REVENUE ACT OF 1962

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-SEVENTH CONGRESS

SECOND SESSION

ON

H.R. 10650

AN ACT TO AMEND THE REVENUE ACT OF 1954 TO PROVIDE A CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY, TO ELIMINATE CERTAIN DEFECTS AND INEQUITIES, AND FOR OTHER PURPOSES

APRIL 26 AND 27, 1962

PART 7

Printed for the use of the Committee on Finance

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REVENUE ACT OF 1962

THURSDAY, APRIL 26, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Gore, Douglas, Williams, Carlson and Curtis.

Also present: Elizabeth B. Springer, committee clerk; and Colin F. Stam and L. N. Woodworth of the Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

Senator CARLSON. Mr. Chairman, I want to submit for printing in the record at this point the Baker-Herlong bill, H.R. 2030.

The CHAIRMAN. Without objection the insertion will be made.

Senator CARLSON. I think I should state this is a revised version of the bill as introduced by Mr. Herlong on January 6, 1961 and no doubt we will have testimony on it and it will receive further consideration by the committee.

(The bill referred to follows:)

87TH CONGRESS
1ST SESSION

H.R. 2030
(As revised)

IN THE HOUSE OF REPRESENTATIVES

JANUARY 6, 1961

Mr. Herlong introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 so as to provide for scheduled personal and corporate income tax reductions, and for other purposes.

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

SECTION 1. Section 1(a) of the Internal Revenue Code of 1954 (relating to rates of tax on individuals) is hereby amended by inserting before "Rates of Tax on Individuals" the number "(1)" and adding a new paragraph (2) to read as follows:

"(2) SCHEDULE FOR REDUCTION OF TAX ON INDIVIDUALS.—In the case of each taxable year beginning on or after the date specified in the following subparagraphs, the tax imposed by paragraph (1) shall, subject to the provisions of sec-

tion 22, be determined under this paragraph at the rates provided and effective for the taxable years prescribed in the following subparagraphs:

"(A) For taxable years beginning on or after January 1, 1962;

"If the taxable income is:	The tax is:
Not over $2,000	19.5% of the taxable income.
Over $2,000 but not over $4,000	$390, plus 21.25% of excess over $2,000.
Over $4,000 but not over $6,000	$815, plus 25.25% of excess over $4,000.
Over $6,000 but not over $8,000	$1,320, plus 29% of excess over $6,000.
Over $8,000 but not over $10,000	$1,900, plus 32.5% of excess over $8,000.
Over $10,000 but not over $12,000	$2,550, plus 36.5% of excess over $10,000.
Over $12,000 but not over $14,000	$3,280, plus 41% of excess over $12,000.
Over $14,000 but not over $16,000	$4,100, plus 44.5% of excess over $14,000.
Over $16,000 but not over $18,000	$4,990, plus 47.5% of excess over $16,000.
Over $18,000 but not over $20,000	$5,940, plus 50.5% of excess over $18,000.
Over $20,000 but not over $22,000	$6,950, plus 53% of excess over $20,000.
Over $22,000 but not over $26,000	$8,010, plus 56% of excess over $22,000.
Over $26,000 but not over $32,000	$10,250, plus 58.5% of excess over $26,000.
Over $32,000 but not over $38,000	$13,760, plus 61.5% of excess over $32,000.
Over $38,000 but not over $44,000	$17,450, plus 65% of excess over $38,000.
Over $44,000 but not over $50,000	$21,350, plus 68% of excess over $44,000.
Over $50,000 but not over $60,000	$25,430, plus 70.5% of excess over $50,000.
Over $60,000 but not over $70,000	$32,480, plus 73.5% of excess over $60,000.
Over $70,000 but not over $80,000	$39,830, plus 76% of excess over $70,000.
Over $80,000 but not over $90,000	$47,430, plus 79% of excess over $80,000.
Over $90,000 but not over $100,000	$55,330, plus 82% of excess over $90,000.
Over $100,000 but not over $150,000	$63,480, plus 83.5% of excess over $100,000.
Over $150,000 but not over $200,000	$105,230, plus 85% of excess over $150,000.
Over $200,000	$147,730, plus 86.5% of excess over $200,000.

"(B) For taxable years beginning on or after January 1, 1963:

"If the taxable income is:	The tax is:
Not over $2,000	19% of the taxable income.
Over $2,000 but not over $4,000	$380,000, plus 20.5% of excess over $2,000.
Over $4,000 but not over $6,000	$790, plus 24.5% of excess over $4,000.
Over $6,000 but not over $8,000	$1,280, plus 28% of excess over $6,000.
Over $8,000 but not over $10,000	$1,840, plus 31% of excess over $8,000.
Over $10,000 but not over $12,000	$2,460, plus 35% of excess over $10,000.
Over $12,000 but not over $14,000	$3,160, plus 39% of excess over $12,000.
Over $14,000 but not over $16,000	$3,940, plus 42% of excess over $14,000.
Over $16,000 but not over $18,000	$4,780, plus 45% of excess over $16,000.
Over $18,000 but not over $20,000	$5,680, plus 48% of excess over $18,000.
Over $20,000 but not over $22,000	$6,640, plus 50% of excess over $20,000.
Over $22,000 but not over $26,000	$7,640, plus 53% of excess over $22,000.
Over $26,000 but not over $32,000	$9,760, plus 55% of excess over $26,000.
Over $32,000 but not over $38,000	$13,060, plus 58% of excess over $32,000.
Over $38,000 but not over $44,000	$16,540, plus 61% of excess over $38,000.
Over $44,000 but not over $50,000	$20,200, plus 64% of excess over $44,000.
Over $50,000 but not over $60,000	$24,040, plus 66% of excess over $50,000.
Over $60,000 but not over $70,000	$30,640, plus 69% of excess over $60,000.
Over $70,000 but not over $80,000	$37,540, plus 71% of excess over $70,000.
Over $80,000 but not over $90,000	$44,640, plus 74% of excess over $80,000.
Over $90,000 but not over $100,000	$52,040, plus 76% of excess over $90,000.
Over $100,000 but not over $150,000	$59,640, plus 78% of excess over $100,000.
Over $150,000 but not over $200,000	$98,640, plus 80% of excess over $150,000.
Over $200,000	$138,640, plus 82% of excess over $200,000.

"(C) For taxable years beginning on or after January 1, 1964:

"If the taxable income is:	The tax is:
Not over $2,000	18% of the taxable income.
Over $2,000 but not over $4,000	$360, plus 19.5% of excess over $2,000.
Over $4,000 but not over $6,000	$750, plus 23% of excess over $4,000.
Over $6,000 but not over $8,000	$1,210, plus 26% of excess over $6,000.
Over $8,000 but not over $10,000	$1,730, plus 28% of excess over $8,000.
Over $10,000 but not over $12,000	$2,290, plus 32% of excess over $10,000.
Over $12,000 but not over $14,000	$2,930, plus 35% of excess over $12,000.
Over $14,000 but not over $16,000	$3,630, plus 37% of excess over $14,000.
Over $16,000 but not over $18,000	$4,370, plus 40% of excess over $16,000.
Over $18,000 but not over $20,000	$5,170, plus 42% of excess over $18,000.
Over $20,000 but not over $22,000	$6,010, plus 44% of excess over $20,000.
Over $22,000 but not over $26,000	$6,890, plus 47% of excess over $22,000.
Over $26,000 but not over $32,000	$8,770, plus 48% of excess over $26,000.
Over $32,000 but not over $38,000	$11,650, plus 51% of excess over $32,000.
Over $38,000 but not over $44,000	$14,710, plus 53% of excess over $38,000.
Over $44,000 but not over $50,000	$17,890, plus 56% of excess over $44,000.
Over $50,000 but not over $60,000	$21,250, plus 57% of excess over $50,000.
Over $60,000 but not over $70,000	$26,950, plus 60% of excess over $60,000.
Over $70,000 but not over $80,000	$32,950, plus 62% of excess over $70,000.
Over $80,000 but not over $90,000	$39,150, plus 64% of excess over $80,000.
Over $90,000 but not over $100,000	$45,550, plus 66% of excess over $90,000.
Over $100,000 but not over $150,000	$52,150, plus 68% of excess over $100,000.
Over $150,000 but not over $200,000	$86,150, plus 70% of excess over $150,000.
Over $200,000	$121,150, plus 72% of excess over $200,000.

"(D) For taxable years beginning on or after January 1, 1965:

"If the taxable income is:	The tax is:
Not over $2,000	17% of the taxable income.
Over $2,000 but not over $4,000	$340, plus 18.5% of excess over $2,000.
Over $4,000 but not over $6,000	$710, plus 21.5% of excess over $4,000.
Over $6,000 but not over $8,000	$1,140, plus 24% of excess over $6,000.
Over $8,000 but not over $10,000	$1,620, plus 25% of excess over $8,000.
Over $10,000 but not over $12,000	$2,120, plus 28% of excess over $10,000.
Over $12,000 but not over $14,000	$2,680, plus 31% of excess over $12,000.
Over $14,000 but not over $16,000	$3,300, plus 32% of excess over $14,000.
Over $16,000 but not over $18,000	$3,940, plus 35% of excess over $16,000.
Over $18,000 but not over $20,000	$4,640, plus 36% of excess over $18,000.
Over $20,000 but not over $22,000	$5,360, plus 38% of excess over $20,000.
Over $22,000 but not over $26,000	$6,120, plus 40% of excess over $22,000.
Over $26,000 but not over $32,000	$7,720, plus 41% of excess over $26,000.
Over $32,000 but not over $38,000	$10,180, plus 43% of excess over $32,000.
Over $38,000 but not over $44,000	$12,760, plus 45% of excess over $38,000.
Over $44,000 but not over $50,000	$15,460, plus 47% of excess over $44,000.
Over $50,000 but not over $60,000	$18,280, plus 48% of excess over $50,000.
Over $60,000 but not over $70,000	$23,080, plus 51% of excess over $60,000.
Over $70,000 but not over $80,000	$28,180, plus 52% of excess over $70,000.
Over $80,000 but not over $90,000	$33,380, plus 54% of excess over $80,000.
Over $90,000 but not over $100,000	$38,780, plus 56% of excess over $90,000.
Over $100,000 but not over $150,000	$44,380, plus 58% of excess over $100,000.
Over $150,000 but not over $200,000	$73,380, plus 60% of excess over $150,000.
Over $200,000	$103,380, plus 62% of excess over $200,000.

"(E) For taxable years begining on or after January 1, 1966:

"If the taxable income is:	The tax is:
Not over $2,000	16% of the taxable income.
Over $2,000 but not over $4,000	$320, plus 17.5% of excess over $2,000.
Over $4,000 but not over $6,000	$670, plus 20% of excess over $4,000.
Over $6,000 but not over $8,000	$1,070, plus 21% of excess over $6,000.
Over $8,000 but not over $10,000	$1,490, plus 22% of excess over $8,000.
Over $10,000 but not over $12,000	$1,930, plus 24% of excess over $10,000.
Over $12,000 but not over $14,000	$2,410, plus 26% of excess over $12,000.
Over $14,000 but not over $16,000	$2,930, plus 27% of excess over $14,000.
Over $16,000 but not over $18,000	$3,470, plus 29% of excess over $16,000.
Over $18,000 but not over $20,000	$4,050, plus 30% of excess over $18,000.
Over $20,000 but not over $22,000	$4,650, plus 32% of excess over $20,000.
Over $22,000 but not over $26,000	$5,290, plus 33% of excess over $22,000.
Over $26,000 but not over $32,000	$6,610, plus 34% of excess over $26,000.
Over $32,000 but not over $38,000	$8,650, plus 36% of excess over $32,000.
Over $38,000 but not over $44,000	$10,810, plus 37% of excess over $38,000.
Over $44,000 but not over $50,000	$13,030, plus 38% of excess over $44,000.
Over $50,000 but not over $60,000	$15,310, plus 39% of excess over $50,000.
Over $60,000 but not over $70,000	$19,210, plus 40% of excess over $60,000.
Over $70,000 but not over $80,000	$23,210, plus 41% of excess over $70,000.
Over $80,000 but not over $90,000	$27,310, plus 44% of excess over $80,000.
Over $90,000 but not over $100,000	$31,710, plus 46% of excess over $90,000.
Over $100,000 but not over $150,000	$36,310, plus 48% of excess over $100,000.
Over $150,000 but not over $200,000	$60,310, plus 50% of excess over $150,000.
Over $200,000	$85,310, plus 52% of excess over $200,000.

"(F) For taxable years beginning on or after January 1, 1967:

"If the taxable income is:	The tax is:
Not over $2,000	15% of the taxable income.
Over $2,000 but not over $4,000	$300, plus 16% of excess over $2,000.
Over $4,000 but not over $6,000	$620, plus 17% of excess over $4,000.
Over $6,000 but not over $8,000	$960, plus 18% of excess over $6,000.
Over $8,000 but not over $10,000	$1,320, plus 19% of excess over $8,000.
Over $10,000 but not over $12,000	$1,700, plus 20% of excess over $10,000.
Over $12,000 but not over $14,000	$2,100, plus 21% of excess over $12,000.
Over $14,000 but not over $16,000	$2,520, plus 22% of excess over $14,000.
Over $16,000 but not over $18,000	$2,960, plus 23% of excess over $16,000.
Over $18,000 but not over $20,000	$3,420, plus 24% of excess over $18,000.
Over $20,000 but not over $22,000	$3,900, plus 25% of excess over $20,000.
Over $22,000 but not over $26,000	$4,400, plus 26% of excess over $22,000.
Over $26,000 but not over $32,000	$5,440, plus 27% of excess over $26,000.
Over $32,000 but not over $38,000	$7,060, plus 28% of excess over $32,000.
Over $38,000 but not over $44,000	$8,740, plus 29% of excess over $38,000.
Over $44,000 but not over $50,000	$10,480, plus 30% of excess over $44,000.
Over $50,000 but not over $60,000	$12,280, plus 31% of excess over $50,000.
Over $60,000 but not over $70,000	$15,380, plus 32% of excess over $60,000.
Over $70,000 but not over $80,000	$18,580, plus 34% of excess over $70,000.
Over $80,000 but not over $90,000	$21,980, plus 36% of excess over $80,000.
Over $90,000 but not over $100,000	$25,580, plus 38% of excess over $90,000.
Over $100,000 but not over $150,000	$29,380, plus 41% of excess over $100,000.
Over $150,000 but not over $200,000	$49,880, plus 44% of excess over $150,000.
Over $200,000	$71,880, plus 47% of excess over $200,000."

SEC. 2. Section 1(b) of the Internal Revenue Code of 1954 (relating to rates of tax on heads of households) is hereby amended:

(a) by deleting from paragraph (1) the words "The amount of the tax shall be determined in accordance with the following table:" and inserting in lieu thereof "The amount of the tax shall be determined, subject to the provisions of section 22 (except that section 22 shall not apply to subparagraph (A) hereof), under the following subparagraphs for each taxable year beginning on or after the date specified in the following subparagraphs:

"(A) For taxable years beginning on or after January 1, 1954:"

(b) by adding to paragraph (1) the following new subparagraphs:

"(B) For taxable years beginning on or after January 1, 1962:

"If the taxable income is:	The tax is:
Not over $2,000	19.5% of the taxable income.
Over $2,000 but not over $4,000	$390, plus 20.5% of excess over $2,000.
Over $4,000 but not over $6,000	$790, plus 23% of excess over $4,000.
Over $6,000 but not over $8,000	$1,260, plus 25% of excess over $6,000.
Over $8,000 but not over $10,000	$1,760, plus 29% of excess over $8,000.
Over $10,000 but not over $12,000	$2,340, plus 31% of excess over $10,000.
Over $12,000 but not over $14,000	$2,960, plus 35% of excess over $12,000.
Over $14,000 but not over $16,000	$3,660, plus 37% of excess over $14,000.
Over $16,000 but not over $18,000	$4,400, plus 40% of excess over $16,000.
Over $18,000 but not over $20,000	$5,200, plus 41% of excess over $18,000.
Over $20,000 but not over $22,000	$6,020, plus 45% of excess over $20,000.
Over $22,000 but not over $24,000	$6,920, plus 46.5% of excess over $22,000.
Over $24,000 but not over $28,000	$7,850, plus 49% of excess over $24,000.
Over $28,000 but not over $32,000	$9,810, plus 51.5% of excess over $28,000.
Over $32,000 but not over $38,000	$11,870, plus 55% of excess over $32,000.
Over $38,000 but not over $44,000	$15,170, plus 58.5% of excess over $38,000.
Over $44,000 but not over $50,000	$18,380, plus 62.5% of excess over $44,000.
Over $50,000 but not over $60,000	$22,430, plus 64% of excess over $50,000.
Over $60,000 but not over $70,000	$22,830, plus 67% of excess over $60,000.
Over $70,000 but not over $80,000	$35,530, plus 69.5% of excess over $70,000.
Over $80,000 but not over $90,000	$42.480, plus 72% of excess over $80,000.
Over $90,000 but not over $100,000	$49,680, plus 75% of excess over $90,000.
Over $100,000 but not over $150,000	$57,180, plus 78% of excess over $100,000.
Over $150,000 but not over $200,000	$96,180, plus 82% of excess over $150,000.
Over $200,000 but not over $300,000	$137,180, plus 85% of excess over $200,000.
Over $300,000	$222,180, plus 86.5% of excess over $300,000.

"(C) For taxable years beginning on or aicer January 1, 1963:

"If the taxable income is:	The tax is:
Not over $2,000	19% of the taxable income.
Over $2,000 but not over $4,000	$380, plus 20% of excess over $2,,000.
Over $4,000 but not over $6,000	$780, plus 22% of excess over $4,000.
Over $6,000 but not over $8,000	$1,220, plus 24% of excess over $6,000.
Over $8,000 but not over $10,000	$1,700, plus 28% of excess over $8,000.
Over $10,000 but not over $12,000	$2,260, plus 30% of excess over $10,000.
Over $12,000 but not over $14,000	$2,860, plus 34% of excess over $12,000.
Over $14,000 but not over $16,000	$3,540, plus 35% of excess over $14,000.
Over $16,000 but not over $18,000	$4,240, plus 38% of excess over $16,000.
Over $18,000 but not over $20,000	$5,000, plus 39% of excess over $18,000.
Over $20,000 but not over $22,000	$5,780, plus 43% of excess over $20,000.
Over $22,000 but not over $24,000	$6,640, plus 44% of excess over $22,000.
Over $24,000 but not over $28,000	$7,520, plus 46% of excess over $24,000.
Over $28,000 but not over $32,000	$9,360, plus 49% of excess over $28,000.
Over $32,000 but not over $38,000	$11,320, plus 52% of excess over $32,000.
Over $38,000 but not over $44,000	$14,440, plus 55% of excess over $38,000.
Over $44,000 but not over $50,000	$17,740, plus 59% of excess over $44,000.
Over $50,000 but not over $60,000	$21,280, plus 60% of excess over $50,000.
Over $60,000 but not over $70,000	$27,280, plus 63% of excess over $60,000.
Over $70,000 but not over $80,000	$33,580, plus 65% of excess over $70,000.
Over $80,000 but not over $90,000	$40,080, plus 68% of excess over $80,000.
Over $90,000 but not over $100,000	$46,880, plus 70% of excess over $90,000.
Over $100,000 but not over $150,000	$53,880, plus 73% of excess over $100,000.
Over $150,000 but not over $200,000	$90,380, plus 77% of excess over $150,000.
Over $200,000 but not over $300,000	$128,880, plus 80% of excess over $200,000.
Over $300,000	$208,880, plus 82% of excess over $300,000.

"(D) For taxable years beginning on or after January 1, 1964:

"If the taxable income is:	The tax is:
Not over $2,000	18% of the taxable income.
	$360, plus 19% of excess over $2,000.
Over $4,000 but not over $6,000	$740, plus 21% of excess over $4,000.
Over $6,000 but not over $8,000	$1,160, plus 23% of excess over $6,000.
Over $8,000 but not over $10,000	$1,620, plus 25% of excess over $8,000.
Over $10,000 but not over $12,000	$2,120, plus 28% of excess over $10,000.
Over $12,000 but not over $14,000	$2,680, plus 30% of excess over $12,000.
Over $14,000 but not over $16,000	$3,280, plus 32% of excess over $14,000.
Over $16,000 but not over $18,000	$3,920, plus 34% of excess over $16,000.
Over $18,000 but not over $20,000	$4,600, plus 35% of excess over $18,000.
Over $20,000 but not over $22,000	$5,300, plus 38% of excess over $20,000.
Over $22,000 but not over $24,000	$6,060, plus 40% of excess over $22,000.
Over $24,000 but not over $28,000	$6,860, plus 41% of excess over $24,000.
Over $28,000 but not over $32,000	$8,500, plus 43% of excess over $28,000.
Over $32,000 but not over $38,000	$10,220, plus 46% of excess over $32,000.
Over $38,000 but not over $44,000	$12,980, plus 48% of excess over $38,000.
Over $44,000 but not over $50,000	$15,860, plus 51% of excess over $44,000.
Over $50,000 but not over $60,000	$18,920, plus 52% of excess over $50,000.
Over $60,000 but not over $70,000	$24,120, plus 55% of excess over $60,000.
Over $70,000 but not over $80,000	$29,620, plus 57% of excess over $70,000.
Over $80,000 but not over $90,000	$35,320, plus 59% of excess over $80,000.
Over $90,000 but not over $100,000	$41,220, plus 61% of excess over $90,000.
Over $100,000 but not over $150,000	$47,320, plus 64% of excess over $100,000.
Over $150,000 but not over $200,000	$79,320, plus 67% of excess over $150,000.
Over $200,000 but not over $300,000	$112,820, plus 70% of excess over $200,000.
Over $300,000	$182,820, plus 72% of excess over $300,000.

"(E) For taxable years beginning on or after January 1, 1965:

"If the taxable income is:	The tax is:
Not over $2,000	17% of the taxable income.
Over $2,000 but not over $4,000	$340, plus 18% of excess over $2,000.
Over $4,000 but not over $6,000	$700, plus 20% of excess over $4,000.
Over $6,000 but not over $8,000	$1,100, plus 21% of excess over $6,000.
Over $8,000 but not over $10,000	$1,520, plus 23% of excess over $8,000.
Over $10,000 but not over $12,000	$1,980, plus 25% of excess over $10,000.
Over $12,000 but not over $14,000	$2,480, plus 27% of excess over $12,000.
Over $14,000 but not over $16,000	$3,020, plus 28% of excess over $14,000.
Over $16,000 but not over $18,000	$3,580, plus 30% of excess over $16,000.
Over $18,000 but not over $20,000	$4,180, plus 31% of excess over $18,000.
Over $20,000 but not over $22,000	$4,800, plus 33% of excess over $20,000.
Over $22,000 but not over $24,000	$5,460, plus 34% of excess over $22,000.
Over $24,000 but not over $28,000	$6,140, plus 36% of excess over $24,000.
Over $28,000 but not over $32,000	$7,580, plus 37% of excess over $28,000.
Over $32,000 but not over $38,000	$9,060, plus 39% of excess over $32,000.
Over $38,000 but not over $44,000	$11,400, plus 41% of excess over $38,000.
Over $44,000 but not over $50,000	$13,860, plus 43% of excess over $44,000.
Over $50,000 but not over $60,000	$16,440, plus 44% of excess over $50,000.
Over $60,000 but not over $70,000	$20,840, plus 47% of excess over $60,000.
Over $70,000 but not over $80,000	$25,540, plus 48% of excess over $70,000.
Over $80,000 but not over $90,000	$30,340, plus 50% of excess over $80,000.
Over $90,000 but not over $100,000	$35,340, plus 52% of excess over $90,000.
Over $100,000 but not over $150,000	$40,540, plus 54% of excess over $100,000.
Over $150,000 but not over $200,000	$67,540, plus 57% of excess over $150,000.
Over $200,000 but not over $300,000	$96,040, plus 60% of excess over $200,000.
Over $300,000	$156,040, plus 62% of excess over $300,000.

"(F) For taxable years beginning on or after January 1, 1966:

"If the taxable income is:	The tax is:
Not over $2,000	16% of the taxable income.
Over $2,000 but not over $4,000	$320, plus 17% of excess over $2,000.
Over $4,000 but not over $6,000	$660, plus 19% of excess over $4,000.
Over $6,000 but not over $8,000	$1,040, plus 19% of excess over $6,000.
Over $8,000 but not over $10,000	$1,420, plus 21% of excess over $8,000.
Over $10,000 but not over $12,000	$1,840, plus 22% of excess over $10,000.
Over $12,000 but not over $14,000	$2,280, plus 23% of excess over $12,000.
Over $14,000 but not over $16,000	$2,740, plus 24% of excess over $14,000.
Over $16,000 but not over $18,000	$3,220, plus 25% of excess over $16,000.
Over $18,000 but not over $20,000	$3,720, plus 26% of excess over $18,000.
Over $20,000 but not over $22,000	$4,240, plus 28% of excess over $20,000.
Over $22,000 but not over $24,000	$4,800, plus 29% of excess over $22,000.
Over $24,000 but not over $28,000	$5,380, plus 30% of excess over $24,000.
Over $28,000 but not over $32,000	$6,580, plus 31% of excess over $28,000.
Over $32,000 but not over $38,000	$7,820, plus 33% of excess over $32,000.
Over $38,000 but not over $44,000	$9,800, plus 34% of excess over $38,000.
Over $44,000 but not over $50,000	$11,840, plus 35% of excess over $44,000.
Over $50,000 but not over $60,000	$13,940, plus 36% of excess over $50,000.
Over $60,000 but not over $70,000	$17,540, plus 38% of excess over $60,000.
Over $70,000 but not over $80,000	$21,340, plus 39% of excess over $70,000.
Over $80,000 but not over $90,000	$25,240, plus 41% of excess over $80,000.
Over $90,000 but not over $100,000	$29,340, plus 42% of excess over $90,000.
Over $100,000 but not over $150,000	$33,540, plus 44% of excess over $100,000.
Over $150,000 but not over $200,000	$55,540, plus 47% of excess over $150,000.
Over $200,000 but not over $300,000	$79,040, plus 50% of excess over $200,000.
Over $300,000	$129,040, plus 52% of excess over $300,000.

"(G) For taxable years beginning on or after January 1, 1967:

"If the taxable income is:	The tax is:
Not over $2,000	15% of the taxable income.
Over $2,000 but not over $4,000	$300, plus 16% of excess over $2,000.
Over $4,000 but not over $6,000	$620, plus 16% of excess over $4,000.
Over $6,000 but not over $8,000	$940, plus 17% of excess over $6,000.
Over $8,000 but not over $10,000	$1,280, plus 18% of excess over $8,000.
Over $10,000 but not over $12,000	$1,640, plus 19% of excess over $10,000.
Over $12,000 but not over $14,000	$2,020, plus 19% of excess over $12,000.
Over $14,000 but not over $16,000	$2,400, plus 20% of excess over $14,000.
Over $16,000 but not over $18,000	$2,800, plus 21% of excess over $16,000.
Over $18,000 but not over $20,000	$3,220, plus 21% of excess over $18,000.
Over $20,000 but not over $22,000	$3,640, plus 23% of excess over $20,000.
Over $22,000 but not over $24,000	$4,100, plus 23% of excess over $22,000.
Over $24,000 but not over $28,000	$4,560, plus 24% of excess over $24,000.
Over $28,000 but not over $32,000	$5,520, plus 25% of excess over $28,000.
Over $32,000 but not over $38,000	$6,520, plus 26% of excess over $32,000.
Over $38,000 but not over $44,000	$8,080, plus 27% of excess over $38,000.
Over $44,000 but not over $50,000	$9,700, plus 28% of excess over $44,000.
Over $50,000 but not over $60,000	$11,380, plus 29% of excess over $50,000.
Over $60,000 but not over $70,000	$14,280, plus 30% of excess over $60,000.
Over $70,000 but not over $80,000	$17,280, plus 32% of excess over $70,000.
Over $80,000 but not over $90,000	$20,480, plus 34% of excess over $80,000.
Over $90,000 but not over $100,000	$23,880, plus 36% of excess over $90,000.
Over $100,000 but not over $150,000	$27,480, plus 38% of excess over $100,000.
Over $150,000 but not over $200,000	$46,480, plus 41% of excess over $150,000.
Over $200,000 but not over $300,000	$66,980, plus 44% of excess over $200,000.
Over $300,000	$110,980, plus 47% of excess over $300,000."

SEC. 3. Section 3 of the Internal Revenue Code of 1954 (relating to optional tax on income of less than $5,000 is hereby amended by inserting before the words "In lieu of the tax" the letter "(a)" and adding the following new subsection:

"(b) In the case of a taxable year beginning on or after January 1, 1962, the tax imposed by subsection (a) shall, subject to the provisions of section 22, be determined under this paragraph at the rates provided and effective for the taxable years prescribed in the following tables:

"(1) For taxable years beginning on or after January 1, 1962, the tax imposed by this section shall be the mid-point between the tax in effect as of December 31, 1961, and the tax set forth in paragraph (2) subsection (b) of this section.

"(2) For taxable years beginning on or after January 1, 1963, the tax imposed by this section shall be the tax shown in the following table:

"If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—												
								1		2			3							
At least	But less than	1	2	3	4 or more	At least	But less than	And taxpayer is single or married filing separately	And taxpayer is head of household	And taxpayer is single or married filing separately	And taxpayer is head of household	And a joint return is filed	And taxpayer is single or married filing separately	And taxpayer is head of household	And a joint return is filed	4	5	6	7	8 or more
		The tax is—						The tax is—												
$0	$675	$0	$0	$0	$0	$2,325	$2,350	$286	$286	$172	$172	$172	$58	$58	$58	$0	$0	$0	$0	$0
675	700	4	0	0	0	2,350	2,375	290	290	176	176	176	62	62	62	0	0	0	0	0
700	725	8	0	0	0	2,375	2,400	294	294	180	180	180	66	66	66	0	0	0	0	0
725	750	12	0	0	0	2,400	2,425	299	299	185	185	185	71	71	71	0	0	0	0	0
750	775	16	0	0	0	2,425	2,450	303	303	189	189	189	75	75	75	0	0	0	0	0
775	800	21	0	0	0	2,450	2,475	307	307	193	193	193	79	79	79	0	0	0	0	0
800	825	25	0	0	0	2,475	2,500	311	311	197	197	197	83	83	83	0	0	0	0	0
825	850	29	0	0	0	2,500	2,525	316	316	202	202	202	88	88	88	0	0	0	0	0
850	875	33	0	0	0	2,525	2,550	320	320	206	206	206	92	92	92	0	0	0	0	0
875	900	38	0	0	0	2,550	2,575	324	324	210	210	210	96	96	96	0	0	0	0	0
900	925	42	0	0	0	2,575	2,600	328	328	214	214	214	100	100	100	0	0	0	0	0
925	950	46	0	0	0	2,600	2,625	333	333	219	219	219	105	105	105	0	0	0	0	0
950	975	51	0	0	0	2,625	2,650	337	337	223	223	223	109	109	109	0	0	0	0	0
975	1,000	55	0	0	0	2,650	2,675	341	341	227	227	227	113	113	113	0	0	0	0	0
1,000	1,025	59	0	0	0	2,675	2,700	346	346	232	232	232	118	118	118	4	0	0	0	0
1,025	1,050	63	0	0	0	2,700	2,725	350	350	236	236	236	122	122	122	8	0	0	0	0
1,050	1,075	68	0	0	0	2,725	2,750	354	354	240	240	240	126	126	126	12	0	0	1	0
1,075	1,100	72	0	0	0	2,750	2,775	358	358	244	244	244	130	130	130	16	0	0	0	0
1,100	1,125	76	0	0	0	2,775	2,800	363	363	249	249	249	135	135	135	21	0	0	0	0
1,125	1,150	81	0	0	0	2,800	2,825	367	367	253	253	253	139	139	139	25	0	0	0	0
1,150	1,175	85	0	0	0	2,825	2,850	371	371	257	257	257	143	143	143	29	0	0	0	0
1,175	1,200	89	0	0	0	2,850	2,875	375	375	261	261	261	147	147	147	33	0	0	0	0
1,200	1,225	93	0	0	0	2,875	2,900	380	380	266	266	266	152	152	152	38	0	0	0	0
1,225	1,250	98	0	0	0	2,900	2,925	384	384	270	270	270	156	156	156	42	0	0	0	0
1,250	1,275	102	0	0	0	2,925	2,950	389	389	274	274	174	160	160	160	46	0	0	0	0
1,275	1,300	106	0	0	0	2,950	2,975	394	393	279	279	279	165	165	165	51	0	0	0	0
1,300	1,325	110	0	0	0	2,975	3,000	398	398	283	283	283	169	169	169	55	0	0	0	
1,325	1,350	115	1	0	0	3,000	3,050	405	404	289	289	289	175	175	175	61	0	0	0	0
1,350	1,375	119	5	0	0	3,050	3,100	414	414	298	298	298	184	184	184	70	0	0	0	0
1,375	1,400	123	9	0	0	3,100	3,150	424	423	306	306	306	192	192	192	78	0	0	0	0
1,400	1,425	128	14	0	0	3,150	3,200	433	432	315	315	315	201	201	201	87	0	0	0	0
1,425	1,450	132	18	0	0	3,200	3,250	442	441	323	323	323	209	209	209	95	0	0	0	0
1,450	1,475	136	22	0	0	3,250	3,300	451	450	332	332	322	218	218	218	104	0	0	0	0
1,475	1,500	140	26	0	0	3,300	3,350	460	459	341	341	341	227	227	227	113	0	0	0	0
1,500	1,525	145	31	0	0	3,350	3,400	470	468	349	349	349	235	235	235	121	7	0	0	0
1,525	1,550	149	35	0	0	3,400	3,450	479	477	358	358	358	244	244	244	130	16	0	0	0
1,550	1,575	153	39	0	0	3,450	3,500	488	486	366	366	366	252	252	252	139	24	0	0	0
1,575	1,600	157	43	0	0	3,500	3,550	497	495	375	375	375	261	261	261	147	33	0	0	0
1,600	1,625	162	48	0	0	3,550	3,600	507	504	384	384	383	269	269	269	156	41	0	0	0
1,625	1,650	166	52	0	0	3,600	3,650	516	513	393	393	392	278	278	278	164	50	0	0	0
1,650	1,675	170	56	0	0	3,650	3,700	525	522	402	402	400	286	286	286	172	58	0	0	0
1,675	1,700	175	61	0	0	3,700	3,750	534	531	411	411	409	295	295	295	181	67	0	0	0
1,700	1,725	179	65	0	0	3,750	3,800	543	540	420	420	418	304	304	304	190	76	0	0	0
1,725	1,750	183	69	0	0	3,800	3,850	553	549	430	429	426	312	312	312	198	84	0	0	0
1,750	1,775	187	73	0	0	3,850	3,900	562	558	439	438	435	321	321	321	207	93	0	0	0
1,775	1,800	192	78	0	0	3,900	3,950	571	567	448	447	443	329	329	329	215	101	0	0	0
1,800	1,825	196	82	0	0	3,950	4,000	580	576	457	456	452	338	338	338	224	110	0	0	0
1,825	1,850	200	86	0	0	4,000	4,050	590	585	467	465	460	346	346	346	232	118	4	0	0
1,850	1,875	204	90	0	0	4,050	4,100	599	594	476	474	469	355	355	355	241	127	13	0	0
1,875	1,900	209	95	0	0	4,100	4,150	608	603	485	483	477	363	363	363	249	135	21	0	0
1,900	1,925	213	99	0	0	4,150	4,200	617	612	494	492	486	372	372	372	258	144	30	0	0
1,925	1,950	217	103	0	0	4,200	4,250	627	621	504	501	494	381	381	380	266	152	38	0	0
1,950	1,975	222	108	0	0	4,250	4,300	636	630	513	510	503	390	390	389	275	161	47	0	0
1,975	2,000	226	112	0	0	4,300	4,350	645	639	522	519	512	399	399	398	284	170	56	0	0
2,000	2,025	230	116	2	0	4,350	4,400	654	648	531	528	520	408	408	406	292	178	64	0	0
2,025	2,050	234	120	6	0	4,400	4,450	663	657	540	537	529	417	417	415	301	187	73	0	0
2,050	2,075	239	125	11	0	4,450	4,500	673	666	550	546	537	427	426	423	309	195	81	0	0
2,075	2,100	243	129	15	0	4,500	4,550	682	675	559	555	546	436	435	432	318	204	90	0	0
2,100	2,125	247	133	19	0	4,550	4,600	691	684	568	564	554	445	444	440	326	212	98	0	0
2,125	2,150	252	138	24	0	4,600	4,650	700	693	577	573	563	454	453	449	335	221	107	0	0
2,150	2,175	256	142	28	0	4,650	4,700	710	702	587	582	571	464	462	457	343	229	115	1	0
2,175	2,200	260	146	32	0	4,700	4,750	719	711	596	591	580	473	471	466	352	238	124	10	0
2,200	2,225	264	150	36	0	4,750	4,800	728	720	605	600	589	482	480	475	361	247	133	19	0
2,225	2,250	269	155	41	0	4,800	4,850	737	729	614	609	597	491	489	483	369	255	141	27	0
2,250	2,275	273	159	45	0	4,850	4,900	746	738	623	618	606	500	498	492	378	264	150	36	0
2,275	2,300	277	163	49	0	4,900	4,950	756	747	633	627	614	510	507	500	387	272	158	44	0
2,300	2,325	281	167	53	0	4,950	5,000	765	756	642	636	623	519	516	509	396	281	167	53	0

"(3) For taxable years beginning on or after January 1, 1964, the tax imposed by this section shall be the tax shown in the following table:

"If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—												
								1		2			3							
At least	But less than	1	2	3	4 or more	At least	But less than	And taxpayer is single or married filing separately	And taxpayer is head of household	And taxpayer is single or married filing separately	And taxpayer is head of household	And a joint return is filed	And taxpayer is single or married filing separately	And taxpayer is head of household	And a joint return is filed	4	5	6	7	8 or more
		The tax is—						The tax is—												
$0	$675	$0	$0	$0	$0	$2,325	$2,350	$271	$271	$163	$163	$163	$55	$55	$55	$0	$0	$0	$0	$0
675	700	3	0	0	0	2,350	2,375	275	275	167	167	167	59	59	59	0	0	0	0	0
700	725	7	0	0	0	2,375	2,400	279	279	171	171	171	63	63	63	0	0	0	0	0
725	750	11	0	0	0	2,400	2,425	283	283	175	175	175	67	67	67	0	0	0	0	0
750	775	15	0	0	0	2,425	2,450	287	287	179	179	179	71	71	71	0	0	0	0	0
775	800	20	0	0	0	2,450	2,475	291	291	183	183	183	75	75	75	0	0	0	0	0
800	825	24	0	0	0	2,475	2,500	295	295	187	187	187	79	79	79	0	0	0	0	0
825	850	28	0	0	0	2,500	2,525	299	299	191	191	191	83	83	83	0	0	0	0	0
850	875	32	0	0	0	2,525	2,550	303	303	195	195	195	87	87	87	0	0	0	0	0
875	900	36	0	0	0	2,550	2,575	307	307	199	199	199	91	91	91	0	0	0	0	0
900	925	40	0	0	0	2,575	2,600	311	311	203	203	203	95	95	95	0	0	0	0	0
925	950	44	0	0	0	2,600	2,625	315	315	207	207	207	99	99	99	0	0	0	0	0
950	975	48	0	0	0	2,625	2,650	319	319	211	211	211	103	103	103	0	0	0	0	0
975	1,000	52	0	0	0	2,650	2,675	323	323	215	215	215	107	107	107	0	0	0	0	0
1,000	1,025	56	0	0	0	2,675	2,700	327	327	219	219	219	111	111	111	3	0	0	0	0
1,025	1,050	60	0	0	0	2,700	2,725	331	331	223	223	223	115	115	115	7	0	0	0	0
1,050	1,075	64	0	0	0	2,725	2,750	335	335	227	227	227	119	119	119	11	0	0	0	0
1,075	1,100	68	0	0	0	2,750	2,775	340	340	232	232	232	124	124	124	16	0	0	0	0
1,100	1,125	72	0	0	0	2,775	2,800	344	344	236	236	236	128	128	128	20	0	0	0	0
1,125	1,150	76	0	0	0	2,800	2,825	348	348	240	240	240	132	132	132	24	0	0	0	0
1,150	1,175	80	0	0	0	2,825	2,850	352	352	244	244	244	136	136	136	28	0	0	0	0
1,175	1,200	84	0	0	0	2,850	2,875	356	356	248	248	248	140	140	140	32	0	0	0	0
1,200	1,225	88	0	0	0	2,875	2,900	360	360	252	252	252	144	144	144	36	0	0	0	0
1,225	1,250	92	0	0	0	2,900	2,925	364	364	256	256	256	148	148	148	40	0	0	0	0
1,250	1,275	97	0	0	0	2,925	2,950	368	368	260	260	260	152	152	152	44	0	0	0	0
1,275	1,300	101	0	0	0	2,950	2,975	373	373	264	264	264	156	156	156	48	0	0	0	0
1,300	1,325	105	0	0	0	2,975	3,000	377	377	268	268	268	160	160	160	52	0	0	0	0
1,325	1,350	109	1	0	0	3,000	3,050	384	383	274	274	274	166	166	166	58	0	0	0	0
1,350	1,375	113	5	0	0	3,050	3,100	393	392	282	282	282	174	174	174	66	0	0	0	0
1,375	1,400	117	9	0	0	3,100	3,150	401	400	290	290	290	182	182	182	74	0	0	0	0
1,400	1,425	121	13	0	0	3,150	3,200	410	409	298	298	298	190	190	190	82	0	0	0	0
1,425	1,450	125	17	0	0	3,200	3,250	419	417	306	306	306	198	198	198	90	0	0	0	0
1,450	1,475	129	21	0	0	3,250	3,300	428	426	315	315	315	207	207	207	99	0	0	0	0
1,475	1,500	133	25	0	0	3,300	3,350	437	435	323	323	323	215	215	215	107	0	0	0	0
1,500	1,525	137	29	0	0	3,350	3,400	445	443	331	331	331	223	223	223	115	7	0	0	0
1,525	1,550	141	33	0	0	3,400	3,450	454	452	339	339	339	231	231	231	123	15	0	0	0
1,550	1,575	145	37	0	0	3,450	3,500	463	460	347	347	347	239	239	239	131	23	0	0	0
1,575	1,600	149	41	0	0	3,500	3,550	472	469	355	355	355	247	247	247	139	31	0	0	0
1,600	1,625	153	45	0	0	3,550	3,600	480	477	363	363	363	255	255	255	147	39	0	0	0
1,625	1,650	157	49	0	0	3,600	3,650	489	486	372	372	371	263	263	263	155	47	0	0	0
1,650	1,675	161	53	0	0	3,650	3,700	498	494	381	379	379	271	271	271	163	55	0	0	0
1,675	1,700	165	57	0	0	3,700	3,750	507	503	390	390	387	279	279	279	171	63	0	0	0
1,700	1,725	169	61	0	0	3,750	3,800	516	512	399	398	396	288	288	288	180	72	0	0	0
1,725	1,750	173	65	0	0	3,800	3,850	524	520	407	406	404	296	296	296	188	80	0	0	0
1,750	1,775	178	70	0	0	3,850	3,900	533	529	416	415	412	304	304	304	196	88	0	0	0
1,775	1,800	182	74	0	0	3,900	3,950	542	537	425	423	420	312	312	312	204	96	0	0	0
1,800	1,825	186	78	0	0	3,950	4,000	551	546	434	432	428	320	320	320	212	104	0	0	0
1,825	1,850	190	82	0	0	4,000	4,050	559	554	442	440	436	328	328	328	220	112	4	0	0
1,850	1,875	194	86	0	0	4,050	4,100	568	563	451	449	444	336	336	336	228	120	12	0	0
1,875	1,900	198	90	0	0	4,100	4,150	577	571	460	457	452	344	344	344	236	128	20	0	0
1,900	1,925	202	94	0	0	4,150	4,200	586	580	469	466	460	352	352	352	244	136	28	0	0
1,925	1,950	206	98	0	0	4,200	4,250	594	588	477	474	468	360	360	360	252	144	36	0	0
1,950	1,975	210	102	0	0	4,250	4,300	603	597	486	483	477	369	369	369	261	153	45	0	0
1,975	2,000	214	106	0	0	4,300	4,350	612	606	495	492	485	378	378	377	269	161	53	0	0
2,000	2,025	218	110	2	0	4,350	4,400	621	614	504	500	493	387	386	385	277	169	61	0	0
2,025	2,050	222	114	6	0	4,400	4,450	630	623	513	509	501	396	395	393	285	177	69	0	0
2,050	2,075	226	118	10	0	4,450	4,500	638	631	521	517	509	404	403	401	293	185	77	0	0
2,075	2,100	230	122	14	0	4,500	4,550	647	640	530	526	517	413	412	409	301	193	85	0	0
2,100	2,125	234	126	18	0	4,550	4,600	656	648	539	534	525	422	420	417	309	201	93	0	0
2,125	2,150	238	130	22	0	4,600	4,650	665	657	548	543	533	431	429	425	317	209	101	0	0
2,150	2,175	242	134	26	0	4,650	4,700	673	665	556	551	541	439	437	433	325	217	109	1	0
2,175	2,200	246	138	30	0	4,700	4,750	682	674	565	560	549	448	446	441	333	225	117	9	0
2,200	2,225	250	142	34	0	4,750	4,800	691	683	574	569	558	457	455	450	342	234	126	18	0
2,225	2,250	254	146	38	0	4,800	4,850	700	691	583	577	566	466	463	458	350	242	134	26	0
2,250	2,275	258	151	43	0	4,850	4,900	709	700	592	586	574	475	472	466	358	250	142	34	0
2,275	2,300	263	155	47	0	4,900	4,950	717	708	600	594	582	483	480	474	366	258	150	42	0
2,300	2,325	267	159	51	0	4,950	5,000	726	717	609	603	590	492	489	482	375	266	158	50	0

"(4) For taxable years beginning on or after January 1, 1965, the tax imposed by this section shall be the tax shown in the following table:

"If adjusted gross income is— At least	But less than	And the number of exemptions is— 1	2	3	4 or more
		The tax is—			
$0	$675	$0	$0	$0	$0
675	700	3	0	0	0
700	725	7	0	0	0
725	750	11	0	0	0
750	775	15	0	0	0
775	800	18	0	0	0
800	825	22	0	0	0
825	850	26	0	0	0
850	875	30	0	0	0
875	900	34	0	0	0
900	925	38	0	0	0
925	950	41	0	0	0
950	975	45	0	0	0
975	1,000	49	0	0	0
1,000	1,025	53	0	0	0
1,025	1,050	57	0	0	0
1,050	1,075	61	0	0	0
1,075	1,100	64	0	0	0
1,100	1,125	68	0	0	0
1,125	1,150	72	0	0	0
1,150	1,175	76	0	0	0
1,175	1,200	80	0	0	0
1,200	1,225	84	0	0	0
1,225	1,250	87	0	0	0
1,250	1,275	91	0	0	0
1,275	1,300	95	0	0	0
1,300	1,325	99	0	0	0
1,325	1,350	103	1	0	0
1,350	1,375	106	5	0	0
1,375	1,400	110	8	0	0
1,400	1,425	114	12	0	0
1,425	1,450	118	16	0	0
1,450	1,475	122	20	0	0
1,475	1,500	126	24	0	0
1,500	1,525	129	27	0	0
1,525	1,550	133	31	0	0
1,550	1,575	137	35	0	0
1,575	1,600	141	39	0	0
1,600	1,625	145	43	0	0
1,625	1,650	149	47	0	0
1,650	1,675	152	50	0	0
1,675	1,700	156	54	0	0
1,700	1,725	160	58	0	0
1,725	1,750	164	62	0	0
1,750	1,775	168	66	0	0
1,775	1,800	171	69	0	0
1,800	1,825	175	73	0	0
1,825	1,850	179	77	0	0
1,850	1,875	183	81	0	0
1,875	1,900	187	85	0	0
1,900	1,925	191	89	0	0
1,925	1,950	194	92	0	0
1,950	1,975	198	96	0	0
1,975	2,000	202	100	0	0
2,000	2,025	206	104	2	0
2,025	2,050	210	108	6	0
2,050	2,075	214	112	10	0
2,075	2,100	217	115	13	0
2,100	2,125	221	119	17	0
2,125	2,150	225	123	21	0
2,150	2,175	229	127	25	0
2,175	2,200	233	131	29	0
2,200	2,225	237	135	33	0
2,225	2,250	240	138	36	0
2,250	2,275	244	142	40	0
2,275	2,300	248	146	44	0
2,300	2,325	252	150	48	0

If adjusted gross income is— At least	But less than	And the number of exemptions is— 1: And taxpayer is single or married filing separately	1: And taxpayer is head of household	2: And taxpayer is single or married filing separately	2: And taxpayer is head of household	2: And a joint return is filed	3: And taxpayer is single or married filing separately	3: And taxpayer is head of household	3: And a joint return is filed	4	5	6	7	8 or more
		The tax is—												
$2,325	$2,350	$256	$256	$154	$154	$154	$52	$52	$52	$0	$0	$0	$0	$0
2,350	2,375	259	259	157	157	157	55	55	55	0	0	0	0	0
2,375	2,400	263	263	161	161	161	59	59	59	0	0	0	0	0
2,400	2,425	267	267	165	165	165	63	63	63	0	0	0	0	0
2,425	2,450	271	271	169	169	169	67	67	67	0	0	0	0	0
2,450	2,475	275	275	173	173	173	71	71	71	0	0	0	0	0
2,475	2,500	279	279	177	177	177	75	75	75	0	0	0	0	0
2,500	2,525	282	282	180	180	180	78	78	78	0	0	0	0	0
2,525	2,550	286	286	184	184	184	82	82	82	0	0	0	0	0
2,550	2,575	290	290	188	188	188	86	86	86	0	0	0	0	0
2,575	2,600	294	294	192	192	192	90	90	90	0	0	0	0	0
2,600	2,625	298	298	196	196	196	94	94	94	0	0	0	0	0
2,625	2,650	302	302	200	200	200	98	98	98	0	0	0	0	0
2,650	2,675	305	305	203	203	203	101	101	101	0	0	0	0	0
2,675	2,700	309	309	207	207	207	105	105	105	3	0	0	0	0
2,700	2,725	313	313	211	211	211	109	109	109	7	0	0	0	0
2,725	2,750	317	317	215	215	215	113	113	113	11	0	0	0	0
2,750	2,775	321	321	219	219	219	117	117	117	15	0	0	0	0
2,775	2,800	324	324	222	222	222	120	120	120	18	0	0	0	0
2,800	2,825	328	328	226	226	226	124	124	124	22	0	0	0	0
2,825	2,850	332	332	230	230	230	128	128	128	26	0	0	0	0
2,850	2,875	336	336	234	234	234	132	132	132	30	0	0	0	0
2,875	2,900	340	340	238	238	238	136	136	136	34	0	0	0	0
2,900	2,925	344	344	242	242	242	140	140	140	38	0	0	0	0
2,925	2,950	348	348	245	245	245	143	143	143	41	0	0	0	0
2,950	2,975	352	352	249	249	249	147	147	147	45	0	0	0	0
2,975	3,000	356	356	253	253	253	151	151	151	49	0	0	0	0
3,000	3,050	363	362	259	259	259	157	157	157	55	0	0	0	0
3,050	3,100	371	370	266	266	266	164	164	164	62	0	0	0	0
3,100	3,150	379	378	274	274	274	172	172	172	70	0	0	0	0
3,150	3,200	388	386	282	282	282	180	180	180	78	0	0	0	0
3,200	3,250	396	394	289	289	289	187	187	187	85	0	0	0	0
3,250	3,300	404	403	297	297	297	195	195	195	93	0	0	0	0
3,300	3,350	413	411	305	305	305	203	203	203	101	0	0	0	0
3,350	3,400	421	419	312	312	312	210	210	210	108	6	0	0	0
3,400	3,450	429	427	320	320	320	218	218	218	116	14	0	0	0
3,450	3,500	438	435	328	328	328	226	226	226	124	22	0	0	0
3,500	3,550	446	443	335	335	335	233	233	233	131	29	0	0	0
3,550	3,600	454	451	343	343	343	241	241	241	139	37	0	0	0
3,600	3,650	463	459	352	351	351	249	249	249	147	45	0	0	0
3,650	3,700	471	467	360	359	358	256	256	256	154	52	0	0	0
3,700	3,750	479	475	368	367	366	264	264	264	162	60	0	0	0
3,750	3,800	488	484	377	376	374	272	272	272	170	68	0	0	0
3,800	3,850	496	492	385	384	381	279	279	279	177	75	0	0	0
3,850	3,900	504	500	393	392	389	287	287	287	185	83	0	0	0
3,900	3,950	513	508	402	400	397	295	295	295	193	91	0	0	0
3,950	4,000	521	516	410	408	404	302	302	302	200	98	0	0	0
4,000	4,050	529	524	418	416	412	310	310	310	208	106	4	0	0
4,050	4,100	537	532	426	424	419	317	317	317	215	113	11	0	0
4,100	4,150	546	540	435	432	427	325	325	325	223	121	19	0	0
4,150	4,200	554	548	443	440	435	333	333	333	231	129	27	0	0
4,200	4,250	562	556	451	448	442	340	340	340	238	136	34	0	0
4,250	4,300	571	565	460	457	450	349	349	348	246	144	42	0	0
4,300	4,350	579	573	468	465	458	357	357	356	254	152	50	0	0
4,350	4,400	587	581	476	473	465	365	365	363	261	159	57	0	0
4,400	4,450	596	589	485	481	473	374	373	371	269	167	65	0	0
4,450	4,500	604	597	493	489	481	382	381	379	277	175	73	0	0
4,500	4,550	612	605	501	497	488	390	389	386	284	182	80	0	0
4,550	4,600	621	613	510	505	496	399	397	394	292	190	88	0	0
4,600	4,650	629	621	518	513	504	407	405	402	300	198	96	0	0
4,650	4,700	637	629	526	521	511	415	413	409	307	205	103	1	0
4,700	4,750	646	637	535	529	519	424	421	417	315	213	111	9	0
4,750	4,800	654	646	543	538	527	432	430	425	323	221	119	17	0
4,800	4,850	662	654	551	546	534	440	438	432	330	228	126	24	0
4,850	4,900	671	662	560	554	542	449	446	440	338	236	134	32	0
4,900	4,950	679	670	568	562	550	457	454	448	346	244	142	40	0
4,950	5,000	687	678	576	570	557	465	462	455	354	251	149	47	0

"(5) For taxable years beginning on or after January 1, 1966, the tax imposed by this section shall be the tax shown in the following table:

"If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—												
								1		2			3							
At least	But less than	1	2	3	4 or more	At least	But less than	And taxpayer is single or married filing separately	And taxpayer is head of household	And taxpayer is single or married filing separately	And taxpayer is head of household	And a joint return is filed	And taxpayer is single or married filing separately	And taxpayer is head of household	And a joint return is filed	4	5	6	7	8 or more
		The tax is—						The tax is—												
$0	$675	$0	$0	$0	$0	$2,325	$2,350	$241	$241	$145	$145	$145	$49	$49	$49	$0	$0	$0	$0	$0
675	700	3	0	0	0	2,350	2,375	244	244	149	149	149	52	52	52	0	0	0	0	0
700	725	7	0	0	0	2,375	2,400	248	248	152	152	152	56	56	56	0	0	0	0	0
725	750	10	0	0	0	2,400	2,425	251	251	156	156	156	59	59	59	0	0	0	0	0
750	775	14	0	0	0	2,425	2,450	255	255	159	159	159	63	63	63	0	0	0	0	0
775	800	17	0	0	0	2,450	2,475	258	258	163	163	163	67	67	67	0	0	0	0	0
800	825	21	0	0	0	2,475	2,500	262	262	166	166	166	70	70	70	0	0	0	0	0
825	850	24	0	0	0	2,500	2,525	265	265	170	170	170	74	74	74	0	0	0	0	0
850	875	28	0	0	0	2,525	2,550	269	269	173	173	173	77	77	77	0	0	0	0	0
875	900	31	0	0	0	2,550	2,575	272	272	177	177	177	81	81	81	0	0	0	0	0
900	925	35	0	0	0	2,575	2,600	277	277	181	181	181	85	85	85	0	0	0	0	0
925	950	39	0	0	0	2,600	2,625	280	280	184	184	184	88	88	88	0	0	0	0	0
950	975	42	0	0	0	2,625	2,650	284	284	188	188	188	92	92	92	0	0	0	0	0
975	1,000	46	0	0	0	2,650	2,675	287	287	191	191	191	95	95	95	0	0	0	0	0
1,000	1,025	50	0	0	0	2,675	2,700	291	291	195	195	195	99	99	99	3	0	0	0	0
1,025	1,050	53	0	0	0	2,700	2,725	295	295	198	198	198	102	102	102	7	0	0	0	0
1,050	1,075	57	0	0	0	2,725	2,750	298	298	202	202	202	106	106	106	11	0	0	0	0
1,075	1,100	61	0	0	0	2,750	2,775	302	302	205	205	205	110	110	110	14	0	0	0	0
1,100	1,125	64	0	0	0	2,775	2,800	305	305	209	209	209	113	113	113	17	0	0	0	0
1,125	1,150	68	0	0	0	2,800	2,825	309	309	213	213	213	117	117	117	21	0	0	0	0
1,150	1,175	71	0	0	0	2,825	2,850	313	313	217	217	217	121	121	121	24	0	0	0	0
1,175	1,200	75	0	0	0	2,850	2,875	316	316	220	220	220	124	124	124	28	0	0	0	0
1,200	1,225	79	0	0	0	2,875	2,900	320	320	224	224	224	128	128	128	32	0	0	0	0
1,225	1,250	82	0	0	0	2,900	2,925	324	324	227	227	227	131	131	131	35	0	0	0	0
1,250	1,275	86	0	0	0	2,925	2,950	328	327	231	231	231	135	135	135	39	0	0	0	0
1,275	1,300	89	0	0	0	2,950	2,975	332	331	235	235	235	138	138	138	42	0	0	0	0
1,300	1,325	93	0	0	0	2,975	3,000	336	335	238	238	238	142	142	142	46	0	0	0	0
1,325	1,350	97	1	0	0	3,000	3,050	341	341	244	244	244	148	148	148	52	0	0	0	0
1,350	1,375	100	4	0	0	3,050	3,100	349	348	251	251	251	155	155	155	59	0	0	0	0
1,375	1,400	104	8	0	0	3,100	3,150	357	356	258	258	258	162	162	162	66	0	0	0	0
1,400	1,425	107	11	0	0	3,150	3,200	365	364	265	265	265	169	169	169	73	0	0	0	0
1,425	1,450	111	15	0	0	3,200	3,250	373	371	272	272	272	176	176	176	80	0	0	0	0
1,450	1,475	115	19	0	0	3,250	3,300	381	379	280	280	280	184	184	184	88	0	0	0	0
1,475	1,500	118	22	0	0	3,300	3,350	389	387	287	287	287	191	191	191	95	0	0	0	0
1,500	1,525	122	26	0	0	3,350	3,400	397	394	294	294	294	198	198	198	102	6	0	0	0
1,525	1,550	125	29	0	0	3,400	3,450	404	402	301	301	301	205	205	205	109	13	0	0	0
1,550	1,575	129	33	0	0	3,450	3,500	412	410	308	308	308	212	212	212	116	20	0	0	0
1,575	1,600	133	37	0	0	3,500	3,550	420	417	316	316	316	220	220	220	124	27	0	0	0
1,600	1,625	136	40	0	0	3,550	3,600	428	425	323	323	323	227	227	227	131	35	0	0	0
1,625	1,650	140	44	0	0	3,600	3,650	436	433	331	331	330	234	234	234	138	42	0	0	0
1,650	1,675	143	47	0	0	3,650	3,700	444	440	339	338	337	241	241	241	145	49	0	0	0
1,675	1,700	147	51	0	0	3,700	3,750	452	448	347	346	344	248	248	248	152	56	0	0	0
1,700	1,725	151	55	0	0	3,750	3,800	460	456	355	354	352	256	256	256	160	64	0	0	0
1,725	1,750	154	58	0	0	3,800	3,850	467	463	362	361	359	263	263	263	167	71	0	0	0
1,750	1,775	158	62	0	0	3,850	3,900	475	471	370	369	366	270	270	270	174	78	0	0	0
1,775	1,800	161	65	0	0	3,900	3,950	483	479	378	377	373	277	277	277	181	85	0	0	0
1,800	1,825	165	69	0	0	3,950	4,000	491	486	386	384	380	284	284	284	188	92	0	0	0
1,825	1,850	169	72	0	0	4,000	4,050	499	494	394	392	388	292	292	292	196	100	4	0	0
1,850	1,875	172	76	0	0	4,050	4,100	507	501	402	399	395	299	299	299	203	107	11	0	0
1,875	1,900	176	80	0	0	4,100	4,150	515	509	410	407	402	306	306	306	210	114	18	0	0
1,900	1,925	179	83	0	0	4,150	4,200	522	517	418	415	409	313	313	313	217	121	25	0	0
1,925	1,950	183	87	0	0	4,200	4,250	530	524	425	422	416	320	320	320	224	128	32	0	0
1,950	1,975	187	91	0	0	4,250	4,300	538	532	433	430	424	328	328	328	232	136	40	0	0
1,975	2,000	190	94	0	0	4,300	4,350	546	540	441	438	431	336	336	335	239	143	47	0	0
2,000	2,025	194	98	2	0	4,350	4,400	554	547	449	445	438	344	343	342	246	150	54	0	0
2,025	2,050	197	101	5	0	4,400	4,450	562	555	457	453	445	352	351	349	253	157	61	0	0
2,050	2,075	201	105	9	0	4,450	4,500	570	563	465	461	452	360	359	356	260	164	68	0	0
2,075	2,100	205	109	12	0	4,500	4,550	578	570	473	468	460	368	366	364	268	172	76	0	0
2,100	2,125	208	112	16	0	4,550	4,600	586	578	481	476	467	376	374	371	275	179	83	0	0
2,125	2,150	212	116	20	0	4,600	4,650	593	586	488	484	474	384	382	378	282	186	90	0	0
2,150	2,175	215	119	23	0	4,650	4,700	601	593	496	491	481	391	389	385	289	193	97	1	0
2,175	2,200	219	123	27	0	4,700	4,750	609	601	504	499	488	399	397	392	296	200	104	8	0
2,200	2,225	223	127	31	0	4,750	4,800	617	609	512	507	496	407	405	400	304	208	112	16	0
2,225	2,250	226	130	34	0	4,800	4,850	625	616	520	514	503	415	412	407	311	215	119	23	0
2,250	2,275	230	134	38	0	4,850	4,900	633	624	528	522	510	423	420	414	318	222	126	30	0
2,275	2,300	233	137	41	0	4,900	4,950	641	632	536	530	517	431	428	421	325	229	133	37	0
2,300	2,325	237	141	45	0	4,950	5,000	649	639	544	537	524	439	435	428	332	236	140	44	0

"(6) For taxable years beginning on or after January 1, 1967, the tax imposed by this section shall be the tax shown in the following table:

"If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—												
								1		2			3							
At least	But less than	1	2	3	4 or more	At least	But less than	And taxpayer is single or married filing separately	And taxpayer is head of household	And taxpayer is single or married filing separately	And taxpayer is head of household	And a joint return is filed	And taxpayer is single or married filing separately	And taxpayer is head of household	And a joint return is filed	4	5	6	7	8 or more
		The tax is—						The tax is—												
$0	$675	$0	$0	$0	$0	$2,325	$2,350	$226	$226	$136	$136	$136	$46	$46	$46	$0	$0	$0	$0	$0
675	700	3	0	0	0	2,350	2,375	229	229	139	139	139	49	49	49	0	0	0	0	0
700	725	6	0	0	0	2,375	2,400	232	232	142	142	142	52	52	52	0	0	0	0	0
725	750	10	0	0	0	2,400	2,425	236	236	146	146	146	56	56	56	0	0	0	0	0
750	775	13	0	0	0	2,425	2,450	239	239	149	149	149	59	59	59	0	0	0	0	0
775	800	16	0	0	0	2,450	2,475	242	242	152	152	152	62	62	62	0	0	0	0	0
800	825	20	0	0	0	2,475	2,500	246	246	156	156	156	66	66	66	0	0	0	0	0
825	850	23	0	0	0	2,500	2,525	249	249	159	159	159	69	69	69	0	0	0	0	0
850	875	26	0	0	0	2,525	2,550	253	253	163	163	163	73	73	73	0	0	0	0	0
875	900	30	0	0	0	2,550	2,575	256	256	166	166	166	76	76	76	0	0	0	0	0
900	925	33	0	0	0	2,575	2,600	259	259	169	169	169	79	79	79	0	0	0	0	0
925	950	37	0	0	0	2,600	2,625	263	263	173	173	173	83	83	83	0	0	0	0	0
950	975	40	0	0	0	2,625	2,650	266	266	176	176	176	86	86	86	0	0	0	0	0
975	1,000	43	0	0	0	2,650	2,675	269	269	179	179	179	89	89	89	0	0	0	0	0
1,000	1,025	47	0	0	0	2,675	2,700	273	273	183	183	183	93	93	93	3	0	0	0	0
1,025	1,050	50	0	0	0	2,700	2,725	276	276	186	186	186	96	96	96	6	0	0	0	0
1,050	1,075	53	0	0	0	2,725	2,750	280	280	190	190	190	100	100	100	10	0	0	0	0
1,075	1,100	57	0	0	0	2,750	2,775	283	283	193	193	193	103	103	103	13	0	0	0	0
1,100	1,125	60	0	0	0	2,775	2,800	286	286	196	196	196	106	106	106	16	0	0	0	0
1,125	1,150	64	0	0	0	2,800	2,825	290	290	200	200	200	110	110	110	20	0	0	0	0
1,150	1,175	67	0	0	0	2,825	2,850	293	293	203	203	203	113	113	113	23	0	0	0	0
1,175	1,200	70	0	0	0	2,850	2,875	296	296	206	206	206	116	116	116	26	0	0	0	0
1,200	1,225	74	0	0	0	2,875	2,900	300	300	210	210	210	120	120	120	30	0	0	0	0
1,225	1,250	77	0	0	0	2,900	2,925	303	303	213	213	213	123	123	123	33	0	0	0	0
1,250	1,275	80	0	0	0	2,925	2,950	307	307	217	217	217	127	127	127	37	0	0	0	0
1,275	1,300	84	0	0	0	2,950	2,975	311	311	220	220	220	130	130	130	40	0	0	0	0
1,300	1,325	87	0	0	0	2,975	3,000	314	314	223	223	223	133	133	133	43	0	0	0	0
1,325	1,350	91	1	0	0	3,000	3,050	320	320	228	228	228	138	138	138	48	0	0	0	0
1,350	1,375	94	4	0	0	3,050	3,100	327	327	235	235	235	145	145	145	55	0	0	0	0
1,375	1,400	97	7	0	0	3,100	3,150	334	334	242	242	242	152	152	152	62	0	0	0	0
1,400	1,425	101	11	0	0	3,150	3,200	341	341	249	249	249	159	159	159	69	0	0	0	0
1,425	1,450	104	14	0	0	3,200	3,250	348	348	255	255	255	165	165	165	75	0	0	0	0
1,450	1,475	107	17	0	0	3,250	3,300	356	356	262	262	262	172	172	172	82	0	0	0	0
1,475	1,500	111	21	0	0	3,300	3,350	363	363	269	269	269	179	179	179	89	0	0	0	0
1,500	1,525	114	24	0	0	3,350	3,400	370	370	276	276	276	186	186	186	96	6	0	0	0
1,525	1,550	118	28	0	0	3,400	3,450	377	377	282	282	282	192	192	192	102	12	0	0	0
1,550	1,575	121	31	0	0	3,450	3,500	384	384	289	289	289	199	199	199	109	19	0	0	0
1,575	1,600	124	34	0	0	3,500	3,550	392	392	296	296	296	206	206	206	116	26	0	0	0
1,600	1,625	128	38	0	0	3,550	3,600	399	399	303	303	303	213	213	213	123	33	0	0	0
1,625	1,650	131	41	0	0	3,600	3,650	406	406	310	310	309	219	219	219	129	39	0	0	0
1,650	1,675	134	44	0	0	3,650	3,700	413	413	317	317	316	226	226	226	136	46	0	0	0
1,675	1,700	138	48	0	0	3,700	3,750	420	420	324	324	323	233	233	233	143	53	0	0	0
1,700	1,725	141	51	0	0	3,750	3,800	428	428	332	332	330	240	240	240	150	60	0	0	0
1,725	1,750	145	55	0	0	3,800	3,850	435	435	339	339	336	246	246	246	156	66	0	0	0
1,750	1,775	148	58	0	0	3,850	3,900	442	442	346	346	343	253	253	253	163	73	0	0	0
1,775	1,800	151	61	0	0	3,900	3,950	449	449	353	353	350	260	260	260	170	80	0	0	0
1,800	1,825	155	65	0	0	3,950	4,000	456	456	360	360	357	267	267	267	177	87	0	0	0
1,825	1,850	158	68	0	0	4,000	4,050	464	464	368	368	363	273	273	273	183	93	3	0	0
1,850	1,875	161	71	0	0	4,050	4,100	471	471	375	375	370	280	280	280	190	100	10	0	0
1,875	1,900	165	75	0	0	4,100	4,150	478	478	382	382	377	287	287	287	197	107	17	0	0
1,900	1,925	168	78	0	0	4,150	4,200	485	485	389	389	384	294	294	294	204	114	24	0	0
1,925	1,950	172	82	0	0	4,200	4,250	492	492	396	396	390	300	300	300	210	120	30	0	0
1,950	1,975	175	85	0	0	4,250	4,300	500	500	404	404	397	308	308	307	217	127	37	0	0
1,975	2,000	178	88	0	0	4,300	4,350	507	507	411	411	404	315	315	314	224	134	44	0	0
2,000	2,025	182	92	2	0	4,350	4,400	514	514	418	418	411	322	322	321	231	141	51	0	0
2,025	2,050	185	95	5	0	4,400	4,450	521	521	425	425	417	329	329	327	237	147	57	0	0
2,050	2,075	188	98	8	0	4,450	4,500	528	528	432	432	424	336	336	334	244	154	64	0	0
2,075	2,100	192	102	12	0	4,500	4,550	536	536	440	440	431	344	344	341	251	161	71	0	0
2,100	2,125	195	105	15	0	4,550	4,600	543	543	447	447	438	351	351	348	258	168	78	0	0
2,125	2,150	199	109	19	0	4,600	4,650	550	550	454	454	444	358	358	354	264	174	84	0	0
2,150	2,175	202	112	22	0	4,650	4,700	557	557	461	461	451	365	365	361	271	181	91	1	0
2,175	2,200	205	115	25	0	4,700	4,750	564	564	468	468	458	372	372	368	278	188	98	8	0
2,200	2,225	209	119	29	0	4,750	4,800	572	572	476	476	465	380	380	375	285	195	105	15	0
2,225	2,250	212	122	32	0	4,800	4,850	579	579	483	483	471	387	387	381	291	201	111	21	0
2,250	2,275	215	125	35	0	4,850	4,900	586	586	490	490	478	394	394	388	298	208	118	28	0
2,275	2,300	218	129	39	0	4,900	4,950	593	593	497	497	485	401	401	395	305	215	125	35	0
2,300	2,325	222	132	42	0	4,950	5,000	600	600	504	504	492	408	408	402	312	222	132	42	0"

SEC. 4. Section 11 of the Internal Revenue Code of 1954 (relating to the tax on corporations) is hereby amended—

(a) by deleting subsection (b) and inserting in lieu thereof a new subsection (b) to read as follows:

(b) NORMAL TAX.—

"(1) TAXABLE YEARS BEGINNING BEFORE JANUARY 1, 1963.—In the case of a taxable year beginning before January 1, 1963, the normal tax is equal to 30 percent of the taxable income.

"(2) SCHEDULE FOR REDUCTION OF NORMAL TAX.—In the case of taxable years beginning after the date provided in the following table, the normal tax, subject to the provisions of section 22, shall be computed at the rate specified for such a taxable period in the following table:

"For taxable years beginning after:	The normal tax is:
December 31, 1962	29 percent of taxable income.
December 31, 1963	28 percent of taxable income.
December 31, 1964	27 percent of taxable income."

(b) by inserting in subsection (c) before the words "The surtax" the following heading: "(1) TAXABLE YEARS BEGINNING BEFORE JANUARY 1, 1966.—" and adding a new paragraph (2) to read as follows:

"(2) SCHEDULE FOR REDUCTION OF SURTAX.—In the case of taxable years beginning after the date provided in the following table, the surtax, subject to the provisions of section 22, shall be computed at the rate specified for such taxable period in the following table:

"For taxable years beginning after:	The surtax is:
December 31, 1965	21 percent of taxable income.
December 31, 1966	20 percent of taxable income."

SEC. 5. Part III of subchapter A of chapter 1 of the Internal Revenue Code of 1954 is amended by the addition of a new section 22 to read as follows:

"SEC. 22. POSTPONEMENT OF TAX REDUCTIONS.

