the nonguaranteed portion of the loan, where separate obligations may be issued by the obligor) is excluded from the tax.

For this purpose, the acquisition of a debt obligation in connection with a loan the proceeds of which are used by the purchaser to finance the required downpayment in a transaction guaranteed or insured by an agency or wholly owned instrumentality of the United States is not considered to arise out of the sale.

The application of this amendment is illustrated by the following examples:

Example 1.—P, a U.S. person, sells an airplane manufactured by P in the United States, including engines manufactured in the United States by E, also a U.S. person, to X, a foreign corporation, for a total price of $5 million. P receives from X a downpayment of $1 million in cash. These funds were borrowed by X from Z, a U.S. person. The balance of the purchase price is provided under a 7-year Export-Import Bank credit agreement, pursuant to which P agrees to accept 15 percent of the $4 million obligation in part payment for the airplane. E agrees to participate in P's share in the ratio of the sales price of the engines to the sales price of the airplane. The acquisitions by P and E are excluded from tax under section 4914(c)(1). The acquisition of the $1 million debt obligation by Z is not excluded from tax under section 4914(c)(1).

Example 2.—The facts are the same as in example 1 above, except that the $4 million balance of the purchase price is provided under a 7-year loan extended by a commercial bank Y, secured by a guarantee of 85 percent of its face amount by the Export-Import Bank and by a participation by P to the extent of 15 percent of the $4 million obligation in part payment for the airplane. E agrees to participate in P's share in the ratio of the sales price of the engines to the sales price of the airplane. The acquisitions by P and E are excluded from tax.

Paragraph (2) of section 4914(c) as amended

Under the bill as passed by the House, tax would not apply to the acquisition by a U.S. person from a foreign issuer or obligor of its stock in payment for, or a debt obligation arising out of, the sale of tangible personal property if, in general, 30 percent of the purchase price is attributable to property manufactured and/or services performed by the U.S. person receiving the stock or debt obligation and at least 50 percent of the purchase price is attributable to U.S.-produced goods and/or services performed by U.S. persons.

Your committee has amended subparagraph (B) to provide that the tax does not apply to the acquisition of foreign stock or debt obligations if at least 30 percent of the purchase price, or 60 percent of the actual value of the stock or debt obligation acquired, is attributable to the sale of property manufactured, produced, grown, or extracted in the United States by the U.S. person (or by one or more includible corporations in an affiliated group of which such person is a member) or to the performance of services by such U.S. person (or by one or more such corporations), or to both, and at least 50 percent of the purchase price, or 100 percent of the actual value of the stock or debt obligation acquired, is attributable to the sale of property manufactured, produced, grown, or extracted in the United States or to the performance of services by U.S. persons, or both.

New paragraph (3) of section 4914(c)

Your committee has added a new paragraph (3) to this subsection. Succeeding paragraphs in the House bill are renumbered accordingly.

The bill as passed by the House provides no exclusion for acquisitions arising out of the sale or license to foreigners of intangible personal property developed in the United States. Your committee's amendment excludes from tax the acquisition of stock or a debt obligation by a U.S. person from a foreign issuer, if the stock or debt obligation arises out of the sale or licensing to that issuer of any interest in intangible property or in any combination of intangible properties (such as patents, inventions, models or designs, or other like property), either alone or together with services to be performed in connection with the sale or license.

In order for such an export-related acquisition to qualify for this exclusion in circumstances where related services are not performed by the exporter, not less than 85 percent of the purchase price or license fee must be attributable to the sale or license of intangible property which is produced, created, or developed in the United States by the exporting U.S. person or by one or more corporations includible in an affiliated group within the meaning of section 1504 of which such U.S. person is a member. If related services as described in this provision are to be performed in connection with the sale or license, at least 85 percent of the purchase price or license fee must be attributable to a combination of the sale or license of an interest in such property so produced, created, or developed and the performance of such services.

For purposes of your committee's amendment, any intangible property or interest therein which is produced, created, or developed by an employee or consultant of a U.S. person pursuant to an employment or consulting contract which grants proprietary rights in properties so created, developed, or produced to the U.S. person shall be deemed to have been created, developed, or produced by such U.S. person.

The application of this amendment is illustrated by the following example:

Example.—P, a U.S. corporation, grants to X, a British corporation, an exclusive license to manufacture P's patented cameras and films in the United Kingdom for a period of 15 years, together with the right to use certain trademarks for the same period and access to P's related know-how. P's patents, trademarks, and know-how were developed in the United States by P. X agrees to pay P $1 million in cash, 50,000 shares of X stock currently selling at $25 per share and representing 5 percent of X's outstanding shares, and 5 percent of the gross receipts derived from its camera and film manufacturing activities in each of the next 15 years. P's acquisition of X's stock and debt obligation are excluded from tax under this paragraph.

Paragraph 5 of section 4914(c), as amended

Your committee has amended this paragraph in order to expand in certain instances the exclusion from tax for the acquisition of debt obligations in connection with the sale of ores and minerals extracted outside the United States.

The bill as passed by the House excludes from tax the acquisition by a U.S. person of a foreign debt obligation if the foreign purchaser agrees to purchase over at least a 3-year period ores or minerals sold by the U.S. person and extracted outside the United States. The bill provides that the extraction must be by the U.S. person, an affiliated company, or a corporation at least 10 percent of the voting power of which is owned by the U.S. person, so long as 50 percent of the voting power is owned by U.S. persons each of whom owns at least 10 percent of the voting power. The House bill also excludes from tax the acquisition of debt obligations of foreign obligors if the proceeds of the loan are to be used by the borrower to install, maintain, or improve facilities for the storage, handling, transportation, processing, or servicing of ores or minerals extracted outside the United States by the U.S. person, an affiliated corporation, or a 10-percent owned corporation described above.

Under your committee's amendment, the ores or minerals being sold by the U.S. person under a long-term sales contract must be extracted outside the United States by the U.S. person acquiring the debt obligation, an affiliated company, or any corporation in which the U.S. person, domestic corporations owning at least 50 percent of the voting stock of the U.S. person, or one or more affiliated corporations hold a direct investment (10 percent or more of the total voting stock) or it must have been obtained by such corporation or corporations in exchange for similar ores and minerals so extracted. U.S. persons are not required to own 50 percent of the extracting company, as they are under the bill as passed by the House.

Your committee's amendment also qualifies ores and minerals obtained under a contract entered into on or before July 18, 1963, by such U.S. person, domestic corporations, or an affiliated company, regardless of whether they perform the actual extraction, and similar ores and minerals obtained in exchange for such ores and minerals.

As a corollary change, subparagraph (B) is amended to include the definition of ores and minerals extracted or obtained in the manner described above. Accordingly, the acquisition of foreign debt obligations by U.S. persons is excluded from tax if the loan proceeds will be used by the borrower, or by a person controlled by, or controlling, the borrower, to install, maintain, or improve facilities for the storage, handling (including distribution), transportation, processing, or servicing of ores and minerals if a substantial portion of all of the ores and minerals (or derivatives thereof) utilized in the new, additional, or improved facility financed by the loan consists of ores and minerals described in subparagraph (A).

The application of this amendment is illustrated by the following examples:

Example 1.—A, a U.S. corporation which is a wholly owned subsidiary of H, another U.S. corporation, lends $10 million to J, a Japanese corporation, in exchange for the latter's 10-year promissory note. J agrees to use the loan proceeds to build additional refining and distribution facilities which will add 10 percent to J's total refining and distributing capacity, and to use this additional capacity exclusively to refine and distribute crude oil purchased from A, for the ensuing 10-year period. In order to meet its obligations under the contract, A will acquire crude oil from K, a Middle East producer. H owns 10 percent of all of the voting stock of K. A's loan to J is excluded from tax under this paragraph.

Example 2.—J, a Japanese corporation, borrows $10 million in January 1965 from G, a U.S. corporation, to build a new refinery. J gives its 10-year promissory note to G and agrees to buy from G all of the crude oil to be used in its new refining facilities for the 10-year period. G is obligated under a contract entered into on November 1, 1962, to purchase a certain number of barrels of crude oil in each year through 1976 from K, a foreign corporation, which extracts oil in the Middle East. Pursuant to its agreement, G delivers to J oil acquired under its contract with K. G's loan to J is excluded from tax under this paragraph.

Subsection (e) of section 4914, as amended

Under the bill as passed by the House, an insurance company, which is a U.S. person and subject to income taxation under sections 802, 821, or 831 of the code, may exclude from the tax imposed by section 4911 certain acquisitions of stock or debt obligations of a foreign issuer or obligor by (1) establishing a fund or funds of assets with respect to foreign risks insured by the company under contracts the proceeds of which are payable in a foreign currency (other than the currency of a less developed country), and (2) designating certain foreign stock or debt obligations held on and acquired after July 18, 1963, as assets of such fund or funds. The adjusted basis of the assets so designated may in no event exceed 110 percent of the applicable allowable reserve determined annually, after an initial designation of assets, in the manner set forth in the bill.

The fund of assets concept set forth in subsection 4914(e) (1) and (2) and the provisions of paragraphs (3)(A)(ii) and (4)(A) of subsection 4914(e) regarding the time and manner of making the initial designation of assets for such fund and the method of determining the allowable reserve applicable to such fund have, in general, been approved without substantive change.

Section 4914(e)(5), which denies recognition of artificial increases in the allowable reserve for the principal purpose of permitting the designation of additional fund assets, has been approved without change.

Section 4914(e)(1)(B) as passed by the House, which prescribes the maximum amount of assets which may be designated with respect to a fund, has been deleted, but its substance has been incorporated in amended paragraphs (3)(A)(i) and (3)(E)(i) of section 4914(e).

Paragraph (3)(A)(i) of section 4914(e), which provides for the initial designation of foreign stock and debt obligations as the assets of a fund, has been amended to provide a new method for designating and valuing the assets as well as a different date for determining the applicable allowable reserve. The new method for making the initial designation permits certain foreign short-term debt obligations (having a period remaining to maturity of less than 3 years) to be included in the initial designation and also prescribes the following order of prority in designating assets: (1) Foreign stock and long-term debt obligations payable in a foreign currency, (2) at the election of the company, short-term debt obligations payable in a foreign currency, and (3) long-term debt obligations payable solely in U.S. currency. The value at which stock or debt obligations designated as a fund asset shall be taken into account has been changed from its actual value on December 10, 1963, to its adjusted basis (within the meaning of sec. 1011) on July 18, 1963. The allowable reserve applicable to a fund for this purpose is also determined as of the latter date.

Section 4914(e)(3)(B) has been amended, in conformity with the above change in paragraph (3)(A)(i), to permit, within the limits of 110 percent of the applicable allowable reserve, the designation of foreign stock or long-term debt obligations acquired after July 18, 1963 (rather than December 10, 1963) as additional assets to maintain a fund on a current basis. The adjusted basis of these assets (and all other fund assets not included in the initial designation) is determined as of the date of designation.

Section 4914(e)(3)(C) as passed by the House, which limits the amount of additional assets permitted to be designated after the initial designation, has been deleted, but its substance has been incorporated in amended paragraph (3)(E)(i) of section 4914(e).

A new section 4914(e)(3)(C) has been added to the bill which permits, within 31 days after the close of any calendar year other than 1963, the designation of foreign stock or long-term debt obligations owned at the close of the calendar year as additional assets of a fund within limits of 110 percent of the applicable allowable reserve for such calendar year. A credit or refund may be claimed for tax paid (if any) on the acquisition of any foreign stock or debt obligations so designated. In effect, this new paragraph reaches the same result as section 4914(e)(4)(B) of the bill passed by the House, without requiring an election by the insurance company.

A new section 4914(e)(3)(D) has been added to the bill which requires that, after the permissive designation of additional assets under amended section 4914(e)(3)(C), the insurance company must designate as assets of any fund (within the limits of 110 percent of the applicable allowable reserve) foreign stock or debt obligations previously acquired during the year but excluded from the tax imposed by section 4911 by reason of an Executive order issued under section 4917. The designation of these assets is to be made in the same order of priority prescribed for the initial designation of assets in amended paragraph (3)(A)(i) of section 4914(e), and the insurance company may elect to designate debt obligations having a period remaining to maturity (on the date of acquisition) of less than 3 years and payable in foreign currency before designating long-term obligations payable in U.S. currency excluded from tax under the Executive order.

A new paragraph (3)(E) has been added to section 4914(e) of the bill which provides in clause (i) that any designation of foreign stock or debt obligations as part of a fund of assets will be ineffective, to the extent that immediately after such designation the adjusted basis of all the assets in such fund would exceed 110 percent of the applicable allowable reserve as determined under paragraph (4)(B)(i). The acquisition of any stock or debt obligation to the extent it has been ineffectively designated is subject to the tax imposed by section 4911, as of the date of acquisition, plus interest (if any).

Clause (ii) provides that no designation of a debt obligation having a period to maturity of less than 3 years, as of the date of acquisition, may be made to maintain a fund.

Section 4914(e)(4)(B) of the bill passed by the House, which gives the insurance company an election to determine its allowable reserve as of the end of the calendar year in which acquisitions are made, has been amended by your committee to provide in clause (i) that, for purposes of all designations of assets other than the initial designation, the determination of the applicable allowable reserve for any calendar year shall only be made as of the close of such year. Therefore, the allowable reserve applicable to a fund (for purposes other than the initial designation) is determined independently for each calendar year and without reference to the amount of the applicable reserve determined with respect to a preceding calendar year. The amended paragraph also provides in clause (ii) that the allowable reserve applicable to the initial designation of assets shall be determined as of July 18, 1963, but, at the election of the insurance company, the determination may be made by computing the mean of the allowable reserve at the beginning and at the close of the calendar year 1963.

The application of section 4914(e), as amended by your committee, is illustrated by the following example:

Example: (a) Initial designation to establish fund.—Corporation R is a domestic insurance company subject to income taxation under section 802 of the code. Corporation R insures the lives of residents of foreign country X, which is not a less developed country, under contracts the proceeds of which are payable only in the currency of that country. The allowable reserve of corporation R with respect to such contracts, as determined under paragraph (4)(A)(i) of section 4914(e), is $700,000 on January 1, 1963, and $900,000 on December 31, 1963. Corporation R elects to determine its allowable reserve as of July 18, 1963, by computing the mean of the allowable reserve at the beginning and close of 1963, as provided in paragraph(4)(B)(ii) of section 4914(e). Thus, as of July 18, 1963, R corporation has an allowable reserve of $800,000. Corporation R also insures the lives of residents of foreign country Y, which is not a less developed country, under contracts the proceeds of which are payable only in Y country's currency. As of July 18, 1963, the amount of R's allowable reserve with respect to such contracts is $400,000. All corporations (other than R corporation) and all countries (other than the United States) referred to in this example are foreign corporations or countries none of which are less developed countries or less developed country corporations. On July 18, 1963, corporation R owns the following stock or debt obligations (none of which are described in sec. 4916 (a)) having maturities (if applicable) and adjusted bases on that date as follows:

Stock or debt obligation	Period to maturity in years	Adjusted basis
A corporation bonds payable in foreign currency	10	$300,000
B corporation bonds payable in foreign currency	12	100,000
C corporation bonds payable in U.S. currency	10	100,000
D corporation notes payable in U.S. currency	2	40,000
E corporation bonds payable in U.S. currency	5	200,000
F corporation stock		100,000
G corporation stock		200,000
X country notes payable in foreign currency	2	80,000
Y country bonds payable in foreign currency	15	200,000

In order to obtain the benefit of the exclusion provided in section 4914(e)(1), R corporation on September 15, 1964, establishes two funds of assets, one with respect to the risks insured in X country and the other with respect to the risks insured in Y country, by segregating on its books (in accordance with sec. 4914(e)(3)(A)(ii)) the assets which are to be designated as all or part of each fund. The following table sets forth with respect to each fund, the amount which is 110 percent of the allowable reserve as of July 18, 1963, R corporation's designations (in accordance with the priority of designation prescribed by sec. 4914(e)(3)(A)(i) for an initial designation of assets) with respect to the stock or debt obligations described above, and the difference between the amount of permissible and actual designation.

	Currency X fund	Currency Y fund
110 percent of allowable reserve as of July 18, 1963	$880,000	$440,000
Initial designation:		
(1) A corporation bonds	300,000	
(2) B corporation bonds	100,000	
(3) F corporation stock	100,000	
(4) Y country bonds	200,000	
(5) X country notes	80,000	
(6) C corporation bonds	100,000	
(1) G corporation stock		200,000
(2) E corporation bonds		200,000
Adjusted basis of designated assets	880,000	400,000
Difference between amount of permissible and actual designation	0	40,000

Under section 4914(e)(3)(A)(i), corporation R must designate the bonds of corporations A and B, the bonds of Y country and the stock of corporations F and G before designating any other assets as a part of either fund. R corporation may then elect to designate the notes of X country and then must designate the bonds of corporations C and E. Even though the allowable reserve applicable to Y fund would permit an additional designation of $40,000, the D corporation notes may not be designated because such notes have a maturity of less than 3 years on July 18, 1963, and are not payable in foreign currency.

(*b*) *Current designations to maintain fund.*—During the period from July 19 to December 31, 1963, R corporation engages in the following transactions involving foreign stock or debt obligations:

	Date of acquisition	Years to maturity (if any)
H corporation bonds	Aug. 1, 1963	5
I corporation notes	Sept. 5, 1963	2
J corporation stock	Oct. 1, 1963	
X country bonds	do	20
K corporation notes	Nov. 1, 1963	4
L corporation notes	do	5
Y country bonds	Nov. 29, 1963	10

The allowable reserve applicable to the X fund and Y fund for the calendar year 1963 (as determined under sec. 4914(e)(4)(B)(i)) amounted to $900,000 and $450,000, respectively, on December 31, 1963.

In accordance with section 4914(e)(3)(B), R corporation may designate within the limits of 110 percent of the applicable allowable reserve for 1963, foreign stock and debt obligations acquired after July 18, 1963, and prior to January 1, 1964, as additional assets to maintain the funds. These designations are not required to be made in any prescribed order of priority and it is immaterial whether the debt obligations are payable in foreign or U.S. currency. Accordingly, on September 15, 1964 (the date of the initial designation), R corporation designates, as additional assets of funds X and Y for the year 1963, the following stock or debt obligations (the amounts refer to the adjusted basis of the asset):

	Currency X fund	Currency Y fund
110 percent of allowable reserve for 1963	$990,000	$495,000
Initial designation (adjusted basis)	880,000	400,000
Additional designations for 1963:		
Y country debt obligations	90,000	
H corporation debt obligations	20,000	
J corporation stock		15,000
K corporation debt obligations		20,000
L corporation debt obligations		10,000
X country debt obligations		30,000
Adjusted basis of assets designated as of Dec. 31, 1963	990,000	475,000
Difference between amount of permissible and actual designation	0	20,000

The I corporation debt obligations cannot be designated because, under section 4914(e)(3)(E)(ii), no debt obligations with a period remaining to maturity of less than 3 years can be designated as an additional asset to maintain a fund.

(*c*) *Permissive and required designations after close of year.*—At the time of the initial designation (September 15, 1964), and at various times thereafter during 1964, R corporation designates, as additional assets of funds X and Y, foreign stock or debt obligations (with a period to maturity of at least 3 years) acquired during 1964 which have an adjusted basis of $120,000 (fund X) and $75,000 (fund Y). On December 31, 1964, the adjusted basis of all designated assets in fund X is $1,110,000 and in fund Y is $550,000. After the close of 1964, 110 percent of the allowable reserve for the calendar year 1964 is determined to be $1,320,000 with respect to fund X and $660,000 with respect to fund Y.

In addition to the foreign stock or debt obligations designated during 1964, R corporation acquires during the year stock of M corporation and $300,000 (face value) of newly issued 20-year debt obligations of Y country, payable in the currency of Y. The acquisition of the debt obligations is excluded from tax by an Executive order issued under section 4917.

Corporation R has paid the tax imposed by section 4911 on the acquisition of the stock of M corporation. On January 28, 1965, under section 4914(e)(3)(C), R corporation designates the stock (which it still owns) as an asset of fund X with an adjusted basis of $50,000. Thus, R corporation is entitled to a refund or credit for the tax paid on acquisition. After this designation, R corporation may still effectively designate, as assets of fund X, foreign stock or debt obligations acquired during 1964 with an adjusted basis of $160,000 and as assets of fund Y, such stock or debt obligations with an adjusted basis of $110,000. On January 31, 1965, as required under section 4914(e)(3)(D), R corporation designates $160,000 of the Y country debt obligations as an asset of fund X and $110,000 of such debt obligations as an asset of fund Y.

The status of the funds as of December 31, 1964, is as follows:

	Currency X fund	Currency Y fund
110 percent of allowable reserve for 1964	$1,320,000	$660,000
Adjusted basis of assets as of Dec. 31, 1963	990,000	475,000
Adjusted basis of assets designated during 1964	120,000	75,000
Assets acquired in 1964 and designated between Jan. 1 and Jan. 31, 1965:		
(1) M corporation stock	50,000	
(2) Y country debt obligations	160,000	110,000
Adjusted basis of assets designated as of Dec. 31, 1964	1,320,000	660,000
Difference between amount of permissible and actual designations	0	0

(*d*) *Limitations upon designation.*—After the close of the calendar year 1965, it was determined that 110 percent of the allowable reserve for 1965 with respect to fund X was $1,350,000 and with respect to fund Y was $700,000. In anticipation of a larger applicable allowable reserve for the year with respect to each fund, R corporation had acquired and designated, at different times during 1965, the following foreign stock and debt obligations as additional assets of the funds:

	Currency X fund	Currency Y fund	Acquisition date	Designation date
110 percent of allowable reserve for 1965	$1,350,000	$700,000		
Adjusted basis of assets as of Dec. 31, 1964	1,320,000	660,000		
Assets acquired and designated during 1965:				
(1) N corporation 12-year bonds	30,000		Mar. 1	Mar. 15
(2) O corporation stock		40,000	Apr. 15	Apr. 30
(3) P corporation 10-year bonds	50,000		May 1	May 20
(4) Q corporation stock		50,000	June 1	June 10
(5) X country 15-year bonds	80,000		July 15	Aug. 10
(6) S corporation 10-year bonds	50,000		Sept. 15	Oct. 1

On June 15, 1965, $80,000 of X country notes, which were included as an asset of fund X in the initial designation, matured.

After the designation of the N corporation bonds as an asset of fund X on March 15, 1965, and the O corporation stock as an asset of fund Y on April 30, 1965, the total assets of the respective funds amount to $1,350,000 and $700,000, which in the case of each fund was equal to 110 percent of its applicable allowable reserve for 1965. The subsequent designation of the P corporation bonds on May 20, 1965, and the Q corporation stock on June 10, 1965, as assets of funds X and Y, increased the adjusted basis of the assets in each fund to an amount in excess of 110 percent of the applicable allowable reserve. Therefore, under section 4914(e)(3)(E)(i), the designation of such stock and bonds is ineffective, and the acquisition is subject to the tax imposed by section 4911 as of May 1 and June 1, 1965, the respective dates of the acquisitions, plus interest. The designation of the X country 15-year bonds as an asset of fund X on August 10, 1965, is an effective designation, because the total assets of fund X were reduced by the retirement of $80,000 of X country notes before that date. However, the designation of these bonds again brought the adjusted basis of the assets in fund X up to 110 percent of the applicable allowable reserve ($1,350,000). Consequently, the subsequent designation of the S corporation bonds on October 1, 1965, as an asset of fund X is an ineffective designation, and the acquisition of the bonds is subject to the tax imposed by section 4911 as of September 15, 1965, the date of acquisition, plus interest.

New subsection (g) of section 4914

Subsection (g) provides that the tax shall not apply to the acquisition by a U.S. person of a debt obligation if the debt obligation is received in connection with—

(*a*) the sale by such person (or by one or more members of an affiliated group, as defined in section 48(c)(3)(C), of which such person is a member) of all the outstanding shares of a foreign corporation, except for qualifying shares, or

(*b*) the liquidation of a foreign corporation, all of whose outstanding stock, except for qualifying shares, are owned by such U.S. person (or one or more such members).

In the case of an acquisition in connection with a liquidation, the U.S. person will be entitled to the exclusion under this subsection only if its foreign subsidiary acquired the foreign debt obligation which is distributed in liquidation as part or all of the purchase price for the sale of substantially all of the subsidiary's assets.

This exclusion does not apply to the acquisition of a debt obligation by a U.S. person if any of the stock sold or surrendered in connection with such acquisition was originally acquired with the intention to sell or surrender it.

The application of this amendment is illustrated by the following examples:

Example 1.—A, a U.S. corporation, owns all of the outstanding shares of C, a Canadian corporation, except for three qualifying shares owned by Canadian individuals in compliance with local law. A originally acquired its investment in C in 1949. On September 1, 1964, A enters into a contract with B, a British corporation, to sell all of its shares of C to B for an initial payment of $2 million in cash and B's $5 million promissory note which will mature in 5 years. A's acquisition of B's promissory note is excluded from tax.

Example 2.—The facts are the same as in the previous example, except that B purchases C's assets rather than the stock of C held by by A. C accepts the $2 million in cash and B's $5 million promissory note in payment for its assets and immediately adopts a plan of complete liquidation, pursuant to which it distributes to A cash and B's note in exchange for its stock. A's acquisition of B's promissory note is excluded from tax.

New subsection (h) of section 4914

Subsection (h) grants an exclusion from tax in certain circumstances to a U.S. person acquiring a debt obligation from a foreign obligor in connection with the sale of real property located in the United States. In order for the acquisition to qualify under this provision (1) the debt obligation must be secured by a lien against the real property located in the United States (whether by a retention of title by the selling U.S. person until payment is completed by or a mortgage arrangement); (2) the debt obligation must be part of the purchase price of the property, or arise out of a loan made by the U.S. person to the foreign obligor the proceeds of which are used concurrently as part of the purchase price of the property; (3) the owner of the property sold must be a U.S. person; and (4) at least 25 percent of the purchase price of the property must be paid in U.S. currency by the foreign obligor to the seller from funds which have not been obtained from U.S. persons for the purpose of purchasing such property.

The sale of personal property used in connection with the operation of real property is permitted to be included as part of a sale involving real estate without loss of the exclusion if the personal property is related in use to the real property sold.

The application of this amendment is illustrated by the following example:

Example.—On July 1, 1964, A, a U.S. person owning real property in the United States, sells this property, together with all operating fixtures, for $8 million to F, a foreign corporation. F pays $6 million in cash, $4 million of which it borrows from B, a domestic corporation, over a 20-year period and $2 million of which is not obtained from U.S. persons. A takes back a 5-year purchase money mortgage for the balance of the purchase price. The debt obligations acquired by A and B are excluded from tax.

New subsection (i) of section 4914

Your committee has added a new subsection (i) to section 4914. This provision excludes from tax the acquisition of the first $5,000 of the stock of foreign issuers described in this subsection acquired in any year by a U.S. person who is a bona fide resident of a foreign country or who, at the time of acquisition, is performing personal services on a full-time basis in a foreign country, if the following conditions are met: (1) The stock is acquired directly from the foreign issuer; (2) at the close of each calendar quarter ending on or after June 30, 1963, preceding such acquisition, during any part of which such foreign issuer is in existence, the assets of the issuer (apart from money or bank deposits) consist solely of stock or debt obligations of domestic corporations (other than investment companies electing foreign status under section 4920(a)(3)(B)) or of the United States or any political subdivision thereof, or debt obligations of U.S. persons; (3) money and deposits with other than U.S. banks constitute less than 5 percent of the assets of the foreign issuer; and (4) less than 25 percent of each class of issued and outstanding stock of the foreign issuer is held of record by U.S. persons. A U.S. person who obtains an exclusion under this subsection is treated as other than a U.S. person with respect to stock so excluded if he sells or otherwise disposes of such stock after July 30, 1964.

For purposes of this subsection, an individual who owns an interest in the shares of an investment company through the acquisition of an interest in a unit investment trust or similar custodial entity will be considered to have made a direct acquisition of shares from such investment company.

The application of this amendment is illustrated by the following examples:

Example 1.—On September 1, 1964, U, a U.S. citizen who is a bona fide resident of France, purchases 100 shares of C, a Canadian mutual fund, from C for $4,000. C has only one class of shares outstanding. At all times since its organization in 1961 through December 31, 1964, C has kept at least 98 percent of its assets invested in the common stock of U.S. industrial corporations. The balance of its assets is maintained as a cash reserve deposited in accounts with persons carrying on the banking business. From the time of its organization through December 31, 1964, not more than 20 percent of C's shares have been owned of record by U.S. persons. U makes no other investments during 1964. U's acquisition of C's shares is excluded from tax under this subsection.

Example 2.—The facts are the same as in example 1, except that on November 1, 1964, U purchases for $2,100 an additional 50 shares of C stock from the C Systematic Accumulation Plan, a unit investment trust set up by C to sell C's shares under contractual arrangements. C is liable for tax in the amount of $165 (15 percent of $1,100, the amount by which his total acquisitions of such shares exceed $5,000 during 1964).

Example 3.—The facts are the same as in example 2, except that on September 30, 1964, C's assets include 5,000 shares of R, a Dutch corporation, which were acquired during the third quarter of 1964. U is liable for tax in the amount of $315 (15 percent of $2,100); no tax is due with respect to the $4,000 acquisition on September 1.

New subsection (j) of section 4914

Subparagraph 4914(j)(1)(A)(iii), permits a U.S. person acquiring a foreign debt obligation in connection with an export transaction described in subsection 4914(c)(1)(B), (2) or (3) to transfer that debt obligation to any U.S. person without incurring tax liability at the time of the subsequent transfer, provided that the original extension of credit and the acquisition of the debt obligation related thereto was reasonably necessary to accomplish the sale of property or services out of which the debt obligation arose and the terms of the debt obligation were not unreasonable in light of credit practices in the business in which the exporter is engaged.

SECTION 4915. EXCLUSION FOR DIRECT INVESTMENTS

Section 4915(a), as passed by the House, provides an exclusion from tax for acquisitions of stock or debt obligations of a foreign corporation or partnership if the acquiring U.S. person has at the time of the acquisition, or at the end of the calendar year in which the acquisition is made, a 10-percent voting stock interest in the foreign corporation or a 10-percent interest in the profits of the foreign partnership.

Your committee has modified this section in three respects. First, it has provided an exemption in cases where the debt obligations acquired by the U.S. person were received by the foreign corporation in the ordinary course of its trade or business in connection with the sale of property produced by it or services performed by it. Second, your committee has provided for a credit or refund with respect to a taxable acquisition if the acquiring U.S. person meets the 10-percent ownership requirement at any time within 12 months after such acquisition. Third, it treats certain foreign corporations as commercial banks.

For a technical explanation of section 4915 (other than the amendments made by your committee), see pages 50 through 54 of the report of the Committee on Ways and Means and amendments on the bill.

Paragraph (1) of section 4915(a), as amended

Paragraph (1) of section 4915(a), as passed by the House, states the general rule that an acquisition by a U.S. person of stock (as defined in sec. 4920(a)(2)) or debt obligations (as defined in sec. 4920(a)(1)) of a foreign corporation or foreign partnership is not subject to tax if immediately after the acquisition such person (or one or more includible corporations in an affiliated group, as defined in section 1504 of the code, of which such person is a member) owns (directly or indirectly) 10 percent or more of the total combined voting power of all classes of stock of such foreign corporation, or if such person owns (directly or indirectly) 10 percent or more of the profits interest of such foreign partnership. Your committee's amendment extends this direct investment exclusion to the acquisition by a U.S. person of a debt obligation from such a foreign corporation if the corporation acquired such obligation in the ordinary course of its trade or business as a result of the sale or rental of products manufactured or assembled by it or the performance of services by it.

Paragraph (2) of section 4915(a), as amended

Paragraph (2) of section 4915(a), as passed by the House, provides that the tax paid on the acquisition of stock of a foreign corporation or foreign partnership by a U.S. person will constitute an overpayment if such person continuously holds such stock from the time of its acquisition to the last day of the calendar year in which the acquisition was made and as of such last day owns 10 percent or more of the total combined voting power of all classes of stock of the corporation or 10 percent or more of the profits interest of the partnership.

Your committee has amended the holding period requirement to provide that a U.S. person may qualify for credit or refund with respect to an acquisition of stock or a debt obligation of a foreign corporation or foreign partnership (or a debt obligation referred to in your committee's amendment to par. (1) of sec. 4915(a)) if such person meets the 10 percent or more ownership requirement of paragraph (1) with respect to such foreign corporation or foreign partnership at any time within 12 months from the date of acquisition of such stock or debt obligation and holds the stock or debt obligation continuously from the date of such acquisition to the last day of the calendar year in which such ownership requirement is first met.

The application of this amendment is illustrated by the following example:

Example.—On September 10 and November 10, 1964, and on January 10 and March 10, 1965, respectively, P, a U.S. person, acquires from S, a foreign corporation, 2,500 shares of the only class of stock of foreign corporation N, which has a total of 100,000 shares outstanding. On September 20, 1964, P lends N \$10,000, taking a 5-year promissory note in return. On January 5, 1965, P acquires \$5,000 in debt obligations from N, having maturities in excess of 3 years from the date of acquisition. Such debt obligations were acquired by N in the ordinary course of its manufacturing business as a result of the sale of products manufactured by it. P sells the \$10,000 promissory note of N to R, a U.S. person on December 1, 1965, but holds the \$5,000 debt obligation acquired from N and the 10,000 shares of stock of N on December 31, 1965. P is entitled to a credit or refund (without interest) of the tax applicable to the stock acquired on September 10 and November 10, 1964, and on January 10, 1965, and with respect to the debt obligations acquired on January 5, 1965, because P met the 10 percent or more ownership requirement within 12 months after such acquisitions. The acquisition of stock made on March 10, 1965, is excluded from tax under section 4915(a)(1) as a direct investment. P incurs a tax of \$435 (4.35 percent of \$10,000) on the acquisition of the 5-year promissory note of N on September 20, 1964, because P did not hold the note until December 31, 1965.

Paragraph (2) of section 4915(c), as amended

Section 4915(c)(1) provides that the provisions of subsections (a) and (b) of section 4915 are inapplicable where the foreign corporation or foreign partnership is formed or availed of by the U.S. person for the principal purpose of acquiring, through such corporation or partnership, an interest in stock or debt obligations (of one or more other foreign issuers or obligors) the direct acquisition of which by the U.S. person would be subject to the tax imposed by section 4911. Paragraph (2) of section 4915(c) as passed by the House provides that for purposes of subsection (c) of section 4915, the acquisition by a U.S. person of stock or debt obligations of a foreign corporation or foreign partnership which acquires stock or debt obligations of foreign issuers or obligors in making loans in the ordinary course of its business as a commercial bank shall not, by reason of such acquisitions, be considered an acquisition by the U.S. person of an interest in stock or debt obligations of foreign issuers or obligors.

Your committee has amended paragraph (2) to provide that any foreign corporation or foreign partnership which is regularly engaged in the business of accepting deposits from customers and receiving other borrowed funds in foreign currencies and making loans in such currencies shall be treated as a commercial bank for purposes of paragraph (2). An organization will be considered to have been regularly engaged, from its inception, in the business of accepting deposits from customers where it had initially been precluded by law from so doing until it had taken certain actions (such as, for example, publication of a first balance sheet) provided thereafter it regularly so accepts deposits.

SECTION 4916. EXCLUSION FOR INVESTMENTS IN LESS DEVELOPED COUNTRIES

Section 4916 has, in general, been amended in four principal respects by your committee. First, your committee has provided that investments required to be made by a U.S. person in connection with the nationalization of its properties by a less developed country are to be treated as investments in less developed country corporations for purposes of the bill. Second, it has authorized the President to designate possessions of the United States as less developed countries for purposes of the tax; third, it has modified the 80 percent income and asset tests required to be met by a foreign corporation in order for it to be classified as a less developed country corporation, and, finally, it has clarified the provision which permits a U.S. person to acquire debt obligations tax free if the proceeds are used within less developed countries by the foreign obligor so as to permit the U.S. person to acquire such debt obligations in exchange for money as well as other property. In all other respects section 4916 is approved without change.

For a technical explanation of section 4916 (other than the amendments made by your committee) see pages 54 through 59 of the report of the Committee on Ways and Means on the bill.

Paragraph (3) of section 4916(a), as amended, and paragraph (2) of section 4916(d), as amended

Paragraph (3) of section 4916(a), as passed by the House, provides an exclusion from tax with respect to the acquisition by a U.S. person of a debt obligation issued by an individual or partnership resident in a less developed country in return for property which is used, consumed, or disposed of wholly within one or more less developed countries. Under subsection 4916(d)(2), this exclusion terminates and liability for tax is incurred by the acquiring U.S. person as of the time the property exchanged for the foreign debt obligation is first used, consumed, or disposed of other than within one or more less developed countries.

Your committee has added language to the foregoing paragraphs to make clear that the exclusion is available where money (as well as other property) is exchanged for the foreign debt obligation.

As a general rule, money or other property exchanged for the debt obligation of an individual or partnership resident in a less developed country will be presumed, for purposes of these paragraphs, to be used, consumed, or otherwise disposed of within a less developed country or countries unless the U.S. person knew or should have known from all the facts and circumstances surrounding his acquisition that the money or other property exchanged for the debt obligation would not be so used, consumed, or disposed of.

New paragraph (4) of section 4916(a)

Your committee has added a new paragraph (4) to section 4916(a). This amendment grants an exclusion to a U.S. person acquiring the stock or debt obligations of a foreign issuer or obligor where such acquisition is required as a reinvestment within a less developed country by the terms of a contract with such country, or a political subdivision, agency or instrumentality thereof (including any corporation or other business entity which is controlled by such government or a subdivision or agency thereof through ownership of more than 50 percent of its voting stock, or, in the case of a nonstock entity, through the authority to elect or appoint a majority of its directors or equivalent body). The contract must provide for the sale of (or indemnification for) property previously held within such country by the U.S. person or its controlled foreign corporation (as defined in sec. 957) more than 50 percent of the total combined voting power of all classes of stock entitled to vote of which is owned (within the meaning of sec. 958) by the U.S. person. The U.S. person must also demonstrate that he entered into such contract as a result of a nationalization, expropriation or seizure (or threat thereof) by such a country or political subdivision, or such an agency or instrumentality, or of an action by any of the foregoing which threatens or has the effect of nationalizing, expropriating, or seizing a substantial portion of the property so owned, in order to receive indemnification with respect to such property already seized, nationalized, or expropriated.

