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# INTEREST EQUALIZATION TAX ACT

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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]

| Year | Amount | Period | Amount |
|---|---|---|---|
| 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 | Total | 1963 [1] | | | | 1964 [1] |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | 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 | −728 | 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 | 204 | 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 | 401 | 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 | 680 | 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 owner-

ship 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 responsi-

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

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 partner-

ship 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 indus-

trialized 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 re-

ceived. 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. Th 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 ordi-

nary 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 2 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 acquisitions 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).