"(a) SIX-MONTH POSTPONEMENT OF REDUCTION OF RATES.—The President by November 15 shall determine whether an imbalance in the budget of the Federal Government for the current fiscal year would exist if the reductions in taxes under sections 1, 3, and 3042 (relating to income taxes on individuals) and section 11 (relating to the income tax on corporations) scheduled for January 1, 1964 and subsequent dates take effect. If the President determines that an imbalance in the budget would so exist, he shall, stating his reasons therefor in an Executive order, postpone until July 1 the date upon which such reductions of taxes are otherwise scheduled to take effect. In the next annual budget message to the Congress the President shall recommend whether any reduction in a rate of tax postponed under this subsection shall become effective on July 1 or whether such reductions shall be further postponed until the following January 1.

"(b) CONGRESSIONAL ACTION ON RATE REDUCTIONS POSTPONED UNDER SUBSECTION (a).—Congress may by means of a joint resolution which has become law before May 15 act—

"(1) to make effective upon July 1 next the rate reductions scheduled under sections 1, 3, and 3402 which have been previously postponed under subsection (a) or to postpone further such rate reduction dates until January 1 and/or

"(2) to make effective upon July 1 next the rate reduction scheduled under section 11 which has been previously postponed under subsection (a) or to postpone further such rate reduction date until January 1.

"(c) FURTHER PRESIDENTIAL ACTION ON RATE REDUCTIONS POSTPONED UNDER SUBSECTION (a).—With respect to any rate reduction postponed under subsection (a) as to which Congress has not acted under subsection (b) by means of a joint resolution which has become law before May 15, the President shall, by May 15, further postpone until January 1—

"(1) any rate reduction scheduled under section 11 which has been postponed previously under paragraphs (a) (1) or (2), or

"(2) any rate reductions scheduled under sections 1, 3, and 3402 and section 11 and which have been postponed previously under paragraph (a) (2).

The authority of the President to postpone any scheduled tax reduction under this subsection shall be used so as to permit the maximum possible reduction to take effect on July 1 next in the taxes imposed by sections 1, 3, 11, and 3402

without causing an imbalance in the budget of the Federal Government for the following fiscal year.

"(d) TOTAL POSTPONEMENT NOT TO EXCEED ONE YEAR.—Under this section the date upon which a rate reduction is scheduled to take effect under section 1, 3, 11, or 3402 cannot be postponed under subsections (a) and (b) for more than one year.

"(e) EFFECT OF POSTPONEMENT ON SUBSEQUENT REDUCTION DATES.—When a rate reduction date otherwise scheduled to take effect under section 1, 3, 11, or 3402 has been postponed under subsection (b) until January 1, then as to the tax whose rate reduction date has been so postponed, the rate reduction dates not affected by such further postponement shall be deferred for one year upon the occurrence of each such further postponement.

"(f) DEFINITIONS.—When used in this section:

"(1) 'Imbalance in the budget' means the existence of a situation where 'budget expenditures' exceed 'budget receipts' as those terms are used in the 'Annual Budget Message of the President' as submitted to the Congress.

"(2) 'Rate reduction date' means the date upon which would become effective a reduction in the rate of a tax imposed by section 1, 3, 11 or 3402.

"(3) 'Current fiscal year' means the fiscal year used for Federal Government accounting purposes during which a postponement provided by this section is or can be made.

"(4) 'Following fiscal year' means the fiscal year used for Federal governmental accounting purposes which immediately follows the fiscal year during which a postponement provided by this section is made."

SEC. 6 (a) Section 167 of the Internal Revenue Code of 1954 (relating to depreciation) is amended by changing the designation of subsection "(h)" to "(k)" and adding four new subsections (h), (i), (j), and (l) as follows:

"(h) OPTIONAL DETERMINATION OF USEFUL LIFE.—If, after December 31, 1961, the useful life of property subject to depreciation (determined in any manner other than that provided in subsection (i)) is greater than that set forth in subsection (i) reduced by 25 percent, then at the election of the taxpayer the useful life of such property shall, for purposes of determining the depreciation deduction allowed by this section, be reduced by such an amount as will reduce said useful life to one equal to the useful life as determined in accordance with subsection (i) reduced by 25 percent.

"(i) CLASSIFICATION AND DETERMINATION OF USEFUL LIFE OF PROPERTY.—The Secretary or his delegate shall publish a schedule covering all classes of depreciable property, which said schedule shall be divided into not more than 12 separate categories. For each category of depreciable property so determined, the Secretary or his delegate shall also determine and publish as part of the same schedule the minimum useful life of such property recognized as a basis for depreciation for income tax purposes as of December 31, 1960.

"(j) LIMITATIONS.—The reduction provided in subsection (h) in useful life of property subject to the allowance for depreciation shall be subject to the following limitations:

"(1) Such reduction shall be applicable only in the case of property with a useful life of three years or more (determined without reference to to subsection (h))—

"(A) The construction, reconstruction or erection of which is comcompleted after December 31, 1961, and then only to that portion of the basis which is properly attributable to such construction, reconstruction, or erection after December 31, 1961, or

"(B) Acquired after December 31, 1961, if the original use of such property commences with the taxpayer and commences after such date.

"(2) Except for taxpayers whose accounting practices are prescribed by some regulatory body duly authorized under the laws of the United States or of any State thereof, the provisions of subsection (h) shall be applicable only to taxpayers whose books and records are kept in accordance with the determination of useful life of depreciable property there set forth and as limited by this subsection.

"(l) CROSS REFERENCE.—

"For special rule for treatment of gain (or loss) on sale of property for which depreciation has been computed or has been allowable under the provisions of this section, see section 1231(c)."

(b) Section 1231 of the Internal Revenue Code of 1954 (relating to property used in the trade or business) is amended by the addition after subsection (b) thereof of the following new subsection (c):

"(c) PROPERTY SUBJECT TO SPECIAL RULE FOR DEPRECIATION.—In the case of property subject to the special rule for depreciation provided in section 167(h), the provisions of subsection (a) shall not be applicable except to that portion of the consideration received on the sale or exchange thereof which exceeds the original cost or other basis of said property in the hands of the taxpayer."

(c) The Secretary or his delegate shall, within six months after the date on which this bill shall have been enacted into law, prepare and publish the schedule of useful lives of depreciable property provided for in subsection (i) of section 167 of the Internal Revenue Code of 1954 as added by subsection (a) hereof.

SEC. 7. Part III of subchapter O of chapter 1 of the Internal Revenue Code of 1954 is amended by the addition of a new section 1037 as follows:

"SEC. 1037. NONRECOGNITION OF GAIN ON CERTAIN SALES OR EXCHANGES OF CAPITAL ASSETS.

"(a) NONRECOGNITION OF GAIN.—If capital assets are sold by an individual taxpayer within a taxable year beginning after December 31, 1961, and within such taxable year capital assets are purchased, by the taxpayer, gain (if any) from such sale or sales shall not be recognized to the extent that the aggregate purchase prices of the capital assets purchased during the taxable year exceed the taxpayer's adjusted basis of capital assets sold during such year.

"(b) PROPERTY TO WHICH THIS SECTION APPLIES.—For the purposes of this section the term 'capital assets' shall be limited to:

"(1) Capital assets as defined in section 1221, or

"(2) Property used in the trade or business as defined in section 1231(b) (1) but not including property described in section 1231(b) (2), (3) or (4), held for a period of more than six months.

"(c) BASIS OF CAPITAL ASSET ACQUIRED.—To the extent that the purchase or purchases of capital assets results, under subsection (a), in the nonrecognition of gain on the sale of capital assets, then, as of the en of the taxable year during which occurred the transaction or transactions upon which the gain was not recognized under subsection (a), the adjustments to basis of each of the capital assets purchased during and held at the end of such taxable year shall include a reduction by an amount equal to the total amount of gain not so recognized allocated to each capital asset so purchased and held at the end of such taxable year in the proportion that the purchase price of such asset bears to the aggregate of the purchase prices of all such assets purchased during such taxable year and held at the end of such taxable year.

"(d) ELECTION TO APPLY THIS SECTION.—An individual taxpayer to have this section apply shall, under regulations prescribed by the Secretary or his delegate, file an election with his return for the taxable year in which occurred the sale or sales of the capital assets with respect to which an amount of gain would not be recognized under subsection (a)."

SEC. 8. Section 2001 of the Internal Revenue Code of 1954 (relating to the rate of tax on estates) is amended to read as follows:

"SECTION 2001. RATE OF TAX.

"A tax computed in accordance with the following table is hereby imposed on the transfer of the taxable estate, determined as provided in section 2051, of every decedent, citizen or resident of the United States dying after the date of enactment of this Act:

"If the taxable estate is:	The tax shall be:
Not over $5,000	1.75% of the taxable estate.
Over $5,000 but not over $10,000	$88, plus 4.25% of excess over $5,000.
Over $10,000 but not over $20,000	$300, plus 6.75% of excess over $10,000.
Over $20,000 but not over $30,000	$975, plus 8.5% of excess over $20,000.
Over $30,000 but not over $40,000	$1,825, plus 11% of excess over $30,000.
Over $40,000 but not over $50,000	$2,925, plus 13.5% of excess over $40,000.
Over $50,000 but not over $60,000	$4,275, plus 15.25% of excess over $50,000.
Over $60,000 but not over $100,000	$5,800, plus 17% of excess over $60,000.
Over $100,000 but not over $250,000	$12,600, plus 18.25% of excess over $100,000.
Over $250,000 but not over $500,000	$39,975, plus 19.5% of excess over $250,000.
Over $500,000 but not over $750,000	$88,725, plus 21.25% of excess over $500,000.
Over $750,000 but not over $1,000,000.	$141,845, plus 22.5% of excess over $750,000.
Over $1,000,000 but not over $1,250,000.	$198,095, plus 23.75% of excess over $1,000,000.
Over $1,250,000 but not over $1,500,000.	$257,460, plus 25.5% of excess over $1,250,000.
Over $1,500,000 but not over $2,000,000.	$321,210, plus 27.5% of excess over $1,500,000.
Over $2,000,000 but not over $2,500,000.	$458,710, plus 30% of excess over $2,000,000.
Over $2,500,000 but not over $3,000,000.	$608,710, plus 32.25% of excess over $2,500,000.
Over $3,000,000 but not over $3,500,000.	$769,960, plus 34.25% of excess over $3,000,000.
Over $3,500,000 but not over $4,000,000.	$941,210, plus 36% of excess over $3,500,000.
Over $4,000,000 but not over $5,000,000.	$1,121,210, plus 38.5% of excess over $4,000,000.
Over $5,000,000 but not over $6,000,000.	$1,506,210, plus 41% of excess over $5,000,000.
Over $6,000,000 but not over $7,000,000.	$1,916,210, plus 42.75% of excess over $6,000,000.
Over $7,000,000 but not over $8,000,000.	$2,343,710, plus 44.5% of excess over $7,000,000.
Over $8,000,000 but not over $10,000,000.	$2,788,710, plus 46.25% of excess over $8,000,000.
Over $10,000,000	$3,713,710, plus 47% of excess over $10,000,000."

SEC. 9. (a) Section 2501 of the Internal Revenue Code of 1954 (relating to the imposition of tax on gifts) is amended by changing "calendar year 1955" to read "calendar year 1962."

(b) Section 2502 (relating to the rate of tax on gifts) is amended by deleting the "rate schedule" in its entirety and inserting a new rate schedule as follows:

RATE SCHEDULE

"If the taxable gifts are:	The tax shall be:
Not over $5,000	1.25% of the taxable gifts.
Over $5,000 but not over $10,000	$62.50, plus 3.25% of excess over $5,000.
Over $10,000 but not over $20,000	$225, plus 5% of excess over $10,000.
Over $20,000 but not over $30,000	$725, plus 6.25% of excess over $20,000.
Over $30,000 but not over $40,000	$1,350, plus 8.25% of excess over $30,000.
Over $40,000 but not over $50,000	$2,175, plus 10.25% of excess over $40,000.
Over $50,000 but not over $60,000	$3,190, plus 11.5% of excess over $50,000.
Over $60,000 but not over $100,000	$4,340, plus 12.75% of excess over $60,000.
Over $100,000 but not over $250,000	$9,440, plus 13.75% of excess over $100,000.
Over $250,000 but not over $500,000	$30,065, plus 14.5% of excess over $250,000.
Over $500,000 but not over $750,000	$66,315, plus 16% of excess over $500,000.
Over $750,000 but not over $1,000,000	$106,315, plus 16.75% of excess over $750,000.
Over $1,000,000 but not over $1,250,000	$148,190, plus 17.75% of excess over $1,000,000.
Over $1,250,000 but not over $1,500,000	$192,565, plus 19% of excess over $1,250,000.
Over $1,500,000 but not over $2,000,000	$239,565, plus 20.5% of excess over $1,500,000.
Over $2,000,000 but not over $2,500,000	$342,065, plus 23.5% of excess over $2,000,000.
Over $2,500,000 but not over $3,000,000	$459,565, plus 24.25% of excess over $2,500,000.
Over $3,000,000 but not over $3,500,000	$580,815, plus 25.75% of excess over $3,000,000.
Over $3,500,000 but not over $4,000,000	$709,565, plus 27% of excess over $3,500,000.
Over $4,000,000 but not over $5,000,000	$844,565, plus 28.75% of excess over $4,000,000.
Over $5,000,000 but not over $6,000,000	$1,125,315, plus 30.75% of excess over $5,000,000.
Over $6,000,000 but not over $7,000,000	$1,426,065, plus 32% of excess over $6,000,000.
Over $7,000,000 but not over $8,000,000	$1,746,065, plus 33.5% of excess over $7,000,000.
Over $8,000,000 but not over $10,000,000.	$2,081,065, plus 34.5% of excess over $8,000,000.
Over $10,000,000	$2,771,065, plus $35.25% of excess over $10,000,000."

SEC. 10. Section 3402 of the Internal Revenue Code of 1954 (relating to collection of income tax at source) is hereby amended—

(a) by inserting in subsection (a) after the letter "(a)" the number "(1)" and adding a new paragraph (2) to read as follows:

"(2) REDUCTION OF WITHHOLDING TAX.—In the case of every employer making payment of wages, the rate of tax imposed by paragraph (1) shall, subject to the provisions of section 22, be the rate specified in the following table for all wage payments made after the date provided in the following table:

"For payments made after:	The withholding tax rate is:
June 30, 1962	17.1 percent.
December 31, 1963	16.2 percent.
December 31, 1964	15.3 percent.
December 31, 1965	14.4 percent.
December 31, 1966	13.5 percent."

(b) in subsection (c)—

(1) by inserting after "withheld under subsection (a):" the following:

"(A) FOR WAGES PAID AFTER DECEMBER 31, 1954:"

(2) by adding at the end of the tables in paragraph (1) the following:

"(B) FOR WAGES PAID AFTER JUNE 30, 1962:

"If the payroll period with respect to an employee is weekly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$12	17.1% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$12	$14	$2.30	.10	0	0	0	0	0	0	0	0	0
$14	$15	2.50	.30	0	0	0	0	0	0	0	0	0
$15	$16	2.70	.50	0	0	0	0	0	0	0	0	0
$16	$17	2.80	.60	0	0	0	0	0	0	0	0	0
$17	$18	3.00	.80	0	0	0	0	0	0	0	0	0
$18	$19	3.20	1.00	0	0	0	0	0	0	0	0	0
$19	$20	3.30	1.10	0	0	0	0	0	0	0	0	0
$20	$21	3.50	1.30	0	0	0	0	0	0	0	0	0
$21	$22	3.70	1.50	0	0	0	0	0	0	0	0	0
$22	$23	3.80	1.70	0	0	0	0	0	0	0	0	0
$23	$24	4.00	1.80	0	0	0	0	0	0	0	0	0
$24	$25	4.20	2.00	0	0	0	0	0	0	0	0	0
$25	$26	4.40	2.20	0	0	0	0	0	0	0	0	0
$26	$27	4.50	2.30	.10	0	0	0	0	0	0	0	0
$27	$28	4.80	2.50	.30	0	0	0	0	0	0	0	0
$28	$29	4.90	2.70	.50	0	0	0	0	0	0	0	0
$29	$30	5.00	2.80	.70	0	0	0	0	0	0	0	0
$30	$31	5.20	3.00	.80	0	0	0	0	0	0	0	0
$31	$32	5.40	3.20	1.00	0	0	0	0	0	0	0	0
$32	$33	5.60	3.40	1.20	0	0	0	0	0	0	0	0
$33	$34	5.70	3.50	1.30	0	0	0	0	0	0	0	0
$34	$35	5.90	3.70	1.50	0	0	0	0	0	0	0	0
$35	$36	6.10	3.90	1.70	0	0	0	0	0	0	0	0
$36	$37	6.20	4.00	1.90	0	0	0	0	0	0	0	0
$37	$38	6.40	4.20	2.00	0	0	0	0	0	0	0	0
$38	$39	6.60	4.40	2.20	0	0	0	0	0	0	0	0
$39	$40	6.80	4.60	2.40	.20	0	0	0	0	0	0	0
$40	$41	6.90	4.70	2.50	.30	0	0	0	0	0	0	0
$41	$42	7.10	4.90	2.70	.50	0	0	0	0	0	0	0
$42	$43	7.30	5.10	2.90	.70	0	0	0	0	0	0	0
$43	$44	7.40	5.20	3.10	.90	0	0	0	0	0	0	0
$44	$45	7.60	5.40	3.20	1.00	0	0	0	0	0	0	0
$45	$46	7.80	5.60	3.40	1.20	0	0	0	0	0	0	0
$46	$47	8.00	5.80	3.60	1.40	0	0	0	0	0	0	0
$47	$48	8.10	5.90	3.70	1.50	0	0	0	0	0	0	0
$48	$49	8.30	6.10	3.90	1.70	0	0	0	0	0	0	0
$49	$50	8.50	6.30	4.10	1.90	0	0	0	0	0	0	0
$50	$51	8.60	6.40	4.30	2.10	0	0	0	0	0	0	0
$51	$52	8.80	6.60	4.40	2.20	0	0	0	0	0	0	0
$52	$53	9.00	6.80	4.60	2.40	.20	0	0	0	0	0	0
$53	$54	9.10	7.00	4.80	2.60	.40	0	0	0	0	0	0
$54	$55	9.30	7.10	4.90	2.70	.60	0	0	0	0	0	0
$55	$56	9.50	7.30	5.10	2.90	.70	0	0	0	0	0	0
$56	$57	9.70	7.50	5.30	3.10	.90	0	0	0	0	0	0
$57	$58	9.80	7.60	5.40	3.30	1.10	0	0	0	0	0	0
$58	$59	10.00	7.80	5.60	3.40	1.20	0	0	0	0	0	0
$59	$60	10.20	8.00	5.80	3.60	1.40	0	0	0	0	0	0
$60	$62	10.40	8.20	6.00	3.90	1.70	0	0	0	0	0	0
$62	$64	10.77	8.60	6.40	4.20	2.00	0	0	0	0	0	0
$64	$66	11.10	8.90	6.70	4.50	2.30	.10	0	0	0	0	0
$66	$68	11.50	9.30	7.10	4.90	2.70	.40	0	0	0	0	0
$68	$70	11.80	9.60	7.40	5.20	3.00	.80	0	0	0	0	0
$70	$72	12.10	9.90	7.80	5.60	3.40	1.10	0	0	0	0	0
$72	$74	12.50	10.30	8.10	5.90	3.70	1.40	0	0	0	0	0
$74	$76	12.80	10.60	8.40	6.20	4.10	1.80	0	0	0	0	0
$76	$78	13.20	11.00	8.80	6.60	4.40	2.10	0	0	0	0	0
$78	$80	13.50	11.30	9.10	6.90	4.70	2.50	.40	0	0	0	0
$80	$82	13.90	11.70	9.50	7.30	5.10	2.80	.70	0	0	0	0
$82	$84	14.20	12.00	9.80	7.60	5.40	3.10	1.00	0	0	0	0
$84	$86	14.50	12.30	10.20	8.00	5.80	3.50	1.40	0	0	0	0
$86	$88	14.90	12.70	10.50	8.30	6.10	3.80	1.70	0	0	0	0
$88	$90	15.20	13.00	10.80	8.60	6.40	4.20	2.10	0	0	0	0
$90	$92	15.60	13.40	11.20	9.00	6.80	4.50	2.40	.20	0	0	0
$92	$94	15.90	13.70	11.50	9.30	7.10	4.90	2.70	.60	0	0	0
$94	$96	16.20	14.10	11.90	9.70	7.50	5.20	3.10	.90	0	0	0
$96	$98	16.60	14.40	12.20	10.00	7.80	5.50	3.40	1.20	0	0	0
$98	$100	16.90	14.70	12.50	10.40	8.20	5.90	3.80	1.60	0	0	0
$100	$105	17.50	15.30	13.10	11.00	8.80	6.50	4.40	2.20	0	0	0
$105	$110	18.40	16.20	14.00	11.80	9.60	7.30	5.20	3.00	.80	0	0
$110	$115	19.20	17.00	14.90	12.70	10.50	8.20	6.10	3.90	1.70	0	0
$115	$120	20.10	17.90	15.70	13.50	11.30	9.00	6.90	4.70	2.60	.40	0
$120	$125	21.00	18.80	16.60	14.40	12.20	9.90	7.80	5.60	3.40	1.20	0
$125	$130	21.80	19.60	17.40	15.20	13.00	10.80	8.60	6.50	4.30	2.10	0
$130	$135	22.70	20.50	18.30	16.10	13.90	11.60	9.50	7.30	5.10	2.90	.70
$135	$140	23.60	21.30	19.10	16.90	14.70	12.50	10.40	8.20	6.00	3.80	1.60
$140	$145	24.40	22.20	20.00	17.80	15.60	13.30	11.20	9.00	6.80	4.60	2.40
$145	$150	25.20	23.00	20.80	18.60	16.50	14.20	12.10	9.90	7.70	5.50	3.30
$150	$160	26.50	24.30	22.10	19.90	17.70	15.50	13.40	11.20	9.00	6.80	4.60
$160	$170	28.20	26.00	23.80	21.60	19.40	17.20	15.10	12.90	10.70	8.50	6.30
$170	$180	29.90	27.70	25.50	23.30	21.20	18.90	16.80	14.60	12.40	10.20	8.00
$180	$190	31.60	29.40	27.30	25.10	22.90	20.60	18.50	16.30	14.10	11.90	9.70
$190	$200	33.30	31.20	29.00	26.80	24.60	22.30	20.20	18.00	15.80	13.60	11.40
		17.1 percent of the excess over $200 plus—										
$200 and over		34.20	32.00	29.80	27.60	25.40	23.20	21.00	18.90	16.70	14.50	12.30

"If the payroll period with respect to an employee is biweekly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$26	17.1% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$26	$28	$4.60	.20	0	0	0	0	0	0	0	0	0
$28	$30	5.00	.60	0	0	0	0	0	0	0	0	0
$30	$32	5.30	.90	0	0	0	0	0	0	0	0	0
$32	$34	5.60	1.30	0	0	0	0	0	0	0	0	0
$34	$36	6.00	1.60	0	0	0	0	0	0	0	0	0
$36	$38	6.30	1.90	0	0	0	0	0	0	0	0	0
$38	$40	6.70	2.30	0	0	0	0	0	0	0	0	0
$40	$42	7.00	2.60	0	0	0	0	0	0	0	0	0
$42	$44	7.40	3.00	0	0	0	0	0	0	0	0	0
$44	$46	7.70	3.30	0	0	0	0	0	0	0	0	0
$46	$48	8.00	3.70	0	0	0	0	0	0	0	0	0
$48	$50	8.40	4.00	0	0	0	0	0	0	0	0	0
$50	$52	8.70	4.30	0	0	0	0	0	0	0	0	0
$52	$54	9.10	4.70	.30	0	0	0	0	0	0	0	0
$54	$56	9.40	5.00	.60	0	0	0	0	0	0	0	0
$56	$58	9.70	5.40	1.00	0	0	0	0	0	0	0	0
$58	$60	10.10	5.70	1.30	0	0	0	0	0	0	0	0
$60	$62	10.40	6.00	1.70	0	0	0	0	0	0	0	0
$62	$64	10.80	6.40	2.00	0	0	0	0	0	0	0	0
$64	$66	11.10	6.70	2.30	0	0	0	0	0	0	0	0
$66	$68	11.50	7.10	2.70	0	0	0	0	0	0	0	0
$68	$70	11.80	7.40	3.00	0	0	0	0	0	0	0	0
$70	$72	12.10	7.80	3.40	0	0	0	0	0	0	0	0
$72	$74	12.50	8.10	3.70	0	0	0	0	0	0	0	0
$74	$76	12.80	8.40	4.10	0	0	0	0	0	0	0	0
$76	$78	13.20	8.80	4.40	0	0	0	0	0	0	0	0
$78	$80	13.50	9.10	4.70	.40	0	0	0	0	0	0	0
$80	$82	13.90	9.50	5.10	.70	0	0	0	0	0	0	0
$82	$84	14.20	9.80	5.40	1.00	0	0	0	0	0	0	0
$84	$86	14.50	10.20	5.80	1.40	0	0	0	0	0	0	0
$86	$88	14.90	10.50	6.10	1.70	0	0	0	0	0	0	0
$88	$90	15.20	10.80	6.40	2.10	0	0	0	0	0	0	0
$90	$92	15.60	11.20	6.80	2.40	0	0	0	0	0	0	0
$92	$94	15.90	11.50	7.10	2.70	0	0	0	0	0	0	0
$94	$96	16.20	11.90	7.50	3.10	0	0	0	0	0	0	0
$96	$98	16.60	12.20	7.80	3.40	0	0	0	0	0	0	0
$98	$100	16.90	12.50	8.20	3.80	0	0	0	0	0	0	0
$100	$102	17.30	12.90	8.50	4.10	0	0	0	0	0	0	0
$102	$104	17.60	13.20	8.80	4.50	0	0	0	0	0	0	0
$104	$106	18.00	13.60	9.20	4.80	.40	0	0	0	0	0	0
$106	$108	18.30	13.90	9.50	5.10	.80	0	0	0	0	0	0
$108	$110	18.60	14.30	9.90	5.50	1.10	0	0	0	0	0	0
$110	$112	19.00	14.60	10.20	5.80	1.40	0	0	0	0	0	0
$112	$114	19.30	14.90	10.60	6.20	1.80	0	0	0	0	0	0
$114	$116	19.70	15.30	10.90	6.50	2.10	0	0	0	0	0	0
$116	$118	20.00	15.60	11.20	6.90	2.50	0	0	0	0	0	0
$118	$120	20.30	16.00	11.60	7.20	2.80	0	0	0	0	0	0
$120	$124	20.90	16.50	12.10	7.70	3.30	0	0	0	0	0	0
$124	$128	21.50	17.20	12.80	8.40	4.00	0	0	0	0	0	0
$128	$132	20.20	17.80	13.50	9.10	4.70	0	0	0	0	0	0
$132	$136	22.90	18.50	14.10	9.80	5.40	1.00	0	0	0	0	0
$136	$140	23.60	19.20	14.80	10.40	6.10	1.70	0	0	0	0	0
$140	$144	24.30	19.90	15.50	11.10	6.70	2.40	0	0	0	0	0
$144	$148	25.00	20.60	16.20	11.80	7.40	3.00	0	0	0	0	0
$148	$152	25.70	21.30	16.90	12.50	8.10	3.70	0	0	0	0	0
$152	$156	26.30	21.90	17.60	13.20	8.80	4.40	0	0	0	0	0
$156	$160	27.00	22.60	18.20	13.90	9.50	5.00	.70	0	0	0	0
$160	$164	27.70	23.30	18.90	14.50	10.20	5.80	1.40	0	0	0	0
$164	$168	28.40	24.00	19.60	15.20	10.80	6.50	2.10	0	0	0	0
$168	$172	29.10	24.70	20.30	15.90	11.50	7.10	2.80	0	0	0	0
$172	$176	29.80	25.40	21.00	16.60	12.20	7.80	3.40	0	0	0	0
$176	$180	30.40	26.00	21.70	17.30	12.90	8.50	4.10	0	0	0	0
$180	$184	31.10	26.70	22.40	18.00	13.60	9.20	4.80	.40	0	0	0
$184	$188	31.80	27.40	23.00	18.70	14.30	9.90	5.50	1.10	0	0	0
$188	$192	32.50	28.10	23.70	19.30	15.00	10.60	6.20	1.80	0	0	0
$192	$196	33.20	28.80	24.40	20.00	15.60	11.30	6.90	2.50	0	0	0
$196	$200	33.90	29.50	25.10	20.70	16.30	11.90	7.60	3.20	0	0	0
$200	$210	35.10	30.70	26.30	21.90	17.50	13.10	8.70	4.40	0	0	0
$210	$220	36.80	32.30	28.00	23.60	19.20	14.80	10.50	6.10	1.70	0	0
$220	$230	38.50	34.10	29.70	25.30	20.90	16.60	12.20	7.80	3.40	0	0
$230	$240	40.20	35.80	31.40	27.00	22.60	18.30	13.90	9.50	5.10	.70	0
$240	$250	41.90	37.50	33.10	28.70	24.40	20.00	15.60	11.20	6.80	2.40	0
$250	$260	43.60	39.20	34.80	30.50	26.10	21.70	17.30	12.90	8.50	4.10	0
$260	$270	45.30	40.90	36.50	32.20	27.80	23.40	19.00	14.60	10.20	5.90	1.50
$270	$280	47.00	42.60	38.30	33.90	29.50	25.10	20.70	16.30	11.90	7.60	3.20
$280	$290	48.70	44.40	40.00	35.60	31.20	26.80	22.40	18.00	13.70	9.30	4.90
$290	$300	50.40	46.10	41.70	37.30	32.90	28.50	24.10	19.80	15.40	11.00	6.60
$300	$320	53.00	48.60	44.20	39.90	35.50	31.10	26.70	22.30	17.90	13.50	9.20
$320	$340	56.40	52.00	47.70	43.30	38.90	34.50	30.10	25.70	21.40	17.00	12.60
$340	$360	59.90	55.40	51.10	46.70	42.30	37.90	33.50	29.20	24.80	20.40	16.00
$360	$380	63.30	58.90	54.50	49.10	45.70	41.30	37.00	32.60	28.20	23.80	19.40
$380	$400	66.70	62.30	57.90	53.50	49.20	44.80	40.40	36.00	31.60	27.20	22.80
		17.1 percent of the excess over $400 plus—										
$400 and over		68.40	64.00	59.60	55.20	50.80	46.50	42.10	37.70	33.30	28.90	24.50

"If the payroll period with respect to an employee is semimonthly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$28	17.1% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$28	$30	$5.00	.20	0	0	0	0	0	0	0	0	0
$30	$32	5.30	.60	0	0	0	0	0	0	0	0	0
$32	$34	5.60	.90	0	0	0	0	0	0	0	0	0
$34	$36	6.00	1.20	0	0	0	0	0	0	0	0	0
$36	$38	6.30	1.50	0	0	0	0	0	0	0	0	0
$38	$40	6.70	1.90	0	0	0	0	0	0	0	0	0
$40	$42	7.00	2.20	0	0	0	0	0	0	0	0	0
$42	$44	7.40	2.60	0	0	0	0	0	0	0	0	0
$44	$46	7.70	2.90	0	0	0	0	0	0	0	0	0
$46	$48	8.00	3.20	0	0	0	0	0	0	0	0	0
$48	$50	8.40	3.60	0	0	0	0	0	0	0	0	0
$50	$52	8.70	4.00	0	0	0	0	0	0	0	0	0
$52	$54	9.10	4.30	0	0	0	0	0	0	0	0	0
$54	$56	9.40	4.70	0	0	0	0	0	0	0	0	0
$56	$58	9.70	5.00	.20	0	0	0	0	0	0	0	0
$58	$60	10.10	5.30	.60	0	0	0	0	0	0	0	0
$60	$62	10.40	5.70	.90	0	0	0	0	0	0	0	0
$62	$64	10.80	6.00	1.30	0	0	0	0	0	0	0	0
$64	$66	11.10	6.40	1.50	0	0	0	0	0	0	0	0
$66	$68	11.50	6.70	2.00	0	0	0	0	0	0	0	0
$68	$70	11.80	7.00	2.30	0	0	0	0	0	0	0	0
$70	$72	12.10	7.40	2.60	0	0	0	0	0	0	0	0
$72	$74	12.50	7.70	3.00	0	0	0	0	0	0	0	0
$74	$76	12.80	8.10	3.30	0	0	0	0	0	0	0	0
$76	$78	13.20	8.40	3.70	0	0	0	0	0	0	0	0
$78	$80	13.50	8.80	4.00	0	0	0	0	0	0	0	0
$80	$82	13.90	9.10	4.40	0	0	0	0	0	0	0	0
$82	$84	14.20	9.40	4.70	0	0	0	0	0	0	0	0
$84	$86	14.50	9.80	5.00	.30	0	0	0	0	0	0	0
$86	$88	14.90	10.10	5.40	.60	0	0	0	0	0	0	0
$88	$90	15.20	10.50	5.70	1.00	0	0	0	0	0	0	0
$90	$92	15.60	10.80	6.10	1.30	0	0	0	0	0	0	0
$92	$94	15.90	11.20	6.40	1.70	0	0	0	0	0	0	0
$94	$96	16.20	11.50	6.70	2.00	0	0	0	0	0	0	0
$96	$98	16.60	11.80	7.10	2.30	0	0	0	0	0	0	0
$98	$100	16.90	12.20	7.40	2.70	0	0	0	0	0	0	0
$100	$102	17.30	12.50	7.80	3.00	0	0	0	0	0	0	0
$102	$104	17.60	12.90	8.10	3.40	0	0	0	0	0	0	0
$104	$106	18.00	13.20	8.50	3.70	0	0	0	0	0	0	0
$106	$108	18.30	13.50	8.80	4.00	0	0	0	0	0	0	0
$108	$110	18.60	13.90	9.10	4.40	0	0	0	0	0	0	0
$110	$112	19.00	14.20	9.50	4.70	0	0	0	0	0	0	0
$112	$114	19.30	14.50	9.80	5.10	.30	0	0	0	0	0	0
$114	$116	19.70	14.90	10.20	5.40	.70	0	0	0	0	0	0
$116	$118	20.00	15.30	10.50	5.80	1.00	0	0	0	0	0	0
$118	$120	20.30	15.60	10.80	6.10	1.30	0	0	0	0	0	0
$120	$124	20.90	16.10	11.40	6.60	1.90	0	0	0	0	0	0
$124	$128	21.50	16.80	12.00	7.30	2.50	0	0	0	0	0	0
$128	$132	22.20	17.50	12.70	8.00	3.20	0	0	0	0	0	0
$132	$136	22.90	18.20	13.40	8.70	3.90	0	0	0	0	0	0
$136	$140	23.60	18.80	14.10	9.30	4.60	0	0	0	0	0	0
$140	$144	24.30	19.50	14.80	10.00	5.30	.50	0	0	0	0	0
$144	$148	25.00	20.20	15.50	10.70	6.00	1.20	0	0	0	0	0
$148	$152	25.70	20.90	16.10	11.40	6.60	1.90	0	0	0	0	0
$152	$156	26.30	21.60	16.80	12.10	7.30	2.60	0	0	0	0	0
$156	$160	27.00	22.30	17.50	12.80	8.00	3.30	0	0	0	0	0
$160	$164	27.70	23.00	18.20	13.50	8.70	4.00	0	0	0	0	0
$164	$168	28.40	23.60	18.90	14.10	9.40	4.60	0	0	0	0	0
$168	$172	29.10	24.30	19.60	14.80	10.00	5.30	.60	0	0	0	0
$172	$176	29.80	25.00	20.30	15.50	10.80	6.00	1.30	0	0	0	0
$176	$180	30.40	25.70	20.90	16.20	11.40	6.70	1.90	0	0	0	0
$180	$184	31.10	26.40	21.60	16.90	12.10	7.40	2.60	0	0	0	0
$184	$188	31.80	27.10	22.30	17.60	12.80	8.10	3.30	0	0	0	0
$188	$192	32.50	27.70	23.00	18.20	13.50	8.70	4.00	0	0	0	0
$192	$196	33.20	28.40	23.70	18.90	14.20	9.40	4.70	0	0	0	0
$196	$200	33.90	29.10	24.40	19.60	14.90	10.10	5.40	.60	0	0	0
$200	$210	35.10	30.30	25.60	20.00	16.10	11.30	6.60	1.80	0	0	0
$210	$220	36.80	32.00	27.30	22.50	17.80	13.00	8.30	3.50	0	0	0
$220	$230	38.50	33.70	29.00	24.20	19.50	14.70	10.00	5.20	.50	0	0
$230	$240	40.20	35.40	30.70	25.90	21.20	16.40	11.70	6.90	2.20	0	0
$240	$250	41.90	37.10	32.40	27.60	22.90	18.10	13.40	8.60	3.90	0	0
$250	$260	43.60	38.90	34.10	29.40	24.60	19.90	15.10	10.40	5.60	.90	0
$260	$270	45.30	40.60	35.80	31.10	26.30	21.60	16.80	12.10	7.30	2.60	0
$270	$280	47.00	42.30	37.50	32.80	28.00	23.30	18.50	13.80	9.00	4.30	0
$280	$290	48.70	44.00	39.20	34.50	29.70	25.00	20.20	15.50	10.70	6.00	1.20
$290	$300	50.40	45.70	40.90	36.20	31.40	26.70	21.90	17.20	12.40	7.70	2.90
$300	$320	53.00	48.30	43.50	38.80	34.00	29.30	24.50	19.80	15.00	10.30	5.50
$320	$340	56.40	51.70	46.90	42.20	37.40	32.70	27.90	23.20	18.40	13.70	8.90
$340	$360	59.90	55.10	50.30	45.60	40.80	36.10	31.30	26.60	21.80	17.10	12.30
$360	$380	63.30	58.50	53.80	49.00	44.30	39.50	34.80	30.00	25.30	20.50	15.80
$380	$400	66.70	61.90	57.20	52.40	47.70	42.90	38.20	33.40	28.70	23.90	19.20
$400	$420	70.10	65.40	60.60	55.90	51.10	46.40	41.60	36.90	32.10	27.40	22.60
$420	$440	73.50	68.80	64.00	59.30	54.50	49.80	45.00	40.30	35.50	30.80	26.00
$440	$460	77.00	72.20	67.40	62.70	57.90	53.20	48.40	43.70	38.90	34.20	29.40
$460	$480	80.40	75.60	70.90	66.10	61.40	56.60	51.90	47.10	42.40	37.60	32.90
$480	$500	83.80	79.00	74.30	69.60	64.80	60.00	55.30	50.50	45.80	41.00	36.30
		17.1 percent of the excess over $500 plus—										
$500 and over		85.50	80.70	76.00	71.20	66.50	61.70	57.00	52.20	47.50	42.70	38.00

"If the payroll period with respect to an employee is monthly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$56	17.1% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$56	$60	$9.90	.40	0	0	0	0	0	0	0	0	0
$60	$64	10.60	1.10	0	0	0	0	0	0	0	0	0
$64	$68	11.30	1.80	0	0	0	0	0	0	0	0	0
$68	$72	12.00	2.50	0	0	0	0	0	0	0	0	0
$72	$76	12.70	3.20	0	0	0	0	0	0	0	0	0
$76	$80	13.30	3.80	0	0	0	0	0	0	0	0	0
$80	$84	14.00	4.50	0	0	0	0	0	0	0	0	0
$84	$88	14.70	5.20	0	0	0	0	0	0	0	0	0
$88	$92	15.40	5.90	0	0	0	0	0	0	0	0	0
$92	$96	16.10	6.60	0	0	0	0	0	0	0	0	0
$96	$100	16.80	7.30	0	0	0	0	0	0	0	0	0
$100	$104	17.40	7.90	0	0	0	0	0	0	0	0	0
$104	$108	18.10	8.60	0	0	0	0	0	0	0	0	0
$108	$112	18.80	9.30	0	0	0	0	0	0	0	0	0
$112	$116	19.50	10.00	.50	0	0	0	0	0	0	0	0
$116	$120	20.20	10.70	1.20	0	0	0	0	0	0	0	0
$120	$124	20.90	11.40	1.90	0	0	0	0	0	0	0	0
$124	$128	21.50	12.00	2.50	0	0	0	0	0	0	0	0
$128	$132	22.20	12.70	3.20	0	0	0	0	0	0	0	0
$132	$136	22.90	13.40	3.90	0	0	0	0	0	0	0	0
$136	$140	23.60	14.10	4.60	0	0	0	0	0	0	0	0
$140	$144	24.30	14.80	5.30	0	0	0	0	0	0	0	0
$144	$148	25.00	15.50	6.00	0	0	0	0	0	0	0	0
$148	$152	25.70	16.10	6.60	0	0	0	0	0	0	0	0
$152	$156	26.30	16.80	7.30	0	0	0	0	0	0	0	0
$156	$160	27.00	17.50	8.00	0	0	0	0	0	0	0	0
$160	$164	27.70	18.20	8.70	0	0	0	0	0	0	0	0
$164	$168	28.40	18.90	9.40	0	0	0	0	0	0	0	0
$168	$172	29.10	19.60	10.10	.60	0	0	0	0	0	0	0
$172	$176	29.80	20.30	10.80	1.30	0	0	0	0	0	0	0
$176	$180	30.40	20.90	11.40	1.90	0	0	0	0	0	0	0
$180	$184	31.10	21.60	12.10	2.60	0	0	0	0	0	0	0
$184	$188	31.80	22.30	12.80	3.30	0	0	0	0	0	0	0
$188	$192	32.50	23.00	13.50	4.00	0	0	0	0	0	0	0
$192	$196	33.20	23.70	14.20	4.70	0	0	0	0	0	0	0
$196	$200	33.90	24.40	14.90	5.40	0	0	0	0	0	0	0
$200	$204	34.50	25.00	15.50	6.00	0	0	0	0	0	0	0
$204	$208	35.20	25.70	16.20	6.70	0	0	0	0	0	0	0
$208	$212	35.90	26.40	16.90	7.40	0	0	0	0	0	0	0
$212	$216	36.60	27.10	17.60	8.10	0	0	0	0	0	0	0
$216	$220	37.30	27.80	18.30	8.80	0	0	0	0	0	0	0
$220	$224	38.00	28.50	19.00	9.50	0	0	0	0	0	0	0
$224	$228	38.60	29.10	19.60	10.00	.60	0	0	0	0	0	0
$228	$232	39.30	29.80	20.30	10.80	1.30	0	0	0	0	0	0
$232	$236	40.00	30.50	21.00	11.50	2.00	0	0	0	0	0	0
$236	$240	40.70	31.20	21.70	12.20	2.70	0	0	0	0	0	0
$240	$248	41.72	32.20	22.70	13.20	3.70	0	0	0	0	0	0
$248	$256	43.10	33.60	24.10	14.60	5.10	0	0	0	0	0	0
$256	$264	44.50	35.00	25.50	16.00	6.50	0	0	0	0	0	0
$264	$272	45.80	36.30	26.80	17.30	7.80	0	0	0	0	0	0
$272	$280	47.20	37.70	28.20	18.70	9.20	0	0	0	0	0	0
$280	$288	48.60	39.10	29.60	20.10	10.60	1.10	0	0	0	0	0
$288	$296	49.90	40.40	30.90	21.40	11.90	2.40	0	0	0	0	0
$296	$304	51.30	41.80	32.30	22.80	13.30	3.80	0	0	0	0	0
$304	$312	52.70	43.20	33.70	24.20	14.70	5.20	0	0	0	0	0
$312	$320	54.00	44.50	35.00	25.50	16.00	6.50	0	0	0	0	0
$320	$328	55.40	45.90	36.40	26.90	17.40	7.90	0	0	0	0	0
$328	$336	56.80	47.30	37.80	28.30	18.80	9.30	0	0	0	0	0
$336	$344	58.10	48.60	39.10	29.60	20.10	10.60	1.10	0	0	0	0
$344	$352	59.50	50.00	40.50	31.00	21.50	12.00	2.50	0	0	0	0
$352	$360	60.90	51.40	41.90	32.40	22.90	13.40	3.90	0	0	0	0
$360	$368	62.20	52.70	43.20	33.70	24.20	14.70	5.20	0	0	0	0
$368	$376	63.60	54.10	44.60	35.10	25.60	16.10	6.60	0	0	0	0
$376	$384	65.00	55.50	46.00	36.50	27.00	17.50	8.00	0	0	0	0
$384	$392	66.30	56.80	47.30	37.80	28.30	18.80	9.30	0	0	0	0
$392	$400	67.70	58.20	48.70	39.20	29.70	20.20	10.70	1.20	0	0	0
$400	$420	70.10	60.60	51.10	41.60	32.10	22.60	13.10	3.60	0	0	0
$420	$440	73.50	64.00	54.50	45.00	35.50	26.00	16.50	7.00	0	0	0
$440	$460	77.00	67.40	57.90	48.40	38.90	29.40	19.90	10.50	1.00	0	0
$460	$480	80.40	70.90	61.40	51.90	42.40	32.90	23.40	13.90	4.40	0	0
$480	$500	83.80	74.30	64.80	55.30	45.80	36.30	26.80	17.30	7.80	0	0
$500	$520	87.20	77.70	68.20	58.70	49.20	39.70	30.20	20.70	11.20	1.70	0
$520	$540	90.60	81.10	71.60	62.10	52.60	43.10	33.60	24.10	14.60	5.10	0
$540	$560	94.10	84.50	75.00	65.50	56.00	46.50	37.00	27.60	18.10	8.60	0
$560	$580	97.50	88.00	78.50	69.00	59.50	50.00	40.50	31.00	21.50	12.00	2.60
$580	$600	100.90	91.40	81.90	72.40	62.90	53.40	43.90	34.40	24.90	15.40	5.90
$600	$640	106.00	96.50	87.00	77.50	68.00	58.50	49.00	39.50	30.00	20.50	11.00
$640	$680	112.90	103.40	93.90	84.40	74.90	65.40	55.90	46.40	36.90	27.40	17.90
$680	$720	119.70	110.20	100.70	91.20	81.70	72.20	62.70	53.20	43.70	34.20	24.70
$720	$760	126.50	117.00	107.50	98.00	88.50	79.00	69.50	60.00	50.50	41.00	31.50
$760	$800	133.40	123.90	114.40	104.90	95.40	85.90	76.40	66.90	57.40	47.90	38.40
$800	$840	140.20	130.70	121.20	111.70	102.20	92.70	83.20	73.70	64.20	54.70	45.20
$840	$880	147.10	137.60	128.10	118.60	109.10	99.60	90.10	80.60	71.10	61.60	52.10
$880	$920	153.90	144.40	134.90	125.40	115.90	106.40	96.90	87.40	77.90	68.40	58.90
$920	$960	160.70	151.20	141.70	132.20	122.70	113.20	103.70	94.20	84.70	75.20	65.70
$960	$1,000	167.60	158.10	148.60	139.10	129.60	120.10	110.60	101.10	91.60	82.10	72.60
		17.1 percent of the excess over $1,000 plus—										
$1,000 and over		171.00	161.50	152.00	142.50	133.00	123.50	114.00	104.50	95.00	85.50	76.00

"If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period—

"And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of tax to be withheld shall be the following amount multiplied by the number of days in such period—										
$0	$2.00	17.1% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$2.00	$2.25	$0.35	.05	0	0	0	0	0	0	0	0	0
$2.25	$2.50	.40	.10	0	0	0	0	0	0	0	0	0
$2.50	$2.75	.45	.15	0	0	0	0	0	0	0	0	0
$2.75	$3.00	.50	.20	0	0	0	0	0	0	0	0	0
$3.00	$3.25	.55	.20	0	0	0	0	0	0	0	0	0
$3.25	$3.50	.60	.25	0	0	0	0	0	0	0	0	0
$3.50	$3.75	.60	.30	0	0	0	0	0	0	0	0	0
$3.75	$4.00	.65	.35	.05	0	0	0	0	0	0	0	0
$4.00	$4.25	.70	.40	.10	0	0	0	0	0	0	0	0
$4.25	$4.50	.75	.45	.10	0	0	0	0	0	0	0	0
$4.50	$4.75	.80	.50	.15	0	0	0	0	0	0	0	0
$4.75	$5.00	.85	.50	.20	0	0	0	0	0	0	0	0
$5.00	$5.25	.90	.55	.25	0	0	0	0	0	0	0	0
$5.25	$5.50	.90	.60	.30	0	0	0	0	0	0	0	0
$5.50	$5.75	.95	.65	.35	0	0	0	0	0	0	0	0
$5.75	$6.00	1.00	.70	.40	.05	0	0	0	0	0	0	0
$6.00	$6.25	1.05	.75	.40	.10	0	0	0	0	0	0	0
$6.25	$6.50	1.10	.80	.50	.15	0	0	0	0	0	0	0
$6.50	$6.75	1.15	.80	.50	.20	0	0	0	0	0	0	0
$6.75	$7.00	1.20	.85	.55	.25	0	0	0	0	0	0	0
$7.00	$7.25	1.20	.90	.60	.30	0	0	0	0	0	0	0
$7.25	$7.50	1.25	.95	.65	.30	0	0	0	0	0	0	0
$7.50	$7.75	1.30	1.00	.70	.35	0	0	0	0	0	0	0
$7.75	$8.00	1.35	1.05	.70	.40	.10	0	0	0	0	0	0
$8.00	$8.25	1.40	1.10	.80	.45	.15	0	0	0	0	0	0
$8.25	$8.50	1.45	1.10	.80	.50	.15	0	0	0	0	0	0
$8.50	$8.75	1.50	1.15	.85	.55	.20	0	0	0	0	0	0
$8.75	$9.00	1.50	1.20	.90	.60	.25	0	0	0	0	0	0
$9.00	$9.25	1.55	1.25	.95	.60	.30	0	0	0	0	0	0
$9.25	$9.50	1.60	1.30	1.00	.65	.35	.05	0	0	0	0	0
$9.50	$9.75	1.65	1.35	1.00	.70	.40	.10	0	0	0	0	0
$9.75	$10.00	1.70	1.40	1.05	.75	.45	.15	0	0	0	0	0
$10.00	$10.50	1.75	1.45	1.15	.80	.50	.20	0	0	0	0	0
$10.50	$11.00	1.85	1.55	1.20	.90	.60	.30	0	0	0	0	0
$11.00	$11.50	1.90	1.60	1.30	1.00	.65	.35	.05	0	0	0	0
$11.50	$12.00	2.00	1.70	1.35	1.10	.75	.45	.15	0	0	0	0
$12.00	$12.50	2.10	1.80	1.50	1.15	.85	.55	.20	0	0	0	0
$12.50	$13.00	2.20	1.85	1.55	1.25	.90	.60	.30	0	0	0	0
$13.00	$13.50	2.25	1.95	1.65	1.35	1.00	.70	.40	.10	0	0	0
$13.50	$14.00	2.35	2.05	1.75	1.40	1.10	.80	.50	.15	0	0	0
$14.00	$14.50	2.45	2.10	1.80	1.50	1.20	.90	.55	.25	0	0	0
$14.50	$15.00	2.50	2.20	1.90	1.60	1.25	.95	.65	.35	0	0	0
$15.00	$15.50	2.60	2.30	2.00	1.70	1.35	1.05	.75	.40	.10	0	0
$15.50	$16.00	2.70	2.40	2.05	1.75	1.45	1.15	.80	.50	.20	0	0
$16.00	$16.50	2.80	2.45	2.15	1.85	1.50	1.20	.90	.60	.30	0	0
$16.50	$17.00	2.90	2.55	2.25	1.95	1.60	1.30	1.00	.70	.35	.05	0
$17.00	$17.50	2.95	2.65	2.30	2.00	1.70	1.40	1.10	.75	.45	.15	0
$17.50	$18.00	3.00	2.70	2.40	2.10	1.80	1.50	1.15	.85	.55	[illegible]	0
$18.00	$18.50	3.10	2.80	2.50	2.20	1.85	1.55	1.25	.95	.60	[illegible]	0
$18.50	$19.00	3.20	2.90	2.60	2.25	1.95	1.65	1.35	1.00	.70	.40	.10
$19.00	$19.50	3.30	3.00	2.65	2.35	2.05	1.75	1.40	1.10	.80	.50	.15
$19.50	$20.00	3.40	3.05	2.75	2.45	2.10	1.80	1.50	1.20	.90	.55	.25
$20.00	$21.00	3.50	3.20	2.90	2.55	2.25	1.95	1.65	1.30	1.00	.70	.40
$21.00	$22.00	3.70	3.35	3.05	2.75	2.40	2.10	1.80	1.50	1.20	.85	.55
$22.00	$23.00	3.85	3.55	3.20	2.90	2.60	2.30	2.00	1.65	1.35	1.05	.70
$23.00	$24.00	4.00	3.70	3.40	3.10	2.75	2.45	2.15	1.85	1.50	1.20	.90
$24.00	$25.00	4.20	3.90	3.55	3.25	2.90	2.65	2.30	2.00	1.70	1.40	1.05
$25.00	$26.00	4.40	4.05	3.75	3.40	3.10	2.80	2.50	2.20	1.85	1.55	1.25
$26.00	$27.00	4.55	4.20	3.90	3.60	3.25	3.00	2.65	2.35	2.05	1.70	1.40
$27.00	$28.00	4.70	4.40	4.10	3.75	3.45	3.15	2.85	2.50	2.20	1.90	1.60
$28.00	$29.00	4.90	4.55	4.25	3.95	3.60	3.30	3.00	2.70	2.40	2.05	1.75
$29.00	$30.00	5.05	4.75	4.40	4.10	3.80	3.50	3.15	2.85	2.55	2.25	1.90
		17.1 percent of the excess over $30 plus—										
$30.00 and over		5.15	4.80	4.50	4.20	3.90	3.55	3.25	2.90	2.65	2.30	2.00

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"(C) FOR WAGES PAID AFTER DECEMBER 31, 1963:

"If the payroll period with respect to an employee is weekly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$13	16.2% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$13	$14	$2.20	.10	0	0	0	0	0	0	0	0	0
$14	$15	2.30	.20	0	0	0	0	0	0	0	0	0
$15	$16	2.50	.40	0	0	0	0	0	0	0	0	0
$16	$17	2.70	.60	0	0	0	0	0	0	0	0	0
$17	$18	2.80	.70	0	0	0	0	0	0	0	0	0
$18	$19	3.00	.90	0	0	0	0	0	0	0	0	0
$19	$20	3.20	1.10	0	0	0	0	0	0	0	0	0
$20	$21	3.30	1.20	0	0	0	0	0	0	0	0	0
$21	$22	3.50	1.40	0	0	0	0	0	0	0	0	0
$22	$23	3.60	1.50	0	0	0	0	0	0	0	0	0
$23	$24	3.80	1.70	0	0	0	0	0	0	0	0	0
$24	$25	4.00	1.90	0	0	0	0	0	0	0	0	0
$25	$26	4.10	2.00	0	0	0	0	0	0	0	0	0
$26	$27	4.30	2.20	.20	0	0	0	0	0	0	0	0
$27	$28	4.50	2.30	.30	0	0	0	0	0	0	0	0
$28	$29	4.60	2.50	.40	0	0	0	0	0	0	0	0
$29	$30	4.80	2.70	.60	0	0	0	0	0	0	0	0
$30	$31	4.90	2.80	.70	0	0	0	0	0	0	0	0
$31	$32	5.10	3.00	.90	0	0	0	0	0	0	0	0
$32	$33	5.30	3.20	1.10	0	0	0	0	0	0	0	0
$33	$34	5.40	3.30	1.20	0	0	0	0	0	0	0	0
$34	$35	5.60	3.50	1.40	0	0	0	0	0	0	0	0
$35	$36	5.80	3.60	1.50	0	0	0	0	0	0	0	0
$36	$37	5.90	3.80	1.70	0	0	0	0	0	0	0	0
$37	$38	6.10	4.00	1.90	0	0	0	0	0	0	0	0
$38	$39	6.20	4.10	2.00	0	0	0	0	0	0	0	0
$39	$40	6.40	4.30	2.20	.20	0	0	0	0	0	0	0
$40	$41	6.60	4.50	2.30	.30	0	0	0	0	0	0	0
$41	$42	6.70	4.60	2.50	.40	0	0	0	0	0	0	0
$42	$43	6.90	4.80	2.70	.60	0	0	0	0	0	0	0
$43	$44	7.00	4.90	2.80	.70	0	0	0	0	0	0	0
$44	$45	7.20	5.10	3.00	.90	0	0	0	0	0	0	0
$45	$46	7.40	5.30	3.20	1.10	0	0	0	0	0	0	0
$46	$47	7.60	5.40	3.30	1.20	0	0	0	0	0	0	0
$47	$48	7.70	5.60	3.50	1.40	0	0	0	0	0	0	0
$48	$49	7.90	5.80	3.60	1.50	0	0	0	0	0	0	0
$49	$50	8.00	5.90	3.80	1.70	0	0	0	0	0	0	0
$50	$51	8.20	6.10	4.00	1.90	0	0	0	0	0	0	0
$51	$52	8.30	6.20	4.10	2.00	0	0	0	0	0	0	0
$52	$53	8.50	6.40	4.30	2.20	.20	0	0	0	0	0	0
$53	$54	8.70	6.60	4.50	2.30	.30	0	0	0	0	0	0
$54	$55	8.80	6.70	4.60	2.50	.40	0	0	0	0	0	0
$55	$56	9.00	6.90	4.80	2.70	.60	0	0	0	0	0	0
$56	$57	9.20	7.00	4.90	2.80	.70	0	0	0	0	0	0
$57	$58	9.30	7.20	5.10	3.00	.90	0	0	0	0	0	0
$58	$59	9.50	7.40	5.30	3.20	1.10	0	0	0	0	0	0
$59	$60	9.60	7.50	5.40	3.30	1.20	0	0	0	0	0	0
$60	$62	9.90	7.80	5.70	3.60	1.50	0	0	0	0	0	0
$62	$64	10.20	8.10	6.00	3.90	1.80	0	0	0	0	0	0
$64	$66	10.50	8.40	6.30	4.20	2.10	0	0	0	0	0	0
$66	$68	10.90	8.70	6.60	4.50	2.40	.30	0	0	0	0	0
$68	$70	11.20	9.10	7.00	4.90	2.80	.60	0	0	0	0	0
$70	$72	11.50	9.40	7.30	5.20	3.10	1.00	0	0	0	0	0
$72	$74	11.80	9.70	7.60	5.50	3.40	1.30	0	0	0	0	0
$74	$76	12.20	10.00	7.90	5.80	3.70	1.60	0	0	0	0	0
$76	$78	12.50	10.40	8.30	6.20	4.10	1.90	0	0	0	0	0
$78	$80	12.80	10.70	8.60	6.50	4.40	2.30	.20	0	0	0	0
$80	$82	13.10	11.00	8.90	6.80	4.70	2.60	.50	0	0	0	0
$82	$84	13.40	11.30	9.20	7.10	5.00	2.90	.80	0	0	0	0
$84	$86	13.80	11.70	9.60	7.50	5.30	3.20	1.10	0	0	0	0
$86	$88	14.10	12.00	9.90	7.80	5.70	3.60	1.50	0	0	0	0
$88	$90	14.40	12.30	10.20	8.10	6.00	3.90	1.80	0	0	0	0
$90	$92	14.70	12.60	10.50	8.40	6.30	4.20	2.10	0	0	0	0
$92	$94	15.10	13.00	10.90	8.70	6.60	4.50	2.40	.30	0	0	0
$94	$96	15.40	13.30	11.20	9.10	7.00	4.90	2.80	.60	0	0	0
$96	$98	15.70	13.60	11.50	9.40	7.30	5.20	3.10	1.00	0	0	0
$98	$100	16.00	13.90	11.80	9.70	7.60	5.50	3.40	1.30	0	0	0
$100	$105	16.60	14.50	12.40	10.30	8.20	6.10	4.00	1.90	0	0	0
$105	$110	17.40	15.30	13.20	11.10	9.00	6.90	4.80	2.70	.60	0	0
$110	$115	18.20	16.10	14.00	11.90	9.80	7.70	5.60	3.50	1.40	0	0
$115	$120	19.00	16.90	14.80	12.70	10.60	8.50	6.40	4.30	2.20	.10	0
$120	$125	19.80	17.70	15.60	13.50	11.40	9.30	7.20	5.10	3.00	.90	0
$125	$130	20.70	18.50	16.40	14.30	12.20	10.10	8.00	5.90	3.80	1.70	0
$130	$135	21.50	19.40	17.30	15.10	13.00	10.90	8.80	6.70	4.60	2.50	.40
$135	$140	22.30	20.20	18.10	16.00	13.90	11.70	9.60	7.50	5.40	3.30	1.20
$140	$145	23.10	21.00	18.90	16.80	14.70	12.60	10.40	8.30	6.20	4.10	2.00
$145	$150	23.90	21.80	19.70	17.60	15.50	13.40	11.30	9.20	7.00	4.90	2.80
$150	$160	25.10	23.00	20.90	18.80	16.70	14.60	12.50	10.40	8.30	6.20	4.10
$160	$170	26.70	24.60	22.50	20.40	18.30	16.20	14.10	12.00	9.90	7.80	5.70
$170	$180	28.40	26.30	24.10	22.00	19.90	17.80	15.70	13.60	11.50	9.40	7.30
$180	$190	30.00	27.90	25.80	23.70	21.50	19.40	17.30	15.20	13.10	11.00	8.90
$190	$200	31.60	29.50	27.40	25.30	23.20	21.10	19.00	16.80	14.70	12.60	10.50
		16.2 percent of the excess over $200 plus—										
$200 and over		32.40	30.30	28.20	26.10	24.00	21.90	19.80	17.70	15.60	13.40	11.30

"If the payroll period with respect to an employee is biweekly

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$26	16.3% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$26	$28	$4.40	.20	0	0	0	0	0	0	0	0	0
$28	$30	4.70	.50	0	0	0	0	0	0	0	0	0
$30	$32	5.00	.90	0	0	0	0	0	0	0	0	0
$32	$34	5.30	1.20	0	0	0	0	0	0	0	0	0
$34	$36	5.70	1.50	0	0	0	0	0	0	0	0	0
$36	$38	6.00	1.80	0	0	0	0	0	0	0	0	0
$38	$40	6.30	2.20	0	0	0	0	0	0	0	0	0
$40	$42	6.60	2.50	0	0	0	0	0	0	0	0	0
$42	$44	7.00	2.80	0	0	0	0	0	0	0	0	0
$44	$46	7.30	3.10	0	0	0	0	0	0	0	0	0
$46	$48	7.60	3.50	0	0	0	0	0	0	0	0	0
$48	$50	7.90	3.80	0	0	0	0	0	0	0	0	0
$50	$52	8.30	4.10	0	0	0	0	0	0	0	0	0
$52	$54	8.60	4.40	.30	0	0	0	0	0	0	0	0
$54	$56	8.90	4.80	.60	0	0	0	0	0	0	0	0
$56	$58	9.20	5.10	.90	0	0	0	0	0	0	0	0
$58	$60	9.60	5.40	1.30	0	0	0	0	0	0	0	0
$60	$62	9.90	5.70	1.60	0	0	0	0	0	0	0	0
$62	$64	10.20	6.10	1.90	0	0	0	0	0	0	0	0
$64	$66	10.50	6.40	2.20	0	0	0	0	0	0	0	0
$66	$68	10.90	6.70	2.50	0	0	0	0	0	0	0	0
$68	$70	11.20	7.00	2.90	0	0	0	0	0	0	0	0
$70	$72	11.50	7.30	3.20	0	0	0	0	0	0	0	0
$72	$74	11.80	7.70	3.50	0	0	0	0	0	0	0	0
$74	$76	12.20	8.00	3.80	0	0	0	0	0	0	0	0
$76	$78	12.50	8.30	4.20	0	0	0	0	0	0	0	0
$78	$80	12.80	8.60	4.50	.30	0	0	0	0	0	0	0
$80	$82	13.10	9.00	4.80	.70	0	0	0	0	0	0	0
$82	$84	13.40	9.30	5.10	1.00	0	0	0	0	0	0	0
$84	$86	13.80	9.60	5.50	1.30	0	0	0	0	0	0	0
$86	$88	14.10	10.00	5.80	1.60	0	0	0	0	0	0	0
$88	$90	14.40	10.30	6.10	2.00	0	0	0	0	0	0	0
$90	$92	14.70	10.60	6.40	2.30	0	0	0	0	0	0	0
$92	$94	15.10	10.90	6.80	2.60	0	0	0	0	0	0	0
$94	$96	15.40	11.20	7.10	2.90	0	0	0	0	0	0	0
$96	$98	15.70	11.60	7.40	3.30	0	0	0	0	0	0	0
$98	$100	16.00	11.90	7.70	3.60	0	0	0	0	0	0	0
$100	$102	16.40	12.20	8.10	3.90	0	0	0	0	0	0	0
$102	$104	16.70	12.50	8.40	4.20	.10	0	0	0	0	0	0
$104	$106	17.00	12.90	8.70	4.50	.40	0	0	0	0	0	0
$106	$108	17.33	13.20	9.00	4.90	.70	0	0	0	0	0	0
$108	$110	17.70	13.50	9.40	5.20	1.00	0	0	0	0	0	0
$110	$112	18.00	13.80	9.70	5.50	1.40	0	0	0	0	0	0
$112	$114	18.30	14.20	10.00	5.80	1.70	0	0	0	0	0	0
$114	$116	18.60	14.50	10.30	6.20	2.00	0	0	0	0	0	0
$116	$118	19.00	14.80	10.60	6.50	2.30	0	0	0	0	0	0
$118	$120	19.30	15.10	11.00	6.80	2.70	0	0	0	0	0	0
$120	$124	19.80	15.60	11.50	7.30	3.10	0	0	0	0	0	0
$124	$128	20.40	16.30	12.10	8.00	3.80	0	0	0	0	0	0
$128	$132	21.10	16.90	12.80	8.60	4.40	.30	0	0	0	0	0
$132	$136	21.70	17.60	13.40	9.20	5.10	.90	0	0	0	0	0
$136	$140	22.40	18.20	14.00	9.90	5.70	1.60	0	0	0	0	0
$140	$144	23.00	18.90	14.70	10.50	6.40	2.20	0	0	0	0	0
$144	$148	23.70	19.50	15.30	11.20	7.00	2.90	0	0	0	0	0
$148	$152	24.30	20.10	16.00	11.80	7.70	3.50	0	0	0	0	0
$152	$156	24.90	20.80	16.60	12.50	8.30	4.20	0	0	0	0	0
$156	$160	25.60	21.40	17.30	13.10	9.00	4.80	.70	0	0	0	0
$160	$164	26.20	22.10	17.90	13.80	9.60	5.50	1.30	0	0	0	0
$164	$168	26.[illegible]	22.70	18.60	14.40	10.30	6.10	2.00	0	0	0	0
$168	$172	27.50	23.40	19.20	15.10	10.90	6.80	2.60	0	0	0	0
$172	$176	28.20	24.00	19.90	15.70	11.60	7.40	3.30	0	0	0	0
$176	$180	28.80	24.70	20.50	16.40	12.20	8.10	3.90	0	0	0	0
$180	$184	29.50	25.30	21.20	17.00	12.90	8.70	4.60	.40	0	0	0
$184	$188	30.10	26.00	21.80	17.70	13.50	9.[illegible]	5.20	1.10	0	0	0
$188	$192	30.80	26.60	22.50	18.30	14.20	10.00	5.90	1.70	0	0	0
$192	$196	31.40	27.30	23.10	19.00	14.80	10.70	6.50	2.10	0	0	0
$196	$200	32.10	27.90	23.80	19.60	15.50	11.40	7.20	3.00	0	0	0
$200	$210	33.20	29.10	24.90	20.70	16.60	12.10	8.30	4.10	0	0	0
$210	$220	34.80	30.70	26.50	22.40	18.20	14.10	9.90	5.80	1.60	0	0
$220	$230	36.50	32.30	28.10	24.00	19.80	15.70	11.50	7.40	3.20	0	0
$230	$240	38.10	33.90	29.80	25.60	21.50	17.30	13.10	9.00	4.80	.70	0
$240	$250	39.70	35.50	31.40	27.20	23.10	18.90	14.80	10.60	6.50	2.30	0
$250	$260	41.30	37.20	34.00	28.80	24.70	20.50	16.40	12.20	8.10	3.90	0
$260	$270	42.90	38.80	34.60	30.50	26.30	22.20	18.00	13.90	9.70	5.50	1.40
$270	$280	44.60	40.40	36.20	32.10	27.90	23.80	19.60	15.50	11.30	7.20	3.00
$280	$290	46.20	42.00	37.90	33.70	29.60	25.40	21.20	17.10	12.90	8.80	4.60
$290	$300	47.80	43.60	39.50	35.30	31.20	27.00	22.90	18.70	14.60	10.40	6.30
$300	$320	50.20	46.10	41.90	37.80	33.60	29.50	25.30	21.10	17.00	12.80	8.70
$320	$340	53.50	49.30	45.20	41.00	36.80	32.70	28.50	24.40	20.20	16.10	11.90
$340	$360	56.70	52.50	48.40	44.20	40.10	35.90	31.80	27.60	23.40	19.30	15.20
$360	$380	59.90	55.80	51.60	47.50	43.30	39.20	35.00	30.90	26.70	22.60	18.40
$380	$400	63.20	59.00	54.90	50.70	46.60	42.40	38.30	34.10	30.00	25.80	21.60
		16.2 percent of the excess over $400 plus—										
$400 and over		64.80	60.60	56.50	52.30	48.20	44.00	39.90	35.70	31.60	27.40	23.30