Subsection (b) of section 4916, as amended

Your committee has amended subsection (b) of section 4916 to authorize the President to designate, by Executive order, a possession of the United States as a less developed country. Moreover, your committee has been assured by the Treasury Department that in interpreting Executive Order 11071 dated December 27, 1962, it considers the term "Trust Territories" as used therein to include mandated territories (such as South-West Africa).

Your committee's amendment would permit a corporation organized outside the United States to include assets located in a possession of the United States, such as Puerto Rico, and income derived therefrom, as less developed country assets and income for purposes of section 4916(c).

Subsection (c) of section 4916, as amended

Your committee has amended paragraph (1) of section 4916(c) and has added a new paragraph (2). Paragraph (2) of the bill as passed by the House is renumbered (3), and subsequent paragraphs are renumbered accordingly.

Your committee's amendments to subsection (c) revise and extend the asset and income criteria for determining whether a foreign corporation qualifies as a less developed country corporation (the acquisition of whose stock is excluded from tax under this section). Substantive changes made by your committee are as follows:

(1) Tangible property located in the United States, stock of domestic corporations, obligations of a U.S. person (other than deposits in the United States with persons carrying on the banking business), and any right to the use in the United States of a patent or copyright, an invention, model, or design (whether or not patented), a secret formula or process, and any other similar property right, regardless of when acquired, and income derived therefrom, are excluded completely in making the 80-percent gross income and assets tests of both operating and holding companies.

2. Debt obligations of less developed country corporations are treated as qualifying assets for both operating and holding companies even though, at the time of their acquisition, they have a period remaining to maturity of less than 1 year.

3. In the case of holding companies—

(*a*) money, obligations of the United States, and deposits in the United States with persons carrying on the banking business are treated as assets which may qualify the corporation as a less developed country corporation;

(*b*) income from deposits in the United States with persons carrying on the banking business constitute qualifying income;

(*c*) deposits outside the United States (other than deposits in a less developed country) with persons carrying on the banking business and income from such deposits are excluded from the gross income and asset computations;

(*d*) debt obligations of partnerships and individuals resident in less developed countries constitute qualifying assets; and

(*e*) if such a corporation does not receive any gross income during an annual accounting period, the 80-percent income test is inapplicable.

The changes effected by these amendments are illustrated by the following examples:

Example 1.—Corporation D is a holding company organized and located in a less developed country on January 2, 1964. At all times during 1964, not less than 12 percent of D's assets consist of debt obligations of less developed country corporations which have less than 6 months remaining to maturity, and which were originally acquired by A, a wholly owned subsidiary which qualifies as a less developed country corporation. These debt obligations have been rediscounted by A with D. At all times during the same year, not less than 13 percent of D's assets consist of U.S. Government obligations and deposits in banks in the United States. D also owns a minority stock interest in a U.S. manufacturing business, equal to 3 percent of D's total assets, which it carries as a long-term investment. All other assets consist of stock in other less developed country corporations. D qualifies as a less developed country corporation. The short-term debt obligations of less developed country corporations, the U.S. Government obligations and deposits in banks within the United States and any income from these sources will be included among qualifying assets and income. The investment in the stock of the U.S. manufacturer and any income therefrom will not be taken into account.

Example 2.—X is a foreign corporation organized in a country other than a less developed country on March 1, 1964. It is contemplated that X will invest its capital in long-term projects in various less developed countries. No long-term commitments are made by X during 1964. During that year, X's capital is invested in short-term U.S. Government obligations, in part, and the balance is placed temporarily in interest-bearing bank accounts in the United States and in French and German banks. X qualifies as a less developed country corporation during 1964. The U.S. Government obligations and deposits with banks in the United States and any income therefrom constitute qualifying assets and income. The deposits in European banks and the income derived therefrom are excluded from the respective asset and income computations.

Example 3.—On January 2, 1965, the corporation X described in the preceding example invests half of its capital in the stock of less developed country corporation Y, a newly organized corporation which engages in food processing and nutritional research activities. Y operates at a loss in 1965. During that year, X invests the balance of its capital in private home construction projects in various less developed countries, taking back debt obligations from partnerships, corporations and individuals resident in those countries. X derives no income whatever from its investments during 1965. X qualifies as a less developed country corporation during 1965. In the absence of any gross income, the income test does not apply. All of the assets acquired by X constitute qualifying assets for purposes of the latter test.

If a ruling is issued by the Secretary of the Treasury or his delegate pursuant to section 4916(c)(3) holding that a foreign corporation has met the requirements of section 4916(c)(1) for a particular accounting period, all acquisitions of stock or debt obligations of that corporation subsequent to such issuance (but before revocation) during the annual accounting period for which the ruling is effective will be entitled to an exclusion under section 4916(a)(2), and the corporation's subsequent failure to meet the requirements of section 4916(c)(1) will not result in the loss of such exclusion.

SECTION 4917. EXCLUSION FOR ORIGINAL OR NEW ISSUES WHERE REQUIRED FOR INTERNATIONAL MONETARY STABILITY

Your committee has modified subsections (b) and (c) of section 4917(1) by providing that the President may extend the period of time within which an acquisition of an original or new issue may be made after notice of acquisition was first filed in cases where a limitation on the acquisitions excluded under this section is imposed; (2) by treating a debt obligation as a new issue if it is acquired not later than 90 days (rather than 60 days as provided in the bill as passed by the House) after the date on which interest begins to accrue; and (3) by providing special rules for treating debt obligations secured by a lien on improvements on real property as original or new issues. In all other respects, section 4917 of the House bill has been approved by your committee without change.

For the technical explanation of section 4917 (other than the amendments made by your committee), see pages 58 and 59 of the report of the Committee on Ways and Means on the bill.

Subsection 4917(b), as amended

Subsection (b) of section 4917 provides that an Executive order described in section 4917(a) may be applicable to all original or new issues, or only to an aggregate amount or classification thereof, as stated in the order. If the order is applicable to a limited aggregate amount of such issues, it will apply to those acquisitions as to which notice of acquisition is first filed, but any such acquisition must be made within 90 days after filing of such notice. Your committee's amendment provides that a period of time longer than 90 days may be specified in the order.

Subsection 4917(c), as amended

Under the bill as passed by the House, subsection (c) provides that a debt obligation is treated as part of an original or new issue (for purposes of sec. 4917) only if acquired not later than 60 days after the date on which interest begins to accrue on such obligation. Your committee has substituted a 90-day period for the 60-day period. Your committee has also amended section 4917(c) by adding a new subparagraph (2) which provides that a debt obligation secured by a lien on improvements on real property under construction or to be constructed at the time the obligation is issued (or if a series of obligations is involved, when the first is issued) will be treated as part of an original or new issue if two conditions are satisfied. First, the obligation must be acquired within 90 days of the date on which interest begins to accrue on the total amount of the obligation (or if a series of obligations is involved, on the last issued) and, second, the acquiring person must become committed to such acquisition not later than 90 days after the date interest first begins to accrue on any part of the obligation (or if a series of obligations is involved, on the first issued).

SECTION 4918. EXEMPTION FOR PRIOR AMERICAN OWNERSHIP

Section 4918 has been amended in two respects. Technical changes are made first, in the procedure for establishing prior American ownership and, second, in the provision relating to the content of the written confirmation issued by members or member organizations of national securities exchanges. For the technical explanation of this section of the bill (other than the amendments made by your committee), see pages 59 through 62 of the report on the bill of the Committee on Ways and Means.

Subsection (a) of section 4918, as amended

Section 4918(a) as passed by the House provides an exemption from the tax imposed by section 4911 with respect to foreign stock or debt obligations acquired from a U.S. person if such person was a U.S. person throughout the period of his ownership or continously since July 18, 1963. The acquiring person is permitted to establish such prior American ownership by any clear and convincing evidence.

Your committee has amended section 4918(a) by deleting the reference to clear and convincing evidence and prescribing a more specific procedure (set forth in new subsec. (f) of sec. 4918) for establishing prior American ownership. Section 4918(a), as amended, also provides that an exemption based on prior American ownership only applies if the U.S. person from whom a foreign stock or debt obligation is acquired was eligible to execute a certificate of American ownership. For example, a U.S. dealer or underwriter who claims a credit or refund with respect to stock or debt obligations under amended section 4919 is not eligible to execute a certificate of American ownership with respect to such stock or debt obligations.

Subsection (c) of section 4918, as amended

Under the bill as passed by the House, a written confirmation received from a member or member organization of a national securities exchange registered with the Securities and Exchange Commission stating that the acquisition was made in the regular market on such exchange serves as conclusive proof of prior American ownership for purposes of section 4918(a). As amended, section 4918(c) provides that a written confirmation will serve as conclusive proof of prior American ownership if the confirmation does not contain a statement that such acquisition was made subject to a special contract.

Subsection (f) of section 4918, as amended

A new subsection (f) has been added to section 4918 by your committee; this changes the requirement for establishing the exemption for prior American ownership provided in section 4918(a). The new subsection provides, as a general rule, that the methods of proving this exemption are limited to the furnishing of (1) a certificate of American ownership described in section 4918(b) or (2) a written confirmation from a member or member organization of a registered national securities exchange or association (acting as a broker) described in amended subsection (c) or (d) of section 4918. Other evidence of prior American ownership for purposes of the exemption provided in section 4918(a) may be used only if the person claiming the exemption shows there is reasonable cause for his inability to produce the appropriate certificate of American ownership or written confirmation.

SECTION 4919. SALES BY UNDERWRITERS AND DEALERS TO FOREIGN PERSONS

Subsection (a) of section 4919, as amended

Paragraph (1) of section 4919(a) provides that a credit against, or refund of, the tax paid under section 4911 upon the acquisition of stock or debt obligations of a foreign issuer or obligor may be allowed or made if the stock or debt obligations are acquired by an underwriter in connection with a private placement or a public offering by a foreign issuer or obligor (or a person or persons, directly or indirectly, controlling, controlled by, or under common control with such issuer or obligor) and are sold as part of such private placement or private offering by the underwriter (including sales by other underwriters who are U.S. persons participating in the placement or distribution of the stock or debt obligations acquired by the underwriter) to persons other than U.S. persons. Control with respect to an issuer or obligor has the same meaning for this purpose (and for purposes of the definition in section 4919(c)(1)) as under the Securities Act of 1933.

Paragraph (2) of section 4919(a) provides that a credit against, or refund of, the tax paid under section 4911 upon the acquisition of debt obligations of a foreign obligor may be allowed or made if the debt obligations are acquired by a dealer in the ordinary course of his business and are sold by him within 90 days after purchase (or within 90 days before, in the case of purchases made to cover short sales) to (1) persons other than U.S. persons or (2) a U.S. person who is a dealer if the purchasing dealer resells the debt obligations on the same or the next business day to persons other than U.S. persons.

Paragraph (3) of section 4919(a) permits a dealer to qualify for a credit or refund of tax imposed under section 4911 where he purchases stock of a foreign issuer in the ordinary course of his business and resells such stock on the same day on which he purchases it or on either of the next two business days (or in the case of purchases made to cover short sales, on the same or either of the two immediately preceding business days) to persons other than U.S. persons.

In the case of the purchase or sale of stock or debt obligations by dealers qualifying under the 90-day or 3-day rules provided in subparagraphs (2) and (3), respectively, the day of purchase or sale of any stock or debt obligation is the day on which an order to purchase or to sell, as the case may be, is executed.

Where an acquisition by an underwriter is concerned, if the underwriter sells all or part of the stock or debt obligations acquired to persons other than U.S. persons during the same return period in which the acquisition of such stock or debt obligations is made, the acquisition will be subject to the tax imposed by section 4911 and an offsetting tax credit for such sales will be allowed under section 4919. If the sales by the underwriter to persons other than U.S. persons occur in a return period subsequent to the return period in which the acquisition by the underwriter is made, the tax imposed by section 4911 on the acquisition will be paid with the interest equalization tax return filed for the prior period and a credit or refund of tax will be allowed or made under section 4919 upon the filing of a claim therefor. It is contemplated that a tax credit may also be allowed to the underwriter, if claimed, for sales to persons other than U.S. persons which take place after the reporting period during which the acquisition occurred but before the return for that period is due. The credit or refund arising from the resale of stock or debt obligations by dealers will be claimed and allowed in a similar manner.

Subsection (b) of section 4919, as amended

Paragraph (1) of section 4919(b) sets forth the general rule that a credit or refund shall be allowed to an underwriter or dealer under subsection (a) with respect to any stock or debt obligation sold by him if (1) the underwriter or dealer files with the quarterly return required by section 6011(d) on which credit is claimed, or with a claim for refund, such information as the Secretary of the Treasury or his delegate may prescribe by regulations and (2) establishes that the stock or debt obligations involved were sold to persons other than U.S. persons.

It is contemplated that the type of information required from an underwriter with respect to a private placement or public offering may include the following:

(A) The name and address of the foreign issuer or obligor whose stock or debt obligations were acquired, the person (whether the foreign issuer or obligor or the person or persons related in control) from whom the acquisitions were made, and the date of acquisition;

(B) The consideration paid or to be paid by the underwriter for the stock or debt obligations acquired;

(C) The total number of shares of stock or the total face amount of debt obligations acquired and a brief description thereof; and

(D) The total sold; the total sold to persons other than U.S. persons; the total sold by U.S. persons participating in the distribution; and a copy of any prospectus, agreement, or offering circular governing, or used in effectuating, any of the sales.

It is contemplated that the type of information required from a dealer claiming the credit or refund may include a description of the debt obligations involved, the names and addresses of the persons to whom they were sold, and the date or dates of sale.

Paragraph (1) of section 4919(b) also provides that in any case where two or more underwriters form a group for the purpose of purchasing and distributing (through resale) stock or debt obligations of a foreign issuer or obligor, any one of such underwriters may, to the extent prescribed by the Secretary of the Treasury or his delegate, satisfy the requirement of paragraph (1) on behalf of all the underwriters.

Paragraph (2) of section 4919(b) provides that, for purposes of establishing a sale to a foreign person of stock or debt obligations acquired by an underwriter in connection with a private placement or public offering, and not sold by him to a person other than a U.S. person, a certificate of sale to a foreign person, executed by the underwriter who actually made the sale, shall be conclusive proof that the stock or debt obligation involved was sold to a person other than a U.S. person unless the underwriter claiming the credit or refund, and relying upon the certificate, has actual knowledge that the certificate is false in any material respect. Such a certificate shall set forth such information, and be filed in such manner, as the Secretary of the Treasury or his delegate may prescribe by regulations.

Subparagraph (A) of section 4919(b)(3) provides that, for purposes of satisfying the requirements of section 4919(b)(1)(B) with respect to a claim for credit or refund under section 4919(a)(2), relating to the sale of a debt obligation by a dealer within 90 days of the purchase, the sale by a dealer of a debt obligation on a national securities exchange (registered with the Securities and Exchange Commission) subject to a special contract, shall be conclusive proof that the debt obligation was sold to a person other than a U.S. person if the exchange has adopted rules which require (1) a member of the exchange selling a debt obligation as a dealer or effecting a sale as a broker of a debt obligation on the exchange on behalf of a dealer to furnish a comparison or confirmation to the member of the exchange who purchases the debt obligation for his own account as a dealer, or on behalf of another dealer, stating that such sale is being made as a dealer, or on behalf of a dealer, and (2) by the terms of the contract governing the transaction that a purchasing dealer who receives such a notice undertake to resell the debt obligation to a person other than a U.S. person on the day of purchase or on the next business day. For this purpose, the day of purchase or sale of a debt obligation is the day on which an order to purchase or to sell, as the case may be, is executed. Subparagraph (A) also provides that a dealer purchasing a debt obligation on the special foreign market maintained by a registered national securities exchange having in effect the rules described in clauses (i) and (ii) in a transaction in which a confirmation or comparison under subparagraph (A) is furnished shall not be entitled to a credit or refund of tax under section 4919(a)(3), relating to resale of debt obligations to a foreigner within 90 days, unless he can establish that he resold such a debt obligation, on the day on which he purchased it or the next business day, to other than a U.S. person.

Subparagraph (B) of section 4919(b)(3) provides that, for purposes of satisfying the requirements of section 4919(b)(1)(B) with respect to a claim for credit or refund under section 4919(a)(2), relating to resale of debt obligations to foreigners within 90 days, a dealer can conclusively prove that a debt obligation sold other than on a registered national securities exchange was sold to a person other than a U.S. person with a written confirmation, furnished to him by a member or member organization of a national securities association registered with the Securities and Exchange Commission, stating that such member or member organization either (1) effected the purchase of the debt obligation as a broker on behalf of a person other than a U.S. person or (2) purchased the debt obligation and resold it on the same or the next business day to a person other than a U.S. person, if the selling dealer does not know the confirmation to be false in any material respect and if the registered national securities association of which the selling dealer is a member has adopted the rules described in section 4919(b)(3)(B). These rules must provide that if a member or organization purchases, or effects the purchase, of a debt obligation from a dealer who notifies such member or member organization that the dealer is selling the debt obligation and intending to claim a credit or refund under section 4919(a)(2) with respect to the sale, then such member or member organization must give to the dealer a written confirmation stating (1) whether or not the purchase was effected on behalf of a person other than a U.S. person, or (2) whether or not the member or member organization resold the debt obligation to a person other than a U.S. person on the same day as purchased or on the next business day. As in the case of transactions on the special market of a registered national securities exchange, the date of purchase or sale of a debt obligation is the day on which an order to purchase or sell, as the case may be, is executed.

Paragraph (4) of section 4919(b) provides that in the case of a claim for credit or refund of tax by a dealer under section 4919(a)(3), relating to resale of stock to a foreigner on the day of purchase or on either of the 2 succeeding business days, a sale subject to a special contract on a national securities exchange registered with the Securities and Exchange Commission shall be conclusive proof that such stock was sold to a person other than a U.S. person, unless at the time of sale the selling dealer knew that the purchaser of the stock was a dealer purchasing it for his own account.

Subsection (c) of section 4919, as amended

Paragraph (1) of section 4919(c) defines the term "underwriter" to mean any person who has purchased stock or debt obligations from the issuer or obligor thereof (or from a person controlling, controlled by, or under common control with such issuer or obligor), or from another underwriter, with a view to the distribution through resale of such stock or debt obligations.

Paragraph (2) defines a "dealer" as any person who is a member of a national securities association registered with the Securities and Exchange Commission and who is regularly engaged, as a merchant, in purchasing stock or debt obligations and selling them to customers (including other dealers) with a view to the gains and profits which may be derived therefrom.

SECTION 4920. DEFINITIONS; SPECIAL RULES

Your committee has amended section 4920 by, in general, (1) permitting a foreign branch of a domestic corporation or partnership engaged as a dealer in securities to elect to be treated as a foreign corporation or partnership, (2) allowing foreign underwriters participating in certain distributions with U.S. underwriters to be treated as U.S. persons and (3) treating foreign corporations more than 65 percent owned by U.S. persons as domestic corporations. Your committee has also clarified the definition of the period remaining to maturity of a debt obligation payable on demand. For a technical explanation of the provisions of section 4920 (other than the amendments made by your committee), see pages 64 through 68 of the report of the Committee on Ways and Means on the bill. Subsection (b) of the bill, as passed by the House, has been relettered (c).

Paragraph (5) of section 4920(a), as amended

Paragraph (5) of section 4920(a), as passed by the House, provides that the terms "domestic corporation" and "domestic partnership" mean, respectively, a corporation or partnership created or organized in the United States or under the law of the United States or of any State. Your committee has amended paragraph (5) to permit a domestic corporation or partnership to elect to treat a branch office located outside the United States as a foreign corporation or partnership for purposes of this chapter. In order for an election to be made under this paragraph, such corporation or partnership must be a dealer in securities as defined in section 4919(c) (without regard to the activities of the branch), and the branch must have been located outside the United States on July 18, 1963, and regularly engaged, as a merchant, in purchasing and selling stock or debt obligations of foreign issuers or obligors with a view to the gains and profits which may be derived therefrom, for at least 12 consecutive calendar months prior to July 18, 1963. Furthermore, in order for an election to be made, all acquisitions by the branch of foreign stock or debt obligations must be made in the ordinary course of its business as such a merchant or as an underwriter, and the office must maintain separate books and records reasonably reflecting the assets and liabilities properly attributable to the office. For these purposes, the business of a merchant of securities includes the buying and selling of securities on an exchange, as well as from and to individual customers, all for the account of the branch office as principal in the ordinary course of its business.

An election under paragraph (5) must be made on or before the 60th day after enactment under regulations prescribed by the Secretary or his delegate. The election shall be effective as of July 18, 1963, and shall remain effective until revoked under regulations prescribed by the Secretary of the Treasury or his delegate. The election shall be deemed revoked if, at any time, the branch ceases to meet the requirements of subparagraphs (A), (C), or (D) of paragraph (5). When an election is revoked, a further election may be made subject to such limitations as may be prescribed by the Secretary of the Treasury or his delegate. An election under paragraph (5) shall be made with respect to each branch office of a domestic corporation or partnership. For the rules applicable to transfers to or borrowings by a branch electing under paragraph (5), see the amendment made by your committee in section 4912(b)(2).

Clause (iv) of section 4920(a)(7)(B), as amended

Section 4920(a)(7)(B)(iv) provides that the period remaining to maturity of any debt obligation which is payable on demand shall be considered to be less than 3 years. Your committee has amended this provision to make clear that demand bank deposits are exempt from tax under this provision.

New paragraph (8) of section 4920(a)

A new subparagraph (8) has been added to section 4920(a) to provide that a class of stock of a foreign corporation (other than a company registered under the Investment Company Act of 1940) will be treated as the stock of a domestic corporation if (*a*) as of the latest record date before July 19, 1963, more than 65 percent of such class of stock was held of record by U.S. persons; or (*b*) the class of stock was traded on one or more national securities exchanges registered with the Securities and Exchange Commission and such exchanges constituted the principal market for the class of stock during the calendar year 1962 and as of the latest record date before July 19, 1963, more than 50 percent of such class of stock was held of record by U.S. persons (this provision was contained in sec. 4920(a)(3)(B) as passed by the House.

New subsection 4920(b)

Subsection (b) of section 4920, as added by your committee, provides that a partnership or corporation which is not a U.S. person and which is participating, as an underwriter in an underwriting group that includes one or more U.S. persons, in a public offering of stock or debt obligations of a foreign issuer or obligor shall be treated as a U.S. person with respect to its participation in such public offering but only if such partnership or corporation so elects and subject to such terms and conditions as the Secretary or his delegate may prescribe by regulations. It is contemplated that such a foreign underwriter will be required to pay the tax imposed by section 4911 at the time of such public offering.

SECTION 2(C). EFFECTIVE DATE

Paragraph (2) of section 2(c) of the bill has been amended by amending subparagraph (B), by adding new subparagraphs (C) and (E) and by redesignating subparagraph (C) of the House bill as subparagraph (D). For a technical explanation of the provisions of section 2(c) of the bill (other than as charged by your committee), see page 68 through 71 of the report of the Committee on Ways and Means on the bill.

Subparagraph (B) of section 2(c)(2) of the bill, as amended

Paragraph (2)(B) of section 2(c) of the bill, as passed by the House, provides that the tax does not apply to an acquisition from a foreign issuer or obligor if on or before July 18, 1963, the acquiring U.S. person had taken every action to signify approval of the acquisition under its usual procedures in such transactions and had sent or deposited for delivery to the foreign issuer or obligor written evidence of its approval in the form of one or more signed documents setting forth the principal terms of the acquisition, subject only to the execution of formal documents and customary closing conditions.

As amended by your committee, the acquisition may be made from a foreign person other than the issuer or obligor. In addition, the types of documents which may serve as evidence of a preexisting commitment has been changed by your committee to include draft purchase contracts and documents referring to a document, sent by the foreign person from whom the acquisition was made, which sets forth the principal terms of the transaction. The amendment also eliminates the requirement that such documents be signed. A document sent by an authorized representative of one of the parties to the transaction, such as an agent or attorney, will satisfy the requirements of this subparagraph.

Subparagraph (C) of section 2(c)(2) of the bill, as amended

A new subparagraph (C) has been added to section 2(c)(2) of the House bill and subparagraph (C) of the bill has been relettered (D).

Under your committee's amendment, a U.S. person is not liable for tax with respect to an acquisition of stock or debt obligation to the extent that such acquisition is required as a reinvestment within a less developed country of amounts equal to part or all of the consideration received under a contract entered into on or before July 18, 1963, for the sale to the government of such a country, or a political subdivision thereof, or an agency or instrumentality (within the meaning of sec. 4916(a)) of such a government, of—

(1) property owned within such country or political subdivision by the U.S. person or a controlled foreign corporation more than 50 percent of the total combined voting power of all classes of stock entitled to vote of which is owned by such person, or

(2) stock or debt obligations of such a controlled foreign corporation which was actively engaged in the conduct of a trade or business within such country.

Such acquisitions by a U.S. person pursuant to a contract of indemnification with respect to the nationalization, expropriation, or seizure of such property or such stock or debt obligations by the government of a less developed country or political subdivision thereof, or an agency or instrumentality of such government, entered into on or before July 18, 1963, are also exempt from tax under this amendment.

Your committee's amendment also exempts such acquisitions pursuant to such contracts if, on or before July 18, 1963, the acquiring U.S. person had sent or deposited for delivery to the government of a less developed country or political subdivision thereof, or agency or instrumentality of such a government, a commitment letter, memorandum of terms, or other document setting forth the principal terms of such contract.

Subparagraph (E) of section 2(c)(2) of the bill

A new subparagraph (E) has been added to section 2(c)(2) of the bill to provide that a U.S. person is not liable for tax in the case of an acquisition of foreign stock if the stock is acquired, in the initial capitalization of a foreign corporation, by a U.S. person who within 12 months after the acquisition owns 10 percent or more of the voting stock of the foreign corporation, even though the foreign corporation was formed or availed of by the U.S. shareholder to acquire foreign stock or debt obligations which would be taxable if acquired directly by the U.S. shareholder, if at least 75 percent in interest of the U.S. persons who acquired stock in the initial capitalization had signified on or before July 18, 1963, to the person coordinating the organization of such corporation their intention to invest in the stock of the foreign corporation an amount equal to or greater than the amount they ultimately invested.

SECTION 3. RETURNS

Section 3 of the bill has been amended in two respects. For the technical explanation of this section of the bill (except as amended by your committee) see pages 71 and 72 of the report of the Committee on Ways and Means on the bill.

Section 6011(d), as amended

Paragraph (1) of the new section 6011(d) of the code provides that every person shall make a return for each calendar quarter during which he incurs tax under section 4911 or would incur tax but for section 4918, relating to the exemption for prior American ownership. With respect to acquisitions exempted from the tax under section 4918, the return was required under the bill as passed by the House to be accompanied by clear and convincing evidence that such acquisitions were in fact so exempt.

As amended, paragraph (1) requires that returns for a quarter during which a U.S. person would incur liability for tax but for the provisions of section 4918 must be accompanied either (1) by a certificate of American ownership which complies with the provisions of section 4918(e), or (2), in the case of an acquisition for which other proof of exemption is permitted under section 4918(f), by a statement setting forth a summary of the evidence establishing such exemption and the reasons for the person's inability to establish prior American ownership under subsection (b), (c), or (d) of section 4918. Your committee has not changed that aspect of this section which provides that no return or submission of proof is required if the acquisition is made through a member or member organization of a registered national securities exchange or association (acting as a broker) who furnishes a confirmation to the purchaser which, in effect, does not state that the seller was a person other than a U.S. person.

Under the bill as passed by the House, paragraph (3) of the new section 6011(d) provided that members or member organizations of registered national securities exchanges or associations shall keep such records and file such information as is required by regulations prescribed by the Secretary of the Treasury or his delegate in connection with their sales as brokers and in connection with their acquisitions for their own account of stock or debt obligations as to which a certificate of American ownership, or blanket certificate of American ownership, is executed and filed under section 4918(e). Paragraph (3) of section 6011(d), as amended, applies to acquisitions, as well as sales, effected by such member or member organizations as a broker and to acqusitions made for the accounts of such member or member organization, but only to those acquisitions or sales, as the case may be, as to which—

(1) a certificate of American ownership or a blanket certificate of American ownership is executed and filed with such member or member organization under section 4918(e), or

(2) a written confirmation is furnished to a U.S. person stating that the acquisition—

(i) in the case of a transaction on a national securities exchange, was made subject to a special contract, or

(ii) in the case of a transaction not on a national securities exchange, was from a person who had not filed a certificate of American ownership with respect to such stock or debt obligation or a blanket certificate of American ownership with respect to the account from which such stock or debt obligation was sold.

Your committee has been assured by the Treasury Department that any information returns required under paragraph (3) will not be required with respect to transactions occuring before July 1, 1964.

SECTION 4. DISALLOWANCE OF DEDUCTION FOR AMOUNT PAID AS INTEREST EQUALIZATION TAX

This section has been approved by your committee without change. For the technical explanation of section 4, see page 73 of the report of the Committee on Ways and Means on the bill.

SECTION 5. ORIGINAL ISSUE DISCOUNT

A new section 5 relating to original issue discount has been added to the bill. Section 5 of the bill as passed by the House has been renumbered section 6.

Original issue discount

The new section 5 of the bill, added by your committee, amends section 1232(b)(2) of the code, relating to the definition of the term "issue price" for purposes of determining original issue discount. The amendment provides that (in the case of privately placed issues) the price paid by the first buyer of bonds or other evidences of indebtedness will be increased by the amount of interest equalization tax (if any) paid under section 4911. The section is inapplicable, however, to the extent that a credit, refund, or reimbursement of the tax is obtained, directly or indirectly.

The application of new section 5 is illustrated by the following example:

Example.—A, a U.S. person, acquires from foreign corporation M for $80,000 bonds of corporation M, having a period to maturity of 30 years and a redemption value at maturity of $100,000, on October 1, 1963, the date of the original issue of such bonds. The tax paid by A under section 4911 with respect to the acquisition of such bonds is $15,000; however, M corporation reimburses A for $5,000 of such tax. For purposes of section 1232(b), as amended by section 5 of the bill, the issue price of the bonds acquired by A is $90,000 ($80,000 plus $15,000 minus $5,000).

SECTION 6. PENALTIES

Section 6 of the bill (sec. 5 of the bill as passed by the House) has been amended by your committee to provide a civil penalty for willful furnishing of false confirmations or comparisons by members of national securities exchanges and associations, and to clarify the application of the criminal provision. For the technical explanation of this section of the bill (other than the amendments made by your committee), see pages 73 through 75 of the report of the Committee on Ways and Means on the bill.

Subsection (a) of section 6 of the bill

Your committee has added a new subsection (d) to the new section 6681 of the code, relating to false confirmations or comparisons furnished by dealers in transactions governed by the rules of paragraph (3) of section 4919(b), and has redesignated the former subsection (d) as subsection (e). The new subsection (d) provides penalties for willful violation of the procedures set forth in section 4919(b)(3) by members of national securities exchanges, dealers, and members of national dealers associations.

Paragraph (1) of section 6681(d) provides that a member or member organization of a national securities exchange described in section 4919(b)(3)(A) who, in a transaction subject to the rules of such exchange as described in such section, willfully furnishes a written confirmation or comparison which contains a misstatement of material fact or which fails to state a material fact shall be liable to a penalty equal to 125 percent of the amount of the tax imposed by section 4911 on the acquisition of the debt obligation by the dealer for whose benefit such confirmation or comparison is furnished.

Paragraph (2) of section 6681(d) provides that any person who sells a debt obligation as a dealer in a transaction subject to the rules of a national securities exchange as described in section 4919(b)(3)(A), in which such sale is effected on his behalf by a member or member organization of such exchange, and who willfully fails to disclose to such member or member organization of such exchange that such sale is being made by him as a dealer, shall be liable to a penalty equal to 125 percent of the amount of the tax imposed on his acquisition of such debt obligation.

Paragraph (3) of section 6681(d) provides that a member or member organization of a national securities association described in section 4919(b)(3)(B) who willfully furnishes a written confirmation described in such section (in a transaction subject to the rules of such association as described in such section) which contains a misstatement of material fact or which fails to state a material fact shall be liable to a penalty equal to 125 percent of the amount of the tax imposed by section 4911 on the acquisition of the debt obligation by the dealer for whose benefit such confirmation is furnished.

Subsection (b) of section 6 of the bill

Subsection (b) of section 6 of the bill (sec. 5 of the bill as passed by the House) amends part II of subchapter A of chapter 75 of the code (relating to penalties applicable to certain taxes) by adding at the end thereof a new section 7241 with respect to fraudulent equalization tax certificates.

Your committee has amended section 7241 to make clear that the penalties of this section apply only to fraudulent certificates executed on or after the date of the enactment of the bill. However, this change does not affect the applicability of title 18, section 1001 of the United States Code prescribing criminal penalties for false or fraudulent statements or representations in any matter within the jurisdiction of any agency or department of the United States.

V. 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).

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Hu Hulley

US 333 c.3

Public Law 88-563
88th Congress, H. R. 8000
September 2, 1964

JAN 6 1965

An Act

78 STAT. 809.

To amend the Internal Revenue Code of 1954 to impose a tax on acquisitions of certain foreign securities in order to equalize costs of longer-term financing in the United States and in markets abroad, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Interest Equalization Tax Act". Interest Equalization Tax Act.

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment is expressed in terms of an amendment to a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954. 68A Stat. 3. 26 USC 1 et seq.

SEC. 2. INTEREST EQUALIZATION TAX.

(a) IMPOSITION OF TAX.—Subtitle D (relating to miscellaneous excise taxes) is amended by adding at the end thereof the following new chapter:

"CHAPTER 41—INTEREST EQUALIZATION TAX

"SUBCHAPTER A. Acquisitions of foreign stock and debt obligations.
"SUBCHAPTER B. Acquisitions by commercial banks.

"Subchapter A—Acquisitions of Foreign Stock and Debt Obligations

"Sec. 4911. Imposition of tax.
"Sec. 4912. Acquisitions.
"Sec. 4913. Limitation on tax on certain acquisitions.
"Sec. 4914. Exclusion for certain acquisitions.
"Sec. 4915. Exclusion for direct investments.
"Sec. 4916. Exclusion for investments in less developed countries.
"Sec. 4917. Exclusion for original or new issues where required for international monetary stability.
"Sec. 4918. Exemption for prior American ownership.
"Sec. 4919. Sales by underwriters and dealers to foreign persons.
"Sec. 4920. Definitions and special rules.

"SEC. 4911. IMPOSITION OF TAX.

"(a) IN GENERAL.—There is hereby imposed, on each acquisition by a United States person (as defined in section 4920(a)(4)) of stock of a foreign issuer, or of a debt obligation of a foreign obligor (if such obligation has a period remaining to maturity of 3 years or more), a tax determined under subsection (b). Post, p. 837.

"(b) AMOUNT OF TAX.—

"(1) STOCK.—The tax imposed by subsection (a) on the acquisition of stock shall be equal to 15 percent of the actual value of the stock.

"(2) DEBT OBLIGATIONS.—The tax imposed by subsection (a) on the acquisition of a debt obligation shall be equal to a percentage of the actual value of the debt obligation measured by the period remaining to its maturity and determined in accordance with the following table:

"If the period remaining to maturity is:	The tax, as a percentage of actual value, is:
"At least 3 years, but less than 3½ years	2.75 percent
At least 3½ years, but less than 4½ years	3.55 percent
At least 4½ years, but less than 5½ years	4.35 percent
At least 5½ years, but less than 6½ years	5.10 percent
At least 6½ years, but less than 7½ years	5.80 percent
At least 7½ years, but less than 8½ years	6.50 percent
At least 8½ years, but less than 9½ years	7.10 percent
At least 9½ years, but less than 10½ years	7.70 percent
At least 10½ years, but less than 11½ years	8.30 percent
At least 11½ years, but less than 13½ years	9.10 percent
At least 13½ years, but less than 16½ years	10.30 percent
At least 16½ years, but less than 18½ years	11.35 percent
At least 18½ years, but less than 21½ years	12.25 percent
At least 21½ years, but less than 23½ years	13.05 percent
At least 23½ years, but less than 26½ years	13.75 percent
At least 26½ years, but less than 28½ years	14.35 percent
28½ years or more	15.00 percent.

"(c) Persons Liable for Tax.—

"(1) In general.—The tax imposed by subsection (a) shall be paid by the person acquiring the stock or debt obligation involved.

"(2) Cross reference.—

"For imposition of penalty on maker of false certificate in lieu of or in addition to tax on acquisition in certain cases, see section 6681.

"(d) Termination of Tax.—The tax imposed by subsection (a) shall not apply to any acquisition made after December 31, 1965.

"SEC. 4912. ACQUISITIONS.

"(a) In general.—For purposes of this chapter, the term 'acquisition' means any purchase, transfer, distribution, exchange, or other transaction by virtue of which ownership is obtained either directly or through a nominee, custodian, or agent. A United States person acting as a fiscal agent in connection with the redemption or purchase for retirement of stock or debt obligations (whether or not acting under a trust arrangement) shall not be considered to obtain ownership of such stock or debt obligations. The exercise of a right to convert a debt obligation (as defined in section 4920(a)(1)) into stock shall be deemed an acquisition of stock from the foreign issuer by the person exercising such right. Any extension or renewal of an existing debt obligation requiring affirmative action of the obligee shall be considered the acquisition of a new debt obligation.

Post, p. 835.

"(b) Special Rules.—For purposes of this chapter—

"(1) Certain transfers to foreign trusts.—Any transfer (other than in a sale or exchange for full and adequate consideration) of money or other property to a foreign trust shall, if such trust acquires stock or debt obligations (of one or more foreign issuers or obligors) the direct acquisition of which by the transferor would be subject to the tax imposed by section 4911, be deemed an acquisition by the transferor (as of the time of such transfer) of stock of a foreign issuer in an amount equal to the actual value of the money or property transferred or, if less, the actual value of the stock or debt obligations so acquired by such trust. Contributions made by an employer to a foreign pension or profit-sharing trust established by such employer for the exclusive benefit of employees (who are not owner-employees as defined in section 401(c)(3)) who perform personal services for such employer on a full-time basis in a foreign country, and contributions to a foreign pension or profit-sharing

76 Stat. 812.
26 USC 401.

trust established by an employer, made by an employee who performs personal services for such employer on a full-time basis in a foreign country (and is not an owner-employee as defined in section 401(c)(3)), shall not be considered under the preceding sentence as transfers which may be deemed acquisitions of stock of a foreign issuer.

76 Stat. 812.
26 USC 401.

"(2) Certain transfers.—

"(A) Transfers to foreign corporations and partnerships.—Any transfer of money or other property to a foreign corporation or a foreign partnership—

"(i) as a contribution to the capital of such corporation or partnership, or

"(ii) in exchange for one or more debt obligations of such corporation or partnership, if it is a foreign corporation or partnership which is formed or availed of by the transferor for the principal purpose of acquiring (in the manner described in section 4915(c)(1)) an interest in stock or debt obligations the direct acquisition of which by the transferor would be subject to the tax imposed by section 4911,

Post, p. 826.

shall be deemed an acquisition by the transferor of stock of a foreign corporation or partnership in an amount equal to the actual value of the money or property transferred.

"(B) Transfers to foreign branches.—If a domestic corporation or partnership transfers money or other property to, or applies money or other property for the benefit of, a branch office of such corporation or partnership with respect to which there is in effect an election under section 4920(a)(5)(E), or if funds are borrowed by such branch office from a bank (as defined in section 581), other than from a branch of such a bank located outside the United States lending such funds in the ordinary course of its business, such domestic corporation or partnership shall be deemed to have acquired stock of a foreign corporation or partnership in an amount equal to the actual value of the money or property transferred or applied, or the funds borrowed.

26 USC 581.

"(3) Acquisitions from domestic corporation or partnership formed or availed of to obtain funds for foreign issuer or obligor.—The acquisition of stock or a debt obligation of a domestic corporation (other than a domestic corporation described in section 4920(a)(3)(B)), or a domestic partnership, formed or availed of for the principal purpose of obtaining funds (directly or indirectly) for a foreign issuer or obligor, shall be deemed an acquisition (from such foreign issuer or obligor) of stock or a debt obligation of such foreign issuer or obligor.

"(4) Reorganization exchanges.—Any acquisition of stock or debt obligations of a foreign issuer or obligor in an exchange to which section 354, 355, or 356 applies (or would, but for section 367, apply) shall be deemed an acquisition from the foreign issuer or obligor in exchange for its stock or for its debt obligations. For purposes of this paragraph, in determining whether section 354, 355, or 356 applies, or would apply, to any transaction—

26 USC 354-356, 367.

"(A) such transaction shall, if it took place before the date of the enactment of this chapter, be treated as taking place on such date, and

"(B) section 368(a)(1)(B) shall be treated as permitting the receipt by a United States person of money or other property in addition to voting stock.

26 USC 368.

"SEC. 4913. LIMITATION ON TAX ON CERTAIN ACQUISITIONS.

"(a) CERTAIN SURRENDERS, EXTENSIONS, RENEWALS, AND EXERCISES.—

"(1) GENERAL RULE.—If stock or a debt obligation of a foreign issuer or obligor is acquired by a United States person as the result of—

"(A) the surrender to the foreign obligor, for cancellation, of a debt obligation of such obligor;

"(B) the extension or renewal of an existing debt obligation requiring affirmative action of the obligee; or

"(C) the exercise of an option or similar right to acquire such stock or debt obligation (or of a right to convert a debt obligation into stock),

then the tax imposed on such acquisition shall not exceed the amount determined under paragraph (2) or (3).

"(2) GENERAL LIMITATION.—Except in cases to which paragraph (3) applies, the tax imposed upon an acquisition described in paragraph (1) shall be limited to—

"(A) the amount of tax imposed by section 4911, less

"(B) the amount of tax which would have been imposed under section 4911 if the debt obligation which was surrendered, extended, or renewed, or the option or right which was exercised, had been acquired in a transaction subject to such tax immediately before such surrender, extension, renewal, or exercise.

For purposes of this paragraph, a defaulted debt obligation of the government of a foreign country or a political subdivision thereof (or an agency or instrumentality of such a government) which has been in default as to principal for at least 10 years and which is surrendered in exchange for another debt obligation of that government (or agency or instrumentality) shall be deemed to have an actual value and period remaining to maturity equal to that of the debt obligation acquired.

"(3) SPECIAL LIMITATIONS.—

"(A) CONVERSIONS OF DEBT OBLIGATIONS INTO STOCK.—The tax imposed upon an acquisition of stock pursuant to the exercise of a right to convert a debt obligation (as defined in section 4920(a)(1)) into stock shall be limited to— Post, p. 835.

"(i) the amount of tax which would have been imposed by section 4911 if the debt obligation had been treated as stock at the time of its acquisition by the person exercising the right (or by a decedent from whom such person acquired the right by bequest or inheritance or by reason of such decedent's death), less

"(ii) the amount of tax paid by the person exercising the right (or by such decedent) as a result of the acquisition of the convertible debt obligation or, if such acquisition was not subject to the tax imposed by section 4911 the amount of tax which would have been imposed as a result of such acquisition if such acquisition had been subject to such tax.

"(B) EXERCISE OF CERTAIN SHAREHOLDERS' RIGHTS.—The tax imposed upon an acquisition of stock or a debt obligation of a foreign corporation by a United States person, where—

"(i) the stock or debt obligation is acquired pursuant to the exercise of an option or similar right to acquire such stock or debt obligation which was acquired by a shareholder of such corporation in a distribution with respect to its stock, and

"(ii) such option or right is exercised within 90 days from the date of its distribution by such corporation,

shall be limited to the amount of tax which would have been imposed by section 4911 if the price paid under such option or right were the actual value of the stock or debt obligation acquired.

"(C) CERTAIN EMPLOYEE STOCK OPTIONS.—The tax imposed upon an acquisition of stock of a foreign issuer by a United States person pursuant to the exercise of an option or similar right described in section 4914(a)(8) shall be limited to the amount of tax which would have been imposed under section 4911 if the price paid under such option or right were the actual value of the stock acquired. Post, p. 836.

"(b) CERTAIN TRANSFERS WHICH ARE DEEMED ACQUISITIONS.—The tax imposed upon an acquisition which is deemed to have been made by reason of a transfer of money or other property to a foreign trust, or a foreign corporation or partnership, as described in section 4912 (b)(1) or (2)(A), shall be limited to—

"(1) the amount of tax imposed by section 4911, less

"(2) the amount of tax paid by the transferor as the result of the transfer being otherwise taxable as an acquisition under this chapter.

"(c) ACQUISITIONS BY CERTAIN DOMESTIC CORPORATIONS AND PARTNERSHIPS.—If stock or a debt obligation of a foreign issuer or obligor is acquired by a domestic corporation or a domestic partnership with funds obtained as the result of an acquisition by a United States person of stock or a debt obligation of such corporation or partnership which under section 4912(b)(3) is deemed an acquisition by such person of stock or a debt obligation of a foreign issuer or obligor, the tax imposed upon the acquisition by the domestic corporation or the domestic partnership shall be limited to—

"(1) the amount of tax imposed by section 4911, less

"(2) the amount of tax paid by the United States person from whom the funds were obtained on the acquisition by such person which under section 4912(b)(3) is deemed an acquisition of stock or a debt obligation of a foreign issuer or obligor.

"SEC. 4914. EXCLUSION FOR CERTAIN ACQUISITIONS.

"(a) TRANSACTIONS NOT CONSIDERED ACQUISITIONS.—The term 'acquisition' shall not include—

"(1) any transfer between a person and his nominee, custodian, or agent;

"(2) any transfer described in section 4343(a) (relating to certain transfers by operation of law from decedents, minors, incompetents, financial institutions, bankrupts, successors, foreign governments and aliens, trustees, and survivors); 72 Stat. 1297. 26 USC 4343.

"(3) any transfer by legacy, bequest, or inheritance to a United States person, or by gift to a United States person who is an individual;

"(4) any distribution by a corporation of its stock or debt obligations to a shareholder with respect to or in exchange for its stock;

"(5) any distribution to a shareholder by a corporation of stock or debt obligations owned by such corporation on July 18, 1963, in complete or partial liquidation of such corporation, to the extent such shareholder acquired his stock ownership in such corporation in a transaction other than in an acquisition excluded from tax under subsection (b) of this section, or under section 4915, 4916, or 4917;

26 USC 361, 367. "(6) any exchange to which section 361 applies (or would, but for section 367, apply), where the transferor corporation was a domestic corporation and was engaged in the active conduct of a trade or business, other than as a dealer in securities, immediately before the date on which the assets involved are transferred to the acquiring corporation;

"(7) any exercise of a right to convert indebtedness, pursuant to its terms, into stock, if such indebtedness is treated as stock pursuant to section 4920(a)(2)(D); or Post, p. 836.

"(8) the grant of a stock option or similar right to a United States person who is an individual, for any reason connected with his employment by a corporation, if such option or right (A) is granted by the employer corporation, or its parent or subsidiary corporation, to purchase stock of any such corporations, and (B) by its terms is not transferable by such United States person otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him.

"(b) EXCLUDED ACQUISITIONS.—The tax imposed by section 4911 shall not apply to the acquisition—

"(1) THE UNITED STATES.—Of stock or debt obligations by an agency or wholly owned instrumentality of the United States.

"(2) COMMERCIAL BANK LOANS.—

"(A) Of debt obligations by a commercial bank in making loans in the ordinary course of its commercial banking business.

"(B) Of stock or debt obligations by a commercial bank through foreclosure, where such stock or debt obligations were held as security for loans made in the ordinary course of its commercial banking business.

"(3) ACQUISITIONS REQUIRED UNDER FOREIGN LAW.—Of stock or debt obligations by a United States person doing business in a foreign country to the extent that such acquisitions are reasonably necessary to satisfy minimum requirements relating to holdings of stock or debt obligations of foreign issuers or obligors imposed by the laws of such foreign country; except that if any of such requirements relate to the holding of insurance reserves, the exclusion otherwise allowable under this paragraph with respect to acquisitions made by such United States person during any calendar year shall be reduced by the maximum amount of the exclusion which could be allowed under subsection (e) with respect to acquisitions made by such person during that year, or by the amount of the insurance reserves which must be held in order to satisfy such requirements, whichever is less.

"(4) ACQUISITIONS IN LIEU OF PAYMENT OF FOREIGN TAX.—Of stock or debt obligations by a United States person doing business in a foreign country, to the extent such acquisition is made, in conformity with the laws of such foreign country, as a substitute for the payment of tax to such foreign country.

"(5) ACQUISITIONS OF STOCK IN COOPERATIVE HOUSING CORPORATIONS.—Of stock of a foreign corporation which entitles the holder, solely by reason of his ownership of such stock, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation.

"(6) EXPORT CREDIT, ETC., TRANSACTIONS.—Of stock or debt obligations arising from the sale of property or services by United States persons, to the extent provided in subsection (c).

"(7) LOANS TO ASSURE RAW MATERIALS SOURCES.—Of debt obligations by United States persons in connection with loans made to foreign corporations to assure raw materials sources, to the extent provided in subsection (d).

"(8) ACQUISITIONS BY INSURANCE COMPANIES DOING BUSINESS IN FOREIGN COUNTRIES.—Of stock or debt obligations by insurance companies doing business in foreign countries, to the extent provided in subsection (e).

"(9) ACQUISITIONS BY CERTAIN TAX-EXEMPT LABOR, FRATERNAL, AND SIMILAR ORGANIZATIONS HAVING FOREIGN BRANCHES OR CHAPTERS.—Of stock or debt obligations by certain tax-exempt United States persons operating in foreign countries through local organizations, to the extent provided in subsection (f).

"(10) ACQUISITIONS OF DEBT OBLIGATIONS ON SALE OR LIQUIDATION OF WHOLLY OWNED FOREIGN SUBSIDIARIES.—Of debt obligations acquired in connection with the sales or liquidation of a wholly owned foreign corporation, to the extent provided in subsection (g).

"(11) ACQUISITIONS OF DEBT OBLIGATIONS ARISING OUT OF PURCHASE OF REAL PROPERTY LOCATED IN THE UNITED STATES.—Of debt obligations secured by real property located in the United States and arising out of the purchase of such property from United States persons, to the extent provided in subsection (h).

"(12) ACQUISITIONS BY UNITED STATES PERSONS RESIDING IN FOREIGN COUNTRIES OF STOCK OF CERTAIN FOREIGN ISSUERS INVESTING EXCLUSIVELY IN THE UNITED STATES.—Of stock of foreign issuers investing exclusively in the United States by United States persons residing in foreign countries, to the extent provided in subsection (i).

"(c) EXPORT CREDIT, ETC., TRANSACTIONS.—

"(1) IN GENERAL.—The tax imposed by section 4911 shall not apply to the acquisition from a foreign obligor of a debt obligation arising out of the sale of tangible personal property or services (or both) to such obligor by any United States person, if—

"(A) payment of such debt obligation (or of any related debt obligation arising out of such sale) is guaranteed or insured, in whole or in part, by an agency or wholly owned instrumentality of the United States; or

"(B) the United States person acquiring such debt obligation makes the sale in the ordinary course of his trade or business and not less than 85 percent of the purchase price is attributable to the sale of property manufactured, produced, grown, or extracted in the United States, or to the performance of services by such United States person (or by one or more includible corporations in an affiliated group, as defined in section 1504, of which such person is a member), or to both. 26 USC 1504.

The term 'services', as used in this paragraph and paragraph (2), shall not be construed to include functions performed as an underwriter.

"(2) ALTERNATE RULE FOR PRODUCING EXPORTERS.—The tax imposed by section 4911 shall not apply to the acquisition by a United States person from a foreign issuer or obligor of its stock in payment for, or of a debt obligation arising out of, the sale of tangible personal property or services (or both) to such issuer or obligor, if

"(A) at least 30 percent of the purchase price, or 60 percent of the actual value of the stock or debt obligation acquired, is attributable to the sale of property manufactured, pro-

26 USC 1504. duced, grown, or extracted in the United States by such United States person (or by one or more includible corporations in an affiliated group, as defined in section 1504, of which such person is a member), or to the performance of services by such United States person (or by one or more such corporations), or to both, and

"(B) at least 50 percent of the purchase price, or 100 percent of the actual value of the stock or debt obligation acquired, is attributable to the sale of property manufactured, produced, grown, or extracted in the United States, or to the performance of services by United States persons, or to both.

"(3) CERTAIN INTERESTS IN INTANGIBLE PERSONAL PROPERTY.—The tax imposed by section 4911 shall not apply to the acquisition by a United States person from a foreign issuer or obligor of its stock in payment for, or of a debt obligation arising out of, the sale or license to such issuer or obligor of—

"(A) any interest in patents, inventions, models or designs (whether or not patented), copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, or other like property (or any combination thereof), or

"(B) any such interest together with services to be performed in connection with any such interest sold or licensed by such United States person (or by one or more includible corporations in an affiliated group, as defined in section 1504, of which such person is a member),

if not less than 85 percent of the purchase price, or license fee, is attributable to the sale or license of any interest in property described in subparagraph (A) which was produced, created, or developed in the United States by such United States person (or by one or more such includible corporations), or is attributable to the sale or license of any interest in such property so produced, created, or developed and to the performance of services described in subparagraph (B).

"(4) EXPORT-RELATED LOANS.—The tax imposed by section 4911 shall not apply to the acquisition from a foreign obligor by a United States person of a debt obligation arising out of a loan made to the obligor to increase or maintain sales of tangible personal property produced, grown, or extracted in the United States by such United States person (or by one or more includible corporations in an affiliated group, as defined in section 1504, of which such person is a member), but only if the proceeds of the loan will be used by the obligor for the installation, maintenance, or improvement of facilities outside the United States which (during the period the loan is outstanding) will be used for the storage, handling, transportation, processing, packaging, or servicing of property a substantial portion of which is tangible personal property produced, grown, or extracted in the United States by such person (or one or more such corporations).

"(5) OTHER LOANS RELATED TO CERTAIN SALES BY UNITED STATES PERSONS.—The tax imposed by section 4911 shall not apply to the acquisition from a foreign obligor by a United States person of a debt obligation of such obligor if such debt obligation—

"(A) was received by such United States person as all or part of the purchase price provided in a contract under which the foreign obligor agrees to purchase for a period of 3 years or more ores or minerals (or derivatives thereof)—

"(i) extracted outside the United States by such United States person or by one or more includible corporations in an affiliated group (as defined in section 48(c)(3)(C)) of which such United States person is a member, 76 Stat. 969. 26 USC 48.

"(ii) extracted outside the United States by a corporation at least 10 percent of the total combined voting power of all classes of stock of which is owned, directly or indirectly, by such United States person, by one or more such includible corporations, or by domestic corporations which own, directly or indirectly, at least 50 percent of the total combined voting power of all classes of stock of such United States person,

"(iii) obtained under a contract entered into on or before July 18, 1963, by such United States person, by one or more such includible corporations, or by such domestic corporations, or

"(iv) extracted outside the United States and obtained by such United States person, by one or more such includible corporations, or by such domestic corporations in exchange for similar ores or minerals (or derivatives thereof) described in clause (i), (ii), or (iii); or

"(B) arises out of a loan (made by such United States person to such foreign obligor) the proceeds of which will be used by such obligor (or by a person controlled by, or controlling, such obligor) for the installation, maintenance, or improvement of facilities outside the United States which (during the period the loan is outstanding) will be used for the storage, handling, transportation, processing, or servicing of ores or minerals (or derivatives thereof) a substantial portion of which is extracted outside the United States by such United States person or by a corporation referred to in clause (i) or (ii) of subparagraph (A), is obtained under a contract described in clause (iii) of subparagraph (A), or is obtained in an exchange described in clause (iv) of subparagraph (A).

"(6) CROSS REFERENCE.—

"For loss of exclusion otherwise allowable under this subsection in case of certain subsequent transfers, see subsection (j).

"(d) LOANS TO ASSURE RAW MATERIALS SOURCES.—

"(1) GENERAL RULE.—The tax imposed by section 4911 shall not apply to the acquisition by a United States person of a debt obligation arising out of a loan made by such person to a foreign corporation, if—

"(A) such foreign corporation extracts or processes ores or minerals the available deposits of which in the United States are inadequate to satisfy the needs of domestic producers;

"(B) United States persons own at the time of such acquisition at least 50 percent of the total combined voting power of all classes of stock of such foreign corporation; and

"(C) such loan will be amortized under a contract or contracts in which persons owning stock of such corporation (including at least one of the United States persons referred to in subparagraph (B)) agree to pay during the period remaining to maturity of such obligation, by purchasing a part of the production of such corporation or otherwise, a portion of such corporation's costs of operation and costs of amortizing outstanding loans.

"(2) LIMITATION.—The exclusion from tax provided by paragraph (1) shall apply to the acquisition of any debt obligation of a foreign corporation only to the extent that—

"(A) the applicable percentage of (i) the actual value of the debt obligation acquired, plus (ii) the actual value (determined as of the time of such acquisition) of all other debt obligations representing loans which were theretofore made to the foreign corporation during the same calendar year and which are amortizable under contracts of the type described in paragraph (1)(C), exceeds

"(B) the actual value of the debt obligations described in subparagraph (A)(ii) representing loans made by United States persons, to the extent that the acquisition of such obligations was excluded from tax under this subsection.

As used in this paragraph with respect to the acquisition of a debt obligation, the term 'applicable percentage' means the lesser of (i) the percentage of the total combined voting power of all classes of stock of the foreign corporation which is owned by United States persons at the time of such acquisition, or (ii) the percentage of the corporation's operating and amortization costs for the calendar year which all such United States persons have agreed to pay (as of the time of such acquisition) under contracts of the type described in paragraph (1)(C).

"(e) ACQUISITIONS BY INSURANCE COMPANIES DOING BUSINESS IN FOREIGN COUNTRIES.—

"(1) IN GENERAL.—The tax imposed by section 4911 shall not apply to the acquisition of stock or a debt obligation by a United States person which is an insurance company subject to taxation under section 802, 821, or 831, if such stock or debt obligation is designated (in accordance with paragraph (3)) as part of a fund of assets established and maintained by such insurance company (in accordance with paragraph (2)) with respect to foreign risks insured or reinsured by such company under contracts (including annuity contracts) the proceeds of which are payable only in the currency of a foreign country. As used in this subsection, the term 'foreign risks' means risks in connection with property outside, or liability arising out of activity outside, or in connection with the lives or health of residents of countries other than, the United States.

73 Stat. 115; 76 Stat. 989,997. 26 USC 802, 821, 831.

"(2) ESTABLISHMENT AND MAINTENANCE OF FUND OF ASSETS.—Each insurance company which desires to obtain the benefit of exclusions under this subsection shall (as a condition of entitlement to any such exclusion) establish and maintain a fund (or funds) of assets in accordance with this paragraph and paragraph (3). A life insurance company (as defined in section 801(a)) shall establish such a fund of assets separately for each foreign currency (other than the currency of a country which qualifies as a less developed country) in which the proceeds of its insurance contracts are payable and for which insurance reserves are maintained by such company, and with respect to which it desires to obtain the benefits of exclusions under this subsection; and the preceding sentence shall be applied separately to each such fund in determining the company's entitlement to exclude acquisitions of stock and debt obligations designated as a part thereof. An insurance company other than a life insurance company (as so defined) shall establish a single fund of assets for all foreign currencies (other than currencies of countries which qualify as less developed countries at the time of the initial designation) in which the proceeds of its insurance contracts are payable and for which insurance reserves are maintained by such company.

73 Stat. 112. 26 USC 801.

"(3) DESIGNATION OF ASSETS.—

"(A) INITIAL DESIGNATION.—

"(i) REQUIREMENT OF INITIAL DESIGNATION.—An insurance company desiring to establish a fund (or funds) of assets under paragraph (2) shall initially designate, as part or all of such fund (or funds), stock and debt obligations owned by it on July 18, 1963, as follows: First, stock of foreign issuers, and debt obligations of foreign obligors having a period remaining to maturity (on July 18, 1963) of 3 years or more and payable in foreign currency; second, if the company so elects, debt obligations of foreign obligors having a period remaining to maturity (on July 18, 1963) of less than 3 years and payable in foreign currency; and third, debt obligations of foreign obligors having a period remaining to maturity (on July 18, 1963) of 3 years or more and payable solely in United States currency. The designation under the preceding sentence with respect to any fund shall be made, in the order set forth, to the extent that the adjusted basis (within the meaning of section 1011) of the designated stock and debt obligations was (on July 18, 1963) not in excess of 110 percent of the allowable reserve applicable to such fund (determined in accordance with paragraph (4)(B)(ii)), and shall in no case include any stock or debt obligation described in section 4916(a).

26 USC 1011.

Post, p. 827.

"(ii) TIME AND MANNER OF INITIAL DESIGNATION.—Any initial designation which an insurance company is required to make under this subparagraph shall be made on or before the 30th day after the date of the enactment of this chapter (or at such later time as the Secretary or his delegate may by regulations prescribe) by the segregation on the books of such company of the stock or debt obligations (or both) designated.

"(B) CURRENT DESIGNATIONS TO MAINTAIN FUND.—To the extent permitted by subparagraph (E), stock of a foreign issuer or a debt obligation of a foreign obligor acquired by an insurance company after July 18, 1963, may be designated as part of a fund of assets described in paragraph (2), if such designation is made before the expiration of 30 days after the date of such acquisition and the company continues to own the stock or debt obligation until the time the designation is made; except that any such stock or debt obligation acquired before the initial designation of assets to the fund is actually made as provided in subparagraph (A)(ii) may be designated under this subparagraph at the time of such initial designation without regard to such 30-day and continued ownership requirements.

"(C) ADDITIONAL DESIGNATIONS AFTER CLOSE OF YEAR.—If the adjusted basis of the assets held in a fund of assets described in paragraph (2) at the close of a calendar year after 1963 is less than 110 percent of the allowable reserve applicable to such fund at the close of such year, the insurance company may, to the extent permitted by subparagraph (E), designate additional stock or debt obligations (or both) which were acquired during such calendar year as part of such fund, so long as the company still owns such stock or debt obligations at the time of designation. Any designation under this subparagraph shall be made on or before January 31 following the close of the calendar year. Any tax paid by such company under section 4911 on the acquisition of the additional stock or debt obligations so designated shall constitute an overpayment of tax; and, under regulations prescribed by the Secretary or his delegate, credit or refund (without interest) shall be allowed or made with respect to such overpayment.

"(D) SUPPLEMENTAL REQUIRED DESIGNATIONS AFTER CLOSE OF YEAR.—If during any calendar year an insurance company acquires stock or debt obligations which are excluded from the tax imposed by section 4911 under an Executive order described in section 4917, and if at the close of the calendar year (and after the designation of additional assets under subparagraph (C)) the adjusted basis of all assets in a fund described in paragraph (2) is less than 110 percent of the allowable reserve applicable to such fund, such company shall, to the extent permitted by subparagraph (E), designate as part of such fund stock and debt obligations acquired by it during the calendar year and owned by it at the close of the calendar year, as follows: First, stock, and debt obligations having a period remaining to maturity (on the date of acquisition) of 3 years or more and payable in foreign currency, which were excluded from the tax imposed by section 4911 under such Executive order; second, if the company so elects, debt obligations of foreign obligors having a period remaining to maturity (on the date of acquisition) of less than 3 years and payable in foreign currency; and third, debt obligations having a period remaining to maturity (on the date of acquisition) of 3 years or more and payable solely in United States currency, which were excluded from the tax imposed by section 4911 under such Executive order. The designations under this subparagraph shall be made on or before January 31 following the close of the calendar year.

Post, p. 830.

"(E) LIMITATIONS.—

"(i) IN GENERAL.—Stock or a debt obligation may be designated under subparagraph (B), (C), or (D) as part of a fund of assets described in paragraph (2) only to the extent that, immediately after such designation, the adjusted basis of all the assets held in such fund does not exceed 110 percent of the applicable allowable reserve (determined in accordance with paragraph (4) (B)(i)). To the extent any designation of stock or a debt obligation exceeds the amount permitted by the preceding sentence, such designation shall be ineffective and the provisions of this chapter shall apply with respect to the acquisition of such stock or debt obligation as if such designation had not been made.

"(ii) SHORT-TERM OBLIGATIONS.—No designation may be made under subparagraph (B) or (C) of any debt obligation which has a period remaining to maturity (on the date of acquisition) of less than 3 years.

"(4) DETERMINATION OF RESERVES.—

"(A) GENERAL RULE.—For purposes of this subsection, the term 'allowable reserve' means—

"(i) in the case of a life insurance company (as defined in section 801(a)), the items taken into account under section 810(c) arising out of contracts of insurance

73 Stat. 112.
26 USC 801.
26 USC 810.

and reinsurance (including annuity contracts) which relate to foreign risks and the proceeds of which are payable in a single foreign currency (other than the currency of a less developed country); and

"(ii) in the case of an insurance company other than a life insurance company (as so defined), the amount of its unearned premiums (under section 832(b)(4)) and unpaid losses (under section 832(b)(5)) which relate to foreign risks insured or reinsured under contracts providing for payment in foreign currencies (other than currencies of less developed countries) and which are taken into account in computing taxable income under section 832 (for such purpose treating underwriting income of an insurance company subject to taxation under section 821 as taxable income under section 832). 26 USC 832. 76 Stat. 989. 26 USC 821.

"(B) TIME OF DETERMINATION.—

"(i) IN GENERAL.—For purposes of paragraph (3) (other than subparagraph (A) of such paragraph), the determination of an allowable reserve for any calendar year shall be made as of the close of such year.

"(ii) INITIAL DESIGNATION.—For purposes of paragraph (3)(A), the determination of an allowable reserve shall be made as of July 18, 1963. If the insurance company so elects, the determination under this clause may be made by computing the mean of the allowable reserve at the beginning and at the close of the calendar year 1963.

"(5) NONRECOGNITION OF ARTIFICIAL INCREASES IN ALLOWABLE RESERVE.—An insurance or reinsurance contract which is entered into or acquired by an insurance company for the principal purpose of artificially increasing the amount determined as an allowable reserve as provided in paragraph (4) shall not be recognized in computing whether an acquisition of stock or a debt obligation of a foreign issuer or obligor can be excluded under this subsection.

"(f) ACQUISITIONS BY CERTAIN TAX-EXEMPT LABOR, FRATERNAL, AND SIMILAR ORGANIZATIONS HAVING FOREIGN BRANCHES OR CHAPTERS.—The tax imposed by section 4911 shall not apply to the acquisition of stock or debt obligations by a United States person which is described in section 501(c) and exempt from taxation under subtitle A, and which operates in a foreign country through a local organization or organizations, to the extent that— 26 USC 501.

"(1) such acquisition results from the investment or reinvestment of contributions or membership fees paid in the currency of such country by individuals who are members of the local organization or organizations, and

"(2) the stock or debt obligations acquired are held exclusively for the benefit of the members of any of such local organizations.

"(g) SALE OR LIQUIDATION OF WHOLLY OWNED FOREIGN SUBSIDIARY.—

"(1) IN GENERAL.—The tax imposed by section 4911 shall not apply to the acquisition by a United States person of a debt obligation of a foreign obligor if the debt obligation is acquired—

"(A) in connection with the sale by such United States person (or by one or more includible corporations in an affiliated group, as defined in section 48(c)(3)(C), of which such United States person is a member) of all of the outstanding stock, except for qualifying shares, of a foreign corporation; or 76 Stat. 969. 26 USC 48.

"(B) in connection with the liquidation by such United States person (or by one or more such includible corporations) of a foreign corporation all of the outstanding stock of which, except for qualifying shares, is owned by such United States person (or by one or more such includible corporations), but only if such debt obligation had been received by such foreign corporation as part or all of the purchase price in a sale of substantially all of its assets.

"(2) LIMITATION.—Paragraph (1) shall not apply to the acquisition of a debt obligation if any of the stock sold or surrendered in connection with its acquisition was originally acquired with the intent to sell or surrender.

"(h) CERTAIN DEBT OBLIGATIONS SECURED BY UNITED STATES MORTGAGES, ETC.—

"(1) IN GENERAL.—The tax imposed by section 4911 shall not apply to the acquisition from a foreign obligor by a United States person of a debt obligation of such foreign obligor which is secured by real property located in the United States, to the extent that—

"(A) the debt obligation is a part of the purchase price of such real property (or of such real property and related personal property); or

"(B) the debt obligation arises out of a loan made by such United States person to the foreign obligor the proceeds of which are concurrently used as part of the purchase price of such real property (or of such real property and related personal property).

"(2) LIMITATION.—Paragraph (1) shall apply to the acquisition of a debt obligation only if—

"(A) the owner of the property sold is a United States person; and

"(B) at least 25 percent of the purchase price of the property sold is, at the time of such sale, paid in United States currency to such United States person by the foreign obligor from funds not obtained from United States persons for the purpose of purchasing such property.

"(3) RELATED PERSONAL PROPERTY.—For purposes of paragraph (1), the term 'related personal property' means personal property which is sold in connection with the sale of real property for use in the operation of such real property.

"(i) ACQUISITIONS OF STOCK OF FOREIGN ISSUERS INVESTING EXCLUSIVELY IN THE UNITED STATES.—

"(1) IN GENERAL.—The tax imposed by section 4911 shall not apply to the acquisition from a foreign issuer of its stock by a United States person who is a bona fide resident of a foreign country within the meaning of section 911(a)(1), or who at the time of such acquisition is regularly performing personal services on a full-time basis in a foreign country, if at the close of each calendar quarter ending on or after June 30, 1963, preceding such acquisition, during any part of which such foreign issuer is in existence—

76 Stat. 1003.
26 USC 911.

"(A) the assets of such foreign issuer, exclusive of money or deposits with persons carrying on the banking business, consist solely of:

"(i) stock or debt obligations of domestic corporations (other than a corporation which has elected under section 4920(a)(3)(B) to be treated as a foreign issuer or obligor for purposes of this chapter);

Post, p. 836.

"(ii) debt obligations of the United States, or of any State or possession of the United States, or any political subdivision of any State or possession; or

"(iii) debt obligations of citizens or residents of the United States;

"(B) money and deposits with persons carrying on the banking business (other than banks as defined in section 581) constitute less than 5 percent of the value of the assets of such foreign issuer; and

26 USC 581.

"(C) less than 25 percent of each class of issued and outstanding stock of such foreign issuer is held of record by United States persons.

"(2) ACQUISITIONS THROUGH UNIT INVESTMENT TRUSTS.—For purposes of paragraph (1), an acquisition of an interest in a unit investment trust (within the meaning of section 4(2) of the Investment Company Act of 1940), or in an entity performing similar custodial functions, shall be deemed a direct acquisition from the foreign issuer of the stock held by such trust or entity with respect to such interest and shall not be treated as an acquisition of stock issued by such trust or entity.

54 Stat. 799.
15 USC 80a-4.

"(3) LIMITATIONS.—

"(A) Paragraph (1) shall apply only to that portion of the total acquisitions of stock of foreign issuers described in such paragraph (determined in the order acquired) by a United States person in any one calendar year that does not exceed $5,000.

"(B) If, after July 30, 1964, a United States person sells or otherwise disposes of stock the acquisition of which was excluded under paragraph (1) from the tax imposed by section 4911, such person shall not, with respect to such stock, be considered a United States person.

"(j) LOSS OF ENTITLEMENT TO EXCLUSION IN CASE OF CERTAIN SUBSEQUENT TRANSFERS.—

"(1) IN GENERAL.—

"(A) Where an exclusion provided by paragraph (1)(B), (2), (3), (4), or (5) of subsection (c), or the exclusion provided by subsection (d), has applied with respect to the acquisition of a debt obligation by any person, but such debt obligation is subsequently transferred by such person (before the termination date specified in section 4911(d)) to a United States person otherwise than—

"(i) to any agency or wholly-owned instrumentality of the United States;

"(ii) to a commercial bank acquiring the obligation in the ordinary course of its commercial banking business;

"(iii) in the case of an exclusion provided by paragraph (1)(B), (2), or (3) of subsection (c), to any transferee where the extension of credit by such person and the acquisition of the debt obligation related thereto were reasonably necessary to accomplish the sale of property or services out of which the debt obligation arose, and the terms of the debt obligation are not unreasonable in light of credit practices in the business in which such person is engaged; or

"(iv) in a transaction described in subsection (a)(1) or (2), or a transaction (other than a transfer by gift) described in subsection (a)(3).

then liability for the tax imposed by section 4911 (in an amount determined under subparagraph (D) of this paragraph) shall be incurred by the transferor (with respect to such debt obligation) at the time of such subsequent transfer.

"(B) Where the exclusion provided by paragraph (2) or (3) of subsection (c) has applied with respect to the acquisition of stock by any person, but such stock is subsequently transferred by such person (before the termination date specified in section 4911(d)) to a United States person otherwise than in a transaction described in subsection (a) (1) or (2), or a transaction (other than a transfer by gift) described in subsection (a)(3), then liability for the tax imposed by section 4911 (in an amount determined under subparagraph (D) of this paragraph) shall be incurred by the transferor (with respect to such stock) at the time of such subsequent transfer.

"(C) Where the exclusion provided by subsection (f) has applied with respect to the acquisition of stock or a debt obligation by any person, but such stock or debt obligation is subsequently transferred by such person (before the termination date specified in section 4911(d)) to any United States person, then liability for the tax imposed by section 4911 (in an amount determined under subparagraph (D) of this paragraph) shall be incurred by the transferor (with respect to such stock or debt obligation) at the time of such subsequent transfer.

"(D) In any case where an exclusion provided by paragraph (1)(B), (2), (3), (4), or (5) of subsection (c) or by subsection (d) or (f) has applied, but a subsequent transfer described in subparagraph (A), (B), or (C) of this paragraph occurs and liability for the tax imposed by section 4911 is incurred by the transferor as a result thereof, the amount of such tax shall be equal to the amount of tax for which the transferor would have been liable under such section upon his acquisition of the stock or debt obligation involved if such exclusion had not applied with respect to such acquisition.

"(2) UNITED STATES PERSON TREATED AS FOREIGN PERSON ON DISPOSITION OF CERTAIN SECURITIES.—For purposes of this chapter, if, after December 10, 1963, a United States person sells or otherwise disposes of stock or a debt obligation which it—

"(A) acquired to satisfy minimum requirements imposed by foreign law and with respect to which it claimed an exclusion under subsection (b) (3), or

"(B) designated (or was required to designate) as part of a fund of assets under subsection (e),

such person shall not, with respect to that stock or debt obligation, be considered a United States person.

"SEC. 4915. EXCLUSION FOR DIRECT INVESTMENTS.

"(a) IN GENERAL.—

"(1) EXCLUDED ACQUISITIONS.—Except as provided in subsections (c) and (d) of this section, the tax imposed by section 4911 shall not apply to the acquisition by a United States person (A) of stock or a debt obligation of a foreign corporation, or of a debt obligation from a foreign corporation which received such obligation in the ordinary course of its trade or business as a result of the sale or rental of products manufactured or assembled by it or of the performance of services by it, if immediately after the acquisition such person (or one or more

includible corporations in an affiliated group, as defined in section 1504, of which such person is a member) owns (directly or indirectly) 10 percent or more of the total combined voting power of all classes of stock of such foreign corporation, or (B) of stock or a debt obligation of a foreign partnership if immediately after the acquisition such person owns (directly or indirectly) 10 percent or more of the profits interest in such foreign partnership. For purposes of the preceding sentence, stock owned (directly or indirectly) by or for a foreign corporation shall be considered as being owned proportionately by its shareholders, and stock owned (directly or indirectly) by or for a foreign partnership shall be considered as being owned proportionately by its partners. 26 USC 1504.