"If the payroll period with respect to an employee is semimonthly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least	But less than	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$28	16.2% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$28	$30	$4.70	.20	0	0	0	0	0	0	0	0	0
$30	$32	5.00	.50	0	0	0	0	0	0	0	0	0
$32	$34	5.30	.80	0	0	0	0	0	0	0	0	0
$34	$36	5.70	1.10	0	0	0	0	0	0	0	0	0
$36	$38	6.00	1.50	0	0	0	0	0	0	0	0	0
$38	$40	6.30	1.80	0	0	0	0	0	0	0	0	0
$40	$42	6.60	2.10	0	0	0	0	0	0	0	0	0
$42	$44	7.00	2.40	0	0	0	0	0	0	0	0	0
$44	$46	7.30	2.80	0	0	0	0	0	0	0	0	0
$46	$48	7.60	3.10	0	0	0	0	0	0	0	0	0
$48	$50	7.90	3.40	0	0	0	0	0	0	0	0	0
$50	$52	8.30	3.70	0	0	0	0	0	0	0	0	0
$52	$54	8.60	4.10	0	0	0	0	0	0	0	0	0
$54	$56	8.90	4.40	0	0	0	0	0	0	0	0	0
$56	$58	9.20	4.70	.20	0	0	0	0	0	0	0	0
$58	$60	9.60	5.00	.50	0	0	0	0	0	0	0	0
$60	$62	9.90	5.30	.80	0	0	0	0	0	0	0	0
$62	$64	10.20	5.70	1.10	0	0	0	0	0	0	0	0
$64	$66	10.50	6.00	1.50	0	0	0	0	0	0	0	0
$66	$68	10.90	6.30	1.80	0	0	0	0	0	0	0	0
$68	$70	11.20	6.60	2.10	0	0	0	0	0	0	0	0
$70	$72	11.50	7.00	2.40	0	0	0	0	0	0	0	0
$72	$74	11.80	7.30	2.80	0	0	0	0	0	0	0	0
$74	$76	12.20	7.60	3.10	0	0	0	0	0	0	0	0
$76	$78	12.50	7.90	3.40	0	0	0	0	0	0	0	0
$78	$80	12.80	8.30	3.70	0	0	0	0	0	0	0	0
$80	$82	13.10	8.60	4.10	0	0	0	0	0	0	0	0
$82	$84	13.40	8.90	4.40	0	0	0	0	0	0	0	0
$84	$86	13.80	9.20	4.70	.20	0	0	0	0	0	0	0
$86	$88	14.10	9.60	5.00	.50	0	0	0	0	0	0	0
$88	$90	14.40	9.90	5.30	.80	0	0	0	0	0	0	0
$90	$92	14.70	10.20	5.70	1.10	0	0	0	0	0	0	0
$92	$94	15.10	10.50	6.00	1.50	0	0	0	0	0	0	0
$94	$96	15.40	10.90	6.30	1.80	0	0	0	0	0	0	0
$96	$98	15.70	11.20	6.60	2.10	0	0	0	0	0	0	0
$98	$100	16.00	11.50	7.00	2.40	0	0	0	0	0	0	0
$100	$102	16.40	11.80	7.30	2.80	0	0	0	0	0	0	0
$102	$104	16.70	12.20	7.60	3.10	0	0	0	0	0	0	0
$104	$106	17.00	12.50	7.90	3.40	0	0	0	0	0	0	0
$106	$108	17.30	12.80	8.30	3.70	0	0	0	0	0	0	0
$108	$110	17.70	13.10	8.60	4.10	0	0	0	0	0	0	0
$110	$112	18.00	13.40	8.90	4.40	0	0	0	0	0	0	0
$112	$114	18.30	13.80	9.20	4.70	.20	0	0	0	0	0	0
$114	$116	18.60	14.10	9.60	5.00	.50	0	0	0	0	0	0
$116	$118	19.00	14.40	9.90	5.30	.80	0	0	0	0	0	0
$118	$120	19.30	14.70	10.20	5.70	1.10	0	0	0	0	0	0
$120	$124	19.80	15.20	10.70	6.20	1.60	0	0	0	0	0	0
$124	$128	20.40	15.90	11.30	6.80	2.30	0	0	0	0	0	0
$128	$132	21.10	16.50	12.00	7.50	2.90	0	0	0	0	0	0
$132	$136	21.70	17.20	12.60	8.10	3.60	0	0	0	0	0	0
$136	$140	22.40	17.80	13.30	8.70	4.20	0	0	0	0	0	0
$140	$144	23.00	18.50	13.90	9.40	4.90	.30	0	0	0	0	0
$144	$148	23.70	19.10	14.60	10.00	5.50	1.00	0	0	0	0	0
$148	$152	24.30	19.80	15.20	10.70	6.20	1.60	0	0	0	0	0
$152	$156	24.90	20.40	15.90	11.30	6.80	2.30	0	0	0	0	0
$156	$160	25.60	21.10	16.50	12.00	7.50	2.90	0	0	0	0	0
$160	$164	26.20	21.70	17.20	12.60	8.10	3.60	0	0	0	0	0
$164	$168	26.90	22.40	17.80	13.30	8.70	4.20	0	0	0	0	0
$168	$172	27.50	23.00	18.50	13.90	9.40	4.90	.30	0	0	0	0
$172	$176	28.20	23.70	19.10	14.60	10.00	5.50	1.00	0	0	0	0
$176	$180	28.80	24.30	19.80	15.20	10.70	6.20	1.60	0	0	0	0
$180	$184	29.50	24.90	20.40	15.90	11.30	6.80	2.30	0	0	0	0
$184	$188	30.10	25.60	21.10	16.50	12.00	7.50	2.90	0	0	0	0
$188	$192	30.80	26.30	21.70	17.20	12.60	8.10	3.60	0	0	0	0
$192	$196	31.40	26.90	22.40	17.80	13.30	8.70	4.20	0	0	0	0
$196	$200	32.10	27.50	23.00	18.50	13.90	9.40	4.90	.30	0	0	0
$200	$210	33.20	28.70	24.10	19.60	15.10	10.50	6.00	1.50	0	0	0
$210	$220	34.80	30.30	25.80	21.20	16.70	12.20	7.60	3.10	0	0	0
$220	$230	36.50	31.90	27.40	22.80	18.30	13.80	9.20	4.70	.20	0	0
$230	$240	38.10	33.50	29.00	24.50	19.90	15.40	10.90	6.30	1.80	0	0
$240	$250	39.70	35.20	30.60	26.10	21.50	17.00	12.50	7.90	3.40	0	0
$250	$260	41.30	36.80	32.20	27.70	23.20	18.60	14.10	9.60	5.00	.60	0
$260	$270	42.90	38.40	33.90	29.30	24.80	20.30	15.70	11.20	6.60	2.10	0
$270	$280	44.60	40.00	35.50	30.90	26.40	21.90	17.30	12.80	8.30	3.70	0
$280	$290	46.20	41.60	37.10	32.60	28.00	23.50	19.00	14.40	9.90	5.30	.80
$290	$300	47.80	43.30	38.70	34.20	29.60	25.10	20.60	16.00	11.50	7.00	2.40
$300	$320	50.20	45.70	41.10	36.60	32.10	27.50	23.00	18.50	13.90	9.40	4.90
$320	$340	53.50	48.90	44.40	39.90	35.30	30.80	26.20	21.70	17.20	12.60	8.10
$340	$360	56.70	52.20	47.60	43.10	38.60	34.00	29.50	24.90	20.40	15.90	11.30
$360	$380	59.90	55.40	50.80	46.30	41.80	37.30	32.70	28.20	23.70	19.10	14.60
$380	$400	63.20	58.60	54.10	49.60	45.00	40.50	36.00	31.40	26.90	22.40	17.80
$400	$420	66.40	61.90	57.30	52.80	48.30	43.70	39.20	34.70	30.10	25.60	21.10
$420	$440	69.70	65.10	60.60	56.10	51.60	47.00	42.40	37.90	33.40	28.80	24.30
$440	$460	72.90	68.40	63.80	59.30	54.80	50.20	45.70	41.10	36.60	32.10	27.60
$460	$480	76.10	71.60	67.10	62.50	58.00	53.50	48.90	44.40	39.90	35.30	30.80
$480	$500	79.40	74.80	70.30	65.80	61.30	56.70	52.20	47.60	43.10	38.60	34.00
		16.2 percent of the excess over $500 plus—										
$500 and over		81.00	76.50	71.90	67.40	62.90	58.30	53.80	49.30	44.70	40.20	35.60

"If the payroll period with respect to an employee is monthly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$56	16.2% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$56	$60	9.40	.30	0	0	0	0	0	0	0	0	0
$60	$64	10.00	1.00	0	0	0	0	0	0	0	0	0
$64	$68	10.70	1.60	0	0	0	0	0	0	0	0	0
$68	$72	11.30	2.30	0	0	0	0	0	0	0	0	0
$72	$76	12.00	2.90	0	0	0	0	0	0	0	0	0
$76	$80	12.60	3.60	0	0	0	0	0	0	0	0	0
$80	$84	13.30	4.20	0	0	0	0	0	0	0	0	0
$84	$88	13.90	4.90	0	0	0	0	0	0	0	0	0
$88	$92	14.60	5.50	0	0	0	0	0	0	0	0	0
$92	$96	15.20	6.20	0	0	0	0	0	0	0	0	0
$96	$100	15.90	6.80	0	0	0	0	0	0	0	0	0
$100	$104	16.50	7.50	0	0	0	0	0	0	0	0	0
$104	$108	17.20	8.10	0	0	0	0	0	0	0	0	0
$108	$112	17.80	8.70	0	0	0	0	0	0	0	0	0
$112	$116	18.50	9.40	.30	0	0	0	0	0	0	0	0
$116	$120	19.10	10.00	1.00	0	0	0	0	0	0	0	0
$120	$124	19.80	10.70	1.60	0	0	0	0	0	0	0	0
$124	$128	20.40	11.30	2.30	0	0	0	0	0	0	0	0
$128	$132	21.10	12.00	2.90	0	0	0	0	0	0	0	0
$132	$136	21.70	12.60	3.60	0	0	0	0	0	0	0	0
$136	$140	22.40	13.30	4.20	0	0	0	0	0	0	0	0
$140	$144	23.00	13.90	4.90	0	0	0	0	0	0	0	0
$144	$148	23.70	14.60	5.50	0	0	0	0	0	0	0	0
$148	$152	24.30	15.20	6.20	0	0	0	0	0	0	0	0
$152	$156	24.90	15.90	6.80	0	0	0	0	0	0	0	0
$156	$160	25.60	16.50	7.50	0	0	0	0	0	0	0	0
$160	$164	26.20	17.20	8.10	0	0	0	0	0	0	0	0
$164	$168	26.90	17.80	8.70	0	0	0	0	0	0	0	0
$168	$172	27.50	18.50	9.40	.30	0	0	0	0	0	0	0
$172	$176	28.20	19.10	10.00	1.00	0	0	0	0	0	0	0
$176	$180	28.80	19.80	10.70	1.60	0	0	0	0	0	0	0
$180	$184	29.50	20.40	11.30	2.30	0	0	0	0	0	0	0
$184	$188	30.10	21.10	12.00	2.90	0	0	0	0	0	0	0
$188	$192	30.80	21.70	12.60	3.60	0	0	0	0	0	0	0
$192	$196	31.40	22.40	13.30	4.20	0	0	0	0	0	0	0
$196	$200	32.10	23.00	13.90	4.90	0	0	0	0	0	0	0
$200	$204	32.70	23.70	14.60	5.50	0	0	0	0	0	0	0
$204	$208	33.40	24.30	15.20	6.20	0	0	0	0	0	0	0
$208	$212	34.00	24.90	15.90	6.80	0	0	0	0	0	0	0
$212	$216	34.70	25.60	16.50	7.50	0	0	0	0	0	0	0
$216	$220	35.30	26.20	17.20	8.10	0	0	0	0	0	0	0
$220	$224	36.00	26.90	17.80	8.70	0	0	0	0	0	0	0
$224	$228	36.60	27.50	18.50	9.40	.30	0	0	0	0	0	0
$228	$232	37.30	28.20	19.10	10.00	1.00	0	0	0	0	0	0
$232	$236	37.90	28.80	19.80	10.70	1.60	0	0	0	0	0	0
$236	$240	38.60	29.50	20.40	11.30	2.30	0	0	0	0	0	0
$240	$248	39.50	30.50	21.40	12.30	3.20	0	0	0	0	0	0
$248	$256	40.80	31.80	22.70	13.60	4.50	0	0	0	0	0	0
$256	$264	42.10	33.00	24.00	14.90	5.80	0	0	0	0	0	0
$264	$272	43.40	34.30	25.30	16.20	7.10	0	0	0	0	0	0
$272	$280	44.70	35.60	26.60	17.50	8.40	0	0	0	0	0	0
$280	$288	46.00	36.90	27.90	18.80	9.70	.60	0	0	0	0	0
$288	$296	47.30	38.20	29.20	20.10	11.00	1.90	0	0	0	0	0
$296	$304	48.60	39.50	30.50	21.40	12.30	3.20	0	0	0	0	0
$304	$312	49.90	40.80	31.80	22.70	13.60	4.50	0	0	0	0	0
$312	$320	51.20	42.10	33.00	24.00	14.90	5.80	0	0	0	0	0
$320	$328	52.50	43.40	34.30	25.30	16.20	7.10	0	0	0	0	0
$328	$336	53.80	44.70	35.60	26.60	17.50	8.40	0	0	0	0	0
$336	$344	55.10	46.00	36.90	27.90	18.80	9.70	.60	0	0	0	0
$344	$352	56.40	47.30	38.20	29.20	20.10	11.00	1.90	0	0	0	0
$352	$360	57.70	48.60	39.50	30.50	21.40	12.30	3.20	0	0	0	0
$360	$368	59.00	49.90	40.80	31.80	22.70	13.60	4.50	0	0	0	0
$368	$376	60.30	51.20	42.10	33.00	24.00	14.90	5.80	0	0	0	0
$376	$384	61.60	52.50	43.40	34.30	25.30	16.20	7.10	0	0	0	0
$384	$392	62.90	53.80	44.70	35.60	26.60	17.50	8.40	0	0	0	0
$392	$400	64.20	55.10	46.00	36.90	27.90	18.80	9.70	.60	0	0	0
$400	$420	66.40	57.30	48.30	39.20	30.10	21.10	12.00	2.90	0	0	0
$420	$440	69.70	60.60	51.50	42.40	33.40	24.30	15.20	6.20	0	0	0
$440	$460	72.90	63.80	54.80	45.70	36.60	27.50	18.50	9.40	.30	0	0
$460	$480	76.10	67.10	58.00	48.90	39.90	30.80	21.70	12.60	3.60	0	0
$480	$500	79.40	70.30	61.20	52.20	43.10	34.00	24.90	15.90	6.80	0	0
$500	$520	82.60	73.50	64.50	55.40	46.30	37.30	28.20	19.10	10.00	1.00	0
$520	$540	85.90	76.80	67.70	58.60	49.60	40.50	31.40	22.40	13.30	4.20	0
$540	$560	89.10	80.00	71.00	61.90	52.80	43.70	34.70	25.60	16.50	7.50	0
$560	$580	92.30	83.30	74.20	65.10	56.10	47.00	37.90	28.80	19.80	10.70	1.60
$580	$600	95.60	86.50	77.40	68.40	59.30	50.20	41.10	32.10	23.00	13.90	4.90
$600	$640	100.40	91.40	82.30	73.20	64.20	55.10	46.00	36.90	27.90	18.80	9.70
$640	$680	106.90	97.80	88.80	79.70	70.60	61.60	52.50	43.40	34.30	25.30	16.20
$680	$720	113.40	104.30	95.30	86.20	77.10	68.00	59.00	49.90	40.80	31.80	22.70
$720	$760	119.90	110.80	101.70	92.70	83.60	74.50	65.40	56.40	47.30	38.20	29.20
$760	$800	126.40	117.30	108.20	99.10	90.10	81.00	71.90	62.90	53.80	44.70	35.60
$800	$840	132.80	123.80	114.70	105.60	96.60	87.50	78.40	69.30	60.30	51.20	42.10
$840	$880	139.30	130.20	121.20	112.10	103.00	94.00	84.90	75.80	66.70	57.70	48.60
$880	$920	145.80	136.70	127.70	118.60	109.50	100.40	91.40	82.30	73.20	64.20	55.10
$920	$960	152.30	143.20	134.10	125.10	116.00	106.90	97.80	88.80	79.70	70.60	61.60
$960	$1,000	158.80	149.70	140.60	131.50	122.50	113.40	104.30	95.30	86.20	77.10	68.00
		16.2 percent of the excess over $1,000 plus—										
$1,000 and over		162.00	152.90	143.90	134.80	125.70	116.60	107.60	98.50	89.40	80.40	71.30

"If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period—

"And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of tax to be withheld shall be the following amount multiplied by the number of days in such period—										
$0	$2.00	18% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$2.00	$2.25	$0.35	.05	0	0	0	0	0	0	0	0	0
$2.25	$2.50	.40	.10	0	0	0	0	0	0	0	0	0
$2.50	$2.75	.40	.15	0	0	0	0	0	0	0	0	0
$2.75	$3.00	.45	.15	0	0	0	0	0	0	0	0	0
$3.00	$3.25	.50	.20	0	0	0	0	0	0	0	0	0
$3.25	$3.50	.55	.25	0	0	0	0	0	0	0	0	0
$3.50	$3.75	.60	.30	0	0	0	0	0	0	0	0	0
$3.75	$4.00	.60	.35	.05	0	0	0	0	0	0	0	0
$4.00	$4.25	.65	.40	.10	0	0	0	0	0	0	0	0
$4.25	$4.50	.70	.40	.10	0	0	0	0	0	0	0	0
$4.50	$4.75	.75	.45	.15	0	0	0	0	0	0	0	0
$4.75	$5.00	.80	.50	.20	0	0	0	0	0	0	0	0
$5.00	$5.25	.85	.55	.25	0	0	0	0	0	0	0	0
$5.25	$5.50	.90	.60	.30	0	0	0	0	0	0	0	0
$5.50	$5.75	.90	.60	.30	.05	0	0	0	0	0	0	0
$5.75	$6.00	.95	.65	.35	.10	0	0	0	0	0	0	0
$6.00	$6.25	1.00	.70	.40	.10	0	0	0	0	0	0	0
$6.25	$6.50	1.05	.75	.45	.15	0	0	0	0	0	0	0
$6.50	$6.75	1.10	.80	.50	.20	0	0	0	0	0	0	0
$6.75	$7.00	1.10	.80	.55	.25	0	0	0	0	0	0	0
$7.00	$7.25	1.15	.85	.60	.30	0	0	0	0	0	0	0
$7.25	$7.50	1.20	.90	.60	.30	.05	0	0	0	0	0	0
$7.50	$7.75	1.25	.95	.65	.35	.10	0	0	0	0	0	0
$7.75	$8.00	1.30	1.00	.70	.40	.10	0	0	0	0	0	0
$8.00	$8.25	1.30	1.00	.75	.45	.15	0	0	0	0	0	0
$8.25	$8.50	1.35	1.05	.80	.50	.20	0	0	0	0	0	0
$8.50	$8.75	1.40	1.10	.80	.50	.25	0	0	0	0	0	0
$8.75	$9.00	1.45	1.15	.85	.55	.25	0	0	0	0	0	0
$9.00	$9.25	1.50	1.20	.90	.60	.30	0	0	0	0	0	0
$9.25	$9.50	1.50	1.20	.95	.65	.35	.05	0	0	0	0	0
$9.50	$9.75	1.55	1.25	1.00	.70	.40	.10	0	0	0	0	0
$9.75	$10.00	1.60	1.30	1.05	.70	.40	.15	0	0	0	0	0
$10.00	$10.50	1.65	1.35	1.10	.80	.50	.20	0	0	0	0	0
$10.50	$11.00	1.75	1.45	1.15	.85	.60	.30	0	0	0	0	0
$11.00	$11.50	1.80	1.55	1.25	.95	.65	.35	.05	0	0	0	0
$11.50	$12.00	1.90	1.60	1.30	1.00	.75	.45	.15	0	0	0	0
$12.00	$12.50	2.00	1.70	1.40	1.10	.80	.50	.25	0	0	0	0
$12.50	$13.00	2.05	1.80	1.50	1.20	.90	.60	.30	0	0	0	0
$13.00	$13.50	2.15	1.85	1.55	1.30	1.00	.70	.40	.10	0	0	0
$13.50	$14.00	2.20	1.95	1.65	1.35	1.05	.75	.50	.15	0	0	0
$14.00	$14.50	2.30	2.00	1.70	1.45	1.15	.85	.55	.25	0	0	0
$14.50	$15.00	2.40	2.10	1.80	1.50	1.20	.95	.65	.35	.05	0	0
$15.00	$15.50	2.50	2.20	1.90	1.60	1.30	1.00	.70	.40	.15	0	0
$15.50	$16.00	2.55	2.25	1.95	1.70	1.40	1.10	.80	.50	.20	0	0
$16.00	$16.50	2.65	2.35	2.05	1.75	1.45	1.15	.90	.60	.30	.10	0
$16.50	$17.00	2.70	2.40	2.15	1.85	1.55	1.25	.95	.70	.40	.15	0
$17.00	$17.50	2.80	2.50	2.20	1.90	1.60	1.35	1.05	.75	.45	.25	0
$17.50	$18.00	2.90	2.60	2.30	2.00	1.70	1.40	1.15	.85	.55	.35	0
$18.00	$18.50	2.95	2.65	2.40	2.10	1.80	1.50	1.20	.90	.65	.40	.05
$18.50	$19.00	3.05	2.75	2.45	2.15	1.85	1.60	1.30	1.00	.70	.50	.10
$19.00	$19.50	3.10	2.80	2.55	2.25	1.95	1.65	1.35	1.10	.80	.50	.20
$19.50	$20.00	3.20	2.90	2.60	2.30	2.05	1.75	1.45	1.15	.85	.60	.30
$20.00	$21.00	3.30	3.00	2.70	2.45	2.15	1.85	1.55	1.30	1.00	.70	.40
$21.00	$22.00	3.50	3.20	2.90	2.60	2.30	2.05	1.75	1.45	1.15	.90	.55
$22.00	$23.00	3.65	3.35	3.05	2.80	2.50	2.20	1.90	1.60	1.30	1.00	.75
$23.00	$24.00	3.80	3.50	3.20	2.95	2.65	2.35	2.05	1.75	1.45	1.20	.90
$24.00	$25.00	3.95	3.65	3.40	3.10	2.80	2.50	2.20	1.95	1.65	1.35	1.05
$25.00	$26.00	4.15	3.85	3.55	3.25	3.00	2.70	2.40	2.10	1.80	1.50	1.20
$26.00	$27.00	4.30	4.00	3.70	3.40	3.10	2.85	2.55	2.25	2.00	1.65	1.40
$27.00	$28.00	4.45	4.15	3.90	3.60	3.30	3.00	2.70	2.40	2.10	1.80	1.55
$28.00	$29.00	4.60	4.30	4.00	3.75	3.45	3.15	2.85	2.60	2.30	2.00	1.70
$29.00	$30.00	4.80	4.50	4.20	3.90	3.60	3.30	3.00	2.75	2.45	2.15	1.85
		16.2 percent of the excess over $30 plus—										
$30.00 and over		4.85	4.55	4.30	4.00	3.70	3.40	3.10	2.80	2.55	2.25	1.95

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"(D) FOR WAGES PAID AFTER DECEMBER 31, 1964:

"If the payroll period with respect to an employee is weekly—

"And the wages are		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$13	15.3% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$13	$14	$2.10	.10	0	0	0	0	0	0	0	0	0
$14	$15	2.20	.20	0	0	0	0	0	0	0	0	0
$15	$16	2.40	.40	0	0	0	0	0	0	0	0	0
$16	$17	2.50	.50	0	0	0	0	0	0	0	0	0
$17	$18	2.70	.70	0	0	0	0	0	0	0	0	0
$18	$19	2.80	.80	0	0	0	0	0	0	0	0	0
$19	$20	3.00	1.00	0	0	0	0	0	0	0	0	0
$20	$21	3.10	1.10	0	0	0	0	0	0	0	0	0
$21	$22	3.30	1.30	0	0	0	0	0	0	0	0	0
$22	$23	3.40	1.50	0	0	0	0	0	0	0	0	0
$23	$24	3.60	1.60	0	0	0	0	0	0	0	0	0
$24	$25	3.70	1.80	0	0	0	0	0	0	0	0	0
$25	$26	3.90	1.90	0	0	0	0	0	0	0	0	0
$26	$27	4.10	2.10	.10	0	0	0	0	0	0	0	0
$27	$28	4.20	2.20	.20	0	0	0	0	0	0	0	0
$28	$29	4.40	2.40	.40	0	0	0	0	0	0	0	0
$29	$30	4.50	2.50	.50	0	0	0	0	0	0	0	0
$30	$31	4.70	2.70	.70	0	0	0	0	0	0	0	0
$31	$32	4.80	2.80	.80	0	0	0	0	0	0	0	0
$32	$33	5.00	3.00	1.00	0	0	0	0	0	0	0	0
$33	$34	5.10	3.10	1.10	0	0	0	0	0	0	0	0
$34	$35	5.30	3.30	1.30	0	0	0	0	0	0	0	0
$35	$36	5.40	3.40	1.50	0	0	0	0	0	0	0	0
$36	$37	5.60	3.60	1.60	0	0	0	0	0	0	0	0
$37	$38	5.70	3.70	1.80	0	0	0	0	0	0	0	0
$38	$39	5.90	3.90	1.90	0	0	0	0	0	0	0	0
$39	$40	6.00	4.10	2.10	.10	0	0	0	0	0	0	0
$40	$41	6.20	4.20	2.20	.20	0	0	0	0	0	0	0
$41	$42	6.30	4.40	2.40	.40	0	0	0	0	0	0	0
$42	$43	6.50	4.50	2.50	.50	0	0	0	0	0	0	0
$43	$44	6.70	4.70	2.70	.70	0	0	0	0	0	0	0
$44	$45	6.80	4.80	2.80	.80	0	0	0	0	0	0	0
$45	$46	7.00	5.00	3.00	1.00	0	0	0	0	0	0	0
$46	$47	7.10	5.10	3.10	1.10	0	0	0	0	0	0	0
$47	$48	7.30	5.30	3.30	1.30	0	0	0	0	0	0	0
$48	$49	7.40	5.40	3.40	1.50	0	0	0	0	0	0	0
$49	$50	7.60	5.60	3.60	1.60	0	0	0	0	0	0	0
$50	$51	7.70	5.70	3.70	1.80	0	0	0	0	0	0	0
$51	$52	7.90	5.90	3.90	1.90	0	0	0	0	0	0	0
$52	$53	8.00	6.00	4.10	2.10	.10	0	0	0	0	0	0
$53	$54	8.20	6.20	4.20	2.20	.20	0	0	0	0	0	0
$54	$55	8.30	6.30	4.40	2.40	.40	0	0	0	0	0	0
$55	$56	8.50	6.50	4.50	2.50	.50	0	0	0	0	0	0
$56	$57	8.60	6.70	4.70	2.70	.70	0	0	0	0	0	0
$57	$58	8.80	6.80	4.80	2.80	.80	0	0	0	0	0	0
$58	$59	9.00	7.00	5.00	3.00	1.00	0	0	0	0	0	0
$59	$60	9.10	7.10	5.10	3.10	1.10	0	0	0	0	0	0
$60	$62	9.30	7.30	5.40	3.40	1.40	0	0	0	0	0	0
$62	$64	9.60	7.70	5.70	3.70	1.70	0	0	0	0	0	0
$64	$66	9.90	8.00	6.00	4.00	2.00	0	0	0	0	0	0
$66	$68	10.30	8.30	6.30	4.30	2.30	.30	0	0	0	0	0
$68	$70	10.60	8.60	6.60	4.60	2.60	.60	0	0	0	0	0
$70	$72	10.90	8.90	6.90	4.90	2.90	.90	0	0	0	0	0
$72	$74	11.20	9.20	7.20	5.20	3.20	1.20	0	0	0	0	0
$74	$76	11.50	9.50	7.50	5.50	3.50	1.50	0	0	0	0	0
$76	$78	11.80	9.80	7.80	5.80	3.80	1.80	0	0	0	0	0
$78	$80	12.10	10.10	8.10	6.10	4.10	2.10	.20	0	0	0	0
$80	$82	12.40	10.40	8.40	6.40	4.40	2.40	.50	0	0	0	0
$82	$84	12.70	10.70	8.70	6.70	4.70	2.80	.80	0	0	0	0
$84	$86	13.00	11.00	9.00	7.00	5.00	3.10	1.10	0	0	0	0
$86	$88	13.30	11.30	9.30	7.30	5.40	3.40	1.40	0	0	0	0
$88	$90	13.60	11.60	9.60	7.70	5.70	3.70	1.70	0	0	0	0
$90	$92	13.90	11.90	9.90	8.00	6.00	4.00	2.00	0	0	0	0
$92	$94	14.20	12.20	10.30	8.30	6.30	4.30	2.30	.30	0	0	0
$94	$96	14.50	12.50	10.60	8.60	6.60	4.60	2.60	.60	0	0	0
$96	$98	14.80	12.90	10.90	8.90	6.90	4.90	2.90	.90	0	0	0
$98	$100	15.10	13.20	11.20	9.20	7.20	5.20	3.20	1.20	0	0	0
$100	$105	15.70	13.70	11.70	9.70	7.70	5.70	3.70	1.80	0	0	0
$105	$110	16.40	14.50	12.50	10.50	8.50	6.50	4.50	2.50	.50	0	0
$110	$115	17.20	15.30	13.20	11.30	9.30	7.30	5.30	3.30	1.30	0	0
$115	$120	18.00	16.00	14.00	12.00	10.00	8.00	6.00	4.10	2.10	.10	0
$120	$125	18.70	16.80	14.80	12.80	10.80	8.80	6.80	4.80	2.80	.80	0
$125	$130	19.50	17.50	15.50	13.50	11.60	9.60	7.60	5.60	3.60	1.60	0
$130	$135	20.30	18.30	16.30	14.30	12.30	10.30	8.30	6.30	4.40	2.40	.40
$135	$140	21.00	19.00	17.10	15.10	13.10	11.10	9.10	7.10	6.10	3.10	1.10
$140	$145	21.80	19.80	17.80	15.80	13.80	11.90	9.90	7.90	5.90	3.90	1.90
$145	$150	22.60	20.60	18.60	16.60	14.60	12.60	10.60	8.60	6.70	4.70	2.70
$150	$160	23.70	21.70	19.70	17.70	15.80	13.80	11.80	9.80	7.80	5.80	3.80
$160	$170	25.20	23.30	21.30	19.30	17.30	15.30	13.30	11.30	9.30	7.30	5.40
$170	$180	26.80	24.80	22.80	20.90	18.90	16.90	14.80	12.90	10.90	8.90	6.90
$180	$190	28.30	26.30	24.30	22.30	20.30	18.40	16.40	14.40	11.40	10.40	8.40
$190	$200	29.90	27.80	25.90	23.90	21.90	19.90	17.90	15.90	13.90	11.90	9.90
		15.3 percent of the excess over $200 plus—										
$200 and over		30.60	28.60	26.60	24.60	22.60	20.70	18.70	16.70	14.70	12.70	10.70

"If the payroll period with respect to an employee is biweekly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$26	15.3% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$26	$28	$4.10	.20	0	0	0	0	0	0	0	0	0
$28	$30	4.40	.50	0	0	0	0	0	0	0	0	0
$30	$32	4.70	.80	0	0	0	0	0	0	0	0	0
$32	$34	5.00	1.10	0	0	0	0	0	0	0	0	0
$34	$36	5.40	1.40	0	0	0	0	0	0	0	0	0
$36	$38	5.70	1.70	0	0	0	0	0	0	0	0	0
$38	$40	6.00	2.00	0	0	0	0	0	0	0	0	0
$40	$42	6.30	2.30	0	0	0	0	0	0	0	0	0
$42	$44	6.60	2.60	0	0	0	0	0	0	0	0	0
$44	$46	6.90	2.90	0	0	0	0	0	0	0	0	0
$46	$48	7.20	3.20	0	0	0	0	0	0	0	0	0
$48	$50	7.50	3.50	0	0	0	0	0	0	0	0	0
$50	$52	7.80	3.80	0	0	0	0	0	0	0	0	0
$52	$54	8.10	4.10	.20	0	0	0	0	0	0	0	0
$54	$56	8.40	4.40	.50	0	0	0	0	0	0	0	0
$56	$58	8.70	4.70	.80	0	0	0	0	0	0	0	0
$58	$60	9.00	5.00	1.10	0	0	0	0	0	0	0	0
$60	$62	9.30	5.40	1.40	0	0	0	0	0	0	0	0
$62	$64	9.60	5.70	1.70	0	0	0	0	0	0	0	0
$64	$66	9.90	6.00	2.00	0	0	0	0	0	0	0	0
$66	$68	10.30	6.30	2.30	0	0	0	0	0	0	0	0
$68	$70	10.60	6.60	2.60	0	0	0	0	0	0	0	0
$70	$72	10.90	6.90	2.90	0	0	0	0	0	0	0	0
$72	$74	11.20	7.20	3.20	0	0	0	0	0	0	0	0
$74	$76	11.50	7.50	3.50	0	0	0	0	0	0	0	0
$76	$78	11.80	7.80	3.80	0	0	0	0	0	0	0	0
$78	$80	12.10	8.10	4.10	.20	0	0	0	0	0	0	0
$80	$82	12.40	8.40	4.40	.50	0	0	0	0	0	0	0
$82	$84	12.70	8.70	4.70	.80	0	0	0	0	0	0	0
$84	$86	13.00	9.00	5.00	1.10	0	0	0	0	0	0	0
$86	$88	13.30	9.30	5.40	1.40	0	0	0	0	0	0	0
$88	$90	13.60	9.60	5.70	1.70	0	0	0	0	0	0	0
$90	$92	13.90	9.90	6.00	2.00	0	0	0	0	0	0	0
$92	$94	14.20	10.30	6.30	2.30	0	0	0	0	0	0	0
$94	$96	14.50	10.60	6.60	2.60	0	0	0	0	0	0	0
$96	$98	14.80	10.90	6.90	2.90	0	0	0	0	0	0	0
$98	$100	15.10	11.20	7.20	3.20	0	0	0	0	0	0	0
$100	$102	15.50	11.50	7.50	3.50	0	0	0	0	0	0	0
$102	$104	15.80	11.80	7.80	3.80	0	0	0	0	0	0	0
$104	$106	16.10	12.10	8.10	4.10	.20	0	0	0	0	0	0
$106	$108	16.40	12.40	8.40	4.40	.50	0	0	0	0	0	0
$108	$110	16.70	12.70	8.70	4.70	.80	0	0	0	0	0	0
$110	$112	17.00	13.00	9.00	5.00	1.10	0	0	0	0	0	0
$112	$114	17.30	13.30	9.30	5.40	1.40	0	0	0	0	0	0
$114	$116	17.60	13.60	9.60	5.70	1.70	0	0	0	0	0	0
$116	$118	17.90	13.90	9.90	6.00	2.00	0	0	0	0	0	0
$118	$120	18.20	14.20	10.30	6.30	2.30	0	0	0	0	0	0
$120	$124	18.70	14.70	10.70	6.70	2.80	0	0	0	0	0	0
$124	$128	19.30	15.30	11.30	7.30	3.40	0	0	0	0	0	0
$128	$132	19.90	15.90	11.90	8.00	4.00	0	0	0	0	0	0
$132	$136	20.50	15.60	12.50	8.60	4.60	.60	0	0	0	0	0
$136	$140	21.10	17.10	13.20	9.20	5.20	1.20	0	0	0	0	0
$140	$144	21.70	17.70	13.80	9.80	5.80	1.80	0	0	0	0	0
$144	$148	22.30	18.40	14.40	10.40	6.40	2.40	0	0	0	0	0
$148	$152	23.00	19.00	15.00	11.00	7.00	3.10	0	0	0	0	0
$152	$156	23.60	19.60	15.60	11.60	7.70	3.70	0	0	0	0	0
$156	$160	24.20	20.20	16.20	12.20	8.30	4.30	.30	0	0	0	0
$160	$164	24.80	20.80	16.80	12.90	8.90	4.90	.90	0	0	0	0
$164	$168	25.40	21.40	17.40	13.50	9.50	5.50	1.50	0	0	0	0
$168	$172	26.00	22.00	18.10	14.10	10.10	6.10	2.10	0	0	0	0
$172	$176	26.60	22.60	18.70	14.70	10.70	6.70	2.80	0	0	0	0
$176	$180	27.20	23.30	19.30	15.30	11.30	7.30	3.40	0	0	0	0
$180	$184	27.80	23.90	19.90	15.90	11.90	8.00	4.00	0	0	0	0
$184	$188	28.50	24.50	20.50	16.50	12.50	8.60	4.60	.60	0	0	0
$188	$192	29.10	25.10	21.10	17.10	13.20	9.20	5.20	1.20	0	0	0
$192	$196	29.70	25.70	21.70	17.70	13.80	9.80	5.80	1.80	0	0	0
$196	$200	30.30	26.30	22.30	18.40	14.40	10.40	6.40	2.40	0	0	0
$200	$210	31.40	27.40	23.40	19.40	15.50	11.50	7.50	3.50	0	0	0
$210	$220	32.90	28.90	24.90	21.00	17.00	13.00	9.00	5.00	1.10	0	0
$220	$230	34.40	30.40	26.50	22.50	18.50	14.50	10.60	6.60	2.60	0	0
$230	$240	36.00	32.00	28.00	24.00	20.00	16.10	12.10	8.10	4.10	.20	0
$240	$250	37.50	33.50	29.50	25.60	21.60	17.60	13.60	9.60	5.70	1.70	0
$250	$260	39.00	35.00	31.10	27.10	23.10	19.10	15.10	11.20	7.20	3.20	0
$260	$270	40.50	36.60	32.60	28.60	24.60	20.70	16.70	12.70	8.70	4.70	.80
$270	$280	42.10	38.10	34.10	30.10	26.20	22.20	18.20	14.20	10.30	6.30	2.30
$280	$290	43.60	39.60	35.60	31.70	27.70	23.70	19.70	15.80	11.80	7.80	3.80
$290	$300	45.10	41.20	37.20	33.20	29.20	25.20	21.30	17.30	13.30	9.30	5.40
$300	$320	47.40	43.50	39.50	35.50	31.50	27.50	23.60	19.60	15.60	11.60	7.70
$320	$340	50.50	46.50	42.50	38.60	34.60	30.60	26.60	22.60	18.70	14.70	10.70
$340	$360	53.60	49.60	45.60	41.60	37.60	33.70	29.70	25.70	21.70	17.70	13.80
$360	$380	56.60	52.60	48.70	44.70	40.70	36.70	32.70	28.80	24.80	20.80	16.80
$380	$400	59.70	55.70	51.70	47.70	43.80	39.80	35.80	31.80	27.80	23.90	19.90
		15.3 percent of the excess over $400 plus—										
$400 and over		61.20	57.20	53.20	49.30	45.30	41.30	38.90	34.90	30.90	26.90	22.90

"If the payroll period with respect to an employee is semimonthly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$28	15.3% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$28	$30	$4.40	.20	0	0	0	0	0	0	0	0	0
$30	$32	4.70	.50	0	0	0	0	0	0	0	0	0
$32	$34	5.00	.80	0	0	0	0	0	0	0	0	0
$34	$36	5.40	1.10	0	0	0	0	0	0	0	0	0
$36	$38	5.70	1.40	0	0	0	0	0	0	0	0	0
$38	$40	6.00	1.70	0	0	0	0	0	0	0	0	0
$40	$42	6.30	2.00	0	0	0	0	0	0	0	0	0
$42	$44	6.60	2.30	0	0	0	0	0	0	0	0	0
$44	$46	6.90	2.60	0	0	0	0	0	0	0	0	0
$46	$48	7.20	2.90	0	0	0	0	0	0	0	0	0
$48	$50	7.50	3.20	0	0	0	0	0	0	0	0	0
$50	$52	7.80	3.50	0	0	0	0	0	0	0	0	0
$52	$54	8.10	3.80	0	0	0	0	0	0	0	0	0
$54	$56	8.40	4.10	0	0	0	0	0	0	0	0	0
$56	$58	8.70	4.40	.20	0	0	0	0	0	0	0	0
$58	$60	9.00	4.70	.50	0	0	0	0	0	0	0	0
$60	$62	9.30	5.00	.80	0	0	0	0	0	0	0	0
$62	$64	9.60	5.40	1.10	0	0	0	0	0	0	0	0
$64	$66	9.90	5.70	1.40	0	0	0	0	0	0	0	0
$66	$68	10.30	6.00	1.70	0	0	0	0	0	0	0	0
$68	$70	10.60	6.30	2.00	0	0	0	0	0	0	0	0
$70	$72	10.90	6.60	2.30	0	0	0	0	0	0	0	0
$72	$74	11.20	6.90	2.60	0	0	0	0	0	0	0	0
$74	$76	11.50	7.20	2.90	0	0	0	0	0	0	0	0
$76	$78	11.80	7.50	3.20	0	0	0	0	0	0	0	0
$78	$80	12.10	7.80	3.50	0	0	0	0	0	0	0	0
$80	$82	12.40	8.10	3.80	0	0	0	0	0	0	0	0
$82	$84	12.70	8.40	4.10	0	0	0	0	0	0	0	0
$84	$86	13.00	8.70	4.40	.20	0	0	0	0	0	0	0
$86	$88	13.30	9.00	4.70	.50	0	0	0	0	0	0	0
$88	$90	13.60	9.30	5.00	.80	0	0	0	0	0	0	0
$90	$92	13.90	9.60	5.40	1.10	0	0	0	0	0	0	0
$92	$94	14.20	9.90	5.70	1.40	0	0	0	0	0	0	0
$94	$96	14.50	10.30	6.00	1.70	0	0	0	0	0	0	0
$96	$98	14.80	10.60	6.30	2.00	0	0	0	0	0	0	0
$98	$100	15.10	10.90	6.60	2.30	0	0	0	0	0	0	0
$100	$102	15.50	11.20	6.90	2.60	0	0	0	0	0	0	0
$102	$104	15.80	11.50	7.20	2.90	0	0	0	0	0	0	0
$104	$106	16.10	11.80	7.50	3.20	0	0	0	0	0	0	0
$106	$108	16.40	12.10	7.80	3.50	0	0	0	0	0	0	0
$108	$110	16.70	12.40	8.10	3.80	0	0	0	0	0	0	0
$110	$112	17.00	12.70	8.40	4.10	0	0	0	0	0	0	0
$112	$114	17.30	13.00	8.70	4.40	.20	0	0	0	0	0	0
$114	$116	17.60	13.30	9.00	4.70	.50	0	0	0	0	0	0
$116	$118	17.90	13.60	9.30	5.00	.80	0	0	0	0	0	0
$118	$120	18.20	13.90	9.60	5.40	1.10	0	0	0	0	0	0
$120	$124	18.70	14.40	10.10	5.80	1.50	0	0	0	0	0	0
$124	$128	19.30	15.00	10.70	6.40	2.10	0	0	0	0	0	0
$128	$132	19.90	15.60	11.30	7.00	2.80	0	0	0	0	0	0
$132	$136	20.50	16.20	11.90	7.70	3.40	0	0	0	0	0	0
$136	$140	21.10	16.80	12.50	8.30	4.00	0	0	0	0	0	0
$140	$144	21.70	17.40	13.20	8.90	4.60	.30	0	0	0	0	0
$144	$148	22.30	18.10	13.80	9.50	5.20	.90	0	0	0	0	0
$148	$152	23.00	18.70	14.40	10.10	5.80	1.50	0	0	0	0	0
$152	$156	23.60	19.30	15.00	10.70	6.40	2.10	0	0	0	0	0
$156	$160	24.20	19.90	15.60	11.30	7.00	2.80	0	0	0	0	0
$160	$164	24.80	20.50	16.20	11.90	7.70	3.40	0	0	0	0	0
$164	$168	25.40	21.10	16.80	12.50	8.30	4.00	0	0	0	0	0
$168	$172	26.00	21.70	17.40	13.20	8.90	4.60	.30	0	0	0	0
$172	$176	26.60	22.30	18.10	13.80	9.50	5.20	.90	0	0	0	0
$176	$180	27.20	23.00	18.70	14.40	10.10	5.80	1.50	0	0	0	0
$180	$184	27.80	23.60	19.30	15.00	10.70	6.40	2.10	0	0	0	0
$184	$188	28.50	24.20	19.90	15.60	11.30	7.00	2.80	0	0	0	0
$188	$192	29.10	24.80	20.50	16.20	11.90	7.70	3.40	0	0	0	0
$192	$196	29.70	25.40	21.10	16.80	12.50	8.30	4.00	0	0	0	0
$196	$200	30.30	26.00	21.70	17.40	13.20	8.90	4.60	.30	0	0	0
$200	$210	31.40	27.10	22.80	18.50	14.20	9.90	5.70	1.40	0	0	0
$210	$220	32.90	28.60	24.30	20.00	15.80	11.50	7.20	2.90	0	0	0
$220	$230	34.40	30.10	25.90	21.60	17.30	13.00	8.70	4.40	.20	0	0
$230	$240	36.00	31.70	27.40	23.10	18.80	14.50	10.30	6.00	1.70	0	0
$240	$250	37.50	33.20	28.90	24.60	20.30	16.10	11.80	7.50	3.20	0	0
$250	$260	39.00	34.70	30.40	26.20	21.90	17.60	13.30	9.00	4.70	.50	0
$260	$270	40.50	36.30	32.00	27.70	23.40	19.10	14.80	10.60	6.30	2.00	0
$270	$280	42.10	37.80	33.50	29.20	24.90	20.70	16.40	12.10	7.80	3.50	0
$280	$290	43.60	39.30	35.00	30.80	26.50	22.20	17.90	13.60	9.30	5.00	.80
$290	$300	45.10	40.90	36.60	32.30	28.00	23.70	19.40	15.10	10.90	6.60	2.30
$300	$320	47.40	43.10	38.90	34.60	30.30	26.00	21.70	17.40	13.20	8.90	4.60
$320	$340	50.50	46.20	41.90	37.60	33.40	29.10	24.80	20.50	16.20	11.90	7.70
$340	$360	53.60	49.30	45.00	40.70	36.40	32.10	27.90	23.60	19.30	15.00	10.70
$360	$380	56.60	52.30	48.00	43.80	39.50	35.20	30.90	26.60	22.30	18.10	13.80
$380	$400	59.70	55.40	51.10	46.80	42.50	38.30	34.00	29.70	25.40	21.10	16.80
$400	$420	62.70	58.40	54.20	49.90	45.60	41.30	37.00	32.70	28.50	24.20	19.90
$420	$440	65.80	61.50	57.20	52.90	48.70	44.40	40.10	35.80	31.50	27.20	23.00
$440	$460	68.90	64.60	60.30	56.00	51.70	47.40	43.10	38.90	34.60	30.30	26.00
$460	$480	71.90	67.60	63.30	59.10	54.80	50.50	46.20	41.90	37.60	33.40	29.10
$480	$500	75.00	70.70	66.40	62.10	57.80	53.50	49.30	45.00	40.70	36.40	32.10
		15.3 percent of the excess over $500 plus—										
$500 and over		76.50	72.20	67.90	63.60	59.40	55.10	50.80	46.50	42.20	37.90	33.70

"If the payroll period with respect to an employee is monthly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$56	15.3% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$56	$60	$8.90	.30	0	0	0	0	0	0	0	0	0
$60	$64	9.50	.90	0	0	0	0	0	0	0	0	0
$64	$68	10.10	1.50	0	0	0	0	0	0	0	0	0
$68	$72	10.70	2.10	0	0	0	0	0	0	0	0	0
$72	$76	11.30	2.80	0	0	0	0	0	0	0	0	0
$76	$80	11.90	3.40	0	0	0	0	0	0	0	0	0
$80	$84	12.50	4.00	0	0	0	0	0	0	0	0	0
$84	$88	13.20	4.60	0	0	0	0	0	0	0	0	0
$88	$92	13.80	5.20	0	0	0	0	0	0	0	0	0
$92	$96	14.40	5.80	0	0	0	0	0	0	0	0	0
$96	$100	15.00	6.40	0	0	0	0	0	0	0	0	0
$100	$104	15.60	7.00	0	0	0	0	0	0	0	0	0
$104	$108	16.20	7.70	0	0	0	0	0	0	0	0	0
$108	$112	16.80	8.30	0	0	0	0	0	0	0	0	0
$112	$116	17.40	8.90	.30	0	0	0	0	0	0	0	0
$116	$120	18.10	9.50	.90	0	0	0	0	0	0	0	0
$120	$124	18.70	10.10	1.50	0	0	0	0	0	0	0	0
$124	$128	19.30	10.70	2.10	0	0	0	0	0	0	0	0
$128	$132	19.90	11.30	2.80	0	0	0	0	0	0	0	0
$132	$136	20.50	11.90	3.40	0	0	0	0	0	0	0	0
$136	$140	21.10	12.50	4.00	0	0	0	0	0	0	0	0
$140	$144	21.70	13.20	4.60	0	0	0	0	0	0	0	0
$144	$148	22.30	13.80	5.20	0	0	0	0	0	0	0	0
$148	$152	23.00	14.40	5.80	0	0	0	0	0	0	0	0
$152	$156	23.60	15.00	6.40	0	0	0	0	0	0	0	0
$156	$160	24.20	15.60	7.00	0	0	0	0	0	0	0	0
$160	$164	24.80	16.20	7.70	0	0	0	0	0	0	0	0
$164	$168	25.40	16.80	8.30	0	0	0	0	0	0	0	0
$168	$172	26.00	17.40	8.90	0	0	0	0	0	0	0	0
$172	$176	26.60	18.10	9.50	0	0	0	0	0	0	0	0
$176	$180	27.20	18.70	10.10	0	0	0	0	0	0	0	0
$180	$184	27.80	19.30	10.70	0	0	0	0	0	0	0	0
$184	$188	28.50	19.90	11.30	0	0	0	0	0	0	0	0
$188	$192	29.10	20.50	11.90	0	0	0	0	0	0	0	0
$192	$196	29.70	21.10	12.50	0	0	0	0	0	0	0	0
$196	$200	30.30	21.70	13.20	0	0	0	0	0	0	0	0
$200	$204	30.90	22.30	13.80	0	0	0	0	0	0	0	0
$204	$208	31.50	23.00	14.40	0	0	0	0	0	0	0	0
$208	$212	32.10	23.60	15.00	0	0	0	0	0	0	0	0
$212	$216	32.70	24.20	15.60	0	0	0	0	0	0	0	0
$216	$220	33.40	24.80	16.20	0	0	0	0	0	0	0	0
$220	$224	34.00	25.40	16.80	0	0	0	0	0	0	0	0
$224	$228	34.60	26.00	17.40	.30	0	0	0	0	0	0	0
$228	$232	35.20	26.60	18.10	.90	0	0	0	0	0	0	0
$232	$236	35.80	27.20	18.70	1.50	0	0	0	0	0	0	0
$236	$240	36.40	27.80	19.30	2.10	0	0	0	0	0	0	0
$240	$248	37.30	28.80	20.20	11.60	3.10	0	0	0	0	0	0
$248	$256	38.60	30.00	21.40	12.90	4.30	0	0	0	0	0	0
$256	$264	39.80	31.20	22.60	14.10	5.50	0	0	0	0	0	0
$264	$272	41.00	32.40	23.90	15.30	6.70	0	0	0	0	0	0
$272	$280	42.20	33.70	25.10	16.50	8.00	0	0	0	0	0	0
$280	$288	43.50	34.90	26.30	17.70	9.20	.60	0	0	0	0	0
$288	$296	44.70	36.10	27.50	19.00	10.40	1.80	0	0	0	0	0
$296	$304	45.90	37.30	28.80	20.20	11.60	3.10	0	0	0	0	0
$304	$312	47.10	38.60	30.00	21.40	12.90	4.30	0	0	0	0	0
$312	$320	48.30	39.80	31.20	22.60	14.10	5.50	0	0	0	0	0
$320	$328	49.60	41.00	32.40	23.90	15.30	6.70	0	0	0	0	0
$328	$336	50.80	42.20	33.70	25.10	16.50	8.00	0	0	0	0	0
$336	$344	52.00	43.50	34.90	26.30	17.70	9.20	.60	0	0	0	0
$344	$352	53.20	44.70	36.10	27.50	19.00	10.40	1.80	0	0	0	0
$352	$360	54.50	45.90	37.30	28.80	20.20	11.60	3.10	0	0	0	0
$360	$368	55.70	47.10	38.60	30.00	21.40	12.90	4.30	0	0	0	0
$368	$376	56.90	48.30	39.80	31.20	22.60	14.10	5.50	0	0	0	0
$376	$384	58.10	49.60	41.00	32.40	23.90	15.30	6.70	0	0	0	0
$384	$392	59.40	50.80	42.20	33.70	25.10	16.50	8.00	0	0	0	0
$392	$400	60.60	52.00	43.50	34.90	26.30	17.70	9.20	.60	0	0	0
$400	$420	62.70	54.20	45.60	37.00	28.50	19.90	11.30	2.80	0	0	0
$420	$440	65.80	57.20	48.70	40.10	31.50	23.00	14.40	5.80	0	0	0
$440	$460	68.90	60.30	51.70	43.10	34.60	26.00	17.40	8.90	.30	0	0
$460	$480	71.90	63.30	54.80	46.20	37.60	29.10	20.50	11.90	3.40	0	0
$480	$500	75.00	66.40	57.80	49.30	40.70	32.10	23.60	15.00	6.40	0	0
$500	$520	78.00	69.50	60.90	52.30	43.80	35.20	26.60	18.10	9.50	.90	0
$520	$540	81.10	72.50	64.00	55.40	46.80	38.30	29.70	21.10	12.50	4.00	0
$540	$560	84.20	75.60	67.00	58.40	49.90	41.30	32.70	24.20	15.60	7.00	0
$560	$580	87.20	78.60	70.10	61.50	52.90	44.40	35.80	27.20	18.70	10.10	1.50
$580	$600	90.30	81.70	73.10	64.60	56.00	47.40	38.90	30.30	21.70	13.20	4.60
$600	$640	94.90	86.30	77.70	69.20	60.60	52.00	43.50	34.90	26.30	17.70	9.20
$640	$680	101.00	92.40	83.80	75.30	66.70	58.10	49.60	41.00	32.40	23.90	15.30
$680	$720	107.10	98.50	90.00	81.40	72.80	64.30	55.70	47.10	38.60	30.00	21.40
$720	$760	113.20	104.70	96.10	87.50	78.90	70.40	61.80	53.20	44.70	36.10	27.50
$760	$800	119.30	110.80	102.20	93.60	85.10	76.50	67.90	59.40	50.80	42.20	33.70
$800	$840	125.50	116.90	108.30	99.80	91.20	82.60	74.10	65.50	56.90	48.30	39.80
$840	$880	131.60	123.00	114.40	105.90	97.30	88.70	80.20	71.60	63.00	54.50	45.90
$880	$920	137.70	129.10	120.60	112.00	103.40	94.90	86.30	77.70	69.20	60.60	52.00
$920	$960	143.80	135.30	126.70	118.10	109.50	101.00	92.40	83.80	75.30	66.70	58.10
$960	$1,000	149.90	141.40	132.80	124.20	115.70	107.10	98.50	90.00	81.40	72.80	64.30
		15.3 percent of the excess over $1,000 plus—										
$1,000 and over		153.00	144.40	135.90	127.30	118.70	110.20	101.60	93.00	84.50	75.90	67.30

"If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period—

"And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of tax to be withheld shall be the following amount multiplied by the number of days in such period—										
$0	$2.00	15.3% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$2.00	$2.25	$0.35	.05	0	0	0	0	0	0	0	0	0
$2.25	$2.50	.35	.10	0	0	0	0	0	0	0	0	0
$2.50	$2.75	.40	.15	0	0	0	0	0	0	0	0	0
$2.75	$3.00	.45	.15	0	0	0	0	0	0	0	0	0
$3.00	$3.25	.50	.20	0	0	0	0	0	0	0	0	0
$3.25	$3.50	.50	.25	0	0	0	0	0	0	0	0	0
$3.50	$3.75	.55	.30	0	0	0	0	0	0	0	0	0
$3.75	$4.00	.60	.30	.05	0	0	0	0	0	0	0	0
$4.00	$4.25	.65	.35	.10	0	0	0	0	0	0	0	0
$4.25	$4.50	.70	.40	.10	0	0	0	0	0	0	0	0
$4.50	$4.75	.70	.45	.15	0	0	0	0	0	0	0	0
$4.75	$5.00	.75	.50	.20	0	0	0	0	0	0	0	0
$5.00	$5.25	.80	.50	.25	0	0	0	0	0	0	0	0
$5.25	$5.50	.80	.55	.30	0	0	0	0	0	0	0	0
$5.50	$5.75	.85	.60	.30	.05	0	0	0	0	0	0	0
$5.75	$6.00	.90	.65	.35	.10	0	0	0	0	0	0	0
$6.00	$6.25	.95	.65	.40	.10	0	0	0	0	0	0	0
$6.25	$6.50	1.00	.70	.45	.15	0	0	0	0	0	0	0
$6.50	$6.75	1.00	.75	.45	.20	0	0	0	0	0	0	0
$6.75	$7.00	1.05	.80	.50	.25	0	0	0	0	0	0	0
$7.00	$7.25	1.10	.80	.55	.25	0	0	0	0	0	0	0
$7.25	$7.50	1.15	.85	.60	.30	0	0	0	0	0	0	0
$7.50	$7.75	1.15	.90	.60	.35	.05	0	0	0	0	0	0
$7.75	$8.00	1.20	.95	.65	.40	.10	0	0	0	0	0	0
$8.00	$8.25	1.25	1.00	.70	.40	.15	0	0	0	0	0	0
$8.25	$8.50	1.30	1.00	.75	.45	.20	0	0	0	0	0	0
$8.50	$8.75	1.30	1.05	.75	.50	.20	0	0	0	0	0	0
$8.75	$9.00	1.35	1.10	.80	.55	.25	0	0	0	0	0	0
$9.00	$9.25	1.40	1.10	.85	.60	.30	0	0	0	0	0	0
$9.25	$9.50	1.45	1.15	.90	.60	.35	.05	0	0	0	0	0
$9.50	$9.75	1.50	1.20	.90	.65	.35	.10	0	0	0	0	0
$9.75	$10.00	1.50	1.25	.95	.70	.40	.15	0	0	0	0	0
$10.00	$10.50	1.55	1.30	1.00	.75	.45	.20	0	0	0	0	0
$10.50	$11.00	1.65	1.35	1.10	.80	.55	.25	0	0	0	0	0
$11.00	$11.50	1.70	1.45	1.15	.90	.60	.35	.05	0	0	0	0
$11.50	$12.00	1.80	1.50	1.25	1.00	.70	.40	.15	0	0	0	0
$12.00	$12.50	1.90	1.60	1.35	1.05	.80	.50	.20	0	0	0	0
$12.50	$13.00	1.95	1.70	1.40	1.10	.85	.60	.30	0	0	0	0
$13.00	$13.50	2.05	1.75	1.50	1.20	.95	.65	.40	.10	0	0	0
$13.50	$14.00	2.10	1.85	1.55	1.30	1.00	.75	.45	.15	0	0	0
$14.00	$14.50	2.20	1.90	1.65	1.35	1.10	.80	.55	.25	0	0	0
$14.50	$15.00	2.25	2.00	1.70	1.45	1.15	.90	.60	.35	.05	0	0
$15.00	$15.50	2.35	2.05	1.80	1.50	1.25	.95	.70	.40	.15	0	0
$15.50	$16.00	2.40	2.15	1.85	1.60	1.30	1.05	.75	.50	.20	0	0
$16.00	$16.50	2.50	2.20	1.95	1.65	1.40	1.10	.85	.55	.30	0	0
$16.50	$17.00	2.55	2.30	2.00	1.75	1.45	1.20	.90	.65	.35	.10	0
$17.00	$17.50	2.65	2.35	2.10	1.80	1.55	1.25	1.00	.70	.45	.15	0
$17.50	$18.00	2.70	2.45	2.15	1.90	1.60	1.35	1.05	.80	.50	.25	0
$18.00	$18.50	2.80	2.50	2.25	1.95	1.70	1.40	1.15	.85	.60	.30	.05
$18.50	$19.00	2.85	2.60	2.30	2.05	1.75	1.50	1.20	.95	.65	.40	.10
$19.00	$19.50	2.95	2.65	2.40	2.10	1.85	1.55	1.30	1.00	.75	.45	.20
$19.50	$20.00	3.00	2.75	2.45	2.20	1.90	1.65	1.35	1.10	.80	.55	.25
$20.00	$21.00	3.15	2.85	2.60	2.30	2.05	1.75	1.50	1.20	.95	.65	.40
$21.00	$22.00	3.30	3.00	2.75	2.45	2.20	1.90	1.65	1.35	1.10	.80	.55
$22.00	$23.00	3.45	3.15	2.90	2.60	2.35	2.05	1.80	1.50	1.25	.95	.70
$23.00	$24.00	3.60	3.30	3.05	2.75	2.50	2.20	1.95	1.65	1.40	1.10	.85
$24.00	$25.00	3.75	3.45	3.20	2.90	2.65	2.35	2.10	1.80	1.55	1.25	1.00
$25.00	$26.00	3.90	3.60	3.35	3.10	2.80	2.50	2.25	1.95	1.70	1.40	1.15
$26.00	$27.00	4.05	3.80	3.50	3.25	2.95	2.70	2.40	2.15	1.85	1.60	1.30
$27.00	$28.00	4.20	3.95	3.65	3.40	3.10	2.85	2.55	2.30	2.00	1.75	1.45
$28.00	$29.00	4.35	4.10	3.80	3.55	3.25	3.00	2.70	2.45	2.15	1.90	1.60
$29.00	$30.00	4.50	4.25	3.95	3.70	3.40	3.15	2.85	2.60	2.30	2.05	1.75
		15.3 percent of the excess over $30 plus—										
$30.00 and over		4.60	4.30	4.05	3.75	3.50	3.20	2.95	2.65	2.40	2.10	1.85

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"(E) FOR WAGES PAID AFTER DECEMBER 31, 1965:

"If the payroll period with respect to an employee is weekly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0........	$13......	14.4% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$13........	$14......	$1.90	.10	0	0	0	0	0	0	0	0	0
$14........	$15......	2.10	.20	0	0	0	0	0	0	0	0	0
$15........	$16......	2.20	.40	0	0	0	0	0	0	0	0	0
$16........	$17......	2.40	.50	0	0	0	0	0	0	0	0	0
$17........	$18......	2.50	.60	0	0	0	0	0	0	0	0	0
$18........	$19......	2.70	.80	0	0	0	0	0	0	0	0	0
$19........	$20......	2.80	.90	0	0	0	0	0	0	0	0	0
$20........	$21......	3.00	1.10	0	0	0	0	0	0	0	0	0
$21........	$22......	3.10	1.20	0	0	0	0	0	0	0	0	0
$22........	$23......	3.20	1.40	0	0	0	0	0	0	0	0	0
$23........	$24......	3.40	1.50	0	0	0	0	0	0	0	0	0
$24........	$25......	3.50	1.70	0	0	0	0	0	0	0	0	0
$25........	$26......	3.70	1.80	0	0	0	0	0	0	0	0	0
$26........	$27......	3.80	1.90	.10	0	0	0	0	0	0	0	0
$27........	$28......	4.00	2.10	.20	0	0	0	0	0	0	0	0
$28........	$29......	4.10	2.20	.40	0	0	0	0	0	0	0	0
$29........	$30......	4.20	2.40	.50	0	0	0	0	0	0	0	0
$30........	$31......	4.40	2.50	.60	0	0	0	0	0	0	0	0
$31........	$32......	4.50	2.70	.80	0	0	0	0	0	0	0	0
$32........	$33......	4.70	2.80	.90	0	0	0	0	0	0	0	0
$33........	$34......	4.80	3.00	1.10	0	0	0	0	0	0	0	0
$34........	$35......	5.00	3.10	1.20	0	0	0	0	0	0	0	0
$35........	$36......	5.10	3.20	1.40	0	0	0	0	0	0	0	0
$36........	$37......	5.30	3.40	1.50	0	0	0	0	0	0	0	0
$37........	$38......	5.40	3.50	1.70	0	0	0	0	0	0	0	0
$38........	$39......	5.50	3.70	1.80	0	0	0	0	0	0	0	0
$39........	$40......	5.70	3.80	1.90	.10	0	0	0	0	0	0	0
$40........	$41......	5.80	4.00	2.10	.20	0	0	0	0	0	0	0
$41........	$42......	6.00	4.10	2.20	.40	0	0	0	0	0	0	0
$42........	$43......	6.10	4.20	2.40	.50	0	0	0	0	0	0	0
$43........	$44......	6.30	4.40	2.50	.60	0	0	0	0	0	0	0
$44........	$45......	6.40	4.50	2.70	.80	0	0	0	0	0	0	0
$45........	$46......	6.60	4.70	2.80	.90	0	0	0	0	0	0	0
$46........	$47......	6.70	4.80	3.00	1.10	0	0	0	0	0	0	0
$47........	$48......	6.80	5.00	3.10	1.20	0	0	0	0	0	0	0
$48........	$49......	7.00	5.10	3.20	1.40	0	0	0	0	0	0	0
$49........	$50......	7.10	5.30	3.40	1.50	0	0	0	0	0	0	0
$50........	$51......	7.30	5.40	3.50	1.70	0	0	0	0	0	0	0
$51........	$52......	7.40	5.50	3.70	1.80	0	0	0	0	0	0	0
$52........	$53......	7.60	5.70	3.80	1.90	.10	0	0	0	0	0	0
$53........	[illegible]......	7.70	5.80	4.00	2.10	.20	0	0	0	0	0	0
$54........	[illegible]......	7.80	6.00	4.10	2.20	.40	0	0	0	0	0	0
$55........	$56......	8.00	6.10	4.20	2.40	.50	0	0	0	0	0	0
$56........	$57......	8.10	6.30	4.40	2.50	.60	0	0	0	0	0	0
$57........	$58......	8.30	6.40	4.50	2.70	.80	0	0	0	0	0	0
$58........	$59......	8.40	6.60	4.70	2.80	.90	0	0	0	0	0	0
$59........	$60......	8.60	6.70	4.80	3.00	1.10	0	0	0	0	0	0
$60........	$62......	8.80	6.90	5.00	3.20	1.30	0	0	0	0	0	0
$62........	$64......	9.10	7.20	5.30	3.50	1.60	0	0	0	0	0	0
$64........	$66......	9.40	7.50	5.60	3.70	1.90	0	0	0	0	0	0
$66........	$68......	9.60	7.80	5.90	4.00	2.20	.30	0	0	0	0	0
$68........	$70......	9.90	8.10	6.20	4.30	2.40	.60	0	0	0	0	0
$70........	$72......	10.20	8.40	6.50	4.60	2.70	.90	0	0	0	0	0
$72........	$74......	10.50	8.60	6.80	4.90	3.00	1.20	0	0	0	0	0
$74........	$76......	10.80	8.90	7.10	5.20	3.30	1.40	0	0	0	0	0
$76........	$78......	11.10	9.20	7.30	5.50	3.60	1.70	0	0	0	0	0
$78........	$80......	11.40	9.50	7.60	5.80	3.90	2.00	.10	0	0	0	0
$80........	$82......	11.70	9.80	7.90	6.00	4.20	2.30	.40	0	0	0	0
$82........	$84......	12.00	10.10	8.20	6.30	4.50	2.60	.70	0	0	0	0
$84........	$86......	12.20	10.40	8.50	6.60	4.80	2.90	1.00	0	0	0	0
$86........	$88......	12.50	10.70	8.80	6.90	5.00	3.20	1.30	0	0	0	0
$88........	$90......	12.80	10.90	9.10	7.20	5.30	3.50	1.60	0	0	0	0
$90........	$92......	13.10	11.20	9.40	7.50	5.60	3.70	1.90	0	0	0	0
$92........	$94......	13.40	11.50	9.60	7.80	5.90	4.00	2.20	.30	0	0	0
$94........	$96......	13.70	11.80	9.90	8.10	6.20	4.30	2.40	.60	0	0	0
$96........	$98......	14.00	12.10	10.20	8.40	6.50	4.60	2.70	.90	0	0	0
$98........	$100......	14.30	12.40	10.50	8.60	6.80	4.90	3.00	1.20	0	0	0
$100........	$105......	14.80	12.90	11.00	9.10	7.30	5.40	3.50	1.70	0	0	0
$105........	$110......	15.50	13.60	11.70	9.90	8.00	6.10	4.20	2.40	.50	0	0
$110........	$115......	16.20	14.30	12.50	10.60	8.70	6.80	5.00	3.10	1.20	0	0
$115........	$120......	16.90	15.00	13.20	11.30	9.40	7.60	5.70	3.80	1.90	.10	0
$120........	$125......	17.60	15.80	13.90	12.00	10.20	8.30	6.40	4.50	2.70	.80	0
$125........	$130......	18.40	16.50	14.60	12.70	10.90	9.00	7.10	5.30	3.40	1.50	0
$130........	$135......	19.10	17.20	15.30	13.50	11.60	9.70	7.80	6.00	4.10	2.20	.40
$135........	$140......	19.80	17.90	16.10	14.20	12.30	10.40	8.60	6.70	4.80	3.00	1.10
$140........	$145......	20.50	18.60	16.80	14.90	13.00	11.20	9.30	7.40	5.50	3.7[illegible]	1.80
$145........	$150......	21.20	19.40	17.50	15.60	13.80	11.90	10.00	8.10	6.30	4.40	2.50
$150........	$160......	22.30	20.40	18.60	16.70	14.83	13.00	11.10	9.20	7.30	5.50	3.60
$160........	$170......	23.80	21.90	20.00	18.10	16.30	14.40	12.50	10.70	8.80	6.90	5.00
$170........	$180......	25.20	23.30	21.50	19.60	17.70	15.80	14.00	12.10	10.20	8.70	6.50
$180........	$190......	26.60	24.80	22.90	21.00	19.20	17.30	15.40	13.50	11.70	9.80	7.90
$190........	$200......	28.10	26.20	34.30	22.60	20.60	18.70	16.80	15.00	13.10	11.20	9.40
		14.4 percent of the excess over $200 plus—										
$200 and over........		28.80	26.90	25.10	23.20	21.30	19.40	17.60	15.70	13.80	12.00	10.10

"If the payroll period with respect to an employee is biweekly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$26	14.4% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$26	$28	$3.90	.10	0	0	0	0	0	0	0	0	0
$28	$30	4.20	.40	0	0	0	0	0	0	0	0	0
$30	$32	4.50	.70	0	0	0	0	0	0	0	0	0
$32	$34	4.80	1.00	0	0	0	0	0	0	0	0	0
$34	$36	5.00	1.30	0	0	0	0	0	0	0	0	0
$36	$38	5.30	1.60	0	0	0	0	0	0	0	0	0
$38	$40	5.60	1.90	0	0	0	0	0	0	0	0	0
$40	$42	5.90	2.20	0	0	0	0	0	0	0	0	0
$42	$44	6.20	2.40	0	0	0	0	0	0	0	0	0
$44	$46	6.50	2.70	0	0	0	0	0	0	0	0	0
$46	$48	6.80	3.00	0	0	0	0	0	0	0	0	0
$48	$50	7.10	3.30	0	0	0	0	0	0	0	0	0
$50	$52	7.30	3.60	0	0	0	0	0	0	0	0	0
$52	$54	7.60	3.90	.10	0	0	0	0	0	0	0	0
$54	$56	7.90	4.20	.40	0	0	0	0	0	0	0	0
$56	$58	8.20	4.50	.70	0	0	0	0	0	0	0	0
$58	$60	8.50	4.80	1.00	0	0	0	0	0	0	0	0
$60	$62	8.80	5.00	1.30	0	0	0	0	0	0	0	0
$62	$64	9.10	5.30	1.60	0	0	0	0	0	0	0	0
$64	$66	9.40	5.60	1.90	0	0	0	0	0	0	0	0
$66	$68	9.60	5.90	2.20	0	0	0	0	0	0	0	0
$68	$70	9.90	6.20	2.40	0	0	0	0	0	0	0	0
$70	$72	10.20	6.50	2.70	0	0	0	0	0	0	0	0
$72	$74	10.50	6.80	3.00	0	0	0	0	0	0	0	0
$74	$76	10.80	7.10	3.30	0	0	0	0	0	0	0	0
$76	$78	11.10	7.30	3.60	0	0	0	0	0	0	0	0
$78	$80	11.40	7.60	3.90	.10	0	0	0	0	0	0	0
$80	$82	11.70	7.90	4.20	.40	0	0	0	0	0	0	0
$82	$84	12.00	8.20	4.50	.70	0	0	0	0	0	0	0
$84	$86	12.20	8.50	4.80	1.00	0	0	0	0	0	0	0
$86	$88	12.50	8.80	5.00	1.30	0	0	0	0	0	0	0
$88	$90	12.80	9.10	5.30	1.60	0	0	0	0	0	0	0
$90	$92	13.10	9.40	5.60	1.90	0	0	0	0	0	0	0
$92	$94	13.40	9.60	5.90	2.20	0	0	0	0	0	0	0
$94	$96	13.70	9.90	6.20	2.40	0	0	0	0	0	0	0
$96	$98	14.00	10.20	6.50	2.70	0	0	0	0	0	0	0
$98	$100	14.30	10.50	6.80	3.00	0	0	0	0	0	0	0
$100	$102	14.50	10.80	7.10	3.30	0	0	0	0	0	0	0
$102	$104	14.80	11.10	7.30	3.60	0	0	0	0	0	0	0
$104	$106	15.10	11.40	7.60	3.90	.10	0	0	0	0	0	0
$106	$108	15.40	11.70	7.90	4.20	.40	0	0	0	0	0	0
$108	$110	15.70	12.00	8.20	4.50	.70	0	0	0	0	0	0
$110	$112	16.00	12.20	8.50	4.80	1.00	0	0	0	0	0	0
$112	$114	16.30	12.50	8.80	5.00	1.30	0	0	0	0	0	0
$114	$116	16.60	12.80	9.10	5.30	1.60	0	0	0	0	0	0
$116	$118	16.80	13.10	9.40	5.60	1.90	0	0	0	0	0	0
$118	$120	17.10	13.40	9.60	5.90	2.20	0	0	0	0	0	0
$120	$124	17.60	13.80	10.10	6.30	2.60	0	0	0	0	0	0
$124	$128	18.10	14.40	10.70	6.90	3.20	0	0	0	0	0	0
$128	$132	18.70	15.00	11.20	7.50	3.70	0	0	0	0	0	0
$132	$136	19.30	15.60	11.80	8.10	4.30	.60	0	0	0	0	0
$136	$140	19.90	16.10	12.40	8.60	4.90	1.20	0	0	0	0	0
$140	$144	20.40	16.70	13.00	9.20	5.50	1.70	0	0	0	0	0
$144	$148	21.00	17.30	13.60	9.80	6.00	2.30	0	0	0	0	0
$148	$152	21.60	17.90	14.10	10.40	6.60	2.90	0	0	0	0	0
$152	$156	22.20	18.40	14.70	10.90	7.20	3.50	0	0	0	0	0
$156	$160	22.80	19.00	15.30	11.50	7.80	4.00	.30	0	0	0	0
$160	$164	23.30	19.60	15.80	12.10	8.40	4.60	.90	0	0	0	0
$164	$168	23.90	20.20	16.40	12.70	8.90	5.20	1.40	0	0	0	0
$168	$172	24.50	20.70	17.00	13.20	9.50	5.80	2.00	0	0	0	0
$172	$176	25.10	21.30	17.60	13.80	10.10	6.30	2.60	0	0	0	0
$176	$180	25.60	21.90	18.10	14.40	10.70	6.90	3.20	0	0	0	0
$180	$184	26.20	22.50	18.70	15.00	11.20	7.50	3.70	0	0	0	0
$184	$188	26.80	23.00	19.30	15.60	11.80	8.10	4.30	.60	0	0	0
$188	$192	27.40	23.60	19.90	16.10	12.40	8.60	4.90	1.20	0	0	0
$192	$196	27.90	24.20	20.40	16.70	13.00	9.20	5.50	1.70	0	0	0
$196	$200	28.50	24.80	21.00	17.30	13.50	9.80	6.00	2.30	0	0	0
$200	$210	29.50	25.80	22.00	18.30	14.50	10.80	7.10	3.30	0	0	0
$210	$220	31.00	27.20	23.50	19.70	16.00	12.20	8.50	4.80	1.00	0	0
$220	$230	32.40	28.70	24.90	21.20	17.40	13.70	9.90	6.20	2.40	0	0
$230	$240	33.80	30.10	26.40	22.60	18.90	15.10	11.40	7.60	3.90	.10	0
$240	$250	35.30	31.50	27.80	24.00	20.30	16.60	12.80	9.10	5.30	1.60	0
$250	$260	36.70	33.00	29.20	25.50	21.70	18.00	14.30	10.50	6.80	3.00	0
$260	$270	38.20	34.40	30.70	26.90	23.20	19.40	15.70	12.00	8.20	4.50	.70
$270	$280	39.60	35.90	32.10	28.40	24.60	20.90	17.10	13.40	9.60	5.90	2.20
$280	$290	41.00	37.30	33.60	29.80	26.10	22.30	18.60	14.80	11.10	7.30	3.60
$290	$300	42.50	38.70	35.00	31.20	27.50	23.80	20.00	16.30	12.50	8.80	5.00
$300	$320	44.60	40.90	37.20	33.40	29.70	25.90	22.30	18.40	14.70	10.90	7.20
$320	$340	47.50	43.80	40.00	36.30	32.50	28.80	25.10	21.30	17.60	13.80	10.10
$340	$360	50.40	46.70	42.90	39.20	35.40	31.70	27.90	24.20	20.40	16.70	13.00
$360	$380	53.30	49.50	45.80	42.00	38.30	34.60	30.80	27.10	23.30	19.60	15.80
$380	$400	56.20	52.40	48.70	44.90	41.20	37.40	33.70	30.00	26.20	22.50	18.70
		14.4 percent of the excess over $400 plus—										
$400 and over		57.60	53.90	50.10	46.40	42.60	38.90	36.60	32.80	29.10	25.30	21.60