"(2) OVERPAYMENT WITH RESPECT TO CERTAIN TAXABLE ACQUISITIONS.—The tax paid under section 4911 on the acquisition by a United States person of stock or a debt obligation of a foreign corporation or foreign partnership, or a debt obligation from a foreign corporation which received such obligation in the ordinary course of its trade or business as a result of the sale or rental of products manufactured or assembled by it or the performance of services by it, shall (unless this subsection is inapplicable by reason of subsection (c) or (d)) constitute an overpayment of tax if such person—

"(A) meets the ownership requirement of paragraph (1) with respect to such corporation or partnership at any time within 12 months after the date of such acquisition, and

"(B) holds the stock or debt obligation continuously from the date of such acquisition to the last day of the calendar year in which such ownership requirement is first met.

Under regulations prescribed by the Secretary or his delegate, credit or refund (without interest) shall be allowed or made with respect to such overpayment.

"(b) SPECIAL RULE FOR GOVERNMENT-CONTROLLED ENTERPRISES.—A United States person shall be considered to meet the ownership requirement of subsection (a)(1) with respect to a foreign corporation or a foreign partnership if—

"(1) the government of a foreign country or any political subdivision thereof, or an agency or instrumentality of such a government, directly or indirectly through such corporation or partnership or otherwise, restricts to less than 10 percent the percentage of the total combined voting power of all classes of stock of such corporation, or the percentage of the profits interest in such partnership, which may be owned by such United States person;

"(2) such person owns at least 5 percent of the total combined voting power of so much of such stock, or at least 5 percent of so much of such profits interest, as is not owned by any such government, agency, or instrumentality;

"(3) a trade or business actively conducted in one or more foreign countries by such United States person (or by one or more corporations in an affiliated group, as defined in section 48(c)(3)(C), of which such person is a member) is directly related to the business carried on by such foreign corporation or foreign partnership; and 76 Stat. 969. 26 USC 48.

"(4) such person, and one or more other United States persons each of which satisfies the conditions set forth in paragraphs (2) and (3), together meet the ownership requirement of subsection (a)(1).

"(c) Exception for Foreign Corporations or Partnerships Formed or Availed of for Tax Avoidance.—

"(1) In general.—The provisions of subsections (a) and (b) shall be inapplicable in any case where the foreign corporation or foreign partnership is formed or availed of by the United States person for the principal purpose of acquiring, through such corporation or partnership, an interest in stock or debt obligations (of one or more other foreign issuers or obligors) the direct acquisition of which by the United States person would be subject to the tax imposed by section 4911.

"(2) Commercial banks, underwriters, and required holdings.—For purposes of this subsection, the acquisition by a United States person of stock or debt obligations of a foreign corporation or foreign partnership which acquires stock or debt obligations of foreign issuers or obligors—

"(A) in making loans in the ordinary course of its business as a commercial bank,

"(B) in the ordinary course of its business of underwriting and distributing securities issued by other persons, or

"(C) to satisfy minimum requirements relating to holdings of stock or debt obligations of foreign issuers or obligors imposed by the laws of foreign countries where such foreign corporation or foreign partnership is doing business,

shall not, by reason of such acquisitions by the foreign corporation or foreign partnership, be considered an acquisition by the United States person of an interest in stock or debt obligations of foreign issuers or obligors. For purposes of subparagraph (A), any foreign corporation or foreign partnership which is regularly engaged in the business of accepting deposits from customers and receiving other borrowed funds in foreign currencies and making loans in such currencies shall be treated as a commercial bank.

"(3) Loss of entitlement to exclusion or refund where foreign corporation or partnership is availed of for tax avoidance.—In any case where—

"(A) the exclusion provided by subsection (a)(1) has applied with respect to the acquisition of stock or a debt obligation by a United States person, or

"(B) a credit or refund of tax under subsection (a)(2) has been received by a United States person with respect to acquisitions of stock made during a calendar year,

but the foreign corporation or partnership is availed of by such person (after the acquisition described in subparagraph (A) is made or the calendar year described in subparagraph (B) has ended, but before the termination date specified in section 4911 (d)) for the principal purpose described in paragraph (1) of this subsection, then liability for the tax imposed by section 4911 shall be incurred by such person (with respect to such stock or debt obligation) at the time the foreign corporation or partnership is so availed of; and the amount of such tax shall be equal (in a case described in subparagraph (A)) to the amount of tax for which such person would have been liable under such section upon his acquisition of the stock or debt obligations involved if such exclusion had not applied to such acquisition, or (in a case described in subparagraph (B)) to the aggregate amount of tax for which such person was liable under such section upon his acquisitions of the stock involved.

"(d) Exception for Acquisitions Made With Intent To Sell to United States Persons.—The provisions of subsections (a) and (b)

shall be inapplicable in any case where the acquisition of stock or debt obligations of the foreign corporation or foreign partnership is made with an intent to sell, or to offer to sell, any part of the stock or debt obligations acquired to United States persons.

"SEC. 4916. EXCLUSION FOR INVESTMENTS IN LESS DEVELOPED COUNTRIES.

"(a) General Rule.—The tax imposed by section 4911 shall not apply to the acquisition by a United States person of—

"(1) a debt obligation issued or guaranteed by the government of a less developed country or a political subdivision thereof, or by an agency or instrumentality of such a government;

"(2) stock or a debt obligation of a less developed country corporation;

"(3) a debt obligation issued by an individual or partnership resident in a less developed country in return for money or other property which is used, consumed, or disposed of wholly within one or more less developed countries; or

"(4) stock or a debt obligation of a foreign issuer or obligor, to the extent that such acquisition is required as a reinvestment within a less developed country by the terms of a contract of sale to, or of a contract of indemnification with respect to the nationalization, expropriation, or seizure by, the government of such less developed country or a political subdivision thereof, or an agency or instrumentality of such government, of property owned within such less developed country or such political subdivision by such United States person, or by a controlled foreign corporation (as defined in section 957) more than 50 percent of the total combined voting power of all classes of stock entitled to vote of which is owned (within the meaning of section 958) by such United States person, but only if such contract was entered into because the government of such less developed country or political subdivision, or such agency or instrumentality— 76 Stat. 1017. 26 USC 957. 26 USC 958.

"(A) has nationalized or has expropriated or seized, or has threatened to nationalize or to expropriate or seize, a substantial portion of the property owned within such less developed country or such political subdivision by such United States person or such controlled foreign corporation; or

"(B) has taken action which has the effect of nationalizing or of expropriating or seizing, or of threatening to nationalize or to expropriate or seize, a substantial portion of the property so owned.

For purposes of this subsection, an instrumentality of the government of a less developed country or a political subdivision thereof includes a corporation or other entity with respect to which such government, or any agency of such government, owns more than 50 percent of the total combined voting power of all classes of stock entitled to vote or, in the case of a corporation or other entity not issuing shares of stock, has the authority to elect or appoint a majority of the board of directors or equivalent body of such corporation or other entity.

"(b) Less Developed Country Defined.—For purposes of this section, the term 'less developed country' means any foreign country (other than an area within the Sino-Soviet bloc) or any possession of the United States with respect to which, as of the date of an acquisition referred to in subsection (a), there is in effect an Executive order by the President of the United States designating such country as an economically less developed country for purposes of the tax imposed by section 4911. For purposes of the preceding sentence, Executive Order Numbered 11071, dated December 27, 1962 (designating certain areas as economically less developed countries for 26 USC 955 note.

26 USC 901-905, 951-964. 26 USC 1248.

purposes of subparts A and F of part III of subchapter N, and section 1248 of part IV of subchapter P, of chapter 1), shall be deemed to have been issued and in effect, for purposes of the tax imposed by section 4911, on July 18, 1963, and continuously thereafter until there is in effect the Executive order referred to in the preceding sentence. An overseas territory, department, province, or possession of any foreign country may be designated as a separate country. No designation shall be made under this subsection with respect to any of the following:

Australia	Luxembourg
Austria	Monaco
Belgium	Netherlands
Canada	New Zealand
Denmark	Norway
France	Republic of South Africa
Germany (Federal Republic)	San Marino
Hong Kong	Spain
Italy	Sweden
Japan	Switzerland
Liechtenstein	United Kingdom.

Notification to Congress.

After the President (under the first sentence of this subsection) has designated any foreign country as an economically less developed country for purposes of the tax imposed by section 4911, he shall not terminate such designation (either by issuing an Executive order for that purpose or by issuing an Executive order which has the effect of terminating such designation) unless, at least 30 days before such termination, he has notified the Senate and the House of Representatives of his intention to terminate such designation.

"(c) LESS DEVELOPED COUNTRY CORPORATION DEFINED.—

"(1) IN GENERAL.—For purposes of this section, the term 'less developed country corporation' means a foreign corporation which for the applicable periods set forth in paragraph (3)—

76 Stat. 1013. 26 USC 955.

"(A) meets the requirements of section 955(c) (1) or (2); or

"(B) derives 80 percent or more of its gross income, if any, from sources within less developed countries, or from deposits in the United States with persons carrying on the banking business, or both, and has assets 80 percent or more in value of which consists of—

"(i) money, and deposits in the United States with persons carrying on the banking business,

"(ii) stock or debt obligations of any other less developed country corporation,

"(iii) debt obligations of a less developed country,

"(iv) investments which are required because of restrictions imposed by a less developed country,

"(v) debt obligations described in paragraph (3) of subsection (a) of this section, and

"(vi) obligations of the United States.

In applying this paragraph the determination of whether a foreign country is a less developed country shall be made in accordance with subsection (b) of this section.

"(2) SPECIAL RULES.—

26 USC 956.

"(A) For purposes of subparagraphs (A) and (B) of paragraph (1), property described in section 956(b)(1) (regardless of when acquired), other than deposits with persons carrying on the banking business, and income derived from such property, shall not be taken into account.

"(B) For purposes of subparagraph (A) of paragraph (1), obligations of any other less developed country corporation shall be taken into account under section 955(c) (1) (B) (iii) without regard to the period remaining to maturity at the time of their acquisition. 76 Stat. 1013. 26 USC 955.

"(C) For purposes of subparagraph (B) of paragraph (1), deposits outside the United States (other than deposits in a less developed country) with persons carrying on the banking business, and income from such deposits, shall not be taken into account.

"(3) APPLICABLE PERIODS.—The determinations required by subparagraphs (A) and (B) of paragraph (1) shall be made (A) for the annual accounting period (if any) of the foreign corporation immediately preceding its accounting period in which the acquisition involved is made, (B) for the annual accounting period of the foreign corporation in which such acquisition is made, and (C) for the next succeeding annual accounting period of the foreign corporation.

"(4) SPECIAL RULES FOR TREATMENT OF CORPORATIONS AS LESS DEVELOPED COUNTRY CORPORATIONS.—A foreign corporation shall be treated as satisfying the definition in paragraph (1) with respect to the acquisition by a United States person of stock or a debt obligation if—

"(A) before the acquisition occurs (or, in the case of an acquisition occurring before or within 60 days after the date of the enactment of this chapter, pursuant to application made within such period following such date as may be prescribed by the Secretary or his delegate in regulations), it is established to the satisfaction of the Secretary or his delegate that such foreign corporation—

"(i) has met the applicable requirements of paragraph (1) for the period (if any) referred to in paragraph (3)(A), and

"(ii) may reasonably be expected to satisfy such requirements for the periods referred to in paragraphs (3) (B) and (C); or

"(B) in the case of an acquisition occurring on or before December 10, 1963, the applicable requirements of paragraph (1) are met for the annual accounting period of the foreign corporation immediately preceding its accounting period in which the acquisition occurred.

"(5) TREATMENT OF CORPORATIONS AS LESS DEVELOPED COUNTRY CORPORATIONS IN OTHER CASES.—A foreign corporation may also be treated as satisfying the definition in paragraph (1) with respect to the acquisition by a United States person of stock or a debt obligation (but subject to possible subsequent liability for tax under subsection (d)(1)), if—

"(A) such corporation has met the applicable requirements of paragraph (1) for the period (if any) referred to in paragraph (3)(A), and

"(B) such person reasonably believes that such corporation will satisfy such requirements for the periods referred to in paragraphs (3) (B) and (C).

"(d) SUBSEQUENT LIABILITY FOR TAX IN CERTAIN CASES.—

"(1) STOCK AND DEBT OBLIGATIONS OF CERTAIN CORPORATIONS.—Where a foreign corporation is treated under subsection (c)(5) as satisfying the definition in subsection (c)(1) and the exclusion provided by subsection (a)(2) has applied with respect to the acquisition of stock or a debt obligation of such corporation by any person, but such corporation fails to satisfy the definition contained in subsection (c)(1) for either of the applicable accounting periods referred to in clauses (B) and (C) of subsection (c)(3) (and it is not treated under subsection (c)(4) as satisfying such definition), then liability for the tax imposed by section 4911 shall be incurred by such person (with respect to such stock or debt obligation) as of the close of the earliest such applicable accounting period (ending on or before the termination date specified in section 4911(d)) with respect to which the corporation fails to satisfy such definition; and the amount of such tax shall be equal to the amount of tax for which such person would have been liable under such section upon the acquisition of the stock or debt obligation involved if such exclusion had not applied with respect to such acquisition.

"(2) Debt obligations issued in return for certain property.—Where the exclusion provided by subsection (a)(3) has applied with respect to the acquisition by a United States person of a debt obligation issued in return for money or other property as provided in such subsection, but part or all of such money or property is used, consumed, or disposed of (before the termination date specified in section 4911(d)) otherwise than wholly within one or more less developed countries, then liability for the tax imposed by section 4911 shall be incurred by such person (with respect to such debt obligation) as of the time such money or property is first so used, consumed, or disposed of; and the amount of such tax shall be equal to the amount of tax for which such person would have been liable under such section upon the acquisition of the debt obligation involved if such exclusion had not applied with respect to such acquisition.

"SEC. 4917. EXCLUSION FOR ORIGINAL OR NEW ISSUES WHERE REQUIRED FOR INTERNATIONAL MONETARY STABILITY.

"(a) In General.—If the President of the United States shall at any time determine that the application of the tax imposed by section 4911 will have such consequences for a foreign country as to imperil or threaten to imperil the stability of the international monetary system, he may by Executive order specify that such tax shall not apply to the acquisition by a United States person of stock or a debt obligation of the government of such foreign country or a political subdivision thereof, any agency or instrumentality of any such government, any corporation, partnership, or trust (other than a company registered under the Investment Company Act of 1940) organized under the laws of such country or any such subdivision, or any individual resident therein, to the extent that such stock or debt obligation is acquired as all or part of an original or new issue as to which there is filed such notice of acquisition as the Secretary or his delegate may prescribe by regulations. In the case of acquisitions made during the period beginning July 19, 1963, and ending with the date of the enactment of this chapter, the notice of acquisition may be filed within such period following the date of such enactment as the Secretary or his delegate may prescribe by regulations.

54 Stat. 789.
15 USC 80a-51.

"(b) Applicability of Executive Order.—An Executive order described in subsection (a) may be applicable to all such original or new issues or to any aggregate amount or classification thereof which shall be stated in such order and shall apply to acquisitions occurring during such period of time as shall be stated therein. If the order is applicable to a limited aggregate amount of such issues it shall apply (under regulations prescribed by the Secretary or his delegate) to those acquisitions as to which notice of acquisition was first filed, provided that in the case of any such notice the acquisition described

in the notice is made before or within 90 days after the date of filing or within such longer period after such date as may be specified in such order.

"(c) Original or New Issue.—For purposes of this section—

"(1) stock shall be treated as part of an original or new issue only when it is acquired from the issuer by the United States person claiming the exclusion; and

"(2) a debt obligation shall be treated as part of an original or new issue only if acquired not later than 90 days after the date on which interest begins to accrue on such obligation, except that a debt obligation secured by a lien on improvements on real property which are under construction or are to be constructed at the time such obligation is issued (or if such obligation is one of a series, at the time the first obligation in such series is issued) shall be treated as part of an original or new issue if—

"(A) such obligation is acquired not later than 90 days after the date on which interest begins to accrue on the total amount of such obligation (or if such obligation is one of a series, on the last issued of the obligations in such series); and

"(B) the United States person claiming the exclusion became committed to the acquisition of such obligation not later than 90 days after the date on which interest began to accrue on any part of such obligation (or, if such obligation is one of a series, on the first obligation issued in such series).

"SEC. 4918. EXEMPTION FOR PRIOR AMERICAN OWNERSHIP.

"(a) General Rule.—The tax imposed by section 4911 shall not apply to an acquisition of stock or a debt obligation of a foreign issuer or obligor if it is established in the manner provided in this section that the person from whom such stock or debt obligation was acquired was a United States person throughout the period of his ownership or continuously since July 18, 1963, and was a United States person eligible to execute a certificate of American ownership with respect to such acquisition.

"(b) Certificate of American Ownership.—For purposes of subsection (a), a certificate of American ownership received in connection with an acquisition shall be conclusive proof for purposes of this exemption of prior American ownership unless the person making such acquisition has actual knowledge that the certificate is false in any material respect.

"(c) Trading on Certain National Securities Exchanges.—For purposes of subsection (a), a written confirmation received from a member or member organization of a national securities exchange registered with the Securities and Exchange Commission in connection with an acquisition on such exchange, which does not state that such acquisition was made subject to a special contract, shall be conclusive proof for purposes of this exemption of prior American ownership (unless the person making such acquisition has actual knowledge that the confirmation is false in any material respect), if such exchange has in effect at the time of the acquisition rules providing that—

"(1) any stock or debt obligation, the acquisition of which by any United States person would be subject to the tax imposed by section 4911 but for the provisions of this section, shall be sold in the regular market on such exchange (and not subject to a special contract) only if the member or member organization of such exchange who effects the sale of such stock or debt obligation as broker has in his possession (A) a certificate of American ownership with respect to the stock or debt obligation sold, or (B) a blanket certificate of American ownership with respect to the account for which such stock or debt obligation is sold; and

"(2) any member or member organization of such exchange effecting as broker a purchase of any such stock or debt obligation subject to a special contract (and not in the regular market) shall furnish the person making such an acquisition a written confirmation stating that the acquisition was made subject to such special contract.

"(d) TRADING IN THE OVER-THE-COUNTER MARKET.—For purposes of subsection (a), a written confirmation from a member or member organization of a national securities association registered with the Securities and Exchange Commission received in connection with an acquisition made other than on a national securities exchange described in subsection (c) shall be conclusive proof for purposes of this exemption of prior American ownership, unless the confirmation states that the acquisition was made from a person who has not executed and filed a certificate of American ownership with respect to the stock or debt obligation sold or a blanket certificate of American ownership with respect to the account from which the stock or debt obligation is sold (or the person making such acquisition has actual knowledge that the confirmation is false in any material respect), if such association has in effect at the time of the acquisition rules providing that any member or member organization of such association who effects a sale as broker other than on a national securities exchange of any stock or debt obligation, the acquisition of which by any United States person would be subject to the tax imposed by section 4911 but for the provisions of this section, must—

"(1) have in his possession (A) a certificate of American ownership with respect to the stock or debt obligation sold, or (B) a blanket certificate of American ownership with respect to the account for which such stock or debt obligation is sold; or

"(2) furnish to the person acquiring such stock or debt obligation written confirmation stating that the acquisition is from a person who has not executed and filed a certificate of American ownership with respect to such stock or debt obligation or a blanket certificate of American ownership with respect to the account from which such stock or debt obligation is sold.

Any member or member organization of such an association who acquires any stock or debt obligation for his or its own account other than on a national securities exchange may treat a blanket certificate of American ownership with respect to the seller's account as conclusive proof for purposes of this exemption of prior American ownership, unless such member or member organization has actual knowledge that such certificate is false in any material respect.

"(e) EXECUTION, FILING, AND CONTENTS OF CERTIFICATE.—A certificate of American ownership or blanket certificate of American ownership under this section must be executed and filed in such manner and set forth such information as the Secretary or his delegate shall prescribe by regulations.

"(f) OTHER PROOF OF EXEMPTION.—For purposes of subsection (a), if a person establishes, with respect to an acquisition, that there is reasonable cause for his inability to establish prior American ownership under subsection (b), (c), or (d), he may establish prior American ownership for purposes of this exemption by other evidence that the person from whom such acquisition was made was a United States person eligible to execute a certificate of American ownership with respect to such acquisition.

"SEC. 4919. SALES BY UNDERWRITERS AND DEALERS TO FOREIGN PERSONS.

"(a) CREDIT OR REFUND.—The tax paid under section 4911 on the acquisition of stock or debt obligations of a foreign issuer or obligor shall constitute an overpayment of tax to the extent that such stock or debt obligations—

"(1) PRIVATE PLACEMENTS AND PUBLIC OFFERINGS.—Are acquired by an underwriter in connection with a private placement or a public offering by a foreign issuer or obligor (or a person or persons directly or indirectly controlling, controlled by, or under common control with such issuer or obligor) and are sold as part of such private placement or public offering by the underwriter (including sales by other underwriters who are United States persons participating in the placement or distribution of the stock or debt obligations acquired by the underwriter) to persons other than United States persons;

"(2) CERTAIN DEBT OBLIGATIONS.—Consist of debt obligations—

"(A) acquired by a dealer in the ordinary course of his business and sold by him, within 90 days after their purchase, to—

"(i) persons other than United States persons, or

"(ii) another dealer who resells them on the same or the next business day to persons other than United States persons; or

"(B) acquired by a dealer in the ordinary course of his business to cover short sales made by him, within 90 days before their purchase, to—

"(i) persons other than United States persons, or

"(ii) another dealer who resold them on the same or the next business day to persons other than United States persons; or

"(3) CERTAIN STOCK.—Consist of stock—

"(A) acquired by a dealer in the ordinary course of his business and sold by him on the day of purchase or on either of the two succeeding business days to persons other than United States persons; or

"(B) acquired by a dealer in the ordinary course of his business to cover short sales made by him on the day of purchase or on either of the two preceding business days to persons other than United States persons.

Under regulations prescribed by the Secretary or his delegate, credit or refund (without interest) shall be allowed or made with respect to such overpayment. For purposes of paragraphs (2) and (3) of this subsection and for purposes of paragraph (3) of subsection (b), the day of purchase or sale of any stock or debt obligation is the day on which an order to purchase or to sell, as the case may be, is executed.

"(b) EVIDENCE TO SUPPORT CREDIT OR REFUND.—

"(1) IN GENERAL.—Credit or refund shall be allowed to an underwriter or dealer under subsection (a) with respect to any stock or debt obligation sold by him only if the underwriter or dealer—

"(A) files with the return required by section 6011(d) on which credit is claimed, or with the claim for refund, such information as the Secretary or his delegate may prescribe by regulations, and Post, p. 843.

"(B) establishes that such stock or debt obligation was sold to a person other than a United States person.

In any case where two or more underwriters form a group for the purpose of purchasing and distributing (through resale) stock or debt obligations of a single foreign issuer or obligor, any one of such underwriters may, to the extent provided by regulations prescribed by the Secretary or his delegate, satisfy the requirements of this paragraph on behalf of all such underwriters.

"(2) CERTAIN SALES BY UNDERWRITERS.—For purposes of paragraph (1)(B), in the case of a claim for credit or refund under subsection (a)(1) with respect to stock or a debt obligation acquired by an underwriter and not sold by him directly to a person other than a United States person, a certificate of sale to a foreign person (setting forth such information, and filed in such manner, as the Secretary or his delegate may prescribe by regulations), executed by the underwriter who made such sale, shall be conclusive proof that such stock or debt obligation was sold to a person other than a United States person, unless the underwriter relying upon the certificate has actual knowledge that the certificate is false in any material respect.

"(3) SALES OF DEBT OBLIGATIONS BY DEALERS.—

"(A) SALES ON NATIONAL SECURITIES EXCHANGES.—For purposes of paragraph (1)(B), in the case of a claim for credit or refund under subsection (a)(2), the sale by a dealer of a debt obligation on a national securities exchange registered with the Securities and Exchange Commission subject to a special contract (and not in the regular market) shall be conclusive proof that such debt obligation was sold to a person other than a United States person, if such exchange has in effect at the time of the sale rules providing that—

"(i) a member or member organization of such exchange selling a debt obligation as a dealer, or effecting the sale as broker of a debt obligation on behalf of a dealer, on such exchange subject to a special contract (and not in the regular market) shall furnish to the member or member organization purchasing such debt obligation as a dealer, or effecting the purchase as broker of such debt obligation on behalf of a dealer, a written confirmation or comparison stating that such sale is being made as a dealer, or on behalf of a dealer; and

"(ii) if the purchaser of such debt obligation is a dealer (whether or not a member or member organization of such exchange), the terms of the contract applicable to such sale shall require the purchasing dealer to undertake to resell such debt obligation on the day of purchase or the next business day to a person other than a United States person.

A dealer who acquires a debt obligation in a transaction in which a written confirmation or comparison described in clause (i) is furnished shall not be entitled to a credit or refund under subsection (a)(2) with respect to his acquisition of such debt obligation unless he establishes that such debt obligation was sold by him on the day on which it was purchased or the next business day to a person other than a United States person.

"(B) OVER-THE-COUNTER SALES.—For purposes of paragraph (1)(B), in the case of a claim for credit or refund under subsection (a)(2) with respect to a debt obligation sold in a transaction not on a national securities exchange, a written confirmation furnished by a member or member organization of a national securities association registered with the Securities and Exchange Commission stating that such member or member organization—

"(i) effected the purchase as broker of a debt obligation on behalf of a person other than a United States person, or

"(ii) purchased a debt obligation which he resold on the day of purchase or the next business day to a person other than a United States person,

shall be conclusive proof that such debt obligation was sold to a person other than a United States person (unless the dealer relying upon the confirmation has actual knowledge that the confirmation is false in any material respect), if such association has in effect at the time of the purchase rules providing that a member or member organization who effects a purchase of, or purchases, a debt obligation from a dealer who notifies such member or member organization that such debt obligation is being sold by such dealer and that such dealer intends to claim a credit or refund under subsection (a)(2), shall furnish to such dealer a written confirmation stating that the purchase of such debt obligation was (or was not) effected by such member or member organization on behalf of a person other than a United States person, or that such debt obligation was (or was not) sold by such member or member organization on the day of purchase or the next business day to a person other than a United States person.

"(4) SALES OF STOCK BY DEALERS.—For purposes of paragraph (1)(B), in the case of a claim for credit or refund under subsection (a)(3), the sale by a dealer of stock on a national securities exchange registered with the Securities and Exchange Commission subject to a special contract (and not in the regular market) shall be conclusive proof that such stock was sold to a person other than a United States person, unless such dealer has actual knowledge at the time of such sale that the purchaser of such stock is a dealer (whether or not a member or member organization of such exchange).

"(c) DEFINITIONS.—For purposes of this section—

"(1) the term 'underwriter' means any person who has purchased stock or debt obligations from the issuer or obligor (or from a person controlling, controlled by, or under common control with such issuer or obligor), or from another underwriter, with a view to the distribution through resale of such stock or debt obligations; and

"(2) the term 'dealer' means any person who is a member of a national securities association registered with the Securities and Exchange Commission and who is regularly engaged, as a merchant, in purchasing stock or debt obligations and selling them to customers with a view to the gains and profits which may be derived therefrom.

"SEC. 4920. DEFINITIONS AND SPECIAL RULES.

"(a) IN GENERAL.—For purposes of this chapter—

"(1) DEBT OBLIGATION.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'debt obligation' means—

"(i) any indebtedness, whether or not represented by a bond, debenture, note, certificate, or other writing, whether or not secured by a mortgage, and whether or not bearing interest; and

"(ii) any interest in, or any option or similar right to acquire, a debt obligation referred to in this subparagraph, whether or not such interest, option, or right is in writing.

"(B) EXCEPTIONS.—The term 'debt obligation' shall not include any obligation which—

"(i) is convertible by its terms into stock of the obligor, if it is so convertible only within a period of 5 years or less from the date on which interest begins to accrue thereon; or

"(ii) arises out of the divorce, separate maintenance, or support of an individual who is a United States person.

"(2) STOCK.—The term 'stock' means—

"(A) any stock, share, or other capital interest in a corporation;

"(B) any interest of a partner in a partnership;

"(C) any interest in an investment trust;

"(D) any indebtedness which is convertible by its terms into stock of the obligor, if it is so convertible only within a period of 5 years or less from the date on which interest begins to accrue thereon; and

"(E) any interest in, or option or similar right to acquire, any stock described in this paragraph.

"(3) FOREIGN ISSUER OR OBLIGOR.—The terms 'foreign issuer', 'foreign obligor', and 'foreign issuer or obligor' mean any issuer of stock or obligor of a debt obligation, as the case may be, which is—

"(A) (i) an international organization of which the United States is not a member,

"(ii) the government of a foreign country or any political subdivision thereof, or an agency or instrumentality of such a government,

"(iii) a corporation, partnership, or estate or trust which is not a United States person as defined in paragraph (4); or

"(iv) a nonresident alien individual;

"(B) a domestic corporation which, as of July 18, 1963, was a management company registered under the Investment Company Act of 1940 if— 54 Stat. 789. 15 USC 80a-51.

"(i) at least 80 percent of the value of the stock and debt obligations owned by such corporation on July 18, 1963, and at least 80 percent of the value of the stock and debt obligations owned by such corporation at the end of every calendar quarter thereafter (through the quarter preceding the quarter in which the acquisition involved is made), consists of stock or debt obligations of foreign issuers or obligors and other debt obligations having an original maturity of 90 days or less;

"(ii) such corporation elects to be treated as a foreign issuer or obligor for purposes of this chapter; and

"(iii) such corporation does not materially increase its assets during the period from July 18, 1963, to the date on which such election is made through borrowing or through issuance or sale of its stock (other than stock issued or sold on or before September 16, 1963, as part of a public offering with respect to which a registration statement was first filed with the Securities and Exchange Commission on July 18, 1963, or within 90 days before that date).

The election under clause (ii) shall be made on or before the 60th day after the date of the enactment of this chapter under regulations prescribed by the Secretary or his delegate. Such election shall be effective as of the date specified by the corporation, but not later than the date on which such election is made, and shall remain in effect until revoked. If, at the close of any succeeding calendar quarter, the company ceases to meet the requirement of clause (i), the election shall thereupon (with respect to quarters after such calendar quarter) be deemed revoked. When an election is revoked no further election may be made. If the assets of a foreign corporation are acquired by a domestic corporation in a reorganization described in subparagraph (D) or (F) of section 368(a)(1), the two corporations shall be considered a single domestic corporation for purposes of this subparagraph. 26 USC 368.

"(4) UNITED STATES PERSON.—The term 'United States person' means—

"(A) a citizen or resident of the United States,

"(B) a domestic partnership,

"(C) a domestic corporation, other than a corporation described in paragraph (3)(B),

"(D) an agency or wholly-owned instrumentality of the United States,

"(E) a State or political subdivision, or any agency or instrumentality thereof, and

"(F) any estate or trust—

"(i) the income of which from sources without the United States is includible in gross income under subtitle A (or would be so includible if not exempt from tax under section 501(a), section 521(a), or section 584(b)), or 26 USC 501, 521, 584.

"(ii) which is situated in the Commonwealth of Puerto Rico or a possession of the United States.

"(5) DOMESTIC CORPORATION; DOMESTIC PARTNERSHIP.—The terms 'domestic corporation' and 'domestic partnership' mean, respectively, a corporation or partnership created or organized in the United States or under the laws of the United States or of any State, except that such terms do not include a branch office of such a corporation or partnership located outside the United States if —

"(A) such corporation or partnership (without regard to the activities of such office) is a dealer (as defined in section 4919(c)(2)); *Ante*, p.833.

"(B) such office (which is operated by employees or partners of such corporation or partnership) was located outside the United States on July 18, 1963, and was regularly engaged, as a merchant, in purchasing and selling stock or debt obligations of foreign issuers or obligors with a view to the gains and profits which may be derived therefrom, for a period of not less than 12 consecutive calendar months prior to July 18, 1963;

"(C) all acquisitions by such branch office of stock of foreign issuers and debt obligations of foreign obligors are made in the ordinary course of its business as such a merchant or as an underwriter (as defined in section 4919(c)(1));

"(D) such office maintains separate books and records reasonably reflecting the assets and liabilities properly attributable to such office; and

"(E) there is in effect an election that such branch office be treated as a foreign corporation or foreign partnership for purposes of this chapter.

The election under subparagraph (E) shall be made by such corporation or partnership on or before the 60th day after the date of the enactment of this chapter under regulations prescribed by the Secretary or his delegate. A separate election may be made with respect to each branch office of such corporation or partnership. Such election shall be effective as of July 18, 1963, and shall remain in effect until revoked in accordance with such regulations. If, at any time, a branch office ceases to meet the requirements of subparagraph (A), (C), or (D), the election with respect to such office shall thereupon be deemed revoked. When an election is revoked, a new election under subparagraph (E) may be made subject to such conditions and limitations as may be prescribed by the Secretary or his delegate.

"(6) UNITED STATES; STATE.—The term 'United States' when used in a geographical sense includes the States, the District of Columbia, the Commonwealth of Puerto Rico, and the possessions of the United States; and the term 'State' includes the District of Columbia, the Commonwealth of Puerto Rico, and the possessions of the United States.

"(7) PERIOD REMAINING TO MATURITY.—

"(A) IN GENERAL.—Subject to the modifications set forth in subparagraph (B), the period remaining to maturity of a debt obligation shall be that period beginning on the date of its acquisition and ending on the fixed or determinable date when, according to its terms, the payment of principal becomes due.

"(B) MODIFICATIONS.—The period remaining to maturity—

"(i) of any interest in, or any option or similar right to acquire, any debt obligation shall be the period remaining to maturity of that debt obligation at the time of the acquisition of such interest, option, or right;

"(ii) of any debt obligation which is renewable without affirmative action by the obligee, or of any interest in or option or similar right to acquire such a debt obligation, shall end on the last day of the final renewal period;

"(iii) of any debt obligation which has no fixed or determinable date when the payment of principal becomes due shall be considered to be 28½ years;

"(iv) of any debt obligation which is payable on demand (including any bank deposit) shall be considered to be less than 3 years; and

"(v) of a debt obligation which is subject to retirement before its maturity through operation of a mandatory sinking fund shall be determined under regulations prescribed by the Secretary or his delegate.

"(8) FOREIGN STOCK ISSUES TREATED AS DOMESTIC.—

54 Stat. 789.
15 USC 80a-51.

"(A) IN GENERAL.—A foreign corporation (other than a company registered under the Investment Company Act of 1940) shall not be considered a foreign issuer with respect to any class of its stock if, as of the latest record date before July 19, 1963, more than 65 percent of such class of stock was held of record by United States persons.

"(B) STOCK TRADED ON NATIONAL SECURITIES EXCHANGES.—A foreign corporation (other than a company registered under the Investment Company Act of 1940) shall not be considered a foreign issuer with respect to any class of its stock which is traded on one or more national securities exchanges registered with the Securities and Exchange Commission, if the trading on such national securities exchanges constituted the principal market for such class of stock during the calendar year 1962 and if, as of the latest record date before July 19, 1963, more than 50 percent of such class of stock was held of record by United States persons.

"(b) SPECIAL RULE FOR FOREIGN UNDERWRITERS.—A partnership or corporation which is not a United States person and which participates, as an underwriter in an underwriting group that includes one or more United States persons, in a public offering of stock or debt obligations of a foreign issuer or obligor shall, if such partnership or corporation so elects and subject to such terms and conditions as the Secretary or his delegate may prescribe by regulations, be treated as a United States person for purposes of this chapter with respect to its participation in such public offering.

"(c) CROSS REFERENCE.—

"For definition of 'acquisition', see section 4912.

"Subchapter B—Acquisitions by Commercial Banks

"Sec. 4931. Commercial bank loans.

"SEC. 4931. COMMERCIAL BANK LOANS.

"(a) STANDBY AUTHORITY.—The provisions of this section shall apply only if the President of the United States—

"(1) determines that the acquisition of debt obligations of foreign obligors by commercial banks in making loans in the ordinary course of the commercial banking business has materially impaired the effectiveness of the tax imposed by section 4911, because such acquisitions have, directly or indirectly, replaced acquisitions by United States persons, other than commercial banks, of debt obligations of foreign obligors which are subject to the tax imposed by such section, and

"(2) specifies by Executive order that the provisions of this section shall apply to acquisitions by commercial banks of debt obligations of foreign obligors, to the extent specified in such order.

Such Executive order shall be effective, to the extent specified therein, with respect to acquisitions made during the period beginning on the day after the date on which the order is issued and ending on the date set forth in section 4911(d). Such Executive order may be modified from time to time (by Executive order), except that no such modification shall (A) have the effect of excluding from the application of subsection (b) or (c) a significant class of acquisitions to which such subsection applied under such Executive order or any modification thereof, or (B) subject any acquisition made on or before the date of issuance of such modification to the application of subsection (b) or (c).

"(b) DEBT OBLIGATIONS WITH MATURITY OF 3 YEARS OR MORE, ETC.—During the period in which an Executive order issued under subsection (a) is effective, and to the extent specified in such order (and any modifications thereof), sections 4914(b)(2)(A), 4914(j)(1)(A)(ii), and 4915(c)(2)(A) shall not apply. Ante, p. 813.

"(c) DEBT OBLIGATIONS WITH MATURITY FROM 1 TO 3 YEARS.—During the period in which an Executive order issued under subsection (a) is effective, and to the extent specified in such order (and any modifications thereof), there is hereby imposed, on each acquisition by a United States person (as defined in section 4920(a)(4)) which is a commercial bank of a debt obligation of a foreign obligor (if such obligation has a period remaining to maturity of 1 year or more and less than 3 years), a tax equal to a percentage of the actual value of the debt obligation measured by the period remaining to its maturity and determined in accordance with the following table:

"If the period remaining to maturity is:	The tax, as a percentage of actual value, is:
At least 1 year, but less than 1¼ years	1.05 percent
At least 1¼ years, but less than 1½ years	1.30 percent
At least 1½ years, but less than 1¾ years	1.50 percent
At least 1¾ years, but less than 2¼ years	1.85 percent
At least 2¼ years, but less than 2¾ years	2.30 percent
At least 2¾ years, but less than 3 years	2.75 percent

For purposes of this title, the tax imposed under this subsection shall be treated as imposed under section 4911, except that, for such purposes, the provisions of section 4918 shall not apply.

Ante, p. 831.

"(d) EXCLUSIONS.—

"(1) EXPORT LOANS.—The provisions of subsection (b), and the tax imposed under subsection (c), shall not apply with respect to the acquisition by a commercial bank of a debt obligation arising out of the sale of personal property or services (or both) if—

"(A) not less than 85 percent of the amount of the loan is attributable to the sale of property manufactured, produced, grown, extracted, created, or developed in the United States, or to the performance of services by United States persons, or to both, and

"(B) the extension of credit and the acquisition of the debt obligation related thereto are reasonably necessary to accomplish the sale of property or services out of which the debt obligation arises, and the terms of the debt obligation are not unreasonable in light of credit practices in the business in which the United States person selling such property or services is engaged.

"(2) FOREIGN CURRENCY LOANS BY FOREIGN BRANCHES.—The provisions of subsection (b), and the tax imposed under subsection (c), shall not apply to the acquisition by a commercial bank of a debt obligation of a foreign obligor payable in the currency of a foreign country if, under regulations prescribed by the Secretary or his delegate—

"(A) such bank establishes and maintains, for each of its branches located outside the United States, a fund of assets with respect to deposits payable in foreign currency to customers (other than banks) of such branch, and

"(B) such debt obligation is designated, to the extent permitted by this paragraph, as part of a fund of assets described in subparagraph (A) (but only after debt obligations of foreign obligors payable in foreign currency having a period remaining to maturity of less than one year held by such bank have been designated as part of such a fund).

A debt obligation may be designated as part of a fund of assets described in subparagraph (A) only to the extent that, immediately after such designation, the adjusted basis of all the assets held in such fund does not exceed 110 percent of the deposits payable in foreign currency to customers (other than banks) of the branch with respect to which such fund is maintained.

"(3) PREEXISTING COMMITMENTS.—The provisions of subsection (b), and the tax imposed under subsection (c), shall not apply to the acquisition by a commercial bank of a debt obligation of a foreign obligor—

"(A) made pursuant to an obligation to acquire which on August 4, 1964—

"(i) was unconditional, or

"(ii) was subject only to conditions contained in a formal contract under which partial performance had occurred; or

"(B) as to which on or before August 4, 1964, the acquiring commercial bank (or, in a case where 2 or more commercial banks are making acquisitions as part of a single transaction, a majority in interest of such banks) had taken every action to signify approval of the acquisition under the procedures ordinarily employed by such bank (or banks) in similar transactions and had sent or deposited for delivery to the foreign person from whom the acquisition was made written evidence of such approval in the form of a document setting forth, or referring to a document sent by the foreign person from whom the acquisition was made which set forth, the principal terms of such acquisition.

"(e) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations (not inconsistent with the provisions of this section or of an Executive order issued under subsection (a)) as may be necessary to carry out the provisions of this section."

(b) TECHNICAL AMENDMENT.—The table of chapters for subtitle D is amended by adding at the end thereof the following item:

"Chapter 41. Interest equalization tax."

(c) EFFECTIVE DATE.—

(1) GENERAL RULE.—Except as provided by paragraphs (2), (3), (4), (5), (6), and (7), the amendments made by this section shall apply with respect to acquisitions of stock and debt obligations made after July 18, 1963.

(2) PREEXISTING COMMITMENTS.—Such amendments shall not apply to an acquisition—

(A) made pursuant to an obligation to acquire which on July 18, 1963—

(i) was unconditional, or

(ii) was subject only to conditions contained in a formal contract under which partial performance had occurred;

(B) as to which on or before July 18, 1963, the acquiring United States person (or, in a case where 2 or more United States persons are making acquisitions as part of a single transaction, a majority in interest of such persons) had taken every action to signify approval of the acquisition under the procedures ordinarily employed by such person (or persons) in similar transactions and had sent or deposited for delivery to the foreign person from whom the acquisition was made written evidence of such approval in the form of a commitment letter, memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the foreign person from whom the acquisition was made which set forth, the principal terms of such acquisition, subject only to the execution of formal documents evidencing the acquisition and to customary closing conditions;

(C) if, on or before July 18, 1963, the acquiring United States person—

(i) had entered into a contract for the sale to the government of a less developed country or a political subdivision thereof, or an agency or instrumentality of such government (within the meaning of section 4916

Ante, p. 827.

(a)), of property owned within such less developed country or political subdivision by such person or by a controlled foreign corporation (as defined in section 957)

76 Stat. 1017.
26 USC 957.

more than 50 percent of the total combined voting power of all classes of stock entitled to vote of which was owned (within the meaning of section 958) by such

26 USC 958.

person, or of stock or debt obligations of such a controlled foreign corporation which was actively engaged in the conduct of a trade or business within such less developed country; or had entered into a contract of indemnification with respect to the nationalization, expropriation, or seizure of such property or of such stock or debt obligations by the government of a less developed country or political subdivision thereof, or an agency or instrumentality of such government (within the meaning of section 4916(a)), or

(ii) had sent or deposited for delivery to the government of a less developed country or political subdivision thereof, or an agency or instrumentality of such government (within the meaning of section 4916(a)), a commitment letter, memorandum of terms, or other document setting forth the principal terms of a contract described in clause (i),

to the extent such acquisition is required by the terms of the contract as a reinvestment within such less developed country of amounts equal to part or all of the consideration received under the contract;

(D) which would be excluded from tax under section 4915 of the Internal Revenue Code of 1954 but for the provisions of subsection (c) thereof, if (i) on or before July 18, 1963, the acquiring United States person applied for and received from a foreign government (or an agency or instrumentality thereof) authorization to make such acquisition and approval of the amount thereof, and (ii) such authorization was required in order for such acquisition to be made; or

(E) of stock in the initial capitalization of a foreign corporation which would be excluded from tax under section 4915 of the Internal Revenue Code of 1954 but for the provisions of subsection (c) thereof, if at least 75 percent in interest of the United States persons who acquired stock in such initial capitalization had signified on or before July 18, 1963, to the person coordinating the organization of such corporation the intention to invest a specified amount of money through the purchase of such stock, which amount was equal to or greater than the amount ultimately so invested.

(3) Public offering.—Such amendments shall not apply to an acquisition made on or before September 16, 1963, if—

(A) a registration statement (within the meaning of the Securities Act of 1933) was in effect with respect to the stock or debt obligation acquired at the time of its acquisition;

48 Stat. 74.
15 USC 77a.

(B) the registration statement was first filed with the Securities and Exchange Commission on July 18, 1963, or within 90 days before that date; and

(C) no amendment was filed with the Securities and Exchange Commission after July 18, 1963, and before the acquisition which had the effect of increasing the number of shares of stock or the aggregate face amount of the debt obligations covered by the registration statement.

(4) Investment of proceeds of subscription offering.—Such amendments shall not apply to an acquisition of stock or debt obligations of a foreign issuer or obligor by a corporation electing under section 4920(a)(3)(B) of the Internal Revenue Code of 1954 to be treated as a foreign issuer or obligor for purposes of Ante, p. 836.
chapter 41 of such Code, to the extent that the amount of consideration paid for all such stock and debt obligations does not exceed the proceeds received by such corporation from a subscription offering (completed on or before September 16, 1963) as to which a registration statement was filed with the Securities and Exchange Commission on July 18, 1963, or within 90 days before that date.

(5) Listed securities.—Such amendments shall not apply to an acquisition made on or before August 16, 1963, if the stock or debt obligation involved was acquired on a national securities exchange registered with the Securities and Exchange Commission.

(6) Options, foreclosures, and conversions.—Such amendments shall not apply to an acquisition—

(A) of stock pursuant to the exercise of an option or similar right (or a right to convert a debt obligation into stock), if such option or right was held on July 18, 1963, by the person making the acquisition or by a decedent from whom such person acquired the right to exercise such option or right by bequest or inheritance or by reason of such decedent's death, or

(B) of stock or debt obligations as a result of a foreclosure by a creditor pursuant to the terms of an instrument held by such creditor on July 18, 1963.

(7) Domestication.—Such amendments shall not apply to the acquisition by a domestic corporation of the assets of a foreign corporation pursuant to a reorganization described in subparagraph (C), (D), or (F) of section 368(a)(1) of the Internal Revenue Code of 1954 if the acquisition occurs on or before the 26 USC 368.
180th day after the date of the enactment of this Act and the foreign corporation was a management company registered under the Investment Company Act of 1940 from July 18, 1963, until 54 Stat. 789.
the time of the acquisition. 15 USC 80a-51.

(8) Meaning of terms.—Terms used in this subsection (except as specifically otherwise provided) shall have the same meaning as when used in chapter 41 of the Internal Revenue Code of 1954.

SEC. 3. RETURNS.

(a) Making of Returns.—Section 6011 (relating to general 72 Stat. 1305.
requirement of return, statement, or list) is amended by redesig- 26 USC 6011.
nating subsection (d) as subsection (e), and by adding after subsection (c) the following new subsection:

"(d) Interest Equalization Tax Returns, etc.—

"(1) In general.—Every person shall make a return for each calendar quarter during which he incurs liability for the tax imposed by section 4911, or would so incur liability but for the provisions of section 4918. The return shall, in addition to such other information as the Secretary or his delegate may by regulations require, include a list of all acquisitions made by such person during the calendar quarter which are exempt under the

Ante, p. 831.

provisions of section 4918, and shall, with respect to each such acquisition, be accompanied either (A) by a certificate of American ownership which complies with the provisions of section 4918(e), or (B) in the case of an acquisition for which other proof of exemption is permitted under section 4918(f), by a statement setting forth a summary of the evidence establishing such exemption and the reasons for the person's inability to establish prior American ownership under subsection (b), (c), or (d) of section 4918. No return or accompanying evidence shall be required under this paragraph in connection with any acquisition with respect to which a written confirmation, furnished in accordance with the requirements described in section 4918 (c) or (d), is treated as conclusive proof of prior American ownership; nor shall any such acquisition be required to be listed in any return made under this paragraph.

"(2) INFORMATION RETURNS OF COMMERCIAL BANKS.—Every United States person (as defined in section 4920(a)(4)) which is a commercial bank shall file a return with respect to loans and commitments to foreign obligors at such times, in such manner, and setting forth such information as the Secretary or his delegate shall by forms and regulations prescribe.

"(3) REPORTING REQUIREMENTS FOR MEMBERS OF EXCHANGES AND ASSOCIATIONS.—Every member or member organization of a national securities exchange or of a national securities association registered with the Securities and Exchange Commission shall keep such records and file such information as the Secretary or his delegate may by regulations prescribe in connection with acquisitions and sales effected by such member or member organization as a broker, and acquisitions made for the account of such member or member organization, of stock or debt obligations—

"(A) as to which a certificate of American ownership or blanket certificate of American ownership is executed and filed with such member or member organization as prescribed under section 4918(e); and

"(B) as to which a written confirmation is furnished to a United States person stating that the acquisition—

"(i) in the case of a transaction on a national securities exchange, was made subject to a special contract, or

"(ii) in the case of a transaction not on a national securities exchange, was from a person who had not filed a certificate of American ownership with respect to such stock or debt obligation or a blanket certificate of American ownership with respect to the account from which such stock or debt obligation was sold."

26 USC 6071-6075.

(b) TIME FOR FILING RETURNS.—Part V of subchapter A of chapter 61 (relating to time for filing returns and other documents) is amended by adding at the end thereof the following new section:

"SEC. 6076. TIME FOR FILING INTEREST EQUALIZATION TAX RETURNS.

Ante, p.843.

"Each return made under section 6011(d)(1) (relating to interest equalization tax) shall be filed on or before the last day of the first month following the period for which it is made."

26 USC 6103.

(c) PUBLICITY OF RETURNS.—Section 6103(a)(2) (relating to public record and inspection) is amended by striking out "and subchapter B of chapter 37" and inserting in lieu thereof "subchapter B of chapter 37, and chapter 41".

(d) CLERICAL AMENDMENT.—The table of sections for part V of subchapter A of chapter 61 is amended by adding at the end thereof the following:

"Sec. 6076. Time for filing interest equalization tax returns."

(e) FIRST RETURN PERIOD.—Notwithstanding any provision of section 6011(d)(1) of the Internal Revenue Code of 1954, the first period for which returns shall be made under such section 6011(d)(1) shall be the period commencing July 19, 1963, and ending at the close of the calendar quarter in which the enactment of this Act occurs. Ante, p. 843.

SEC. 4. DISALLOWANCE OF DEDUCTION FOR AMOUNT PAID AS INTEREST EQUALIZATION TAX.

Section 263(a) (relating to capital expenditures) is amended by adding at the end thereof the following new paragraph: 26 USC 263.

"(3) Any amount paid as tax under section 4911 (relating to imposition of interest equalization tax) except to the extent that any amount attributable to the amount paid as tax is included in gross income for the taxable year."

SEC. 5. ORIGINAL ISSUE DISCOUNT.

Section 1232(b)(2) (relating to definition of issue price) is amended by inserting before the period at the end of the second sentence thereof the following: "increased by the amount, if any, of tax paid under section 4911 (and not credited, refunded, or reimbursed) on the acquisition of such bond or evidence of indebtedness by the first buyer". 26 USC 1232.

SEC. 6. PENALTIES.

(a) ASSESSABLE PENALTIES.—Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new sections: 26 USC 6671-6679.

"SEC. 6680. FAILURE TO FILE INTEREST EQUALIZATION TAX RETURNS.

"In addition to the penalty imposed by section 7203 (relating to willful failure to file return, supply information, or pay tax) any person who is required under section 6011(d)(1) (relating to interest equalization tax returns) to file a return for any period in respect of which, by reason of the provisions of section 4918, he incurs no liability for payment of the tax imposed by section 4911 and who fails to file such return within the time prescribed by section 6076, shall pay a penalty of $10 or 5 percent of the amount of tax for which he would incur liability for payment under section 4911 but for the provisions of section 4918, whichever is the greater, for each such failure unless it is shown that the failure is due to reasonable cause. The penalty imposed by this section shall not exceed $1,000 for each failure to file a return. 26 USC 7203. Ante, p. 831. Ante, p. 844.

"SEC. 6681. FALSE EQUALIZATION TAX CERTIFICATES.

"(a) FALSE CERTIFICATE OF AMERICAN OWNERSHIP.—In addition to the criminal penalty imposed by section 7241, any person who willfully executes a certificate of American ownership or blanket certificate of American ownership described in section 4918(e) which contains a misstatement of material fact shall be liable to a penalty equal to 125 percent of the amount of tax imposed by section 4911 on the acquisition of the stock or debt obligation involved which, but for the provisions of section 4918, would be payable by the person acquiring the stock or debt obligation. Post, p. 847.

"(b) LIABILITY OF MEMBERS OF NATIONAL SECURITIES EXCHANGES AND ASSOCIATIONS.—A member or member organization of a national securities exchange described in section 4918(c) or a national securities association described in section 4918(d) shall be liable to a penalty equal to 125 percent of the amount of tax imposed by section 4911 on the acquisition (in a transaction subject to the rules of such exchange or association as described in section 4918 (c) or (d)) of stock or a debt obligation which but for the provisions of section 4918, would be payable by the person acquiring the stock or debt obligation, if such member or member organization—

Ante, p. 831.

"(1) willfully effects the sale of such stock or debt obligation or furnishes a written confirmation with respect to the purchase or sale of such stock or debt obligation other than in accordance with the requirements described in section 4918 (c) or (d); or

"(2) has actual knowledge that—

"(A) the certificate of American ownership or the blanket certificate of American ownership (referred to in section 4918) in his possession in connection with the sale of such stock or debt obligation is false in any material respect; or

"(B) the person who executed and filed the blanket certificate of American ownership in his possession was not a United States person at the time of sale.

"(c) FALSE CERTIFICATE OF SALES TO FOREIGN PERSONS.—In addition to the criminal penalty imposed by section 7241, any person who willfully executes a certificate of sales to foreign persons described in section 4919(b)(2) which contains a misstatement of material fact shall be liable to a penalty equal to 125 percent of the amount of the tax imposed by section 4911 on the acquisition by the underwriter of the stock or debt obligation with respect to which such certificate is executed.

Post, p. 847.

"(d) FALSE CONFIRMATIONS OR COMPARISONS FURNISHED BY DEALERS.—

"(1) MEMBERS OF NATIONAL SECURITIES EXCHANGES.—A member or member organization of a national securities exchange described in section 4919(b)(3)(A) who, in a transaction subject to the rules of such exchange as described in such section, willfully furnishes a written confirmation or comparison which contains a misstatement of material fact or which fails to state a material fact shall be liable to a penalty equal to 125 percent of the amount of the tax imposed by section 4911 on the acquisition of the debt obligation by the dealer for whose benefit such confirmation or comparison is furnished.

"(2) DEALERS.—Any person who sells as a dealer a debt obligation in a transaction subject to the rules of a national securities exchange as described in section 4919(b)(3)(A), in which such sale is effected on his behalf by a member or member organization of such exchange, and who willfully fails to disclose to such member or member organization that such sale is being made by him as a dealer, shall be liable to a penalty equal to 125 percent of the amount of the tax imposed on his acquisition of such debt obligation.

"(3) MEMBERS OF NATIONAL SECURITIES ASSOCIATIONS.—A member or member organization of a national securities association described in section 4919(b)(3)(B) who willfully furnishes a written confirmation described in such section (in a transaction subject to the rules of such association as described in such section) which contains a misstatement of material fact or which fails to state a material fact shall be liable to a penalty equal to 125 percent of the amount of the tax imposed by section 4911 on the acquisition of the debt obligation by the dealer for whose benefit such confirmation is furnished.

"(e) PENALTY TO BE IN LIEU OF TAX IN CERTAIN CASES.—Unless the person acquiring the stock or debt obligation involved had actual knowledge that the certificate was false in any material respect, the

penalty under subsection (a) or (c) shall be in lieu of any tax on the acquisition of such stock or debt obligation under section 4911."

(b) CRIMINAL PENALTY.—Part II of subchapter A of chapter 75 (relating to penalties applicable to certain taxes) is amended by adding at the end thereof the following new section:

26 USC 7231-7240.

"SEC. 7241. PENALTY FOR FRAUDULENT EQUALIZATION TAX CERTIFICATES.

"Any person who, on or after the date of the enactment of the Interest Equalization Tax Act, willfully executes a certificate of American ownership or blanket certificate of American ownership described in section 4918(e), or a certificate of sales to foreign persons described in section 4919(b)(2), which is known by him to be fraudulent or to be false in any material respect shall be guilty of a misdemeanor and, upon conviction thereof, shall for each offense be fined not more than $1,000, or imprisoned not more than 1 year, or both."

Ante, p. 831.

(c) CLERICAL AMENDMENTS.—

(1) The table of sections for subchapter B of chapter 68 is amended by adding at the end thereof the following:

"Sec. 6680. Failure to file interest equalization tax returns.
"Sec. 6681. False equalization tax certificates."

(2) The table of sections for part II of subchapter A of chapter 75 is amended by adding at the end thereof the following:

"Sec. 7241. Penalty for fraudulent equalization tax certificates."

Approved September 2, 1964.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 1046 (Comm. on Ways & Means) and No. 1816 (Comm. of Conference).
SENATE REPORT No. 1267 (Comm. on Finance).
CONGRESSIONAL RECORD, Vol. 110 (1964):
Mar. 4: Considered in House.
Mar. 5: Considered and passed House.
Aug. 3: Considered in Senate.
Aug. 4: Considered and passed Senate, amended.
Aug.18: House agreed to conference report.
Aug.19: Senate agreed to conference report.

LRist/mh 13th March 1967.

The Interest Equalization Tax.

I. Historical.

1. On July 18 1963 the President sent a special message to Congress relating to the U.S. balance of payments. Among other things the message called for the enactment of an "interest equalization tax" to discourage the outflow of U.S. capital. This tax was to apply to portfolio investments made by Americans in foreign securities and was to increase by approximately one percentage point the interest cost to foreigners of obtaining capital in the U.S. Investments in so-called 'less-developed countries' would not be subject to the tax and from the very beginning it was hinted that new security issues could be exempted by the President "in the interest of international monetary stability - presumably new Canadian securities". 1/ It was indicated that when adopted the tax would be retroactive to July 18,1963.

2. The law was passed as Public Law 88-563 on September 2, 1964. It applied, among others, to debt obligation of a foreign obligor having a period "remaining to maturity of three years or more". It was retroactive to July 18 1963 and applicable to December 31, 1965. The list of countries subject to tax as of July 18, 1963 included:

Australia
Austria
Belgium
Canada 2/
Denmark
France
Germany - Federal Republic
Hong Kong
Italy

1/ Quotations from Annual Report of the Secretary of the Treasury for fiscal year ended June 30, 1963, page 52.

2/ New Canadian securities exempt.

Japan 1/
Liechtenstein
Luxembourg
Monaco
Netherlands
New Zealand
Norway
South Africa
San Marino
Spain
Sweden
Switzerland
United Kingdom
Sino-Soviet Bloc.

3. In fact this was the same as that of the countries mentioned as not being economically less-developed in Executive order 11071 dated December 27,1962 for other internal revenue purposes. It was repeated in the text of Public Law 88-563 Section 4916b. It was clearly stated that the President may change the list by Executive order.

4. On the 14th May 1965 the list of countries subject to the tax was extended by Executive order 11224 to include:

Bahamas Islands
Bermuda
Ireland
Kuwait
Portugal.

5. On 9th October 1965 Public Law 89-243 extended the applicability of the interest equalization tax from December 31 1965 to July 31 1967 and made debt obligations of a foreign obligor liable to the tax when the period remaining to maturity is one year or more instead of three years or more.

6. On 10th June 1966 the following countries were added to the list of

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1/ $100 million exemption of debt obligation permitted per annum.

non-exempt countries by Executive order 11285:

Abu Dhabi
Bahrein
Iran
Iraq
Kuwait-Saudi Arabia Neutral Zone
Libya
Qatar
Saudi Arabia.

7. On 25th January 1967 the U.S. Government announced that the tax would be doubled as of that date but the House Ways and Means Committee recommended that the increase in the tax be limited to 50 percent - in other words, that it be raised to the equivalent of 1.5% in annual interest cost, effective from the 25th January. Authority would be given to the President to vary the tax between 1 and 1.5 percent.

II. Criteria for defining less-developed countries.

8. On 20th August 1963 Mr. Dillon, Secretary of the Treasury, explained the purposes of the tax before the House Ways and Means Committee. There was no indication as to what criteria would be used to designate which countries would not be considered less developed. The statement just said:

> "The tax would not be applied to acquisition of securities issued by less-developed countries as defined by Executive order of the President .. At the present time it is contemplated that this exclusion would apply to the securities of all Latin-American countries, African countries with the exception of South Africa, Asian countries except for Japan and the Crown Colony of Hong Kong and to a few other nations outside the Sino-Soviet Bloc. This exclusion is designed to avoid any impediment to the flow of private capital to those nations with chronic capital shortages, urgent development needs and limited capability for foreign borrowing on normal commercial terms. An exemption by an Executive order, for new issues only, would be provided if the President finds that the application of the tax would have such consequences for a foreign country as to imperil, or threaten to imperil, the stability of the international monetary system .... In my judgment, only Canada would today qualify for

> exemption on these grounds ...... Although we are prepared to appraise with officials of Japan and other countries the impact of the tax over time in the light of their particular circumstances, we cannot now see any reason for further exemptions." 1/

A similar statement was made by Secretary Dillon before the Senate Finance Committee on June 29 1964. 2/

9. In the discussions held in June 1965 in the Committee on Ways and Means of the House, a few remarks were made concerning the "procedures" which are followed in determining which countries should be considered developed or less-developed in connection with the interest equalization tax. The answers were most guarded. Mr. Thomas Mann said that

> "after talking with Mr. Deming we both think that we would have another look at this, not with the idea of following any particular set of criteria,"

and he added:

> "We will not consider ourselves limited to any particular set of criteria but we will take into account other broader issues as well, political as well as economic." 3/

10. In short, the quotation from Mr. Dillon's statement, given in paragraph 2 above, seems to be still valid. The tests would include "chronic capital shortages, urgent development needs and limited capability for foreign borrowing on normal commercial terms." It would probably be fair to add that aside from national interest which is a matter of course, the level of foreign exchange reserves and the prospects of earning dollars in the foreseeable future would also be important. This would explain the inclusion of Portugal, Iran, Iraq, etc.

1/ Report of the Secretary of the Treasury - fiscal year 1963, page 342.

2/ Annual Report of the Secretary of the Treasury for fiscal year 1964, page 263.

3/ Executive Session, IET Extension Act of 1965, June 24, 1965, House of Representatives Committee on Ways and Means.

11. Finally, it was privately explained to our Mr. Hulley at the Treasury that the fact that AID does not support a particular country is also a factor in favour of making it subject to the interest equalization tax. This would apply in particular to Iran of which the AID program for fiscal year '67 said:

> "Economic improvements will permit AID to terminate concessional lending to Iran after fiscal year 1966 but the technical cooperation program will continue through fiscal year 1968 to complete existing programs and finance analyses of specific development sectors preparatory to the formulation of the Fourth Plan."

H. Friedman.

cc: Mr. Broches
Mr. Cavanaugh
Mr. Hulley

FORM No. 155
(1.64)

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

PRESS CLIPPING SHEET

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U.S. tax concession is refused to Australia

BY OUR AUSTRALIAN CORRESPONDENT

CANBERRA, March 5.

THE U.S. Government has made it known that it will not be able to accede to long-standing representations from the Australian Government for preferred treatment for Australia under the U.S. interest equalisation tax and the guidelines setting limits on the amount of bank loans which may be made from U.S. banks and financial institutions to Australia in any one year.

The news of the rejection of the Australian representations has not yet been made public, but the private reaction of Australian Ministers to the news has been one of disappointment ranging to anger.

Possible action

There has already been private talk about the possibility of action by the Australian Government against U.S. commercial interests in Australia as a means of bringing home to the Americans the sense of grievance felt by Australia.

The representations to the U.S. Government go at least as far back as the meeting of the International Monetary Fund in Washington last September, when the Australian Treasurer, Mr. William McMahon, had private conversations with the Secretary to the Treasury, Mr. Henry Fowler, in Washington and during the same period had a private meeting with the President. The purpose of the meeting with the Treasury Secretary, at which the Australian Ambassador, Mr. J. K. Waller, was also present along with Australian Treasury officials, was to press on the U.S. Government the need for some preferential treatment for Australia in respect of the tax and the banking guidelines.

In the subsequent prolonged negotiations and conversations, the U.S. Ambassador to Australia, Mr. Ed Clark, reputedly a personal friend of the President, has played an active role in pressing the Australian claim.

Australian resentment at the decision is enhanced by the knowledge of the great progress made by U.S. trade in Australia in recent years (U.S. exports to Australia have doubled between 1961-62 and 1965-66 to $A760m. making Australia the fourth biggest individual customer of the U.S.); the very large defence and civil aircraft orders placed in America in the last two or three years and the restraint exercised by the Australian Government in assisting U.S. investment in Australia when the political climate has not always been favourable.

Most immediately affected by the refusal of preferential treatment will be the big mineral projects which depend heavily on U.S. bank finance.

FORM No. 155 (1.64)

INTERNATIONAL DEVELOPMENT ASSOCIATION | INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT | INTERNATIONAL FINANCE CORPORATION

PRESS CLIPPING SHEET

ROUTING LIST	ROOM	FROM Mfl		COUNTRY	FILE
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6. RESEARCH FILES		DISCARD	☐		

Dollar Loans of Banks' Foreign Units Exempted From Equalization Tax

Presidential Order Can Affect Balance of Payments by Aiding Credit for U.S. Firms Abroad

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON—President Johnson exempted dollar loans made by foreign branches of U.S. banks from the interest-equalization tax, the White House announced.

The exemption applies to such bank loans to foreigners of more than one year maturity, since shorter loans have always been exempted from the levy intended to add one percentage point to the interest cost the foreign borrower would otherwise incur.

The action thus grants to the dollar-denominated loans the same exemption already granted to foreign currency loans made by the foreign offices of U.S. banks.

In his executive order granting the exemption, President Johnson said it is intended to "put U.S.-branch banks abroad on an equal footing with foreign banks in dollar operations," and to "increase the sources of offshore funds available to U.S. corporations and their foreign subsidiaries for their foreign operations."

Indirectly, the move should help reduce the U.S. balance-of-payments deficit, officials said, which occurs when foreigners aquire more dollars in all transactions than they return. It should do this, they reasoned, by providing more on-the-scene credit for overseas subsidiaries of U.S. companies, leaving them with less need to borrow dollars in the U.S.

With their lending of dollars to foreigners subject to the tax, analysts said, the U.S. banking offices abroad had little incentive to compete vigorously for deposits of dollars owned by foreigners, the so-called "Euro-dollars." But if they can freely lend such dollars to foreigners, they will seek more of the necessary deposits of them, and will also be more apt than are foreign-owned banks to lend the Euro-dollars to American corporate units overseas, they said.

The authority to exempt such lending from the tax was granted by Congress last year in the Foreign Investors Tax Act, an official noted.

Revisions in U.S. Interest Equalization Tax

U.S. Government Proposes Higher IET Rates, But Exempts Offshore Dollar Loans

The U.S. Interest Equalization Tax (IET), first introduced in July 1963 as a temporary balance-of-payments measure, will be strengthened and extended another two years, to nobody's great surprise. The IET is applied to U.S. purchases of foreign bonds and stocks and to U.S. bank loans to foreigners with terms of one year or more, with the tax until now adding roughly one percentage point a year to borrowing costs. Exempted from the tax are: direct U.S. investment abroad, U.S. export credits, loans or investments in less developed countries, loans or credit instruments with a maturity of less than one year, newly issued Canadian securities, and an annual $100 million of new Japanese issues.

The effectiveness of the IET has been varied. It brought to a virtual halt the flotation in New York of new European bond issues. But some reduction in U.S. purchases of European and Japanese stocks would probably have occurred in any case due to their declining price trend, and the big reduction in U.S. banks' foreign lending in 1965-66 was mainly a consequence of mounting U.S. credit demands, as well as the Voluntary Balance of Payments Program. The U.S. Government's present purpose in strengthening the IET is to prevent a resumption of U.S. foreign portfolio investments at a time when domestic interest rates could decline more rapidly than European interest rates.

Higher IET Rates. Acting on the Government's IET request, the House Ways and Means Committee recommended a 50% increase in the tax rate to the equivalent of 1.5 percent in annual interest cost, effective from January 25, and Presidential authority to vary the tax between one and 1.5 percent. Foreign stock purchases would be taxed at a flat 22.5% of purchase price, foreign debt obligations at 1.58% to 22.5% depending on maturity, and commercial bank loans from one to three years at 1.58% to 4.13%. All previous exemptions would be continued. Since Ways and Means Committee recommendations carry considerable weight, chances are that this version of the IET amendment will become law.

Overseas Exemption. In another action, President Johnson has exempted from the IET all offshore dollar loans (Euro-dollars) extended by foreign branches of U.S. banks. This puts U.S. banks' overseas branches on an equal footing with foreign banks in the medium-term Euro-dollar market. Transactions in these offshore dollars have no direct impact on the U.S. balance of payments. However, to the extent that the limited supply of medium-term Euro-dollars can be more easily channeled to U.S. subsidiaries in Europe, their need for exporting capital funds from the United States should be reduced somewhat.

ALANCE OF PAYMENTS			MONEY AND BANKING					COUNTRIES
nths nports ed (MI)	12-month change in MI	influences	latest data	12-month changes consumer prices	12-month changes domestic credit	central bank rate	monetary conditions	
n. a.	n. a.	Disruption of copper exports draws down foreign exchange reserves.	Sept.	+15 %	n. a.	4.5%	Credit is tight.	Congo (Kinshasa)
6.1	− 9%	Lower coffee earnings keep trade balance in deficit.	Nov.	n. a.	+17%	4.5%	Strong demand for bank credit.	Ethiopia
3.5	−15%	Trade account improving, but large debt payments reduce reserves.	Aug.	− 2 %	+13%	7.0%	Ample credit supply.	Ghana
2.5	+14%	Good export earnings from cocoa and timber.	Nov.	+ 2.5%	− 3%	3.5%	Bank credit remains tight.	Ivory Coast
n. a.	n. a.	Trade surplus and continuing high earnings from tourism.	Dec.	+ 2 %	n. a.	—	Ample credit supply.	Kenya
n. a.	n. a.	Increasing iron ore exports but heavy debt service.	Dec. (1965)	+ 2 %	n. a.	—	Credit remains tight.	Liberia
10.6	+ 8%	Oil exports continue at record level.	Aug.	+ 8 %	+34%	5.0%	Credit expansion continues despite monetary restraints.	Libya
2.2	−19%	Payments deficit persists despite import restrictions.	Oct.	no change	− 3%	3.5%	Credit continues very tight.	Morocco
3.7	− 5%	Lower imports help maintain small trade surplus.	Sept.	+44 %	+25%	5.0%	Ample credit supply but loan policy cautious.	Nigeria
n. a.	n. a.	Official statistics or reliable information not available.	—	n. a.	n. a.	4.5%	Strict monetary controls to combat sanctions.	Rhodesia
n. a.	n. a.	Drop in diamond exports and heavy debt service.	June	+ 4 %	− 6%	5.5%	Considerable credit stringency.	Sierra Leone
4.1	+46%	Rising exports and capital inflows sharply improve balance of payments.	Oct.	+ 5 %	+ 4%	6.0%	Credit remains tight to check inflationary pressures.	South Africa
3.3	− 8%	Import controls stabilize trade balance.	Nov.	+ 9 %	+21%	4.0%	Seasonal credit expansion.	Sudan
n. a.	n. a.	Cotton exports contribute to trade surplus.	Dec.	+ 1 %	n. a.	—	Government loan policy not yet clarified.	Tanzania
1.2	+ 9%	Good tourist receipts, but trade deficit continues.	Nov.	+ 8 %	+24%	5.0%	Bank credit is tight.	Tunisia
n. a.	n. a.	Trade surplus bolstered by increased coffee exports.	Dec.	− 8 %	n. a.	—	Bank credit is tightening.	Uganda
2.2	−21%	Sharp import rise cancels 1965 balance-of-payments gains.	Sept.	+ 8 %	+ 8%	5.0%	Restraints begin to slow credit expansion.	U.A.R. (Egypt)
8	+ 1%	Export receipts reduced due to drop in copper shipments.	Sept.	+ 6 %	n. a.	5.0%	Bank credit in good supply.	Zambia

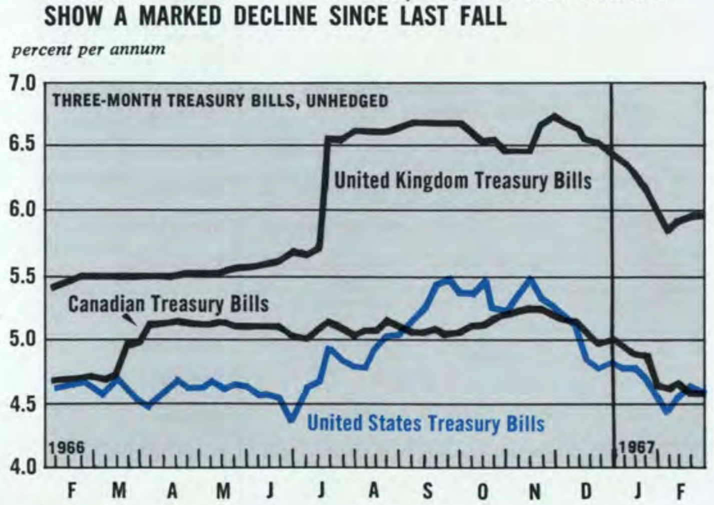
Interest Rates in New York and Abroad

market rates as of February 24, 1967

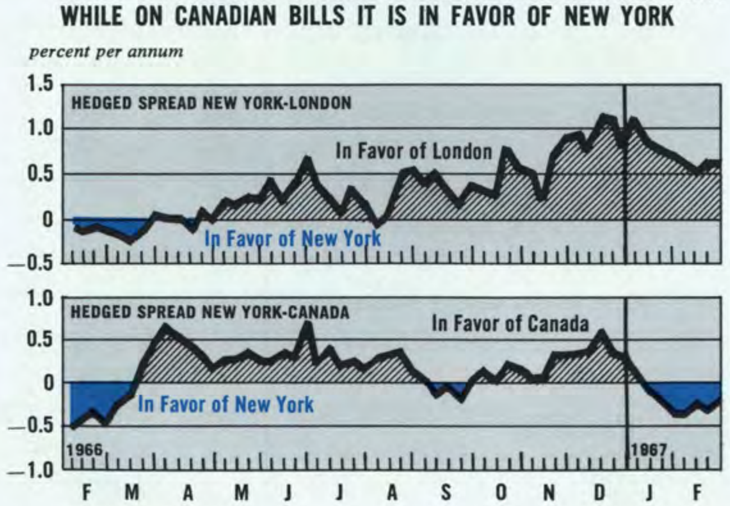
in percent per annum	New York	Canada	London	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	4.5	5.0	6.5	5.0	3.5	4.0	3.5	5.0	3.5	5.475
Day-to-Day Money	4.5 fed. funds	4.25	6.0	3.35	5.25 privee	5.0	no market	5.0	4.5	5.84
Treasury Bills 90-day, Middle Rates	4.58	4.59 15% tax w/h	5.97	6.0 120-day	4.86 6-month	3.75	3.4 1-year	4.75	no market	5.65 2-month
Commercial Paper prime 3-month, asked	5.125 finance paper	6.0 finance paper 15% tax w/h	6.1 H. P. on discount basis	4.95 visaed, import	4.0	no market	5.0 4-month	no market	no market	5.475 not traded
Bankers' Acceptances 3-month, asked	5.0	5.375	6.1875	4.95 visaed, import	4.0	4.97	5.0 not traded	no market	4.25 not traded	no market
Government Bonds long-term effective yield	4.49	5.79	6.43 after tax	6.84 15% tax w/h	6.64	7.34	6.33	5.95	4.4	6.789
Industrial Bonds long-term, prime effective yield	5.22 Aa corporates	6.6	6.69 after tax	7.7 15% tax w/h	7.61	7.36	6.92	6.66	5.54	7.69
Bank Short-Term Rate to best borrowers (prime rate)	5.5 prime rate	6.0	7.0	6.75	6.45	8.0	7.0	7.0	6.25	7.5
Bank Sight Deposits ●*residents only*	zero	zero	4.5 7-days' notice	0.5	zero	0.5	0.5	1.5	1.0	2.555 2-days' notice 10% tax w/h
Bank Time Deposits 3-month ●*residents only*	5.125 Cert. of Dep.	5.1875	6.3125 Local Auth. Dep.	3.80	2.25	3.5	2.25	4.5	5.0	4.0 10% tax w/h
Bank Time Deposits 6-month ●*residents only*	5.125 Cert. of Dep.	5.375	6.125 Local Auth. Dep.	4.30	2.75	4.25	3.0	5.0	5.25	5.0 10% tax w/h
Euro-Dollar Deposits 3-month	—	5.375	5.625	5.5	5.5	5.5	5.625	5.5	5.5	6.375
Exchange Rates in U.S. Dollars, cables / par value	—	.9243 / .92500	2.7924 / 2.8000	.020105 / .02000	.2021 / .20255	.251675 / .25000	.00159925 / .0016000	.276975 / .27624	.23065 / .22867	.002759 / .00277778
Forward Exchange Cover 3-month, in percent p.a. *D = discount, P = premium*	—	*D* .17	*D* .77	*D* .46	*P* .30	*D* .28	*P* .50	*D* .11	*P* .26	*D* .10
Covered Arb. Margins on 3-month Treasury bills + *in Favor of New York*	—	+.16	—.62	—.96	—.58	+1.11	+.68	—.06	—	—.97

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Borrowers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

TREASURY BILL RATES IN BRITAIN, THE U.S. AND CANADA SHOW A MARKED DECLINE SINCE LAST FALL



COVERED ARBITRAGE ON BRITISH BILLS IS AGAINST NEW YORK WHILE ON CANADIAN BILLS IT IS IN FAVOR OF NEW YORK



COMMERCIAL POLICY

Canadian—American Free Trade Proposal

David Rockefeller, President of the Chase Manhattan Bank, delivered an address on 'Shifting Patterns of Trade and Investment' before the Canadian Club in Toronto, Ontario, on February 27, 1967. Here is a summary of Mr. Rockefeller's speech:

"Both Canada and the United States have extended their foreign trade remarkably in recent years, not only between themselves but with the world at large, and the economic health of both countries demands that this rate of growth continue and, if possible, be increased. Yet, more and more, the United States and Canada find themselves 'odd men out' in dealing with the other great trading nations.