"If the payroll period with respect to an employee is semimonthly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$28	14.4% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$28	$30	$4.20	.10	0	0	0	0	0	0	0	0	0
$30	$32	4.50	.40	0	0	0	0	0	0	0	0	0
$32	$34	4.80	.70	0	0	0	0	0	0	0	0	0
$34	$36	5.00	1.00	0	0	0	0	0	0	0	0	0
$36	$38	5.30	1.30	0	0	0	0	0	0	0	0	0
$38	$40	5.60	1.60	0	0	0	0	0	0	0	0	0
$40	$42	5.90	1.90	0	0	0	0	0	0	0	0	0
$42	$44	6.20	2.20	0	0	0	0	0	0	0	0	0
$44	$46	6.50	2.40	0	0	0	0	0	0	0	0	0
$46	$48	6.80	2.70	0	0	0	0	0	0	0	0	0
$48	$50	7.10	3.00	0	0	0	0	0	0	0	0	0
$50	$52	7.30	3.30	0	0	0	0	0	0	0	0	0
$52	$54	7.60	3.60	0	0	0	0	0	0	0	0	0
$54	$56	7.90	3.90	0	0	0	0	0	0	0	0	0
$56	$58	8.20	4.20	.10	0	0	0	0	0	0	0	0
$58	$60	8.50	4.50	.40	0	0	0	0	0	0	0	0
$60	$62	8.80	4.80	.70	0	0	0	0	0	0	0	0
$62	$64	9.10	5.00	1.00	0	0	0	0	0	0	0	0
$64	$66	9.40	5.30	1.30	0	0	0	0	0	0	0	0
$66	$68	9.60	5.60	1.60	0	0	0	0	0	0	0	0
$68	$70	9.90	5.90	1.90	0	0	0	0	0	0	0	0
$70	$72	10.20	6.20	2.20	0	0	0	0	0	0	0	0
$72	$74	10.50	6.50	2.40	0	0	0	0	0	0	0	0
$74	$76	10.80	6.80	2.70	0	0	0	0	0	0	0	0
$76	$78	11.10	7.10	3.00	0	0	0	0	0	0	0	0
$78	$80	11.40	7.30	3.30	0	0	0	0	0	0	0	0
$80	$82	11.70	7.60	3.60	0	0	0	0	0	0	0	0
$82	$84	12.00	7.90	3.90	0	0	0	0	0	0	0	0
$84	$86	12.20	8.20	4.20	.10	0	0	0	0	0	0	0
$86	$88	12.50	8.50	4.50	.40	0	0	0	0	0	0	0
$88	$90	12.80	8.80	4.80	.70	0	0	0	0	0	0	0
$90	$92	13.10	9.10	5.00	1.00	0	0	0	0	0	0	0
$92	$94	13.40	9.40	5.30	1.30	0	0	0	0	0	0	0
$94	$96	13.70	9.60	5.60	1.60	0	0	0	0	0	0	0
$96	$98	14.00	9.90	5.90	1.90	0	0	0	0	0	0	0
$98	$100	14.30	10.20	6.20	2.20	0	0	0	0	0	0	0
$100	$102	14.50	10.50	6.50	2.40	0	0	0	0	0	0	0
$102	$104	14.80	10.80	6.80	2.70	0	0	0	0	0	0	0
$104	$106	15.10	11.10	7.10	3.00	0	0	0	0	0	0	0
$106	$108	15.40	11.40	7.30	3.30	0	0	0	0	0	0	0
$108	$110	15.70	11.70	7.60	3.60	0	0	0	0	0	0	0
$110	$112	16.00	12.00	7.90	3.90	0	0	0	0	0	0	0
$112	$114	16.30	12.20	8.20	4.20	.10	0	0	0	0	0	0
$114	$116	16.60	12.50	8.50	4.50	.40	0	0	0	0	0	0
$116	$118	16.80	12.80	8.80	4.80	.70	0	0	0	0	0	0
$118	$120	17.10	13.10	9.10	5.00	1.00	0	0	0	0	0	0
$120	$124	17.60	13.50	9.50	5.50	1.40	0	0	0	0	0	0
$124	$128	18.10	14.10	10.10	6.00	2.00	0	0	0	0	0	0
$128	$132	18.70	14.70	10.70	6.60	2.60	0	0	0	0	0	0
$132	$136	19.30	15.30	11.20	7.20	3.20	0	0	0	0	0	0
$136	$140	19.90	15.80	11.80	7.80	3.70	0	0	0	0	0	0
$140	$144	20.40	16.40	12.40	8.40	4.30	.30	0	0	0	0	0
$144	$148	21.00	17.00	13.00	8.90	4.90	.90	0	0	0	0	0
$148	$152	21.60	17.60	13.50	9.50	5.50	1.40	0	0	0	0	0
$152	$156	22.20	18.10	14.10	10.10	6.00	2.00	0	0	0	0	0
$156	$160	22.80	18.70	14.70	10.70	6.60	2.60	0	0	0	0	0
$160	$164	23.30	19.30	15.30	11.20	7.20	3.20	0	0	0	0	0
$164	$168	23.90	19.90	15.80	11.80	7.80	3.70	0	0	0	0	0
$168	$172	24.50	20.40	16.40	12.40	8.40	4.30	.30	0	0	0	0
$172	$176	25.10	21.00	17.00	13.00	8.90	4.90	.90	0	0	0	0
$176	$180	25.60	21.60	17.60	13.50	9.50	5.50	1.40	0	0	0	0
$180	$184	26.20	22.20	18.10	14.10	10.10	6.00	2.00	0	0	0	0
$184	$188	26.80	22.80	18.70	14.70	10.70	6.60	2.60	0	0	0	0
$188	$192	27.40	23.30	19.30	15.30	11.20	7.20	3.20	0	0	0	0
$192	$196	27.90	23.90	19.90	15.80	11.80	7.80	3.70	0	0	0	0
$196	$200	28.50	24.50	20.40	16.40	12.40	8.40	4.30	.30	0	0	0
$200	$210	29.50	25.50	21.50	17.40	13.40	9.40	5.30	1.30	0	0	0
$210	$220	31.00	26.90	22.90	18.90	14.80	10.80	6.80	2.70	0	0	0
$220	$230	32.40	28.40	24.30	20.30	16.30	12.20	8.20	4.20	.10	0	0
$230	$240	33.80	29.80	25.80	21.70	17.70	13.70	9.60	5.60	1.60	0	0
$240	$250	35.30	31.20	27.20	23.20	19.20	15.10	11.10	7.10	3.00	0	0
$250	$260	36.70	32.70	28.70	24.60	20.60	16.60	12.50	8.50	4.50	.40	0
$260	$270	38.20	34.10	30.10	26.10	22.00	18.00	14.00	9.90	5.90	1.90	0
$270	$280	39.60	35.60	31.50	27.50	23.50	19.40	15.40	11.40	7.30	3.30	0
$280	$290	41.00	37.00	33.00	28.90	24.90	20.90	16.80	12.80	8.80	4.80	.70
$290	$300	42.50	38.40	34.40	30.40	26.40	22.30	18.30	14.30	10.20	6.20	2.20
$300	$320	44.60	40.60	36.60	32.50	28.50	24.50	20.40	16.40	12.40	8.40	4.30
$320	$340	47.50	43.50	39.50	35.40	31.40	27.40	23.30	19.30	15.30	11.20	7.20
$340	$360	50.40	46.40	42.30	38.30	34.30	30.20	26.20	22.20	18.10	14.10	10.10
$360	$380	53.30	49.20	45.20	41.20	37.20	33.10	29.10	25.10	21.00	17.00	13.00
$380	$400	56.20	52.10	48.10	44.10	40.00	36.00	32.00	27.90	23.90	19.90	15.80
$400	$420	59.00	55.00	51.00	46.90	42.90	38.90	34.80	30.80	26.80	22.80	18.70
$420	$440	61.90	57.90	53.90	49.80	45.80	41.80	37.70	33.70	29.70	25.60	21.60
$440	$460	64.80	60.80	56.70	52.70	48.70	44.60	40.60	36.60	32.50	28.50	24.50
$460	$480	67.70	63.60	59.60	55.60	51.60	47.50	43.50	39.50	35.40	31.40	27.40
$480	$500	70.60	66.50	62.50	58.50	54.40	50.40	46.40	42.30	38.30	34.30	30.20
		14.4 percent of the excess over $500 plus—										
$500 and over		72.00	68.00	63.90	59.90	55.90	51.80	47.80	43.80	39.70	35.70	31.70

"If the payroll period with respect to an employee is monthly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$56	14.4% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$56	$60	$8.40	.30	0	0	0	0	0	0	0	0	0
$60	$64	8.90	.90	0	0	0	0	0	0	0	0	0
$64	$68	9.50	1.40	0	0	0	0	0	0	0	0	0
$68	$72	10.10	2.00	0	0	0	0	0	0	0	0	0
$72	$76	10.70	2.60	0	0	0	0	0	0	0	0	0
$76	$80	11.20	3.20	0	0	0	0	0	0	0	0	0
$80	$84	11.80	3.70	0	0	0	0	0	0	0	0	0
$84	$88	12.40	4.30	0	0	0	0	0	0	0	0	0
$88	$92	13.00	4.90	0	0	0	0	0	0	0	0	0
$92	$96	13.50	5.50	0	0	0	0	0	0	0	0	0
$96	$100	14.10	6.00	0	0	0	0	0	0	0	0	0
$100	$104	14.70	6.60	0	0	0	0	0	0	0	0	0
$104	$108	15.30	7.20	0	0	0	0	0	0	0	0	0
$108	$112	15.80	7.80	0	0	0	0	0	0	0	0	0
$112	$116	16.40	8.40	.30	0	0	0	0	0	0	0	0
$116	$120	17.00	8.90	.90	0	0	0	0	0	0	0	0
$120	$124	17.60	9.50	1.40	0	0	0	0	0	0	0	0
$124	$128	18.10	10.10	2.00	0	0	0	0	0	0	0	0
$128	$132	18.70	10.70	2.60	0	0	0	0	0	0	0	0
$132	$136	19.30	11.20	3.20	0	0	0	0	0	0	0	0
$136	$140	19.90	11.80	3.70	0	0	0	0	0	0	0	0
$140	$144	20.40	12.40	4.30	0	0	0	0	0	0	0	0
$144	$148	21.00	13.00	4.90	0	0	0	0	0	0	0	0
$148	$152	21.60	13.50	5.50	0	0	0	0	0	0	0	0
$152	$156	22.20	14.10	6.00	0	0	0	0	0	0	0	0
$156	$160	22.80	14.70	6.60	0	0	0	0	0	0	0	0
$160	$164	23.30	15.30	7.20	0	0	0	0	0	0	0	0
$164	$168	23.90	15.80	7.80	0	0	0	0	0	0	0	0
$168	$172	24.50	16.40	8.40	.30	0	0	0	0	0	0	0
$172	$176	25.10	17.00	8.90	.90	0	0	0	0	0	0	0
$176	$180	25.60	17.60	9.50	1.40	0	0	0	0	0	0	0
$180	$184	26.20	18.10	10.10	2.00	0	0	0	0	0	0	0
$184	$188	26.80	18.70	10.70	2.60	0	0	0	0	0	0	0
$188	$192	27.40	19.30	11.20	3.20	0	0	0	0	0	0	0
$192	$196	27.90	19.90	11.80	3.70	0	0	0	0	0	0	0
$196	$200	28.50	20.40	12.40	4.30	0	0	0	0	0	0	0
$200	$204	29.10	21.00	13.00	4.90	0	0	0	0	0	0	0
$204	$208	29.70	21.60	13.50	5.50	0	0	0	0	0	0	0
$208	$212	30.20	22.20	14.10	6.00	0	0	0	0	0	0	0
$212	$216	30.80	22.80	14.70	6.60	0	0	0	0	0	0	0
$216	$220	31.40	23.30	15.30	7.20	0	0	0	0	0	0	0
$220	$224	32.00	23.90	15.80	7.80	0	0	0	0	0	0	0
$224	$228	32.50	24.50	16.40	8.40	.30	0	0	0	0	0	0
$228	$232	33.10	25.10	17.00	8.90	.90	0	0	0	0	0	0
$232	$236	33.70	25.60	17.60	9.50	1.40	0	0	0	0	0	0
$236	$240	34.30	26.20	18.10	10.10	2.00	0	0	0	0	0	0
$240	$248	35.10	27.10	19.00	10.90	2.90	0	0	0	0	0	0
$248	$256	36.30	28.20	20.20	12.10	4.00	0	0	0	0	0	0
$256	$264	37.40	29.40	21.30	13.20	5.20	0	0	0	0	0	0
$264	$272	38.60	30.50	22.50	14.40	6.30	0	0	0	0	0	0
$272	$280	39.70	31.70	23.60	15.60	7.50	0	0	0	0	0	0
$280	$288	40.90	32.50	24.80	16.70	8.60	.60	0	0	0	0	0
$288	$296	42.00	34.00	25.90	17.90	9.80	1.70	0	0	0	0	0
$296	$304	43.20	35.10	27.10	19.00	10.90	2.90	0	0	0	0	0
$304	$312	44.40	36.30	28.20	20.20	12.10	4.00	0	0	0	0	0
$312	$320	45.50	37.40	29.40	21.30	13.20	5.20	0	0	0	0	0
$320	$328	46.70	38.60	30.50	22.50	14.40	6.30	0	0	0	0	0
$328	$336	47.80	39.70	31.70	23.60	15.60	7.50	0	0	0	0	0
$336	$344	49.00	40.90	32.80	24.80	16.70	8.60	.60	0	0	0	0
$344	$352	50.10	42.00	34.00	25.90	17.90	9.80	1.70	0	0	0	0
$352	$360	51.30	43.20	35.10	27.10	19.00	10.90	2.90	0	0	0	0
$360	$368	52.40	44.40	36.30	28.20	20.20	12.10	4.00	0	0	0	0
$368	$376	53.60	45.50	37.40	29.40	21.30	13.20	5.20	0	0	0	0
$376	$384	54.70	46.70	38.60	30.50	22.50	14.40	6.30	0	0	0	0
$384	$392	55.90	47.80	39.70	31.70	23.60	15.60	7.50	0	0	0	0
$392	$400	57.00	49.00	40.90	32.80	24.80	16.70	8.60	.60	0	0	0
$400	$420	59.00	51.00	42.90	34.80	26.80	18.70	10.70	2.60	0	0	0
$420	$440	61.90	53.90	45.80	37.70	29.70	21.60	13.50	5.50	0	0	0
$440	$460	64.80	56.70	48.70	40.60	32.70	24.50	16.40	8.40	.30	0	0
$460	$480	67.70	59.60	51.60	43.50	35.40	27.40	19.30	11.20	3.20	0	0
$480	$500	70.60	62.50	54.40	46.40	38.30	30.20	22.20	14.10	6.00	0	0
$500	$520	73.40	65.40	57.30	49.20	41.20	33.10	25.10	17.00	8.90	.90	0
$520	$540	76.30	68.30	60.20	52.10	44.10	36.00	27.90	19.90	11.80	3.70	0
$540	$560	79.20	71.10	63.10	55.00	46.90	38.90	30.80	22.80	14.70	6.60	0
$560	$580	82.10	74.00	66.00	57.90	49.80	41.80	33.70	25.60	17.60	9.50	1.40
$580	$600	85.00	76.90	68.80	60.80	52.70	44.60	36.60	28.50	20.40	12.40	4.30
$600	$640	89.30	81.20	73.20	65.10	57.00	49.00	40.90	32.80	24.80	16.70	8.60
$640	$680	95.00	87.00	78.90	70.80	62.80	54.70	46.70	38.60	30.50	22.50	14.40
$680	$720	100.80	92.70	84.70	76.60	68.50	60.50	52.40	44.40	30.30	24.20	20.20
$720	$760	106.60	98.50	90.40	82.40	74.30	66.20	58.20	50.10	42.00	34.00	25.00
$760	$800	112.30	104.30	90.20	88.10	80.10	72.00	63.90	55.90	47.80	39.70	31.70
$800	$840	118.10	110.00	102.00	93.90	85.80	77.80	69.70	61.60	53.60	45.50	37.40
$840	$880	123.80	115.80	107.70	99.60	91.60	83.50	75.50	67.40	59.30	51.30	43.20
$880	$920	129.60	121.50	113.50	105.40	97.30	89.30	81.20	73.20	65.10	57.00	49.00
$920	$960	135.40	127.30	119.20	111.20	103.10	95.00	87.00	78.90	70.80	62.80	54.70
$960	$1,000	141.10	133.10	125.00	116.90	108.90	100.80	92.70	81.70	76.60	68.50	60.50
		14.4 percent of the excess over $1,000 plus—										
$1,000 and over		144.00	135.90	127.90	119.80	111.70	103.70	95.60	87.60	79.50	71.40	63.40

"If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period—

"And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of tax to be withheld shall be the following amount multiplied by the number of days in such period—										
$0	$2.00	14.4% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$2.00	$2.25	$0.30	.05	0	0	0	0	0	0	0	0	0
$2.25	$2.50	.35	.10	0	0	0	0	0	0	0	0	0
$2.50	$2.75	.40	.10	0	0	0	0	0	0	0	0	0
$2.75	$3.00	.40	.15	0	0	0	0	0	0	0	0	0
$3.00	$3.25	.45	.20	0	0	0	0	0	0	0	0	0
$3.25	$3.50	.50	.25	0	0	0	0	0	0	0	0	0
$3.50	$3.75	.50	.25	0	0	0	0	0	0	0	0	0
$3.75	$4.00	.55	.30	.05	0	0	0	0	0	0	0	0
$4.00	$4.25	.60	.35	.10	0	0	0	0	0	0	0	0
$4.25	$4.50	.65	.40	.10	0	0	0	0	0	0	0	0
$4.50	$4.75	.65	.40	.15	0	0	0	0	0	0	0	0
$4.75	$5.00	.70	.45	.20	0	0	0	0	0	0	0	0
$5.00	$5.25	.75	.50	.20	0	0	0	0	0	0	0	0
$5.25	$5.50	.80	.50	.25	0	0	0	0	0	0	0	0
$5.50	$5.75	.80	.55	.30	.05	0	0	0	0	0	0	0
$5.75	$6.00	.85	.60	.35	.10	0	0	0	0	0	0	0
$6.00	$6.25	.90	.65	.35	.10	0	0	0	0	0	0	0
$6.25	$6.50	.90	.65	.40	.15	0	0	0	0	0	0	0
$6.50	$6.75	.95	.70	.45	.20	0	0	0	0	0	0	0
$6.75	$7.00	1.00	.75	.50	.20	0	0	0	0	0	0	0
$7.00	$7.25	1.05	.75	.50	.25	0	0	0	0	0	0	0
$7.25	$7.50	1.05	.80	.55	.30	0	0	0	0	0	0	0
$7.50	$7.75	1.10	.85	.60	.30	.05	0	0	0	0	0	0
$7.75	$8.00	1.15	.90	.60	.35	.10	0	0	0	0	0	0
$8.00	$8.25	1.15	.90	.65	.40	.15	0	0	0	0	0	0
$8.25	$8.50	1.20	.95	.70	.45	.15	0	0	0	0	0	0
$8.50	$8.75	1.25	1.00	.75	.45	.20	0	0	0	0	0	0
$8.75	$9.00	1.30	1.00	.75	.50	.25	0	0	0	0	0	0
$9.00	$9.25	1.30	1.05	.80	.55	.30	0	0	0	0	0	0
$9.25	$9.50	1.35	1.10	.85	.60	.30	.05	0	0	0	0	0
$9.50	$9.75	1.40	1.15	.90	.60	.35	.10	0	0	0	0	0
$9.75	$10.00	1.40	1.15	.90	.65	.40	.15	0	0	0	0	0
$10.00	$10.50	1.50	1.20	.95	.70	.45	.20	0	0	0	0	0
$10.50	$11.00	1.55	1.30	1.05	.80	.50	.25	0	0	0	0	0
$11.00	$11.50	1.60	1.35	1.10	.85	.60	.35	.05	0	0	0	0
$11.50	$12.00	1.70	1.45	1.20	.90	.65	.40	.15	0	0	0	0
$12.00	$12.50	1.75	1.50	1.25	1.00	.75	.45	.20	0	0	0	0
$12.50	$13.00	1.85	1.60	1.30	1.05	.80	.55	.30	0	0	0	0
$13.00	$13.50	1.90	1.65	1.40	1.15	.90	.60	.35	.10	0	0	0
$13.50	$14.00	2.00	1.70	1.45	1.20	.95	.70	.45	.15	0	0	0
$14.00	$14.50	2.05	1.80	1.55	1.30	1.00	.75	.50	.25	0	0	0
$14.50	$15.00	2.10	1.85	1.60	1.35	1.10	.85	.55	.30	.05	0	0
$15.00	$15.50	2.20	1.95	1.70	1.40	1.15	.90	.65	.40	.10	0	0
$15.50	$16.00	2.25	2.00	1.75	1.50	1.25	1.00	.70	.45	.20	0	0
$16.00	$16.50	2.35	2.10	1.80	1.55	1.30	1.05	.80	.55	.25	0	0
$16.50	$17.00	2.40	2.15	1.90	1.65	1.40	1.10	.85	.60	.35	.10	0
$17.00	$17.50	2.50	2.25	2.00	1.70	1.45	1.20	.95	.65	.40	.15	0
$17.50	$18.00	2.55	2.30	2.05	1.80	1.50	1.25	1.00	.75	.50	.25	0
$18.00	$18.50	2.65	2.35	2.10	1.85	1.60	1.35	1.10	.80	.55	.30	.05
$18.50	$19.00	2.70	2.45	2.00	1.90	1.65	1.40	1.15	.90	.65	.35	.10
$19.00	$19.50	2.75	2.50	2.25	2.00	1.75	1.50	1.20	.95	.70	.45	.20
$19.50	$20.00	2.85	2.60	2.35	2.05	1.80	1.55	1.30	1.05	.75	.50	.25
$20.00	$21.00	2.95	2.70	2.45	2.15	1.90	1.65	1.40	1.15	.90	.60	.35
$21.00	$22.00	3.10	2.85	2.60	2.30	2.05	1.80	1.55	1.30	1.00	.75	.50
$22.00	$23.00	3.25	3.00	2.70	2.45	2.20	1.95	1.70	1.45	1.15	.90	.65
$23.00	$24.00	3.40	3.10	2.85	2.60	2.35	2.10	1.85	1.55	1.30	1.05	.80
$24.00	$25.00	3.55	3.25	3.00	2.75	2.50	2.25	1.95	1.70	1.45	1.20	.95
$25.00	$26.00	3.65	3.40	3.15	2.90	2.65	2.40	2.10	1.85	1.60	1.35	1.10
$26.00	$27.00	3.80	3.55	3.30	3.05	2.80	2.50	2.25	2.00	1.75	1.50	1.20
$27.00	$28.00	3.95	3.70	3.45	3.20	2.90	2.65	2.40	2.15	1.90	1.65	1.35
$28.00	$29.00	4.10	3.85	3.60	3.35	3.05	2.80	2.55	2.30	2.05	1.75	1.50
$29.00	$30.00	4.25	4.00	3.75	3.45	3.20	2.95	2.70	2.45	2.15	1.90	1.65
		14.4 percent of the excess over $30 plus—										
$30.00 and over		4.30	4.05	3.80	3.55	3.30	3.00	2.75	2.50	2.25	2.00	1.75

1 "(F) FOR WAGES PAID AFTER DECEMBER 31, 1966:

"If the payroll period with respect to an employee is weekly—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$13	13.5% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$13	$14	$1.80	.10	0	0	0	0	0	0	0	0	0
$14	$15	2.00	.20	0	0	0	0	0	0	0	0	0
$15	$16	2.10	.30	0	0	0	0	0	0	0	0	0
$16	$17	2.20	.50	0	0	0	0	0	0	0	0	0
$17	$18	2.40	.60	0	0	0	0	0	0	0	0	0
$18	$19	2.50	.70	0	0	0	0	0	0	0	0	0
$19	$20	2.60	.90	0	0	0	0	0	0	0	0	0
$20	$21	2.80	1.00	0	0	0	0	0	0	0	0	0
$21	$22	2.90	1.10	0	0	0	0	0	0	0	0	0
$22	$23	3.00	1.30	0	0	0	0	0	0	0	0	0
$23	$24	3.20	1.40	0	0	0	0	0	0	0	0	0
$24	$25	3.30	1.60	0	0	0	0	0	0	0	0	0
$25	$26	3.40	1.70	0	0	0	0	0	0	0	0	0
$26	$27	3.60	1.80	.10	0	0	0	0	0	0	0	0
$27	$28	3.70	2.00	.20	0	0	0	0	0	0	0	0
$28	$29	3.80	2.10	.30	0	0	0	0	0	0	0	0
$29	$30	4.00	2.20	.50	0	0	0	0	0	0	0	0
$30	$31	4.10	2.40	.60	0	0	0	0	0	0	0	0
$31	$32	4.30	2.50	.70	0	0	0	0	0	0	0	0
$32	$33	4.40	2.60	.90	0	0	0	0	0	0	0	0
$33	$34	4.50	2.80	1.00	0	0	0	0	0	0	0	0
$34	$35	4.70	2.90	1.10	0	0	0	0	0	0	0	0
$35	$36	4.80	3.00	1.30	0	0	0	0	0	0	0	0
$36	$37	4.90	3.20	1.40	0	0	0	0	0	0	0	0
$37	$38	5.10	3.30	1.60	0	0	0	0	0	0	0	0
$38	$39	5.20	3.40	1.70	0	0	0	0	0	0	0	0
$39	$40	5.30	3.60	1.80	.10	0	0	0	0	0	0	0
$40	$41	5.50	3.70	2.00	.20	0	0	0	0	0	0	0
$41	$42	5.60	3.80	2.10	.30	0	0	0	0	0	0	0
$42	$43	5.70	4.00	2.20	.50	0	0	0	0	0	0	0
$43	$44	5.90	4.10	2.40	.60	0	0	0	0	0	0	0
$44	$45	6.00	4.30	2.50	.70	0	0	0	0	0	0	0
$45	$46	6.10	4.40	2.60	.90	0	0	0	0	0	0	0
$46	$47	6.30	4.50	2.80	1.00	0	0	0	0	0	0	0
$47	$48	6.40	4.70	2.90	1.10	0	0	0	0	0	0	0
$48	$49	6.50	4.80	3.00	1.30	0	0	0	0	0	0	0
$49	$50	6.70	4.90	3.20	1.40	0	0	0	0	0	0	0
$50	$51	6.80	5.10	3.30	1.60	0	0	0	0	0	0	0
$51	$52	7.00	5.20	3.40	1.70	0	0	0	0	0	0	0
$52	$53	7.10	5.30	3.60	1.80	.10	0	0	0	0	0	0
$53	$54	7.20	5.50	3.70	2.00	.20	0	0	0	0	0	0
$54	$55	7.40	5.60	3.80	2.10	.30	0	0	0	0	0	0
$55	$56	7.50	5.70	4.00	2.20	.50	0	0	0	0	0	0
$56	$57	7.60	5.90	4.10	2.40	.60	0	0	0	0	0	0
$57	$58	7.80	6.00	4.30	2.50	.70	0	0	0	0	0	0
$58	$59	7.90	6.10	4.40	2.60	.90	0	0	0	0	0	0
$59	$60	8.00	6.30	4.50	2.80	1.00	0	0	0	0	0	0
$60	$62	8.20	6.50	4.70	3.00	1.30	0	0	0	0	0	0
$62	$64	8.50	6.80	5.00	3.20	1.50	0	0	0	0	0	0
$64	$66	8.80	7.00	5.30	3.50	1.80	0	0	0	0	0	0
$66	$68	9.00	7.30	5.50	3.80	2.00	.30	0	0	0	0	0
$68	$70	9.30	7.60	5.80	4.10	2.30	.50	0	0	0	0	0
$70	$72	9.60	7.80	6.10	4.30	2.60	.80	0	0	0	0	0
$72	$74	9.90	8.10	6.30	4.60	2.80	1.10	0	0	0	0	0
$74	$76	10.10	8.40	6.60	4.90	3.10	1.40	0	0	0	0	0
$76	$78	10.40	8.60	6.90	5.10	3.40	1.60	0	0	0	0	0
$78	$80	10.70	8.90	7.20	5.40	3.60	1.90	.10	0	0	0	0
$80	$82	10.90	9.20	7.40	5.70	3.90	2.20	.40	0	0	0	0
$82	$84	11.20	9.50	7.70	5.90	4.20	2.40	.70	0	0	0	0
$84	$86	11.50	9.70	8.00	6.20	4.50	2.70	.90	0	0	0	0
$86	$88	11.70	10.00	8.20	6.50	4.70	3.00	1.20	0	0	0	0
$88	$90	12.00	10.30	8.50	6.80	5.00	3.20	1.50	0	0	0	0
$90	$92	12.30	10.50	8.80	7.00	5.30	3.50	1.80	0	0	0	0
$92	$94	12.60	10.80	9.00	7.30	5.50	3.80	2.00	.30	0	0	0
$94	$96	12.80	11.10	9.30	7.60	5.80	4.10	2.30	.50	0	0	0
$96	$98	13.10	11.30	9.60	7.80	6.10	4.30	2.60	.80	0	0	0
$98	$100	13.40	11.60	9.90	8.10	6.30	4.60	2.80	1.10	0	0	0
$100	$105	13.80	12.10	10.30	8.60	6.80	5.10	3.30	1.60	0	0	0
$105	$110	14.60	12.80	11.00	9.20	7.50	5.70	4.00	2.20	.50	0	0
$110	$115	15.20	13.40	11.70	9.90	8.20	6.40	4.70	2.90	1.10	0	0
$115	$120	15.90	14.10	12.40	10.60	8.80	7.10	5.30	3.60	1.80	.10	0
$120	$125	16.50	14.80	13.00	11.30	9.50	7.80	6.00	4.30	2.50	.70	0
$125	$130	17.20	15.50	13.70	11.90	10.20	8.40	6.70	4.90	3.20	1.40	0
$130	$135	17.90	16.10	14.40	12.60	10.90	9.10	7.40	5.60	3.80	2.10	.30
$135	$140	18.60	16.80	15.10	13.30	11.50	9.80	8.00	6.30	4.50	2.80	1.00
$140	$145	19.20	17.50	15.70	14.00	12.20	10.50	8.70	7.00	5.20	3.40	1.70
$145	$150	19.90	18.20	16.40	14.60	12.90	11.10	9.40	7.60	5.90	4.10	2.40
$150	$160	20.90	19.20	17.40	15.70	13.90	12.20	10.40	8.60	6.90	5.10	3.40
$160	$170	22.30	20.50	18.80	17.00	15.30	13.50	11.70	10.00	8.20	6.50	4.70
$170	$180	23.60	21.90	20.10	18.40	16.60	14.90	13.10	11.30	9.60	7.80	6.10
$180	$190	25.00	23.20	21.50	19.70	18.00	16.20	14.40	12.70	10.90	9.20	7.40
$190	$200	26.30	24.60	22.80	21.10	19.30	17.60	15.80	14.00	12.30	10.50	8.80
		13.5 percent of the excess over $200 plus—										
$200 and over		27.00	25.20	23.50	21.70	20.00	18.20	16.50	14.70	13.00	11.20	9.50

"If the payroll period with respect to an employee is biweekly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$26	13.5% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$26	$28	$3.60	.10	0	0	0	0	0	0	0	0	0
$28	$30	3.90	.40	0	0	0	0	0	0	0	0	0
$30	$32	4.20	.70	0	0	0	0	0	0	0	0	0
$32	$34	4.50	.90	0	0	0	0	0	0	0	0	0
$34	$36	4.70	1.20	0	0	0	0	0	0	0	0	0
$36	$38	5.00	1.50	0	0	0	0	0	0	0	0	0
$38	$40	5.30	1.80	0	0	0	0	0	0	0	0	0
$40	$42	5.50	2.00	0	0	0	0	0	0	0	0	0
$42	$44	5.80	2.30	0	0	0	0	0	0	0	0	0
$44	$46	6.10	2.60	0	0	0	0	0	0	0	0	0
$46	$48	6.30	2.90	0	0	0	0	0	0	0	0	0
$48	$50	6.60	3.10	0	0	0	0	0	0	0	0	0
$50	$52	6.90	3.40	0	0	0	0	0	0	0	0	0
$52	$54	7.20	3.60	.10	0	0	0	0	0	0	0	0
$54	$56	7.40	3.90	.40	0	0	0	0	0	0	0	0
$56	$58	7.70	4.20	.70	0	0	0	0	0	0	0	0
$58	$60	8.00	4.50	.90	0	0	0	0	0	0	0	0
$60	$62	8.20	4.70	1.20	0	0	0	0	0	0	0	0
$62	$64	8.50	5.00	1.50	0	0	0	0	0	0	0	0
$64	$66	8.80	5.30	1.80	0	0	0	0	0	0	0	0
$66	$68	9.00	5.50	2.00	0	0	0	0	0	0	0	0
$68	$70	9.30	5.80	2.30	0	0	0	0	0	0	0	0
$70	$72	9.60	6.10	2.60	0	0	0	0	0	0	0	0
$72	$74	9.90	6.30	2.80	0	0	0	0	0	0	0	0
$74	$76	10.10	6.60	3.10	0	0	0	0	0	0	0	0
$76	$78	10.40	6.90	3.40	0	0	0	0	0	0	0	0
$78	$80	10.70	7.20	3.60	.10	0	0	0	0	0	0	0
$80	$82	10.90	7.40	3.90	.40	0	0	0	0	0	0	0
$82	$84	11.20	7.70	4.20	.70	0	0	0	0	0	0	0
$84	$86	11.50	8.00	4.50	.90	0	0	0	0	0	0	0
$86	$88	11.70	8.20	4.70	1.20	0	0	0	0	0	0	0
$88	$90	12.00	8.50	5.00	1.50	0	0	0	0	0	0	0
$90	$92	12.30	8.80	5.30	1.80	0	0	0	0	0	0	0
$92	$94	12.60	9.00	5.50	2.00	0	0	0	0	0	0	0
$94	$96	12.80	9.30	5.80	2.30	0	0	0	0	0	0	0
$96	$98	13.10	9.60	6.10	2.60	0	0	0	0	0	0	0
$98	$100	13.40	9.90	6.30	2.80	0	0	0	0	0	0	0
$100	$102	13.60	10.10	6.60	3.10	0	0	0	0	0	0	0
$102	$104	13.90	10.40	6.90	3.40	0	0	0	0	0	0	0
$104	$106	14.20	10.70	7.20	3.60	.10	0	0	0	0	0	0
$106	$108	14.40	10.90	7.40	3.90	.40	0	0	0	0	0	0
$108	$110	14.70	11.20	7.70	4.20	.70	0	0	0	0	0	0
$110	$112	15.00	11.50	8.00	4.50	.90	0	0	0	0	0	0
$112	$114	15.30	11.70	8.20	4.70	1.20	0	0	0	0	0	0
$114	$116	15.50	12.00	8.50	5.00	1.50	0	0	0	0	0	0
$116	$118	15.80	12.30	8.80	5.30	1.80	0	0	0	0	0	0
$118	$120	16.10	12.60	9.00	5.50	2.00	0	0	0	0	0	0
$120	$124	16.50	13.00	9.50	5.90	2.40	0	0	0	0	0	0
$124	$128	17.00	13.50	10.00	6.50	3.00	0	0	0	0	0	0
$128	$132	17.60	14.00	10.50	7.00	3.50	0	0	0	0	0	0
$132	$136	18.10	14.60	11.10	7.60	4.10	.50	0	0	0	0	0
$136	$140	18.60	15.10	11.60	8.10	4.60	1.10	0	0	0	0	0
$140	$144	19.20	15.70	12.20	8.60	5.10	1.60	0	0	0	0	0
$144	$148	19.70	16.20	12.70	9.20	5.70	2.20	0	0	0	0	0
$148	$152	20.30	16.70	13.20	9.70	6.20	2.70	0	0	0	0	0
$152	$156	20.80	17.30	13.80	10.30	6.60	3.20	0	0	0	0	0
$156	$160	21.30	17.80	14.30	10.80	7.30	3.80	.30	0	0	0	0
$160	$164	21.90	18.40	14.90	11.30	7.80	4.30	.80	0	0	0	0
$164	$168	22.40	18.90	15.40	11.90	8.40	4.90	1.40	0	0	0	0
$168	$172	23.00	19.40	15.90	12.40	8.90	5.40	1.90	0	0	0	0
$172	$176	23.50	20.00	16.50	13.00	9.50	5.90	2.40	0	0	0	0
$176	$180	24.00	20.50	17.00	13.50	10.00	6.50	3.00	0	0	0	0
$180	$184	24.60	21.10	17.60	14.00	10.50	7.00	3.50	0	0	0	0
$184	$188	25.10	21.60	18.10	14.60	11.10	7.60	4.10	.60	0	0	0
$188	$192	25.70	22.10	18.60	15.10	11.60	8.10	4.60	1.10	0	0	0
$192	$196	26.20	22.70	19.20	15.70	12.20	8.60	5.10	1.60	0	0	0
$196	$200	26.70	23.20	19.70	16.20	12.70	9.20	5.70	2.20	0	0	0
$200	$210	27.70	24.20	20.70	17.10	13.60	10.10	6.60	3.10	0	0	0
$210	$220	29.00	25.50	22.00	18.50	15.00	11.50	8.00	4.50	.90	0	0
$220	$230	30.40	26.90	23.40	19.80	16.30	12.80	9.30	5.80	2.30	0	0
$230	$240	31.70	28.20	24.70	21.20	17.70	14.20	10.70	7.20	3.60	.10	0
$240	$250	33.10	29.60	26.10	22.50	19.00	15.50	12.00	8.50	5.00	1.50	0
$250	$260	34.40	30.90	27.40	23.90	20.40	16.90	13.40	9.90	6.30	2.80	0
$260	$270	35.80	32.30	28.80	25.20	21.70	18.20	14.70	11.20	7.70	4.20	.70
$270	$280	37.10	33.60	30.10	26.60	23.10	19.60	16.10	12.60	9.00	5.50	2.00
$280	$290	38.50	35.00	31.50	27.90	24.40	20.90	17.40	13.90	10.40	6.90	3.40
$290	$300	39.80	36.30	32.80	29.30	25.80	22.30	18.80	15.30	11.70	8.20	4.70
$300	$320	41.90	38.30	34.80	31.30	27.80	24.30	20.80	17.30	13.80	10.30	6.80
$320	$340	44.60	41.00	37.50	34.00	30.50	27.00	23.50	20.00	16.50	13.00	9.50
$340	$360	47.30	43.70	40.20	36.70	33.20	29.70	26.20	22.70	19.20	15.70	12.20
$360	$380	50.00	46.40	42.90	39.40	35.90	32.40	28.90	25.40	21.90	18.40	14.90
$380	$400	52.70	49.10	45.60	42.10	38.60	35.10	31.60	28.10	24.60	21.10	17.60
		13.5 percent of the excess over $400 plus—										
$400 and over		54.00	50.50	47.00	43.50	40.00	36.50	34.30	30.80	27.30	23.80	20.30

"If the payroll period with respect to an employee is semimonthly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$28	13.5% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$28	$30	$3.90	.10	0	0	0	0	0	0	0	0	0
$30	$32	4.20	.40	0	0	0	0	0	0	0	0	0
$32	$34	4.50	.70	0	0	0	0	0	0	0	0	0
$34	$36	4.70	.90	0	0	0	0	0	0	0	0	0
$36	$38	5.00	1.20	0	0	0	0	0	0	0	0	0
$38	$40	5.30	1.50	0	0	0	0	0	0	0	0	0
$40	$42	5.50	1.80	0	0	0	0	0	0	0	0	0
$42	$44	5.80	2.00	0	0	0	0	0	0	0	0	0
$44	$46	6.10	2.30	0	0	0	0	0	0	0	0	0
$46	$48	6.30	2.60	0	0	0	0	0	0	0	0	0
$48	$50	6.60	2.80	0	0	0	0	0	0	0	0	0
$50	$52	6.90	3.10	0	0	0	0	0	0	0	0	0
$52	$54	7.20	3.40	0	0	0	0	0	0	0	0	0
$54	$56	7.40	3.60	0	0	0	0	0	0	0	0	0
$56	$58	7.70	3.90	.10	0	0	0	0	0	0	0	0
$58	$60	8.00	4.20	.40	0	0	0	0	0	0	0	0
$60	$62	8.20	4.50	.70	0	0	0	0	0	0	0	0
$62	$64	8.50	4.70	.90	0	0	0	0	0	0	0	0
$64	$66	8.80	5.00	1.20	0	0	0	0	0	0	0	0
$66	$68	9.00	5.30	1.50	0	0	0	0	0	0	0	0
$68	$70	9.30	5.50	1.80	0	0	0	0	0	0	0	0
$70	$72	9.60	5.80	2.00	0	0	0	0	0	0	0	0
$72	$74	9.90	6.10	2.30	0	0	0	0	0	0	0	0
$74	$76	10.10	6.30	2.60	0	0	0	0	0	0	0	0
$76	$78	10.40	6.60	2.80	0	0	0	0	0	0	0	0
$78	$80	10.70	6.90	3.10	0	0	0	0	0	0	0	0
$80	$82	10.90	7.20	3.40	0	0	0	0	0	0	0	0
$82	$84	11.20	7.40	3.60	0	0	0	0	0	0	0	0
$84	$86	11.50	7.70	3.90	.10	0	0	0	0	0	0	0
$86	$88	11.70	8.00	4.20	.40	0	0	0	0	0	0	0
$88	$90	12.00	8.20	4.50	.70	0	0	0	0	0	0	0
$90	$92	12.30	8.50	4.70	.90	0	0	0	0	0	0	0
$92	$94	12.60	8.80	5.00	1.20	0	0	0	0	0	0	0
$94	$96	12.80	9.00	5.30	1.50	0	0	0	0	0	0	0
$96	$98	13.10	9.30	5.50	1.80	0	0	0	0	0	0	0
$98	$100	13.40	9.60	5.80	2.00	0	0	0	0	0	0	0
$100	$102	13.60	9.90	6.10	2.30	0	0	0	0	0	0	0
$102	$104	13.90	10.10	6.30	2.50	0	0	0	0	0	0	0
$104	$106	14.20	10.40	6.60	2.80	0	0	0	0	0	0	0
$106	$108	14.40	10.70	6.90	3.10	0	0	0	0	0	0	0
$108	$110	14.70	10.90	7.20	3.40	0	0	0	0	0	0	0
$110	$112	15.00	11.20	7.40	3.60	0	0	0	0	0	0	0
$112	$114	15.30	11.50	7.70	3.90	.10	0	0	0	0	0	0
$114	$116	15.50	11.70	8.00	4.20	.40	0	0	0	0	0	0
$116	$118	15.80	12.00	8.20	4.50	.70	0	0	0	0	0	0
$118	$120	16.10	12.30	8.50	4.70	.90	0	0	0	0	0	0
$120	$124	16.50	12.70	8.90	5.10	1.40	0	0	0	0	0	0
$124	$128	17.00	13.20	9.50	5.70	1.90	0	0	0	0	0	0
$128	$132	17.60	13.80	10.00	6.20	2.40	0	0	0	0	0	0
$132	$136	18.10	14.30	10.50	6.80	3.00	0	0	0	0	0	0
$136	$140	18.60	14.90	11.10	7.30	3.50	0	0	0	0	0	0
$140	$144	19.20	15.40	11.60	7.80	4.10	.30	0	0	0	0	0
$144	$148	19.70	15.90	12.20	8.40	4.60	.80	0	0	0	0	0
$148	$152	20.30	16.50	12.70	8.90	5.10	1.40	0	0	0	0	0
$152	$156	20.80	17.00	13.20	9.50	5.70	1.90	0	0	0	0	0
$156	$160	21.30	17.60	13.80	10.00	6.20	2.40	0	0	0	0	0
$160	$164	21.90	18.10	14.30	10.50	6.80	3.00	0	0	0	0	0
$164	$168	22.40	18.60	14.90	11.10	7.30	3.50	0	0	0	0	0
$168	$172	23.00	19.20	15.40	11.60	7.80	4.10	.30	0	0	0	0
$172	$176	23.50	19.70	15.90	12.20	8.40	4.60	.80	0	0	0	0
$176	$180	24.00	20.30	16.50	12.70	8.90	5.10	1.40	0	0	0	0
$180	$184	24.60	20.80	17.00	13.20	9.50	5.70	1.90	0	0	0	0
$184	$188	25.10	21.30	17.60	13.80	10.00	6.20	2.40	0	0	0	0
$188	$192	25.70	21.90	18.10	14.30	10.50	6.80	3.00	0	0	0	0
$192	$196	26.20	22.40	18.60	14.90	11.10	7.30	3.50	0	0	0	0
$196	$200	26.70	23.00	19.20	15.40	11.60	7.80	4.10	.30	0	0	0
$200	$210	27.70	23.90	20.10	16.30	12.60	8.80	5.00	1.20	0	0	0
$210	$220	29.00	25.20	21.50	17.70	13.90	10.10	6.30	2.60	0	0	0
$220	$230	30.40	26.60	22.80	19.00	15.30	11.50	7.70	3.90	.10	0	0
$230	$240	31.70	27.90	24.20	20.40	16.60	12.80	9.00	5.30	1.50	0	0
$240	$250	33.10	29.30	25.50	21.70	18.00	14.20	10.40	6.60	2.80	0	0
$250	$260	34.40	30.60	26.90	23.10	19.30	15.50	11.70	8.00	4.20	.40	0
$260	$270	35.80	32.00	28.20	24.40	20.70	16.90	13.10	9.30	5.50	1.80	0
$270	$280	37.10	33.30	29.60	25.80	22.00	18.20	14.40	10.70	6.90	3.10	0
$280	$290	38.50	34.70	30.90	27.10	23.40	19.60	15.80	12.00	8.20	4.50	.70
$290	$300	39.80	36.00	32.30	28.50	24.70	20.90	17.10	13.40	9.60	5.80	2.00
$300	$320	41.90	38.10	34.30	30.50	26.70	23.00	19.20	15.40	11.60	7.80	4.10
$320	$340	44.60	40.80	37.00	33.20	29.40	25.70	21.90	18.10	14.30	10.50	6.80
$340	$360	47.30	43.50	39.70	35.90	32.10	28.40	24.60	20.80	17.00	13.20	9.50
$360	$380	50.00	46.20	42.40	38.60	34.80	31.10	27.30	23.50	19.70	15.90	12.20
$380	$400	52.70	48.90	45.10	41.30	37.50	33.80	30.00	26.20	22.40	18.60	14.90
$400	$420	55.40	51.60	47.80	44.00	40.20	36.50	32.70	28.90	25.10	21.30	17.60
$420	$440	58.10	54.30	50.50	46.70	42.90	39.20	35.40	31.60	27.80	24.00	20.30
$440	$460	60.80	57.00	53.20	49.40	45.60	41.90	38.10	34.30	30.50	26.70	23.00
$460	$480	63.50	59.70	55.90	52.10	48.30	44.60	40.80	37.00	33.20	29.40	25.70
$480	$500	66.20	62.40	58.60	54.80	51.00	47.30	43.50	39.70	35.90	32.40	28.40
		13.5 percent of the excess over $500 plus—										
$500 and over		67.50	63.70	59.90	56.20	52.40	48.60	44.80	41.00	37.30	33.50	29.70

"If the payroll period with respect to an employee is monthly—

"And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of tax to be withheld shall be—										
$0	$56	13.5% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$56	$60	$7.80	.30	0	0	0	0	0	0	0	0	0
$60	$64	8.40	.80	0	0	0	0	0	0	0	0	0
$64	$68	8.90	1.40	0	0	0	0	0	0	0	0	0
$68	$72	9.50	1.90	0	0	0	0	0	0	0	0	0
$72	$76	10.00	2.40	0	0	0	0	0	0	0	0	0
$76	$80	10.50	3.00	0	0	0	0	0	0	0	0	0
$80	$84	11.10	3.50	0	0	0	0	0	0	0	0	0
$84	$88	11.60	4.10	0	0	0	0	0	0	0	0	0
$88	$92	12.20	4.60	0	0	0	0	0	0	0	0	0
$92	$96	12.70	5.10	0	0	0	0	0	0	0	0	0
$96	$100	13.20	5.70	0	0	0	0	0	0	0	0	0
$100	$104	13.80	6.20	0	0	0	0	0	0	0	0	0
$104	$108	14.30	6.80	0	0	0	0	0	0	0	0	0
$108	$112	14.90	7.30	0	0	0	0	0	0	0	0	0
$112	$116	15.40	7.80	.30	0	0	0	0	0	0	0	0
$116	$120	15.90	8.40	.80	0	0	0	0	0	0	0	0
$120	$124	16.50	8.90	1.40	0	0	0	0	0	0	0	0
$124	$128	17.00	9.50	1.90	0	0	0	0	0	0	0	0
$128	$132	17.60	10.00	2.40	0	0	0	0	0	0	0	0
$132	$136	18.10	10.50	3.00	0	0	0	0	0	0	0	0
$136	$140	18.60	11.10	3.50	0	0	0	0	0	0	0	0
$140	$144	19.20	11.60	4.10	0	0	0	0	0	0	0	0
$144	$148	19.70	12.20	4.60	0	0	0	0	0	0	0	0
$148	$152	20.30	12.70	5.10	0	0	0	0	0	0	0	0
$152	$156	20.80	13.20	5.70	0	0	0	0	0	0	0	0
$156	$160	21.30	13.80	6.20	0	0	0	0	0	0	0	0
$160	$164	21.90	14.30	6.80	0	0	0	0	0	0	0	0
$164	$168	22.40	14.90	7.30	0	0	0	0	0	0	0	0
$168	$172	23.00	15.40	7.80	.30	0	0	0	0	0	0	0
$172	$176	23.50	15.90	8.40	.80	0	0	0	0	0	0	0
$176	$180	24.00	16.50	8.90	1.40	0	0	0	0	0	0	0
$180	$184	24.60	17.00	9.50	1.90	0	0	0	0	0	0	0
$184	$188	25.10	17.60	10.00	2.40	0	0	0	0	0	0	0
$188	$192	25.70	18.10	10.50	3.00	0	0	0	0	0	0	0
$192	$196	26.20	18.60	11.10	3.50	0	0	0	0	0	0	0
$196	$200	26.70	19.20	11.60	4.10	0	0	0	0	0	0	0
$200	$204	27.30	19.70	12.20	4.60	0	0	0	0	0	0	0
$204	$208	27.80	20.30	12.70	5.10	0	0	0	0	0	0	0
$208	$212	28.40	20.80	13.20	5.70	0	0	0	0	0	0	0
$212	$216	28.90	21.30	13.80	6.20	0	0	0	0	0	0	0
$216	$220	29.40	21.90	14.30	6.80	0	0	0	0	0	0	0
$220	$224	30.00	22.40	14.90	7.30	0	0	0	0	0	0	0
$224	$228	30.50	23.00	15.40	7.80	.30	0	0	0	0	0	0
$228	$232	31.10	23.50	15.90	8.40	.80	0	0	0	0	0	0
$232	$236	31.60	24.00	16.50	8.90	1.40	0	0	0	0	0	0
$236	$240	32.10	24.60	17.00	9.50	1.90	0	0	0	0	0	0
$240	$248	32.90	25.40	17.80	10.30	2.70	0	0	0	0	0	0
$248	$256	34.00	26.50	18.90	11.30	3.80	0	0	0	0	0	0
$256	$264	35.10	27.50	20.00	12.40	4.90	0	0	0	0	0	0
$264	$272	36.20	28.60	21.10	13.50	5.90	0	0	0	0	0	0
$272	$280	37.30	29.70	22.10	14.60	7.00	0	0	0	0	0	0
$280	$288	38.30	30.80	23.20	15.70	8.10	.50	0	0	0	0	0
$288	$296	39.40	31.90	24.30	16.70	9.20	1.60	0	0	0	0	0
$296	$304	40.50	32.90	25.40	17.80	10.30	2.70	0	0	0	0	0
$304	$312	41.60	34.00	26.50	18.90	11.30	3.80	0	0	0	0	0
$312	$320	42.70	35.10	27.50	20.00	12.40	4.90	0	0	0	0	0
$320	$328	43.70	36.20	28.60	21.10	13.50	5.90	0	0	0	0	0
$328	$336	44.80	37.30	29.70	22.10	14.60	7.00	0	0	0	0	0
$336	$344	45.90	38.30	30.80	23.20	15.70	8.10	.50	0	0	0	0
$344	$352	47.00	39.40	31.90	24.30	16.70	9.20	1.60	0	0	0	0
$352	$360	48.10	40.50	32.90	25.40	17.80	10.30	2.70	0	0	0	0
$360	$368	49.10	41.60	34.00	26.50	18.90	11.30	3.80	0	0	0	0
$368	$376	50.20	42.70	35.10	27.50	20.00	12.40	4.90	0	0	0	0
$376	$384	51.30	43.70	36.20	28.60	21.10	13.50	5.90	0	0	0	0
$384	$392	52.40	44.80	37.30	29.70	22.10	14.60	7.00	0	0	0	0
$392	$400	53.50	45.90	38.30	30.80	23.20	15.70	8.10	.50	0	0	0
$400	$420	55.40	47.80	40.20	32.70	25.10	17.60	10.00	2.40	0	0	0
$420	$440	58.10	50.50	42.90	35.40	27.80	20.30	12.70	5.10	0	0	0
$440	$460	60.80	53.20	45.60	38.10	30.50	23.00	15.40	7.80	.30	0	0
$460	$480	63.50	55.90	48.30	40.80	33.20	25.70	18.10	10.50	3.00	0	0
$480	$500	66.20	58.60	51.00	43.50	35.90	28.40	20.80	13.20	5.70	0	0
$500	$520	68.90	61.30	53.70	46.20	38.60	31.10	23.50	15.90	8.40	.80	0
$520	$540	71.60	64.00	56.40	48.90	41.30	33.80	26.20	18.60	11.10	3.50	0
$540	$560	74.30	66.70	59.10	51.60	44.00	36.50	28.90	21.30	13.80	6.20	0
$560	$580	77.00	69.40	61.80	54.30	46.70	39.20	31.60	24.00	16.50	8.90	1.40
$580	$600	79.70	72.10	64.50	57.00	49.40	41.90	34.30	26.70	19.20	11.60	4.10
$600	$640	83.70	76.10	68.60	61.00	53.50	45.90	38.30	30.80	23.20	15.70	8.10
$640	$680	89.10	81.50	74.00	66.40	58.90	51.30	43.70	36.20	28.60	21.10	13.50
$680	$720	94.50	86.90	79.40	71.80	64.30	56.70	49.10	41.60	34.00	26.50	18.90
$720	$760	99.90	92.30	84.80	77.20	69.70	62.10	54.50	47.00	39.40	31.90	24.30
$760	$800	105.30	97.70	90.20	82.60	75.10	67.50	59.90	52.40	44.80	37.30	29.70
$800	$840	110.70	103.10	95.60	88.00	80.50	72.90	65.30	57.80	50.20	42.70	35.10
$840	$880	116.10	108.50	101.00	93.40	85.90	78.30	70.70	63.20	55.60	48.10	40.50
$880	$920	121.50	113.90	106.40	98.80	91.30	83.70	76.10	68.60	61.00	53.50	45.90
$920	$960	126.90	119.30	111.80	104.20	96.70	89.10	81.50	74.00	66.40	58.90	51.30
$960	$1,000	132.30	124.70	117.20	109.60	102.10	94.50	86.90	79.40	71.80	64.30	56.70
		13.5 percent of the excess over $1,000 plus—										
$1,000 and over		135.00	127.40	119.90	112.30	104.80	97.20	89.60	82.10	74.50	67.00	59.40

"If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period—

"And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of tax to be withheld shall be the following amount multiplied by the number of days in such period—										
$0	$2.00	13.5% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$2.00	$2.25	$0.30	.05	0	0	0	0	0	0	0	0	0
$2.25	$2.50	.30	.10	0	0	0	0	0	0	0	0	0
$2.50	$2.75	.35	.10	0	0	0	0	0	0	0	0	0
$2.75	$3.00	.40	.15	0	0	0	0	0	0	0	0	0
$3.00	$3.25	.40	.20	0	0	0	0	0	0	0	0	0
$3.25	$3.50	.45	.20	0	0	0	0	0	0	0	0	0
$3.50	$3.75	.50	.25	0	0	0	0	0	0	0	0	0
$3.75	$4.00	.55	.30	.05	0	0	0	0	0	0	0	0
$4.00	$4.25	.55	.30	.05	0	0	0		0	0	0	0
$4.25	$4.50	.60	.35	.10	0	0	3	0	0	0	0	0
$4.50	$4.75	.60	.40	.15	0	0	0	0	0	0	0	0
$4.75	$5.00	.65	.40	.15	0	0	0	0	0	0	0	0
$5.00	$5.25	.70	.45	.20	0	0	0	0	0	0	0	0
$5.25	$5.50	.75	.50	.25	0	0	0	0	0	0	0	0
$5.50	$5.75	.75	.50	.25	.05	0	0	0	0	0	0	0
$5.75	$6.00	.80	.55	.30	.05	0	0	0	0	0	0	0
$6.00	$6.25	.85	.60	.35	.10	0	0	0	0	0	0	0
$6.25	$6.50	.85	.60	.35	.15	0	0	0	0	0	0	0
$6.50	$6.75	.90	.65	.40	.15	0	0	0	0	0	0	0
$6.75	$7.00	.95	.70	.45	.20	0	0	0	0	0	0	0
$7.00	$7.25	.95	.70	.50	.25	0	0	0	0	0	0	0
$7.25	$7.50	1.00	.75	.50	.25	0	0	0	0	0	0	0
$7.50	$7.75	1.05	.80	.55	.30	.05	0	0	0	0	0	0
$7.75	$8.00	1.05	.80	.60	.35	.10	0	0	0	0	0	0
$8.00	$8.25	1.10	.85	.60	.35	.10	0	0	0	0	0	0
$8.25	$8.50	1.15	.90	.65	.40	.15	0	0	0	0	0	0
$8.50	$8.75	1.15	.90	.70	.45	.20	0	0	0	0	0	0
$8.75	$9.00	1.20	.95	.70	.45	.25	0	0	0	0	0	0
$9.00	$9.25	1.25	1.00	.75	.50	.25	0	0	0	0	0	0
$9.25	$9.50	1.25	1.00	.80	.55	.30	.05	0	0	0	0	0
$9.50	$9.75	1.30	1.05	.80	.60	.35	.10	0	0	0	0	0
$9.75	$10.00	1.35	1.10	.85	.60	.35	.10	0	0	0	0	0
$10.00	$10.50	1.40	1.15	.90	.65	.40	.15	0	0	0	0	0
$10.50	$11.00	1.45	1.20	.95	.70	.50	.25	0	0	0	0	0
$11.00	$11.50	1.50	1.30	1.05	.80	.55	.30	.05	0	0	0	0
$11.50	$12.00	1.60	1.35	1.10	.85	.60	.35	.15	0	0	0	0
$12.00	$12.50	1.65	1.40	1.15	.90	.70	.45	.20	0	0	0	0
$12.50	$13.00	1.70	1.50	1.25	1.00	.75	.50	.25	0	0	0	0
$13.00	$13.50	1.80	1.55	1.30	1.05	.80	.60	.35	.10	0	0	0
$13.50	$14.00	1.85	1.60	1.35	1.15	.90	.65	.40	.15	0	0	0
$14.00	$14.50	1.95	1.70	1.45	1.20	.95	.70	.45	.20	0	0	0
$14.50	$15.00	2.00	1.75	1.50	1.25	1.00	.80	.55	.30	.05	0	0
$15.00	$15.50	2.05	1.80	1.55	1.35	1.10	.85	.60	.35	.10	0	0
$15.50	$16.00	2.15	1.90	1.65	1.40	1.15	.90	.65	.45	.20	0	0
$16.00	$16.50	2.20	1.95	1.70	1.45	1.20	1.00	.75	.50	.25	0	0
$16.50	$17.00	2.25	2.00	1.80	1.55	1.30	1.05	.80	.55	.30	.05	0
$17.00	$17.50	2.35	2.10	1.85	1.60	1.35	1.10	.85	.65	.40	.15	0
$17.50	$18.00	2.40	2.15	1.90	1.65	1.40	1.20	.95	.70	.45	.20	0
$18.00	$18.50	2.45	2.20	2.00	1.75	1.50	1.25	1.00	.75	.50	.30	.05
$18.50	$19.00	2.55	2.30	2.05	1.80	1.55	1.30	1.05	.85	.60	.35	.10
$19.00	$19.50	2.60	2.35	2.10	1.85	1.65	1.40	1.15	.90	.65	.40	.15
$19.50	$20.00	2.65	2.40	2.20	1.95	1.70	1.45	1.25	.95	.70	.50	.25
$20.00	$21.00	2.75	2.50	2.30	2.05	1.80	1.55	1.30	1.05	.80	.60	.35
$21.00	$22.00	2.90	2.65	2.40	2.15	1.95	1.70	1.45	1.20	.95	.70	.50
$22.00	$23.00	3.05	2.80	2.55	2.30	2.05	1.80	1.60	1.35	1.10	.85	.60
$23.00	$24.00	3.15	2.90	2.70	2.45	2.20	1.95	1.70	1.45	1.25	1.00	.75
$24.00	$25.00	3.30	2.95	2.80	2.60	2.35	2.10	1.85	1.60	1.35	1.10	.90
$25.00	$26.00	3.45	3.05	2.95	2.70	2.45	2.25	2.00	1.75	1.50	1.25	1.00
$26.00	$27.00	3.60	3.20	3.10	2.85	2.60	2.35	2.10	1.90	1.65	1.40	1.15
$27.00	$28.00	3.70	3.35	3.25	3.00	2.75	2.50	2.25	2.00	1.75	1.55	1.30
$28.00	$20.00	3.85	3.45	3.35	3.10	2.90	2.65	2.40	2.15	1.90	1.65	1.40
$29.00	$30.00	4.00	3.60	3.50	3.25	3.00	2.75	2.50	2.30	2.05	1.80	1.55
		13.5 percent of the excess over $30 plus—										
$30.00 and over		4.05	3.80	3.55	3.30	3.10	2.85	2.60	2.35	2.10	1.85	1.60"

SEC. 11. Section 6015 of the Internal Revenue Code of 1954 (relating to declaration of estimated income tax by individuals) is hereby amended by inserting in subsection (c) after the phrase "the individual estimates" where it first appears the following: ", on the basis of the tax rates in effect on the last day prescribed for the timely filing of the declaration of estimated tax."

SEC. 12. Section 6016 of the Internal Revenue Code of 1954 (relating to the declaration of estimated income tax by corporations) is hereby amended by inserting in paragraph (1) of subsection (b) after the words "the corporation estimates" the following: ", on the basis of the tax rates in effect on the last day prescribed for the timely filing of the declaration of estimated tax,".

The CHAIRMAN. The first witness is John L. Connolly, Council of the State Chambers of Commerce.

Take a seat, sir.

STATEMENT OF JOHN L. CONNOLLY, ON BEHALF OF MEMBER STATE CHAMBERS OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE; ACCOMPANIED BY EUGENE F. RINTA, EXECUTIVE DIRECTOR, COUNCIL OF THE STATE CHAMBERS OF COMMERCE

Mr. CONNOLLY. My name is John L. Connolly. I reside in St. Paul, Minn.; I am general counsel of Minnesota Mining Manufacturing Co. I am chairman of the Federal Finance Committee of the Council of State Chambers of Commerce, and I appear before you on behalf of the 28 State and regional chambers of commerce which are listed in my statement.

I have with me on my right, Mr. Eugene Rinta, who is executive director of the Council of State Chambers and a resident of the District of Columbia.

Senator CARLSON. Mr. Chairman, if I may state, I am pleased to note Mr. Connolly is representing the Kansas State Chamber of Commerce, as one of them. I have known Mr. Connolly and of his great background as a tax accountant and attorney, counsel and attorney, so I want our people back in Kansas to know they are well represented.

Mr. CONNOLLY. We direct our remarks to the subject of tax on foreign income. In addition, I would like to submit for the record our views on certain other features of H.R. 10650.

SECTION 6

Section 6 amends section 482 of the U.S. InIternal Revenue Code of 1954 by adding a new subsection which contains specific factors to be used in allocating income derived from purchases and sales of goods between American corporations and their controlled foreign subsidiaries.

We are not opposed to any changes that are necessary but we feel that the proposal is not necessary.

Section 482 now authorizes the Secretary or his delegate to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any organizations, trades, or businesses.

We feel that the present section is clear and gives the Secretary all the authority needed to prevent evasion of U.S. taxes, or clearly to reflect the income of any organization, trade, or business.

Section 6 contains broad rules but does not provide any definite formula to be followed. We feel that the suggested changes will do more harm than good. The definition of an arm's-length price contained in the proposed section is restrictive.

Most manufacturing companies sell their products to distributors and not to other manufacturers. In sales to distributors the distributors perform the necessary selling function, which when sold to a controlled foreign corporation will have to be performed by the purchaser. In no event should there be quarrel with a selling price for U.S. purposes if the domestic corporation sold to a controlled foreign corporation at a price which included approximately the same margin of markup as was made on domestic business after reduction for such cost factors as further processing, packaging, sales, distribution, advertising, and transportation not required to be performed by the domestic corporation. In some cases a lesser price is fully justified.

SECTION 11

We are opposed to section 11. The present provisions for determining the foreign tax credit have been in the law for many years. We agree with Congressman Curtis of Missouri when he said, as set out on p. B 33 of the report by the Committee on Ways and Means of the House:

> Thus, the gross-up proposal as contained in H.R. 10650 is fallacious in principle, inequitable in result, violative of treaty obligations, and dangerous in its economic implications with respect to America's role in international trade.

It requires the corporation to take into income amounts that have been paid to some foreign government that have not been received and never shall be received. This raises a serious constitutional question that is hereafter developed in detail in this statement. The section is also contrary to many U.S. tax treaties with other countries.

Secretary Dillon is not satisfied with the change in the foreign tax credit under section 11. He suggests that the foreign tax credit on investment income be computed separately and apart from the foreign tax credits on other income.

SECTION 13

We are opposed to section 13. This section sets apart certain kinds of income received by controlled foreign corporations and taxes such income annually to U.S. shareholders. These types of income include personal holding company income, income derived from patents, copyrights, exclusive formulas and processes, insurance premiums on U.S. risks, income derived from foreign base company sales, and the earnings of controlled foreign corporations due to increase of their investments from earnings in developed countries.

We in the Council of State Chambers of Commerce have long had a policy that no taxpayer should be permitted to avoid his legal obligation to pay taxes to the U.S. Government. On the other hand, we are opposed to placing all taxpayers operating in these countries in a straitjacket because of tax evasion by some.

To the extent that some American taxpayers may be shifting to controlled foreign corporations income derived from patents, copyrights, exclusive formulas and processes, insurance premiums on U.S.

risks, and from base company sales or purchases between the domestic corporation and a controlled foreign corporation, we believe the practice can be halted by adequate enforcement of the present section 482 of the Internal Revenue Code. There is no evasion of U.S. tax on income derived from purchases and sales between controlled foreign corporations organized and doing business in different foreign countries. Taxation of such income to U.S. shareholders would be an unwarranted interference by the Treasury in the economies of other countries. This would be equally applicable to intercorporate dividends and interest paid or received between controlled foreign corporations in different countries.

To tax U.S. shareholders on the current undistributed income of a controlled foreign corporation which is a bona fide operating corporation is uneconomic, has never been attempted, and, in our opinion, is unconstitutional. If this radical policy is adopted with respect to foreign corporations, what will be the next step? Our views on the constitutional and economic questions are discusssed in the detailed statement which follows.

Secretary Dillon is not satisfied with the provisions of section 13, drastic as they are. As we understand his testimony before this committee on April 2, he urges that U.S. shareholders be required to report and pay income tax annually on their proportionate share of profits earned by any controlled foreign corporation organized under the laws of a developed foreign country.

The Congress should consider the provisions of section 13 not only as an internal revenue measure but as legislation directly relating to our foreign trade and economic policies. The section deals with external trade and taxation in several ways, including the taxation of income from transactions between two or more controlled foreign corporations and taxation of earnings of a single controlled corporation because of investments in expansion or diversification. We feel certain that no foreign country would long ignore this indirect U.S. tax on trade between and among foreign countries.

In view of the implications of section 13 and other sections relating to the taxation of foreign income, we strongly urge that they be referred to the Joint Committee on Internal Revenue Taxation and to the Foreign Relations Committee for their thorough study.

The pertinent constitutional and economic questions relative to sections 11 and 13 are discussed in the pages that follow.

THE CORPORATION CONCEPT

A corporation is a separate and distinct entity created by law and having the same characteristics as a natural person. It can own property, sue and be sued, have a domicile, enter into contracts and so forth.

The corporate concept was developed to satisfy the needs of the commercial world—to facilitate the pooling of capital in a common owner separate and distinct from the shareholders.

This concept has been fundamental in the Anglo-American system of jurisprudence.

Our courts have consistently and uniformly respected the integrity of the corporate entity and have refused to disregard it except in those

cases where the corporation is used to work a wrong, evade statutes, or where it is an alter ego of the shareholders.[1]

U.S. HISTORY OF TAXING THE CORPORATION AND ITS SHAREHOLDERS

Congress in enacting income tax laws—with the exception of the Revenue Acts of 1913, 1916, and 1918 and the Foreign Holding Company Act of 1937 hereinafter noted—has imposed the income tax on the corporation and not the shareholders.

The Revenue Acts of 1913 and 1916 provided that if a corporation was formed or fraudulently availed of for the purpose of preventing the imposition of the additional income tax upon its shareholders, then undistributed profits of such corporations should be reported as income by the shareholders.[2] Although the requirement of affirmative fraud was eliminated from the Revenue Act of 1918, the requirement of tax evasion remained.[3]

The Revenue Act of 1921 eliminated the provision requiring shareholders to report corporate earnings and instead imposed a penalty tax on the corporation if formed or availed of for the prohibited purposes.[4] This change was made by reason of the Supreme Court decision in the *Eisner* case.[5] At that time this committee said that the case cast considerable doubt on the constitutionality of the existing law.[6] Presumably this proceeded from a doubt as to whether imposition of the tax was strictly limited to cases of sham and evasion.

The testimony taken by the Joint Committee on Tax Evasion and Avoidance of 1937 showed that foreign personal holding companies were being utilized by citizens and residents of the United States as a device for tax avoidance purposes.[7] Income which would otherwise be subject to Federal income tax was being diverted to and accumulated in foreign countries in order that the American shareholder would escape being taxed. To prevent evasion, Congress enacted legislation which taxed the income of the foreign personal holding companies to U.S. shareholders whether such income was actually distributed or not. However, Congress did not attempt to tax the earnings to the shareholders of genuine foreign operating companies or widely held holding companies.[8] Congress has made no material change in the foreign personal holding company provisions since 1937.

It must be emphasized again that at no time in the past has Congress attempted to tax the undistributed profits of a bona fide operating company to its shareholders. Nor have the courts ever intimated that the profits of a bona fide operating company can ever be taxed, without severance, as income to its shareholders. The statutory enactments referred to in the Revenue Acts of 1913, 1916, 1918, and 1937 are no more than a congressional declaration of policy within a conventional constitutional framework which, even without the statute, clearly permits any court to look through the corporate entity where the corporation is formed or availed of for purposes of tax evasion.

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[1] Fletcher, "Cyclopedia Corporations," vol. 1, sec. 25 et seq.
[2] Revenue Act of 1913, sec. II, subsec. 2; Revenue Act of 1916, sec. 3.
[3] Revenue Act of 1918, sec. 220.
[4] Revenue Act of 1921, sec. 220.
[5] U.S. Constitution, amendment 16.
[6] Ways and Means Committee, 67th Cong., 1st sess., H. Rept. 350.
[7] Report of Joint Committee on Tax Evasion and Avoidance, Aug. 5, 1937, Ways and Means Committee, 75th Cong., Rept. 1546.
[8] Revenue Act of 1937, sec. 201.