"The reason for this is the world trend toward development of trade blocs—groups of nations committed to exchanging goods with each other on terms more favorable than those they grant outsiders. The growing importance of trade blocs has narrowed the scope of multilateral tariff reductions. Already, Canadian and U.S. trade negotiators, instead of bargaining with the national representatives of each of the six Common Market nations, find themselves facing a joint Common Market negotiating team. The significance of this is that regardless of the outcome of the Kennedy Round—and the prognosis for those negotiations is still unclear—Canada and the United States will not be able to expand trade as rapidly as in the past if they continue to rely exclusively on the multilateral approach to tariff reduction.

Free Trade Area Proposal: Under these circumstances, should not Canada and the United States move toward establishment of a free trade area of their own? One of the advantages of a free trade area is that it would not be as restrictive as a customs union. It would, for example, permit Canada to maintain her Commonwealth preference agreements. And it could—and should—be an open-ended arrangement. In time, a Canadian-American Free Trade Area might be extended to include Mexico, thus creating a truly North American market. Also, if the United Kingdom is unsuccessful in its current effort to join the European Common Market, the British Government, too, might ultimately find membership in a Canadian-American Free Trade Area attractive.

"What effect would a free trade area have on the economies of Canada and the United States? Here, the best guidepost we have is provided by the automotive trade agreement of 1965. Canadian auto exports to the United States have risen roughly fourfold from their $166 million level in 1965, while total U.S. auto-related exports to Canada also increased substantially from their much higher base, reducing Canada's automotive trade deficit with the United States from $720 million in 1965 to an estimated $500 million last year. In other words, the result has been a considerable two-way expansion of trade. There are several manufacturing industries in Canada—among them rubber goods, drugs, chemicals and electrical goods—which operate under conditions similar to those which gave rise to the automotive trade pact. These are industries in which there is heavy American investment and which would stand to gain dramatically from longer production runs.

"Those who deny the feasibility or desirability of free trade between the United States and Canada overlook the degree to which trade between the two countries is already free. In dollar value, more than half the goods which cross the border do so without paying duty. The impact which this can have on a Canadian industry is strikingly visible in the field of agricultural machinery. There, thanks to the absence of tariffs, large and efficient Canadian plants operate with great success on a continental basis. The truth is that, even where tariff barriers apply, Canadian industry has significantly increased its penetration of the U.S. market. Three-quarters of Canada's industrial exports—which have been increasing at the rate of 16% a year since 1959—now go to the United States. This is scarcely surprising, for Canadian industry is far more competitive with U.S. industry than is often believed. In view of this, why hasn't Canadian industry grown far faster than it has? The answer which most economists offer to that question was restated recently by your Finance Minister, Mitchell Sharp, who said: 'The competitive weakness of many Canadian industries is due not to bad management, outdated techniques or inadequate equipment. Where weakness exists, it can most often be traced to an inadequate scale of production. Or, to put it another way, existing tariffs deny the majority of Canadian manufacturers access to the 200 million consumers of the United States, while a basic economic need of Canada is a broader market which would encourage greater specialization and an increase in the scale of production.

"The transition to Canadian-American free trade would have to be gradual. Moreover, extreme care would have to be taken to ensure that undue hardship was not inflicted upon producers in either country. But, as the experience of the European Free Trade Association has demonstrated, it is entirely possible to work out satisfactory formulae for such a transition. Perhaps, because free trade would obviously have a greater impact upon Canadian industry than upon U.S. industry, a longer transitional period might be accorded Canadian manufacturers. Perhaps, too, the first move toward free trade might simply be to establish arrangements similar to the automotive trade agreement in some of the other similarly situated industries which I cited before. But I myself see no halfway house which would be nearly as effective as a Free Trade Area in promoting the economic goals which both Canada and the United States pursue—namely, a rapid expansion of foreign trade, a general increase in business activity, and a higher standard of living for their citizens.

Free Movement of Capital: "A Canadian-American Free Trade Area would, of course, be unworkable without free movement of capital between the two countries. The prime concern of those critical of U.S. direct investment in Canada is that Canadian subsidiaries of U.S. companies are not fully responsive to the political and economic policies of the Canadian Government and that, as a result, Canada's independent identity is threatened. However, on the basis of my own understanding of the role U.S. investment plays in Canada, I would appraise the situation somewhat differently.

"The Economic Council of Canada has made a detailed analysis of Canadian capital requirements. The Council estimates that, if Canada is to maintain an annual growth rate of 5.5% in real gross national product, it will have to find investment capital amounting to nearly $17 billion a year by 1970. With the avowed purpose of achieving the maximum possible Canadian ownership of industry, your Government is trying to insure that as much of this capital as possible is obtained from Canadian sources, both private and public. This is a laudable and necessary effort. But even its most ardent advocates merely hope that this program will reduce somewhat Canada's traditional dependence on foreign capital; they do not for a moment suggest that the capital requirements projected by the Economic Council can be met by Canadian sources alone. Yet, despite this, some people continue to call for restrictions on U.S. investors in Canada. I can only conclude that they believe that U.S. investment will continue to flow into Canada in adequate quantities regardless of restrictions. Yet that seems to me a highly arguable assumption since Canada, for all its traditional attractions, is only one of many areas holding out the promise of profitable operation.

"Some Canadians argue that a relative diminution in United States investment in Canada might be a good thing. They are, I believe, mistaken, for such policies would mean higher prices, less demand for labor, less exchange of technology with the United States, and slower economic growth. Another argument often made by the restrictionists is the notion that any great degree of economic interdependence between our countries will somehow impair Canada's political independence. Certainly, trade dependence does not lead inevitably to political union. If that were so, the United States and Canada would long since have been united. Moreover, the criticisms so frequently made of the behavior of U.S. subsidiaries in Canada are, for the most part, unfounded. Specifically, the notion that U.S. affiliates do not contribute sufficiently to Canada's export drive founders on one fact: they account for over 40% of all Canadian exports to the United States and almost 40% of total Canadian exports to third countries. Another often-raised specter—the danger that U.S. subsidiaries will feel obliged to adhere to U.S. anti-trust laws and the U.S. Trading with the Enemy Act—has assumed reality in only a very few cases. The solution to that problem surely lies in political negotiations between Ottawa and Washington, not in a crackdown on U.S. investment.

"It is precisely because I desire to see both our countries make their distinctive contributions as fully and effectively as possible that I lay so much emphasis on the unrestricted movement of goods and capital between Canada and the United States. Given the degree to which nature and recent history have bound Canada and the United States together, I doubt that there will ever again be a time when mutual aloofness will be a practicable relationship between us. Certainly that time is not now, at a moment in history when we both find ourselves being left out of one trade bloc after another. At such a moment, rather than trying to find ways to disengage from each other, it would seem only prudent for us to spend more time considering how we can work together more effectively for our common benefit."

INTERNATIONAL FINANCE

a Chase Manhattan bi-weekly service for the exclusive use of corporate customers

March 6, 1967

Financial Highlights

EXIMBANK
East-West trade

The U.S. Export-Import Bank and the Foreign Credit Insurance Association (FCIA) have been authorized to widen their medium-term guaranty and short-term insurance programs to include U.S. exports to Bulgaria, Czechoslovakia, Hungary, Poland, and Rumania. This is in line with the U.S. Government's current policy to facilitate U.S. trade with Eastern Europe. The Eximbank can issue guaranties covering 80% of the export invoice value, for up to five years, with the East European importer required to make a 20% down payment. In order to qualify for coverage, the U.S. exporter must obtain a guaranty from the state-owned foreign trade bank or central bank of the importing country. Following the Eximbank's practice in issuing credit guaranties for U.S. exports to many free-world countries, the financing is expected to be provided by U.S. commercial banks, with the Eximbank guaranteeing payment for the 80% financed portion. **Although commercial trade opportunities remain limited, the new program should facilitate U.S. export trade to the small Eastern European countries.**

AUSTRALIA
economic pause

Business activity continues sluggish in Australia, although mineral developments are boosting the economy's long-term potential. A mild recession has persisted for a year now, making consumers cautious in buying cars, houses, and other durables. Many factories are operating below capacity, creating pockets of joblessness despite the country's still high overall employment rate. Investment spending has also weakened, and private capital inflow from abroad has dropped off from its peak last summer. Yet, the longer-run investment outlook is clearly favorable, as indicated by the scheduled development of additional iron ore mines, bauxite deposits and natural gas fields. Moreover, a 100,000 barrel-per-day oil field—equal to one-quarter of Australia's crude oil consumption—has been found off-shore near Melbourne, and a significant copper deposit has been discovered at Bougainville. This succession of major mineral investments is increasingly diversifying Australia's economic structure. But the impact of these investments will be spread over an extended period, giving little immediate impetus to the economy. **Thus, it is likely that Australian business activity will remain subdued for some months longer.**

COTTON
pricing change

New U.S. Government measures to reduce surplus cotton stocks are contributing to production, price and export declines in other major cotton-producing countries. This season, the United States lowered its basic support price for cotton, thereby making U.S. cotton more competitive in world markets. Although the new cotton crop will be substantially below last season's, U.S. foreign sales are expected to rise because of the lower domestic price and the availability of huge surplus stocks. Latest estimates put the cotton exports of other free world countries during the current season at 11.1 million bales, compared with 11.7 million bales in the previous season. This reduced volume, coupled with a decline in average cotton export prices of between one and two cents per pound, will probably reduce the cotton export revenues of other countries by a total of $110-$170 million, mainly in Mexico, Syria, Iran and Peru. **Since the U.S. Government is expected to continue its liquidation of surplus stocks until the 1969-1970 season, the cotton production and exports of other cotton producers are unlikely to increase over the next three years.**

BRITAIN
budget increase

The British Government's preliminary budget estimate, calling for a 9% spending increase in 1967-68, would have a moderately expansionary impact on the overall economy. Most of the increased Government spending is scheduled for health, housing, education and welfare programs; but the final shape of the Government's spending and taxation plans, as well as the size of the budget deficit, will not be known until the budget is formally presented in April. Since the private economy continues to be depressed, the projected budget increase should not halt the improvement of Britain's balance-of-payments position. The estimated $476 million trade deficit in 1966 represents a roughly 50% improvement over 1965. And, according to British estimates, this year's trade outlook promises a $400-$500 million surplus or better. **Even though the indicated budget increase follows other recent selective measures to ease somewhat the Government's economic squeze, Britain's business outlook remains one of restrained activity and reduced investment throughout 1967.**

CANADA
tax proposals

A Canadian Government-appointed commission has recommended sweeping changes in Canada's tax system which, if ultimately enacted, would result in higher business taxation. The proposals aim both at income redistribution and simplification of Canada's tax structure: income and capital gains in all forms would be taxed, and a uniform tax treatment established for all corporations. For instance, repeal of depletion allowances for Canadian extractive industries is advocated, special tax treatment for life insurance companies and certain other industries would be ended, and business capital gains, currently tax-exempt, would be taxed at the flat 50% corporate income tax rate. Moreover, the commission of tax experts recommends that Canadian personal income and excise taxes be made more progressive. **Since the new tax proposals go far beyond technical changes and would have important socio-economic implications, the recommendations are expected to generate an extended public debate, with no legislative action expected for several years.**

CONGO (Kinshasa)
copper exports

The Congolese Government's nationalization dispute with Union Miniere, the large Belgian-owned copper company, has been tentatively resolved by allowing the immediate resumption of copper exports. Under a working agreement just concluded, a newly created state-owned Congolese company has taken over the assets of Union Miniere. However, Union Miniere's Belgian-based marketing firm will be responsible for the production, refining and marketing of the Congo's copper. Thus, for the immediate future, copper production and exports are expected to continue, supplying roughly 7% of free-world copper demand. **Yet, longer run prospects remain clouded by uncertainties about the willingness of key operating personnel to stay on in Katanga and the Government's ability to carry out adequate investments to maintain mining capacity in the future.**

INDIA
political shift

The recent Indian elections, which sharply weakened Congress Party control, add to the country's economic and political uncertainties. As numerous Congress Party candidates were defeated, the formerly dominant Congress Party is left with only a small majority in the national Parliament and in control of only eight of the 16 states. The major electoral gains went to the free-enterprise Swatantra and the nationalist Jan Sangh parties, with the Communist parties making similar but smaller gains. This abrupt shift in India's political line-up could lead to much-needed reforms, but chances are that the diffusion of political power will subject economic policy making even more to regional and political compromises than in the past. Despite sizable foreign aid, India's economy is stagnating, with little or no increase in output per capita and severe food shortages. **With the political situation in flux, and the economy in deep trouble, India's business climate appears at low ebb.**

MEXICO
faster growth

Mexico's economy has rebounded from the mild 1965 slowdown, and the accelerated expansion is expected to continue through this year. Spurred by an 18% rise in investment outlays and sizable gains in manufacturing output, real GNP increased 7% during 1966, compared with 5% the year before. Higher cotton and food sales boosted exports 6%, while imports were held to a 3% increase—primarily by a policy of monetary restraint. The narrowed trade deficit, record tourist earnings, and heavy borrowing abroad during the fourth quarter, resulted in an overall balance in Mexico's international accounts last year. However, recently announced increases in public investment may aggravate existing inflationary pressures. Also, stepped-up investment should draw in imports at a faster rate this year, while exports to the United States—which takes almost two-thirds of the total—could be adversely affected by the U.S. business slowdown. **Therefore, resumption of strong economic expansion is likely to push Mexico's balance of payments into moderate deficit this year.**

JAPAN
strong expansion

The Japanese economy is rapidly accelerating after a year of moderate expansion, raising again the specter of renewed price and balance-of-payments pressures. Most of the impetus is from rapidly rising consumer spending and large public works expenditures. Also, corporate plant and equipment outlays are beginning to rise more rapidly. Latest indicators show that department store sales are up some 16%, factory output is running 20% ahead of a year ago, and the money supply is increasing at a 15% annual rate. Meanwhile, wholesale prices have climbed 5% in the last 12 months, exports have slowed, and imports accelerated. **If the monetary and fiscal expansion continues at current rates, real GNP might rise by more than 10% this year, but at the expense of renewed pressure on prices and Japan's balance of payments.**

PERU
payments deficit

Peru's investment boom contributed to an estimated $20 million balance-of-payments deficit last year, the first since 1958. Figures through November 1966 show a trade gap of $61 million, up 50% from the year-ago level, due largely to a sharp increase in capital goods and raw materials imports, as well as last year's 7.5% domestic inflation. Despite high copper earnings, exports rose more slowly than imports, as fishmeal sales—which account for 30% of total exports—were curbed by labor stoppages, rising costs and depressed world prices. Capital inflows, particularly Government borrowings abroad, only partially offset the trade deficit. Thus, international reserves fell to $155 million at end-1966, while Peru's official foreign debt increased to an estimated $580 million. Servicing of this debt amounts to a relatively low 11% of export earnings, but payments on short-term debt have been mounting rapidly and could become a problem. **In view of continued strong investment activity and the adverse effects of inflation on foreign trade, some worsening of Peru's international payments position is expected during 1967.**

INTERNATIONAL LOANS

Union Oil International Finance Corporation: $15 million, 5-year notes, 6.25% coupon, 6.37% yield, parent company guaranteed, issued March 1 in New York for sale outside the U.S.

Transalpine Holdings, S.A.: $30 million, 15 years, 6.75% coupon, 6.88% yield, issued February 15 in Luxembourg.

Money and Capital Markets

In New York, the financial market was highlighted by the Federal Reserve's decision on February 28 to reduce from 4% to 3% the reserve requirements against commercial bank savings deposits and the first $5 million of other time deposits. The reduction, which will be in two stages and takes complete effect by March 16, is expected to free about $850 million of bank reserves for credit expansion. Following the Federal Reserve's announcement, both short- and long-term interest rates fell sharply, reversing the rising trend of recent weeks. The three- and six-month Treasury bill rates, for example, fell from 4.538% and 4.534% at the February 27 auction to an identical 4.39% on Thursday, March 2—the lowest levels since January. In addition, significant rate reductions were recorded in the bond market, and sales of newly offered corporate and tax-exempt issues picked up considerably from the sluggish rate of the past several weeks.

Some form of Federal Reserve credit easing was called for in view of near-term credit developments. In addition to heavy corporate bank borrowings to meet tax and dividend payments, a record $1.5 billion of corporate securities are scheduled to reach the market this month. However, the Federal Reserve's move does not necessarily signal a sharply easier monetary policy and should be interpreted with caution. There are several reasons why the Federal Reserve may have chosen the reserve requirement cut to ease the seasonal pressures, rather than traditional open market operations which would have been equally effective, though with less of a psychological impact. For one thing, since the reduction in reserve requirements applies to the smaller class of time deposits, it will most likely have a beneficial effect on the mortgage market, which the Government is attempting to stimulate. For another, an equivalent amount of open market purchases would have had a greater downward impact on market interest rates, a development which the Federal Reserve might want to avoid. But, although it is not possible to forecast Federal Reserve policy at this time, the persistence of negative economic indicators suggests that apart from seasonal factors money markets will remain relatively easy. Moreover, the very high rate of inventory accumulation in recent months could drop off sharply. In this case a further easing in credit conditions might occur.

In Canada, short-term money market rates resumed last week their recent decline, similar to the New York trend. As of March 2, the three-month rate on Treasury bills had fallen to 4.47%, and that on prime finance paper to 5.625%-5.875%. Also, reversing their mid-February gains, Government bond yields declined an average 20 basis points to 5.57% by March 2.

In London, the pound sterling maintained its steady tone in the foreign exchange market, with the spot rate closing at $2.7948 and the three-month forward discount at .79% on March 2. With Euro-dollar rates edging upwards, the covered arbitrage margin between three-month Euro-dollars and U.K. local authority loans has been running slightly in the dollar's favor since mid-February. However, the U.S.-U.K. covered margin on three-month Treasury bills has remained in London's favor and widened to .80% by March 2, largely due to the renewed decline in the U.S. bill rate.

In Italy, the Government re-introduced, on February 24, a 5% withholding tax on stock dividends received by Italian residents, while maintaining the flat 30% coupon tax on dividends received by non-residents. A 15% dividend withholding tax was enacted at the end of 1962, which required Italian stockholders to disclose their stock holdings and, thereby, tended to increase their tax assessment for the *complementare,* a progressive surtax of up to 65% of total income. Partly as a result, an estimated $1.5 billion of Italian funds left the country in 1963, compelling the Government to grant stockholders the option to either (1) pay a 5% withholding tax and declare all dividend income or (2) pay a flat 30% withholding rate with no further tax liability. The decision to abolish this second alternative will increase primarily the tax liability of large personal stockholdings. Indeed, strong selling has depressed stock prices 9% since February 22, leaving the index on March 2 only 3% above its 1964 low.

In Japan, interest rates for day-to-day money moved upward. The overnight call rate rose to 5.84% from the 5.475% level it had maintained since October 1965. While the rise reflects some seasonal pressure from holiday spending and tax payments, it also indicates a strengthening of credit demand due to the present economic upswing.

In Mexico, the new 1967 tax revenue law calls for slight increases in personal and business taxes. Individuals will now be taxed on incomes in excess of $8,000, instead of the previous $12,000. For business firms, the structure of tax rates on taxable profits has been raised, with the lowest tax rate increased from 32.58% to 34% and the maximum rate of 42% now being extended to profits in excess of $40,000, instead of $80,000 as before.

Africa REGIONAL SURVEY OF BUSINESS AND FINANCE

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS(1)		GNP IN 1965*		E			
		latest data	12-month change	in millions of dollars	per capita	latest data	reserves in millions of dollars	12-month change	m… of i… cove…
Congo (Kinshasa)	Copper dispute slowing down an already sluggish economy.	Dec.	+11%	$ 1,280	$ 80	Dec.	$ 45	+12%	
Ethiopia	New investments stimulate growth of construction and light industries.	Aug.	no change	1,110	55	Dec.	79	+ 3%	
Ghana	Government austerity program curtails business activity, but cocoa sales are good.	July	+24%	2,205	285	Dec.	126	− 5%	
Ivory Coast	Business continues favorable with imports rising.	Aug.	+20%	965	250	Nov.	54	+28%	
Kenya	Construction industry stimulated by demand for tourist facilities.	Aug.	+21%	845	90	—	n. a.	n. a.	
Liberia	New investments have induced some construction activity and business spending.	Dec.	+ 7%	210	190	—	n. a.	n. a.	
Libya	Booming petroleum and construction industries keep the economy at a high level.	Oct.	+35%	865	540	Dec.	339	+38%	
Morocco	Agriculture slowly recovering from severe drought; unemployment still a major problem.	June	−39%	2,605	195	Nov.	92	− 9%	
Nigeria	Business depressed by growing threat of regional breakup.	Sept.	− 1%	4,850	110	Dec.	223	− 9%	
Rhodesia	Economy under considerable strain due to international sanctions.	—	n. a.	1,020	240	—	n. a.	n. a.	
Sierra Leone	Modest investment expenditures provide some impetus to an otherwise sluggish economy.	June	−35%	260	115	June	19	n. a.	
South Africa	Business expansion levelling off as anti-inflationary measures take hold.	Nov.	+19%	10,720	535	Dec.	780	+35%	
Sudan	Business activity at low level due to austerity measures and continuing problems in the South.	July	+ 7%	1,415	105	Dec.	57	− 5%	
Tanzania	Business activity slowed down by nationalization measures and new currency controls.	Aug.	+38%	755	70	—	n. a.	n. a.	
Tunisia	Business restricted by government austerity policy; agriculture recovering from the drought.	Oct.	+48%	850	180	Nov.	26	+11%	
Uganda	Business activity picking up somewhat as a result of good coffee sales.	Aug.	+21%	625	80	—	n. a.	n. a.	
U.A.R. (Egypt)	Government cuts investment spending to ease international payments problems.	Oct.	+18%	4,500	150	June	192	− 2%	
Zambia	Copper deliveries hampered by fuel shortages and transportation difficulties.	Dec.	+30%	660	190	Dec.	225	+14%	

* *estimated*

(1) *Latest 3-month export total compared with same 3-month total of previous year.*

In Canada, short-term money market rates resumed last week their recent decline, similar to the New York trend. As of March 2, the three-month rate on Treasury bills had fallen to 4.47%, and that on prime finance paper to 5.625%-5.875%. Also, reversing their mid-February gains, Government bond yields declined an average 20 basis points to 5.57% by March 2.

In London, the pound sterling maintained its steady tone in the foreign exchange market, with the spot rate closing at $2.7948 and the three-month forward discount at .79% on March 2. With Euro-dollar rates edging upwards, the covered arbitrage margin between three-month Euro-dollars and U.K. local authority loans has been running slightly in the dollar's favor since mid-February. However, the U.S.-U.K. covered margin on three-month Treasury bills has remained in London's favor and widened to .80% by March 2, largely due to the renewed decline in the U.S. bill rate.

In Italy, the Government re-introduced, on February 24, a 5% withholding tax on stock dividends received by Italian residents, while maintaining the flat 30% coupon tax on dividends received by non-residents. A 15% dividend withholding tax was enacted at the end of 1962, which required Italian stockholders to disclose their stock holdings and, thereby, tended to increase their tax assessment for the *complementare*, a progressive surtax of up to 65% of total income. Partly as a result, an estimated $1.5 billion of Italian funds left the country in 1963, compelling the Government to grant stockholders the option to either (1) pay a 5% withholding tax and declare all dividend income or (2) pay a flat 30% withholding rate with no further tax liability. The decision to abolish this second alternative will increase primarily the tax liability of large personal stockholdings. Indeed, strong selling has depressed stock prices 9% since February 22, leaving the index on March 2 only 3% above its 1964 low.

In Japan, interest rates for day-to-day money moved upward. The overnight call rate rose to 5.84% from the 5.475% level it had maintained since October 1965. While the rise reflects some seasonal pressure from holiday spending and tax payments, it also indicates a strengthening of credit demand due to the present economic upswing.

In Mexico, the new 1967 tax revenue law calls for slight increases in personal and business taxes. Individuals will now be taxed on incomes in excess of $8,000, instead of the previous $12,000. For business firms, the structure of tax rates on taxable profits has been raised, with the lowest tax rate increased from 32.58% to 34% and the maximum rate of 42% now being extended to profits in excess of $40,000, instead of $80,000 as before.

Revisions in U.S. Interest Equalization Tax

U.S. Government Proposes Higher IET Rates, But Exempts Offshore Dollar Loans

The U.S. Interest Equalization Tax (IET), first introduced in July 1963 as a temporary balance-of-payments measure, will be strengthened and extended another two years, to nobody's great surprise. The IET is applied to U.S. purchases of foreign bonds and stocks and to U.S. bank loans to foreigners with terms of one year or more, with the tax until now adding roughly one percentage point a year to borrowing costs. Exempted from the tax are: direct U.S. investment abroad, U.S. export credits, loans or investments in less developed countries, loans or credit instruments with a maturity of less than one year, newly issued Canadian securities, and an annual $100 million of new Japanese issues.

The effectiveness of the IET has been varied. It brought to a virtual halt the flotation in New York of new European bond issues. But some reduction in U.S. purchases of European and Japanese stocks would probably have occurred in any case due to their declining price trend, and the big reduction in U.S. banks' foreign lending in 1965-66 was mainly a consequence of mounting U.S. credit demands, as well as the Voluntary Balance of Payments Program. The U.S. Government's present purpose in strengthening the IET is to prevent a resumption of U.S. foreign portfolio investments at a time when domestic interest rates could decline more rapidly than European interest rates.

Higher IET Rates. Acting on the Government's IET request, the House Ways and Means Committee recommended a 50% increase in the tax rate to the equivalent of 1.5 percent in annual interest cost, effective from January 25, and Presidential authority to vary the tax between one and 1.5 percent. Foreign stock purchases would be taxed at a flat 22.5% of purchase price, foreign debt obligations at 1.58% to 22.5% depending on maturity, and commercial bank loans from one to three years at 1.58% to 4.13%. All previous exemptions would be continued. Since Ways and Means Committee recommendations carry considerable weight, chances are that this version of the IET amendment will become law.

Overseas Exemption. In another action, President Johnson has exempted from the IET all offshore dollar loans (Euro-dollars) extended by foreign branches of U.S. banks. This puts U.S. banks' overseas branches on an equal footing with foreign banks in the medium-term Euro-dollar market. Transactions in these offshore dollars have no direct impact on the U.S. balance of payments. However, to the extent that the limited supply of medium-term Euro-dollars can be more easily channeled to U.S. subsidiaries in Europe, their need for exporting capital funds from the United States should be reduced somewhat.

Africa REGIONAL SURVEY OF BUSINESS AND FINANCE

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS(1)		GNP IN 1965*		BALANCE OF PAYMENTS						MONEY AND BANKING					COUNTRIES
		latest data	12-month change	in millions of dollars	per capita	latest data	reserves in millions of dollars	12-month change	months of imports covered (MI)	12-month change in MI	influences	latest data	12-month changes: consumer prices	12-month changes: domestic credit	central bank rate	monetary conditions	
Congo (Kinshasa)	Copper dispute slowing down an already sluggish economy.	Dec.	+11%	$ 1,280	$ 80	Dec.	$ 45	+12%	n. a.	n. a.	Disruption of copper exports draws down foreign exchange reserves.	Sept.	+15 %	n. a.	4.5%	Credit is tight.	**Congo (Kinshasa)**
Ethiopia	New investments stimulate growth of construction and light industries.	Aug.	no change	1,110	55	Dec.	79	+ 3%	6.1	− 9%	Lower coffee earnings keep trade balance in deficit.	Nov.	n. a.	+17%	4.5%	Strong demand for bank credit.	**Ethiopia**
Ghana	Government austerity program curtails business activity, but cocoa sales are good.	July	+24%	2,205	285	Dec.	126	− 5%	3.5	−15%	Trade account improving, but large debt payments reduce reserves.	Aug.	− 2 %	+13%	7.0%	Ample credit supply.	**Ghana**
Ivory Coast	Business continues favorable with imports rising.	Aug.	+20%	965	250	Nov.	54	+28%	2.5	+14%	Good export earnings from cocoa and timber.	Nov.	+ 2.5%	− 3%	3.5%	Bank credit remains tight.	**Ivory Coast**
Kenya	Construction industry stimulated by demand for tourist facilities.	Aug.	+21%	845	90	—	n. a.	n. a.	n. a.	n. a.	Trade surplus and continuing high earnings from tourism.	Dec.	+ 2 %	n. a.	—	Ample credit supply.	**Kenya**
Liberia	New investments have induced some construction activity and business spending.	Dec.	+ 7%	210	190	—	n. a.	n. a.	n. a.	n. a.	Increasing iron ore exports but heavy debt service.	Dec. (1965)	+ 2 %	n. a.	—	Credit remains tight.	**Liberia**
Libya	Booming petroleum and construction industries keep the economy at a high level.	Oct.	+35%	865	540	Dec.	339	+38%	10.6	+ 8%	Oil exports continue at record level.	Aug.	+ 8 %	+34%	5.0%	Credit expansion continues despite monetary restraints.	**Libya**
Morocco	Agriculture slowly recovering from severe drought; unemployment still a major problem.	June	−39%	2,605	195	Nov.	92	− 9%	2.2	−19%	Payments deficit persists despite import restrictions.	Oct.	no change	− 3%	3.5%	Credit continues very tight.	**Morocco**
Nigeria	Business depressed by growing threat of regional breakup.	Sept.	− 1%	4,850	110	Dec.	223	− 9%	3.7	− 5%	Lower imports help maintain small trade surplus.	Sept.	+44 %	+25%	5.0%	Ample credit supply but loan policy cautious.	**Nigeria**
Rhodesia	Economy under considerable strain due to international sanctions.	—	n. a.	1,020	240	—	n. a.	n. a.	n. a.	n. a.	Official statistics or reliable information not available.	—	n. a.	n. a.	4.5%	Strict monetary controls to combat sanctions.	**Rhodesia**
Sierra Leone	Modest investment expenditures provide some impetus to an otherwise sluggish economy.	June	−35%	260	115	June	19	n. a.	n. a.	n. a.	Drop in diamond exports and heavy debt service.	June	+ 4 %	− 6%	5.5%	Considerable credit stringency.	**Sierra Leone**
South Africa	Business expansion levelling off as anti-inflationary measures take hold.	Nov.	+19%	10,720	535	Dec.	780	+35%	4.1	+46%	Rising exports and capital inflows sharply improve balance of payments.	Oct.	+ 5 %	+ 4%	6.0%	Credit remains tight to check inflationary pressures.	**South Africa**
Sudan	Business activity at low level due to austerity measures and continuing problems in the South.	July	+ 7%	1,415	105	Dec.	57	− 5%	3.3	− 8%	Import controls stabilize trade balance.	Nov.	+ 9 %	+21%	4.0%	Seasonal credit expansion.	**Sudan**
Tanzania	Business activity slowed down by nationalization measures and new currency controls.	Aug.	+38%	755	70	—	n. a.	n. a.	n. a.	n. a.	Cotton exports contribute to trade surplus.	Dec.	+ 1 %	n. a.	—	Government loan policy not yet clarified.	**Tanzania**
Tunisia	Business restricted by government austerity policy; agriculture recovering from the drought.	Oct.	+48%	850	180	Nov.	26	+11%	1.2	+ 9%	Good tourist receipts, but trade deficit continues.	Nov.	+ 8 %	+24%	5.0%	Bank credit is tight.	**Tunisia**
Uganda	Business activity picking up somewhat as a result of good coffee sales.	Aug.	+21%	625	80	—	n. a.	n. a.	n. a.	n. a.	Trade surplus bolstered by increased coffee exports.	Dec.	− 8 %	n. a.	—	Bank credit is tightening.	**Uganda**
U.A.R. (Egypt)	Government cuts investment spending to ease international payments problems.	Oct.	+18%	4,500	150	June	192	− 2%	2.2	−21%	Sharp import rise cancels 1965 balance-of-payments gains.	Sept.	+ 8 %	+ 8%	5.0%	Restraints begin to slow credit expansion.	**U.A.R. (Egypt)**
Zambia	Copper deliveries hampered by fuel shortages and transportation difficulties.	Dec.	+30%	660	190	Dec.	225	+14%	8	+ 1%	Export receipts reduced due to drop in copper shipments.	Sept.	+ 6 %	n. a.	5.0%	Bank credit in good supply.	**Zambia**

* estimated

(1) *Latest 3-month export total compared with same 3-month total of previous year.*

INTERNATIONAL [BANK] FOR
RECONSTRUCTION AND [DE]VELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

INTERNATIONAL FINANCE CORPORATION

factors influencing choice of countries subject to IET

level o reserves.
GNP per capita
rate of growth
political factors.
= oil countries doing well.
– No AID activity.

(Hulley's info from Treasury

Form No. 155 (1.64) INTERNATIONAL DEVELOPMENT ASSOCIATION INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT INTERNATIONAL FINANCE CORPORATION

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Interest-Equalization Tax Boost of 50%, Half of Johnson Request, Voted by Panel

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON — The House Ways and Means Committee approved a bill allowing a 50% increase in the tax on Americans' purchases of foreign securities from foreigners.

The measure probably will be passed by the House next week.

The higher interest-equalization tax would be imposed retroactive to Jan. 25. The President would be given unlimited authority to vary the tax rate after the law is enacted.

The current tax, on the books since mid-1963, has added one percentage point to borrowing costs by foreigners in the U.S. It applies to most foreign bonds, stocks and bank loans and is designed to curb dollar outflows that worsen the U.S. balance-of-payments deficit, which occurs when foreigners acquire more dollars than they return in all transactions.

The Ways and Means bill would have the effect of increasing borrowing costs by foreigners by as much as 1.5 percentage points; the Administration had sought a maximum increase of two percentage points.

The Administration also had requested flexibility so it could adjust the tax from zero to two percentage points. The House panel rejected this, but it recommended the President be given limited authority to adjust the tax between a minimum of one percentage point and a maximum of 1.5 percentage points.

Under the committee's bill, the tax would start at 1.5 percentage points and fall automatically to one percentage point 30 days after enactment unless the President chooses to maintain a higher rate. The measure would extend the tax to July 31, 1969.

Administration officials have indicated they would take action to maintain the tax above one percentage point. A decision by the President to adjust the tax rate would have to be accompanied by a finding that this was consistent with overall balance-of-payments policy.

Although the tax is imposed on Americans' purchase of foreign securities, in effect it is absorbed by foreigners because they have to mark up yields on securities to offset the tax. In practice, the tax has had the effect of almost drying up the market in the U.S. for foreign securities subject to the tax.

Under the committee bill, an American buying a foreign stock would be subject to a 22.5% tax, up from 15%. The tax on a foreign debt obligation would range from 1.58%, on a maturity of at least a year but less than 1¼ years, to 22.5% on a maturity of 28½ years or more; the current range is 1.05% to 15%. The levy on a commercial bank loan, applicable on loans of from one to three years, would range from 1.58% to 4.13%; the current range is 1.05% to 2.79%.

The committee bill also broadens a number of relatively minor exemptions from the tax. One new provision would give a securities dealer purchasing foreign debt obligations from another dealer more time to dispose of the bonds before becoming liable for interest-equalization tax.