The proposals in H.R. 10650, to tax U.S. shareholders, disregard the distinction between the substance of legitimate business activities and corporate sham. In our view the history of the income tax laws enacted by Congress after the adoption of the 16th amendment clearly indicates that Congress has fully recognized the great body of judicial decisions to the effect that the corporate entity should remain inviolate except where the corporation is used to work wrong, evade statutes, or where it is an alter ego of the shareholder.

THE CONSTITUTIONAL QUESTIONS RAISED BY H.R. 10650

The power of Congress to tax is granted by article 1, sections 2 and 9, and the 16th amendment of the Federal Constitution.

It is not proposed that the tax imposed by sections 11 and 13 be apportioned according to population. Therefore, it can be sustained, if at all, only under the 16th amendment which permits a tax on income.

The 16th amendment authorized Congress to lay and collect taxes on income, from whatever source derived, without apportionment among several States, and without regard to any census or enumeration.[9]

SECTION 13—UNDISTRIBUTED PROFITS OF CONTROLLED FOREIGN CORPORATIONS

In examining the constitutionality of section 13 of the bill we must determine whether an income tax upon U.S. shareholders for certain classes of undistributed profits of a controlled foreign corporation is a tax upon income. If the profits are not income to shareholders, then it is clear that such a tax would be unconstitutional, without apportionment, et cetera.

What is income? The Supreme Court has expressed itself very clearly on this subject several times. In the leading case, *Eisner* v. *Macomber*, the Supreme Court said:[10]

> * * * it becomes essential to distinguish between what is and what is not "income" * * *; and to apply the distinction, as cases may arise, according to truth and substance without regard to form. Congress cannot, by any definition it may adopt, conclude the matter since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate * * *.

In defining income in the *Eisner* case, the Supreme Court said that income was "everything that became income in the ordinary sense of the word, after the adoption of the amendment."[11]

There can be no dispute that profits and earnings of a corporation are income. But the question is—whose income? The corporation's or the shareholder's. The Supreme Court in the *Eisner* case answered that question by saying that the income was that of the corporation:

> * * * (L)ooking through the form, we cannot disregard the essential truth disclosed; ignore the substantial difference between corporation and stockholder; treat the entire organization as unreal; look upon the stockholders as partners, when they are not such; treat them as having in equity a right to a partition of the corporate assets, when they have none; and indulge the fiction that they have received and realized a share of the profits of the company which in truth they have neither received nor realized.

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[9] U.S. Constitution, amendment 16.
[10] *Eisner* v. *Macomber*, 252 U.S. 189, 206 (1919) ; 64 Law Ed. 521.
[11] Ibid., p. 204.

On the other hand, in *Gregory* v. *Helvering* [12] the Supreme Court looked through the form and found that the corporation had no business or corporate purpose and, therefore, disregarded the corporate form for the purpose of taxation. This decision is in accordance with the judicial decisions of the courts that the corporate entity is only disregarded in those cases where the corporation is used to work a wrong, evade statutes, or where it is the alter ego of the shareholders.

If shareholders are to be taxed in respect of the profits of the corporation, the distinct entities of corporation and shareholders is ignored; the corporate organization is treated as unreal; the stockholders are looked upon as partners. The Supreme Court said emphatically in the *Eisner* case: [13]

> The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money * * * in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance, and not to form, he (the shareholder) has received nothing that answers the definition of income within the meaning of the 16th amendment.

The Supreme Court has had ample opportunity to overrule the *Eisner* case had it desired to do so, as, for example, in *Helvering* v. *Griffiths*.[14] To the contrary, in the *Griffith* case the Court explicitly recognized that the *Eisner* case was direct authority for the proposition that Congress may not tax to the shareholders the undistributed profits of a corporation.

In the cases of *Railway Express Agency, Inc.* v. *Commissioner* and *National Carbide Corporation* v. *Commissioner* the Supreme Court of the United States refused to ignore the corporate entities of subsidiaries and to hold that the income of the subsidiaries was income of the parent.[15]

The U.S. Supreme Court in *Hoeper* v. *Tax Commissioner of Wisconsin*, which was an attempt by Wisconsin to tax the income of Hoeper's wife to Hoeper, said: [16]

> * * * any attempt by a State to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the 14th amendment, that which is not in fact the taxpayer's income cannot be made such by calling it income.

This is precisely what H.R. 10650 does.

In our view the *Eisener* case was good law when it was decided and it continues to be the law today. It is our opinion that the proposal to tax undistributed profits of a controlled foreign corporation to its U.S. shareholders is unconstitutional.

SECTION 11—FOREIGN TAX CREDIT

The bill requires a domestic croporation receiving dividends from a foreign corporation to report as income annually not only the divi-

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[12] *Gregory* v. *Helvering*, 293 U.S. 465 (1934).
[13] *Eisner* v. *Macomber*, supra, p. 211.
[14] *Helvering* v. *Griffiths*, 318 U.S. 371 (1942).
[15] *Railway Express Agency, Inc.* v. *Commissioner* (1948), 169 Fed. 2d 193, cert. denied 336 U.S. 944. *National Carbide* v. *Commission* (1949), 336 U.S. 422.
[16] *Hoeper* v. *Tax Commissioner* (1930), 284 U.S. 206.

dend received, but in addition to report as income annually a part of the foreign tax paid by the foreign corporation.

The Supreme Court of the United States in the *Biddle* case had under consideration the right of U.S. shareholders to include in their returns the amount of dividends received from a British company and also a part of the taxes paid by the British company to the British Government. The Court, sustaining the decision of the Board of Tax Appeals, refused to allow the taxpayers to include in their income tax returns a part of the taxes paid by the British company and to claim as a foreign tax credit the amount of British tax that was reported by them as income. The Court said:[17]

> The Board held that the sums in dispute should not have been included in gross income, because they represented neither property received by the taxpayer nor the discharge of any taxes owed by them to the British Government.

We fail to understand how, under the views expressed by the Court in this case, the Congress can constitutionally require a domestic corporation to include in net income taxes extracted from a foreign corporation by a foreign government since the taxes do not represent property received by the taxpayer nor the discharge of any taxes owed by the taxpayer to the foreign government.

No matter how you look at the provision of section 11 it is an attempt to measure the corporation's U.S. tax by reference to the income paid by the foreign corporation as tax to a foreign country.

We trust that this committee will give serious consideration to these constitutional questions. Congress and the members of this committee, as well as the U.S. Supreme Court, are custodians of the Constitution.

ECONOMIC ISSUES RELATIVE TO TAXING U.S. SHAREHOLDERS ON UNDISTRIBUTED PROFITS OF CONTROLLED FOREIGN CORPORATIONS

The administration has advanced four arguments for taxing U.S. shareholders on the undistributed profits of foreign controlled corporations. One is that it will improve our balance-of-payments position. Another is that it will bring greater equity to the taxation of controlled foreign corporations in relation to domestic corporations. The third is that it will increase the domestic investment at the expense of foreign investment and, thus, will improve employment opportunities in the United States. Finally, it is stated that the change in law would substantially increase Treasury revenues.

THE BALANCE-OF-PAYMENTS ISSUE

With reference to available data on foreign investments and our balance of payments, it should be recognized that they do not portray the relationships between the two with anything like the certainty and validity required for legislative judgments to be based on them.

About a year and a half ago the Department of Commerce published a 147-page analysis, "U.S. Business Investments in Foreign Countries." In commenting on the difficulties and uncertainties in

[17] *Biddle v. Commissioner* (1937), 302 U.S. 57, p. 577.

the relationships of business investments and our balance of payments, this report, on page 65, declares:

> The process of establishing a vast complex of enterprises abroad, and producing with these facilities new streams of goods and services, necessarily alters in many direct and indirect ways the existing structure of international transactions as well as that of domestic economies. These changes cannot be summed up in a single measure for several reasons—even for the direct effects the necessary data are lacking, and the indirect effects may take considerable time to work out and may well consist of changes not capable of measurement.

The Department of Commerce report, on page 67, further states:

> A major result of assembling these data on the overall effects on balances of payments of direct foreign investments is to point up the inadequacy of conclusions about these effects based solely on considerations of the relationship between net capital outflows and income receipts. These two items are highly significant, but the whole range of international transactions is also affected by the investments, as well as the degree and manner of utilization of the world's resources.

The Treasury appraisal of the balance-of-payments problem appears to rest substantially on conjecture. It is true, of course, that if foreign investment should be discouraged by unfavorable tax legislation, the outflow of dollars would be reduced. But the balance of payments would not be improved in anything like the amount of diminution of investment abroad. First of all, a substatnial part of the investment is normally spent promptly for capital goods and services in the United States with a consequent return of dollars. Secondly, once the foreign activity is established, it usually generates additional exports in the form of materials, parts, services, and even finished goods. These exports in all likelihood would not occur if the investment had not been made. Thus, the short-run improvement that could be expected in our balance of payments from the proposed legislation is more apparent than real.

Over the longer term there is no question at all about the effects of curtailment of foreign investment. They would be adverse to the balance of payments. This is clear from the record of recent years, and it is demonstrated even in the Secretary's own hypothetical case of a foreign investment which he used to support his position in testimony before the Ways and Means Committee.

TAXATION OF FOREIGN EARNINGS TO U.S. SHAREHOLDERS NOT EQUITABLE

The Secretary asserts that as a matter of equity investments in the United States and those abroad must be placed on the same basis with respect to taxation of earnings. There are two points we would like to make to this argument. First, equity in taxation calls for equal tax treatment of taxpayers in similar situations. It cannot, however, be successfully argued that a controlled foreign corporation operating outside this country is in the same situation as the domestic corporation operating within the United States. The domestic corporation is taxed to finance Government expenditures which in various ways, including protection, provide benefits to the corporation within the United States. But the foreign subsidiary, operating abroad, gets little benefit and, at times no protection, from the expenditures of the U.S. Government. Seizures of American investments in Cuba and elsewhere are a case in point. In the list of the entirely different risks involved in foreign investments, they cannot be considered as comparable to domestic investments for the purpose of taxation.

Equity of taxation also implies equal treatment of competitors. The foreign subsidiary is competing primarily with firms in the country or countries where it is operatng. To the extent that its income is taxed by the United States in addition to the taxes it pays the foreign country, it is already burdened by lack of equity. Imposition of the existing U.S. tax on undistributed earnings would compound the inequity against the subsidiary in relation to its competitors.

If it is fair for the United States to tax investments of its citizens in this manner, it is equally fair for other countries to tax their citizens in a like manner on their investments in the United States. It is very doubtful if the American economy could have advanced to its present stage of development if the European countries had adopted such an unfavorable tax policy during the 19th century. If we now adopt this policy, we feel certain that other countries will increase their tax rates on our controlled foreign subsidiaries to the level of our rates for the benefit of their own treasuries. They will do this because of the operation of the foreign tax credit provisions of our tax law.

The question of equity with respect to taxation of foreign branch operations as compared to subsidiaries has also been raised. To this we would say that their situations are not similar. Where a corporation takes the option to operate in a foreign country through a branch instead of a subsidiary, the choice is usually made because of favorable U.S. tax considerations not available to a subsidiary, such as depletion allowances, net loss deductions, capital gains, and so on.

EFFECT OF FOREIGN INVESTMENT ON DOMESTIC ECONOMY

One of the reasons advanced for discouraging investment in developed countries is that it results in diminished investment and employment at home. No convincing factual support is offered for this argument. It is based on the erroneous assumption that the foreign investment is made in lieu of a domestic investment. There is no assurance that such funds would be invested at home if a foreign investment were not made. But even if they were invested at home, they might in the long run be less productive and beneficial to employment, income, and the balance of payments.

In addition to development of natural resources abroad, foreign investments are usually made to acquire new markets, to maintain markets which would otherwise be lost, or to regain markets which have already been lost. None of these foreign investments can be shown to have adversely affected employment here. If the investments were not made, the new markets would not be captured, existing markets would be lost, and markets previously lost would not be regained.

Once the investments are made, they tend to promote greater employment and production here. They develop a permanent interest of the American investor in foreign markets. Products which the company produces at home, as well as those produced abroad, begin to gain acceptance in the foreign country. Foreign sales and distribution organizations are built up with consequent development of new and expanded export business. The result is greater production and bigger employment needs at home.

REVENUE EFFECT ON TAX ON UNDISTRIBUTED INCOME

Obviously, the proposed tax on foreign income would give some temporary lift to Treasury revenues. It is equally obvious that in the long run it would adversely affect Treasury revenues. This adverse effect would result from two factors. First, the income available for reinvestment and production of additional income would be reduced to the extent of the U.S. tax extraction from undistributed profits. Second, the proposal would discourage foreign investment and would reduce future taxable foreign income from the level it would otherwise reach. Moreover, no evidence has been offered to support the contention or assumption that if foreign investments were discouraged, domestic investments would be increased.

Even for the short run, any estimate of increased Federal revenues would be highly speculative. In view of the paucity of reliable data concerning the operations of American subsidiaries and the likelihood that other governments would increase their taxes on the income of our subsidiaries, it could be that the revenues realized by the Treasury would merely be nominal.

INVESTMENTS IN DEVELOPED COUNTRIES HELP UNDERDEVELOPED COUNTRIES

The administration's proposals are designed to discourage investment in developed countries while continuing present tax provisions with respect to underdeveloped countries except for "tax haven corporations."

American investments and business operations in the highly developed countries have brought benefits to the underdeveloped countries. Improvements in production and marketing in other highly developed countries, as well as in the United States, have lowered the prices of goods and services, brought new products into being, and increased the availability of new productive facilities and techniques for the underdeveloped countries.

The profits of American business in the more highly developed countries have provided surplus funds which may be invested in these countries or in the underdeveloped countries. The increased prosperity in the highly developed countries to which American business investments have contributed also make it possible for these countries to share with us the foreign aid programs for the benefit of the underdeveloped countries. It should also be feasible for the highly developed countries to share to a greater extent the costs of mutual defense measures. These developments should act to ease the foreign drain on our gold.

Continuing prosperity in both the highly developed and the underdeveloped countries should contribute to a growing demand for American goods and services. These countries can sell to us only if they buy from us, because they, too, must reckon with balance-of-payments problems and the need for gold.

THE INVESTMENT TAX CREDIT AND OUR INTERNATIONAL ECONOMIC POSITION

The Treasury has supported the investment tax credit as a measure to encourage the modernization of American plant and equipment, the lowering of production costs, and the increase of American exports. Actually, this credit would subsidize some firms which would increase investments anyway, would not necessarily stimulate the export industries significantly, and would invite overinvestment by some firms to gain a tax reduction, in spite of the effects on costs. It is not clear that the credit, on balance, would materially benefit our exports and the balance of payments.

At any rate, while the investment tax credit might have some stimulating effects on our economy, other provisions proposed by the Treasury, as previously noted, would seriously penalize American investment abroad and react unfavorably upon our foreign trade and the balance of payments.

In our opinion, the best way to encourage growth of the American economy is to reduce our high tax rates, and thus lower the tax costs of our firms at home and abroad. We further feel that urgently needed reforms in depreciation allowances would go a long way toward speeding up plant modernization, lowering business costs, and improving our exports and balance-of-payments position.

In conclusion, we reiterate our opposition to sections 11 and 13 of H.R. 10650 and to the Treasury's proposal to broaden the effect of section 13 on the grounds of constitutionality and their detrimental effect on our foreign trade.

VIEWS ON CERTAIN OTHER SECTIONS OF H.R. 10650

In addition to the foregoing statement on foreign income provisions of H.R. 10650, we wish to submit for the record our views on several other sections of the bill which are of considerable interest and concern to State chambers of commerce. These views follow:

INVESTMENT TAX CREDIT—SECTION 2

The investment tax credit is a device for reducing the taxes of businesses which invest in certain depreciable property. It was proposed by the President as a means of accelerating economic growth and improving the competitive position of American industry in world markets through modernization of our industrial plant.

We do not believe that this tax credit device is a desirable method of reducing business taxes or that it is the best way to encourage plant modernization. Moreover, its revenue cost would tend to delay enactment of needed depreciation reform and alleviation of other tax restraints to economic growth.

As a tax reduction provision, the investment credit is discriminatory. In manufacturing industries it favors those whose plans call for large investment in the immediate future and penalizes others who have largely completed their modernization programs in the recent past. Public utilities would be given a 3-percent credit as compared to 7 percent for other industries under H.R. 10650, and would be allowed no credit under the Treasury's recommendations

while other industries would be allowed 8 percent. With respect to industrial firms generally, the tax credit would favor businesses which are currently growing rapidly as compared to those which have matured. Also, it would favor well-financed companies over those which lack adequate capital or credit.

By its very preferential nature, the investment tax credit is inappropriate as a means of reducing business taxes. When business taxes are to be reduced—and we believe their reduction is urgently needed—the direct approach of rate reduction should be employed.

As an incentive for investment in modern industrial equipment and machinery, the tax credit is a business subsidy since the property acquired could still be depreciated at 100 percent of cost and it would needlessly reward concerns which planned to make investments in any event. The member State chambers of commerce in this council do not seek a Federal subsidy for business. Instead, they favor reductions in Federal subsidies generally as one source of funds for general tax relief and reform.

REALISTIC DEPRECIATION NEEDED

Both the President and Secretary Dillon have expressed full recognition of the need to modernize our industrial plant to meet the formidable competition of other advanced industrial nations in the world markets. But this need will not be accomplished, in our view, through the adoption of the tax credit, even though supplemented with possible modest administrative revisions in useful asset lives as have been effected for the textile industry. We need much greater flexibility in depreciating capital assets if the plant modernization objective of the President is to be attained. Briefly stated, our position is this:

Business management can best determine the propriety of a particular method of depreciation and obsolescence in any given case. Within the limits of sound and consistent accounting, business management should be allowed to exercise discretion in the choice of the method and the rates of depreciation and obsolescence. At the same time, however, the taxpayer should be limited in his depreciation deductions for tax purposes to the amounts he records in his books. Such a limitation would reduce the initial revenue losses which might otherwise occur and would prevent possible abuse of the provision.

In addition to the foregoing provisions, the Revenue Code should also grant taxpayers the optional choice of asset class or bracket depreciation along the lines provided in the Canadian tax law. Under this system assets are grouped into a relatively small number of classes—17 in Canada—and specific depreciation rates, or minimum and maximum rates, are assigned to each class. Thus, the concept of useful lives is eliminated. If the taxpayer should choose this method of depreciation, he should be permitted to keep separate depreciation accounts, as at present, for tax and book purposes.

We urge the Congress to consider at an early date legislation along the lines I have suggested as the best long-term means of keeping our industrial plant up to date. We are not very hopeful, however, that these proposals will be enacted as a part of H.R. 10650. What the administration apparently is seeking through the investment credit is

a quick stimulant rather than a long-term solution to the problem of obsolescence. This objective can be attained by a simple amendment to section 179 of the 1954 Revenue Code. That section now provides for an additional 20-percent depreciation allowance in the year of acquisition of tangible personal property but with a cost limitation of $10,000 on which the additional allowance may be taken. Removal of this limitation would provide the stimulus that is sought through the investment credit but without the subsidy involved in the latter.

LEGISLATIVE EXPENSES—SECTION 3

Section 3 of H.R. 10650 is a partial solution to a problem which was created by court and administrative decisions. It relates to the deduction of expenses in connection with expression of business taxpayer views at Federal, State, and local legislative levels.

There has never been a provision in the Internal Revenue Code prohibiting the deduction of a business expense incurred for the purpose of influencing legislation. The only limitation has been that the expense must be "ordinary and necessary." Treasury regulations and court decisions, however, have created a situation in which all such expenses are now subject to disallowance.

Section 3 attempts to resolve the situation on a selective basis with deduction of certain types of expenditures being permitted and others being denied. Generally, expenses incurred for direct communications with individual legislators or with legislative bodies are deductible but the cost of efforts to influence public opinion are not. We fail to see the logic of this distinction.

Expenses incurred in attempts to influence the general public, or segments thereof, for the purpose of legally protecting a business against the enactment of damaging legislation are as necessary to the business as any other expenses. Without having made the expenditures, the business might no longer be able to produce as much income, or any at all, for the Government to share. Similarly, expenditures are often made by business firms to help promote community development campaigns involving bond issues. Under section 3 deduction of these expenditures would be denied as attempts to influence the public, although their normal result is improved business conditions and higher incomes.

The provisions of section 3 which deal affirmatively with these expenses are only a partial solution to the problem. For an adequate solution we urge substitution of the language in S. 467, by Senators Hartke and Kerr, or H.R. 640 by Representative Boggs for the language in section 3. Unless this action is taken, business taxpayers will remain under a considerable handicap in attempting to compete with tremendous Government propaganda machines whose activities they are already helping to finance. Moreover, the denial of deduction of the expense of communicating with the public, or segments thereof, under section 3 may be construed as being even more restrictive than the present Treasury regulation in that respect.

BUSINESS EXPENSES—SECTION 4

While the provisions of section 4 are not as onerous and restrictive generally as the Treasury's recommendations, they still substitute statutory judgment and the judgment of the Internal Revenue Service for business judgment as to what expenses are "ordinary and necessary" expenses. These provisions would also create serious complications for taxpayers in attempting to determine and substantiate deductions of legitimate business expenses.

We recognize that some abuses in business expense accounts do occur, but they are the exception rather than the rule. The abuses can be minimized by better policing on the part of the Revenue Service and by requiring taxpayers to adequately substantiate the amount and purpose of deductions.

A more detailed statement of views which we generally support was submitted by Mr. Clarence L. Turner on April 12 on behalf of the Pennsylvania and other State chambers of commerce.

GAINS FROM DISPOSITION OF DEPRECIABLE PROPERTY—SECTION 14

Present law provides for the treatment of gains on disposition of depreciable property as capital gains. Under existing restrictive allowances for depreciation, this provision provides a sound means of encouraging business to replace worn and obsolete assets. Consequently, we oppose elimination of the capital gains provision as provided in section 14. Upon enactment by Congress of provisions permitting adequate flexibility to management in depreciating assets, elimination of the capital gains feature would be a logical step.

TAX TREATMENT OF COOPERATIVES AND PATRONS—SECTION 17

We have consistently urged that cooperatives should be subject to Federal income taxes similar to those imposed upon private enterprises. Otherwise, the private taxpaying competitor will surely be destroyed and the Treasury loses not only the revenue it should have from the cooperative enterprise, but also revenues it previously collected from the taxpaying competitior.

Under section 17 it is intended to collect one tax upon cooperative income. Unfortunately, by implying consent of the patron to assume the tax on paper allocations from a general bylaw and notice, it is very doubtful whether it will effectively provide a single tax. No one will know whether it really does until after litigation. Unless the bylaw consent provision is to be eliminated, the bill should be amended to provide that the cooperative, as a related taxpayer, should remain liable for tax upon any paper patronage dividends determined to be nontaxable to the patron. We do not like the callous tax-the-patron approach but, if it is to be followed, it is questionable legislative practice to reenact a loophole clearly pointed out by prior court decisions.

WITHHOLDING OF TAX ON INTEREST AND DIVIDENDS—SECTION 19

We oppose this section. Its provisions would add considerable complexity, confusion, and cost to both the taxpayers and the Treasury

in the administration of the tax laws, and with questionable amounts of net additional revenues to result therefrom. Operation of automatic data processing by Internal Revenue Service within a few years should minimize such tax evasion as is now believed existent.

REPEAL OF DIVIDEND CREDIT AND EXCLUSION—TREASURY PROPOSAL

The House Ways and Means Committee and the House did not see fit to include in H.R. 10650 the administration's proposal that the 4 percent dividend credit and the $50 dividend exclusion be repealed. Secretary Dillon, however, has again urged such action by your committee.

In the light of the basic argument offered by the administration on behalf of the investment credit—to accelerate capital investment and economic growth—the proposal to repeal the modest relief now available to investors from double taxation of dividends is completely illogical. We certainly agree in the need to accelerate economic growth but it does not make sense to us to penalize an important source of capital formation in seeking the objective. Instead of being repealed, the dividend credit should be enlarged at the earliest practicable date. This would be a positive move to encourage more investments in equity capital which is a basic source of economic growth.

The following organizations have subscribed to this statement:

Alabama State Chamber of Commerce.
Arkansas State Chamber of Commerce.
Colorado State Chamber of Commerce.
Connecticut State Chamber of Commerce.
Delaware State Chamber of Commerce.
Florida State Chamber of Commerce.

The Florida State Chamber of Commerce desires to be recorded as abstaining from the recommendations in this statement with respect to taxation of cooperatives and patrons.

Georgia State Chamber of Commerce.
Idaho State Chamber of Commerce.
Indiana State Chamber of Commerce.
Kansas State Chamber of Commerce.
Kentucky State Chamber of Commerce.
Maine State Chamber of Commerce.
Michigan State Chamber of Commerce.
Missouri State Chamber of Commerce.[1]

[1] The Missouri State Chamber of Commerce desires to be recorded as believing that the Revenue Act of 1962, H.R. 10650, contains some very good provisions; therefore, it does not want to be interpreted as wanting to see this bill killed. Rather, it is endorsing a statement which makes suggestions for improving the bill. It also desires to be recorded on three sections of the bill as follows:

"(1) *Investment tax credit.*—While we very strongly support depreciation reform and feel that this is a basic need for a sound tax system, we are not opposed to the investment tax credit per se.

"(2) *Legislative expenses.*—We believe that sec. 3 of this bill is a very important part of the bill that can make a major contribution to successful operation of our democratic institutions. While we strongly endorse Mr. Connolly's suggestion that this section could be materially improved by the substitution of the language of S. 467 (by Hartke and Kerr) or H.R. 640 (by Boggs), we believe that sec. 3 constitutes more than a move in the right direction, but rather would make a real contribution toward solving basic phases of this problem.

"(3) *Tax treatment of cooperatives.*—Sec. 17 is a step in the right direction, but we are certainly hopeful that the Senate will see fit to strengthen this provision by going just as far as is feasible toward equalizing the unfair competitive situation that cooperatives now have over their private enterprise competitors."

Montana Chamber of Commerce.

New Jersey State Chamber of Commerce.

Empire State Chamber of Commerce (New York).

The Empire State Chamber of Commerce desires to be recorded as having no position with respect to the investment tax credit, the tax treatment of cooperatives, and tax withholding on interest and dividends.

Ohio Chamber of Commerce.

The Ohio Chamber of Commerce desires to be recorded as endorsing the investment tax credit provisions of the bill.

Oklahoma State Chamber of Commerce.

Pennsylvania State Chamber of Commerce.

The Pennsylvania State Chamber of Commerce desires to be recorded as not being opposed to section 11 of the bill which provides for the gross-up into a domestic corporation's income of foreign taxes paid.

South Carolina State Chamber of Commerce.

The South Carolina State Chamber of Commerce desires to be recorded as having taken no position with respect to sections 11 and 13 of the bill dealing with foreign income.

Greater South Dakota Association.

East Texas Chamber of Commerce.

South Texas Chamber of Commerce.

West Texas Chamber of Commerce.

Lower Rio Grande Valley Chamber of Commerce (Texas).

West Virginia Chamber of Commerce.

Wisconsin State Chamber of Commerce.

While the Mississippi State Chamber of Commerce has no policy position with respect to H.R. 10650, it would urge Congress to enact the Herlong-Baker tax revision bill, H.R. 2030 and H.R. 2031, and the Boggs legislative expenditures bill, H.R. 640.

One other State chamber of commerce in the council—Virginia—did not have an opportunity to consider this statement prior to its presentation.

I thank you.

The CHAIRMAN. Mr. Connolly, I am interested in your discussion of the investment tax credit.

I think you have made an excellent argument in opposition to it——

Mr. CONNOLLY. Thank you.

The CHAIRMAN. With which I fully agree, and I note you close your statement by calling it a subsidy. We have had quite an argument among the members of the committee as to whether it was a subsidy or not. I contend it is a subsidy, and I think you say in your statement that it is a subsidy.

Mr. CONNOLLY. I think we agree, Mr. Chairman.

The CHAIRMAN. I think you have made a very clear statement of the reasons why the tax credit section should be eliminated from the bill and I agree with it. I want to congratulate you on your views.

Mr. CONNOLLY. I am sorry, I did not hear that.

The CHAIRMAN. I say I think you have made an excellent argument, one of the best that has been made before the committee for the deletion and defeat of the tax credit provision in the bill.

You are opposed to tax credit, aren't you?

Mr. CONNOLLY. That is correct.

The credit for the statement on the investment credit is not due to me; it is due to the members of our committee and our executive director, Mr. Eugene Rinta.

The CHAIRMAN. I just want to commend you for it because the chairman is opposed to the tax credit.

So I am in agreement with you. And I want to thank you. I have read your statement hastily but I think it is an excellent presentation for the defeat of the tax credit in the bill.

Mr. CONNOLLY. Thank you, Mr. Chairman.

As I say, the credit for the statement is due to our committee and Mr. Rinta.

The CHAIRMAN. I am glad you called it a subsidy because that is what it is.

Some members of the committee take issue with the chairman when he calls it a subsidy.

Senator Williams?

Senator WILLIAMS. No questions.

I just merely join the chairman in congratulating you on the statement and in fact that you are opposing this subsidy.

Mr. CONNOLLY. Thank you, Senator.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Connolly, there is at least one member of this committee that would like to write some accelerated depreciation that I think we need in this country.

I would appreciate very much if you could come up with some language that would be helpful to me, and I am sure to other members of this committee on that.

Mr. CONNOLLY. Are you talking, Senator, about reform in our present depreciation policies?

Senator CARLSON. Well, I want to make the changes that I think are essential if our industry is to modernize and to be able to meet competition in foreign countries, and I would like to participate in writing that type of legislation that I would call accelerated depreciation that is needed, I think, and I would sure appreciate some language along that line.

The CHAIRMAN. I think the witness deals with that in his statement.

Senator CARLSON. I hadn't caught that. If he has, why, that is all right.

The CHAIRMAN. There is one statement that I do not agree with.

You said what the administration apparently is seeking through the investment credit is a quick stimulant rather than a long-term solution to the problem of obsolescence.

I don't think it is intended to be temporary. If this is adopted, it will be a continuing tax credit throughout the years, and the staff of the committee has estimated that the cost of the first year would be $1,400 million and in 10 years that increases to more than $2 billion a year.

So, I don't think if it is adopted it is going to be a temporary expedient.

Mr. CONNOLLY. The chairman may be correct.

But the history of investment credit provisions in foreign countries seems to be temporary. They start out to make the credit permanent but soon abandon it.

The CHAIRMAN. Well, it is intended to be permanent, I am confident of that.

When you start a subsidy, it is hard to stop it. We don't stop subsidies. We have a number of subsidies now and I don't know of any that have been stopped. To the contrary they have been increased year by year.

Mr. CONNOLLY. I might say that our committee is opposed to it, whether it is for 1 year or a thousand.

[Laughter.]

Senator WILLIAMS. It is my understanding, Mr. Connolly, that you feel that liberalization of the present depreciation rates would be in order but that it should be done in the framework of existing law by more rapid acceleration of depreciation rates.

Mr. CONNOLLY. Section 179 of the code, I think it was put in by the Small Business Act, permits a 20-percent additional depreciation to be written off in the year of acquisition, but it is limited to $10,000. We say if something has to be done immediately, some kind of a stimulant granted, then the limitation should be removed, and a complete overhauling of our depreciation rates should be done later.

Senator WILLIAMS. That was my understanding. But all of that would be done under the framework of a formula where the amount of the writeoff over the period of years would be limited to 100 percent of the cost.

Mr. CONNOLLY. That is correct.

Senator WILLIAMS. Yes.

Mr. CONNOLLY. In no case is the additional and regular depreciation allowed more than 100 percent of the cost.

Senator WILLIAMS. Thank you.

The CHAIRMAN. Thank you very much, Mr. Connolly.

Senator CARLSON. Mr. Connolly, before you leave I believe you stated in your testimony this morning that you thought the foreign tax, the taxation of foreign income provisions or section of this bill had not been thought through and it ought to be referred to a committee for further study, isn't that correct?

Mr. CONNOLLY. The Joint Committee on Internal Revenue Taxation and the Foreign Relations Committee.

Senator CARLSON. That is all, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Connolly.

The next witness is Mr. Paul D. Seghers, Institute on U.S. Taxation of Foreign Income.

Will you come forward and take a seat, please?

STATEMENT OF PAUL D. SEGHERS, PRESIDENT, INSTITUTE ON U.S. TAXATION OF FOREIGN INCOME, INC.

Mr. SEGHERS. Mr. Chairman, my name is Paul D. Seghers, and I am a practicing attorney in New York City.

My appearance today here is on behalf of the Institute of U.S. Taxation of Foreign Income of which I am president. I also speak on behalf of the New York Board of Trade's international section, of which I am counsel.

In view of the limited time allotted my oral testimony I will only stress a few points of major significance and I request that our written statement which has been filed with the committee be made a part of the record.

The CHAIRMAN. Without objection, it will be made a part of the record following your oral presentation.

Mr. SEGHERS. First as to the proposed amendment of section 482.

We are heartily in agreement with the objective of this proposal. We believe, however, this objective could best be attained by the Treasury making use of the great powers it already has under section 482 in conjunction with the additional information it is able to obtain under the new section 6038 which goes into effect this year.

We believe that the suggestions in the proposed revision to proposed section 482 with regard to fixing of prices of intercompany sales would, in practice, cause great difficulty; no matter what is said or intended, in all cases of intercompany sales involving a foreign corporation, no revenue agent would be satisfied that prices were at arm's length until he had checked the results by comparison with the application of his concept of the new provisions of section 482.

I say his concept, because some time would elapse before there would be regulations for his guidance for this section.

The existing section 482 never had any regulations under it until very recently. There were no real regulations until those that have just been issued. And until such time as the regulations were issued—and you must remember that under the 1954 code some regulations haven't yet been issued—it would be a matter of interpretation by the individual agent, and if his idea of the formula would produce more taxes, then the taxpayer would have to contest that.

The proposed addition to section 482 would cause a great deal of uncertainty and difficulty.

In the past, the test has been: "What is the fair price?" Neither the law nor the regulations attempted to prescribe a formula.

This bill likewise prescribes no formula, although it does mention a number of suggested factors and a few rules regarding it. The only positive rule for pricing is that the assets to be taken as a factor in any computation shall not include inventories or intangible assets, which term includes accounts receivable from customers abroad.

We think that is a mistake. But the principal point is that legislation regarding a method of fixing the prices of goods in sales between related parties should not be enacted until the Treasury has given a fair trial to the powers it now has under the existing sections 482 and 6038 and has acquired some practical experience in this field.

TAX NEUTRALITY

Before going further it might be helpful to attempt to clarify two points on which I fear there is basic misunderstanding.

First of all, it is constantly being said that income earned abroad by a foreign corporation should be taxed at as high a rate as income earned in the United States by a U.S. corporation.

Is that true?

Why should a foreign corporation pay as much for the privilege of earning income abroad as a U.S. corporation pays for the privilege of earning income in the United States?

Is it not worth something to be a resident of the United States? Who grants the foreign corporation the privilege of earning its income abroad? It is not the United States, that is certain. Is it worth something to be able to operate in the United States and make money here?

Don't our taxes buy something for us here in the United States?

Then why should foreign corporations pay as much U.S. taxes for the privilege of earning income abroad as a U.S. corporation pays for the privilege it enjoys here when earning income here?

It must be kept in mind that our tax on corporation income is only a privilege tax. The same income, or what is left of it after that privilege tax, is taxed again when it is received by any stockholder. This is recognized in the bill. U.S. individuals owning shares in a foreign corporation would not be subject to our corporate privilege tax if they choose not to avail themselves of the form of a U.S. corporation to own the foreign shares.

Why, then, should the income earned and retained abroad by a foreign corporation be taxed by us at as high a rate as income earned by a U.S. corporation earned here in this country where it is free to enjoy all of the benefits its tax dollars pay for?

Has not the owner of foreign shares the right to cry out that "taxation without benefit is tyranny"?

Until that money is brought home, what is the benefit for which those taxes are being proposed to be levied, until there is some U.S. taxpayer who has received some benefit?

BRICK AND MORTAR

The next point with respect to which there has been the greatest amount of incomplete reasoning has to do with investments abroad of income earned abroad. It is said that the money so invested never will be repatriated. I am replying to the charge that we will never get the benefit of that money, either as a contribution to our international balance-of-payments position or for the purpose of income tax, unless this bill is passed.

This is incomplete reasoning. Let us stop and think this out. When a U.S. company takes its shareholders' money and builds a plant with it, it will never get that money back—unless the plant is disposed of. But no one says the shareholders or the Government is thereby cheated. We know that the businessmen who have planned and decided upon that investment expect to get back many times its cost through its use, and the income it will produce, and that is what happens in all but a few instances.

Now, what about the investment in foreign brick and mortar? Are not the same principles applicable? Unless the plant is sold the money spent for it will not come home but the purpose of all business is to make money for its owners. They do not wickedly accumulate all profit abroad just for the pleasure of not paying U.S. taxes.

They expect to and in the aggregate they do bring home for their shareholders far more money than has been invested in that brick and mortar and pay it out to their shareholders as dividends.

Therefore, in the sense that it is being used it is not true to say that the profits earned abroad and put into brick and mortar will never be received here or taxed. They will come home and they will be taxed.

Decisions in matters of this kind must be made in the light of ordinary human experience and not abstract theory or trick phrases.

THE PROPOSED TAX ON THE ANNUAL INCREMENT IN THE VALUE OF SHARES IN CONTROLLED FOREIGN CORPORATIONS

Now we get to the principal issue. The proposal to tax U.S. owners of shares of a foreign corporation on the income it earns abroad before they receive that income.

What would be the effect of that tax?

It would make it almost impossible for American enterprises to do business abroad. This proposal not only runs counter to our foreign economic policy but will also establish a monstrous precedent. Although a stockholder in a business doing business at home pays no tax except on dividends as received, American shareholders in a foreign corporation would be required to pay a tax immediately upon income earned by the company, even though they had received no income whatever from it.

Those earnings upon which stockholders were taxed would still be subject to the risks of the business and might never be paid out to them.

We would have established a clear statutory precedent for ignoring corporate entities and taxing shareholders directly for the earnings of a business rather than taxing the dividends they received.

Having so condemned this monstrous proposal, what more shall I say? The record speaks for itself. Many scores of businessmen, many thousands of pages of testimony, many thousands and hundreds, even hundreds of thousands of businessmen represented by their associations have opposed these proposals, which are quite different from those tentatively adopted and announced by the Ways and Means Committee on February 1.

The Senate Finance Committee will, we are certain, act wisely and fairly in judging the cause, not the cause of certain taxpayers but of our foreign trade.

Government could not exist without the revenue it collects from business and whatever hurts our business hurts Government as well as the Treasury. What is more vital than the cause of our position in the free world, which can remain free only if we can remain strong and united? We are convinced our strongest ties with our neighbors in the free world are created by U.S. business abroad rather than by Government gifts.

May I stress here that this bill embodies a radically new and untried theory devised by the Treasury for taxing U.S. taxpayers on amounts which are not their income, that they did not earn, have not received and may never receive. This is the tax on the annual increment in value of shares of a foreign corporation, to be collected in advance of the taxpayer's realization of any income, a tax which Congress does not have authority under the Constitution to levy in the form of an income tax.

The changes proposed by the Treasury in basic principles of taxation in effect for the past 40 years are not justified by the use of catch phrases. Expressions such as "abolishing the privilege of tax deferral," or "doing away with interest-free loans," do not justify taxing in advance income that has not been received or realized by the taxpayer.

Criticisms of "artificial incentives" and "tax privileges" do not explain why the Treasury has made no proposal to repeal any provisions of the Internal Revenue Code which grant such privileges.

There is a great deal of talk about taking away the privileges, but no one has suggested any repeal of any provision. The truth is that there are no such provisions to repeal. The statement that such tax legislation was enacted at the time of the Marshall plan to encourage U.S. business to help in the reconstruction of Western Europe is a myth without foundation in fact. What the first of these Treasury proposals seeks to accomplish is not the repeal of tax privileges, but a hitherto unheard of extension of national sovereignty and jurisdiction to tax.

No other country claims authority to tax income earned by a foreign corporation beyond the borders of the taxing state and not received by any taxpayer subject to its jurisdiction.

It cannot be taken for granted in considering these innovations that every Congress since the inception of the income tax has been blind to the nature and effect of existing law in regard to U.S. taxation of foreign income.

It would seem that the Treasury has a heavy burden of proof to justify these proposed untried, radical changes in existing law, in the face of all the évidence regarding their effect presented at these hearings by U.S. businessmen whose experience and knowledge of business, both at home and abroad, entitle their testimony to be accorded great weight.

Finally, may I repeat the recommendation I have made many times over the years: That, instead of seeking to handicap U.S. business abroad, genuine help be given U.S. manufacturers producing goods for export. Why not a tax credit based upon the amount of income from the sale of such goods in export? This would pinpoint aid where it could do the most good in promoting exports and increasing factory employment here at home.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. I think I should pass, Mr. Chairman, because I was not here during the testimony of the witness.

Mr. SEGHERS. I regret, Senator, I won't have the pleasure of exchanging answers with you.

Senator DOUGLAS. I may return later. [Laughter.]

This may be only a pleasure deferred.

Mr. SEGHERS. Thank you.

Senator DOUGLAS. But I have nothing at the moment.

The CHAIRMAN. Senator Gore?

Senator GORE. No questions.

The CHAIRMAN. Senator Carlson?

Senator Curtis?

Mr. SEGHERS. I am sorry I didn't follow my statement, Senator Gore, perhaps you would have had questions prepared ready for me but I thought I should bring up some new points.

Senator DOUGLAS. Mr. Chairman, I don't want to let the witness depart without having him clear up some questions that are in my mind. [Laughter.]

Would you agree that the present arrangements on the taxation of subsidiaries of American corporations abroad amount to this: That their reinvested corporate earnings are not taxed whereas the reinvested corporate earnings of American corporations or of the parent companies and the partner companies are taxed?

Mr. SEGHER. I think the fact that they are owned by Americans is irrelevant. We cannot tax the foreign income of a foreign corporation. We should not discriminate, therefore, against the income of a foreign corporation that happens to be owned by Americans and discriminate in favor of one that is owned by foreigners.

Senator DOUGLAS. The reply is not responsive to my question.

I am not the expert that you are. But just a plain, blunt, rather stupid man, and I have to find these things out painfully, and I wanted to ask you whether the present system of taxation of subsidiaries of American corporations abroad amounts to their not being taxed on reinvested income whereas American corporations here at home are taxed on reinvested income?

Mr. SEGHERS. Senator, you were not here when I dealt with this problem.

Senator DOUGLAS. I think this question is appropriate. Would you clear that up? Am I wrong or am I right?

Mr. SEGHERS. Well, I don't agree that the income of a corporation should be taxed on its shareholders. You probably have shares of stock of American corporations and don't pay tax until you get the dividends.

Now, as for income earned under the American flag and obtaining the benefits of our American system certainly is getting some benefit from the enormous taxes being collected. Certainly, there is some benefit in operating here in the United States and that benefit is being paid for out of the profits of business earned here.

Senator DOUGLAS. Mr. Seghers, I want to say in all kindness, I don't think you are responding to my question.

Mr. SEGHERS. I am not going to answer what you want me to say.

Senator DOUGLAS. What?

Mr. SEGHERS. Pardon me. I am not going to say "Yes" to a question which I don't think properly states the problem.

The problem is this: Should we tax stockholders on income they haven't received from their corporation?

Senator DOUGLAS. At the moment I am not going into the question as to whether we should or should not. I merely am going into a question of fact as to whether the existing law taxes corporations here at home on their earnings prior to reinvestment and, therefore, taxes amounts reinvested whereas abroad it will tax earnings only as they come back to this country, but earnings of the subsidiaries reinvested are not taxed.

There is just a question of the existing law. Not on the question as to whether the existing law should continue or should be changed. But I am simply trying to find out what the existing law is.

Mr. SEGHERS. Well, the existing law is we have no authority to tax corporations that are not organized under the laws of this country, that do not earn their income here. You are correct in that.

Senator DOUGLAS. Well, then, is the answer "Yes" to my question?

Mr. SEGHERS. I cannot answer a question of that kind simply, "Yes." I have to get the facts. By labeling it a subsidiary you are saying in effect that a foreign corporation is and should be taxed differently depending on whether it is owned by foreigners or Americans.

Senator DOUGLAS. I am not going into the question as to whether the present tax system should not continue. I am trying to find out what the present tax system is. I hope I am trying to find it out courteously even though I notice there may be irritation in my voice at times. If so, I can eliminate it.

May I again ask: You understand the question?

Mr. SEGHERS. I would rather have it repeated if it is a yes-or-no question. [Laughter.]

Senator DOUGLAS. All right. Let me start simply. Is it true in the United States the corporate profits tax applies on net earnings after operating costs and interest on bonds have been met but before earnings have been reinvested, is that true?

Mr. SEGHERS. Yes.

Senator DOUGLAS. All right.

Is it true that subsidiaries of American corporations abroad are taxed only when the profits are returned to the United States, yes or no?

Mr. SEGHERS. I will rephrase the question by saying all foreign corporations in place of subsidiaries.

Senator DOUGLAS. Including American subsidiaries?

Mr. SEGHERS. Yes, including foreign subsidiaries of American companies.

Senator DOUGLAS. Good.

Is it true if a subsidiary of an American corporation reinvests some of its earnings abroad that those earnings are not taxed prior to reinvestment, is that correct?

Mr. SEGHERS. I would rephrase that by saying no income of a foreign corporation is taxed until it is received by someone subject to the jurisdiction of the United States.

Senator DOUGLAS. Including no earnings of an American subsidiary?

Mr. SEGHERS. Right, as to any foreign corporation, whether or not a subsidiary.

Senator DOUGLAS. That has been a long way around, but this is my understanding.

Senator WILLIAMS. Will the Senator yield? I wanted one further question for clarification on that point: Did not these foreign corporations and the foreign subsidiaries of American corporations which are doing business abroad pay taxes in the respective countries in which they are operating prior to any reinvestment?

Mr. SEGHERS. The answer to that is emphatically yes.

Senator WILLIAMS. So there is a tax paid in all instances, as I understand it, prior to reinvestment whether it be in this country or abroad?

Mr. SEGHERS. Correct.

Senator WILLIAMS. Either paid in this country at domestic rates or paid in foreign countries at the rate of the respective countries involved.

Mr. SEGHERS. Yes, plus two additional taxes when it is brought home as a dividend.

Senator WILLIAMS. Yes, that is right.

Mr. SEGHERS. The United States first taxes the corporation and then when the money is received by the stockholders it is taxed again so there are three taxes on foreign income: two by the United States and one by the foreign government.

Senator WILLIAMS. But the second and third tax comes only after it is returned to this country.

Mr. SEGHERS. Yes, in the same way we are now taxing foreign dividends only when they are paid to the shareholders.

Senator DOUGLAS. Is the Senator from Delaware through?

Senator WILLIAMS. Yes.

Senator DOUGLAS. Suppose you have a corporation, corporation A, and it bases its decision on whether it will reinvest earnings at home or set up a subsidiary and operate abroad; does it not follow, therefore, that it will be taxed more heavily on each million dollars of savings or earnings here at home than on each million dollars of earnings abroad?

Mr. SEGHERS. No foreign corporation is taxed on earnings abroad. Therefore, you are comparing zero with a tax.

Senator DOUGLAS. Mr. Seghers, you are a very astute New York attorney.

Mr. SEGHERS. Thank you.

Senator DOUGLAS. But I want to ask you this question: Suppose you have a corporation in the United States, and for the sake of anonymity we will just call it corporation A, and it is deciding whether it will expand operations here out of net earnings or whether it will go abroad and engage in business there.

Now, if it goes abroad and reinvests part of its earnings, it does not have to pay any American tax. If it stays at home it will have to pay the tax. Therefore, is there not a price advantage to this American company to reinvest abroad rather than to reinvest at home?

Is not that true?

Mr. SEGHERS. No. The fact is that it will pay tax on all the income that it makes, whether at home or abroad.

Senator DOUGLAS. Well, now, wait a minute.

Mr. SEGHERS. That is correct.

Senator DOUGLAS. The subsidiary is in effect a——

Mr. SEGHERS. No, that is not so. If you own shares in United States Steel——

Senator DOUGLAS. You are adopting Daniel Webster's idea of the corporation being invisible and intangible and existing only in the contemplation of the law.

I was not present when the Pfizer people testified yesterday, but do you mean the Pfizer people are different from the Pfizer people of

Panama or the Pfizer people of Panama are different from the Pfizer people of the United States?

Mr. SEGHERS. Most certainly they are. It is an entirely separate organization.

Senator DOUGLAS. Well, aren't you entranced by your own legal subtleties in this matter?

Mr. SEGHERS. No, I happen to know the facts in that case.

Senator DOUGLAS. What?

Mr. SEGHERS. I happen to know the facts in that case.

Senator DOUGLAS. I am not going to argue the Pfizer case because it so happens I was not present at the very able cross-examination which the Senator from Tennessee gave yesterday.

But what you are saying was in effect that an American corporation by setting up a subsidiary abroad can divorce itself from all connections with that subsidiary?

Mr. SEGHERS. No, there is not reason to say that. If it sets up an American subsidiary it pays no tax on the income of the American subsidiary until it receives a dividend.

Senator DOUGLAS. But the subsidiary will pay taxes on its reinvested capital.

Mr. SEGHERS. But why? Because those earnings are earned in the United States where it is getting the benefit of U.S. taxation. The foreign corporation, I don't care who owns it, that earns its money abroad is not earning it under the protection and with the benefit of the U.S. Government.

There is your difference.

Senator DOUGLAS. Well, now, just a minute.

Will not the subsidiary abroad obtain the diplomatic protection of the United States?

Mr. SEGHERS. No.

Senator DOUGLAS. It will not?

Mr. SEGHERS. What protection? Will you tell me of some protection in Cuba, in Brazil?

Senator DOUGLAS. What about Germany?

Mr. SEGHERS. Pardon me?

Senator DOUGLAS. Or England.

Doesn't it have some really diplomatic protection?

Mr. SEGHERS. I haven't heard of any.

Senator DOUGLAS. You haven't heard of any?

Mr. SEGHERS. No, and I have been denying it for some time in public and I would like to be shown where protection has been afforded to the property of a foreign corporation operating in a foreign country.

Senator DOUGLAS. Since the Arabian-American Oil Co. does not——

Mr. SEGHERS. Are those foreign corporations?

Senator DOUGLAS. No, I guess they are not; that is right.

Mr. SEGHERS. Well, that is the difference, and why do they operate abroad as an American corporation?

Senator DOUGLAS. Well, they operate abroad as an American corporation in order to credit the 50-percent royalty as a tax and thus escape American taxation.

Mr. SEGHERS. Senator, I am sorry to have to correct you on that, but it is not necessary to be an American corporation to get the benefit of that foreign tax credit. We have that system——

Senator DOUGLAS. Like the grace of God it shines on all—foreigners and all?

Mr. SEGHERS Yes, we get it.

Senator DOUGLAS. Well now, I would like to see you get your fee on this matter so——

Mr. SEGHERS. My greatest fee is satisfaction.

Senator DOUGLAS. If I ask you another question you will even more abundantly earn your fee.

The fact that an American corporation by setting up a subsidiary abroad will not have to pay as large taxes on its earnings abroad as it would on its earnings at home will naturally encourage it to invest abroad.

Therefore, by a tax system we encourage investment abroad rather than investments at home. And I had always thought that one of the basic principles of taxation was that it should be neutral as between different types of business activity, unless, there is a controlling public purpose to induce this.

Is there any such controlling public purpose in Western Europe? I think you are quite right in saying this was originally not designed to further the Marshall plan but it has been kept in existence in part because of the argument that it did contribute to the upbuilding of Western Europe and hasn't that justification for its continuance largely ceased in view of the tremendous economic progress which Western Europe is making?

Mr. SEGHERS. We have had this law over 40 years.

Senator DOUGLAS. Yes.

Mr. SEGHERS. There never has been any attack of this kind on it until the present, until November 1960. There was really no attack on this type of corporation.

Senator DOUGLAS. You mean the Government didn't know about it?

Mr. SEGHERS. The Government was fully aware of it.

Senator DOUGLAS. Why did they not push it? They wanted revenue.

Mr. SEGHERS. Because the policy of the United States was to encourage expansion abroad.

Senator DOUGLAS. Well, that is exactly so.

Mr. SEGHERS. And it has brought home—to encourage expansion, because it brings home more money than it puts out.

Senator DOUGLAS. Ultimately, but not immediately; not immediately?

Mr. SEGHERS. If you build a plant, it may take you a year or two before the income comes in.

Senator DOUGLAS. But immediately——

Mr. SEGHERS. What has that to do with the question—"not immediately"?

Senator DOUGLAS. It has a great deal to do with it—excuse me.

Mr. SEGHERS. Pardon me, sir.

Senator DOUGLAS. It has a great deal to do with it, sir, because one of the immediate problems that we face is an unfavorable balance of payments, which has resulted in a gold outflow.

Mr. SEGHERS. That is a slogan, but it is doubtful that it is correct.

Senator DOUGLAS. It is; it is a reality.

Mr. SEGHERS. It is doubtful if that is correct.

Senator DOUGLAS. You mean there is no outflow of gold?

We have lost $4 billion in gold in the last few years.

Mr. SEGHERS. But business has brought in a surplus. The deficit comes from foreign aid and——

Senator DOUGLAS. On past investments; on investments which go back to 1900.

Mr. SEGHERS. Investments even over a short period show a great increase and inflow of surplus income over outgo. Even over a period of 10 years.

Senator DOUGLAS. The Senator from Tennessee punctured that yesterday.

Mr. SEGHERS. Punctured what? No one has punctured. I saw no puncture. I perceived none.

Senator DOUGLAS. Your automobile may be going down the street but the international auto or the international chamber of commerce is not going down the street because its tires were punctured yesterday.

Mr. SEGHERS. Well, I did not see the puncture.

The thing about the balance of payments is that you are speaking as though a farmer is improvident because he buys seed. If he did not buy the seed, he would have more money in the bank that year.

Now, the payout period for foreign investment is very rapid. That is one of the business inducements to going abroad. You go abroad for the same reason that you expand in this country—to make money.

Senator DOUGLAS. The payout in the underdeveloped countries may be rather brief, but the payout in Europe, because the interest and profit rates are lower, is not brief.

I do not want to take up any more time because my humble position on this committee does not justify my consuming so much time, but I would like to state very briefly again that the general presumption on which the tax system is based is that it should be neutral as between different types of expenses.

Mr. SEGHERS. I agree with you.

Senator DOUGLAS. This is not neutral. It favors foreign investments over domestic investments.

Mr. SEGHERS. We do not.

Senator DOUGLAS. Well, I will be finished in just a minute.

Mr. SEGHERS. A foreign corporation that is making money, the shareholder pays his tax when he gets the dividends. If he invests in American business here at home, he pays the tax when he gets the dividends. The principle is still the same.

If you say that we should tax a foreign corporation on income earned abroad before any income is received by any taxpayer subject to the U.S. jurisdiction, I would say that is basically unfair; not the question of who owns it, but the question of where is the income earned.

What benefit does a foreign corporation obtain while it is earning that money abroad—from the U.S. Government?

It obtains benefits in the country where it operates. It makes the money there and it pays its tax there.

Senator DOUGLAS. But it diverts invested capital from the U.S. temporarily.

Mr. SEGHERS. I think that if you followed Mr. Ruttenberg's AFL–CIO testimony, you will see that it starts out by saying that there are many basic misconceptions about this balance-of-payments situation.

That there is no lack of capital here at home for all the expansion that is desired.

That we actually have excess capacity.

If that is so——

Senator DOUGLAS. You are not in favor of the investment credit then?

Mr. SEGHERS. I am not in favor of the investment credit; no, sir.

Senator DOUGLAS. Mr. Chairman, who is in favor of investment credit?

The CHAIRMAN. I do not know.

Mr. SEGHERS. How did it get in here?

Senator DOUGLAS. Mr. Seghers, let me complete what I have to say.

I made a statement with which you agreed in theory that the presumption is against a tax system which favors one type of expenditure rather than another, or one type of investment as compared to another.

The second part was going to be that this should only be overridden if there is such a compelling public interest as to make the judgments of the marketplace inaccurate from the standpoint of the public welfare.

Now, the third point I was going to make was that I see no such argument at the present time so far as investments in Western Europe are concerned, because Western Europe is now on its feet and no longer needs to be built up. That one argument that might have been advanced for the continuance of this system no longer exists.

On the contrary, the immediate problem which we face is an unfavorable balance of payments, which puts our gold supply in jeopardy, and, therefore, this is a case in which the public presumption at the moment reinforces the economic and fiscal considerations, and, therefore, strengthens the argument for nondiscriminations in favor of foreign investment. That is my point of view as of this moment.

A great many of my friends are very anxious to talk to me and convince me of the error of my ways, and I dare say that I will increase their feelings very much by talking to them, but this is my opinion as of this moment.

Mr. SEGHERS. I disagree somewhat with the latter part of your statement.

But the main difficulty is that it is founded on a mere catchword without a logical basis.

You speak of equal treatment. I agree with you, there should be equal treatment of income earned within the jurisdiction of the United States. Now, if the income is earned outside of the jurisdiction of the United States by a corporation which is not subject to the jurisdiction of the United States, where should the United States complain, since no U.S. person can receive any benefit from that income without becoming liable for the tax at the full rate?

Senator DOUGLAS. You talk about equal treatment; I say, "Yes, equal treatment."

Here you have a million dollars. It can either go into investments at home or create a subsidiary abroad.

Under the present tax system the inducement is all to go abroad insofar as taxes are concerned.

If there are comparative earnings, I would say, "Yes, that is fine; those are legitimate considerations."

Mr. SEGHERS. Are you saying the United States gives no benefits to a corporation that earns its money here?

Are you saying that a corporation that earns its income here obtains no benefit from the U.S. Government, Senator?

Senator DOUGLAS. I hope you mean that.

Mr. SEGHERS. Then should it not pay its tax when it earns the income here?

Senator DOUGLAS. Yes.

Mr. SEGHERS. And does a foreign corporation get any benefit from the U.S. Government when it earns its income abroad?

Senator DOUGLAS. Even though the dollars originally came from the United States.

Mr. SEGHERS. Do you tax a stockholder here because he used U.S. dollars to buy shares?

Senator DOUGLAS. I did not hear that.

Mr. SEGHERS. Do you tax a U.S. citizen on the income of a corporation because he had bought its shares? Should there be any different principle?

If he buys the shares of a domestic corporation, American Tel & Tel——

Senator DOUGLAS. I am speaking of subsidiaries; I am speaking of subsidiaries.

Mr. SEGHERS. But by saying "subsidiaries," you do not change the fact—it is still another corporation. It is a different corporation and earning money in a different place. We do not tax——

Senator DOUGLAS. Can you tell me if it is true that General Motors has a subsidiary in Germany and Ford operates under its own name, or is it the reverse?

Mr. SEGHERS. I did not tell you about either of those companies.

Senator DOUGLAS. But would you clarify my ignorance on that?

Mr. SEGHERS. I personally do not know. I only know by hearsay.

Senator DOUGLAS. Would Mr. Woodworth know on that question?

Mr. WOODWORTH. No.

Mr. SEGHERS. I happen to know in Brazil it operates as Ford do Brasil.

Senator DOUGLAS. It is a separate company?

Mr. SEGHERS. It is a subsidiary, yes, and it can use——

Senator DOUGLAS. Is there not a connection between Ford of Brazil and Ford of the United States?

Mr. SEGHERS. In that case, it was a separate corporation, and they paid a U.S. penalty tax on it, and it was a U.S. subsidiary even though it had the name "Ford do Brasil."

Senator DOUGLAS. So there is a connection?

Mr. SEGHERS. The U.S. corporation known as Ford do Brasil, operating in Brazil, paid a U.S. tax because it enjoyed the privilege of a U.S. charter.

Senator DOUGLAS. On reinvested earnings?
Mr. SEGHERS. On its earnings.
Senator DOUGLAS. On reinvested earnings, as well as distributed?
Mr. SEGHERS. We tax earnings, not reinvested earnings.
Senator DOUGLAS. That is right. Therefore, reinvested?
Mr. SEGHERS. We tax earnings whether they are reinvested or not.
Senator DOUGLAS. I think you will find that is right because there is no incorporation in Brazil.
Let me ask you this:
Opel is the subsidiary of General Motors—is it in Germany?
Mr. SEGHERS. That is what I am told.
Senator DOUGLAS. Yes, I think that is right. That is separately incorporated in Germany.
Mr. SEGHERS. I do not know.
Senator DOUGLAS. I think that is right. Let us assume it is separately incorporated.
Mr. SEGHERS. Yes.
Senator DOUGLAS. Do you deny there is any connection between Opel and General Motors?
Mr. SEGHERS. No.
I do not deny there is any connection between any stockholder and the corporation in which it owns shares.
Senator DOUGLAS. Well, is not Opel controlled by General Motors?
Mr. SEGHERS. Certainly.
Senator DOUGLAS. What?
Mr. SEGHERS. Yes.
Senator DOUGLAS. Exactly so. It is really a part of General Motors, is it not?
Mr. SEGHERS. Not any more than any corporation is a part of its shareholders. As a body, they own the corporation.
Senator DOUGLAS. Well, I would say that you are sponsoring the ghost theory of corporations.
Mr. SEGHERS. No, I am sponsoring, on the contrary, the reality, the reality of the fact that a corporation has only the privileges granted to it by its incorporating State and it may enjoy those in any jurisdiction where it is qualified to operate.
Senator DOUGLAS. And I am saying they are Siamese twins and have a mutually connecting system between them.
Mr. SEGHERS. Right. And when its blood flows, it will be taxed.
Senator DOUGLAS. Yes.
Mr. SEGHERS. More than half will be taken here.

Senator DOUGLAS. And when the blood flows out and when the second twin begins to grow, the nutrients of the second twin are not taxed, is that not true?

Mr. SEGHERS. Well, I am not a medical man. [Laughter.]

Senator DOUGLAS. Only when you choose to be.

That is all, Mr. Chairman.

Senator CURTIS. Mr. Chairman?

The CHAIRMAN. Senator Curtis.

Senator CURTIS. How about a situation where American investors invest in a foreign corporation that has no parent corporation in this country.

I have read in the papers that Phillips Lamp Co. is going to sell securities for some $400 million in this country. Will that affect the outflow of gold?

Mr. SEGHERS. Yes, it will; just as our companies abroad produce an inflow of gold to us, the other fellows' companies will produce an outflow.

Senator CURTIS. If this bill is passed, will the Phillips Co., removing $400 million from America to invest in their company—they operate in lands other than the United States—have an advantage over an American company that owns a subsidiary operating in the same country or countries?

Mr. SEGHERS. Yes, because the individual U.S. citizen will receive his dividends without having passed through and paid a 52 percent corporation rate, U.S. corporation tax.

Certainly this bill will be a very great boon to our foreign competitors in many different ways and you have only mentioned one of them.

Senator CURTIS. If the passing of this bill will cause the money to flow directly into shares of foreign corporations, rather than to an American parent, you would not only have inequality of taxation for American citizens, but you would have accentuated the balance-of-payments problem.

Mr. SEGHERS. I must congratulate you, Senator Curtis. You are ahead of the game. I expect people to wake up to some of these defects with a very sad morning-after headache, if it is passed.

I hope to God that enough Senators will be able to see the light before that damage is done to our economy.

Senator CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Seghers.

Mr. SEGHERS. Thank you, Mr. Chairman.

The CHAIRMAN. I am glad you appeared before us.

Mr. SEGHERS. Well, the biggest satisfaction is the few words I have exchanged with the two distinguished Senators.

(The complete prepared statement of Mr. Seghers is as follows:)

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PAUL D. SEGHERS
PRESIDENT

COMMITTEE ON FINANCE, U.S. SENATE
Hearings on H.R. 10650, the proposed "Revenue Act of 1962"
Statement filed by
Paul D. Seghers
(of Seghers & Reinhart, Attorneys, New York City)
President, INSTITUTE ON U.S. TAXATION OF FOREIGN INCOME, INC.

April 26, 1962

re: I - Proposal to tax the annual increment in value of shares of foreign corporations;

II - Proposal to grant additional authority to the Treasury to allocate to U.S. taxpayers an increased share of actual or estimated income arising out of sales to or purchases from related foreign corporations; and

III - Proposal to increase U.S. taxes on dividends received from foreign subsidiaries.

The pending tax bill embodies a radically new and untried theory devised by the Treasury for taxing U.S. taxpayers on amounts which are not their income, that they did not earn, have not received and may never receive. This is the tax on the annual increment in value of shares of a foreign corporation, to be collected in advance of the taxpayer's realization of any income -- a tax which Congress does not have authority, under the Constitution, to levy as an income tax.

The changes proposed by the Treasury in basic principles of taxation, in effect for the past 40 years, are not justified merely by the prolific use of clever slogans and catch phrases. Expressions such as "abolishing the privilege of tax deferral" and "doing away

with interest free loans," no matter how often repeated, do not justify taxing in advance income that has not been received or realized by the taxpayer.

Criticisms of "artificial incentives" and "tax privileges" do not explain why the Treasury has made no proposal to repeal any provisions of the Internal Revenue Code which grant such privileges. The truth is that there are no such provisions to repeal. The statement that such tax legislation was enacted at the time of the Marshall Plan, to encourage U.S. business to help in the reconstruction of Western Europe, is a myth, without foundation in fact.

What the first of these Treasury proposals seek to accomplish is not the repeal of tax privileges, but a hitherto unheard of extension of national soverignty and jurisdiction to tax. No other country claims authority to tax income earned by a foreign corporation beyond the borders of the taxing state and not received by any taxpayer subject to its jurisdiction.

The Treasury would get dangerously broad and unneeded additional authority under this bill to fix prices on all intercompany sales between related domestic and foreign corporations, and to estimate the amount of income from such sales and tax it, if not satisfied with the detailed information supplied regarding the income and operations of such corporations.

The Treasury also proposes to increase the amount of U.S. taxes payable on dividends received by U.S. corporations from foreign subsidiaries, the amount of the increase in tax bearing most heavily, in most instances, on dividends from subsidiaries in the less developed countries. This change in rules in effect for the past 40 years has been explained by the Treasury as a correction of legislative oversight.

It can not be taken for granted, in considering these innovations, that every Congress since the inception of the income tax has been blind to the nature and effect of existing law in regard to U.S. taxation of foreign income.

It would seem that the Treasury has a heavy burden of proof to justify these proposed untried, radical changes in existing law, especially in the face of all the evidence regarding their effect presented in these hearings by U.S. businessmen whose experience and knowledge of business, both at home and abroad, entitle their testimony to be accorded great weight.

The grounds advanced by the Treasury in support of these proposals are not their desirability as a means of raising revenue, which is the only justification for taking the property of citizens of a democracy under the doctrine of the right to tax. No, what

the Treasury advances in justification are a number of hoped-for objective which are not the proper purpose of a taxing statute. It is perhaps less serious that, in the majority view of those competent to judge the probable consequences of these Treasury proposals, they would not accomplish these objectives.

It is the purpose of the present statement to highlight (very briefly) facts and arguments that have been presented by both sides (the Treasury and business) regarding the most significant aspects of these proposals.

Part I

PROPOSAL TO TAX THE ANNUAL INCREMENT IN VALUE OF SHARES OF FOREIGN CORPORATIONS

What is proposed

Sec. 13 of H.R. 10650 would tax annually U.S. shareholders of certain foreign corporations on all or a part of the increase in the value of the shares of such corporations attributable to the undistributed income earned outside the United States by such a corporation, to the extent not currently invested by such corporation in certain prescribed property.

The fact that it is the increment in value of the shares owned by the taxpayer that is taxed, is confirmed by the proposed new I.R.C. Sec. 958, which provides for the addition of the amount so taxed to the statutory "basis" of the property so taxed. This evidences Treasury recognition that, having taxed this increment in value before it is realized, it should not be taxed again if and when the property is sold or exchanged.

Treasury's stated objectives of proposal

1) To help reduce the annual deficits in the United States international balance of payments.

2) To bring about "tax neutrality" [by taxing immediately undistributed income earned abroad by a foreign corporation at the same rate as income earned in the U.S. by a U.S. corporation]:

a) As a matter of abstract [i.e., theoretical] fairness, and

b) To divert U.S. capital from business abroad to use in the U.S. and thereby help employment here.

(NOTE: A somewhat contradictory objective is seen in the proposed exclusion of certain classes of such income from immediate tax if currently invested in "qualified property" in "less developed countries")

3) To take away from U.S.-owned foreign corporations the opportunity to effect tax savings /In foreign taxes/ through the use of corporations organized in "tax haven" countries, and

4) To prevent /unspecified/ tax abuses.

Treasury's arguments as to effect on our international balance of payments deficit and answers thereto

The present status of the Treasury's arguments is as follows:

a) The Treasury has admitted that, for the long pull, the present proposal would have an adverse effect on our balance of payments position, and

b) The Treasury has admitted that the figures it originally used to support its argument omitted factors which are favorable to the position presented by business.

c) The Treasury still argues that the outflow of cash from the United States as a result of U.S. business investments in Western Europe (and, apparently, Canada and (?) Japan) will, in the aggregate, exceed cash inflow resulting from such investments during the ensuing 10 to 15 years /The Treasury no longer argues for a minimum of 17 years, as it did last year/,

d) The Treasury still argues that our balance of payments deficits are so serious that we should enact this proposal regardless of any long-term adverse consequences,

e) The Treasury argues that the rate of annual cash inflow from U.S. business investment in Western Europe, etc. is lower than shown by business in its testimony, disagreeing both as to statistics and conclusions drawn therefrom, and

f) The Treasury argues that the present proposal would force immediate payment by foreign corporations of larger dividends to their U.S. parent companies and thereby help reduce our balance of payments deficits.

The answers of business to the foregoing have been presented in great detail to both the House Ways & Means Committee and to the Senate Finance Committee. Facts have been submitted as to overseas business operations of individual U.S. organizations; statistics of similar operations of groups of such companies having both domestic and overseas operations; and studies and analyses of statistics of overseas business operations of U.S.-owned companies, including special studies made by the Department of Commerce.

It would be a monumental task fully to summarize and document all the evidence already presented, including all the additional information yet to be presented during the course of the present hearings. It may be of some value, however, to highlight the impressions derived from the evidence and arguments already presented by business (including the reports of economists) regarding the arguments of the Treasury summarized above.

Since the Treasury admits that the proposal would, in the long run, have an adverse effect on our international balance of payments position, there is no difference of opinion in this regard.

It has been pointed out, however, that the Administration has given no indication how long it may be before overseas military expenditures and foreign aid cease to be the greatest factors in our overseas balance of payments deficits. Hence, it is not clear that the long-term view can safely be ignored. The increased cash inflow that would hereafter result from present business investment overseas may still be badly needed when it does become available.

There is a wide difference of opinion as to how long a period of time would elapse before a current reduction in U.S. business investment overseas (in those markets where the greatest opportunities for profits exist), would adversely affect our balance of payments, and the magnitude of such adverse effect.

Both sides can not possibly be correct in their conclusions as to the foregoing, and there is a striking difference as to the facts presented. The evidence seems convincing that the cash inflow from overseas business investment will exceed the outflow in a far shorter time than alleged by the Treasury. Aside from the statistics, this conclusion finds support in the fact that U.S. business makes these investments in the expectation of quicker payouts than

computed by the Treasury. Business must reach correct decisions in such matters or fail -- it can not make up deficits and errors of judgments by levying taxes.

The evidence likewise supports the view that business is correct in attributing a far larger portion of our exports of manufactured products to the effects of U.S. business investment abroad than the Treasury now admits (after having omitted this factor from its calculations last year). Finally, on this point, we have found nothing in the Treasury's statements that convinces us that it is correct in asserting that such exports are largely offset by imports of goods manufactured abroad by U.S. owned establishments.

We find unconvincing the Treasury's assertion (not backed up by any figures) that the very large amount of U.S. exports to U.S. owned subsidiaries in Western Europe, and exports generated by such subsidiaries, are largely offset by U.S. imports of goods manufactured there by U.S. owned subsidiaries.

To begin with, the amount of those imports is so small that it can not possibly offset such exports. The Department of Commerce study (of Undersecretary Gudeman, June 1961) shows imports (other than paper pulp and foodstuffs) from 80% of the U.S. owned manufacturing subsidiaries in Europe as follows:

1959	$208 million	--	125%	=	$260 million
1960	$ 90 "	--	125%	=	$113 "

These imports include (and are believed to consist largely of) automobile parts and automobiles. This confirmed by the corresponding decrease in the total (world-wide) passenger automobile imports (from both U.S. subsidiaries and foreign-owned producers -- assumed to be almost entirely from Europe) as follows:

1959	$735 million
1960	$513 million

The foregoing statistics show the very small amount of imports of products from manufacturing subsidiaries in Western Europe and the striking reduction (in 1960 as compared with 1959) in the amount of such imports and the corresponding reduction in total passenger automobile imports.

The figures as to automobile imports illustrates how serious is the competition from Western Europe, and how much more important it is to cope with that, than to attempt to stifle U.S. expansion in Europe, for fear that it competes with U.S. exports to that market.

If European competition can thus penetrate the market here, U.S. production and sale of goods abroad is not the real obstacle to sale of U.S. products abroad. In other words, although U.S. business can sell in Western Europe large quantities of the goods it produces there, no facts have been introduced by the Treasury to support a reasonable inference that, were it not for the competition of such U.S. establishments abroad, a substantial portion of such sales would be made by exporters of U.S. products.

The foregoing deals primarily with the Treasury's balance of payments arguments, but also is relevant to the "export of jobs" slogan discussed further below.

Conclusion as to balance of payments

There are only two points in the Treasury's arguments as to this objective with which we agree:

1) That the long-run effect of these proposals would be harmful to our balance of payments position (as income to the U.S. resulting directly and indirectly from U.S. business investments abroad would, at some time in the future, exceed the aggregate cash outflow) and

2) That, during the first few years, the income from each new business investment abroad will be less than the capital outlay. (This obvious fact was put forward by the Treasury as part of its rebuttal of the conclusions of witnesses regarding the effect of such business investments on our balance of payments position.)

We are left with the conclusion that the Treasury has not demonstrated that U.S. business investment abroad (world-wide or in Western Europe) has had or will have, in the aggregate, an unfavorable effect on our balance of payments.

Surely nothing has been adduced on this score sufficiently convincing to justify the proposed radical and untried change in our taxing system, in the face of what seems to us overwhelming evidence as to the actual economic results under the present system.

Tax Neutrality

The Treasury's next objective likewise is a new concept, with the oft-reiterated title of "tax neutrality."

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What the Treasury is advocating

The Treasury advances, as one of the motives for its proposal, the need for "tax neutrality."

This is the theory that, in the case of a foreign corporation 50% or more owned by U.S. persons, income earned by it abroad should be taxed currently to its U.S. shareholders at the same rate as if earned in the United States by a domestic (i.e., U.S.) corporation.

Comments on the Treasury's theory

This is very different from the basic principle that property or income of the same kind within the same country, state or municipality should be taxed substantially alike. A property-owner who can show that his property is assessed at more than his neighbors', in proportion to true value, may be entitled to relief on grounds of tax equality. However, no court would hear a plea that his property was unfairly assessed in relation to the value of property in another state or taxing jurisdiction.

Why should the income earned outside the United States by a foreign corporation be taxed at as high a rate as if earned by a corporation operating here in the United States, enjoying the protection of the flag and all the tax-paid benefits flowing to it from Washington?

The Treasury has not brought forth any arguments which convince us that this is a self-evident truth. Mere rephrasing of terms such as "tax neutrality," "tax equality," etc., do not convince. This is stressed, because the Treasury's arguments revolve to a large extent about its assumption that what it calls "tax neutrality" is so obviously fair as to need no justification. However, no one who hears and reads the statements of men experienced in international trade can doubt that they are convinced that all the circumstances surrounding the earnings of such income, including greater business risks and competition from traders of other nations which give genuine incentives to promote overseas business, would justify taxing such income at a far lower rate than is paid by a domestic corporation on its income earned right here at home.

That is the view of U.S. business men engaged in international trade. What does the U.S. business man engaged in business here at home think -- does *he* complain that it is unfair not to tax the income earned abroad by a U.S. owned foreign corporation at as high a rate, before it is brought home, as the income earned at home by his domestic corporation?

Despite all the unfavorable (and strikingly identical) publicity in the press regarding "loopholes" and "abuses" (including the sad but irrelevant story of the Venezuelan race track winner), no segment of U.S. business has, to our knowledge, expressed support for these proposals for legislating "tax neutrality."

Resentment of real, and more often fancied, competition from abroad does exist, and this resentment probably could be channeled into complaints about alleged tax unneutrality. However, this is not yet evident. What is resented is the competition, whether foreign owned or U.S. owned, and the U.S. business man is not interested in abstract theories of "tax neutrality" if they would not reduce that competition. And how could they? If a foreign-owned producer can sell his overseas products here, without bearing any U.S. tax burden on his overseas manufacturing income, how would it help the U.S. company suffering from this competition, for the U.S.-owned producer to be penalized in the name "tax neutrality"? It would not immediately cut off the supply from that source and, by the time that it was curtailed, the foreign-owned producer would gladly step into its place.

So -- domestic business has not, as a matter of fact, supported these proposals, and it can be shown that they would not prove helpful to such business.

The foregoing is intended to cover the Treasury's argument of abstract justice or fairness in support of its "tax neutrality" objective.

"Tax neutrality" to divert capital to use in the United States

Treasury's stated objective

Aside from the abstract theory of "tax neutrality" as an objective in itself, the Treasury argues that it would divert U.S. capital from use in the highly industrialized countries (Western Europe, etc.) to use in the United States and thereby increase U.S. employment of factory labor.

Treasury's arguments in support of proposal and answers thereto

The Treasury argues that: U.S. capital is now going to Europe, etc., in preference to use in the United States; if this capital were diverted to the United States it would make more jobs; and "tax neutrality" should, therefore, be legislated, so that capital, being free of incentives to go to Europe, would decide in favor of investment in the United States.

We do not believe any of this is correct.

1) *If* there is no shortage of capital available for any profitable use in the United States, the purpose would not be served by diverting capital here.

2) If there are ample productive facilities here, in part idle and unused, increases in such facilities would not make more jobs.

Either the Treasury is wrong or the surprise ally of business in this regard, the AFL-CIO, is wrong. This is an astonishing situation, but on this issue the AFL-CIO is in harmony with business. The AFL-CIO statement introduced in these Hearings on April 3, 1962 by Mr. Stanley H. Ruttenberg, contains the following statements on this subject:

> "In determining what should and should not be done to come to grips realistically with our economic growth and balance of payments problems, a number of widespread falacies need to be exposed." (p. 2 of his statement).

> "Is it true that American business needs the tax credit to help finance new investments because otherwise funds would not be available?" (p. 2)

> "...much of our productive capacity [is] still idle because of lagging domestic demand." (p. 3)

> "Larger capital outlays are *not* being deterred because of any overall lack of available private investable funds.
>
> On the contrary, savings available for capital formation are substantial. Actually many businesses now finance new plants and equipment solely with their own "internally" generated funds - ... In 1961, this internal cash flow actually exceeded last year's total outlay for new plant and equipment by 6%." (p. 4)

> "According to the Council of Economic Advisors, about two-thirds of our manufacturing exports are accounted for by the metal, machinery and transport industries. Yet, it is precisely

the major companies in these industries that are most generously endowed with internally generated funds available for capital improvements. In fact, in recent years they have seldom been forced to sell stock or borrow to meet their new investment needs." (p. 4)

"The findings of the Wall Street Journal's survey support this conclusion completely. It found many concerns are now worried "by excess capacity, which makes spending large sums of money for new machinery seem to them a dubious proposition regardless of tax laws." As one business executive put it, 'the problem now is trying to find markets for our present production, not getting money to make more.'" (p. 8)

Many business witnesses have testified to the same effect.

Conclusion as to the need to divert capital to the United States

There is no need to force U.S. capital to choose domestic investment in preference to foreign; the supply of capital is ample for both; all that is needed is opportunities to invest profitably.

Increased capital available for investment here would not, of itself, create more job opportunities.

Hence, "tax neutrality," even if effective in discouraging business investment abroad and forcing capital to remain here, would not thereby increase domestic prosperity or jobs.

Prevention of tax savings through "tax havens" as an objective in itself

The bill does not use or define "tax haven" or "tax haven operations," and neither has the Treasury, although the latter constantly and repeatedly uses the term as if it connoted something evil. It will be necessary then, first to deal with the Treasury's attacks, and then relate them to the provisions in the bill.

The Treasury's position as to "Tax Havens"

First, what does the Treasury mean by "tax havens"? It never has given a definition, and in the legislation it has drafted from

time to time it has avoided the term, while proposing therein different tests for what it calls by that name in its attacks.

Next, what results from the use of a "tax haven" corporation instead of any other foreign corporation? Under existing law:

1) Income of a foreign corporation is taxable to its U.S. shareholders when distributed and not before -- regardless of where it is incorporated -- hence, what is the basis of the charges of "tax avoidance," and worse, leveled at so-called "tax haven" corporations organized in countries such as Switzerland and Panama. Are they enemy territories?

2) If the income of a foreign subsidiary corporation earned abroad is taxed at a low average rate, it means that when it pays a dividend, its U.S. parent company will pay more U.S. tax per dollar distributed to it, than it would on a dividend received from a subsidiary paying foreign taxes on its income at a higher average rate. Is that bad for us?

It is exasperating to deal with insinuations and vague charges. The fact that a foreign corporation minimizes it foreign taxes is referred to as something somehow evil, that somehow justifies our taking steps to penalize and put an end to it. There are two answers:

If there is a violation of foreign law, by a foreign corporation, in a foreign jurisdiction -- should we attempt to legislate against it -- in the absence of protest or request from the foreign government? Has our State Department of Commerce been asked its views in this regard? If not, is our Treasury Department justified in its attacks and in its use of this argument in support of its proposals?

The second answer to these attacks is better and more in keeping with our American way of looking at things -- we are interested in business morality for its own sake, but here, fortunately, there is no moral problem. A foreign corporation can keep down its tax rates, by good business management, not only within the letter of the laws of the various foreign countries involved, but also within their spirit. Foreign governments, recognizing that taxes can come only from earnings, are in many cases willing to cooperate. A lower tax that is collected, is better than a higher tax, avoided by not doing business in that country. Their tax authorities, strangely enough, think not only of the rate of tax or how much tax they will collect from the taxpayer, but also of the business the taxpayer may generate, if assisted rather than penalized.

Conclusion as to "Tax Havens"

Penalizing a "tax haven" corporation, or rather its U.S. stockholders, is not an objective in itself -- therefore there are, and can be, no arguments in its favor as an objective, but merely in favor of such penalties as a means of attaining some real objective.

The Treasury has made no showing that penalizing U.S. owners of a "tax haven" corporation is, in itself, a worthy objective. All the arguments it advances and examples it gives, are irrelevant to that subject. The abuses the Treasury cites can be dealt with under existing law, and are only reasons why the law should be enforced -- not why the owners of a corporation organized in a country with a low tax rate should be penalized for that reason alone.

Provisions of the bill intended to strike at the Treasury's latest concept of "tax haven" income

The bill "lumps" a number of very dissimilar classes of income for penalty treatment:

1) Income from insurance and reinsurance of U.S. risks, as to which nothing further will be said except that the proper place for this to be dealt with would be the sections of the Code (Secs. 861 and 862) defining income from sources within and without the United States.

2) Income from foreign patents (called, in the bill, "United States patents"), copyrights and exclusive formulas and processes (discussed further below), which may have nothing to do with anything resembling a "tax haven,"

3) Income from multi-country selling and trading activities, which would operate effectively as an ANTI-EXPORT device, penalizing the sale of goods produced, for example, in the United States by a U.S. parent company, and thereby favoring production abroad or purchase from foreign producers.

It likewise would force compartmentalizing U.S. owned operations in Europe, at the very moment when we are forced to face Common Market competition, and finally,

4) Passive income, such as dividends, interest, rents and similar items, which may represent investment income from property not connected with the foreign corporation's business, or may flow from property used or held directly in connection with such business.

Our concern is with the second and third of these classes of income. The Treasury's general attacks on what it calls "tax haven" operations do not present any pertinent reasons why such income should be singled out and penalized. On the other hand, a mere analysis of these proposals, and some reflection as to their consequences, should be sufficient to reach a conclusion whether the harm they obviously would do to our overseas business, would not outweigh any theoretical advantages that might be imagined.

Some comments might be in order - regarding, for example, the fact that the "tax haven" penalty applicable to income from selling activities abroad in more than one country is not applicable if sales are made only in the country of incorporation. This is part of the "tax haven" witch hunt -- there is some magic about conducting business outside of the state of incorporation -- so off to the stake with the witch. Is this reason or modern day superstition -- or the new isolationism?

As for the "United States patents" -- under the bill, they can only be foreign patents. If really U.S. patents, the income therefrom would be U.S. income when received, since they run not beyond our borders. Here there is a compounding of the error of proposing to tax U.S. shareholders on what is not their income, by taxing them on an amount which may be derived from what has long been the property of the foreign corporation -- perhaps even purchased from an unrelated person.

The numerous objections to the treatment of the two classes of income discussed above as "tax haven" income, and therefore deserving of immediate confiscation to the extent of 52%, have been presented at great length by others appearing at these hearings, and need no further emphasis herein.

Technical Objections and Problems

No one can fully foresee or foretell all the difficulties inherent in these proposals. It can be said, however, that any tax based upon unreceived income earned and retained abroad by foreign corporations can not, as a practical matter, ever be equitably administered. It would be considered unthinkable not to have the Internal Revenue Service investigate the tax returns

and underlying records of all large corporations here in the United States. That is a big task, but any comparable investigation of the returns and underlying records of all the U.S. owned foreign corporations all over the world would present a far greater task.

Until examined, a U.S. corporation having foreign subsidiaries could never know the extent of its U.S. tax liability. Such uncertainty is a handicap to business planning, and would be an additional handicap in meeting foreign competition in world markets.

A great many objections have been raised to specific aspects of these provisions for taxing in advance what is not the taxpayer's income. These criticisms relate to the manner in which the determination is to be made whether the penalty tax applies, including the "catch-all" provisions (of the proposed new I.R.C. Sec. 953) for taxing the U.S. shareholders on all undistributed income of the foreign corporation not already taxed to them, unless invested (by the foreign corporation) in certain prescribed ways.

These are questions as to the way the victim is skinned -- the basic question is --- is the penalty deserved and will it help his fellow citizens? How much further will this process go, in the attempt to control business life through taxation of what is not income of the taxpayer? Will domestic corporations be the next object of attack, taxing majority stockholders on the dividends they did not receive, if the profits of the corporation are not invested as required by Government? How about taxing shareholders of oil companies on their share of depletion allowances on foreign operations?

Part II

PROPOSAL TO GRANT ADDITIONAL AUTHORITY TO THE TREASURY TO ALLOCATE TO U.S. TAXPAYERS AN INCREASED SHARE OF ACTUAL OR ESTIMATED INCOME ARISING OUT OF SALES TO OR PURCHASES FROM RELATED FOREIGN CORPORATIONS

Existing law and the Treasury's administration thereof

There has long been in the law a provision ("old Section 45," and now I.R.S. Sec. 482) granting the Treasury authority, in its discretion, to "reshuffle" income and expenses when, in its discretion. it considers this to be necessary" in order to prevent evasion of taxes or clearly to reflect the income of any" person.

This is a powerful weapon in the hands of the Treasury, but it has long neglected it, having heretofore applied it in relatively few instances.

Since the enactment of the present I.R.C. Sec. 6038 the Treasury has means of obtaining all the information it needs for the application of these provisions (of Sec. 482) to correct any improper shifting of income from a U.S. taxpayer to a related foreign corporation. (The latter, incidentally while improper and resulting in an actual "tax deferral," does not result in a permanent escape from U.S. taxes, as such taxes will be payable as and when the U.S. shareholders of such a corporation realize any income therefrom.)

The Treasury complains of difficulties it has experienced in the past in applying the provisions of Sec. 482, both in making adjustments thereunder and sustaining them in the courts. As to the latter, we have analized every reported court decision, and the reasons for the Treasury's failures may clearly be seen therefrom. There is no evidence of any weakness in existing law. Neither is there any indication that the result in any of these cases would have been different had the present law been in effect, save in one particular: where the Treasury has proposed an increase in tax as a result of "shifting" net income to the taxpayer, without indicating the extent that this arose from understatement of income and/or overstatement of expenses, the Courts have upheld the existing statutory requirement that this be done, whereas the proposed addition to Sec. 482 would permit an adjustment of net income from such intercompany sales.

So much for past history.

Scope of the proposed addition to I.R.C. Sec. 482

The proposed addition to I.R.C. Sec. 482 is limited in scope to profits and commissions derived in connection with sales of tangible property between related domestic and foreign persons (including, of course, corporations).

Pricing of Inter-Company Sales

The bill states principles to be observed by the Treasury in determining what are to be considered as "arm's length prices." Where the taxpayer can not establish such prices to the satisfaction of the Treasury, the latter would have authority to adjust the income of a domestic (U.S.) person selling goods to or buying goods from a related foreign person by taking

into consideration certain specified factors, within and without the United States, and other factors, "including the special risks (if any) of the market in which the property is sold."

In lieu of such method the Treasury would be required to use any other method which the taxpayer could establish "to the satisfaction of the Secretary or his delegate" as clearly reflecting the income of each organization involved.

The specified factors to be taken into consideration as set forth above would be:

1) Real property and tangible personal property, whether owned or leased (but not including inventories or accounts receivable from customers), to the extent used in the production, distribution and sale of the goods,

2) Compensation of officers and employees, to the extent attributable to the production, distribution and sale of the goods, and

3) Advertising, selling and sales promotion expenses (including technical and servicing expenses) "to the extent attributable to the property."

Such property would be valued at its adjusted basis "in the hands of the taxpayer" [Query: What about leased assets?] "... or, if such basis is not available in the case of a foreign organization, then their book values, adjusted to approximate their adjusted basis."

No portion of the income would be allocated to a foreign organization "whose assets, personnel, and office and other facilities which are not attributable to the United States are grossly inadequate for its activities outside the United States."

The Treasury also would be authorized to prescribe rules, for the purpose of the foregoing, and also "for the allocation of commissions arising from sales of tangible property" between domestic and foreign organizations.

The Internal Revenue Service would be permitted, in case of inability to obtain the required information, to estimate the amount of income from such inter-company transactions and to allocate the amount so estimated between the related organizations.

Comments:

The specific statutory exclusion of inventories and accounts receivable from customers from the factors to be taken into consideration in making the allocation would work hardships in many instances. Furthermore, this exclusion would take away the incentive otherwise available to an organization engaged in the distribution and sale of goods abroad, to purchase U.S. products (requiring a larger stock of goods), instead of goods which could be obtained upon shorter notice from suppliers in the same country or a nearby country.

The problems, difficulties, and expense of determining the amounts of the enumerated specific factors would be tremendous. It would not be enough to determine the amount of the property and expenses of the kind specified, within and without the United States. It would be necessary to determine what portion (amount) of such property and expenses were "attributable" to the amount of the particular goods sold (or purchased), for which a pricing adjustment might be proposed by the Treasury.

As stated above, the Treasury already has, under the existing Sec. 482, full authority to do all that is proposed, with the exception noted, which can readily be shown to be of no practical significance.

It is the concensus that, until the Treasury has had a substantial amount of experience in administering the existing Sec. 482 under (a) the existing provisions (of I.R.C. Sec. 6038) requiring detailed information to be furnished by U.S. corporations regarding related foreign corporations and (b) the Regulations which it has just promulgated, for the first time, under the existing Sec. 482, the principles suggested (but not put into the form of specific rules) in the present bill should not be crystalized into law by incorporation in the Internal Revenue Code.

In the meantime, a thorough study should be made of the possibility of some specific rules for pricing intercompany sales (for inclusion in or along with I.R.C. Secs. 861-864), which could be relied upon by taxpayers, thereby affording them some degree of certainty, unavailable under either the present or proposed provisions of Sec. 482.

Part III

PROPOSAL TO INCREASE THE AMOUNT OF U.S. TAXES ON DIVIDENDS RECEIVED FROM FOREIGN SUBSIDIARIES

What is proposed by the Treasury

This Treasury proposal, which would increase the amount of U.S. taxes on dividends received from foreign subsidiaries, is in the form of a provision that a U.S. corporation which claims the "deemed paid" foreign tax credit with respect to dividends received from a foreign subsidiary would be required to include in its income subject to U.S. tax, in addition to the amount of the dividend it actually received, the amount of the foreign taxes paid or deemed paid by that subsidiary (to foreign governments) with respect to the total income out of which it paid both such taxes and the dividend. The credit would then be computed on the basis of this artificially inflated income.

The Treasury's position regarding "gross up"

The Treasury proposal is designed to give effect to its newly-invented theory of "tax neutrality," in this instance primarily as a means of achieving abstract justice. It brushes aside the objection that its radical new method of computing the foreign tax credit disregards 40 years of experience with the present method, on its further theory that this was somehow an oversight of all previous Congressional tax committees and Secretaries of the Treasury. It chooses to ignore the fact that a bill introduced in the 86th Congress to engraft the "gross up" concept into the foreign tax competition, was not favorably acted upon by the Ways & Means Committee after hearings in April 1960, only two years ago.

The Treasury alleges that the present method allows both a deduction and a credit for the same foreign tax. All the Treasury's structure of defense rests on a conclusion (which we believe erroneous) which it draws from a mathematical computation.

Answer to the Treasury's arguments

We draw a contrary conclusion from the same facts as used by the Treasury in its computation, which we believe should convince anyone that there is not both a deduction and a credit allowed under the existing method for any part of the foreign income

tax allowed as a credit.... Only that portion of the foreign income tax which has been paid with respect to the income actually received by and taxable (usually at 52%) to the U.S. taxpayer, is allowed as a credit. This can readily be seen from the figures used in the Secretary's own "Explanation" (p. 56 of the printed edition) given in connection with his appearance before the Ways & Means Committee last May and June:

1)	Foreign corporation B earns in country X	$100.00
2)	B pays income tax to country X	20.00
3)	B pays balance of income as a dividend to the owner of its stock, U.S. Corporation A	$ 80.00
4)	A's U.S. tax on $80 at 52% is	$ 41.60
5)	LESS: Credit for foreign tax on the $80 paid to A (at 20%)	16.00
6)	U.S. tax payable by A (net)	$ 25.60

From the foregoing it is clear that:

1) A is taxed at 52% on the full $80 that it receives from B.

2) A gets credit only for the foreign tax paid by B on the $80 of income it pays to A.

3) A gets no benefit from the $4 of foreign income tax paid by B on the $20 of income B uses to pay its (B's) foreign income tax.

Where is the double benefit to A? Why should A be taxed, as proposed in the Secretary's "Explanation," on the $20 it did <u>not</u> and never can receive from B?

There is no such inequity here as to require the proposed radical change in a method which has been in effect for some 40 years.

Many billions of dollars have been placed at risk abroad by American business in reliance upon the existing method of allowing credit for foreign income taxes. Is this to be overturned overnight, merely because of theoretical considerations? This change would mean little to U.S. owners of foreign corporations operating in Canada, the United Kingdom, France, Germany or Japan (because of their high tax rates), but would hit hardest those having foreign subsidiaries in, for example Latin America, or partially developed countries like the Mezzogiorno region of Italy.

Hence it would, in most instances, conflict with the President's avowed purpose of encouraging U.S. business investment in "less developed countries."

This is a vital point, with respect to which there has been the greatest amount of misinformation, both in the press and in statements by individuals whose duty it is to know whereof they speak, or to keep silent.

Conclusion

The "gross-up" proposal, if adopted, would impose an increased burden of U.S. taxes on dividends from income earned abroad -- one of the inflow factors which helps to overcome the deficits in our international balance of payments created by our overseas military expenditures and foreign aid programs.

The proposed change would be unfair to business, which for many years has relied on continuance of the present method of computing the foreign tax credit (as well as the long-standing policy of our Government to encourage overseas expansion) while investing billions of dollars in business activities abroad.

The present method does not allow any U.S. taxpayer both a deduction and a credit for the same foreign tax, and it provides that every dollar of foreign dividends received (but not more) is to be included in taxable income and taxed at the full U.S. tax rate, subject, however, to credit for not more than the amount of foreign income taxes actually paid with respect to the full amount of the dividends received.

We find no sound moral or economic reason for the change in method initiated by Congress over 40 years ago and unchanged since then.

Over-All Conclusions

Our over-all conclusion, in the light of all the statements of witnesses and others , heard and read, is that our overseas business contributes so much toward our economic welfare (including the minimizing of our international balance of payments deficit situation) that it should be aided rather than penalized.

It is the personal view of the writer that our long-standing policy of expanding overseas operations (which has paid off so handsomely over the years) should be continued and strengthened, rather than abruptly discontinued. In fact, the writer goes further, and repeats a recommendation made many times in past years:

income from the manufacture in the United States of goods sold in export (for use or consumption abroad) should be taxed at less than the full U.S. income tax rates. And it is his firm conviction that the resulting expansion of exports, and consequent increase in employment and gross national production, would increase overall tax revenues more than enough to offset any loss due to the recommended rate reduction.

We have concluded that the Treasury has failed to justify its radical proposal to tax in advance U.S. shareholders on the undistributed overseas earnings of foreign corporations, on the basis of any of its asserted objectives.

We are convinced that it would be unwise to enact at this time the proposed extension of I.R.C. Sec. 482 (intercompany pricing principles, not formulae), before the Treasury has had more experience actually administering the provision of the present Sec. 482 with the help of the additional information now available by virtue of I.R.C. Sec. 6038. (Incidentally, we believe that the Treasury neither needs nor would, in practice, gain any net benefit from the proposed addition to I.R.C. Sec. 482.)

Finally, we are convinced, for the reasons heretofore stated, that the proposed radical change in the method, in use for more than 40 years, of computing the foreign tax credit, is neither just nor justifiable.

Much more could be written regarding technical problems (including Constitutional questions) raised by the bill as drafted, and the heavy burden of labor, expense, trouble and uncertainty which compliance and verification would impose on both taxpayers and the Treasury.

We feel, however, that the only sound test to be applied to measures such as these, intended to be for the common good, is:

Will it accomplish
that objective?

If we believed that these new devices would work and be for the common good, we would support them wholeheartedly.

We do not believe they would, and so we do not support them.

The CHAIRMAN. The next witness is Mr. Ray R. Eppert, Greater Detroit Board of Commerce.

Take a seat, sir.

STATEMENT OF RAY R. EPPERT, PRESIDENT, BURROUGHS CORP., AND VICE PRESIDENT, GREATER DETROIT BOARD OF COMMERCE

Mr. EPPERT. Mr. Chairman, my name is Ray R. Eppert, president of Burroughs Corp. and vice president of the Greater Detroit Board of Commerce.

I am testifying today on behalf of the board of commerce, which is a nonprofit organization incorporated under the laws of the State of Michigan. The statement we are presenting pertains to the sections of H.R. 10650 which deal with the taxation of income earned abroad by subsidiaries of American corporations.

It is our opinion that this bill, if enacted in its present form, would materially decrease the ability of American business to compete in the world market. It becomes increasingly apparent that the United States needs the world market more than the world market needs the United States and, if any action is taken which weakens our competitive posture and prevents maximum development in this world market, it is certain that severe repercussions would occur in our domestic economy.

Adequate job levels, a satisfactory balance-of-payments position, the attainment of an increasing export surplus, and the production of increased business earnings which will maximize the U.S. Treasury tax revenue are all dependent upon American business maintaining and improving its present competitive position in the world market.

We emphasize this point because it is the one essential fundamental that is involved in the proposed program.

For this reason, the hearings now being conducted by your committee are crucial insofar as U.S. foreign economic policy is concerned. We use the phrase "foreign economic policy" rather than "foreign taxes" because this committee will shortly be dealing with H.R. 9900, the Trade Expansion Act of 1962, which will establish a new basis for trade and tariff relationships with other countries of the free world and, particularly, the Common Market.

We do not think it is practicable to finalize tax legislation involving business both at home and abroad without first considering the legislation which will be proposed on tariffs and trade. The definite interrelationship makes this a two-sided coin and a unilateral approach to either taxes or to trade without proper consideration of the other would take a fundamental problem out of an essential total context.

We feel that Congress has the opportunity in this session to create an excellent climate for strong U.S. economic growth or, conversely, to pass legislation which could, in the long run, reduce the United States to a second-class economic power. A combination of the wrong tax and the wrong trade conclusions could do just that. We have every confidence that this will not happen and that this committee and the Congress will work to achieve an effective overall foreign economic policy.

We firmly believe that sound foreign trade legislation must be predicated on a preservation of the freedom to move capital for the most advantageous development for the United States of the foreign market potential. It is basic to say that this invested capital and the overseas economic effort it generates for the United States should be allowed and encouraged to grow. It should not be subject to attack by punitive tax measures directed against U.S. foreign subsidiaries.

The talents and abilities of the several thousand American companies with substantial international interests represent priceless shock troops to spearhead the drive for free world economic growth and for the forward progress of America's economy, in particular. These companies are providing technical assistance; they provide the greatest motivating force available to the United States for the maintenance and the improvement of living standards of both the developed and underdeveloped countries of the world.

It is our belief that proposals for current taxation by the U.S. Government of income earned by subsidiaries of U.S. companies operating in other countries, whether or not dividends are remitted, at rates higher than those established by the country in which the income is earned would (1) greatly weaken the competitive position of American business versus foreign-owned business in the world market; (2) seriously reduce the rate of new private investments abroad through lower availability of foreign-earned income for reinvestment, or produce an unfavorable effect on the U.S. balance of payments if the rate of foreign investment is maintained; (3) the proposals would eliminate the incentive for American companies to organize overseas operations so as to have (*a*) the lowest tax base abroad, (*b*) the largest amount of retained earnings for reinvestment and remittance to the United States, and (*c*) the lowest foreign tax credit as earnings are remitted to the United States thus maximizing taxes for the U.S. Treasury; (4) the proposed changes would reduce our favorable export surplus; (5) reduce domestic employment and retard future job security and growth; and (6) require even larger expenditures of U.S. funds for foreign economic aid to offset the reduced rate of private investment thus creating a still further adverse effect on the balance of payments generated by Government aid programs.

We believe we should not overlook the fact that all countries in which American foreign subsidiaries are located—every one of them—have their own balance of payments and revenue problems. The imposition of a U.S. tax on income earned in these countries, not based on dividend remittances, could be interpreted as a U.S. move to create greater than normal drain on their resources and could well lead to tax measures there designed to protect their position on balance of payments and revenue. It seems to us that this might even create political problems within some of the countries which would be involved and the action might be considered as U.S. economic tax imperialism.

Underlying the tax proposals, we believe, is a basic misunderstanding of the purpose and function of direct American investment abroad. These direct investments are made to take advantage of potential demand, market demand, to satisfy potential markets that cannot be served through U.S. exports. It has been said again and again that American business does not go to all the difficulties of

creating oversea operations if the market can be successfully served by the very simple means of exporting finished commodities. American business invests abroad in order to create a supply structure that will remain competitive with foreign competitors and to maintain and expand exports of semifinished or finished exports as part of a balanced worldwide marketing effort.

There is no alternative to American business investing abroad if we are to hold and expand markets for American enterprise. This is vital to the maintenance and expansion of the number of jobs in the United States and the attainment of a maximum export trade surplus. Stated differently, this oversea activity contributes greatly and directly to our domestic economy.

Increasing the cost of doing business abroad would negatively affect America's economy. We know of no case, Mr. Chairman, where a country proposed a program to make it more difficult for its citizens and therefore itself to compete with foreigners for world markets.

The committee is already aware of the fact that direct foreign investments have produced a net inflow of funds, thus relieving the pressure on the U.S. balance of payments. For the period 1950 to 1960, the net return to the United States from foreign investments has been in excess of $8 billion. For the year 1961, a dramatic increase occurred, and the net favorable flow was $1,051 million.

The proposals being studied—I am referring to dividends only, sir—the proposals being studied would place an increased burden on our total unfavorable balance of payments position. Much expansion of oversea operations is with income earned abroad and taxed at lower income tax rates by the country in which it was earned. The proposed lower availability of such funds abroad might well accelerate the investment flow directly from the United States. Obviously this would result in a worsening of our balance of payments position.

There has been much discussion of loopholes and tax havens. It has been well documented in previous hearings that the present Internal Revenue Code contains adequate provisions for eliminating any malpractice. Incidentally, to put a legitimate corporation that is owned by many thousands——

Senator GORE. Mr. Chairman?

I would like to ask you, you say it has been well documented. The Secretary of the Treasury said existing law was wholly inadequate.

Mr. EPPERT. I would like to come back to that, if I may, Senator.

Senator GORE. You could just tell us now.

Mr. EPPERT. When I say "well documented," I would suggest a reference to volume 4, June 5, 6, 7, 8, and 9, the hearings on foreign taxes before the Committee on Ways and Means. There are a thousand pages of testimony there.

Incidentally, to put a legitimate corporation that is owned by many thousands and even hundreds of thousands of stockholders in the category of a personal holding company in their oversea operations is, to say the least, somewhat unrealistic.

The proposals, if adopted, are an invitation to the countries in which the income is earned to increase their income or remittance taxes to U.S. levels. This would transfer the funds now available for reinvestment abroad or dividend remittances to the United States

into the tax collections of overseas countries. The net result is a tax loss to the United States. It would also retard the rate of U.S. development of oversea markets essential to our national well-being.

U.S. exports directly traceable as sales to oversea subsidiaries and branches of U.S. companies have been estimated to have been valued at more than $2.6 billion in 1957. Private estimates indicate these exports may have doubled since 1957. Undoubtedly they have been running at a much higher rate in more recent years. Capital goods exports alone, also due to the purchases in the United States of direct investment enterprises abroad, have recently been estimated at $1 billion or about one-quarter of our total capital goods exports. Thus at least one-half and possibly all our recent trade surplus of almost $5 billion was generated by subsidiaries of American companies operating abroad.

We have outlined how direct foreign investment contributes greatly to our export surplus. It thus creates jobs in the United States.

Instead of exporting finished products exclusively, American direct investment abroad leads to the exportation of capital equipment, raw materials, subassemblies, and component parts. These exports would not occur at all if it were not for the subsidiaries abroad.

There would not be such an export.

This is in addition to the continued exportation of fully assembled or fully finished merchandise, much of the latter of a more advanced and technologically sophisticated nature. The important point is that without the American direct investment abroad, we would not be sharing the oversea market to the same degree. That is the vital point.

American business does not have a choice, Mr. Chairman, between exporting goods made at home, or producing abroad. Unless American business is willing to venture abroad and produce abroad where the markets cannot be supplied by exports from the United States, the growing markets for components, subassemblies, semifinished capital goods will not be American markets. Also, our exports of finished commodities dependent on a balanced-marketing program will be seriously reduced.

The rapidly developing world market is the greatest economic frontier and challenge the United States has ever faced, and the development of this frontier requires a two-pronged attack—direct exports and oversea direct investments and operations to generate added exports and income. We believe direct oversea operations should actually carry a top priority in the program to maximize the growth of the U.S. economy.

The United States is involved, whether we like it or not, in an economic world series and a lot of games have to be played on the road and not just in our own ball park. When American business is playing the game of competition for the United States on the road in those foreign parks, it is obvious that handicaps cannot be placed on our players which are not placed on our opponents.

We are not that good.

I might add it is vital to the welfare of the United States that we win ball games on the road as well as at home.

If the administration feels that U.S. business operating abroad should currently be under the same tax burden as when it operates at

home, such a position would only be practical at the time when the U.S. Government is able to negotiate with all industrial nations a uniform income tax rate while it is negotiating uniform tariff taxation. Only on this basis would American business remain competitive.

Obviously, that cannot be done, and, therefore, any change in the rules of the game would militate against the best interests of the United States.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. You made a reference on the next-to-the-last page of your testimony to the alleged tax havens. Is it your contention that there are no tax havens?

Mr. EPPERT. Not for a legitimate business.

Senator DOUGLAS. May I say——

Mr. EPPERT. Let me explain what I mean, Senator, because that sounds like I brushed off your question, and I did not.

If an American corporation is able to organize its international operations and network in such a way that they minimize the foreign taxes paid, the net result, of course, is that there is created temporarily a contribution to working capital that can be used to increase the asset position of the United States overseas, to increase the business, and to increase the earnings, and, therefore, bring back——

Senator DOUGLAS. So it is your contention——

Mr. EPPERT. May I finish, sir?

Senator DOUGLAS. Certainly.

Mr. EPPERT. In other words, let us say it has been a temporary working-capital haven.

If it is a tax haven for anyone, because, bear in mind, the result of doing what I have outlined is to bring back the minimum foreign tax credit to apply against U.S. taxes—if it is a tax haven for anyone, it is not a tax haven for the business, it is a tax haven for the U.S. Treasury.

Senator DOUGLAS. Do I understand, therefore, that it really benefits the U.S. Treasury for companies to incorporate in the Bahamas and Panama and Venezuela and Switzerland and in Liberia?

Mr. EPPERT. It depends on whether or not it is a paper, a sham, corporation, or whether it has substance.

Senator DOUGLAS. What is the difference between the two?

Mr. EPPERT. Sir?

Senator DOUGLAS. What is the difference? How would you judge?

Mr. EPPERT. Well, is it a going business?

The best yardstick I can find for my own thinking, Senator, is the answer I gave when I was asked that question by some members of the Ways and Means Committee.

Senator DOUGLAS. Well, you are asked again.

Mr. EPPERT. What is a sham corporation?

I said I am not certain I can describe a sham corporation, but I think I can define what a legitimate operation is. A legitimate operation can very easily be determined by merely looking at the balance sheet and the operating statement and making certain the money is working.

If the money is working, it is legitimate, because it is working for the benefit of the company and the United States.

Senator DOUGLAS. Well, I want to say to the witness that this committee has been very enterprising. I want to congratulate the chairman and the staff in printing the testimony and the exhibits of the Secretary of the Treasury and his testimony.

Mr. EPPERT. I have that here. I wanted to comment on it.

Senator DOUGLAS. Just a minute, please.

Do you have a copy of these hearings?

Mr. EPPERT. Yes.

Senator DOUGLAS. The green book?

Mr. EPPERT. Yes, but I wanted to comment on the Joint Committee report.

Senator DOUGLAS. Just a minute, please, if you will answer my questions.

Mr. EPPERT. Sir?

Senator DOUGLAS. If you will answer my questions, I would prefer that.

Will you turn to pages 224 and 225?

And may I say, Mr. Chairman, I want to congratulate you and the staff for printing and making available in the latter part of these hearings the testimony we rely upon, instead of waiting until later. It is an excellent idea.

Have you looked at those pages?

Mr. EPPERT. Yes.

Senator DOUGLAS. I ask you to look at page 225. That has the following titles, "Subsidiaries in Selected 'Tax Haven' Countries and Total in All Countries in 1959 for a Group of 1,075 U.S. Corporations, Classified by Year of Incorporation of Subsidiaries."

Then there are the years, in the left-hand column, and in the successive columns, the following countries: The Bahamas, Panama, Venezuela, Switzerland, Liberia, all of these countries with very small domestic markets.

Now, if you will notice, you will see that from 1950 to 1959, there were 2,285 subsidiaries incorporated in these five very small countries.

Mr. EPPERT. No, that is in all countries, Senator.

Senator DOUGLAS. Pardon?

Mr. EPPERT. Look at the heading.

Senator DOUGLAS. Yes, I beg your pardon.

Mr. EPPERT. In all countries; that is in all countries, Senator.

Senator DOUGLAS. Yes, in all countries, I beg your pardon. And in these five countries there were about 600 incorporated during those 10 years, is that not true?

Mr. EPPERT. Yes, sir.

Senator DOUGLAS. And the vast majority of these were incorporated from 1955 to 1959. About 430 of the 600 were in the last 5 years, is that not true?

Mr. EPPERT. Yes, that is right.

Senator DOUGLAS. In the 10 years from 1950 to 1959, inclusive, there were approximately 600 corporations incorporated in these countries, of which 430 were incorporated in the last 5 years.

These are approximate figures.

Is that true?

Mr. EPPERT. Yes, sir.

Senator DOUGLAS. Now, then, we come to 1960 and 1961.

Seventy in Switzerland in the year 1960; 101 in Panama; 16 in Venezuela; 61 in the Bahamas; 49 in Liberia.

Now, that is 70 in Switzerland, as compared to 118 in 10 years; 101 in Panama in 1 year, as compared to 200 in 10 years; 16 in Venezuela in 1 year, as compared to 126 in 10 years.

Sixty-one in the Bahamas in 1 year, compared to 46 in 10 years.

And 49 in Liberia in 1 year, as contrasted to 47 in 10 years.

Now, that is only 1960, but we also have figures for 1961.

If you will check me to see if I am right in this:

Seventy-eight in Switzerland in 1961, as compared to 118 in the 10 years, and thus there were 148 in 2 years as compared to 118 in 10 years in Switzerland.

In Panama, 42, as compared to 200, or 143 in 2 years, as compared to 200 in 10 years.

Nine in Venezuela, or a total of 25, as contrasted with 126 in 10 years.

Apparently there has not been an increase in Venezuela.

Thirty-seven in the Bahamas, as compared to 48 in the 10 years; in the Bahamas in the 2 years, 98 in 2 years, as compared to 46 in 10 years.

Liberia, 17 in 1961, as compared to 47 in 10 years, or 66 in 2 years, as compared to 47 in 10 years, thus indicating much greater acceleration of this pace so far as Switzerland, Panama, the Bahamas, and Liberia are concerned, although a decrease in the pace so far as Venezuela is concerned.

Now, you think it is the high state of domestic productivity and cultural advance in Liberia which makes Liberia so attractive to American corporations?

Is it the huge domestic market in Liberia which makes it as a magnet, as it were, to draw this large number of corporations to it?

Mr. EPPERT. Senator, I do not believe that is the question.

Senator DOUGLAS. Well, it is my question.

Mr. EPPERT. You are not saying, I hope you are not saying, that every subsidiary formed in any of these five countries is there because it is a sham operation.

Senator DOUGLAS. I do not say that everyone is, but I say that this tremendous popularity of these extremely small countries, does create a presumption that some of them are there as a sham?

Mr. EPPERT. It could be.

Senator DOUGLAS. It could be.

Do you think it is?

Mr. EPPERT. We do not support malpractice, believe me.

Senator DOUGLAS. Do you not look with suspicion on this tremendous rush toward these four countries?

Mr. EPPERT. Are we going to tar legitimate business, tar and feather legitimate business——

Senator DOUGLAS. We are not tarring and feathering anyone. They can go there. The question is whether they can go there to escape taxation, and I have not mentioned a single name, although I could.

Mr. EPPERT. Senator, the Internal Revenue Department has encouraged business to organize its oversea affairs——

Senator DOUGLAS. You mean because of the present taxes?

Mr. EPPERT. Legitimate taxes.

Senator DOUGLAS. Because of the present tax laws?
Mr. EPPERT. In order to protect as much U.S. tax as possible.
Senator DOUGLAS. Then you look with favor, then, upon this migration to Liberia?
Mr. EPPERT. No, not necessarily, I do not know a thing about Liberia.
Senator DOUGLAS. Do you or do you not?
Does this create any suspicions in your mind whatsoever?
Mr. EPPERT. I have no personal knowledge of Liberia and I would not be competent to answer that question.
Senator DOUGLAS. Look at those figures.
You are a highly intelligent man. Does this strike you as strange, 47 companies in 5 years, 66 companies in 2 years? Liberia is a small country. The average income is low. There is not an appreciable domestic market.
I had not thought that Monrovia was the most attractive place in the world.
Mr. EPPERT. Are you not going to mention Switzerland?
Senator DOUGLAS. I am mentioning Liberia at the moment. I will come to Switzerland later.
Mr. EPPERT. I would not have any knowledge at all of Liberia.
Senator DOUGLAS. Let us stay inside this ball park.
Mr. EPPERT. I will answer your question by saying this, Senator, and it is the only answer I can give because of my lack of knowledge of what goes on in Liberia.
I do know this: That Liberia is growing rapidly. That is all I do know about it. But I do know that industry, as a whole, has tried to protect not only its own working capital position by minimizing foreign taxes, but to preserve the minimum foreign tax credit when the dividends come home.
That is one of the reasons.
Senator DOUGLAS. Minimize U.S. taxes, too?
Mr. EPPERT. Sir?
Senator DOUGLAS. And minimize U.S. taxes?
Mr. EPPERT. No. Maximize U.S. taxes.
Senator DOUGLAS. I see.
Mr. EPPERT. Maximize.
Senator DOUGLAS. In other words, people who go to Liberia are conferring a great favor upon the United States?
Mr. EPPERT. I did not say that. I said they organize their oversea affairs to minimize foreign taxes, not U.S. taxes.
Senator DOUGLAS. Is it not presumptive that they went to Liberia in part to minimize foreign taxes?
Mr. EPPERT. Are you suggesting that the money will never come home?
Senator DOUGLAS. Then you favor their going to Liberia?
Mr. EPPERT. I did not say that.
Senator DOUGLAS. Oh.
Mr. EPPERT. I did not say that.
Senator DOUGLAS. Now, take the Bahamas. We will approach Switzerland through warmer climates. [Laughter.]
Ninety-eight companies in 1960 and 1961 went there; 36 companies from 1955 to 1959. Does that arouse any suspicion in your mind?
Mr. EPPERT. If I were the Internal Revenue Department, yes.

Senator DOUGLAS. They have published these figures.

Mr. EPPERT. If I were the Internal Revenue Department, I would take section 482 of the code and find out what goes on, Senator.

Senator DOUGLAS. You are a citizen. The Internal Revenue person is simply a citizen, also, working for the Government.

Mr. EPPERT. The Internal Revenue Department has many tools at present in their possession for looking at malpractice and determining malpractice.

Senator DOUGLAS. But in some cases, it is frequently better to head it off at the source by removing temptation.

Mr. EPPERT. I want to repeat, they have encouraged the operation of legitimate business in such a way that the minimum foreign tax credit will be returned to the United States with the dividend, thus preserving the maximum U.S. tax. Let me give you an illustration.

Senator DOUGLAS. I do not want to be arbitrary, but I have not finished this parade of countries yet and I would like to turn to Panama, if I may.

Mr. EPPERT. My answer will be the same on Panama as Liberia, Senator.

Senator DOUGLAS. Let us get the figures on Panama; 143 companies incorporated in Panama in 1960 and 1961; and 156 from 1955 to 1959. Is it the domestic market of Panama, the high per capita incomes of the Panamanians, which served as an attraction, or is it the low tax rates of Panama?

Mr. EPPERT. I do not know. But the Internal Revenue Department can find out, Senator.

Senator DOUGLAS. Well, is it proper for Congress to find out?

Mr. EPPERT. Yes.

Senator DOUGLAS. Is it not proper for Congress to have some suspicion?

Mr. EPPERT. I wish I could answer your question. I wish I could tell you who these companies are and exactly what they are doing. I do not know.

Senator DOUGLAS. Well, you came to testify on the subject.

Mr. EPPERT. I came to testify on the subject of section 13, which covers nondeferral of tax.

Senator DOUGLAS. That is what I am talking about.

Mr. EPPERT. Senator, I do not want to disagree with you, and I do not want to be impertinent, but I think we are missing here this morning the biggest point that is involved in this whole thing.

Senator DOUGLAS. Go ahead.

Mr. EPPERT. You said, when you were talking to Mr. Seghers a little while ago, that unless there was a public interest involved, why should there not be exact parallel tax treatment both at home and abroad.

Senator DOUGLAS. I said that the presumption.

Mr. EPPERT. I want to say to you, sir, that there is a public interest involved. I started with my company as a kid 18 years of age, 41 years ago, as a branch shipping clerk out in Ogden, Utah. I was not there more than 24 hours before I found out the facts of free enterprise life, which is that nothing happens, taxes, jobs or anything, until somebody sells something.

The public interest is involved in an increasing incoming order index for the benefit of the American economy both at home and abroad. The growth of the world market is faster, more dramatic at the moment, as you know, than our own.

We talk about the developed nations, Western Europe and the United Kingdom. Where do you think competition is the toughest? Right there. Why do we single them out for punitive action on American enterprise that is over there trying to increase the revenue, the incoming orders, if you please, for American products?

Let me give you an illustration.

Let us take our own industry. The Burroughs Corp. is in the business machines industry, the office equipment industry.

Here is a tabulation of the Department of Commerce going back to 1950 on our industry; 1961 was the best year so far.

Exports, direct exports from here in 1961 were $310,997,000. Imports were $95,505,000, a contribution of commercial transactions alone of $215 million to the balance of payments. It has nothing to do with dividends.

Senator GORE. Will the Senator yield there?

Would you, since you are in this business, give us the figures on portable typewriters?

Mr. EPPERT. The figures are not broken out on portables.

Senator GORE. Well, it is a fact, is it not, that 80 percent of portable typewriters sold in the United States are no longer manufactured in the United States but are manufactured by foreign subsidiaries owned by U.S. corporations, and these U.S. corporations utilize their sales force here to sell these typewriters imported from abroad.

How does that affect the balance of payments?

Mr. EPPERT. It makes a great contribution.

Senator GORE. You mean U.S. dollars?

Mr. EPPERT. Going abroad for those imports.

Senator GORE. Outflow?

Mr. EPPERT. Yes.

Senator GORE. By bringing in from abroad 80 percent of the portable typewriters sold in this country?

Mr. EPPERT. Yes, it helps our balance of payments.

Senator GORE. That is strange mathematics.

Mr. EPPERT. Let me explain why they are building a portable typewriter over there.

Senator GORE. Well that is—I am asking you how this affects the balance of payments.

Mr. EPPERT. I am coming to that.

Will you bear with me for just a moment?

Senator GORE. Yes, you start a long way back but go ahead.

Mr. EPPERT. You have to start a long way back. There is no particular reason for building a portable typewriter over there if it could be built here and sold competitively over there and here.

You see, unfortunately, or rather fortunately, foreign enterprises have suddenly discovered, after all of these years, that free competitive enterprise is a fine thing, and they don't fully appreciate that from our standpoint it would be better if competition on their part stopped at the water's edge.

For your information, 40 percent of the adding machines sold in the United States are foreign and are not manufactured by a subsidiary of a U.S. company. But, back to typewriters.

When do you take a product overseas if you are going to move it completely? You take it at the precise moment when you find that you can no longer build it here and sell it competitively there, oversea, in competition with foreign manufacturers.

Senator GORE. That is the first step.

Mr. EPPERT. Just a moment. Unless we work with the same rules of the game——

Senator GORE. Let's identify the step.

Mr. EPPERT. No, let me finish; if we don't do that, Senator——

Senator GORE. Well, do you mind if I understand what you are saying as you go?

Mr. EPPERT. All right, please.

Senator GORE. Your first step now that you take is to establish a subsidiary abroad to supply the market abroad.

Now, you proceed to the next step.

Mr. EPPERT. No, that is not what I said. I said when you find you can no longer build it here and export it and be competitive on that product then you are going to do one of two things.

Senator GORE. It seems to me you have said exactly what I have said.

Mr. EPPERT. Then you are going to do one of two things. You are either going to build it over there and protect America's competitive position in the world market, and as a result of that operation, have dividends flowing back or you better make a decision to do something else and that is to liquidate that particular product and forget it because it is only a question of when, not if, you won't have the market in the United States or overseas.

Senator GORE. Well, you have now identified the first step which may or may not be caused in all cases by the circumstances which you have described.

The first historic step here you have described, and that is the establishment of foreign subsidiaries, manufacturing subsidiaries, to supply the demand for the market abroad which in many instances had previously been supplied by factories here in the United States.

Now, whether it is necessary to establish a foreign subsidiary in order to keep those markets is a question.

In some instances it may be necessary but the tax subsidy for the export of this capital and of this industry is an important factor, that is an important factor which you have overlooked.

It is a part of this first step.

But now that we have identified the first step and analyzed it briefly, if you desire I am prepared to listen to the second step.

Mr. EPPERT. All right.

The second step is this, and this applies to a lot of things in the United States.

Senator GORE. I didn't quite understand.

Mr. EPPERT. Let's go back to 1950.

In 1950, the sum total of all research and development in the United States was approximately $2 billion.

In 1960 that had risen to roughly $13.5 billion, and it is estimated that by 1970 it will nearly double what it is now.

What I am trying to say, Senator, is thank heavens we are doing this: We have more research and development going on in the United States and have built the greatest pool of competency anywhere in the world.

Now, out of that must flow the products necessary to hold our position in the world market, and export from here the maximum to protect the jobs here. We must try to be ahead of the game and be exporting model 2 while the importing territories are in a model 1 phase.

And when they move into model 2 we had better be ready with model 3. If we are not we are in trouble.

Senator GORE. Let's go to the next step; you haven't reached it. I will outline it for you and ask you to comment.

The second rather typical step is that because of the tax advantages of income earned abroad, because of labor costs in some instances, because of several factors one of which is preferential tax treatment of income earned abroad, the foreign subsidiary begins to import back into the United States.

Mr. EPPERT. Sure.

Senator GORE. And that is why I asked you——

Mr. EPPERT. We import into the United States in order to protect the American market against the foreign manufacturer.

Senator GORE. Well, I just gave you an example, portable typewriters, in which foreign manufacturers are supplying now 80 percent of sales in the United States.

Mr. EPPERT. But when you say foreign manufacturer you are including American subsidiaries overseas as well as foreign manufacturers, in other words, foreign parent companies, in those countries.

Senator GORE. It is peculiar that you would draw such a distinction, because who has jobs making the portable typewriters that are made abroad?

Mr. EPPERT. Pardon?

Senator GORE. What workers are employed in the factories in Holland?

Mr. EPPERT. Dutch.

Senator GORE. Not Americans?

Mr. EPPERT. No. And there would be a lot more Dutchmen employed in parent companies in Holland making portable typewriters if the foreign subsidiary of an American corporation wasn't building some portables there and exporting them to themselves in the United States. To be absurd for just a moment, Senator——

Senator GORE. Let's not do that.

Mr. EPPERT. I think maybe it would be a good idea if I was absurd for just one moment.

Senator GORE. All right. It might be in style.

Mr. EPPERT. Let me ask you a question. This is impossible and absurd, but the happiest situation in which we could find ourselves in the United States would be if every import we ever received or needed was being produced by a subsidiary, a foreign subsidiary of an American company. We would have no balance-of-payments problems, I can assure you. That, of course, will never happen. But we are doing it in part.

Senator GORE. I am not sure the Secretary of the Treasury understands the balance-of-payments problem the same as you.

Mr. EPPERT. Pardon? I am not sure he does, either. Look, I am very certain [laughter]—I am very certain he doesn't, Senator, and I will go further and say sometimes I wonder if Secretary Dillion really understands what causes an export. Do we have an idea that parent companies——

Senator GORE. I rather think he does.

Mr. EPPERT. Now, wait a minute. I hope he doesn't, and I will tell you why. I hope he does——

Senator GORE. Does?

Mr. EPPERT. Does not understand what causes an export, because if he did why is he recommending that we put a straitjacket on the sales force. If I were about to invest in a corporation that badly needed an incoming order increase to overcome creeping costs, and they suddenly decided the way to do this is to inhibit, to reduce, not to increase, not to develop, not to expand, marketing, I think I would draw back and not make the investment. Exports are generated by marketing effort.

Senator GORE. I am asking you not about exports, I am asking you about imports.

Mr. EPPERT. You were talking about balance of payments.

Senator GORE. I am asking about the importation of 80 percent of domestic sales of portable typewriters. I asked you what citizens——

Mr. EPPERT. Now, wait a minute, before we leave that, let's go back to the portable typewriters.

Senator GORE. Let me put the question, please, sir. I asked you what workers were employed manufacturing these typewriters, and you said Dutch.

Now, I would like to ask you what workers have lost their jobs manufacturing typewriters in the United States?

Mr. EPPERT. I don't know. But let me answer that a different way.

Senator GORE. To be absurd, of what nationality are they?

Mr. EPPERT. Who have lost jobs here?

Senator GORE. Yes, when the factories have been closed.

Mr. EPPERT. If any have lost jobs they would be American, I assume.

Senator GORE. So does that help U.S. employment? You say this, in some way which you haven't yet explained, helps the balance of payments. How does it affect employment? There are no unemployment problems in many countries of Western Europe. They are importing workers from other countries. We have 5 million people walking the streets looking for work.

How does this importation of 80 percent of our portable typewriters contribute to full employment in the United States?

Mr. EPPERT. Let me ask you a question.

Senator GORE. Mr. Chairman——

Mr. EPPERT. I would like to keep this in a proper context.

Senator GORE. Well, I think it is in a proper context. We are talking about balance of payments. We are talking about employment.

Mr. EPPERT. Let me ask you this——

Senator GORE. I would like for you to answer my question, and then I shall be glad to hear yours.

Mr. EPPERT. I don't know that anyone lost a job because everyone that is building portable typewriters abroad so far as I know abroad, and they are members of our industry.

Senator DOUGLAS. What happened to Ilion, N.Y.?

Mr. EPPERT. Just a moment. I don't know, they may have had a change in employment levels in different places in the United States if they were dispersed by products in manufacturing.

Senator GORE. Don't be that absurd. There are thousands of people who have lost jobs in the typewriter industry.

Mr. EPPERT. Well, if they have it is for one reason, Senators, because foreign manufacturers and not foreign subsidiaries of the United States have been taking the typewriter market away, and our main point of superiority remaining on typewriters in this country is the more sophisticated equipment, the electric equipment, and are we exporting those. There again we are back to R. & D., Senator.

Senator GORE. Well, contrary to your statement, a great many of this 80 percent of portable typewriters are in fact manufactured by foreign subsidiaries of U.S. corporations.

Mr. EPPERT. There were $4,187,000 worth of standard typewriters exported in 1961 and there were $8,240,000 electrics, in total, $12¼ million.

Senator GORE. Will you, since you have said that this contributes to the balance of payments, explain how it contributes to employment?

Mr. EPPERT. Sir?

Senator GORE. Since you have, in some way, discovered a method of attributing to this importation of 80 percent of portable typewriters a contribution to the solution of our balance-of-payments problem, please tell the committee how it contributes to our full employment problem?

Mr. EPPERT. Senator, I may appear to be digressing and avoiding a question. I am not when I say that when you are considering H.R. 9900, the trade bill, one of the things that must be faced on a tariff program where we are dealing with categories of products across the board, as we have to with the Common Market, one of the things we have to face is the fact that we are not going to have realistic, a totally realistic worldwide tariff program vis-a-vis the United States and keep everybody happy in the United States and not hurt anybody. What I am saying is that some of the products we are building in America today probably will not be built in the United States as time goes on.

Senator GORE. Well, what I am saying is we now provide a tax subsidy to remove the manufacturing of products out of this country.

Mr. EPPERT. We provide a tax subsidy?

Senator GORE. Yes. You stated it about as well as I can, on page 3 of your statement.

Mr. EPPERT. You mean the foreign tax is less.

Senator GORE. I refer to the deferral of taxes. You stated on page 3 of your prepared statement——

Mr. EPPERT. Let me ask you this.

Senator GORE. May I read your own statement in answer to your question?

Mr. EPPERT. I know the question.

Senator GORE. The second result, you state, of this bill would be—

seriously to reduce the rate of new private investments abroad through lower availability of foreign earned income for reinvestment.

Mr. EPPERT. Yes.

Senator GORE. Thank you, sir.

Mr. EPPERT. You know why they will be reduced?

Senator GORE. Yes; I know.

Mr. EPPERT. Why would they be reduced?

Senator GORE. Because the bill would require, at least I think the bill we are going to pass will require, the payment of taxes annually.

Mr. EPPERT. Right. You are exactly right, Senator.

Senator GORE. Thank you.

Mr. EPPERT. And that is why investment would stultify and dry up, and if this ever happens we have had it. The point I am making is this: The reason investments would tend to dry up is because we would not be able to operate there and be competitive with other enterprises resident in that country.

Senator GORE. Now, if you——

Mr. EPPERT. Just a moment.

If the intent of this bill is to—and this is why I said that the one fundamental involved in this whole program is the competitive posture of the American business community in the world market—if the intent is to take America out of the world market and be, you might say, isolationist here, then we had better be very careful what we do with H.R. 9900. We had better back up and build fences as high as we can, and I say that although I am a free trader at heart.

Senator GORE. I know of no one who wants to take U.S. commerce out of the world market.

Mr. EPPERT. Do you think we can play a ball game in, we will say Holland, you mentioned Holland——

Senator GORE. What you have been saying——

Mr. EPPERT. Do you think we can play a ball game and send only two players to bat each inning when they send three?

Senator GORE. That is hardly a proper illustration. What you said is that if the foreign earnings are taxed, you will not be able to retain that portion of those earnings, and reinvest them. You are saying that if you have to pay taxes then you can't grow as fast, you can't keep as much money.

Well, I say the same thing——

Mr. EPPERT. We can't even compete.

Senator GORE. It isn't a question of competition. The bill would levy taxes only on the profits you have earned from successful competition. This doesn't prevent you from competing. This is a canard that several have dragged before this committee. If we pass a law that prevents you from earning profits in international commerce, then you can say we impede your ability to compete.

But all this bill would do is to place an annual tax liability on the profits you actually earn in successfully competing.

Mr. EPPERT. Has anyone brought out the point that you could have a loss in a foreign subsidiary?

Senator GORE. Well, will you——

Mr. EPPERT. What do we do then?

Senator GORE. Will you respond to this? Let me ask you——

Mr. EPPERT. I will respond to your question, the question you just asked.

Senator GORE. Do you pay taxes on a loss?

Mr. EPPERT. Sir?

Senator GORE. You have tax liability only on income, is that right?

Mr. EPPERT. That is right.

Senator GORE. Then unless you have made money in international trade this bill would levy no taxes, would it?

Mr. EPPERT. What happens if you have a loss here in the United States?

Senator GORE. Will you answer my question?

Mr. EPPERT. You say we want tax equality. What happens if we have a loss here?

Senator GORE. Mr. Chairman——

Mr. EPPERT. We would pay no taxes, of course, but is there anything in this bill that gives you a loss carry forward in a foreign subsidiary?

Senator GORE. I have no further questions, Mr. Chairman. Pardon me for interrupting you so much.

Mr. EPPERT. I am answering your question. Sure, we can have a loss and there is no current tax, then what do we do next year under this bill? Is it the same as it is treated here in the United States?

Senator GORE. You were saying that somehow this bill was going to impair your ability to compete.

Mr. EPPERT. Yes, for one simple reason: in the last analysis, price enters into this whole thing, price in the marketplace.

Senator GORE. In other words, if you have to pay taxes you can't compete, is that what you are saying?

Mr. EPPERT. I am saying we cannot absorb as American operations oversea negatives——

Senator GORE. What do you absorb now?

Mr. EPPERT. Negatives which are——

Senator GORE. Let's not talk about absorbing a negative; let's talk about paying taxes; is that what you mean by a negative?

Mr. EPPERT. Personally, I can think of taxes as a negative. I can find a lot of agreement.

Senator GORE. Let's speak in terms of paying taxes, not speak of absorbing negatives.

Mr. EPPERT. Well, we absorb a tax.

Senator GORE. Well, if you pay a tax, how about that?

Mr. EPPERT. If we pay it we have absorbed it.

Senator GORE. Mr. Chairman. That concludes my questions.

Mr. EPPERT. All I am saying is this: Heaven help the United States if we have a tax bill that restricts or impairs effort in any way at a time when competition is getting tougher and tougher overseas. We talked about typewriters. Let me tell you about our industry's balance of payments for the last 11 years.

From 1950 through 1961, our industry alone—and this is on commercial transactions, Senator, it has nothing to do with dividends returned—showed an export surplus contribution to balance of payments in those 11 years of $1,171 million and those are Department of Commerce figures.

This is the time when we ought to be—and I am talking about foreign economic policy, Mr. Chairman—this is a time when we ought to be looking at proposed legislation from the standpoint of what it might do to strengthen America's competitive position, not weaken it.

Incidentally, speaking of investment, I have been hearing around Washington for a long time about the $33 billion we have invested overseas. Here it is charted.

When we talk about developed nations we seem to imply that the job has been done there, and we single those out as special cases.

In my opinion, Mr. Chairman, the job is only starting in the developed nations because that is where our greatest competitive situations are going to be.

When we talk about the developed nations we are talking similarly about the United Kingdom and Europe. If we take this $33 billion and break it down we find that what we have in Europe and the United Kingdom is not $33 billion. We have $6,645 million, and incidentally, the industrial development, the manufacturing investment in Europe and the United Kingdom is only $3,797 million.

Now, let's look at the other side of the coin. The United States has a total of $6,600 million invested there. They have $4,700 million invested here.

Incidentally they have $1,611 million invested in manufacturing. This is at the end of 1960. This is all tabulated by country, by industry, by product in the Department of Commerce October 1961 and August 1961 Bulletins.

I think we h[illegible] to recognize that they seem to think foreign investments are a [illegible]y good idea.

A question [illegible] asked, I think, by you, Senator Curtis, regarding foreign enterprises selling securities in the United States. You mentioned the Phillips $400 million transaction that is now in the offing.

Here is an advertisement from the Wall Street Journal advertising a mutual fund in Japan, the Japan Fund. That offering has been completed, incidentally. If you would like these filed for the record, I will leave them. Here is the prospectus giving the whole story, $17,187,500.

Here is another, a mutual closed-end fund, the Eurofund. I assume as individuals buy these securities in foreign enterprises that we have to pay for them. I don't think they take cruzeiros, I think they want dollars.

Now, does that go as a minus on our balance of payments or not. I do know this: if an enterprise, if a corporation, because of necessity, and to improve the competitive posture of the United States, creates a foreign subsidiary and makes an investment, we are proposing to use an entirely different set of rules. We say we are going to tax immediately whether there is a dividend or not.

What about these dollars that are being invested in a foreign enterprise, not an American subsidiary? What about those?

The CHAIRMAN. Any further questions, Senator Gore?

Senator GORE. No.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. No.

The CHAIRMAN. Did you finish your questions, Senator Douglas? Senator Curtis?

Senator CURTIS. Will the passage of the provisions of this bill relating to further taxation of foreign income curtail the imports of portable typewriters?

Mr. EPPERT. Will the passage of the bill?

Senator CURTIS. Yes.

Mr. EPPERT. No. It might shift the pattern a bit. It might shift from some American production overseas to foreign manufacture.

Senator CURTIS. In your opinion, will it increase the number of, will the passage of this increase the number of jobs for typewriter makers within the United States?

Mr. EPPERT. Not one job, not one job and we will lose some jobs overseas that are now paying dividends to the United States. When a foreign subsidiary suffers a job loss overseas it adversely affects the United States.

Senator CURTIS. Now, will the passage of these provisions of this bill relating to foreign income in your opinion adversely affect employment in the Detroit area?

Mr. EPPERT. Yes.

Senator CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Thank you.

Mr. EPPERT. Incidentally, Mr. Chairman, speaking of investments overseas, yesterday just before I left Detroit I received this letter from the Foreign Service of the United States, U.S. mission in Berlin.

I would like to read you just a couple of paragraphs:

> The commitments which we and our allies have made to West Berlin make it as safe as any city in Europe and we can lose West Berlin only if it fails economically. Thus as the President's personal representative here, I have concerned myself with the maintenance of Berlin as an international and cultural city, and as I become a part-time adviser in Berlin I hope to continue this activity. Obviously in large part it is a German problem. However, American investment seems as a tonic. Moreover, the economic advantages in serving the Common Market from West Berlin are real.
>
> Thus I would like to ask you to consider the possibility of opening a small plant or facility here. Such a move would mean much to the morale of West Berlin and the furthering of American policy—

and so on.

And then:

> And the disadvantages of its location are more than offset by certain economic preferences which are extended to Berlin, principally by the Federal Republic of Germany. The major preferences are—
>
> (1) a 75-percent depreciation allowance in the first 3 years for investment in plant and equipment;
>
> (2) a reduction of 20 percent below the level in the Federal Republic for personal and corporate income tax;
>
> (3) turnover tax rebate paid on all goods produced in Berlin and sold in West Germany totaling 4 percent for the manufacturer and 4 percent for the buyer; and
>
> (4) ERP funds are available for industrial loans under more favorable conditions than those available at the commercial banks or for that matter than for ERP funds in West Germany—

and so on.

The CHAIRMAN. Thank you, Mr. Eppert.

(The memorandums referred to follow:)

Memorandum

Taxation Based on Income of Foreign Legal Entities Would Reverse Congressional Policy of Respecting International Obligations

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Congressional Policy of Respecting International Obligations

Sec. 21 of H.R. 10650 Would Authorize Treaty Violations and Reverse Congressional Policy

Section 21 of H.R. 10650, which was passed by the House of Representatives on March 29, 1962, would specifically disregard the traditional respect of Congress for previously existing treaty obligations which is evidenced by Sections 894 and 7852(d), I.R.C.

Section 894 provides that income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under the subtitle of the Code relating to income taxes.

Section 7852(d) stipulates that no provision of this title of the Code (which covers also estate and gift taxes) shall apply in any case where its application would be contrary to any treaty obligations of the United States in effect on the date of enactment of this title.

Yet Section 21 of H.R. 10650 states: Section 7852(d) of the Internal Revenue Code of 1954 (relating to treaty obligations) shall not apply in respect of any amendment made by this Act.

The House Report No. 1447, p. A 171, adds that "Section 21 of the Bill makes" it clear that in the event there is any conflict with any treaty provision (whether or not such provision was in effect on Aug. 16, 1954) the provisions of the Bill are to govern.

Hence, the Committee considers that this Bill would arbitrarily override solemn commitments to foreign governments in treaties duly approved by the Senate and ratified.

In his statement to the Senate Finance Committee on April 2, 1962 (p. 54) Secretary Dillon said he wished to dispel the impression that "we are overriding our treaty obligations" and recommended the elimination of Section 21 "to make it clear that we are honoring" them. The purpose of this memorandum is to show that if the

Secretary wishes to honor our treaty obligations in spirit as well as in substance, Section 13 should not be enacted.

List of Tax Treaties

Since 1932, when the United States signed with France its first convention to encourage business and investments between the two countries through the prevention of international double taxation, this government has incurred treaty obligations by concluding income tax conventions with 21 foreign countries, and 23 additional jurisdictions, in all parts of the free world, as follows: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Honduras, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Pakistan, Sweden, Switzerland, Union of South Africa and United Kingdom. The convention with the Netherlands has been extended to the Netherlands Antilles, that with Belgium to the Congo and the Trust Territory of Ruanda-Urundi, and that with the United Kingdom to 20 of its overseas territories. This makes in all 44 foreign jurisdictions.

The Bill Would Violate the O.A.S. Charter

The bill would also violate another commitment that was probably overlooked, namely, that in Article 15 of the Charter of the Organization of American States signed on April 30, 1948 at the Ninth International Congress of American States, Bogota, Colombia, which means striking at the very foundation of the Alliance for Progress.

Article 15 reads:

> "No State or group of States has the right to intervene, directly or indirectly, for any reason whatever, in the internal or external affairs of any other State. The foregoing principle prohibits not only armed force but also any other form of interference or attempted threat against the personality of the State or against its political, economic, and cultural elements."

This clearly prohibits intervention or interference in the internal jurisdiction of Latin American governments over corporations

organized under their laws and especially those in which their citizens may own up to 49 percent, and even 50 percent if their law so requires, of their stock by requiring special accounts and the verification thereof, for particular types of income derived by such foreign corporations from sources in such foreign countries but required by the bill to be included in the taxable income of U. S. shareholders. Such taxation obviously flouts the basic principle in the laws of all the O.A.S. countries that a corporation is a legal entity separate from its U. S. and other shareholders who cannot be taxed on the corporation's income until it is distributed to them. Furthermore, it would contravene the basic principle of territoriality in their tax laws.

Moral Obligations of the United States Vis-A-Vis O.E.C.D. Members

In order to understand more readily how the pertinent treaty obligations would be violated at least in spirit, by any of the tax proposals previously described, consideration will first be given to the moral commitments assumed by the United States when it became a member of the Organization for Economic Cooperation and Development (O.E.C.D.) which on September 30, 1961, superseded the Organization for European Economic Cooperation (O.E.E.C.). This organization had a fiscal committee, composed of representatives of its 18 Member States, which is being continued in the O.E.C.D. with representatives now of 20 Member States. Representatives of the U. S. Treasury participated in the Committee's work of preparing articles to be included in a draft convention for the avoidance of double taxation with respect to taxes on income and capital and will now enjoy the prerogatives of a full member.

The Council of the O.E.E.C. recommended that the Member States should use these articles in amending existing conventions and in negotiating future conventions. These recommendations adopted by the Council of the O.E.E.C. will be maintained (by the O.E.C.D.) and they will apply thenceforward to the United States and Canada, as Members of the O.E.C.D. (O.E.E.C., Fourth Report of the Fiscal Committee, 1961, referred to herein as "Report", p. 19).

O.E.C.D. Recommendations in Regard to Dividends

The Commentary on Article XX, Concerning the Taxation of Dividends states, inter alia,, that: "Under the laws of all European Countries, ... joint stock companies are legal entities with a separate juridical personality distinct from all their shareholders or members." The shareholder "is not a trader and the company's profits are not his; so they cannot be attributed to him. He is personally taxable only on those profits which are distributed by the company .... From the shareholders' standpoint, dividends are income from the capital which they have made available to the company as its shareholders." (Report, p. 37.)

It is obvious from the foregoing, that the basic principles of the laws of all European countries regarding recognition of the separate identity of a corporation and its shareholders are the same as those which exist in the United States.

Against this background, the significance of paragraph 5 of Article XX is clear. This paragraph reads:

> "Where a company which is a resident of a Contracting State receives profits or income from the other Contracting State, such other State may not levy any tax on the dividends paid by the company to persons who are not residents of that other State, or subject the company's undistributed profits to a tax on undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State." (Report, p. 25)

According to the commentary: "Paragraph 5 adopts a provision already contained in a number of Conventions. It rules out extra-territorial taxation of dividends and further provides that non-resident companies are not to be subjected to special taxes on undistributed profits." (id., p. 46).

By becoming a Member of the O.E.C.D. the United States agreed that this recommendation (in the preparation of which a U. S. Treasury official participated) would apply to it (id., p. 19).

Yet Section 13 of H.R. 10650 would tax undistributed income of corporations organized in other O.E.C.D. countries which would obviously contravene the spirit of paragraph 5 even if the tax were collected from U. S. shareholders.

Tax Conventions with Members of O.E.C.D.