Current law gives the dealer making the purchase from another dealer only one day to resell the bonds without incurring the tax; this exemption would be extended to 30 days under the bill. The recommended liberalization applies only to debt obligations, not stocks. The bill also continues the requirement that the dealers be buying from and selling to foreigners.

All current exemptions from the tax would be continued under the committee bill. These include exemptions for securities issued by underdeveloped countries, Canada and, to a limited extent, Japan.

Injustice With Interest

There are several comments that can be made about the so-called Interest Equalization Tax, which the Administration is asking Congress not only to extend but increase.

Since the tax attacks the balance-of-payments deficit by penalizing investors who put money in foreign securities, it obviously flies in the face of this nation's traditional support of the freest possible movement of international trade and capital. Moreover, there would be no excuse of any kind for the tax if the Government would show somewhat more restraint in monetary and fiscal matters. Washington is in effect punishing others for its failure to put its own house in order.

That is not all. Whenever the Government ponderously moves in to re-order things in any economic area, it strews a good deal of presumably unintended injustice in its wake. The following is a true story:

While stationed with the U.S. Army in England during World War II, an American married a British girl who owned some British securities. The couple returned to the U.S. after the war, and all income from the investments has been brought to this country, helping U.S. income tax receipts as well as modestly assisting the balance of payments.

From time to time, prudence has dictated the sale of certain securities and the reinvestment of the funds in other British issues. Since the Interest Equalization Tax was enacted, however, each of these portfolio changes has been penalized.

The penalty is exacted even though in no case has any reinvestment involved the transfer of any funds from the U.S. to Britain. It is collected, in other words, despite the fact that this sort of transaction clearly has nothing whatsoever to do with the purpose of the law.

The couple's appeals to Washington so far have gotten nowhere, and perhaps that isn't especially surprising. A Government willing to err on so massive a scale is unlikely to be bothered by relatively minor injustice.

Developed Countries for Purposes of the IET

Non-Exempt Countries	Effective Date of Designation
Abu Dhabi	6/10/66
Australia	7/18/63
Austria	7/18/63
Bahamas Islands	5/14/65
Bahrein	6/10/66
Belgium	7/18/63
Bermuda	5/14/65
Canada *	7/18/63
Denmark	7/18/63
France	7/18/63
Germany (Federal Republic)	7/18/63
Hong Kong	7/18/63
Iran	6/10/66
Iraq	6/10/66
Ireland	5/14/65
Italy	7/18/63
Japan **	7/18/63
Kuwait	5/14/65
Kuwait-Saudi Arabia Neutral Zone	6/10/66
Libya	6/10/66
Liechtenstein	7/18/63
Luxembourg	7/18/63
Monaco	7/18/63
Netherlands	7/18/63
New Zealand	7/18/63
Norway	7/18/63
Portugal	5/14/65
Qatar	6/10/66
Republic of South Africa	7/18/63
San Marino	7/18/63
Saudi Arabia	6/10/66
Sino-Soviet Bloc 1/	7/18/63
Spain	7/18/63
Sweden	7/18/63
Switzerland	7/18/63
United Kingdom	7/18/63

*New Canadian securities exempt as of 7/18/63 and Canadian Bank loans exempt as of 9/12/66.

**$100 million exemption of debt obligation permitted per annum.

1/ Including: Albania, Bulgaria, China Mainland, Cuba, Czechoslovakia, East Germany, Estonia, Hungary, Latvia, Lithuania, Mongolia, North Korea, North Vietnam, Poland, Rumania and USSR.

Presidential Documents

Title 3—THE PRESIDENT

Executive Order 11071

DESIGNATION OF CERTAIN FOREIGN COUNTRIES AS ECONOMICALLY LESS DEVELOPED COUNTRIES FOR PURPOSES OF THE REVENUE ACT OF 1962

By virtue of the authority vested in me by section 955(c)(3) of the Internal Revenue Code of 1954, as added by section 12(a) of the Revenue Act of 1962, approved October 16, 1962 (Public Law 87–834, 76 Stat. 1015), by section 301 of title 3 of the United States Code, and as President of the United States, it is hereby ordered as follows:

Dec 65 Kuwait
Dec 65 Portugal
(Bermuda?)
Ireland

SECTION 1. *Economically less developed countries.* For purposes of subpart A (sec. 901 and following) and subpart F (sec. 951 and following) of part III of subchapter N, and section 1248 of part IV of subchapter P, of chapter 1 of the Internal Revenue Code of 1954, the following areas are designated as economically less developed countries:

Countries added later

(a) all foreign countries (including Trust Territories) in existence on or after December 31, 1962, other than Australia, Austria, Belgium, Canada, Denmark, France, Federal Republic of Germany, Italy, Japan, Liechtenstein, Luxembourg, Monaco, Netherlands, New Zealand, Norway, Union of South Africa, San Marino, Spain, Sweden, Switzerland, United Kingdom, and any foreign country within the Sino-Soviet bloc, as defined in section 2;

Hong Kong

(b) each territory, department, province, and possession (other than Hong Kong) of any foreign country in existence on or after December 31, 1962, other than of a foreign country within the Sino-Soviet bloc, as defined in section 2, if the territory, department, province, or possession is overseas from the foreign country of which it is a territory, department, province, or possession; and

Abu Dhabi
Bahrein
~~Indonesia~~
Iran
Iraq
Libya
Neutral Zone
Qatar
Saudi Arabia

(c) the Commonwealth of Puerto Rico and all possessions of the United States.

SEC. 2. *Definition of the term "foreign country within the Sino-Soviet bloc".* For purposes of this Order, the term "foreign country within the Sino-Soviet bloc" shall mean Albania, Bulgaria, any part of China which is dominated or controlled by International Communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by International Communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Soviet Zone of Germany and the Soviet Sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics, and any part of Viet-Nam which is dominated or controlled by International Communism.

SEC. 3. *Rules and regulations.* The Secretary of the Treasury or his delegate is authorized to prescribe from time to time regulations, rulings, directions, and instructions to carry out the purposes of this Order.

SEC. 4. *Effective date.* This Order shall become effective December 31, 1962.

JOHN KENNEDY

THE WHITE HOUSE,
December 27, 1962.

[F.R. Doc. 62–12935; Filed, Dec. 28, 1962; 10:50 a.m.]

26 USC 901-905, 951-964. 26 USC 1248. purposes of subparts A and F of part III of subchapter N, and section 1248 of part IV of subchapter P, of chapter 1), shall be deemed to have been issued and in effect, for purposes of the tax imposed by section 4911, on July 18, 1963, and continuously thereafter until there is in effect the Executive order referred to in the preceding sentence. An overseas territory, department, province, or possession of any foreign country may be designated as a separate country. No designation shall be made under this subsection with respect to any of the following:

Australia	Luxembourg
Austria	Monaco
Belgium	Netherlands
Canada	New Zealand
Denmark	Norway
France	Republic of South Africa
Germany (Federal Republic)	San Marino
Hong Kong	Spain
Italy	Sweden
Japan	Switzerland
Liechtenstein	United Kingdom.

Notification to Congress. After the President (under the first sentence of this subsection) has designated any foreign country as an economically less developed country for purposes of the tax imposed by section 4911, he shall not terminate such designation (either by issuing an Executive order for that purpose or by issuing an Executive order which has the effect of terminating such designation) unless, at least 30 days before such termination, he has notified the Senate and the House of Representatives of his intention to terminate such designation.

"(c) Less Developed Country Corporation Defined.—

"(1) In general.—For purposes of this section, the term 'less developed country corporation' means a foreign corporation which for the applicable periods set forth in paragraph (3)—

76 Stat. 1013. 26 USC 955. "(A) meets the requirements of section 955(c) (1) or (2); or

"(B) derives 80 percent or more of its gross income, if any, from sources within less developed countries, or from deposits in the United States with persons carrying on the banking business, or both, and has assets 80 percent or more in value of which consists of—

"(i) money, and deposits in the United States with persons carrying on the banking business,

"(ii) stock or debt obligations of any other less developed country corporation,

"(iii) debt obligations of a less developed country,

"(iv) investments which are required because of restrictions imposed by a less developed country,

"(v) debt obligations described in paragraph (3) of subsection (a) of this section, and

"(vi) obligations of the United States.

In applying this paragraph the determination of whether a foreign country is a less developed country shall be made in accordance with subsection (b) of this section.

"(2) Special rules.—

26 USC 956. "(A) For purposes of subparagraphs (A) and (B) of paragraph (1), property described in section 956(b)(1) (regardless of when acquired), other than deposits with persons carrying on the banking business, and income derived from such property, shall not be taken into account.

Filing Date 5/14/65,
which is effective dat

Presidential Documents

Title 3—THE PRESIDENT

Executive Order 11224

DESIGNATION OF CERTAIN FOREIGN COUNTRIES AS ECONOMICALLY LESS DEVELOPED COUNTRIES FOR PURPOSES OF THE INTEREST EQUALIZATION TAX

WHEREAS the Senate and House of Representatives have been duly notified of my intention to terminate the designation of the Bahamas, Bermuda, Ireland, Kuwait, and Portugal as economically less developed countries for purposes of the tax imposed by section 4911 of the Internal Revenue Code;

NOW, THEREFORE, by virtue of the authority vested in me by section 4916(b) of the Internal Revenue Code of 1954, as added by section 2 of the Interest Equalization Tax Act, approved September 2, 1964 (Public Law 88-563), by section 301 of title 3 of the United States Code, and as President of the United States, it is hereby ordered as follows:

SECTION 1. *Economically less developed countries.* For purposes of the tax imposed by section 4911 of the Internal Revenue Code, the following areas are designated as economically less developed countries:

(a) All foreign countries (including Trust Territories) in existence on or after the effective date of this order, other than Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, France, Ireland, Italy, Japan, Kuwait, Liechtenstein, Luxembourg, Monaco, Netherlands, New Zealand, Norway, Portugal, San Marino, Spain, Sweden, Switzerland, Union of South Africa, United Kingdom, and any foreign country within the Sino-Soviet bloc, as defined in section 2:

(b) Each territory, department, province, and possession (other than the Bahamas, Bermuda, and Hong Kong), of any foreign country in existence on or after the effective date of this order, other than a foreign country within the Sino-Soviet bloc, as defined in section 2, if the territory, department, province, or possession is overseas from the foreign country of which it is a territory, department, province, or possession; and

(c) The Commonwealth of Puerto Rico and all possessions of the United States.

SEC. 2. *Definition of the term "foreign country within the Sino-Soviet bloc."* For purposes of this order, the term "foreign country within the Sino-Soviet bloc" shall mean Albania, Bulgaria, any part of China which is dominated or controlled by International Communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by International Communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Soviet Zone of Germany and the Soviet Sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics, and any part of Viet Nam which is dominated or controlled by International Communism.

SEC. 3. *Prior acquisitions and commitments.* Notwithstanding the provisions of sections 1 and 2 of this order, any area which had the status of an economically less developed country under section 4916(b) of the Internal Revenue Code prior to the effective date of this order shall be deemed to be an economically less developed country for purposes of section 4916 with respect to an acquisition of stock or a debt obligation—

(a) If such acquisition was made prior to the effective date of this order;

(b) If such acquisition is made pursuant to an obligation to acquire which, prior to April 6, 1965, was unconditional or was subject only to conditions contained in a formal contract under which partial performance had occurred; or

(c) If, with respect to such acquisition, the acquiring United States person (or, in a case where two or more United States persons are making acquisitions as part of a single transaction, a majority in interest of such persons) had taken every action prior to April 6, 1965, to signify approval of the acquisition under the procedures ordinarily employed by such person (or persons) in similar transactions and had sent or deposited for delivery to the foreign person from whom the acquisition was made written evidence of such approval in the form of a commitment letter, memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the foreign person from whom the acquisition was made which set forth, the principal terms of such acquisition, subject only to the execution of formal documents evidencing the acquisition and to customary closing conditions.

SEC. 4. *Rules and regulations.* The Secretary of the Treasury or his delegate is authorized to prescribe from time to time regulations, rulings, directions, and instructions to carry out the purposes of this order.

SEC. 5. *Effective date.* This order shall become effective upon its filing for publication in the FEDERAL REGISTER.

SEC. 6. *Inapplicability of Executive Order 11071.* Executive Order No. 11071, dated December 27, 1962, is hereby superseded to the extent that such order applies to section 4916 of the Internal Revenue Code.

LYNDON B. JOHNSON

THE WHITE HOUSE,
May 13, 1965.

[F.R. Doc. 65-5249; Filed, May 14, 1965; 11:42 a.m.]

Presidential Documents

Title 3—THE PRESIDENT

Executive Order 11285

DESIGNATION OF CERTAIN FOREIGN COUNTRIES AS ECONOMICALLY LESS DEVELOPED COUNTRIES FOR PURPOSES OF THE INTEREST EQUALIZATION TAX

WHEREAS notice was given on December 7, 1965, that I intended to notify the Senate and House of Representatives of my intention to terminate the designation of Abu Dhabi, Bahrain, Iran, Iraq, Kuwait–Saudi Arabia Neutral Zone, Libya, Qatar, and Saudi Arabia as economically less developed countries for purposes of the tax imposed by section 4911 of the Internal Revenue Code; and

WHEREAS the Senate and House of Representatives have been duly notified of my intention to terminate the designation of these countries as economically less developed countries for such purposes;

NOW, THEREFORE, by virtue of the authority vested in me by section 4916(b) of the Internal Revenue Code of 1954, as added by section 2 of the Interest Equalization Tax Act, approved September 2, 1964 (Public Law 88-563), by section 301 of title 3 of the United States Code, and as President of the United States, it is hereby ordered as follows:

SECTION 1. *Economically less developed countries.* For purposes of the tax imposed by section 4911 of the Internal Revenue Code, the following areas are designated as economically less developed countries:

(a) All foreign countries (including Trust Territories) in existence on or after the effective date of this order, other than Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, France, Iran, Iraq, Ireland, Italy, Japan, Kuwait, Kuwait–Saudi Arabia Neutral Zone, Libya, Liechtenstein, Luxembourg, Monaco, Netherlands, New Zealand, Norway, Portugal, San Marino, Saudi Arabia, Spain, Sweden, Switzerland, Union of South Africa, United Kingdom, and any foreign country within the Sino-Soviet bloc, as defined in section 2;

Abu Dhabi? Bahrain?

(b) Each territory, department, province, and possession (other than Abu Dhabi, the Bahamas, Bahrain, Bermuda, Hong Kong, and Qatar), of any foreign country in existence on or after the effective date of this order, other than a foreign country within the Sino-Soviet bloc, as defined in section 2, if the territory, department, province, or possession is overseas from the foreign country of which it is a territory, department, province, or possession; and

(c) The Commonwealth of Puerto Rico and all possessions of the United States.

SEC. 2. *Definition of the term "foreign country within the Sino-Soviet bloc."* For purposes of this order, the term "foreign country within the Sino-Soviet bloc" shall mean Albania, Bulgaria, any part of China which is dominated or controlled by International Communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by International Communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Soviet Zone of Germany and the

Soviet Sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics, and any part of Viet Nam which is dominated or controlled by International Communism.

SEC. 3. *Prior commitments to acquire.* Notwithstanding the provisions of sections 1 and 2 of this order, any area which had the status of an economically less developed country under Executive Order No. 11224 prior to the effective date of this order shall be deemed to be an economically less developed country for purposes of section 4916 with respect to an acquisition of stock or a debt obligation—

(a) If such acquisition is made pursuant to an obligation to acquire which, prior to December 7, 1965, was unconditional or was subject only to conditions contained in a formal contract under which partial performance had occurred; or

(b) If, with respect to such acquisition, the acquiring United States person (or, in a case where two or more United States persons are making acquisitions as part of a single transaction, a majority in interest of such persons), had taken every action prior to December 7, 1965, to signify approval of the acquisition under the procedures ordinarily employed by such person (or persons) in similar transactions and had sent or deposited for delivery to the foreign person from whom the acquisition was made written evidence of such approval in the form of a commitment letter, memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the foreign person from whom the acquisition was made which set forth, the principal terms of such acquisition, subject only to the execution of formal documents evidencing the acquisition and to customary closing conditions.

SEC. 4. *Rules and regulations.* The Secretary of the Treasury or his delegate is authorized to prescribe from time to time regulations, rulings, directions, and instructions to carry out the purposes of this order.

SEC. 5. *Effective date.* This order shall become effective upon its filing for publication in the FEDERAL REGISTER.

SEC. 6. *Supersedure of Executive Order No. 11224.* The Executive Order No. 11224, dated May 13, 1965, is hereby superseded.

LYNDON B. JOHNSON

THE WHITE HOUSE,

June 10, 1966.

[F.R. Doc. 66-6534; Filed, June 10, 1966; 12:23 p.m.]

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 5732
December 3, 1965]

1966 Guidelines for Banks and Nonbank Financial Institutions
Under the President's Balance of Payments Program

*To All Banks and Other Financial Institutions
in the Second Federal Reserve District:*

The following statement was issued by the Board of Governors of the Federal Reserve System and released for publication in morning newspapers, Monday, December 6:

December 3, 1965

The Board of Governors of the Federal Reserve System today issued new guidelines for financial institutions to follow during 1966 in cooperating with the President's program to improve the Nation's balance of payments.

For the year 1966 the guidelines for both banks and nonbank financial institutions have been revised to suggest limitations on expansion of foreign credits which are comparable to the limitations suggested for 1965, but with variations to remove certain inequities inherent in the 1965 program.

The basic feature of the guidelines for 1965 has been a percentage limitation on increases in foreign credits from the base date of December 31, 1964. In general, each bank was requested to restrict its foreign credits outstanding to an amount not in excess of 105 per cent of the amount outstanding at the end of 1964, and each nonbank financial institution was requested to operate within a framework roughly comparable with that suggested for banks.

Although the banking system as a whole has stayed well under the suggested ceiling for 1965, some further expansion has been provided for in the 1966 program for two reasons: (1) it is believed that banks will continue to cooperate with the spirit as well as the letter of the program and will utilize the expansion suggested only to the extent needed to meet priority credit requirements; and (2) it is intended to make certain that export financing is available in adequate amounts, and that the bona fide credit needs of less developed countries will continue to be met.

Under the 1966 program, commercial banks are requested to restrain any expansion in foreign credits to such an extent that the amount outstanding does not exceed 109 per cent of the amount outstanding on December 31, 1964. Further, in order to spread throughout the year any outflow necessary to meet priority credit requirements, it is requested that the expansion be utilized at a rate of not more than one per cent per calendar quarter; that is, the target would be 106 per cent of the 1964 base during the first quarter, 107 per cent during the second, 108 per cent during the third, and 109 per cent for the remainder of the year. Special consideration for banks with small bases will add about one per cent to the total, bringing the possible expansion for 1966 for the banking system as a whole to about the same amount as that provided for 1965.

The 1966 guidelines for nonbank financial institutions have been made broadly comparable with those of the bank guidelines. But the foreign financial assets of such institutions continue to be classified into three groups — liquid funds, investments and credits maturing in 10 years or less and in financial subsidiaries, and long-term investments — each subject in whole or part to a guideline ceiling. In some cases the guidelines for 1966 are based on outstanding amounts at September 30, 1965, where the use of a December 1964 base might be inequitable to individual institutions.

The priorities established by the 1965 guidelines remain in effect; i.e., an absolute priority for bona fide export credits, and highest priority in nonexport loans to credit to less developed countries.

The Board expressed its appreciation for the cooperation of the financial institutions since February 10, 1965, and its confidence in the continued cooperation of the banks and other financial institutions — so essential to the success of the President's balance of payments program.

Copies of the new guidelines are being made available through the Federal Reserve Banks. Banks and other financial institutions having questions concerning their application are urged to consult with the Federal Reserve Bank of their District.

Following is the text of the guidelines:

THE 1966 VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM FOR FINANCIAL INSTITUTIONS

Preface

Since inception of the voluntary foreign credit restraint effort, immediately following announcement by the President of his balance of payments program in February 1965, commercial banks and other financial institutions have contributed substantially to the improvement in the Nation's payments position. This has been accomplished by the high degree of cooperation and statesmanship exhibited by the financial community in restraining the growth of (and in some instances reducing) claims on foreigners in accordance with guidelines issued by the Board of Governors of the Federal Reserve System.

Although considerable progress has been made and although the voluntary restraint program is temporary in nature, perseverance by financial institutions in the program through 1966 is necessary to attain the goal of equilibrium in the Nation's balance of payments and represents the appropriate response to the President's message of February 10, 1965, in which he issued a personal "call on American businessmen and bankers to enter a constructive partnership with their Government to protect and strengthen the position of the dollar in the world today."

The main feature of the guidelines for 1965 has been a percentage limitation on increases in foreign credits from the base date of December 31, 1964. In general, each bank was requested to restrict its foreign credits outstanding to an amount not in excess of 105 per cent of the amount outstanding at the end of 1964, and each nonbank financial institution was requested to operate within a framework roughly similar to that suggested for banks.

For the year 1966 the guidelines for both banks and nonbank financial institutions have been revised to suggest limitations on expansion of foreign credits which are comparable to the limitations suggested for 1965. These will permit some further expansion in such credits, and provide for variations to remove certain inequities inherent in the 1965 program.

Notwithstanding the fact that the banking system as a whole is presently well below the suggested target for 1965, this additional expansion has been allowed for two reasons: (1) it is believed that banks will continue to cooperate with the spirit as well as the letter of the program and will utilize the expansion suggested only to the extent needed to meet priority credit requirements; and (2) it is intended to make certain that export financing is available in adequate amounts, and that the bona fide credit needs of less developed countries will continue to be met.

Continued restraint on the increase in foreign credits is the basic objective of the bank program for 1966. Generally speaking, commercial banks are requested to restrain any expansion in foreign credits to such an extent that the amount outstanding at year-end will not exceed 109 per cent of the amount outstanding on December 31, 1964. Further, in order to spread throughout the year any outflow necessary to meet priority credit requirements, it is requested that the amount outstanding not exceed 106 per cent of the 1964 base during the first quarter, 107 per cent during the second, and 108 per cent during the third quarter. Special consideration for banks with small bases will add one per cent or less to the total, bringing the potential amount outstanding at the end of 1966 for the banking system as a whole to about 110 per cent of the 1964 base as compared with the 105 per cent target for 1965.

The guidelines for 1966 for nonbank financial institutions have been revised to reflect provisions broadly comparable with those of the bank guidelines. Investments of liquid funds abroad are to be held to minimum practicable levels and ordinarily should not be permitted to exceed the reduced September 30, 1965 total. Investments in credits maturing in 10 years or less and in foreign branches and financial subsidiaries are subject to the same ceiling as suggested for the banks. Long-term investments in developed countries other than Canada and Japan are subject to a ceiling of 105 per cent of the September 30, 1965 amounts during 1966; this base was selected because retroactive use of a 1964 year-end base might have been inequitable for some institutions.

As in 1965, financial institutions are requested to give priority to export credits and credits to less developed countries. In instances where the special base and ceiling calculations for banks with small bases result in a ceiling in excess of 109 per cent, it is requested that the amount in excess of 109 per cent of a bank's base be used exclusively for such priority credits. The leeway for additional foreign credits provided by the 1966 guidelines plus the funds available from repayments on outstanding credits will provide larger resources than last year to finance an expanded volume of exports and to satisfy credit requirements of less developed countries.

The guidelines for banks and nonbank financial institutions follow.

(1) Base, ceiling, and reporting

(A) *Base*

1. The base is a bank's total claims on foreigners for own account, including foreign long-term securities, on December 31, 1964, except for the exclusion in (A)3 below.

2. Meaning of terms:

(a) "Foreigners" include individuals, partnerships, and corporations domiciled outside the United States, irrespective of citizenship, except their agencies or branches within the United States; branches, subsidiaries, and affiliates of United States banks and other United States corporations that are located in foreign countries; and any government of a foreign country or official agency thereof and any official international or regional institution created by treaty, irrespective of location.

(b) "Long-term securities" are those issued without a contractual maturity or with an original maturity of more than one year from the date of issuance.

(c) "Other claims" include all long-term claims other than securities, real assets, net investment in and advances to foreign branches and subsidiaries, and all short-term claims (such as deposits, money-market instruments, customers' liability on acceptances, and loans).

3. Specific inclusions and exclusions:

(a) Claims on foreigners should be included without deduction of any offsets. Foreign customers' liability for acceptances executed should be included whether or not the acceptances are held by the reporting bank. Participations purchased in loans to foreigners (except participations in loans extended by the Export-Import Bank) also should be included.

(b) Contingent claims, unutilized credits, claims held for account of customers, acceptances executed by other United States banks, and participations in loans arranged by or guaranteed by the Export-Import Bank or insured by the Foreign Credit Insurance Association should be excluded.

(B) *Ceiling*

1. The 1966 ceilings with respect to the amount of foreign credits outstanding by a bank with a base of $5 million or more are as follows:

(a) In the first calendar quarter, 106 per cent of its base;

(b) In the second calendar quarter, 107 per cent of its base;

(c) In the third calendar quarter, 108 per cent of its base;

(d) In the fourth calendar quarter, 109 per cent of its base.

2. In lieu of the ceiling prescribed in (B)1 above, a bank with a base of $500,000 but less than $5 million, may use the following special ceiling:

(a) In the first calendar half, its base plus $225,000;

(b) In the second calendar half, its base plus $450,000.

3. The ceiling for a bank with a base below $500,000 is 150 per cent of its base. However, any such bank, or a bank which had no foreign credits outstanding on December 31, 1964, may discuss with the Federal Reserve Bank of the Reserve District in which it is located the possibility of adopting a ceiling that would permit expansion up to $450,000 above the bank's base.

4. In discussing the ceiling of a bank described in paragraph (B)3, the Federal Reserve Bank will ascertain the bank's previous history in foreign transactions, including acceptance of foreign deposits or handling foreign collections, and the reasons why the bank considers it should have additional leeway. Prior to a decision, the Federal Reserve Bank will obtain clearance from the Board of Governors.

5. Any expansion under paragraph (B)2 or (B)3 that is in excess of 109 per cent of the bank's base should be limited to loans or acceptance credits that finance exports of U. S. goods or services or that represent credit extended to less developed countries. Export credits should be limited to transactions originated by the bank's regular customers or by residents of its normal trade territory. Such expansion should not involve (a) participations in loans originated by other banks or purchases of such loans, (b) investments in foreign securities, (c) deposits in foreign banks, or (d) investments in foreign short-term money market instruments.

(C) *Reporting*

1. Banks that report on Treasury Foreign Exchange Form B–2 or B–3 should file a monthly report on foreign claims (Form FR 391) with the Federal Reserve Bank of the Reserve District in which the bank is located.

2. Banks tha[illegible] claims on foreigners in an amount of [illegible]0 or more and do not report on Treasury Foreign Exchange Form B–2 or B–3 should file a quarterly report on foreign claims (Form FR 391A) with the Federal Reserve Bank of the Reserve District in which the bank is located.

3. Copies of Forms FR 391 and 391A are available at the Reserve Banks.

(2) Loans involving Export-Import Bank

Participations in individual export loans arranged by the Export-Import Bank, loans with Export-Import Bank guarantees or insurance, and holdings of "Export-Import portfolio fund" participations are excluded from the ceiling. The role of the Export-Import Bank within the framework of the President's program is coordinated by the National Advisory Council for International Monetary and Financial Problems.

(3) Credits in excess of ceiling

A bank would not be considered as acting in a manner inconsistent with the program if it at times exceeds its ceiling as a result of the (a) draw-down of binding commitments entered into before February 11, 1965; or (b) extension of priority export credits.

The bank should, however, reduce its claims on foreigners to an amount within the ceiling as quickly as possible. It should also take every opportunity to withdraw or reduce commitments, including credit lines, that are not of a firm nature and to assure that drawings under credit lines are kept to normal levels and usage. At time of renewal, each credit line should be reviewed for consistency with the program.

A bank whose foreign credits are in excess of the ceiling will be invited periodically to discuss with the appropriate Federal Reserve Bank the steps it has taken and proposes to take to reduce its credits to a level within its ceiling.

(4) Loan priorities

Within the ceiling, absolute priority should be given to bona fide export credits. Credits that substitute for cash sales or for sales customarily financed out of nonbank or foreign funds are not entitled to priority.

With respect to nonexport credits, banks should give the highest priority to loans to less developed countries and should avoid restrictive policies that would place an undue burden on Canada, Japan, and the United Kingdom.

It is expected that the outstanding amount of nonexport credits to developed countries in continental Western Europe would not be increased during 1966 but rather would be reduced to the extent needed to meet bona fide requests for priority credits within the overall ceiling.

Without attempting to specify all types of loans that should be restricted, it is obvious that credits to developed countries that can be cut back with benefit to our balance of payments and with the least adverse side-effects include: credits to finance third-country trade; credits to finance local currency expenditures outside the United States; credits to finance fixed or working capital needs; and all other nonexport credits to developed countries that do not suffer from balance of payments difficulties.

(5) Banks whose foreign credits consist almost entirely of export credits

A bank whose foreign credits are consistently composed almost entirely of export credits usually should keep its credits within its ceiling. If such a bank exceeds its ceiling from time to time, it would not be considered as acting in a manner inconsistent with the program if the amount of such excess is reasonable and the bank makes every effort to bring the amount of its credits back within the ceiling at the earliest practicable date.

(6) Trust departments

Trust departments of commercial banks should follow the guidelines with respect to nonbank financial institutions.

(7) Transactions for the account of customers

A bank should bear in mind the President's balance of payments program when acting for the account of a customer. Although the bank must follow a customer's instructions, it should not encourage customers to place liquid funds outside the United States. A bank should not place with a customer foreign obligations that, in the absence of the voluntary credit restraint program, it would have acquired or held for its own account.

(8) Foreign branches

The voluntary credit restraint program is not designed to restrict the extension of foreign credits by foreign branches if the funds utilized are derived from foreign sources and do not add to the outflow of capital from the United States.

Total claims of a bank's domestic offices on its foreign branches (including permanent capital invested in as well as balances due from such branches) represent bank credit to nonresidents for the purposes of the program.

(9) "Edge Act" corporations

"Edge Act" corporations and "agreement" corporations are included in the voluntary credit restraint program. Foreign loans and investments of such corporations may be combined with those of the parent bank or a separate ceiling may be adopted for the parent bank and each such subsidiary corporation. If such corporation is owned by a bank holding company, its foreign loans and investments may be combined for purposes of the program with any one or all of the banks in the holding company group.

An "Edge Act" corporation established before February 10, 1965, that had not made any significant volume of loans and investments before December 31, 1964, may take as a base, alone and not in combination with its parent, its paid-in capital and surplus, up to $2.5 million.

(10) United States branches and agencies of foreign banks

Branches and agencies of foreign banks located in the United States are requested to act in accordance with the spirit of the domestic commercial bank voluntary credit restraint program.

(11) Loans to United States residents and substitution of domestic credit for credit from foreign sources

There are a number of situations in which loans to domestic customers may be detrimental to the President's balance of payments program. These include:

(a) Loans to U. S. companies which will aid the borrower in making new foreign loans or investments inconsistent with the President's program. Banks should avoid making new loans that would directly or indirectly enable borrowers to use funds abroad in a manner inconsistent with the Department of Commerce program or with the guidelines for nonbank financial institutions.

(b) Loans to U. S. subsidiaries and branches of foreign companies which otherwise might have been made by the bank to the foreign parent or other foreign affiliate of the company or which normally would have been obtained abroad.

(c) Loans to U. S. companies with foreign activities which take the place of credit normally obtained abroad. Even though such loans are made to domestic firms or those domiciled here, the impact on the U. S. balance of payments is the same as if the bank had made loans to foreigners in the first instance.

To the extent possible, banks should also avoid making loans to domestic borrowers which have an effect similar to that of the loans described in paragraphs (b) and (c).

(12) Management of a bank's liquid funds

A bank should not place its own funds abroad for short-term investment purposes, whether such investments are payable in foreign currencies or in United States dollars. This does not, however, call for a reduction in necessary working balances held with foreign correspondents.

Guidelines for Nonbank Financial Institutions

The types of financial institutions to which these guidelines on foreign lending and investing are applicable include domestic life, fire and casualty insurance companies; corporate noninsured pension funds and State-local retirement systems; mutual savings banks, mutual funds and investment companies; consumer sales and commercial finance companies; college endowment funds and charitable foundations. Also covered by the program are the United States branches of foreign insurance companies and of other foreign financial corporations. Trust companies and trust departments of commercial banks are expected to observe the guidelines in the investment of funds entrusted to them or for which they serve as investment advisor. Investment underwriting firms, security brokers and dealers and investment counseling firms are also covered with respect to foreign assets held for their own account, and are requested to inform customers of the guidelines and to enlist their support in cooperating with the President's program.

Any nonbank financial institution holding \$500,000 or more in foreign loans, investments, or other foreign financial assets is requested to file a statistical report (Form FR 392) at the close of each calendar quarter with the Federal Reserve Bank of the Reserve District in which its principal office is located. Lending institutions not receiving copies of the reporting form may obtain them from the Federal Reserve Bank.

1. *Investment of liquid funds abroad should be reduced to minimum practicable levels consistent with the operating needs of the institution. Such holdings ordinarily should not be permitted to exceed the September 30, 1965 total, except for temporary seasonal excesses.*

This category includes all deposits held with foreign banks or foreign branches of U. S. banks, whether denominated in U. S. dollars or a foreign currency and regardless of maturity. It also includes all liquid money market claims on foreign obligors with an original maturity of one year or less, whether such claims are denominated in U. S. dollars or a foreign currency. The term "liquid money market claims" is interpreted broadly to include the securities of governments and their instrumentalities, commercial paper, finance company paper, bankers' acceptances and other readily marketable paper. This guideline is not applicable to short-term business credits that are not readily marketable (covered under Guideline 2).

2. *Investments and credits maturing in 10 years or less at date of acquisition are subject to a percentage guideline based on the total of such holdings at the end of 1964. The aggregate amount of these investments, and of net financial investment in foreign branches, financial subsidiaries and affiliates (described below), should not exceed 105 per cent of the 1964 base date amount as of the end of 1965, and should not exceed 106 per cent of the base date amount during the first quarter of 1966, 107 per cent during the second quarter, 108 per cent during the third quarter, and 109 per cent in the final quarter of the year.*

This category includes all bonds, notes, mortgages, loans, and other credits carrying maturities at date of acquisition of 10 years or less. The date of final maturity is to be taken in classifying individual credit transactions, except that a credit transaction should not be classified as "long term" (and hence subject to Guideline 3 below) unless 10 per cent or more of the amount to be repaid is scheduled to be repaid after 10 years. Loans guaranteed or arranged by the Export-Import Bank or insured by the Foreign Credit Insurance Association are not to be considered foreign credits for purposes of this program.

Net financial investment in foreign branches, financial subsidiaries and affiliates, if any, is included among the assets subject to the percentage ceilings of this guideline. Such financial investment includes payments into equity and other capital accounts of, and net loans and advances to, foreign corporations engaged principally in finance, insurance or real estate activities, in which the U. S. institution has an ownership interest of 10 per cent or more. Earnings of a foreign affiliate that are reinvested in the business are not included among assets subject to the guideline ceiling, although institutions are requested to repatriate such earnings to the fullest extent feasible.

In administering restraint in foreign lending and investing, institutions are requested to observe the following priorities or guides: (1) Credits and investments that represent bona fide U. S. export financing should receive absolute priority; (2) nonexport credits and investments in the less developed countries, and investments in the securities of international institutions, are to be given priority consideration second only to bona fide export financing; (3) the flow of investment funds to Canada and Japan, which are heavily dependent on U. S. capital markets, need be restricted only to the extent necessary to remain under the guideline ceiling.

It is recognized that some individual institutions may temporarily exceed the guideline ceiling, because of investments made under the first two priorities above, or the taking down of firm commitments to lend or invest entered into prior to June 22, 1965, the effective date of the previous guidelines. In any such case, an institution that exceeds its target should consult with the Federal Reserve Bank of the Reserve District in which it is located regarding a program for moving back within the ceiling in a reasonable period of time.

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3. *Long-term credits (exceeding 10 years in maturity) and stock investments in foreign companies are not subject to an aggregate ceiling for 1966.*

This category includes bonds, notes, mortgages, loans, and other credits maturing more than 10 years after date of acquisition, as well as preferred and common stocks. (Loans and investment in certain subsidiaries and affiliates, however, are covered by Guideline 2.) Term loans and serial-payment notes and bonds are included in this category only if 10 per cent or more of the total amount of the credit is scheduled for repayment to the lender after 10 years beyond date of acquisition.

No percentage ceiling is suggested on long-term credits and investments in the priority categories relating to export financing and to less developed countries (including international institutions) as described in Guideline 2. Long-term investment in Canada and Japan also is not subject to a percentage ceiling, in view of intergovernmental agreements affecting the net amount of financing done by these countries in U. S. financial markets. Lending institutions are requested, however, to limit in 1966 the total of credits and investments in other developed countries to an amount not in excess of 105 per cent of the amount of such holdings on September 30, 1965. Within this category, institutions are expected to avoid any increase in long-term investments in the developed countries of continental Western Europe.

The attention of lending institutions is directed to the need to refrain from making loans and investments inconsistent with the President's balance of payments program. Among these are the following: (1) long-term credits covered by Guideline 3 which substitute for loans that commercial banks would have made in the absence of the voluntary foreign credit restraint effort administered by the Federal Reserve System; (2) credits to U. S. borrowers which would aid in making new foreign loans or investments inconsistent with the voluntary restraint program administered by the Department of Commerce; (3) credits to U. S. subsidiaries and branches of foreign companies which otherwise might have been made to the foreign parent, or which would substitute for funds normally obtained from foreign sources; (4) credits to U. S. companies with foreign activities which would take the place of funds normally obtained abroad. Reasonable efforts should be made to avoid accommodating credit request of these types, regardless of specific guideline targets detailed in this circular.

Notes to guidelines for banks and nonbank financial institutions. None of the guidelines in this circular is intended to apply to the reinvestment of reserves on insurance policies sold abroad in assets within the country involved, in amounts up to 110 per cent of such reserves.