The United States has income tax conventions with 14 of the 19 other members of the O.E.C.D., i.e. Sweden, United Kingdom, Germany, France, Netherlands, Denmark, Norway, Switzerland, Austria, Italy, Belgium, Greece, Ireland and Canada. It has carried on negotiations with Luxembourg and Portugal. The remaining 3 members are Iceland, Spain and Turkey (Report, p. 11).

The conventions entered into by the United States with the members of the O.E.C.D. are all predicated upon respect by the United States for the existence of a corporation of the other contracting State as a legal entity with a separate juridical personality distinct from its U. S. and other shareholders. Consequently, the U. S. shareholders as well as other shareholders "are taxable only on those profits which are distributed by the company." (id., p. 37.)

The same is true under the U. S. tax conventions with Belgium, the Netherlands and the United Kingdom which have been extended to other jurisdictions, and to those which are in force with Finland, Australia, New Zealand, Union of South Africa, Japan, Pakistan, and Honduras. The same principles are inherent in those which have been signed by Egypt, India, and Israel and are awaiting ratification.

These principles are also in the laws of all the countries of the free world with which the United States has diplomatic relations and is bound by international comity.

Treasury's Reference to Tax Treaties

In all the income tax conventions to which the United States is a party, a corporation of the other contracting State is not subject to United States tax except on income from sources in this

country, and in the case of industrial and commercial profits except on the amount of such income allocable to a permanent establishment in the United States. In no case could the United States tax the foreign corporation on the basis of income from sources in the other contracting State or third States.

The Secretary of the Treasury admitted in his statement to the Committee on Ways and Means that the United States could not levy the proposed taxation on a foreign corporation itself because that might conflict with the tax treaties in effect between the United States and 44 foreign countries. As indicated above these treaties all envisage the right of the United States to tax a corporation of the other contracting State only on specified classes of income from sources in the United States and, in the case of business income, only on such income allocable to a permanent establishment in the United States. However, the Secretary said that this possible conflict was to be avoided by collecting the tax from the U. S. shareholders, even if the tax was measured by and based on the earnings of the foreign corporation in the other contracting State. (Hearings before the Committee on Ways and Means on the President's 1961 Tax Recommendations, May 3, 1962, p. 261.)

The President and the Secretary have frequently indicated that one of the purposes of the proposed legislation is to achieve "tax neutrality" between domestic and foreign corporations by subjecting them both to the same United States tax, which evidently envisages in effect a tax on the foreign corporation itself (id., p. 34). Hence, such legislation would, if enacted, constitute a violation of the spirit and intent of the treaty.

Misinterpretation of "Saving Clause" in Tax Treaties

The Secretary may have based his statement on what could be done to avoid a possible conflict with treaty obligations on a strained interpretation of the so-called "saving clause" in most of the income tax conventions to which the U. S. is a party,

which interpretation was never intended when the conventions were negotiated and presumably would not now be accepted by the other contracting States. This clause reserves to each contracting State the right, regardless of any provisions of the convention, to include in the basis upon which its taxes are imposed all items of income taxable under its revenue laws, as if the convention had not come into effect, subject to the granting of the relief from double taxation provided in its laws and the convention.

An explanation of this reservation is found in the commentaries on Articles XXIII and XXIV of the O.E.C.D. Draft Conventions providing for relief from double taxation in terms essentially similar to those of the U. S. credit for foreign taxes, i.e. the State granting relief (which has a progressive scale of taxes) retains the right to take the income from the other State into consideration when determining the rate of tax under its progressive scale to be imposed on the rest of the income (Report, p. 68). This would happen, for example, when the State of residence of the taxpayer exempts income from real estate situated in the other State.

It is obvious that the convention deals only with items of income from sources in one State realized by the taxpayer resident in the other State. Accordingly, as the principle of the separate corporate entity is inherent in all the conventions, profits of a corporation in one State would not become the income of the shareholder in the other State before they were distributed.

The above-mentioned principles of European and United States law regarding the separate corporate entity are embodied in the structure of the convention. Hence, it cannot be claimed that the United States has the right to disregard them, and do indirectly what the Treasury admits it cannot do directly.

The inevitable conclusion is that the basing of a U. S. tax on undistributed income or parts thereof, however described, of corporations in foreign conflicts with the fundamental principles of their law as well as our law which pervade the tax conventions and which the United States is therefore obligated to respect.

The imposition of a levy such as that envisaged in Section 13 of H.R. 10650 would obviously involve the preparation by a foreign corporation of accounts, which are not required by the law of the foreign country, in order to segregate and determine the net income of the categories described in Subpart F, and to show the use and investment of such income in ways that are "qualified" or "non-qualified", and to pay the U. S. tax on the prescribed amounts of income that the foreign corporation would not otherwise distribute because it needs these profits, along with other income, in its business. It would also necessitate the payment of tax on profits which could not be distributed because they would have to be set aside in reserves required by law.*

This would involve in effect an invasion of the tax jurisdiction of the other State in order to apply extraterritorially the U. S. tax, and would contravene the 16th amendment (unless the tax were apportioned among the States) and the 5th amendment under the decisions described in the memorandum entitled "Unconstitutionality of Taxing U. S. Shareholders on Undistributed Income of a Controlled Foreign Corporation".

All these requirements are in sharp contrast with the statement on Article XV, paragraph 1, of the O.E.E.C. draft convention concerning the allocation of income and certain apprehensions about tax avoidance, to wit: That "much more importance is attached to the desirability of interfering as little as possible with existing business organizations and of refraining from inflicting demands for information on foreign enterprises which are unnecessarily onerous." (O.E.E.C., Third Report of the Fiscal Committee, 1960 (referred to herein as "1960 Report") p. 36.)

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* For example, under 671 of the Federal Code of Obligations a Swiss corporation has to set aside as legal reserves each year 5% of its net income until the amount of the reserves reaches 20% of its paid-in capital and, even after the reserves reach that limit, also 10% of any amounts which are distributed out of net income remaining after said payment into reserves and the payment of a 5% dividend.

Treasury's Views on Violation of Tax Conventions and Possible Retaliation

In the memorandum dated June 29, 1961, submitted by Secretary Dillon, which is entitled "Statistical Data and Economic Issues Involved in Treasury's Testimony on Tax Deferral", the Treasury states that if European governments "were to impose special taxes on American business, they would violate their tax treaties with the United States. The United States has treaties with virutally all the industrialized countries. These treaties limit the rates of withholding tax that are the one instrument foreign governments could use to impose special taxes on foreign companies." (Hearings, p. 3532)*

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* It is significant to note at this point that in Bill Sec. 19 (c)(1) there appears the following:

(1) Withholding Rate.--

(A) Section 1441 (relating to withholding of tax on nonresident aliens) is amended by adding at the end thereof the following new subsection:

"(e) Treaties.--In the case of amounts described in section 3452(a) (relating to interest), section 3462(a) (relating to dividends), and section 3472(a) (relating to patronage dividends), the tax required to be deducted and withheld under subsection (a) shall not by reason of the provisions of any treaty be less than 20 percent of such amounts."

(B) Section 1442 (relating to withholding of tax on foreign corporations) is amended by adding at the end thereof the following new sentence: "In the case of amounts described in section 3452(a) (relating to interest), section 3462(a) (relating to dividends), and section 3472(a) deducted and withheld under the preceding sentence shall not by reason of the provisions of any treaty be less than 20 percent of such amounts."

In view of Secretary Dillon's statement, supra, the application of a 20 percent withholding rate despite, for example, a limitation in a tax treaty of the withholding rate for dividends to 15 percent in general and 5 percent for parent corporations, or an exemption at source for interest, would constitute a violation of the treaty obligations of the United States. Nevertheless, under Sec. 15 of H.R. 10650 it is intended that the violation should prevail except it is said that the nonresident alien or foreign corporation could claim a refund of the excess of the amount withheld over the limitation prescribed in the treaty.

The above quotation apparently contemplates that the only special taxes imposed by other contracting States that would violate their tax treaties with the United States would be withholding taxes at rates higher than those stipulated in the convention.

If the other Contracting State did the improbable thing and subjected its resident shareholders to tax on the basis of undistributed profits of subsidiaries in the United States, would not the Treasury consider that to be a violation of the tax treaty, and if so, would not tax in Section 13 of the pending bill or the Secretary's revived proposal be a violation?

Let us suppose that the other contracting State took more direct action and simply amended its law to provide that in cases where a foreign government levied a tax based on certain types or all of the undistributed income of corporations organized in its territory, the rate of its tax on the income of such corporations controlled by persons resident in such other State would be increased on such types or all of the income distributable to such shareholders, to a rate equal to that applicable to the shareholder in such other State. In such a case, the tax would absorb the credit allowable against the U. S. rate and no additional revenue would be derived. However, as the foreign government would impose the tax on its own corporation, would the Treasury acknowledge that such action did not violate the treaty?

A careful examination of the laws of other countries reveals no instance where another government taxes its resident shareholders on certain types or all of the undistributed income of a foreign business corporation. Even in the relatively few cases where a government actually taxes a corporation organized in another country on the grounds that said corporation is regarded as being a resident because of having its central management and control in its territory, that government subjects the foreign corporation itself to tax and not the parent corporation or other resident shareholders.

Under international law and comity, the United States should respect the jurisdiction of foreign governments over legal entities created in their respective territories, and their exclusive right to tax undistributed income of such entities.

Questions as to the Jurisdiction of the United States over Foreign Subsidiaries

Questions that may be raised in view of the limitations on jurisdiction that are fundamental in tax treaties are (1) whether the tax law can properly authorize the Treasury to extend its jurisdiction to transactions between a foreign subsidiary in one country and not only related companies but even independent corporations in third countries, including transactions effected on an arm's length basis and perfectly acceptable to the tax authorities of the countries involved; (2) whether Congress can indirectly force foreign companies to keep accounts of the results of such transactions effected outside the jurisdiction of the United States and which are not required under the laws of their respective countries; and (3) whether Congress can properly authorize the Treasury indirectly to exercise jurisdiction over foreign corporations to ascertain the net income of the categories under Subpart F of Section 13 of H.R. 10650.

No foreign government has been known to show such disregard for the fiscal sovereignty of other governments and to apply in effect its laws within the fiscal jurisdictions of other governments.

It hardly seems consonant with the basic principles of conduct vis-a-vis nations with which this country has diplomatic relations to take hostile measures affecting legal persons existing under their laws just because the majority of their capital stock is owned by U. S. shareholders.

The Proposed Tax Would Conflict with Tax Treaties

An income tax convention between the United States and a foreign country has the status of a treaty and consequently

is "the Supreme Law of the Land" (U.S. Const., Art. VI, §2). "In construing the terms of the Treaty, we are constrained to look 'within the four corners of the Treaty' keeping in mind the purpose of the contracting parties. Any resort to domestic law must be derived from the express terms of the Treaty itself." (American Trust Company v. Smyth, 247 F. 2d 149, 153 (C.A. 9th, 1957))

The Circuit Court states that the following quotation is also true as to an Income Tax Convention (in the cited case between the United States and the United Kingdom), its purpose being to secure reciprocity and equality of tax treatment between the nationals of the two contracting parties. The quotation reads, inter alia:

> " '. . . . Considerations which should govern diplomatic relations between nations and the good faith of treaties, as well, require that their obligations should be liberally construed so as to effect the apparent intention of the parties to secure equality and reciprocity between them. . . . . Jordan v. K. Tashiro, 278 U.S. 123, 127, 49 S. Ct. 47, 73 L. Ed. 214; Geofroy v. Riggs, 133 U.S. 258, 271, 10 S. Ct. 295, 33 L. Ed. 642; In re Ross, 140 U.S. 453, 475, 11 S. Ct. 897, 35 L. Ed. 581; Tucker v. Alexandroff, 183 U.S. 424, 437, 22 S. Ct. 195, 46 L. Ed. 264; Asakura v. City of Seattle, 265 U.S. 332, 44 S. Ct. 515, 68 L. Ed. 1041.' Factor v. Laubenheimer, 1933, 290 U.S. 276, 54 S. Ct. 191, 195, 78 L. Ed. 315."

If a Treasury official would look "within the four corners" of any income tax convention, he would find embodied therein respect for the corporation of the other contracting State as a legal entity distinct from the shareholders who are U. S. citizens, residents or corporations, with the consequence that only the other contracting State could tax as such its undistributed income or parts thereof.

Furthermore, when the said corporation of the other contracting State distributes its income, it withholds its country's tax, if any, from dividends, and the United States citizen, resident or corporation includes the dividend in taxable income subject to being allowed the credit for the other State's tax provided in the Code as of the date prescribed by the Convention.

The foregoing provisions are reciprocal. This reciprocity would be destroyed if the United States should now unilaterally amend its law to interject between (a) the taxation of the foreign corporation itself (on income from U. S. sources), and (b) the taxation of its U. S. shareholders on dividends received from the foreign corporation, a new tax on the U. S. shareholders based on certain types or all of the undistributed income of the foreign corporation from sources in the other contracting State and in third States. No other government now imposes such a tax and presumably would not do so although it might retaliate in other ways.

Tax conventions are intended to prevent international double taxation by limiting the respective jurisdictions of the two contracting States on a reciprocal basis so that a certain class of income is taxed exclusively in one State or the other, or if it is to be taxed first in the State of source and then in the State of residence, the latter agrees to provide relief from double taxation. (This relief may be accomplished by granting either a deduction or credit in respect of the foreign tax on the foreign income against its tax on entire net income.)

Obviously the introduction of a third tax based on certain types or all of the undistributed income of a foreign corporation but collected from the domestic taxpayer, would conflict with the basic principles, the structure, the purpose and spirit of conventions to avoid double taxation. It would be contrary to the established policy of Congress and the jurisprudence of the Supreme Court.

The Tax Would Violate Clause Prohibiting Taxation of a Subsidiary as a Branch

Apart from the foregoing general principles inherent in tax conventions there is a specific provision in the definition of a

permanent establishment that was set forth in the first convention with France, signed April 26, 1932,* and has been included as a standard clause in all subsequent income tax conventions. The primary purpose of this first convention was to prevent France from trying to reach income that its administration believed was being diverted in a given case from a French subsidiary to an American parent company by applying in all cases its dividend tax on a proportion of the dividends distributed by the American corporation in the United States that was deemed to be derived in France. The tax was both extraterritorial and discriminatory.**

In the tax convention it was agreed that if France was able to prove the amount of income diverted from a French subsidiary to an American parent corporation, such amount could be included in the basis of the tax on industrial and commercial profits and also be treated as a dividend subject to the tax on income from securities. To further carry out the principle of territoriality it was also agreed that a subsidiary in France of a U. S. corporation would not be treated as a permanent establishment, so that its profits could not be taxed as the income of the U. S. parent corporation.

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* The provision under Par. III (a) of the Protocol to the convention signed July 25, 1939, which superseded that signed April 27, 1932, states:

"The term 'permanent establishment' includes branches, mines and oil wells, plantations, factories, workshops, stores, purchasing and selling and other offices, agencies, warehouses, and other fixed places of business but does not include a subsidiary corporation" (emphasis supplied).

** This led to the adoption by Congress in 1934 of the provisions now found in Sec. 891, I.R.C. which authorizes the President, whenever he finds that, under the laws of any foreign country, United States citizens and corporations are being subjected to discriminatory or extraterritorial taxes, to so proclaim and double the tax imposed on each citizen and corporation of such foreign country, subject to a maximum rate of 80%.

On the contrary, Section 13 of H.R. 10650 and the Treasury proposal would disregard the separate legal existence of a controlled French corporation and tax the U. S. parent as if it received direct certain types or all of its income from sources in France or elsewhere. Hence, Section 13 of the bill and the Secretary's proposal would violate this specific provision in the tax treaty with France and the similar clause in tax treaties with 43 other governments.

Difference Between Tax Abandoned by France and Contemplated Tax

There is a striking difference between what France was doing and what the House Bill and the Treasury contemplate doing, i.e., while France was seeking to retrieve income it deemed to have been earned in its territory the United States would arbitrarily reach income belonging to a foreign corporation and attributable to French or other foreign sources that had never been within the U.S. Treasury's jurisdiction. It would tax to the U. S. shareholder income that belonged to a French corporation and might be set aside in reserves required by law, used in the expansion of its plant or for other business purposes, and would never be distributed to its shareholders in France and in the United States. Only in the last mentioned case would the income enter the jurisdiction of the United States. Section 13 would thus in effect expropriate the funds of corporations in any foreign country, through forcing the U. S. shareholders either to pay the tax out of their own funds or bring pressure on the foreign corporation to distribute at least enough dividends to pay the tax regardless of the interests of minority shareholders who are nationals of the country.

The Tax Would Violate the Very Purpose of Tax Treaties

The bill poses a problem because normally in foreign countries dividends are not declared until an annual meeting of shareholders is held several months after the close of the company's fiscal year, when the accounts have been audited and approved reserves required by law have been set aside and the disposition of the balance of the earnings has been decided upon. Yet the bill says that the company's income within the purview of the U. S. tax is to be included in gross income currently and at the latest as of the last day of the foreign company's fiscal year. The foreign tax thereon would not be paid before the following year, usually not

before March or April. Yet presumably this tax is to be credited against the U. S. tax, at least to the extent that it corresponds to the income which is included in the taxpayer's gross income.

The foreign tax on dividends could not of course be withheld until the foreign income is distributed. Even if the shareholder wished to obviate paying any part of the tax out of other funds, through prevailing upon the foreign corporation to distribute dividends, it could not distribute income that had to be set aside in legal reserves or used in the conduct of its business.

Often in the preamble of tax treaties reference is made to their basic purpose of encouraging the citizens or corporations of one country to invest or carry on business in the other and the convention covers doing business through branches or subsidiaries. Hence, the imposition of such a levy obviously would not encourage but would discourage investments in, or the conduct of business through, foreign corporations, and would therefore violate the very purpose of the tax treaties with 44 foreign countries, which include the leading countries in all parts of the free world.

Moreover, the conventions clearly limit the territorial jurisdiction over foreign corporations by providing, in substance, that a foreign corporation will not be taxable in the United States on its industrial and commercial income, except in so far as it is allocable to a permanent establishment in the United States and as shown by separate accounts for said establishment. This clearly shows that there was no thought of reaching a foreign corporation in order to tax it on all or any types of its undistributed income, and of requiring it to supply accounts showing such income, as well as the balance sheet and profit and loss statement and other data that may be called for under Section 6038 and the proposed amendments thereto. The exacting of such information via the shareholders is obviously contrary to the very spirit, purpose, and the positive requirements of the tax treaties. It implies intervention or interference in the corporations and therefore the economic affairs of the other contracting States, as well as the 19 other signatories of the O.A.S. Charter.

Conclusion

It is known that foreign tax administrators were disturbed over the U. S. Treasury proposal. They would be all the more disturbed by the provisions in H. R. 10650 affecting corporations organized in their territory because these provisions would conflict with the fundamental principles of their laws that are inherent in tax conventions concluded by the United States and their governments These proposals also would conflict with the above cited provisions in the O.E.E.C. 1961 Report concerning the taxation of dividends in the preparation of which the Treasury was represented.

Foreign officials have stated informally that they consider that the contemplated levy would constitute an incursion into or a transgression of their jurisdiction; that they would not assist in its enforcement and would not permit agents of the I.R.S. to come into their territory to examine the books of account of local subsidiaries. They could consider that as such taxation would conflict with the tax convention. They would not be bound to assist the U. S. Treasury to enforce the provisions for assisting the U. S. Treasury in the allocation of taxable income. Said Articles otherwise would normally assure the cooperation of the administration of the other contracting State in reallocating to the United States income attributable to sources or to a taxpayer in the United States, but not income normally attributable to the other contracting State or to third States.

As the Congress has incorporated in the Internal Revenue Code long-established and generally accepted principles of jurisdiction which are inherent in the duly ratified tax conventions, it is urged that the Senate Finance Committee reject Section 13 of H. R. 10650, and Secretary Dillon's proposals, and replace it by amendments to prevent abuses which would conform to generally accepted principles of territorial jurisdiction over foreign corporations.

Respectfully submitted,
Mitchell B. Carroll

ANNEX I

Obligations in Tax Conventions to Exempt Foreign Corporations From Tax on Profits Except for Profits Allocable to a Permanent Establishment in the United States

The treaty obligation that the United States will not tax a foreign corporation in respect of industrial and commercial income, except in so far as income is allocable to a permanent establishment in the United States in accordance with the terms of the convention, is clearly stated in the conventions with the following countries and in the respective article:

Australia	Art. III	Ireland	Art. III
Austria	Art. III	Italy	Art. III
Belgium	Art. III	Japan	Art. III
Canada	Art. III	Netherlands	Art. III
Denmark	Art. III	New Zealand	Art. III
Finland	Art. III	Norway	Art. III
France	Art. 3	Pakistan	Art. III
Germany	Art. III	Sweden	Art. II
Greece	Art. III	Switzerland	Art. III
Honduras	Art. III	Union of South Africa	Art. V
		United Kingdom	Art. III

ANNEX II

Obligations in Tax Conventions Respecting the Right of the Other Contracting State to Tax Dividends

The treaty obligations to respect the right of the other contracting State to tax the income of corporations organized therein is inherent in the provisions corresponding to those listed from the viewpoint of the United States in Annex III, and in the provisions regarding the taxation of dividends paid to U. S. corporations, as follows:

Australia	Art. VII(1). The amount of Australian tax on dividends paid by an Australian company to a United States resident who is liable for United States tax thereon and is not engaged in trade or business in Australia shall not exceed 15 percent of the dividend.
Austria	Art. VI. The rate of tax imposed by Austria upon dividends received by a U.S. corporation not having a permanent establishment in Austria shall not exceed 50 percent of the Austrian statutory rate, but such rate shall not exceed 5 percent if the U. S. corporation controls, directly or indirectly, at least 95 percent of the entire voting power of the Austrian corporation, and if certain other conditions are met.
Belgium	Art. III. Belgium shall not impose on dividends derived from a Belgian company by a U. S. corporation not having a permanent establishment in Belgium any tax similar to the tax withheld at source on dividends under United States law in the case of nonresident aliens and foreign corporations.

Canada	Art. XI. The rate of income tax imposed by Canada in respect of dividends paid by a Canadian company to a United States corporation, not having a permanent establishment in Canada, shall not exceed 15 percent for each taxable year.
Denmark	Art. VI. Denmark reserves the right to withhold tax at a rate not in excess of 15 percent from dividends paid by a Danish corporation to a United States corporation not having a permanent establishment in Denmark, except that the rate shall not exceed 5 percent if the United States corporation controls, directly or indirectly, at least 95 percent of the entire voting power of the Danish corporation, and if other conditions are met.
Finland	Art. VI. Similar to that in the treaty with Denmark, supra.
France	Art. 6A. A United States corporation not having a permanent establishment in France and deriving dividends from a French corporation is subject at source to a French tax with a rate not in excess of 15 percent.
Germany	Art. VI. The generally applied German withholding rate of 25 percent is reduced to a rate not exceeding 15 percent in the case of dividends paid by a German corporation to a United States corporation not having a permanent establishment in Germany and owning at least 10 percent of the voting stock in the German corporation.
Greece	- - - - - - -
Honduras	- - - - - - -
Ireland	Art. XIII. A United States corporation receiving a dividend from an Irish company shall, for the purpose of the U. S. credit for foreign taxes, be deemed to have paid the Irish income tax appropriate to the dividend if it elects to include in gross income for the purposes of the U. S. tax the amount of such Irish income tax.

Italy	Art. VII. The rate of tax imposed by Italy on dividends paid by an Italian company to a United States corporation not having a permanent establishment in Italy is limited to 15 percent (although actually no such tax is imposed) but provision is made for reducing this tax to not more than 5 percent, if certain conditions are met.
Japan	Art. XIV(c)(ii). Japan imposes no dividend tax, but the United States gives a credit against its tax for a deemed Japanese tax of 25 percent of the amount of the dividend if it includes such deemed tax in gross income.
Netherlands	Art. VII(2). Dividends paid by a Dutch company to a U. S. corporation are exempt from the Dutch dividend tax which would otherwise be 15 percent.
New Zealand	Art. VI. If New Zealand imposed a tax on dividends paid to a U. S. corporation, the rate could not exceed 15 percent, except that it could be reduced to 5 percent if certain conditions are met.
Norway	Art. VI-A. The rate of tax on dividends paid by a Norwegian company to a U. S. corporation not engaged in trade or business in Norway through a permanent establishment may not exceed 15 percent, except that it may not exceed 5 percent if the dividends are received by a U. S. corporation owning more than 50 percent of the voting stock of the Norwegain corporation, and if certain conditions are met.
Sweden	Art. VII. Sweden reserves the right to retain a rate not exceeding 10 percent of the dividend paid by a Swedish company to a U. S. corporation.

Switzerland	Art. VI. Switzerland withholds from dividends paid by a Swiss company to a U. S. corporation, not having a permanent establishment in Switzerland, a rate not exceeding 15 percent, except that it may not exceed 5 percent if the U. S. corporation owns at least 95 percent of the voting stock of the Swiss company, and if other conditions are met.
Union of South Africa	- - - - - - -
United Kingdom	Art. XIII. A U. K. company deducts U. K. income tax of 38 3/4 percent from dividends paid to a U. S. corporation, and the latter is deemed to have paid such tax and may take a credit for such tax against its U. S. tax if it elects to include in gross income for the purposes of the U. S. tax the amount of such U. K. income tax.

ANNEX III

Obligations in Tax Conventions to Allow the Credit for Foreign Taxes on Realized Income as Provided on a Specified Date

Fourteen of the income tax conventions which the United States has entered into with other countries contain provisions obligating the United States to grant a U. S. corporation or other taxpayer a credit for foreign taxes paid in accordance with the pertinent provisions of the Internal Revenue Code as they existed on a particular date. In most cases this date is the date of entry into force of the convention (i.e. the date the instruments of ratification were exchanged), in some cases the date is the date of signature of the convention, in two cases the date is a particular date specified in the convention, and in one case the date is the effective date of the convention.

In all these conventions, the other contracting state allows a similar credit or other equivalent relief from double taxation in consideration of the credit granted by the United States. In all cases the credit envisages only foreign taxes on realized income.

The provisions of the fourteen income tax conventions which obligate the United States to grant a credit for foreign taxes in accordance with existing provisions of the Internal Revenue Code are summarized as follows:

	COUNTRY	CONVENTION PROVISIONS	PERTINENT DATE
1.	Australia	Australian tax allowed as credit subject to Sec. 131 I.R.C. of 1939 as in effect on date of signature of convention. (Art. XV)	Signed 5/14/53
2.	Austria	Austrian taxes allowed as credit subject to provisions of Secs. 901-905 I.R.C. of 1954 as in effect on entry into force of convention. (Art. XV)	In force 10/10/57
3.	Belgium	Belgian taxes allowed as credit in accordance with provisions of Sec. 131 I.R.C. of 1939 as in effect on date of entry into force of convention. (Art. XII)	In force 9/9/53
4.	Finland	Finnish taxes allowed as credit subject to provisions of Sec. 131 I.R.C. of 1939 as in effect on date of entry into force of convention. (Art. XV)	In force 12/18/52
5.	Germany	German taxes allowed as credit subject to provisions of Sec. 131 I.R.C. of 1939 as in effect on date of entry into force of convention. (Art. XV)	In force 12/20/54
6.	Honduras	Honduran tax allowed as credit subject to provisions of Secs. 901-905 I.R.C. of 1954 as in effect on date of signature of convention. (Art. XVI)	Signed 6/25/56
7.	Ireland	Irish tax allowed as credit subject to Sec. 131 I.R.C. of 1939 as in effect on date convention comes into effect, provided dividend grossed up by amount of income tax appropriate thereto. (Art. XIII)	Effective 1/1/51
8.	Japan	Japanese tax allowed as credit subject to provisions of Sec. 131 I.R.C. of 1939 as in effect on January 1, 1954. (Art XIV)	1/1/54

	COUNTRY	CONVENTION PROVISIONS	PERTINENT DATE
9.	New Zealand	New Zealand tax allowed as credit subject to Sec. 131 I.R.C. of 1939 as in effect on date of signature of convention. (Art. XIII)	Signed 3/16/48
10.	Norway	Norwegian taxes allowed as credit subject to provisions of Sec. 131 I.R.C. of 1939 as in effect on date of entry into force of convention. (Art. XIV)	In force 12/11/51
11.	Pakistan	Pakistan tax allowed as credit subject to provisions of I.R.C. as in effect on date of signature of convention. (Art. XV)	Signed 7/1/57
12.	Switzerland	Swiss taxes allowed as credit subject to provisions of Sec. 131 I.R.C. of 1939 as in effect on date of entry into force of convention. (Art. XV)	In force 9/27/51
13.	Union of South Africa	South African income tax allowed as credit in accordance with benefits and limitations of Sec. 131 I.R.C. of 1939 as in effect on date of entry into force of convention. (Art. IV)	In force 7/15/52
14.	United Kingdom	United Kingdom tax allowed as credit subject to Secs. 901-905 I.R.C of 1954 as in effect on January 1, 1956, provided dividend grossed up by amount of tax appropriate thereto. (Art. XIII)	1/1/56

Memorandum

Taxing U.S. Shareholders on Undistributed Income of a Controlled Foreign Corporation Would Disregard Supreme Court Decisions on the 5th and 16th Amendments to the Constitution

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April 17, 1962

Unconstitutionality of Taxing U. S. Shareholders on Undistributed Income of a Controlled Foreign Corporation

Description of Taxes Involved

Questions of constitutionality were raised at the Hearings before the Committee on Ways and Means, the week of June 5, 1962, in regard to the Treasury proposal to tax to U. S. shareholders undistributed profits of controlled foreign corporations and the same basic questions may be raised in regard to the provisions in Section 13 of the Revenue Act of 1962, H.R. 10650, passed by the House of Representatives on March 29, 1962, which would introduce in the Internal Revenue Code new Sections 951 to 958 in order similarly to tax certain categories of income from foreign sources derived by such foreign corporations.

On April 2, 1962, at the beginning of the Hearings on the bill before the Senate Finance Committee, Secretary Dillon proposed that the bill be amended to embody the original concept of taxing all the undistributed income of the controlled foreign corporation.

More specifically, H.R. 10650 would require the inclusion in the gross income of United States persons, owning a direct or indirect interest in a controlled foreign corporation, even unto the third or fourth degree of relationship or beyond, of a corresponding part of the subsidiary's undistributed income which is termed "Subpart F income" which includes (1) income from insuring United States risks, (2) income from patents, copyrights, and exclusive formulas and processes, and (3) net foreign base company income (H.R. Report No. 1447, pp. A93 and 94). This would be done even if there were no tax avoidance of any kind. This novel form of taxation would occur with regard to (3) in the case of any foreign corporation of which more than 50 percent of the total combined voting power of all classes of voting stock, or the total value of shares of all classes of stock, is owned directly or indirectly by no more than 5 United States persons on any day of the taxable year of such foreign corporation, and there is apparently no limit as to the number of shareholders with regard to (1) and (2) except that the provisions do not apply if the U. S. shareholder owns less than 10 percent of the voting stock of the foreign corporation.

As the issue of constitutionality was raised in regard to the President's original proposal, it will now be discussed primarily from that viewpoint although the same questions are raised by Section 13 of H.R. 10650.

The Supreme Court Has Ruled Against Taxing the Shareholder on the Corporation's Undistributed Income Under the 16th Amendment

The most direct answer to the Treasury's premise that under the 16th amendment Congress can tax the undistributed income of a controlled foreign corporation is the "landmark decision" of the Supreme Court in Eisner v. Macomber, 252 U.S. 189, 40 S. Ct. 189 (1920). This decision was mentioned in the Hearings* (p. 313) as not being relevant to the present issue because no stock dividend is involved. However, the Supreme Court held in this case that "neither under the Sixteenth Amendment nor otherwise has Congress power to tax without apportionment a true stock dividend made lawfully and in good faith, or the accumulated profits behind it, as income of the stockholder" (emphasis supplied).

The underscored reference to "accumulated profits" reflects the statement in the decision (40 S. Ct. at p. 197) that

> ". . . the government, . . . virtually abandoning the contention that a stock dividend increases the interest of the stockholder or otherwise enriches him, insisted as an alternative that by the true construction of the act of 1916 the tax is imposed, not upon the stock dividend, but rather upon the stockholder's share of the undivided profits previously accumulated by the corporation." (emphasis supplied)

The fact that it has been the view of the Committee on Ways and Means that Eisner v. Macomber "carries a provision against taxing even undistributed income to the shareholder" was stated in footnote 37 to Helvering v. Griffiths, 318 U.S. 371, 63 S. Ct. 636, 647 (1939). In this case the Government requested that Eisner v. Macomber be overruled so that common stock dividends identical to the stock on which they were declared could be taxed, but the Supreme Court was unable to find that Congress intended to tax the dividends in question and would not reconsider Eisner v. Macomber on the basis of the legislation and Regulations in force. No subsequent decision has been found which in any way limits this decision in regard to the point that Congress has no power to tax a stockholder without apportionment upon the accumulated profits of the corporation.

The Treasury General Counsel suggests (Hearings, p. 315) that Helvering v. Bruun (1940), 309 U.S. 461, overruled the decision of Eisner v. Macomber that income must be represented by something

*Hearings on the President's 1961 Tax Recommendations before the Committee on Ways and Means, House of Representatives, 87th Cong., 1st Sess., herein referred to as "Hearings".

"severable" from the investment. However, in the Bruun case the Court said in essence that the issue was not "severability" but whether there was a transaction on which something was received. The Court held that repossession of land with a new building added was such a transaction, and distinguished the earlier case of M. E. Blatt Co. v. United States (1938), 305 U.S. 267, in which there was no such repossession. Thus, it is clear that Eisner v. Macomber, as explained in the Bruun case, still stands as authority against taxability as income to the shareholder of the undistributed profits of a corporation.

It is therefore relevant to review in this regard pertinent statements of the Supreme Court in Eisner v. Macomber (40 S. Ct. 189).

The Sixteenth Amendment reads:

> "The Congress shall have the power to lay and collect taxes on income, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

The Supreme Court declared: "As repeatedly held, this did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the states of taxes laid on income." (id., p. 193) In other words, if the tax proposed by the Treasury does not qualify as an income tax as is set forth in this decision, then it would have to be apportioned among the States.

Undistributed income of a company cannot be treated as income of the shareholder, according to the Supreme Court, for the following reasons:

(a) "The interest of the stockholder is a capital interest." (id., p. 193)

(b) "Short of liquidation or until a dividend is declared, he has no right to withdraw any part of either capital or profits from the common enterprise; on the contrary, his interest pertains not to any part, divisible or indivisible, but to the entire assets, business and affairs of the company. Nor is it the interest of an owner in the assets themselves, since the corporation has full title, legal and equitable, to the

"whole. The stockholder has the right to have the assets employed in the enterprise, with the incidental rights mentioned; but, as stockholder, he has no right to withdraw, only the right to persist, subject to the risks of the enterprise, and looking only to dividends for his return." (id., pp. 193, 194)

(c) "If profits have been made and not divided they create additional bookkeeping liabilities under the head of 'profit and loss', 'undivided profits', 'surplus account' or the like. None of these, however, gives to the stockholder as a body, much less to any one of them, either a claim against the going concern for any particular sum of money, or a right to any particular portion of the assets or any share in them unless or until the directors conclude that dividends shall be made and a part of the company's assets segregated from the common fund for the purpose. The dividend normally is payable in money, under exceptional circumstances in some other divisible property; and when so paid, then only (excluding, of course, a possible advantageous sale of his stock or winding-up of the company) does the stockholder realize a profit or gain which becomes his separate property, and thus derive income from the capital that he or his predecessor has invested." (id., p. 194)

The Proposed Tax Would Be a Tax on Property Subject to Apportionment Among the States

The foregoing describes income within the meaning of the Sixteenth Amendment. However, H.R. 10650 or Secretary Dillon's proposal contemplate a tax predicated on the shareholder's ownership of stock in the company, which would be a tax on property, although measured by income belonging to the foreign company which Congress could not tax as such. "That Congress has power to tax shareholders on their property interests in the stock of corporations is beyond question, and that such interest might be valued in view of the condition of the company, including its accumulated and undivided profits is equally clear. But that this would be taxation of property because of ownership, and hence would require apportionment under the provisions of the Constitution, is settled beyond peradventure by previous decisions of this court." (emphasis supplied) (id., p. 197)

In view of this categorical statement by the Supreme Court, it is evident that H.R. 10650 would levy, under the guise of an income tax, a tax collected from U. S. shareholders upon their property interests in the stock of foreign corporations. Under that bill the tax would be measured by "Subpart F income" (H.R. 10650, Sec. 952), but the Supreme Court's term "undivided profits" would cover all the items included therein. Nevertheless, in view of the above holding of the Supreme Court, such taxation of property because of ownership of stock in a foreign corporation would be unconstitutional unless the tax were apportioned among the States under the provisions of the Constitution.

Issues Discussed in Official Memoranda Submitted at Hearings

The Treasury General Counsel originally described the issue as being "whether under the 16th amendment undistributed earnings and profits of U. S.-controlled foreign corporations can be held to constitute income to the enumerated classes of U. S. stockholders. If so, it is clearly subject to tax unless it is to be imposed in so arbitrary and discriminatory a fashion as to violate the due-process requirement of the fifth amendment" (Hearings, p. 314).

On the other hand, the top Congressional tax adviser has said: "The administration's proposal is that the income earned by foreign corporations be taxed to the American shareholders without any distribution or dividend declaration. This raises certain basic questions as to whether or not the shareholder has income within the meaning of the 16th amendment when he has received nothing and does not have the right and power to demand any payment" (id., p. 311).

Congress Has No Power Under the 16th Amendment to Tax on the Basis of Constructive Receipt of a Foreign Corporation's Income

The Treasury General Counsel asserts that "Congress has the power under the 16th amendment to impose a tax on the undistributed earnings of a foreign corporation controlled by U. S. shareholders on the ground that it may find that such income is constructively received by the U. S. shareholder to prevent avoidance of taxes or on the broader ground advanced by leading scholars in the field, including some Supreme Court justices, to the effect that any net increase in wealth is taxable" (Hearings, p. 316). However, as has been shown above in citing Eisner v. Macomber and as will be shown, infra, the Treasury does not cite any decisions that support this assertion.

No Decisions Support Constructive Receipt by Shareholder of Foreign Corporation's Income

None of the decisions of the United States Supreme Court cited by the Treasury support its assertion that undistributed income of a foreign corporation is income constructively received by the shareholder.

As regards the assertion that Congress has the power to treat such income as being constructively received to prevent tax avoidance, this is tantamount to admitting that it could not do so where it would not have that justification. Congress would hardly be justified in presupposing tax avoidance in view of the fact that some 20,000 foreign corporations are involved (Hearings, p. 3545) and most of their operations are outside the United States. If any income should be diverted from the parent in the United States to the foreign subsidiary within the purview of Section 482, I.R.C., such income could be allocated back to the parent and taxed. In fact, H.R. 10650 clearly shows that the purpose is to tax income derived by a foreign corporation from sources outside the United States (Sec. 952(a)(2)), that is income which under present law and internationally accepted principles of law is outside the tax jurisdiction of the United States.

Under the law of the United States, the separate identity of a corporation for tax purposes is so well established that the Supreme Court has recognized the legal existence of a corporation as being separate from that of the shareholders and even a sole stockholder. The Courts do not disregard the separate corporate status except to prevent fraud or the evasion of some statutory prohibition or requirement. National Carbide v. Commissioner, 336 U.S. 422 (1949); Moline Properties v. Commissioner, 319 U.S. 436 (1943). It is unreasonable to assume that this exception could envisage all of the 20,000 foreign corporations that are legitimately engaged in foreign business or investments.

This doctrine of the separate corporate entity was recently applied by the Tax Court in Frelbro Corporation, 36 T.C.-, No. 86 (August 18, 1961); C.C.H. Dec. 24, 985 in which that Court held the taxpayer could not be taxed on the earnings of its wholly-owned subsidiary prior to the receipt of a dividend, saying "an accrual basis taxpayer must include dividends in income in the year in which they are made unqualifiedly subject to his demand, i.e. the time when payment is to be made."

In the light of Lester Lumber Co., Inc. v. Commissioner, 14 T.C. 225 (1950), the American shareholder of a foreign corporation has the right to demand payment of a dividend only when the

foreign shareholders have the same right. Thus, in the absence of the declaration of a dividend, no constructive receipt doctrine can be applied (Hearings, p. 313).

Although the Treasury counsel believes that the Supreme Court would hold as constructively received by the shareholders the net earnings of a corporation, while not distributed as dividends, because they serve to increase the wealth of the shareholders (id., p. 314), it has not so held and a court has decided that even where the corporation is enriched through services performed by the shareholder, the latter does not have any income by reason of the increase in value of his stock. Joy Manufacturing Co. v. Commissioner, 230 F. 2d 740 (CA-3, 1956), reversing 23 T.C. 1082; Josephson v. Commissioner, 6 TCM 788 (1947).

The Treasury's contention would not be supported by the definition of income in Eisner v. Macomber, supra, in which the Supreme Court stated, inter alia, that income is not "a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital . . . .". Accordingly, the Court held that a shareholder did not receive taxable income when the corporation distributed a fully proportionate stock dividend in stock identical to that already outstanding. The Court added that its earlier decision in Collector v. Hubbard, 12 Wallace 1 (1870), (which held valid a Civil War statute taxing undistributed corporate profits to the shareholders) "must be regarded as overruled" by Pollock v. Farmers Loan and Trust Co., 158 U.S. 601 (1898).

Even if, as some authorities surmise, the Supreme Court might reverse itself and hold that a proportionate stock dividend could constitutionally be taxed, this would not support the taxability of undistributed earnings when the corporation distributes neither a proportionate nor disproportionate stock dividend. The question of whether or not proportionate stock dividends can be taxed is not really relevant to the issue (Hearings, p. 313). However, the decision in Eisner v. Macomber is relevant in so far as it bars taxing to the shareholders a corporation's accumulated earnings.

It is relevant to note, moreover, that in Eisner v. Macomber, supra, the Supreme Court stressed the unfairness of taxing the undistributed income to the shareholder when in later operations the corporation might lose the income through business reverses so that the shareholders would in fact receive "nothing that answers the definition of income within the meaning of the 16th amendment" (252 U.S. 211).

The Treasury memorandum cites two cases, one involving the right of the taxpayer to receive interest on bonds where he had made a gift to his son of the coupons detached from the bond before the due date (Helvering v. Horst, 311 U.S. 112 (1940)), the other the right of a taxpayer to demand the dividends which had been declared but not paid (Kunze v. Commissioner, 19 T.C. 29 (1952) aff'd. 203 F. 2d 957 (C.A. 2d 1953)). Obviously, neither of these decisions supports the proposal to tax a U. S. shareholder on income that belongs to a foreign legal entity, and has not been declared as a dividend and thus subjected to the shareholder's control.

The Treasury Counsel contends that undistributed earnings of a foreign corporation could be held to be constructively received by the U. S. shareholders on the ground that the foreign personal holding company provisions were upheld as taxation of income under the 16th amendment in Eder v. Commissioner, 47 B.T.A. 235; 138 F. 2d 27 (C.A. 2d 1943). However, in that case neither the Board nor the Court mentioned the 16th amendment. The Board stated (p. 235) that:

> "The sole issue is whether certain foreign exchange restrictions in effect in Colombia, South America, during 1938, except petitioners, shareholders of a foreign personal holding company, organized and existing in Colombia, from the provisions of section 337 of the Revenue Act of 1938 . . . ."

The Board held (at p. 240) that decisions involving the taxability to a United States taxpayer of his "blocked" income were not in point because they were decided under the doctrine of "constructive receipt". Furthermore, the Circuit Court notes (at p. 27) that the taxpayers conceded the Colombian company was a foreign personal holding company and indicates that the issues were whether blocked income could be included in gross income under Section 337 and the rate of exchange at which the "blocked" pesos should be converted into United States dollars for tax purposes. "As the taxpayers could have invested, or spent the 'blocked' pesos in Colombia and, as a result, could there have received economic satisfaction", the Circuit Court remanded the case to the Tax Court for further

consideration of the appropriate measure of evaluation.* In other words, the decision in Eisner v. Macomber, supra, was not raised or challenged.

The foreign personal holding company provisions have never been involved in a case decided by the Supreme Court. Their limited purpose is shown by a "Report on Tax Evasion and Avoidance" submitted by the joint committee on August 5, 1937 (75th Cong., 1st Sess. H. Doc. 337), which states, inter alia: "Real foreign operating companies or widely held holding companies are not included" (Hearings, p. 312).

In short, the Treasury has not been able to cite a single decision in which the Supreme Court has held that undistributed income of a foreign corporation could be regarded as income constructively received by its shareholders under the 16th amendment.

As the issues involved are essentially the same in H.R. 10650 to tax U. S. shareholders on so-called "Subpart F income" of foreign subsidiaries, the conclusion would be the same, i.e. that such taxation would contravene the 16th amendment unless the tax were apportioned among the States.

The Proposals Would Contravene the 5th Amendment

The originally proposed legislation was described by the Treasury as being designed to prevent tax avoidance by the use of "controlled" foreign corporations, and the Treasury stated the belief that the Supreme Court under established doctrine would find the tax consonant with due process requirements of the 5th amendment (Hearings, p. 318). Presumably the same motive is behind the present bill.

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*The rest of the decision relates to the "taxpayers' argument that inability to expend income within the United States, or to use any portion of it in payment of income tax, necessarily precludes taxability". The Court observes: "That the result under the statute here before us may be harsh is no answer to the Government's position; that the purpose of Congress was to deal harshly with 'incorporated pocketbooks' . . . Interpreting the statute to bring about such a consequence does not render the statute unconstitutional . . ." However, as the taxpayer had not raised the question of the constitutionality of the provision, this language evidently pertains only to the question as to whether blocked income could be included in the taxpayer's gross income.

Apart from the doubt that may be expressed as to whether the Congress, or eventually the Supreme Court, would arbitrarily assume that all of the more than 20,000 foreign controlled corporations, in respect of which the tax would be applied, were engaged in tax avoidance, the Treasury memorandum published in the Hearings, Vol. I, fails to cite decisions which prove that any such "established doctrine" exists.

The Treasury concedes (Hearings, p. 318) that Courts have found that a tax laid on one person's income measured by the income of another violates the due process clause of the 5th and 14th amendments (Hoeper v. Tax Commissioner, 284 U.S. 206 (1931); Lewis v. White, 56 F. 2d 290 (D.C. Mass. 1932); and Raymond Pearson Motor Company v. C.I.R., 246 F. 2d 509 (C.A. 5th 1957)).

Moreover, in Lewis v. White (supra at p. 391) the Court said: "That an attempt by Congress to measure the tax on one person with reference to income of another would conflict with the due process clause of the 5th amendment seems clear". The Court cites, in support of this unequivocal statement, Nichols v. Coolidge, 274 U.S. 531 (1927); Blodgett v. Holden, 275 U.S. 142 (1928); White v. Hall, 53 F. 2d 210 (C.A. 1st 1931).

Despite the foregoing admission of the existence of these pertinent decisions, the Treasury argues that the Supreme Court has indicated the due process clause is not violated in cases where the taxpayer has maintained control over the income or enjoys the benefits of income or where Congress has found imposition of the tax necessary to prevent tax avoidance. Thus, the grantor was held taxable on the income of a revocable trust, Corliss v. Bowers, 281 U.S. 376, 378 (1930), and on income of an irrevocable trust where it was used to pay premiums on policies of insurance covering the life of the grantor, Burnet v. Wells, 289 U.S. 670 (1933).

Obviously neither of these decisions supports a tax on the profits of a valid foreign corporation before the corporation declares a dividend which becomes subject only then to the control of the shareholder.

The Treasury also mentions that a corporation has been held subject to a special tax on its undistributed earnings where it was created for the purpose of preventing the imposition of a surtax on the shareholders, Helvering v. National Grocery Company, 304 U.S. 282 (1938), but this was a tax on the corporation itself. Although the Treasury cited Asiatic Petroleum Company v. C.I.R., 79 F. 2d 234 (C.A. 2d 1935), this decision merely upheld a reallocation of income under the provisions of Section 45 of prior law which are now found in Section 482, I.R.C. of 1954.

In short, of the above cases, the only ones in point are the decisions first mentioned under this heading, supra, in which the Supreme Court held that the 5th amendment would be violated in a case where a tax laid on one person's income was measured by income of another person. This would be true of the tax envisaged in H.R. 10650 and of Secretary Dillon's proposal.

Summary of Conclusions Regarding Unconstitutionality of Proposed Taxes

In view of the Treasury's concession in regard to the above-cited cases holding that laying a tax on one person's income measured by the income of another violates the due process clause of the 5th amendment, there can be no doubt that taxing U. S. shareholders on the basis of income belonging to a foreign corporation should be considered as unconstitutional under the 5th amendment.

It has previously been shown that the income of the foreign corporation cannot be treated as income constructively received by the shareholder under the 16th amendment, and that the proposed tax would not be a tax on income under the 16th amendment. Instead, it would be a property tax and would have to be apportioned among the several States (U. S. Constitution, Art. I §2 cl. 3 and §9 cl. 4 requiring direct taxes to be apportioned according to population).

If the Supreme Court has supported the principle of the separate corporate entity with regard to domestic corporations, it is all the more important that Congress and the Supreme Court should, in accordance with international comity, uphold respect for the juridical personality of a corporation organized under the laws of a sovereign foreign State. This is especially true if the State is one of the 44 with which the United States has in force a tax treaty embodying this fundamental principle.

Additional Legal Objections to
Section 13 of H.R. 10650 and the Treasury Proposal

The Proposals are Based on Inappropriate
Existing Code Provisions

The Secretary of the Treasury stated at the Hearings (p. 261) that precedent for the proposed tax treatment may be found in the provisions of existing law dealing with the taxation of U. S. shareholders of foreign personal holding companies, and the Ways and Means Committee said it was extending these provisions to apply to "base" companies. These provisions were enacted in 1937 to prevent the avoidance of surtax by citizens or residents who had resorted to foreign personal holding companies, perhaps to escape the tax regime for domestic personal holding companies.

The Report of the Joint Committee on Tax Evasion and Avoidance to the Congress, dated August 5, 1937, 75th Cong., 1st Sess. House Doc. 337, explains the purpose of these provisions. It refers to the number of companies organized in certain foreign jurisdictions by U. S. citizens and describes a few extreme cases which show "that foreign personal holding companies are being used by citizens and residents as a device for tax-avoidance purposes. Income which otherwise would be subjected to the Federal income taxes is being diverted to, and accumulated by, such companies in order that the American shareholders may escape being taxed thereon." (House Doc. No. 337, p. 16)

The examples indicate the Committee was primarily concerned with income from, and gains from the sale of, American securities.

The Report goes on to say: "There appears to be no justification for the continued existence of foreign personal holding companies . . . . It is believed as a matter of fiscal policy that the dissolution of such companies should be effected as promptly as possible . . . ." (House Doc. No. 337, p. 21).

However, the report of the joint committee made it clear that the legislation was not intended to affect "real foreign operating companies" or widely-owned foreign holding companies (Id., p. 17). (emphasis supplied)

In short, the purpose of this 1937 legislation was to impose such an onerous and punitive regime on the prescribed U. S. individual shareholders in foreign personal holding companies that they would forthwith liquidate such existing companies and would be discouraged from creating any such companies in the future.

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The fact that the Committee on Ways and Means bases its proposed amendments on the 1937 measure raises the question whether it now seeks to force the liquidation of all of the foreign subsidiaries that might fall under the proposed enactments, and restrict future recourse to foreign corporations to carry on perfectly legitimate activities that might happen to fall within the scope of the contemplated amendments.

The Proposals Would be Discriminatory

Subpart F of H.R. 10650 would involve discrimination against U. S. shareholders owning foreign corporations in several ways:

First, by taxing them on the basis of certain income belonging to the controlled foreign corporation, but not on income belonging to controlled domestic corporations engaged in similar activities;

Secondly, by taxing them on certain categories of income arbitrarily defined but not on others, and by taxing them on income used or invested in developed countries but not on income invested in "less developed countries".

Hence, the legislation proposed by the Treasury or by the Committee would be so grossly discriminatory that it would appear to come under the statement by the Supreme Court that discrimination, if gross enough, may be equivalent to confiscation and subject under the Fifth Amendment to challenge and annulment, Charles C. Steward Mach. Co. v. Davis, 57 S. Ct. 1936.

The Proposals Presuppose Tax Avoidance That Under Court Decisions Would Not Generally Exist

Although the Treasury estimates there are some 20,000 controlled foreign corporations, in order to find instances of tax avoidance, the Internal Revenue Service reviewed some 135 cases (Hearings, p. 3535). Of these it published descriptions of 39 cases (Hearings, pp. 3537-3544). About half of these descriptions do not reveal that the corporation did anything contrary to the tax law, and in the others any income allegedly diverted from the United States corporation could have been reallocated to that corporation for taxation purposes under Section 482, I.R.C.

On the basis of this meager sampling, the Treasury sought to justify penalizing the imputed abuses by taxing the U. S. shareholders on income belonging even to "real foreign operating companies". This would be done now although such companies were deliberately excluded from the 1937 legislation (House Doc. No. 337, p. 17). H.R. 10650 uses the term "foreign base company income" which certainly has no opprobrious connotations that would justify departure from the principle of respect for the corporate entity.

Various instances of tax avoidance have been dealt with by the federal courts in upholding the application of the provisions of Section 45 of the 1939 Internal Revenue Code, now found in Section 482 of the 1954 Code. Examples are:

(1) a domestic holding company sold securities, which had considerably appreciated in value, at cost to an affiliated foreign company; the latter immediately resold the securities to another affiliated domestic company at the higher fair market value; and the Court upheld the allocation of the profit back to the first company, Asiatic Petroleum Co. v. Commissioner, 79 F. 2d 234 (C.A. 2, 1935), certiorari denied 296 U.S. 645;

(2) a domestic manufacturer sold products at manufacturing cost plus 10 per cent to a controlled foreign corporation which resold to customers at a mark-up ranging up to 900 per cent and over, despite the fact that the domestic manufacturing business had previously sold the same type of products to customers outside the country through an unrelated organization to which it allowed a 20% discount. The Court upheld allocating back to the manufacturer all the profit in excess of the 20% discount, Jesse E. Hall, Sr., 32 T.C. 390 (1959).

On the other hand, the rule has become well established in court decisions that it is perfectly legitimate for a taxpayer to arrange his affairs so as to limit his liability to tax. As stated by the Supreme Court in Gregory v. Helvering, 293 U.S. 465 (1935) "[t]he legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." Accordingly, it is clearly recognized by judicial authorities that the separate

entity of a related corporation, whether domestic or foreign, cannot be disregarded so as to make its income taxable to another, unless the corporation is found to be unreal or a sham. The corporate form may not be disregarded merely because it was resorted to with the motive to avoid or minimize taxation, if in fact the corporation has some business purpose and activity. Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943); Polak's Frutal Works, Inc. 21 T.C. 953 (1954); John Junker Spencer, 19 T.C. 727 (1953); Chisholm v. Commissioner, 79 F. 2d 14 (1935); and National Investors Corporation v. Hoey, 144 F. 2d 466 (1944).

As stated by the Tax Court in its opinion in Polak's Frutal Works, Inc., supra, "a taxpayer is free to choose the type of organization or form in which he will his business activities to achieve a desired business or tax result . . . . He is not required to adopt or continue with that form of organization which results in the maximum tax upon business income . . . . Furthermore, if a taxpayer actually carried on business in the form chosen, the tax collector may not deprive him of the incidental tax benefits flowing therefrom, unless it first be found to be a fiction or a sham."

The legislation proposed by the Treasury Department, or by the Committee, which would subject U. S. shareholders to tax on the income of controlled foreign corporations arising from sources outside of the United States is in direct conflict with the long-standing principles of taxation developed by our courts. Under this jurisprudence, it is perfectly legal for U. S. citizens or corporations to organize a company with "some business purpose and activity" in a foreign country with rates lower than those in the United States or with no income tax at all, and for that corporation to engage in investments and business transactions with corporations or other persons in the same or a third country.

The Supreme Court has held that a statute, whereby the liability of the taxpayer was made to depend upon past lawful transactions not giving rise to liability when effected, was so arbitrary and capricious as to amount to confiscation, and therefore violated the Fifth Amendment to the Constitution, Nichols v. Coolidge, 274 U.S. 531 (1927). "If the taxation involves reasonableness to meet the desired ends of fair play, it is valid - - - And when the tax is arbitrary and capricious by reason of the terms of the taxing statute, it becomes void under the Fifth Amendment." Corliss v. Bowers, 34 F. 2d 656 (C.A. 2d, 1929), affirmed 281 U.S. 376.

The Treasury premise of general tax avoidance through foreign subsidiaries is practically nullified by the fact that although the Treasury estimates there are some 20,000 controlled foreign corporations (Hearings, p. 3545), it apparently found evidence of tax avoidance in perhaps less than 20 cases (id., pp. 3537-3544). In these, any income shown to have been diverted could have been taxed under Section 482, I.R.C.

Moreover, the imputation of tax avoidance is controverted by the fact that most of the previously-mentioned foreign subsidiaries were created before the income tax was introduced or, if created subsequently, were formed without any intent of escaping U. S. tax, but instead for legitimate business reasons. Furthermore, their transactions with persons in their respective country or in third countries are entirely outside the jurisdiction of the United States and cannot be said to have as their object the avoidance of U. S. taxes.

It has been held that the Congress may adopt a measure calculated to prevent tax avoidance, the "test of validity" in respect of due process being whether the means adopted are appropriate to the end. Helvering v. City Bank Farmers Trust Co., 296 U.S. 85, 56 S. Ct. 70 (1935). However, it would obviously not be appropriate to adopt a measure intended to prevent avoidance in some 20 cases that without such justification would be applied to many if not all of the 20,000 foreign subsidiaries.

Respectfully submitted,
Mitchell B. Carroll

The CHAIRMAN. The next witness is Mr. D. Nelson Adams, Association of the Bar of the City of New York.

STATEMENT OF D. NELSON ADAMS, CHAIRMAN OF THE TAX COMMITTEE OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

Mr. ADAMS. Mr. Chairman, my name is D. Nelson Adams. I appear here as chairman of the Tax Committee of the Association of the Bar of the City of New York.

In that capacity I speak for a committee of 22 lawyers who have approached this bill completely objectively. Our sole purpose in appearing here this morning is to be of whatever assistance we can to this commitee in considering H.R. 10650.

I might add at the outset that, unlike that of some of my predecessors this morning, our report does not deal with the economic aspects of the bill and the balance-of-payments problem.

We leave that to the economists and the businessmen.

We are concerned essentially with the legal and administrative problems involved.

Our report is in two parts. The first contains comments of a general nature with reference to several sections of the bill, namely, section 4 (entertainment expense), section 6 (amendment of sec. 482), section 13 (income of controlled foreign corporations), section 16 (disposition of stock of controlled foreign corporations), and section 21 (treaties). It also includes for consideration another approach to the problem of foreign earnings, in lieu of the provisions contained in sections 13 and 16 of the bill. The second part incorporates the comments of our committee with regard to matters of a more technical nature.

I propose to cover only part 1 in my oral statement, which I believe I can do within the time allotted to me. The balance of our report is already on file with the committee and deals with the more technical aspects. It is available to the committee and for study by the staff.

At the outset, however, we note that while H.R. 10650 contains a number of provisions that deal in an appropriate manner with clear defects and inequities, the bill will in several respects add greatly to the complexity of the code. This is particularly unfortunate when, as in the case of sections 2 and 14, the provisions will have broad application. They will have to be understood and applied by many taxpayers who may be unaccustomed to dealing with such intricacies and not in a position to obtain competent tax advice. Section 13, if enacted, will take its place alongside the present collapsible corporation provisions as among the most incomprehensible provisions of the code. It will be extremely difficult for taxpayers to estimate the tax consequences of investing in foreign corporations, and no less difficult for the Service to enforce.

I. GENERAL COMMENTS

SECTION 4. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES

The current statutory standards governing the deductibility of entertainment expenses are generally thought to be susceptible to widespread abuse. An amendment which will strengthen the hand of the

Commissioner in dealing with this problem would do much to restore public confidence in the integrity of our tax system.

Section 4 of the bill proposes to accomplish this result in, essentially, three ways: (1) by denying the deduction unless the items is "directly related to the active conduct of the taxpayer's trade or business"; (2) by requiring substantiation in all cases; and (3) by allowing no deduction for a facility unless it is used primarily for business purposes and then only to the extent so used. The substantiation and used primarily requirements will, we believe, prove helpful in curbing abuses. We are less convinced of the adequacy of the requirement that the item be directly related to the active conduct of a business.

On its face this phrase merely opens the door to many questions. Indeed, we doubt whether it does anything more than call attention to the problem. Resort to the Ways and Means Committee report is more revealing in that it describes various types of expenses which will or will not qualify under this test. However, even if the committee report may be permitted to fill the statutory vacuum, the examples set forth there do not appear to establish principles of general application.

In view of the apparent widespread abuses in this area and the practical difficulty of drawing legislative boundaries, our committee believes that consideration should be given to disallowing all deductions for entertainment expenses except in certain specifically enumerated cases, including the exceptions in subsection (d) of section 4. Under these exceptions, for example, business meals and meetings would, of course, qualify even if considered entertainment, but where the taxpayer entertains in other ways the expense would have to be incurred without the benefit of a tax deduction.

Senator DOUGLAS. Mr. Chairman, may I be permitted to congratulate the witness and, through him, the Association of the Bar of the City of New York for the attitude you take in this matter.

I always have had an extremely high opinion of the Bar of the City of New York ever since I became acquainted many years ago with Charles C. Burling. Through the years I have felt that the Bar of the City of New York, the Association of the Bar of New York, has been able to, in general, look beyond immediate considerations to the social welfare.

I think this is an extremely statesmanlike statement of yours.

I felt discouraged for I have sat through nearly 5 weeks of hearings with special pleaders and find so few people who are willing to take an objective view of these matters. As one humble member of this committee, I want to congratulate you personally and the Association of the Bar of the City of New York.

Mr. ADAMS. Thank you, Senator.

I am not sure when I go home I will have any clients, but we feel our responsibility to this committee is broader than that. [Laughter.]

Senator DOUGLAS. I am afraid I will be a very poor substitute for your loss of clients.

SECTION 6. AMENDMENT OF SECTION 482

Mr. ADAMS. The committee agrees with the Treasury's view that there have been abuses in the pricing of products and licensing of patents between domestic corporations and foreign affiliates, but it believes that the arm's length standard which the Commissioner has

at his disposal under section 482 is sufficient to enable him to deal with this problem. Part of the difficulty in the past has been the lack of information available to the Service with regard to foreign transactions, but this difficulty has been substantially eliminated with the enactment of the information provisions in 1960, which would be somewhat further expanded by section 20 of the present bill. We do not overlook the difficulty in many cases of determining the effect of arm's length trading, but the Commissioner in such cases may require the taxpayer to establish this or accept the Commissioner's determination if he is unable to do so.

We recognize that if a clear statutory formula could be devised which would operate in at least a majority of the cases, it might be preferable to any general test based on arm's length bargaining. However, in our view section 6 would only make matters more confusing; it would not materially ease the Treasury's burden, and it would create a whole host of new questions that would have to be resolved in the courts. These questions include (a) how much relative weight is to be given the factors set forth in subsection 482(b)(2)(A), (b) what other factors are to be considered, (c) what weight is to be given to the determination made by the Secretary of the Treasury, (d) whether under subsection (b)(2)(B) the discretion of the Secretary is absolute, (e) the meaning of the words "adjusted to approximate their adjusted basis" in subsection (b)(3)(A), (f) what is an "arm's length price" under subsection (b)(4) (as a practical matter the Government's position may be no easier here than under present law), (g) the meaning of the words "grossly inadequate" in subsection (b)(6), (h) the degree to which the Secretary's estimate under subsection (b)(7) is conclusive, and (i) the time by which information must be furnished under subsection (b)(7).

SECTION 13. CONTROLLED FOREIGN CORPORATIONS

It is apparent that section 13, coupled with section 16, will do more than curb the abuses referred to in the Ways and Means Committee report. It will also tend to discourage the investment of American capital in foreign enterprises, and may tend to increase foreign taxes paid by controlled foreign corporations at the ultimate expense of the U.S. revenue. Whether this is sound policy is not within the province of our committee to say. We believe it appropriate, however, to point out some of the major disadvantages which legitimate business activities abroad will encounter in operating under sections 13 and 16.

The effect of these sections is to place controlled foreign corporations at a tax disadvantage vis-a-vis domestic corporations with foreign branches and to place individual 10 percent plus shareholders of controlled foreign corporations at a tax disadvantage both in comparison to corporate shareholders of such corporations and to shareholders of domestic corporations. The disadvantage or controlled foreign corporations is illustrated by the fact that a domestic corporation is entitled to deduct and carry over losses from its foreign operations and to characterize its items of foreign income as capital gain or ordinary income, depending on their intrinsic nature, whereas the parent of a controlled foreign corporation must include the subsidiary's income in its own as ordinary income and is not allowed to deduct or carry

over the subsidiary's losses. The disadvantage is accentuated where foreign operations are conducted by more than one controlled foreign corporation. Losses incurred by one foreign subsidiary are not applied in reduction of the profits of another foreign subsidiary, and this is even the case where the subsidiaries are members of the same chain.

Beyond these factors, an individual, as compared to a corporate stockholder, of a controlled foreign corporation is further penalized since, while the corporate entity of a controlled foreign corporation is disregarded in order to impute the income of the corporation to its shareholders, its corporate entity is relied upon to deny its individual stockholders a credit for foreign income taxes paid by the corporation. Moreover, the individual shareholder of a domestic corporation suffers a direct 52 percent and a maximum indirect 12 percent attrition of retained corporate earnings from foreign sources, whereas the 10 percent plus individual shareholder of a controlled foreign corporation can be taxed on its foreign income at rates ranging up to 91 percent.

Two other aspects of section 13 to which our committee has given specific attention are: (1) Whether it is constitutional, and (2) whether it is workable.

Constitutionality: The major stated objectives of the section as described in the Ways and Means Committee report are to impose current tax on (*i*) what could ordinarily be expected to be U.S. source income, (*ii*) income which is held abroad and not used in the taxpayer's trade or business, unless it is reinvested in another business located in a less developed country, and (*iii*) sales profits from goods manufactured by related parties either in the United States or aboard.

The technique employed is to tax certain U.S. persons who actually or constructively own stock in a controlled foreign corporation on part or all of the income of such corporation, even though no distribution of such income has been made. From the constitutional standpoint it would appear that the validity of this technique must meet the requirement that it is necessary in order to prevent avoidance or evasion of Federal income taxes. In the following instances in which the bill would impute income of a foreign corporation to U.S. persons, the imputation seems difficult to justify on such grounds:

(1) The imputed income may have been subjected in the hands of the foreign corporation to a rate of tax equal to or greater than the U.S. tax.

(2) The imputed income may represent no more than a fair profit for performing selling or distributing services abroad.

(3) The imputed income may represent earnings from a newly organized or recently acquired manufacturing business in an economically developed country which are needed for the conduct or expansion of this business.

(4) The imputed income may constitute income from patents or processes developed outside the United States, but which have been acquired by the foreign corporation from a U.S. person.

In most of the cases enumerated above the imputation of the income to the shareholders of the foreign corporation may be avoided if the foreign corporation invests the income in a less developed country. This in itself would seem to indicate that the income is not regarded

per se as of a character which should attract U.S. tax in order to prevent avoidance or evasion. In any event to predicate immunity from tax on such a basis is difficult to justify on the ground of preventing tax avoidance.

Acordingly, it is the view of our committee that the reach of section 13 of the bill is so broad in certain important areas as to result in doubt as to its constitutionality.

Furthermore, even if not unconstitutional, there is an inequity in taxing the shareholders of a foreign corporation on income of the corporation which cannot be distributed by reason of (*a*) exchange control, (*b*) restrictions imposed by local law, or (*c*) contractual commitments or indebtedness incurred prior to the enactment of the bill. In the domestic personal holding company area, the Congress saw fit to allow a deduction with respect to previously incurred indebtedness (I.R.C. sec. 545(b)(7)).

Workability: Our committee believes that the technical problems involved in the imputation of income to U.S. persons from foreign subsidiaries of all tiers are so numerous and so difficult that the question arises as to whether the provision is workable from a practical standpoint. These problems include the computation of "earnings and profits" from 1963 on, in accordance with U.S. tax rules, of foreign corporations which are not subject to U.S. law; the attribution of profits to different categories of gross income of shareholders depending upon the treatment of such income under section 13; the application of the foreign tax credit in the case of earnings which are imputed; and the effect of the imputation of income on the basis of the stock held by the U.S. persons. Our study of these provisions over the past few weeks has convinced us that the complications are so great that many unintentional inequities and loopholes will be inevitable, and that great difficulty will be experienced by even the most sophisticated taxpayers and their advisers, as well as by Government personnel, in understanding and applying these provisions

Our committee is also concerned with the workability of the stock ownership test, which is the key determination upon which the application of sections 13 and 16 depends. Many foreign corporations issue bearer shares, the ownership of which is not known or readily ascertainable. Indeed, the disclosure of ownership may be illegal under foreign law. A similar problem exists in the case of stock registered in the names of nominees. Except in the case of closely held companies, therefore, there may be no practical way of determining whether the corporation constitutes a "controlled foreign corporation" through the ownership of more than 50 percent of its voting stock by U.S. persons. Stockholders owning 10 percent or more of the stock of such a corporation may live in ignorance of their actual tax liabilities and find themselves at some later date confronted with a large liability for which they are wholly unprepared.

Furthermore, the rules for determining stock ownership involve all of the complicated features of the present attribution requirements of section 318, with additional complications imposed by section 955, and with the further difficulty that these rules will not only affect the status of the U.S. person as a 10-percent stockholder but will also have to be applied by all U.S. persons in determining whether more than 50 percent of the stock is owned by U.S. shareholders.

SECTION 16. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS

This section proceeds on the theory that gain from the sale or exchange of stock of a controlled foreign corporation by a shareholder owning 10 percent or more of the voting stock should be taxed as ordinary income to the extent of his proportionate share of the earnings and profits. It is recognized that this is largely a question of legislative policy. We would point out, however, that all 10-percent-plus shareholders of controlled foreign corporations will as a result of section 16 suffer a disadvantage not generally applied to shareholders of domestic corporations. Upon the sale or exchange of their stock or at the time of liquidation of the corporation their gain attributable to previously untaxed corporate earnings and profits will be taxed at ordinary income tax rates rather than as long-term capital gain.

In addition, a number of extremely serious practical problems are generated by applying the proposed section 1248 to pre-1962 earnings and profits and thus basing present and future tax consequences upon historical earnings and profits extending back some 50 years. Most of the corporations whose stockholders would be affected by section 1248 have heretofore had no reason to compute earnings and profits or to maintain records from which such a computation could be made with reasonable facility. The task of reconstructing long-term accumulated earnings and profits of any corporation is a difficult one. Such a computation for a foreign corporation involves additional complexities, such as currency valuation factors, transposition of foreign accounting concepts to U.S. earnings and profits concepts, and the effect to be given to elections which could have been made for U.S. income tax purposes. For these reasons we recommend that section 16 be made applicable only to earnings and profits realized in taxable years of the foreign corporation beginning after December 31, 1962.

The computation of earnings and profits at interim dates during a taxable year—which would be necessary under sec. 1248(b) and possibly under sec. 1248(a)—raises further obvious complications. In this area particularly, the burden of proof rule in section 1248(d) will presumably aid in protecting the revenue. However, in all phases of an earnings-and-profits computation, the Service will obviously have to evaluate and analyze proof offered by a taxpayer, and the consequent administrative burden and delay are likely to be substantial.

The impact of section 1248 can be extremely drastic where the corporate earnings have been subjected to foreign tax at rates comparable to or higher than U.S. rates. In such cases, the application of section 1248 to individual shareholders can produce an extraordinarily high effective combined rate of tax, and the foreign tax credit in respect of taxes paid by the controlled corporation will not be available to individual shareholders or to corporate shareholders taxed under section 1248(b).

A similar consequence which is difficult to justify involves application of section 1248 to earnings of the foreign corporation in the United States which have actually been subjected to U.S. corporate tax. Notwithstanding a suggestion to the contrary in the Ways and Means Committee report (p. 4), section 1248 does not differentiate these earnings from foreign source earnings, even though an exception for domestic earnings is made by section 952(a) in computing subpart F income.

SECTION 21. TREATIES

Our committee concurs in the recommendation of Secretary Dillon in his testimony before the Senate Finance Committee that section 21 be eliminated from the bill in order to make it clear that we are honoring our treaty obligations (hearings on H.R. 10650, p. 104). We would, however, suggest that in order to eliminate any possible inconsistencies between section 11 of the bill and the foreign tax credit provisions of various treaties consideration should be given to providing that in the event of any such inconsistency the treaty should govern.

Mr. Chairman, we return to the question of taxation of foreign earnings. We recognize there are certain abuses that exist. We did not want to come down here and tell you that without making some suggestion for a possible line or avenue which will cure the abuses and still solve the problems which we see in sections 13 and 16.