Developed countries other than Canada and Japan are: Abu Dhabi, Australia, Austria, the Bahamas, Bahrein, Belgium, Bermuda, Denmark, France, Germany (Federal Republic), Hong Kong, Indonesia, Iran, Iraq, Ireland, Italy, Kuwait, Libya, Liechtenstein, Luxembourg, Monaco, Netherlands, Neutral Zone, New Zealand, Norway, Portugal, Qatar, Republic of South Africa, San Marino, Saudi Arabia, Spain, Sweden, Switzerland, and the United Kingdom.

Also to be considered "developed" are the following countries within the Sino-Soviet bloc: Albania, Bulgaria, any part of China which is dominated or controlled by International Communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by International Communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Soviet Zone of Germany and the Soviet Sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics, and any part of Vietnam which is dominated or controlled by International Communism.

Our Foreign Department (Telephone Extension 1000) will be pleased to confer with you on any problems that may arise under the guidelines.

Additional copies of this circular will be furnished upon request.

ALFRED HAYES,
President.

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 5916
December 13, 1966]

1967 Guidelines for Banks and Nonbank Financial Institutions
Under the President's Balance of Payments Program

*To All Banks and Other Financial Institutions
in the Second Federal Reserve District:*

The following statement was made public today by the Board of Governors of the Federal Reserve System:

> The Board of Governors of the Federal Reserve System today issued new guidelines, effective immediately, for financial institutions cooperating with the President's voluntary program to improve the Nation's balance of payments.
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> The new bank guidelines are in substantially the same form as those in use since 1965. The December 1964 base is retained, as is the present ceiling of 109 per cent of that base. However, banks are requested to limit the use of their leeway as of September 30, 1966 to a rate not exceeding 20 per cent thereof per quarter beginning with the fourth quarter of 1966.
>
> Moreover, banks are requested to limit the increase in nonpriority credits (credits other than those that finance exports or that meet credit needs of developing countries) over the amount outstanding on September 30, 1966, to 10 per cent of the total possible expansion, or to about $120 million. This change is designed to give added stimulus to priority credits by suggesting a quantitative limit for nonexport credits to developed countries.
>
> The program for nonbank financial institutions has been greatly simplified. The three guidelines used in the 1966 program are replaced by a single guideline, which permits an increase of 5 per cent during the 15 months ending December 31, 1967 in assets covered by that guideline. "Covered" assets are redefined to exclude certain types of assets previously subject to target ceilings; for example, bonds of the International Bank for Reconstruction and Development and of the Inter-American Development Bank.
>
> In announcing the new guidelines, the Board expressed its appreciation for the cooperation of banks and other financial institutions since the program was inaugurated in February 1965, as well as its confidence that the Nation can continue to count on the cooperation of these institutions.
>
> Copies of the new guidelines are attached. They are being made available to financial institutions through the Federal Reserve Banks. Banks and other financial institutions having questions concerning the application of the new guidelines are urged to consult with the Federal Reserve Bank of their District.

The text of the new guidelines is printed on the following pages.

Our Foreign Department (Telephone Extension 1000) will be pleased to confer with you on any questions regarding the guidelines. Questions on the reports to be filed under the guidelines should be addressed to our Balance of Payments Division (Telephone Extension 2000).

Additional copies of this circular will be furnished upon request.

Alfred Hayes,
President.

BALANCE OF PAYMENTS PROGRAM

Revised Guidelines for Banks and Nonbank Financial Institutions

During 1966, as in 1965, commercial banks and other financial institutions cooperated admirably in the President's voluntary foreign credit restraint program and contributed substantially toward the correction of the disequilibrium in the international payments of the United States. Foreign credits of commercial banks were actually reduced by $508 million in the first ten months of 1966, with the result that the commercial banks are under the 1966 guideline ceiling by more than $1.2 billion. Nonbank financial institutions reduced their foreign assets subject to the guidelines by $321 million in the first three quarters of this year. Total foreign investments of these institutions in this period declined by $46 million. Long-term investment in Canada and in less developed countries increased, but much less than in 1965.

Despite this record the balance of payments continues to be a serious national problem. Therefore, it is necessary to continue, and in some respects to intensify, the voluntary effort to restrain the outflow of private capital. Accordingly, the Board of Governors of the Federal Reserve System has revised the guidelines for financial institutions as set out hereinafter.

The 1967 Program for Commercial Banks

The 1967 ceiling for commercial banks will remain at 109 per cent of the 1964 base. No increase is provided in view of the fact that as of October 1, 1966, there existed a potential leeway for an outflow of bank credit in excess of $1.2 billion. However, each commercial bank is requested to limit the use of its existing leeway so that it does not use more than 40 per cent thereof before March 31, 1967, more than 60 per cent before June 30, 1967, and more than 80 per cent before September 30, 1967.

Furthermore, each bank is requested not to use more than 10 per cent of its leeway to expand nonexport credits to developed countries between October 1, 1966, and December 31, 1967. For all banks combined, this would permit a maximum expansion of nonexport credits to developed countries of about $120 million.

In order to give a relatively larger leeway to smaller banks so as to enable them more easily to extend export financing, banks with an original base between $500,000 and $10 million, in calculating their leeway, are authorized to use, instead of 109 per cent of their 1964 base, the amount of that base plus $900,000.

This revision in the guidelines, effective as of October 1, 1966, is designed to give a further stimulus to banks to direct their foreign credits toward export financing and the financing of the less developed countries.

The 1967 Program for Nonbank Financial Institutions

Substantial changes are being made in the voluntary foreign credit restraint program for nonbank financial institutions in order to simplify both reporting under the program and the guidelines with which the institutions are requested to comply. The three different guidelines used in the 1966 program are replaced with a single guideline, which permits an increase of 5 per cent over the 15 months from October 1, 1966, through December 31, 1967. Covered assets are redefined to exclude certain types of assets previously subject to target ceilings.

The group of covered institutions includes trust companies and trust departments of commercial banks, mutual savings banks, insurance companies, investment companies, finance companies, employee retirement and pension funds, college endowment funds, and charitable foundations. Also included are the U. S. branches of foreign insurance companies and of other foreign nonbank financial corporations. Investment underwriting firms, securities brokers and dealers, and investment counseling firms also are covered with respect to foreign financial assets held for their own account, and are requested to inform their customers of the program in those cases where it appears applicable.

Guidelines for Banks

1. Base, Ceiling, and Reporting

A. *Base*

(1) The base is a bank's total claims on foreigners for own account, including foreign long-term securities, on December 31, 1964, except for the exclusions in A(3)(b) below.

(2) Meaning of terms:

(a) "Foreigners" include individuals, partnerships, and corporations domiciled outside the United States, irrespective of citizenship, except their agencies or branches within the United States; branches, subsidiaries, and affiliates of U. S. banks and other U. S. corporations that are located in foreign countries; and any government of a foreign country or official agency thereof and any official international or regional institution created by treaty, irrespective of location.

(b) "Foreign long-term securities" are those issued without a contractual maturity or with an original maturity of more than one year from the date of issuance.

(c) "Other claims" include all long-term claims other than securities, real assets, net investment in and advances to foreign branches and subsidiaries, and all short-term claims (such as deposits, money market instruments, customers' liability on acceptances, and loans).

(d) "Leeway" means the difference between the ceiling for 1967 as described in B below and the amount of foreign credits outstanding on September 30, 1966.

(e) "Nonexport credit" means a foreign credit other than one that arises directly out of the financing of U. S. exports of goods or services.

(f) "Developed countries" are Abu Dhabi, Australia, Austria, the Bahamas, Bahrain, Belgium, Bermuda, Canada, Denmark, France, Germany (Federal Republic), Hong Kong, Iran, Iraq, Ireland, Italy, Japan, Kuwait, Kuwait-Saudi Arabia Neutral Zone, Libya, Liechtenstein, Luxembourg, Monaco, Netherlands, New Zealand, Norway, Portugal, Qatar, Republic of South Africa, San Marino, Saudi Arabia, Spain, Sweden, Switzerland, and the United Kingdom. Also to be considered "developed" are the following countries within the Sino-Soviet bloc: Albania, Bulgaria, any part of China which is dominated or controlled by international communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by international communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Soviet Zone of Germany and the Soviet sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics and any part of Viet Nam that is dominated or controlled by international communism.

Indonesia missing (was included in list of Dec 3 1965 circular 5732.)

(3) Specific inclusions and exclusions:

(a) Claims on foreigners should be included without deduction of any offsets. Foreign customers' liability for acceptances executed should be included whether or not the acceptances are held by the reporting bank. Participations purchased in loans to foreigners (except participations in loans extended by the Export-Import Bank) also should be included.

(b) Contingent claims, unutilized credits, claims held for account of customers, acceptances executed by other U. S. banks, and participations in loans arranged by or guaranteed by the Export-Import Bank or insured by the Foreign Credit Insurance Association should be excluded.

B. *Ceiling*

(1) The 1967 ceiling with respect to the amount of foreign credits outstanding by a bank with a base of $10 million or more is 109 per cent of its base. In lieu of a ceiling of 109 per cent of its base, a bank with a base of $500,000 but less than $10 million shall use as a ceiling for 1967 its base plus $900,000.

However, all banks are requested to limit their outstanding foreign credits:

(a) During the fourth quarter of 1966 and the first quarter of 1967, to an amount not in excess of the amount outstanding on September 30, 1966, plus 40 per cent of the leeway.

(b) During the second quarter of 1967, to an amount not in excess of the amount outstanding on September 30, 1966, plus 60 per cent of the leeway.

(c) During the third quarter of 1967, to an amount not in excess of the amount outstanding on September 30, 1966, plus 80 per cent of the leeway.

(2) The ceiling for a bank with a base below $500,000 is 150 per cent of its base. However, any such bank, or a bank which had no foreign credits outstanding on December 31, 1964, may discuss with the Federal Reserve Bank of the Reserve district in which it is located the possibility of adopting a ceiling that would permit expansion up to $900,000 above the bank's base.

In discussing the ceiling of such a bank, the Federal Reserve Bank will ascertain the bank's previous history in foreign transactions, including acceptance of foreign deposits or handling foreign collections, and the reasons why the bank considers it should have additional leeway.

(3) Within the limitations specified in paragraphs 1 and 2, all banks are requested to limit their nonexport credits to developed countries so that the amount of such credits outstanding will not, at any time between October 1, 1966, and December 31, 1967, exceed the amount of such credits outstanding on September 30, 1966, plus 10 per cent of the leeway.

C. *Reporting*

(1) Banks that report on Treasury Foreign Exchange Form B-2 or B-3 or that have been granted a special ceiling under paragraph B(2) should file a Monthly Report on Foreign Claims

(Form FR 391) with the Federal Reserve Bank of the Reserve district in which the bank is located.

(2) Copies of Form FR 391 are available at the Reserve Banks.

2. Loans involving Export-Import Bank

Loans guaranteed or arranged by the Export-Import Bank or insured by the Foreign Credit Insurance Association are excluded from the ceiling. The role of the Export-Import Bank within the framework of the President's program is coordinated by the National Advisory Council for International Monetary and Financial Policies.

3. Credits in excess of ceiling

A bank would not be considered as acting in a manner inconsistent with the program if it at times exceeds its ceiling as a result of the (a) drawdown of binding commitments entered into before December 12, 1966, or (b) extension of bona fide export credits.

The bank should, however, reduce its claims on foreigners to an amount within the ceiling as quickly as possible. It should also take every opportunity to withdraw or reduce commitments, including credit lines, that are not of a firm nature and to assure that drawings under credit lines are kept to normal levels and usage. At time of renewal, each credit line should be reviewed for consistency with the program.

A bank whose foreign credits are in excess of the ceiling will be invited periodically to discuss with the appropriate Federal Reserve Bank the steps it has taken and proposes to take to reduce its credits to a level within its ceiling.

4. Loan priorities

Within the ceiling, absolute priority should be given to bona fide export credits. Credits that substitute for cash sales or for sales customarily financed out of nonbank or foreign funds are not entitled to priority.

With respect to nonexport credits, banks should give the highest priority to loans to less developed countries and should avoid restrictive policies that would place an undue burden on Canada, Japan, and the United Kingdom.

It is expected that the outstanding amount of nonexport credits to developed countries in Continental Western Europe will not be increased during 1967 unless a bank is in a position to meet all bona fide requests for priority credits within the overall ceiling.

5. Trust departments

Trust departments of commercial banks should follow the guidelines with respect to nonbank financial institutions.

6. Transactions for the account of customers

A bank should bear in mind the President's balance of payments program when acting for the account of a customer. Although the bank must follow a customer's instructions, it should not encourage customers to place liquid funds outside the United States. A bank should not place with a customer foreign obligations that, in the absence of the voluntary credit restraint program, it would have acquired or held for its own account.

7. Foreign branches

The voluntary credit restraint program is not designed to restrict the extension of foreign credits by foreign branches if the funds utilized are derived from foreign sources and do not add to the outflow of capital from the United States.

Total claims of a bank's domestic offices on its foreign branches (including permanent capital invested in as well as balances due from such branches) represent bank credit to nonresidents for the purposes of the program.

8. "Edge Act" corporations

"Edge Act" and "Agreement" corporations are included in the voluntary credit restraint program. Foreign loans and investments of such corporations may be combined with those of the parent bank or a separate ceiling may be adopted for the parent bank and each such subsidiary corporation. If such corporation is owned by a bank holding company, its foreign loans and investments may be combined for purposes of the program with any one or all of the banks in the holding company group.

An "Edge Act" corporation established before February 10, 1965, that had not made any significant volume of loans and investments before December 31, 1964, may take as a base, alone and not in combination with its parent, its paid-in capital and surplus, up to $2.5 million.

9. U.S. branches and agencies of foreign banks

Branches and agencies of foreign banks located in the United States are requested to act in accordance with the spirit of the domestic commercial bank voluntary credit restraint program.

10. Loans to U. S. residents and substitution of domestic credit for credit from foreign sources

There are a number of situations in which loans to domestic customers may be detrimental to the President's balance of payments program and hence should be avoided. Examples are:

(a) Loans to U. S. companies which will aid the borrower in making new foreign loans or investments inconsistent with the President's program. Banks should avoid making new loans that would directly or indirectly enable borrowers to use funds abroad in a manner inconsistent with the Department of Commerce program or with the guidelines for nonbank financial institutions.

(b) Loans to U. S. subsidiaries and branches of foreign companies which otherwise might have been made by the bank to the foreign parent or other foreign affiliate of the company, or which normally would have been obtained abroad.

11. Management of a bank's liquid funds

A bank should not place its own funds abroad for short-term investment purposes, whether such investments are payable in foreign currencies or in U. S. dollars. This does not, however, call for a reduction in necessary working balances held with foreign correspondents.

Guidelines for Nonbank Financial Institutions

For calendar 1967, each institution is requested to limit its aggregate holdings of "covered" foreign financial assets to not more than 105 per cent of its "base date" holdings. Thus there is only one guideline applicable to all "covered" foreign assets, rather than the three different guidelines used in the 1966 program. Covered foreign assets are defined below.

"Base date" holdings, on which the 105 per cent ceiling is based, are defined as the lesser of (1) total holdings of covered foreign assets as of September 30, 1966, or (2) the amounts of covered foreign assets that could have been held as of September 30, 1966, in compliance with the guideline ceilings established by the 1966 voluntary program. Base date holdings are to be reduced in subsequent quarters, however, to the extent that equity securities of companies domiciled in developed countries[1] (except Canada and Japan), and included in the current base, are sold to American investors. For institutions previously reporting under the program, the Federal Reserve Banks will calculate current base date holdings as indicated by the reports on file and communicate that calculation to the institutions.

Covered foreign financial assets, subject to the guideline ceiling, include the following types of investments:

1. Foreign bank deposits, including deposits in foreign branches of U. S. banks, and liquid money market claims on foreign obligors, generally defined to include marketable negotiable instruments maturing in 1 year or less.

2. All other claims on foreign obligors written to mature in 10 years or less at date of acquisition. This category includes all bonds, notes, mortgages, loans and other credits, regardless of country of origin. Excluded are bonds and notes of international institutions of which the United States is a member, and loans guaranteed or arranged by the Export-Import Bank or insured by the Foreign Credit Insurance Association.

3. Net financial investment in foreign branches, financial subsidiaries and affiliates located in developed countries[1] other than Canada and Japan. Such financial investment includes payments into equity and other capital accounts of, and net loans and advances to, foreign corporations engaged principally in finance, insurance or real estate activities, in which the U. S. institution has an ownership interest of 10 per cent or more. Excluded are earnings of a foreign affiliate directly retained in the capital accounts of the foreign corporation.

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[1] *Developed countries other than Canada and Japan.* Continental Western Europe includes: Austria, Belgium, Denmark, France, Germany (Federal Republic), Italy, Liechtenstein, Luxembourg, Monaco, Netherlands, Norway, Portugal, San Marino, Spain, Sweden, and Switzerland. Other developed countries are: Abu Dhabi, Australia, the Bahamas, Bahrain, Bermuda, Hong Kong, Iran, Iraq, Ireland, Kuwait, Kuwait-Saudi Arabia Neutral Zone, Libya, New Zealand, Qatar, Republic of South Africa, Saudi Arabia, and the United Kingdom. Also to be considered "developed" are the following countries within the Sino-Soviet bloc: Albania, Bulgaria, any part of China which is dominated or controlled by international communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by international communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Sovet Zone of Germany and the Soviet sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics and any part of Viet Nam that is dominated or controlled by international communism.

4. Long-term credits of foreign obligors domiciled in developed countries[1] other than Canada and Japan. Included in this category are bonds, notes, mortgages, loans and other credits maturing more than 10 years after date of acquisition. Excluded are bonds of international institutions of which the United States is a member.

5. Equity securities of foreign corporations domiciled in developed countries[1] other than Canada and Japan except for those acquired after September 30, 1965 in U. S. markets from American investors. The test of whether an equity security is covered will depend on the institution's obligation to pay interest equalization tax on acquisition. Exclusion from covered assets under this program normally will be indicated when, in acquiring an equity security that otherwise would be covered, the purchasing institution receives a certificate of prior American ownership, or brokerage confirmation thereof.

In making those foreign loans and investments subject to the guideline ceiling, institutions are asked to observe certain priorities. First, top priority should be given to credits which represent the bona fide financing of U. S. exports. Second, nonexport credits and investments in less developed countries should be given priority second only to that for export financing. (Temporary excesses above the guideline ceiling may be permitted, where necessary, in order to accommodate these two types of priority credits.) Third, investment in shorter-term assets in Canada and Japan (aside from bank deposits and money market instruments) need be limited only to the extent necesary to remain within the overall guideline ceiling.

Within the leeway provided by the 105 per cent ceiling, however, institutions also are requested to observe the following limitations. First, the investment of liquid funds abroad, in both bank deposits and money market instruments, should be held to minimum practicable levels consistent with the operating policies of the institution. Second, investments in assets of all types in the developed countries of Continental Western Europe, except those directly financing U. S. exports, should be limited to the fullest practicable extent, and in any event should not be permitted to exceed the total of such assets held on September 30, 1966.

Each nonbank financial institution holding $500,000 or more in foreign financial assets is requested to file a quarterly statistical report covering such assets with the Federal Reserve Bank of the Reserve district in which its principal office is located. The reports are due within 20 days following the close of each calendar quarter, and forms (FR 392R) may be obtained by contacting the Federal Reserve Bank.

Foreign financial assets not covered by the guideline are still reportable on the quarterly statistical reports to the Federal Reserve Banks, but are not subject to ceiling limitations. Such noncovered foreign investments include the following:

1. Bonds and notes of international institutions of which the United States is a member, regardless of maturity.

2. Long-term investments in Canada, Japan and all less developed countries, including credit instruments with final maturities of more than 10 years at date of acquisition, direct investment in financial subsidiaries, and all equity securities issued by firms domiciled in these countries.

3. Equity securities of firms in developed countries other than Canada and Japan that have been acquired in U. S. markets from American investors (see Point 5 above).

General considerations

In cooperating in the voluntary foreign credit restraint program, the nonbank financial institutions are requested to refrain from making loans and investments inconsistent with other aspects of the President's balance of payments program. Among these are the following: (1) noncovered credits under this program which substitute for loans that commercial banks would have made in the absence of that part of the program applicable to them; (2) credits to U. S. corporate borrowers which would enable them to make new foreign loans and investments inconsistent with that part of the program administered by the Department of Commerce; (3) credits to U. S. subsidiaries and branches of foreign companies that otherwise would have been made to the foreign parent, or that would substitute for funds normally obtained from foreign sources.

The voluntary foreign credit restraint program for nonbank financial institutions does not apply to the investment, within the country involved, of reserves accumulated on insurance policies sold abroad, in amounts up to 110 per cent of such reserves. Furthermore, in view of the balance of payments objectives of the program, it is noted that covered investments of nonbank financial institutions may be permitted to exceed the guideline ceiling to the extent that the funds for such investment are borrowed in developed countries other than Canada and Japan. Any such arrangements to offset foreign borrowing against foreign investment should be discussed with the Federal Reserve Bank.

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[1] See footnote on page 5.

Non-Exempt Countr[illegible]es	Effective Date of D[illegible]signation
Abu Dhabi	6/10/66
Australia	7/18/63
Austria	7/18/63
Bahamas Islands	5/14/65
Bahrein	6/10/66
Belgium	7/18/63
Bermuda	5/14/65
Canada *	7/18/63
Denmark	7/18/63
France	7/18/63
Germany (Federal Republic)	7/18/63
Hong Kong	7/18/63
Iran	6/10/66
Iraq	6/10/66
Ireland	5/14/65
Italy	7/18/63
Japan **	7/18/63
Kuwait	5/14/65
Kuwait-Saudi Arabia Neutral Zone	6/10/66
Libya	6/10/66
Liechtenstein	7/18/63
Luxembourg	7/18/63
Monaco	7/18/63
Netherlands	7/18/63
New Zealand	7/18/63
Norway	7/18/63
Portugal	5/14/65
Qatar	6/10/66
Republic of South Africa	7/18/63
San Marino	7/18/63
Saudi Arabia	6/10/66
Sino-Soviet Bloc 1/	7/18/63
Spain	7/18/63
Sweden	7/18/63
Switzerland	7/18/63
United Kingdom	7/18/63

*New Canadian securities exempt as of 7/18/63 and Canadian Bank loans exempt as of 9/12/66.

**$100 million exemption of debt obligation permitted per annum.

1/ Including: Albania, Bulgaria, China Mainland, Cuba, Czechoslovakia, East Germany, Estonia, Hungary, Latvia, Lithuania, Mongolia, North Korea, North Vietnam, Poland, Rumania and USSR.

Presidential Documents

Title 3—THE PRESIDENT

Executive Order 11071

DESIGNATION OF CERTAIN FOREIGN COUNTRIES AS ECONOMICALLY LESS DEVELOPED COUNTRIES FOR PURPOSES OF THE REVENUE ACT OF 1962

By virtue of the authority vested in me by section 955(c)(3) of the Internal Revenue Code of 1954, as added by section ~~12(a)~~ of the Revenue Act of 1962, approved October 16, 1962 (Public Law 87–834, 76 Stat. 1015), by section 301 of title 3 of the United States Code, and as President of the United States, it is hereby ordered as follows:

SECTION 1. *Economically less developed countries.* For purposes of subpart A (sec. 901 and following) and subpart F (sec. 951 and following) of part III of subchapter N, and section 1248 of part IV of subchapter P, of chapter 1 of the Internal Revenue Code of 1954, the following areas are designated as economically less developed countries:

(a) all foreign countries (including Trust Territories) in existence on or after December 31, 1962, other than Australia, Austria, Belgium, Canada, Denmark, France, Federal Republic of Germany, Italy, Japan, Liechtenstein, Luxembourg, Monaco, Netherlands, New Zealand, Norway, Union of South Africa, San Marino, Spain, Sweden, Switzerland, United Kingdom, and any foreign country within the Sino-Soviet bloc, as defined in section 2;

(b) each territory, department, province, and possession (other than Hong Kong) of any foreign country in existence on or after December 31, 1962, other than of a foreign country within the Sino-Soviet bloc, as defined in section 2, if the territory, department, province, or possession is overseas from the foreign country of which it is a territory, department, province, or possession; and

(c) the Commonwealth of Puerto Rico and all possessions of the United States.

SEC. 2. *Definition of the term "foreign country within the Sino-Soviet bloc".* For purposes of this Order, the term "foreign country within the Sino-Soviet bloc" shall mean Albania, Bulgaria, any part of China which is dominated or controlled by International Communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by International Communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Soviet Zone of Germany and the Soviet Sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics, and any part of Viet-Nam which is dominated or controlled by International Communism.

SEC. 3. *Rules and regulations.* The Secretary of the Treasury or his delegate is authorized to prescribe from time to time regulations, rulings, directions, and instructions to carry out the purposes of this Order.

SEC. 4. *Effective date.* This Order shall become effective December 31, 1962.

JOHN KENNEDY

THE WHITE HOUSE,
December 27, 1962.

[F.R. Doc. 62–12935; Filed, Dec. 28, 1962; 10:50 a.m.]

Hong Kong

65 Kuwait
65 Portugal
(Bermuda?)
Ireland

Countries added later

Abu Dhabi
Bahrein
~~Indonesia~~
Iran
Iraq
Libya
Neutral Zone
Qatar
Saudi Arabia

26 USC 901-905, 951-964. 26 USC 1248.

purposes of subparts A and F of part III of subchapter N, and sectio 1248 of part IV of subchapter P, of chapter 1), shall be deemed to hav been issued and in effect, for purposes of the tax imposed by section 4911, on July 18, 1963, and continuously thereafter until there is in effect the Executive order referred to in the preceding sentence. An overseas territory, department, province, or possession of any foreign country may be designated as a separate country. No designation shall be made under this subsection with respect to any of the following:

Australia	Luxembourg
Austria	Monaco
Belgium	Netherlands
Canada	New Zealand
Denmark	Norway
France	Republic of South Africa
Germany (Federal Republic)	San Marino
Hong Kong	Spain
Italy	Sweden
Japan	Switzerland
Liechtenstein	United Kingdom.

Notification to Congress.

After the President (under the first sentence of this subsection) has designated any foreign country as an economically less developed country for purposes of the tax imposed by section 4911, he shall not terminate such designation (either by issuing an Executive order for that purpose or by issuing an Executive order which has the effect of terminating such designation) unless, at least 30 days before such termination, he has notified the Senate and the House of Representatives of his intention to terminate such designation.

"(c) LESS DEVELOPED COUNTRY CORPORATION DEFINED.—

"(1) IN GENERAL.—For purposes of this section, the term 'less developed country corporation' means a foreign corporation which for the applicable periods set forth in paragraph (3)—

76 Stat. 1013. 26 USC 955.

"(A) meets the requirements of section 955(c) (1) or (2); or

"(B) derives 80 percent or more of its gross income, i. any, from sources within less developed countries, or from deposits in the United States with persons carrying on the banking business, or both, and has assets 80 percent or more in value of which consists of—

"(i) money, and deposits in the United States with persons carrying on the banking business,

"(ii) stock or debt obligations of any other less developed country corporation,

"(iii) debt obligations of a less developed country,

"(iv) investments which are required because of restrictions imposed by a less developed country,

"(v) debt obligations described in paragraph (3) of subsection (a) of this section, and

"(vi) obligations of the United States.

In applying this paragraph the determination of whether a foreign country is a less developed country shall be made in accordance with subsection (b) of this section.

"(2) SPECIAL RULES.—

26 USC 956.

"(A) For purposes of subparagraphs (A) and (B) of paragraph (1), property described in section 956(b)(1) (regardless of when acquired), other than deposits with persons carrying on the banking business, and income derived from such property, shall not be taken into account.

Presidential Documents

Title 3—THE PRESIDENT

Executive Order 11224

DESIGNATION OF CERTAIN FOREIGN COUNTRIES AS ECONOMICALLY LESS DEVELOPED COUNTRIES FOR PURPOSES OF THE INTEREST EQUALIZATION TAX

WHEREAS the Senate and House of Representatives have been duly notified of my intention to terminate the designation of the Bahamas, Bermuda, Ireland, Kuwait, and Portugal as economically less developed countries for purposes of the tax imposed by section 4911 of the Internal Revenue Code;

NOW, THEREFORE, by virtue of the authority vested in me by section 4916(b) of the Internal Revenue Code of 1954, as added by section 2 of the Interest Equalization Tax Act, approved September 2, 1964 (Public Law 88–563), by section 301 of title 3 of the United States Code, and as President of the United States, it is hereby ordered as follows:

SECTION 1. *Economically less developed countries.* For purposes of the tax imposed by section 4911 of the Internal Revenue Code, the following areas are designated as economically less developed countries:

(a) All foreign countries (including Trust Territories) in existence on or after the effective date of this order, other than Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, France, Ireland, Italy, Japan, Kuwait, Liechtenstein, Luxembourg, Monaco, Netherlands, New Zealand, Norway, Portugal, San Marino, Spain, Sweden, Switzerland, Union of South Africa, United Kingdom, and any foreign country within the Sino-Soviet bloc, as defined in section 2:

(b) Each territory, department, province, and possession (other than the Bahamas, Bermuda, and Hong Kong), of any foreign country in existence on or after the effective date of this order, other than a foreign country within the Sino-Soviet bloc, as defined in section 2, if the territory, department, province, or possession is overseas from the foreign country of which it is a territory, department, province, or possession; and

(c) The Commonwealth of Puerto Rico and all possessions of the United States.

SEC. 2. *Definition of the term "foreign country within the Sino-Soviet bloc."* For purposes of this order, the term "foreign country within the Sino-Soviet bloc" shall mean Albania, Bulgaria, any part of China which is dominated or controlled by International Communism, Cuba, Czechoslovakia, Estonia, Hungary, any part of Korea which is dominated or controlled by International Communism, Latvia, Lithuania, Outer Mongolia, Poland (including any area under its provisional administration), Rumania, Soviet Zone of Germany and the Soviet Sector of Berlin, Tibet, Union of Soviet Socialist Republics and the Kurile Islands, Southern Sakhalin, and areas in East Prussia which are under the provisional administration of the Union of Soviet Socialist Republics, and any part of Viet Nam which is dominated or controlled by International Communism.

SEC. 3. *Prior acquisitions and commitments.* Notwithstanding the provisions of sections 1 and 2 of this order, any area which had the status of an economically less developed country under section 4916(b) of the Intern[illegible] Revenue Code prior to the effective date [illegible]his order shall be deemed to be an economically less developed [illegible]ountry for purposes of section 4916 with respect to an acquisition of stock or a debt obligation—

(a) If such acquisition was made prior to the effective date of this order;

(b) If such acquisition is made pursuant to an obligation to acquire which, prior to April 6, 1965, was unconditional or was subject only to conditions contained in a formal contract under which partial performance had occurred; or

(c) If, with respect to such acquisition, the acquiring United States person (or, in a case where two or more United States persons are making acquisitions as part of a single transaction, a majority in interest of such persons) had taken every action prior to April 6, 1965, to signify approval of the acquisition under the procedures ordinarily employed by such person (or persons) in similar transactions and had sent or deposited for delivery to the foreign person from whom the acquisition was made written evidence of such approval in the form of a commitment letter, memorandum of terms, draft purchase contract, or other document setting forth, or referring to a document sent by the foreign person from whom the acquisition was made which set forth, the principal terms of such acquisition, subject only to the execution of formal documents evidencing the acquisition and to customary closing conditions.

SEC. 4. *Rules and regulations.* The Secretary of the Treasury or his delegate is authorized to prescribe from time to time regulations, rulings, directions, and instructions to carry out the purposes of this order.

SEC. 5. *Effective date.* This order shall become effective upon its filing for publication in the FEDERAL REGISTER.

SEC. 6. *Inapplicability of Executive Order 11071.* Executive Order No. 11071, dated December 27, 1962, is hereby superseded to the extent that such order applies to section 4916 of the Internal Revenue Code.

LYNDON B. JOHNSON

THE WHITE HOUSE,
May 13, 1965.

[F.R. Doc. 65-5249; Filed, May 14, 1965; 11:42 a.m.]

IET file

Executive Session, IET Extension Act of 1965, June 24, 1965, House of Representatives, Committee on Ways and Means.

Chairman: Secretary Mann we wanted you with us this morning to discuss a little bit the procedures which are followed in determining the "developed" and "undeveloped" countries and purposes of not only the application of the rule which is laid down in connection with the IET but also some other situations. I assume the rules are the same with respect to the application of other laws in this regard. ..... If you want to make a general statement about the matter .... we would be glad to have you do so.

Statement of Honorable Thomas Mann

Mr. Mann: I looked over the list which was gotten together yesterday by Treasury ahd State of the less developed or developing or undeveloped countries. After talking with Mr. Deming (Undersecretary for Monetary Affairs, Department of the Treasury) we both think that we would have another look at this, not with the idea of following any particular set of criteria, but with respect, for example, to the colonies or territories of France and of England.

We might consider whether we have a national interest, as we clearly do think in the case of British Guiana, for example, where you have a Communist threat, of keeping them in the less developed category.

They are moving towards independence.

Mr. Mann: There may be other cases where a territory or colony is very closely tied to, let's day, the French economy, and I think in that type of case, absent some special circumstance, we ought to treat that as if it were part of the Metropolitan France. I suspect it would have very little practical effect. I don't think they borrow much from the United States or invest much or receive many U.S. investments. ..... We will undertake to look at these cases, I think, each one separately, with the viewpoint **not** of following some doctrine or criteria, but doing what makes sense from the standpoint of the U.S. interest.

Chairman: What you are saying, as I understand it, is that you will re-evaluate from the point of view of our national interest whether these countries now on the list should be continued in the category of less developed, plus some of the territories of the United Kingdom and France which receive this favorable treatment of no tax.

In the process of making that further reevaluation I think I detected yesterday some degree of feeling that the decision should not be based entirely upon the exclusive test of whether or not the economic condition within that country justifies the classification.

Apparently some feel that some other factors should be taken into consideration and not just that one factor. I assume that what you mean to say this morning is that factor plus other factors -- that is, the one of economics plus other factors -- would be considered as you reanalyze the situation.

Mr. Mann: That is accurate, Mr. Chairman, speaking particularly to the question of territories of France and the United Kingdom, which is what we are talking about.

Chairman: Mr. Burke has raised the question about some of the countries which are independent. For instance, he had pointed out, as I recall, the U.A.R., and Indonesia.

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Mr. Burke: Yugoslavia, Cambodia, Nigeria, Algeria, UAR, Indonesia, Haiti, British Guiana. These are just some of them I have raised questions about.

Apparently the criterion that is set up here is an economic criterion and nothing else is taken into consideration. (Mr. Burke mentions Indonesia's policy towards the U.S) And, says "It is difficult for me to understand why this country should get any favorable treatment, a country like Indonesia and some of these other countries listed".

Mr. Mann: There may be countries where it makes sense to consider treating them as developing countries. There may be other situations where they are closely allied to the metropole and where for purposes of this Act they ought to be treated as part of a metropolitan European power.

In terms of particular independent countries, and you referred to the case of Indonesia, for example, this is a question which is entirely hypothetical because no long-term bank credits according to our record, which are the only ones subject to the tax, have been made to Indonesia.

There may be countries where it makes sense to consider treating them as developing countries. There may be other situations where they are closely allied to the metropole and where for purposes of this act they ought to be treated as a part of a metropolitan European power.

In terms of particularly independent countries, and you referred to the case of Indonesia, for example, this is a question which is entirely hypothetical because no long-term bank credits according to our record, which are the only ones subject to the tax, have been made to Indonesia.

In the case of other countries, the United Arab Republic, Yugoslavia, and other Western European countries, I would say that the amounts are certainly de minimis; none of them are substantial, and the same thing generally applies in terms of investments.

Our investments in these countries are small or nonexistent and we have no evidence that the 1-percent equalization fee or tax has had any material effect one way or the other, adverse or favorable, in terms of direct investment.

Similarly, none of these countries attempts to raise money in the market in this country. They don't float bonds or anything of that kind, so that it is unimportant from the standpoint of the purposes of the act that we are talking about, which is designed primarily to protect our balance-of-payments position.

We recognize, Mr. Congressman, the importance of asking all countries in the world and expecting all countries in the world to treat us with the same respect with which they themselves expect to be treated and we are conscious of the fact that in days past statements have been issued and made by officials of other governments which from our point of view are offensive.

We intend in all of our economic relations with these countries to deal with them on the basis of mutual respect and on a basis which is compatible with our national interest as well as theirs.

We intend to look at them individually on an ad hoc basis rather than by applying general criteria and I would hope that this committee and the Congress would continue to give to the President the flexibility which he needs in order to deal with different situations in different countries.

The CHAIRMAN. Off the record.

(There was discussion off the record.)

The CHAIRMAN. Will you state it as you want to state it, having heard the question I asked.

Mr. MANN. Mr. Chairman, I can assure this committee that the administration will keep under constant review the list of countries which are in the developed category and that we will review the residual list, which means all those which are not in that category, to see whether they should be changed from one list to the other.

This will be kept under constant review. In addition to that I can assure the chairman that in making this kind of consideration we will not consider ourselves limited to any particular set of economic criteria, but we will take into account broader issues as well, political as well as economic.

Mr. BYRNES. Let me make an inquiry.

The CHAIRMAN. Mr. Byrnes.

New York Times, April 7, 1965, p. 65
Concerning the removal of Bermuda, Bahamas, Ireland, Kuweit, Portugal
U. S. Treasury said each of these countries,
"has progressed to the point where its borrowers should not be in a privileged position" in getting U. S. capital.

"Each is experiencing satisfactory economic growth and each has relatively large international resources to draw upon if it requires additional resources".

"Kuwait had become a net exporter of capital, and the other 4 areas had access to the capital markets of Europe."

New York Times, January 30, 1966, p. 13 (Section III)
Concerning termination of exemption for 9 nations.

"The move is an outgrowth of an intensive review of the U. S. balance of payments program announced December 6."

Note Indonesia was one of the nations included in the list of 9 nations given by President Johnson in January 1966. However, it was not subsequently added to the list of "developed country".