RECOMMENDATIONS WITH REGARD TO THE TAXATION OF FOREIGN EARNINGS

We recognize that the extent to which earnings of a foreign corporation are to be taxed to its U.S. stockholders is in large measure a matter of legislative policy. As noted above, however, we also feel that H.R. 10650 as presently drafted raises constitutional doubts and involves administrative complexities of serious proportions. Because of our concern over the constitutional and administrative problems involved, we offer for consideration an alternative approach to the situations encompassed by sections 13 and 16 of the bill.

As we analyze sections 13 and 16, the tax-avoidance practices which form the focal points of legislative concern are twofold. First, there are cases where income which in an economic sense has been generated in the United States may not be subjected to tax here. Those cases involve premiums from the insurance of U.S. risks, income from patents, and similar property interests developed in the United States, and sales income improperly allocated to a related foreign organization.

Second, there are cases where foreign income is accumulated or transferred outside the United States without any apparent business purpose and presumably to avoid or defer U.S. tax. Such cases involve primarily the accumulation abroad of income beyond the reasonable needs of a foreign business and the transfer of income from one foreign business to another through a foreign base company. If we are correct in this analysis, the objectives of sections 13 and 16 could be attained in large measure through the modification of existing and familiar statutory provisions.

Turning first to premiums from the insurance of U.S. risks, it would seem logical to treat such premiums as income from sources within the United States. They are not so treated under present law, and so escape U.S. taxation when received by foreign corporations. Whether the tax should apply to all foreign insurance companies or only to those controlled by U.S. shareholders, whether foreign insurance companies should be allowed the option of paying a tax based on their net taxable income from the insurance of U.S. risks, and the proper withholding tax rate to be applied, are matters of legislative policy.

The problem of the income from patents and analogous intangibles developed here but exploited abroad without adequate compensation for the development process arises primarily where the foreign income from such property is realized abroad by a related foreign corporation. Basically, this problem is much the same as that of determining the sale profit properly allocable to the activities of a related organization abroad. In view of the additional information now or to become available to the Commissioner as a result of the 1960 amendment to the code and proposed section 20 of the bill, we believe that section 482, if diligently enforced, will provide an adequate solution to both these problems.

The second area of the foreign earnings problem, that of accumulations and transfers of funds outside the United States, could be solved in large measure by two amendments of the present statutory provisions governing foreign personal holding companies. The first amendment would be to include corporations as well as individuals in applying the stockownership test of such companies, and the second would be to include income accumulated beyond the reasonable needs of a foreign business as one of the classes of foreign personal holding company income, with appropriate modification of the gross income test.

The alternatives to sections 13 and 16 of the bill suggested above would in our view substantially put an end to the practices now covered by those sections which might legitimately be considered to involve tax avoidance. This approach would also resolve the constitutional doubts and administrative problems outlined above.

I might add one final word:

I think it would eliminate a number of the Panamanian, Liberian, and Bahaman corporations that Senator Douglas and Senator Gore were so concened about this morning, which are filling the role of being merely base companies.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

We will insert your technical comments, of course, in the record.

Mr. ADAMS. That is right.

The CHAIRMAN. Any questions?

Senator CURTIS. No questions.

The CHAIRMAN. Thank you very much, Mr. Adams.

(Section II of Mr. Adams' prepared statement, entitled "II. Technical Comments," is as follows:)

II. TECHNICAL COMMENTS

SECTION 2. CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY

Section 47(a).—Neither the bill nor the report of the Ways and Means Committee indicates whether the normal retirement of a unit of property carried in a multiple asset account must meet the time test of section 47(a) (1), or whether that test will be met if the average period of retention of assets of the same type in the account meets the test. If the time test must be met in the case of every normal retirement from a multiple asset account, this should be made clear.

Section 47(b) (2).—The failure to except insolvency reorganizations under part IV of subchapter C from the recapture provision of section 47(a) may be occasioned by an assumption that any such reorganization which represents a mere change in the form of conducting the trade or business will qualify under part III of subchapter C and, therefore, under section 381(a). This should, however, be clarified.

Section 48(a). -The provision in section 48(a)(1)(B) that real property, other than a building or its "structural components," may qualify for the credit if it is used as an "integral part of" or "in connection with" certain business operations seems likely to lead to uncertainty and controversy. The explanations of the quoted terms in the committee report leave doubt as to their applicability in many situations. We question whether the prevention of revenue loss through the use of such imprecise terms is as important as clear advance notice of which property will qualify for the credit. Most of the uncertainty would be removed by limiting the exclusion of depreciable real property to buildings and their structural components.

SECTION 4. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES

Inasmuch as proposed section 274 would affect a very large number of small taxpayers, it seems particularly important that any provision respecting entertainment expenses should be drafted in such a manner as to be readily understood. Section 274 is deficient in at least the following respects:

(1) The class of expenditures made nondeductible by subsection (a) is generally described as including any item "with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation," or "with respect to a facility used in connection with" such an activity "unless the taxpayer establishes that the facility was used primarily for the furtherance of the taxpayer's trade or business and that the item was directly related to the active conduct of such trade or business." We have great difficulty in ascertaining in a given case the intended meaning of such key words as "activity," "type," "generally considered" and "directly related." Furthermore, the committee report sheds no light on the intended meaning of the term "active" in the statutory phrase "active conduct of the taxpayer's trade or business." The purpose of this term is particularly mystifying when applied to an item incurred in connection with the production of income, which is treated under proposed section 274(a)(2)(B) as a trade or business. It also appears difficult to characterize deductions such as depreciation and general repair and maintenance expenses incurred in connection with the ownership of a depreciable "entertainment" facility (which is used primarly for the furtherance of the taxpayer's trade or business) as items "directly related to the active conduct of such trade or business." If it is intended to require apportionment of general expense items on the basis of the percentage of usage for business and personal purposes, the statute should be clarified to make this purpose clearer.

(2) It is not clear whether the present language of subsection (a) includes traveling expenses incurred in connection with entertainment or recreation, although subsection (c) might indicate that such expenses are not included.

(3) Defining the term "gift" for purposes of subsection (b) in terms of an item "excludable from gross income of the recipient under section 102" requires determination in assessing the donor's income tax of the tax character of the purported gift to the recipient. Whether or not various types of "business gifts" are includable in the gross income of the recipient or are excludable under section 102 has provided a fertile field for current tax litigation and remains an area unresolved by any clear-cut decisions.

(4) The committee report of the Ways and Means Committee indicates that the term "entertainment" as used in section 274 includes, in addition to its normal meaning "satisfying the personal, living, or family needs of any individual." As a result of this broad interpretation of the term "entertainment," subsection (d) of section 274, setting forth numerous exceptions to the basic rule of subsection (a), may be required. Nevertheless, paragraph (9) of subsection (d), creating an exception for expenses for goods or services which are sold by the taxpayer in a bona fide transaction for full consideration in money or money's worth, appears to be an unnecessary addition to an already undesirably prolix statute. On the other hand, subsection (d) appears to contain no exception applicable to contest prizes granted as part of a business promotion, an item of expense apparently as worthy of specific exception as several others already included. The limitation of the exception contained in paragraph (7) of subsection (d) to expenses incurred at a business meeting or convention of organizations described in section 501(c)(6), creates an inference that expenses related to the attendance of business meetings of similar organizations not qualified under section 501(c)(6) are within the ambit of subsection (a). No reason for this distinction is given in the House committee report.

(5) Throughout the section there is doubt as to whether the portion of any expenditure attributable to a taxpayer's own participation in, or enjoyment of, part of the cost of entertainment, is deductible in part, or not at all.

With reference to the amendment to section 162(a)(2) by section 4(b) of the bill, changing the phraseology permitting the deduction of the "entire amount" expended for meals and lodgings while traveling to a "reasonable allowance" for amounts expended for meals and lodging, we point out that this change may, in addition to placing a ceiling on the total amount deductible for meals and lodging, also be held to preclude the deduction of amounts so incurred which do not exceed the amounts which the taxpayer would have incurred in the absence of travel. We do not believe that any such additional disallowance was intended, and suggest that the language be changed to read "(including reasonable amounts expended for meals and lodging)."

SECTION 9. DISTRIBUTIONS BY FOREIGN TRUSTS

Under the general rule of section 643(a)(3) of the code capital gains or losses are included in distributable net income only if they are distributed or are set aside for charity. Section 9(a)(1) of the bill amends section 643(a) to provide that capital gains and losses are taken into acount in computing distributable net income of a foreign trust. The result is that any accumulation distribution carried back to a year in which net capital gains were realized by the foreign trust, will be taxed as capital gains to the beneficiary for such year. Under the usual rules applicable to throwbacks, the beneficiary will amalgamate such net gains with his own capital gains for the purpose of computing the tax attributable to such year and the proper result is reached.

However, if the so-called shortcut method of computation prescribed by section 669(a)(1)(B) is used, the tax upon capital gains may be distorted. If the beneficiary had large capital losses in the 3 test years they might wipe out the trust's capital gains attributed to those years with the result that the tax computed with respect to the portion of the throwback representing capital gains will be too low. On the other hand, if the beneficiary had large capital losses in some years, but none in the test years, the tax computed with respect to the portion of the throwback representing capital gains will be too high.

Such distortions may be avoided by segregating the net excess of long-term capital gains over short-term capital losses included in the accumulation distribution and computing the tax thereon at 25 percent. The tax on the balance of the accumulation distribution should then be ascertained under the usual shortcut rules. The sum of the two computations represents the tax attributable to the accumulation distribution where the shortcut compuation is used.

SECTION 11. DOMESTIC CORPORATIONS RECEIVING DIVIDENDS FROM FOREIGN CORPORATIONS

This section of the bill would enact into law the so-called gross-up principle of taxation of domestic corporations receiving dividends from foreign corporations and claiming the foreign tax credit; would amend section 861(a)(2)(B) of the code to treat as domestic source income the entire amount of dividends eligible for the 85 percent dividends received deduction received from a foreign corporation; and would repeal section 902(d), relating to special rules for crtain wholly owned foreign corporations paying royalties or similar items in lieu of dividends. The amendment of section 861(a)(2)(B) and repeal of section 902(d) are considered to involve legislative policy only and to be technically adequate. The amendment dealing with the gross-up principle likewise involves primarily a question of legislative policy on which the committee has no comment. The committee notes, however, the following technical problems in the gross-up legislation:

The technique of the bill is to require inclusion in income of the domestic corporation of the portion of foreign taxes paid by a subsidiary which is deemed paid by the domestic corporation for tax credit purposes. The inclusion of such an item in gross income, presumably considered as constitutionally justified as a condition to a credit which Congress might have withheld, nevertheless creates a distortion of income which has side effects unrelated to the

determination of the foreign tax credit or the effective rate of tax upon income from foreign sources. Some of these consequences are as follows:

1. Presumably, earnings and profits would be increased by an amount never received and not available for distribution, possibly altering the character of the domestic corporation's distributions.
2. Gross income and taxable income are increased for the purpose of applying various statutory tests, such as the limitation on the deduction for charitable contributions.
3. Dividend income is increased with resulting effect upon computations of qualifying income for Western Hemisphere trade corporations, subchapter S corporations, and personal holding companies.

These side effects are illustrative of the difficulties arising from the technique adopted in the bill, and the committee suggests that consideration be given to adoption of a differing technique under which gross up would be required only for purposes of foreign tax credit computation.

SECTION 13. CONTROLLED FOREIGN CORPORATIONS

Problems of interpretation and application of this section have been noted as follows:

1. Proposed section 951(a)(2)(A) calls for "pro rata" imputation of subpart F income among certain U.S. persons who are shareholders in a controlled foreign corporation and section 953(a)(2) similarly imputes to such shareholders in the increase in investment in nonqualified property for a taxable year on a "pro rata" basis. The phrase "pro rata" is somewhat elliptical. If, for example, an affected U.S. person owned only preferred stock in a controlled foreign corporation, would the imputed income be limited to an amount equal to his limited preferred dividend, or would the imputed distribution be determined on some other basis? What if the U.S. person owned a class of common stock on which dividends had been waived?

A similar problem may exist where ownership of stock in a controlled foreign corporation is attributed to a U.S. person through a foreign entity. Proposed section 955(a)(2) provides that the stock of the controlled foreign corporation shall be considered as being owned "proportionately" by the shareholders, partners, or beneficiaries of the foreign entity.

2. Proposed section 953(a)(1) limits the amount of earnings of a controlled foreign corporation invested in nonqualified property to an amount not exceeding "the sum of" (i) the earnings and profits for the taxable year and (ii) the earnings and profits accumulated for prior taxable years beginning after December 31, 1962. It is believed that a deficit in earnings and profits would be taken into account so as to reduce current earnings by reason of the use of the phrase "the sum of." This conclusion is, however, not inescapable and clarification would be desirable. In this connection it is noted that under proposed section 952(a)(3), subpart F income of a controlled foreign corporation for any taxable year is limited only by the earnings and profits of such corporation for such year, so that a deficit in earnings and profits at the beginning of a year would presumably not serve to reduce subpart F income.

3. In form, at least, section 13(b) of the bill (amending sec. 551(b) of the code) may not prevent double taxation in all instances where apparently intended. For example, double taxation would appear to result where a controlled foreign corporation is a subsidiary of another controlled foreign corporation and both corporations are foreign personal holding companies.

4. The bill does not indicate the nature of amounts included in gross income for characterization purposes. For example, will such an amount be treated as a dividend for purposes of characterizing the recipient as a personal holding company?

5. The attribution rules of proposed section 955(b)(2), whereby a partnership, estate, trust or corporation owning more than 50 percent of the voting power or total value of all classes of stock of a corporation is considered as owning 100 percent may be construed as permitting the same stock to be counted twice in determining ownership of stock by a single U.S. person.

Certain consequences of section 13, which may be unintended, have been noted as follows:

1. The bill makes no distinction between controlled foreign corporations engaged in trade or business in the United States and those not so engaged as respects imputation of income under section 951(a)(1)(B). Therefore the im-

putation provisions of the bill are presumably applicable even though the foreign corporation concerned currently pays full U.S. income tax on its income from sources within the United States. Indeed, the effect of the bill in this connection is to encourage expatriation of funds by such a corporation, since reinvestment in a domestic business cannot constitute investment in qualified property. The committee notes that, in contrast, section 952(a)(2) excludes from subpart F income items of income "derived from sources within the United States of a foreign corporation engaged in trade or business in the United States."

2. Proposed section 953(b)(3) limits a qualified trade or business carried on outside a less developed country to one which has been carried on by the corporation while "controlled by substantially the same U.S. persons" since December 31, 1962, or during the 5-year period ending with the close of the preceding taxable year. Thus, a controlled foreign corporation formed or acquired after December 31, 1962, would not be permitted to reinvest its earnings in what would otherwise be qualified property and thereby avoid imputation of income to its affected U.S. shareholders until 5 years had elapsed since its formation or acquisition. Further, it is not clear whether the 5-year period begins again if the controlled foreign corporation is merged into or consolidated with another foreign corporation without substantial change of ownership.

3. Proposed section 957(b) does not allow a special limitation for successors in interest to U.S. persons who would be entitled to such a special limitation had they retained their stock. Moreover, proposed section 956 may not prevent double taxation under proposed section 78 of the amount of a tax paid by a foreign corporation receiving a dividend from a second foreign corporation whose income has already been imputed to a U.S. parent.

The following inconsistency between the apparent intention of the Ways and Means Committee as expressed in its report and the language of the bill itself has been noted.

Section 13(b)(1) of the bill amends section 551(b) of the code to provide that amounts included in gross income of U.S. shareholders of foreign personal holding companies shall be reduced by the shareholder's proportionate share of the "undistributed personal holding company income" included in gross income under proposed section 951(a)(1)(A). It is clear from page A106 of the Ways and Means Committee report, however, that the reference in section 13(b) should be to "undistributed foreign personal holding company income."

SECTION 14. GAIN FROM DISPOSITION OF CERTAIN DEPRECIABLE PROPERTY

Effect of section 1245 on other sections. Section 14 of the bill fails to warn adequately that section 1245 overrides other sections of the code. This could prove misleading to those who do not have an intimate familiarity with the code as a whole.

Section 1231 now purports to deal with the treatment of gain on taxable sales or exchanges of all depreciable property held for more than 6 months. Section 1238 covers the treatment of gain attributable to accelerated amortization. We suggest appropriate revision of part IV of subchapter P so as to correlate the rules and applicability of sections 1231, 1238, and the proposed new section 1245.

Section 336 should also be amended to indicate that a liquidation may result in the recognition of section 1245 income to the corporation, and section 337 should be amended to indicate that a sale otherwise qualifying under the provisions of that section may nevertheless result in section 1245 income.

Similar amendments should be made to sections 1031, 1033, 1071, and part VI of subchapter O.

Property in multiple asset accounts.—A very large proportion of section 1245 property is now carried in group or composite accounts. Under present rules the normal retirement of an asset from such an account does not result in gain or loss. All entries on such a retirement are made as debits or credits to the depreciation reserve. The fact that even assets of the same type, put to the same use, may have differing actual service lives is taken into account in determining for the whole account the average useful life and thus the depreciation rate, which are approved by the Internal Revenue Service.

A normal retirement from a multiple asset account is not considered a "sale or exchange" under section 1231. However, the term "disposition" in section 1245(a)(1) might be construed as having broader applicability. We believe that the normal retirement of an asset from a group or composite account should not result in income. Furthermore, the necessity of recomputing basis on such a retirement might result in very substantial additional accounting costs through

calling for detailed and continuing records on individual property units in the account. For these reasons we recommend that the normal retirement of an asset carried in a group or composite account be excepted from the meaning of "disposition" under section 1245(a)(1).

Section 1245(a)(2).—This section should take into account amortization under section 162 where the useful life of an improvement to leased section 1245 property is longer than the remaining term of the lease.

Since the purpose of section 1245 is to "recapture" depreciation deductions which have actually reduced taxable income, it does not seem appropriate to impose a special burden of proof on the taxpayer under section 1245(a)(2) to demonstrate that the amount of depreciation or amortization which has been allowed is less than the amount allowable.

Section 1245(b) (4) and (5).—The acquisition of land or depreciable real property, otherwise qualifying for nonrecognition, may result in section 1245 income in respect of section 1245 property transferred even though the transferor also acquires depreciable personal property in the transaction. We suggest that section 1245(a)(1) should apply only to the extent that the fair market value of section 1245 property transferred exceeds the fair market value of section 1245 property acquired.

Installment sales.—It should be provided that on the casual sale of section 1245 property on the installment method, section 1245 income is realized proportionately with each installment payment, rather than out of the earliest installment payments which cover the amount of section 1245 income.

Section 167(f) added by section 14(c) of the bill.—The proposed new section 167(f) has not been clarified (1) to indicate whether "salvage value" means gross salvage or, as it should, net salvage reflecting the deduction of demolition or removal costs, or (2) to indicate whether the taxpayer has an election, which he should have, to reduce or not to reduce salvage in respect of assets maintained in separate depreciation accounts.

Partnership transactions.—There appears to be little value in further encumbering the Internal Revenue Code with the provisions in proposed section 1245 designed to prevent the shift of the incidence of ordinary income tax generated by this section on a sale of a partnership interest or a distribution to a partner. The amendments to subchapter K as proposed in section 14(e)(1) of the bill will require valuation of the partnership's section 1245 property upon every sale of a partnership interest in a partnership owning such property. In addition, the proposals made will require valuation of all partnership section 1245 property in the event any distributions, other than current distributions solely of cash, are made by the partnership to any partner.

Shifting of the incidence of tax is permitted under proposed section 1245 in the case of gifts, contributions of property to a corporation under section 351, and the sale of corporate stock. In the partnership area, shifting is permitted by the contribution of section 1245 property to a partnership in return for an interest in the partnership. The committee report gives no reason for distinguishing sales of partnership interests and partnership distributions as areas necessitating tighter control.

In order to prevent complete avoidance of the effect of proposed section 1245 in the event that proposed section 14(e)(1) of the bill is deleted, a provision should be added to section 1245(a)(2) providing that in determining "recomputed basis" the adjusted basis with respect to any partnership property should not include any optional adjustment to basis under section 734 or 743 of the Internal Revenue Code. This would prevent the purchaser of a partnership interest or a distributee partner from avoiding the impact of section 1245 upon any subsequent sale by the partnership of section 1245 property. Similarly, in determining "recomputed basis" of any property received in a liquidating distribution from a partnership, adjusted basis should be limited to the basis of such property in the hands of the partnership prior to distribution, as is provided in proposed section 1245(b)(6).

SECTION 15. FOREIGN INVESTMENT COMPANIES

Proposed section 1246 treats any gain from the sale or exchange after December 31, 1962, of stock of a foreign investment company as gain from the sale or exchange of property which is not a capital asset to the extent of the taxpayer's share of earnings and profits accumulated after December 31, 1962 (or during the period the stock was held by the taxpayer if acquired later).

Section 1247 provides that section 1246 shall not apply with respect to a foreign investment company registered under the Investment Company Act of 1940 as a management company or as a unit investment trust which distributes to its shareholders 90 percent or more of its ordinary income computed as if it were a domestic corporation and designates within 30 days after the close of the taxable year in a notice to shareholders the amount of its net long-term capital gain over net short-term capital loss. This provision, however, only applies to U.S. shareholders who in computing their long-term capital gain report their share of undistributed capital gain of the foreign investment company as a long-term capital gain.

While the designation requirement and the definition of qualified shareholder in section 1247(c) imply that undistributed capital gains are taxable as long-term capital gain if the shareholder includes them in income, there is no provision in section 1247 which states that the amount designated as long-term capital gain which is actually distributed is to be taxed as long-term capital gain to the shareholder.

Nor is there any provision for the passthrough of foreign tax credit as in the case of a domestic regulated investment company. If the intent is to treat certain foreign investment companies in the same manner as domestic regulated investment companies, the bill should do so with greater specificity.

Under the definition of qualified shareholder in section 1247(c), a U.S. person is excluded from the definition of qualified shareholder if he fails in any one year to include his share of undistributed capital gain income as long-term capital gain. Unless that failure is due to reasonable cause and not to willful neglect, such U.S. person is thereafter barred from qualified shareholder status. This provision seems unnecessarily harsh; it could result in the shareholder being taxed twice on the same income—first when he included undistributed gains in gross income, and again when he disposed of his stock after losing qualified shareholder status. At a minimum, provision should be made to prevent such double taxation.

SECTION 16. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS

Problems of interpretation and application of this section have been noted as follows:

1. The portion of recognized gain treated as a dividend or ordinary income under section 1248 is defined in terms of "such person's proportionate share" of earnings and profits for the applicable period. The problems noted in the foregoing discussion of section 13 of the bill will also arise here. In addition, section 1248 will apply to dispositions of part, as well as all, of a person's stock holdings in a controlled foreign corporation; and application of the "proportionate share" language in such a situation requires determination of whether the proration is to be made on the basis of the number of shares disposed of, which is the more logical and equitable method, or on the basis of the entire number of shares owned by the U.S. person. The statutory provision is ambiguous, and the examples in the Ways and Means Committee report (pp. 77–78, A 124), which involve disposition of the shareholder's entire stock interest, would be applicable under either test. The text of the committee report may indicate that the proration is to be made on the basis of all stock owned by the shareholder. However, in view of the fact that this interpretation would proliferate the amount of dividends or ordinary income attributable to the same earnings and profits, it would probably be preferable to make some express statutory provision if this result is really intended.

2. Section 1248(c)(3) attempts to achieve correlation with section 951. However, the exclusivity of these provisions is preserved only when the same person has had the inclusion under section 951.

SECTION 19. WITHHOLDING OF INCOME TAX AT SOURCE ON INTEREST, DIVIDENDS, AND PATRONAGE DIVIDENDS

We have the following comments on section 19 of the draft bill:

1. *Individuals.*—Under section 3483(a), an individual over 17 years of age may file with any withholding agent an exemption certificate certifying that he reasonably believes that he will not be liable for any income tax for the years covered by the exemption certificate. Upon the filing of such certificate, amounts payable by the withholding agent would be exempt from withholding. However,

under section 3483(a), an exemption certificate may not be filed by anyone who is subject to tax, even though the full amount of such tax will be withheld through withholding on wages or withholding on other dividends or interest. Accordingly, the provision with respect to exemption certificates is only applicable with respect to those taxpayers who have no taxable income at all after allowing for personal exemptions and certain miscellaneous credits.

Under section 3484, quarterly refunds may be made to individuals upon the filing of appropriate claims for refund. The amount of such refunds may not, however, exceed what is defined under section 3484(b) as an individual's "refund allowance." Under this subsection, the refund allowance is 22 percent of an individual's expected deductions for personal exemptions plus 22 percent of his retirement income less 22 percent of any income which is not subject to withholding for dividends and interest. Under section 3484(e) no claim for refund may be filed by an individual whose gross income is expected to exceed $5,000, or a married individual whose income of himself and his spouse is expected to exceed $10,000 or a head of a household or surviving spouse who expects his gross income to exceed $10,000, or by a child, unless he expects that his parents will not be allowed an exemption for him for the taxable year. In our view, the provisions of section 3484 provide an extremely complicated administrative procedure for refunds of withheld tax on interest and dividends to persons who are in relatively low tax brackets. The persons whom these provisions are designed to benefit are in general not equipped to prepare easily the papers required to obtain their refunds.

One of the big objections which has been voiced against withholding of interest and dividends is that withholding provides a hardship to people who are in relatively low brackets (particularly retired persons and widows) whose income is derived to a great extent from interest and dividends. The problems of these persons could be alleviated by a device other than quarterly refunds. If, for example, the provisions of section 3484 with respect to exemption certificates were broadened so as to permit an individual to file an exemption certificate if his last year's taxable income were less than a prescribed amount and he expected that there would be no tax due by him for the year after deducting amount withheld in respect of wages or dividends and interest paid by payers other than those with respect to which exemption certificates were filed, any alleged hardship to individuals could be alleviated without using the complex machinery set forth in section 3484.

While the broader use of exemption certificates would increase the burden on the withholding agent, once the law provides for any exemption certificates, it may be relatively unimportant to the withholding agent whether the use of such certificates is available to a limited number of people or to a larger group. Furthermore, the use of exemption certificates seems to cause much less inconvenience than the filing of quarterly claims for refunds. It is also a system which will be more readily understandable by taxpayers.

To prevent abuse of the exemption certificate procedure, substantial percentage civil penalties might automatically be imposed on persons filing incorrect exemption certificates. Also, provision might be made for the filing of duplicate certificates, one copy of which would be turned over by the withholding agent to the Service.

2. *Corporations, States, and exempt corporations.*—We question whether the amount of unreported tax on dividends and interest received by corporations and governmental organizations is sufficient to warrant the administrative burden of withholding. This is particularly true since the withholding will be at only a 20-percent rate on interest, whereas the corporate tax rate is 52 percent. In the case of dividends the withholding rate will be 20 percent, whereas most corporations pay only a 7.8-percent tax rate on dividends. To the extent there is a problem of enforcement, it might be preferable if substantial civil penalties were automatically imposed for nonreporting by corporations and governmental organizations.

Assuming that no blanket withholding exemption for corporations and governmental organizations is acceptable, a system of exemption certificates would appear preferable to a system of quaterly refund claims. Exemption would be accorded governmental organizations, exempt organizations, and corporations of a prescribed small size that expect to have no net Federal income tax liability for the ensuing year. It is recognized that the administrative burden imposed on withholding agents by a system of exemption certificates is severe and that a persuasive case may be made for permitting the filing of no exemption certificates. However, once the filing of any exemption certificates is contemplated, the additional burden of extending the privilege to exempt corporations and governmental

organizations seems relatively slight, and to be preferred to the administrative burden to the Treasury of a system of quarterly refunds.

3. *Nonresident aliens and foreign corporations.*—Many nonresident aliens and foreign corporations are entitled, by virtue of various tax treaties entered into by the United States, to a rate of withholding tax of less than 20 percent on dividends and interest from payers in this country. Although the Ways and Means Committee report states that the bill will not affect the tax rate applicable to such recipients, neither the report nor the bill is clear as to whether the rate of withholding is to be no less than 20 percent in all cases of payments to nonresident aliens and foreign corporations. It is possible to interpret section 19(c)(1) of the bill to reach that result, but it is also possible to conclude that the 20-percent minimum applies only where payments are made through a domestic nominee who fails to give the payer notice of a lower applicable treaty rate. The correct interpretation turns upon whether the references to sections 3452(a) and 3462(a) found in section 19(c)(1) of the bill should be read to encompass the exceptions in sections 3452(b)(5) and 3462(b)(5). This question should be clarified.

If the more limited interpretation of the 20-percent minimum is correct, we recognize that there is an administrative problem where the securities owned by the nonresident alien or foreign corporation are held in this country in the name of a domestic nominee, since, unless notified of the nominee status of the recipient, payers will withhold at the 20-percent rate. Assuming that a payer is not so notified and withholds at a rate in excess of the applicable treaty rate, a refund must be made to the person subjected to the burden of overwithholding. The problems presented are whether the nominee or the foreign recipient should bear that burden and what procedures should be adopted for making refunds.

The discussion draft of the revenue bill of 1961, released by the Committee on Ways and Means in August of 1961, provided that the nominee must make up from its own funds any withholding in excess of an applicable treaty rate and must pay the foreign recipient at the applicable treaty rate of withholding. The nominee was then entitled to apply for quarterly refunds of such excess amounts. However, assuming the 20-percent minimum applies only where nominees are involved, the bill adopts a new procedure, placing the burden of excess withholding on the foreign recipient, and providing for annual refunds of excess amount withheld. This change in approach seems unwarranted for two reasons: First, the domestic nominee is able, merely by giving notice of the applicable treaty rate of withholding to the payer, to assure that there will be no excess withholding; and, second, the nominee is in a much better position than the foreign recipient to obtain a refund of any excess tax withheld by the payer. Accordingly, we recommend that the nominee be made to bear the burden of excess withholding and to obtain a refund if it fails to give notice of the proper withholding rate to the payer. In making this recommendation, we also feel that it is consistent with what the foreign recipients and their governments may view as our obligation under the reduced withholding tax provisions of various treaties. Moreover, the governments of foreign countries that allow foreign tax credits may have more than a technical concern over the proposed procedure, since their taxpayers may simply claim a credit rather than apply for refunds in this country.

The CHAIRMAN. The next witness is Mr. J. M. Barker of General Mills.

Mr. Barker, take a seat, sir, and proceed.

Senator CURTIS. Mr. Chairman, may I say that Mr. Barker was in his early life a distinguished citizen of the State of Nebraska. We lost him to Minnesota, but he comes here as a very well-qualified witness.

Mr. BARKER. Thank you.

The CHAIRMAN. We are very glad to have you, Mr. Barker.

Mr. BARKER. Thank you.

STATEMENT OF JOHN M. BARKER, DIRECTOR OF TAXES AND ACCOUNTING FOR GENERAL MILLS, INC.

Mr. BARKER. Mr. Chairman and Senator Curtis, I am glad you are here. I still feel Nebraska is my home. I was born and raised there.

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I would also like to have inserted in the record that General Mills, and I, as as individual, support your opposition to the investment credit and, in fact, I have prepared many statements for the top management of our company in support of such opposition. I have not covered it in my prepared memorandum because I thought I had to stay within the subject of earned income abroad.

I also would like to take note of some of the statistics that were quoted here this morning in regard to some of the growth in the so-called foreign base company countries. Part of my testimony here will relate to some of our foreign operations and I want to make it perfectly clear that some of the corporations that are involved in this testimony were incorporated in these countries, but they were incorporated for a legitimate business reason in those countries and for that reason I don't look upon bare statistics without a search behind them for reasons as being indicative of anything.

I will go into my prepared statement.

I believe that our problems of international payments must be solved, but for our country to adopt policies advocated in the Revenue Act of 1962 is, in my opinion, extremely shortsighted and will do irreparable harm. If the United States is to maintain a predominant position in international trade and maintain the high standard of living for our citizens, we must encourage our business to expand internationally. This will benefit our country at least two ways:

(1) We will have some control in the future over raw materials and natural resources we presently need and for which the need will become more critical in the future to continue our living standards, and,

(2) We will earn a profit from the foreign investments which will offset losses of our present foreign markets due to industrial advancement in the countries where the investments are made.

It is a critical time and bold risk type decisions must be made by the business community. It is not the time for our Government policy to be weak, to lack foresight, and to put obstacles in the way of this area of business expansion.

Much has been said about the advantages of so-called tax havens and golden tax free opportunities in the foreign investment area. I would like to examine them. I will not go into the risks inherent in the investments themselves but confine my remarks to the risks and inequities of the U.S. tax law.

First look at present section 367. This section requires advance permission of the Commissioner to determine if any of the transactions that are listed in that section with foreign corporations are for tax avoidance. Please take particular note that this section is used to determine the extent to which gain will be recognized in the transactions listed. No mention is made of loss which might be incurred in the transactions and, in fact, in any of the situations covered by the section, no loss is ever recognized. I have attached to this memorandum two examples of unfair results the section permits. Time will not permit reading these and I request they be included in the record.

Another area where the Internal Revenue Code is grossly unfair involves those situations where there is less than 80 percent ownership in stock of the foreign enterprise. The capital stock held by a U.S. corporation is a capital asset. Losses because of sale or worthlessness

of the stock are governed by the capital gain and loss rules. Capital losses of corporations can only be deducted against capital gains. They can be carried over for a period of years.

Many corporations seldom have capital gains, except occasionally from sale of depreciable property and land under section 1231. Therefore, loss on a foreign investment will likely never be deductible. The Revenue Act of 1962 proposes to eliminate from capital gain category gains from sale of depreciable personal property which will further restrict deductions for capital losses. If section 1231 is to be amended, as in this proposed Revenue Act, the definition of property used in the trade or business should be expanded to include stock of another corporation, either domestic or foreign, held by a corporation, goodwill, and the intangible value in excess of the basis of property acquired in a reorganization over the market value of the stock surrendered.

I might say it was a little over 2 or 3 years ago that I came down to Washington attempting to get recognition of loss carryovers applicable to foreign operations for U.S. shareholder companies; that is, the parent companies. I did not succeed in this, and I have a memorandum on it at home which I did not bring down.

I now direct my comments to some of the specific provisions of H.R. 10650. Because of time limitations my comments on section 5, part of section 6, section 11, and section 12 are attached to this memorandum. I request that these also be included in the record.

Section 6. Permits allocation of income between and among corporations when sales and purchases are made within the group which includes one or more foreign organizations and one or more domestic organizations.

This section contains broad rules but does not specifically include any definite formula for allocation and, in fact, there is no requirement for the Secretary to publish the various formulas he may use with different taxpayers. I doubt seriously that the courts of this country would permit any State to use differing standards for allocating income under State income tax laws. Such broad rules and power in the hands of administrative personnel shall, in my opinion, be conducive to unequal treatment between and among taxpayers.

I would like to cite a current situation within our company to which this section 6 might be applied. We own a 60-percent interest in a guar gum plant in Karachi, Pakistan. Under our agreement with our co-owners in Pakistan they obtain raw materials for the plant and we sell the manufactured product. For several years our sales department has requested permission of our company to establish stocks of merchandise and to open offices outside the United States. Our legal department has refused to permit the sales department to do this because they do not desire to subject our shareholders' assets to all the various laws and claims of all the countries of the world. Competition is such now that if we are to sell at all, our sales department's requests must be granted. We, therefore, propose that one of our foreign corporations take over foreign sales and that it hire the employees, open the offices, and own the stocks of merchandise.

I might mention right here as an insert that this will be, as proposed, a Panama corporation, and one of the reasons that a Panama corporation is to be used in an operation of this kind is becuse the

country of incorporation, Panama, does not look upon the income of its corporations as being that obtained in worldwide operations.

It only taxes the income from earnings within Panama.

Under the proposed rules we are likely to be taxed on any income, although the arrangement is necessary if we are to stay in business. If tax considerations were to govern this arrangement, it would not exist at all. We would put the parent company over there.

The stocks of merchandise are necessary to service customers. Under the proposed rules the inventory, the only substantial asset, must be ignored. If income is currently allocated as U.S. income, General Mills, Inc., will have an income apportionment problem in 49 States in which we do business. To the best of my knowledge, we have not yet solved the problem of income apportionment among our States in an equitable manner.

Section 13. Income from controlled foreign corporations considered income of U.S. shareholders.

This section is extremely involved and it is difficult to determine the exact application of the various provisions, not only because it is written so broadly, but also what interpretation may be put on it.

There are many problems and inequities in the proposed section 952(e) defining foreign base company income which, in my opinion, will put an effective and immediate stop to foreign investment.

For instance, foreign personal holding company income is included as subject to tax. This will tax a U.S. corporation on all dividends received by a foreign controlled company. We have situations where we have foreign joint ventures with local manufacturers and processors. Most of these have been necessary because of loss of our export market.

I would like to insert here that General Mills and its predecessor companies have been in the export market in the flour business for well over 75 years, and the markets where we have been forced to get into these joint venture arrangements are those where the local country has put a prohibition against the importation of flour.

So far, we have been successful in continuing to export wheat to these countries and have it locally milled under these joint venture arrangements. But how long that will continue, we do not know.

The local venturer owns the manufacturing facilities and our foreign company has sometimes purchased stock in the local manufacturing company in lieu of investing in jointly owned facilities.

In one instance we would have been better off taxwise to own the stock of the manufacturing company, in the parent company. We purposely gave up any available foreign tax credit from that company in order to follow the advice that was given to us locally that the ownership should be kept local; namely, through our foreign subsidiary down there, for political and public relations purposes.

In this case we will pay the U.S. tax on the dividend as it is paid to our controlled corporation—in this particular instance—and, by the way, this particular instance is in Venezuela, one of the so-called tax haven countries, and I would assume it also would be a less-developed country, but our investment down there in the manufacturing facilities is represented by a stock ownership in the local company, but it is held by our foreign subsidiary.

Under section 13, any dividends that go to that foreign subsidiary because of that kind of an arrangement will be currently taxed to the parent.

We have been unable to get permission to remit earnings and, if permission could have been obtained, the amount we could remit at controlled exchange rates was limited. We get no foreign tax credit as it applies to the dividend from the manufacturing company because our foreign company owns less than 50 percent.

Alternatively, if we jointly owned a single corporation which, I am sure, would qualify as being in a less-developed country, no U.S. tax would be due on any of the earnings until remitted as dividends to the U.S. parent. That assumes that Venezuela would be a less-developed country.

Foreign base income as proposed requires certain "sales income" to be included in income of the U.S. taxpayer. Sales income qualifies for inclusion in foreign base company income if property is purchased and is manufactured, produced, or grown outside the country in which the controlled foreign corporation is organized. We have a joint venture in a foreign country with local partners. General Mills, Inc., buys raw materials in the United States, and in this case it is wheat, and it is processed by the joint venture. Our controlled foreign corporation, which is the party to the joint venture, is not created or organized under the laws of the country in which the joint venture operates, but it is qualified to do business in that country. It pays taxes there and sells all its products there. Under this proposal, as it is written, this income is taxed to the U.S. shareholder for the sole reason that the corporation is not incorporated in the country in which it operates.

This happens to be another company in a Central American country and our Panama corporation is doing the activity in this area.

The proposal to tax certain sales income allocates income to U.S. persons even though transactions creating the income may have no connection with or may not be in any way involved with the United States. I am sure that a U.S. policy which will require U.S. shareholders to seek remittance of earnings to pay U.S. taxes on transactions which involve the exports and imports of two foreign countries is not going to cause those two countries to listen very attentively to any U.S. proposition for free world trade. This type of interference in their foreign trade is worse than a high import duty into the United States.

To me this is nothing but an insidious way of imposing a type of impost or import tax.

One further point regarding subpart F—Income. Net income subject to U.S. tax is reduced by investments made by the controlled foreign corporation during the taxable year in less developed countries. In no case can a less developed country be those listed in the proposed statute. Earlier I mentioned our sales organization's establishing offices and warehouse stocks to sell the output from our plant in Pakistan. I would assume Pakistan will qualify as a less developed country. If they do so qualify our investment in the developed countries of the world to sell their product will not qualify as investment in qualified property in less developed countries. I don't believe there is any place else in the world to sell guar gum except in the developed countries.

In other words, our Panama company would be going into Europe to sell the output from Pakistan, and I do not believe there is any place else in the world to sell guar gum except in the developed countries.

I might state here that guar gum is a product of guar beans which grow in a very arid climate. They originated in India and in Pakistan.

During the war we, in cooperation with the Government, tried to develop their growth and manufacture, their growth in Arizona and their manufacture in Minneapolis.

It never was a completely successful operation, and after the war, the Department of Agriculture introduced guar beans into Texas, and they got to the point where there was considerable crop being grown there, and so we built a plant down there. The output from that plant is guar gum, which is a very technical type of product.

A Pakistani could not sell guar gum because he does not know its technical applications. It only can be applied in mining, the flotation process of separating ores and coating for papers, and so forth.

These are but a few of the examples of the unfairness and inequities of writing tax provisions which ignore corporate entities and attempt to tax transactions, classes of income, or classes of taxpayers before the income of the corporation is remitted to the owner as a dividend. It would not be so serious if the results of enactment of these types of provisions only affected us internally. Unfortunately, the result will be to gradually reduce and eliminate our participation in international trade.

I earlier suggested benefits our country can derive from foreign business investment. I believe our country has a strong selfish interest in maintaining and expanding this investment. I also believe that the countries in which our business investments are made will benefit because their income and standards of living will be raised.

I believe it has been and always will be the position of each country of the world that it has the right to tax income earned within its borders. This is the policy of our country; however, the proposals in this bill represent a strong attempt to extend our taxing power into other nations. I do not believe this is right.

I suggest and recommend that U.S. corporations be permitted to bring dividends from foreign corporations into the United States free from U.S. tax. I believe that after foreign tax credits are applied there is little U.S. tax left for U.S. corporations to pay on the dividends. We should be able to afford to exempt this small but important segment of income from double taxation. It should suffice for the U.S. Treasury to collect tax on foreign income as it is distributed to shareholders of the U.S. parent companies. I would include in such recommendation a provision to guard against the incorporated pocketbook of individuals and would give the Secretary authority, which I believe he now has, to allocate income back to a U.S. company where there are clear cases of tax avoidance. For the few individuals who still have sufficient money to make foreign investments directly, I would continue the present foreign tax credit provisions.

It has been stated that this bill will encourage foreign investment and will at least temporarily help to solve our international exchange problems. I see only the opposite results from the proposal. I be-

lieve the adoption of the suggestion to exempt U.S. corporations from U.S. tax on dividends from foreign corporations would accomplish both obectives and that the effect on international exchange would be a continuing and not a temporary benefit.

Senator CURTIS. Could I ask just one question?

The CHAIRMAN. Yes.

Senator CURTIS. Mr. Barker, aside from the obection to this that you have raised and by this I mean the sections of the bill relating to foreign income, do you think that in the overall, if the bill were enacted and its impact reached upon our economy, that in the overall it would substantially increase the revenue of the United States?

Mr. BARKER. No.

Senator CURTIS. Do you think that it would increase the number of jobs in the United States?

Mr. BARKER. No.

Senator CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Barker.

(The attachments referred to follow:)

EXAMPLES OF UNFAIR RESULTS PERMITTED BY SECTION 367

Section 367, among other things, covers liquidations under section 332 of subsidiary companies 80 percent or more owned. Domestic companies liquidated under section 332 are permitted to pick up the operating loss carryover of the subsidiary company. Operating losses of a foreign corporation cannot be picked up. There is only one exception to this harsh rule. If the stock is completely worthless and the operating and 95-percent ownership requirements of section 165(g) are met, then the loss may qualify as an ordinary deduction.

Section 367 also covers transfers of property to corporations controlled by the transferor (sec. 351). Taxpayers transferring property such as patents to a foreign corporation in exchange for stock may be required by the Commissioner to pay a tax on the transfer. Such transfers occur before the foreign enterprise starts operations, and even though the financial success is unknown, the U.S. taxpayer may be required to pay a tax to have the privilege of trying to earn money abroad. If a loss occurs because the venture is unsuccessful no loss deduction is permitted.

COMMENTS ON SECTIONS 5, 6, 11, AND 12 OF THE REVENUE ACT OF 1962

Section 5.—This section taxes dividends received in property at the fair market value of the property received. Two adverse conditions can result from this proposal.

(1) Income to the U.S. Treasury may be reduced because the countries of origin will likely tax the profit on the property distributed.

(2) U.S. taxpayers will likely lose foreign tax credit in whole or in part on the tax on the gain on the property distribution because the gain is not a part of earnings and profits of the distributing corporation.

Section 6.—Further comments.

Arm's-length price is defined in such a restrictive manner that it is doubtful any manufacturing company could qualify within the definition. This is because many manufacturers sell their products to distributors only and not to other manufacturers. The distributors generally perform a good share of the selling function. I would assume that an arm's-length price would be fair for U.S. purposes if the domestic organization sold at a price which included approximately the same margin of markup as was earned on domestic business after reduction for such cost factors as further processing, packaging, sales, distribution, advertising, and transportation not required to be performed by the domestic organization. Such a gross margin approach to price is not permitted under the rules.

It is assumed that foreign income taxes paid by the foreign corporation on the income allocated to the domestic corporation will be available to the domestic corporation as a foreign tax credit. If this is intended to be the case then situations can exist where a U.S. company has other losses in the foreign

country and when this is the case the foreign tax will be lost. Additionally, when the foreign corporation finally remits the earnings allocated to the U.S. company, the country in which the foreign corporation operates will ordinarily withhold income tax on the dividend remittance. The U.S. company may not receive any tax credit for the tax withheld on the dividend because it will not necessarily have income from the foreign country in that year and the income being remitted will have already been allocated to the U.S. company in a prior year.

Section 11.—This section grosses up dividends to an amount equal to the earnings before income taxes.

Adoption of the gross up provision will make the grossed up amount subject to income tax in the States of the United States.

Adoption of this type of policy means income from foreign investments will always be subject to not less than a 52-percent tax, but in the countries of the world where the tax rate (including the dividend withholding tax) exceeds 52 percent, the U.S. taxpayer stands the excess. Under the policy proposed to be abandoned U.S. taxpayers at least had a chance to earn some income at less than a 52-percent rate to average with those over 52 percent. If the policy of the Government is to eliminate the slight advantage now permitted, it would appear the reduced tax rate on income of Western Hemisphere trade corporations is not justified. The Western Hemisphere reduced rate of tax is a justified policy but the type of action here proposed places the rest of the world, to the extent the tax rates of the non-Western Hemisphere countries are below 52 percent, at a disadvantage for U.S. investment.

Section 12.—Limiting the amount of income which may be earned free from U.S. tax by an individual resident abroad.

Adoption of this type of limitation will cause those less developed countries who now grant tax exemption to certain technicians to tax the income of those individuals at high rates above the limits proposed.

It is very unlikely that the U.S. Treasury will receive any tax revenue from this amendment as the U.S. rates will apply to income above the excluded amount, whereas, in most cases, the tax of the foreign country (excluding technicians exempt in some less developed countries) will apply to all the earnings. This result will be especially true in those foreign countries with graduated tax rates.

Adoption of this proposal will cause U.S. companies even greater trouble in staffing their foreign operations with U.S. citizens as there are many areas where U.S. law considers certain payments as income subject to tax, and the foreign country has a rule exempting the item or treating it differently. A few examples are: furnished living facilities, education allowance for children, moving expenses, and nonremittance of earnings.

The CHAIRMAN. Mr. Leon O. Stock, Peat, Merwick, Mitchell & Co.

Take a seat, Mr. Stock.

STATEMENT OF LEON O. STOCK, OF PEAT, MARWICK, MITCHELL & CO.

Mr. STOCK. Mr. Chairman, my name is Leon O. Stock. I appear here as a representative of Peat, Marwick, Mitchell & Co., a national accounting firm.

Operating in our international practice, I am in a position to make a number of observations about what would appear to be right and wrong in this field of international taxation. I have approached section 13 from three standpoints: First, its practicality; secondly, its logic; and third, its morality, and I must confess that I find it defective on all three counts.

We are told by many of our taxpayers that their reason in going abroad is not to minimize U.S. tax but to reach the marketplace, to penetrate the foreign market. It is quite obvious that a company which establishes a manufacturing subsidiary in any of the Western European countries has very little tax to save.

I think it is only fair and proper that we test the good faith of these taxpayers who go abroad for the purpose of advancing their business interests.

Therefore, I would find it unobjectionable to impose a tax, assuming its constitutionality, on foreign income through the imputation process, where foreign income is being accumulated solely or primarily for the sake of saving the shareholder from tax.

I would suggest that where oversea operations are plying their funds for expansion or diversification, I would not impute the profits in those instances. It is obvious that, if an American-controlled food chain operating in Belgium competes against a Belgian-owned food chain, it is pure logic that the Belgian chain is going to be able to expand more rapidly than the American, if the latter is required to pay more tax.

From this standpoint, we can only hurt and damage the competitive position of the American chain abroad.

Therefore, I would suggest that from a logical standpoint we ought to stop trying to do the impossible, equating dissimiliars.

Now, it is perfectly obvious that a domestic corporation on the one hand, and a foreign corporation on the other, are not similar in nature. They fall into totally different business classifications.

However, equity may be obtained by equal treatment of U.S. shareholders who stand behind the domestic company as well as the foreign company. Under current law the U.S. shareholder receiving a dividend from his domestic company pays U.S. tax on that dividend. Likewise the same U.S. shareholder receiving dividends from a controlled foreign corporation pays the same U.S. tax.

There is one area where equation is necessary. A domestic company which accumulates profits, for the purpose of saving the shareholder from U.S. tax, is faced with a penalty tax under section 531.

On the other hand, in this equation proposition, if your foreign controlled company withholds dividends, merely to save the shareholder from tax, in no circumstances, because of jurisdictional questions, can we assert the 531 penalty tax against the foreign corporation. In my humble judgment I think we would be justified in imputing the unreasonably retained earnings to the U.S. shareholder to eliminate this inequity.

Now, I believe that the bill goes far beyond the needs of the case. The bill would impute almost all foreign income to the U.S. shareholder. Interestingly enough, the bill recognizes that a domestic corporation and a foreign corporation are not similar by reason of the fact that a domestic corporation is given the benefit of a loss carry forward. The controlled foreign corporation is denied that same benefit.

If the two are similar, why withhold the benefit in one case and grant it in the other case? I think it is implied and recognized that the two are not similar. They are dissimilars.

Now, from a moral standpoint, I think it is wrong to have encouraged many business people to go abroad, in the last 15 or 20 years into Latin America, into the less developed countries, and now tell these people that "if you liquidate these companies, you are going to be denied capital gains treatment."

That provides no choice but to liquidate these companies immediately before this bill becomes law, if it does become law.

In what way, in what manner are we assisting, enhancing the economy of less developed countries by making it almost imperative that these people liquidate their foreign companies?

Likewise, let us consider the case of the European corporations, controlled by American individuals. There may come a day when these individuals wish to dispose of their stock. The gain will be taxed at the ordinary individual rates, possibly up to 89 percent, notwithstanding the fact that in many of these instances the foreign corporation has paid 50 percent tax on its profits. The proposed law provides no allowance, no tax credit, therefore, to the individual who realizes through sale or liquidation the accumulated surplus, taxable at ordinary rates.

I think that is just immoral.

We have heard a great deal about the tax haven companies. I think there is a tendency to look at some of the bad apples in the barrel, and then classify all the apples therein as being bad. No reputable practitioner has any sympathy for the sham corporation. I think we all agree on that.

The so-called tax haven company, is a company calculated to reduce, or minimize, U.S. taxation. This aim is not present in most oversea operations. A point was made by one of the prior witnesses this morning, the typical case.

An American company has a Dutch manufacturing subsidiary which is paying 47 to 48 percent of its profits in taxes. It is perfectly obvious that if you impute the income of that Dutch sub to the American company there is going to be very little additional revenue to the United States because of the offsetting tax credit.

Now, the Dutch authorities as well as the other European authorities permit the American oversea operation to establish a base trading or sales company in Switzerland. The base company purchases from the manufacturing sister company in Holland, at a price which gives the Dutch company a fair manufacturing profit, subject to Dutch taxation, with the approval of the Dutch authorities.

The profit thereafter realized by the Swiss sub is subject to taxation, perhaps 10 percent. We have thus relieved the selling portion of the overall profit from the Dutch tax of 48 percent and substituted a Swiss tax of 10 percent. That represents a minimization of 38 percent.

Now, as the witness pointed out here this morning, when dividends start flowing through those Swiss companies, they will carry with them only a 10-percent tax foreign credit which means the U.S. Government will get 42 percent thereon.

If we say that these base companies are to be outlawed, the American company utilizing a Swiss company will have no alternative but to dissolve these Swiss companies and do all manufacturing and selling out of the Dutch company.

No private citizen will place himself in a position where he deliberately reduces a foreign tax in order to enhance currently a U.S. tax.

Now, the Dutch authorities, the Belgian authorities, understand the desire to minimize European tax in order to accelerate European expansion, but they will not understand any minimization which is designed to increase our revenue currently.

We will have no alternative but to liquidate these Swiss sales companies, in which event all our profits including our selling profits then would be subject to the full Dutch tax of 48 percent. Just what revenue will that produce for the United States?

Therefore, I would suggest, or submit, that if we fear or if we believe that Americans are avoiding U.S. taxes, I say put them to the test, put them to the same test as shareholders operating in domestic companies.

Let's equate properly. If you are accumulating abroad and cannot justify the retention of your profits by reference to business need, then we ought to impute those earnings to the U.S. shareholders. If there is need for those earnings for the purpose of expansion, for the purpose of diversification as in the case of a domestic company, then we ought not to impute the earnings.

Now, to conclude, Mr. Chairman, I think the section 13 is almost an indictment in itself. Its mere complexity leads one to wonder why should a bill be that complex. There is something wrong with anything that is as complex as section 13, and I think it is complex because it starts off on the basis of factual misconceptions.

Thank you, sir.

The CHAIRMAN. Thank you, Mr. Stock.

(The prepared statement of Mr. Stock follows:)

STATEMENT BY LEON O. STOCK, OF PEAT, MARWICK, MITCHELL & CO., ON SECTION 13 OF REVENUE ACT OF 1962 (H.R. 10650)

My name is Leon O. Stock. I appear here as a representative of the accounting firm of Peat, Marwick, Mitchell & Co. My presentation is limited to section 13, relating to the taxation of the earnings of controlled foreign corporations to their U.S. shareholders.

What does section 13 seek to accomplish?

It would, subject to certain exceptions, impute—or attribute—each year the earnings of a controlled foreign corporation to its U.S. shareholders whether or not they had actually been remitted to them as dividends. The shareholders, in turn, would be required to include such earnings, pro rata, in their Federal income tax returns.

What is the stated justification for section 13?

Within jurisdictional limitations, to place the earnings of a controlled foreign corporation on the same tax footing as those of a domestic corporation, or the foreign branch of a domestic corporatin. The Treasury believes that inability of the United States to tax foreign earnings prior to distribution constitutes a tax advantage for oversea operations which should be eliminated.

What is the underlying philosophy of section 13?

Its position is that controlled foreign corporations should not be permitted to accumulate their earnings rather than make distribution and thus enable U.S. shareholders to avoid the payment of U.S. tax. Domestic corporations accumulating earnings in order to permit shareholders to avoid tax are subject to penalty taxation under section 531 of the Internal Revenue Code. Since a penalty tax cannot validly be assessed against the foreign earnings of a foreign corporation, section 13 would impute such earnings to the U.S. shareholder who is within the taxing jurisdiction of the United States.

Are the provisions of section 13 consistent with its underlying philosophy?

The answer is "No."

SECTION 13 LEFT THE TRACK

Before analyzing section 13 in detail, I should like to comment briefly on its objectives and on the steps proposed to achieve them.

Basically, I believe section 13 started in the right direction, and then left the track.

It is easy to sympathize with the bill's objective: to prevent controlled foreign corporations from unnecessarily accumulating earnings to prevent taxation of its shareholders.

But it is difficult to accept the harmful discriminations against these companies, and the blind refusal to approve the accumulation of earnings for well-recognized and long-accepted business purposes.

The deadline on formation of controlled foreign corporations, which will be taken up in detail later in this presentation, is a case in point. So is the distinction between less developed and more developed countries in determining where accumulated earnings may properly be channeled.

These are tangents which have so distorted the direction and complexion of section 13 as to make it insupportable.

And, basically, they are present because the bill seeks to do what cannot be done—that is, to equate dissimilars, in this case the domestic corporation and the controlled foreign corporation.

CORPORATE DIFFERENCES

The basic fallacy of section 13 is that it unsuccessfully attempts within jurisdictional limits to place the foreign corporation in the same category as the domestic corporation. This would be unobjectionable if they both fell within the same business classification, but obviously they do not. The controlled foreign corporation operating abroad competes against the foreign-owned corporation and not against the domestic corporation. As a foreign corporation it pays the same taxes on its earnings as its foreign competitors. Tax parity is thus maintained, an equitable ingredient of free competition.

If the controlled foreign corporation were equatable to the domestic business organization, which it is not, section 13 would still be defective because of its failure to equate. The domestic corporation computes its taxable earnings only after giving effect to loss carrybacks and carryovers, whereas the earnings of a controlled foreign corporation would be computed without the benefit of such considerations. Various options available to the domestic corporation, such as declining balance and sum-of-the-year's-digits methods of depreciation, would not be available in computing the earnings of the controlled foreign corporation.

SIMILARITIES OF SHAREHOLDERS

Section 13 seeks to tax the earnings of the controlled foreign corporation to the U.S. stockholder as if he had received such earnings as a dividend. This is recognition of the inability of the United States to tax the controlled foreign corporation directly. It suggests the general validity of equating the tax positions of U.S. shareholders of controlled foreign corporations and U.S. shareholders of domestic corporations.

This is precisely what the bill should confine itself to doing. Instead of equating dissimilars—domestic corporations and controlled foreign corporations—section 13 should follow through on equating similars, in this case U.S. taxpayers, whether they own shares in foreign or domestic corporations.

The bill's approach to the objective of equating shareholders—imputing to U.S. stockholders of foreign controlled corporations the accumulated income it cannot surtax in the same manner it surtaxes domestic corporations—is reasonable. But this reasonableness breaks down under the glaring discriminations against controlled foreign corporations to which we have already referred.

The reason for section 13's failure to live up to its promise as a good bill is that its provisions are inconsistent with its underlying philosophy. Consider the following inadequacies:

SAME STANDARDS SHOULD APPLY

It would seem fair and reasonable that the same standards used in determining whether a domestic corporation is justified in withholding dividends should also apply to the controlled foreign corporation. Furthermore, the same standards should be applicable irrespective of when the foreign corporation is organized. In these respects, section 13 is defective.

Equal treatment would not be accorded to all controlled foreign corporations under section 13. Discrimination would be exercised by imposing an arbitrary date and providing different rules for controlled foreign corporations organized before and after the deadline. Thus, the earnings of a controlled foreign cor-

poration, or of a foreign subsidiary of a controlled foreign corporation, organized after December 31, 1962, would be imputed to the U.S. stockholders even though such earnings are essential to and actually used in the operation. In similar circumstances, the earnings of a controlled foreign corporation or its subsidiary, organized and activated on or before December 31, 1962, would not be imputed to the U.S. stockholder. This represents an intolerable form of discrimination.

The post-1962 controlled foreign corporation would be placed in the same category as the pre-1963 corporation—be entitled to equal treatment—after it has been in operation under substantially the same majority ownership for 5 years. But during the 5-year period, it would occupy an obvious position of competitive inferiority.

Section 13 provides that the earnings of the post-1962 controlled foreign corporation would not be attributed to the U.S. stockholders if invested in an active trade or business in a less developed country. However, this does not effectively reduce the discrimination; certainly not for corporations interested in operating in the most profitable markets open to them.

The December 31, 1962, limitation is unreasonable and should be stricken from the bill. Taxpayers similarly circumstanced are entitled to equal treatment, which this bill would deny.

ORDINARY AND NECESSARY

The earnings of controlled foreign corporations would not be taxed to the U.S. stockholders if "ordinary and necessary" to the active conduct of the business. Why the use of these words in a statute aimed at taxing earnings unreasonably withheld from the stockholder? Why not the same well-tested language used in section 531:

"The accumulated earnings tax imposed by section 531 shall apply to every corporation * * * formed or availed of for the purpose of avoiding the income tax with respect to its shareholders * * * by permitting earnings and profits to accumulate instead of being divided or distributed * * *.

"* * * the fact that earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid the income tax with respect to shareholders, unless the corporation by the preponderance of the evidence, shall prove to the contrary."

The phrase "ordinary and necessary" is understandable when related to the deductibility of business expenses, but is without precedent when used as a criterion for determining the need for the retention of earnings in a business. It can only be surmised that the phrase is aimed at restricting or narrowing the types of business needs that would justify the nonattribution of earnings to the U.S. shareholder. Thus, unless the need is immediate, it might well fail to qualify as "ordinary and necessary" to the active conduct of the business.

It is suggested that the phrase "ordinary and necessary" be stricken in favor of the language employed in section 531, appropriately modified, and the latter used as the basis for determining imputability.

QUALIFIED BUSINESS

As previously indicated, the December 31, 1962, limitation should be eliminated by simply deleting or redefining the term "qualified business." Under section 13, as it now stands, income would not be imputed to U.S. shareholders if the earnings represented by money or property are ordinary and necessary for the active conduct of a "qualified trade or business." A trade or business would be qualified if carried on by the controlled corporation "while controlled by substantially the same U.S. persons since December 31, 1962, or during the 5-year period ending with the close of the preceding taxable year * * *."

A qualified trade or business conducted by an 80 percent (or better) owned subsidiary of the controlled foreign corporation would be treated as a qualified trade or business of the controlled foreign corporation. However, here too the business of the subsidiary would not qualify at the outset if established after December 31, 1962. Thus, future earnings of a pre-1963 controlled foreign corporation invested in an operating subsidiary established after December 31, 1962, would be imputed to the U.S. shareholders. The same result would obtain if an operating branch were established by the controlled foreign corporation subsequent to 1962, and the business of such branch were regarded as being different from the pre-1963 business.

The time limitation means that post-1962 diversification, and in many instances expansion, would not qualify as reasonable business needs for the purpose of determining imputability of foreign earnings.

SINGLE STANDARD FOR MEASUREMENT OF BUSINESS NEEDS

Expansion as well as diversification are regarded as reasonable business needs for the purpose of section 531. There would appear to be no valid reason to view such needs as less worthy in the case of oversea operations. Anything other than a single standard would neither serve the cause of tax equality or equality of business opportunity. Accordingly, it is submitted that the criteria employed in determining whether a domestic corporation is unreasonably accumulating surplus should be made applicable to a controlled foreign corporation. Foreign earnings accumulated to prevent the imposition of tax on U.S. shareholders should be imputed to such shareholders. However, where they are related to finance expansion or diversification, regardless of geographical location, they should not be imputed.

The distinction between developed and less-developed countries should be eliminated from the bill. Penalizing the company that finds its impracticable or premature to establish operations in a less-developed country would serve no useful purpose. The provisions of the bill which recognize the employment of earnings from a developed country to finance the expansion, diversification, or inauguration of business in a less-developed country, whether prior or subsequent to December 31, 1962, as adequate reason for not imputing such earnings to the U.S. shareholder, should be stricken from the bill. According preferential treatment to investments in less-developed countries will not increase the flow of capital to such countries. Market conditions, not tax considerations, will determine the extent of such investments.

FOREIGN BASE COMPANY

The foreign base company, which would include the foreign export and import company as well as the foreign base holding company, should also be given the opportunity to expand or diversify in economically developed countries. However, the burden of proof should be more severe in determining the reasonableness of accumulation by such companies. Thus, the mere fact that the company is a foreign base company should be regarded as prima facie evidence of the purpose to avoid income tax with respect to its U.S. shareholders.

LOSS CARRYOVERS

Since, in appropriate circumstances, post-1962 earnings would be imputed to the U.S. shareholders, it would seem only fair to allow post, and even perhaps pre-1962 losses, if any, to be carried forward and offset against such earnings in determining the amount to be imputed. While prior losses might furnish justification for nonimputability, a loss carry-forward provision is needed for those instances where imputability would be proper notwithstanding prior losses.

Unlike section 513, which denies a loss carry-forward in computing net income subject to the penalty surtax, imputability to the U.S. shareholder under the bill should not be regarded as penal in nature and earnings taxed to the U.S. shareholder should accordingly be reduced by loss carry-overs.

RECAPITULATION

Section 13 heads in the right direction but unfortunately aborts in several critical respects, so much so, in fact, as to almost make it a vicious instrument. As now worded, it collides rather than responds to the factual premises on which it is or should be predicated. Let us look at the facts:

1. American business has in the past and will continue in the future to establish oversea operations for only one reason—to more effectively penetrate a developing consumers' market. Companies now overseas, and those that will go over, should be permitted to operate on competitive parity with foreign-owned businesses. They should be permitted to expand and diversify as readily as their foreign competitors. The tax liability of controlled overseas businesses should accordingly be no more burdensome than that of foreign competitors prior to the accomplishment of their business objectives. The business need to expand and diversify free of competitive disabilities should be assured. Statutory deadlines and differentiation between developed and less-developed countries should be eliminated.

2. The statutory standards of section 531 should be applied in determining whether oversea earnings have been retained to meet business needs or to permit the avoidance of tax at the shareholder's level. In the latter instance, the earnings should be imputed to the U.S. shareholder.

The CHAIRMAN. The next witness is Mr. Adrian A. Kragen, professor of law of the University of California.

Take a seat, Mr. Kragen.

Mr. KRAGEN. Thank you, Mr. Chairman.

STATEMENT OF ADRIAN A. KRAGEN, PROFESSOR OF LAW, UNIVERSITY OF CALIFORNIA, BERKELEY, CALIF.

Mr. KRAGEN. I believe I should state at the outset that although in this agenda I am identified as professor of law at the University of California, I am not appearing before this committee in that capacity but rather, although the views and conclusions I am stating are my own, I am presenting them to this committee at the request of the National Foreign Trade Council.

I will discuss in the time allotted to me my opinion as to the constitutional implications of section 13 and not as to the economics or other policy involved.

These constitutional questions, I believe, are raised because the section proposes the attribution to certain U.S. shareholders in foreign corporations of a pro rata share of the undistributed income of such corporations. Thus we need to consider two basic questions:

Can Congress constitutionally provide for such attribution on one of two theories: either the accretion theory that is the attribution of the increase of worth to the shareholder, or on the constructive receipt theory.

If we decide that undistributed income in the situation covered by section 13 could be considered as constructively received, the second basic question appears, that is, is the ownership of more than 50 percent of the shares of a foreign corporation by U.S. persons without more legal justification for the including of a pro rata share of the corporate income to any U.S. shareholder who has 10 percent or more of the shares or of the value of all shares.

My views on these questions are discussed in some detail in a statement which I have filed with the committee.

This oral presentation will only summarize the views there expressed.

When we consider the first question, that is the taxing of income of a corporation through its shareholders on the basis that the income of the corporation may be imputed through the shareholders as an accretion to its net worth we must consider whether realization is still an essential element in the determination of income for Federal income tax purposes. Thus we come again to the question of the present vitality of the doctrine of realization as enunciated by the Supreme Court in the classic case of *Eisner* v. *Macomber*.

I am certain that I need not discuss at this time the basis of that very important decision.

Although the decision has been subjected to continuous attack by the Government, in my opinion, the ruling that the realization as therein defined is required for inclusion in income for Federal income

tax purposes is still the ruling which applies and is still the law of the United States.

In examining the cases which have considered this question I find that despite Government efforts to get the Supreme Court to specifically overrule the *Eisner* case or to rule that realization is not essential to the recognition of income for income tax purposes, the Court has not done so.

In fact, in those cases where the case itself demanded that *Eisner* v. *Macomber* should be distinguished, the Court has specifically indicated the validity of the realization rule and indicated that in the case then before the Court the income had been realized.

The Treasury Department in its legal memorandum presented to the House Ways and Means Committee appears to agree that the *Eisner* doctrine has not been explicitly overruled, but considered that there is a strong possibility that it would be overruled if a proper case were presented.

They rely for this conclusion mainly on the cases of *Helvering* v. *Bruun* and on *Helvering* v. *Horst*. In my opinion neither of these cases justify the Treasury optimism.

The *Bruun* case involved the abandonment of a long-term lease, bringing to the lessor a building which had a useful life far less than the original term of the lease. This, in my opinion, was an actual receipt, actual realization of something new, and the attachment of the building to the land did not in any way make it the less a realization of that physical asset. The *Horst* case involved actual transfer of bond coupons, an exercise of a power by a donor, which brought him, at that time, as the Court determined, economic satisfaction.

The Court in the *Horst* case holds that this exercise of the power constituted realization by the donor and was brought about by a physical severance, not by some accretion or accession.

I do not believe the opinion gives any support to the Treasury view.

Therefore, it is my conclusion that there is nothing at this time which justifies the contention that Congress can constitutionally include in income, for Federal income tax purposes, income, or rather values, I should say, which have not been realized.

The second string to the Treasury bow is that section 13 of H.R. 10650 is justified on the ground that Congress can determine that U.S. shareholders who have what the Treasury considers to be theoretical control over a corporation by reason of stock ownership, can be considered as having constructively received their pro rata share of the corporate income.

In essence, this involves in my mind the actual, if not the theoretical, disregarding of the corporation entity. The independence of the bona fide corporation from its shareholders has long been a basic part of our revenue laws as well as of our general laws, and the constitutional status of that separation was affirmed in the *Eisner* case.

It has been disregarded only in cases where the corporation had no real substance and in my opinion there is no justification for its disregard in the broad sweep which is contained in section 13 of the bill before this committee.

The Treasury considers that these sections do not disregard the corporate entity but rather that they set up a conclusive presumption that the shareholder could have received the income and, therefore, should be considered as having constructively received it.

It relies as authority for the validity of this presumption on the foreign personal holding company provisions of the Internal Revenue Code.

In the limited time available to me, I cannot go into the decisions in the detail which I have in the written memorandum. I can only note that there is no decision which in my opinion sustains these sections as against constitutional attack on the basis of the due process clause. And further, I believe that the premise on which the Treasury contended that these sections were constitutionally valid is an important factor for consideration here because it was the premise that there was widespread flagrant violation or evasion of the revenue laws. When we look at the report of the House Ways and Means Committee and the provisions of section 18 of the present bill, it certainly cannot be said that for a major portion of the corporations involved this aspect is present.

Whether or not there is legal justification, if there is widespread evasion, seems to me an unanswered question. I have grave doubts on that ground, and I don't think it has been answered by the Eder case or any other case that has been decided by circuit courts, and has not been considered by the Supreme Court.

It is my opinion that there is a very real doubt as to the constitutionality of a provision which would compel the disregard of the entity of a bona fide operating corporation where no substantial element of deliberate tax evasion is present.

If we presume that the shareholder has received income merely by reason of the fact of shareholding it is my opinion we are violating a basic prohibition enunciated by the Supreme Court against taxing the income of one entity to another. I do not believe that in the situation involved here we can properly disregard the corporate entity and if we do not disregard the corporate entity we have a long tradition, constitutional and statutory, which treats the corporate entity as completely independent from its shareholders; that is, as two independent individuals, as far as our revenue laws are concerned.

If we assume, however, simply for the purposes of this discussion that ownership of shares of a bona fide corporation can in a proper instance be considered as the equivalent of unimpeded command of its income, we must face the question whether section 18 sets forth an appropriate criterion.

Under the proposal of a 10-percent shareholder of a foreign corporation over 50 percent of whose shares or value of shares is owned by U.S. persons is subject to the attribution of income.

The Treasury contends that this is control, even though it would allow the attribution of corporate income to a 10-percent shareholder who has no relationship, family or otherwise, to the other shareholders, no representation on the board of directors of the corporation, and no possibility of exercising any control over the policies of the corporation. It would attribute income to such shareholder even though the laws of the country in which the corporation was organized precluded any actual distribution to the shareholders.

The Treasury relies for its authority on this point on cases involving the regulatory provisions of the Securities and Exchange Act and the Public Utilities Holding Company Act. I do not believe these decisions are pertinent here. It is an entirely different thing to regu-

late privileges which are allowed to taxpayers from taxing income of one taxpayer to another. I do not think that in any case this type of imputed control has been applied to the revenue laws.

In fact, the cases which I have found under the tax laws of the United States which have disregarded the corporate entity and taxed income to shareholders, are cases where there was actual command of income, actual operation of the corporation in every respect as if it were the alter ego of the shareholder. The fact that we have a 10-percent shareholder who was an American and that other Americans, who may number one or a thousand, hold over 40 percent of the shares, appears to me to be a completely illogical and improper basis for a conclusion that such 10-percent shareholder has that actual command of income which, under the Treasury's own regulations is necessary for the operation of the doctrine of constructive receipt. I believe it is constitutionally necessary that we should have that actual command.

It should make no difference whether U.S. persons other than a 10-percent shareholder, if the Treasury is correct in its theory, hold 41 percent or 5 percent, if we are going to presume that 10 percent is control for attribution of income purposes. The only purpose of the requirement that U.S. persons hold a majority of the shares would seem to be to give some semblance of actual control. Upon analysis, I believe it is clear, that this does not give support sufficient to justify the attribution provision.

I agree with the position that every reasonable and legal effort should be made to prevent the use of foreign countries as tax havens for non-bona fide operating companies but I do not believe we should or that it is necessary to penalize shareholders of a bona fide operating company in order to achieve this purpose and as I have stated in my opinion, there is serious constitutional doubt as to our right to do so.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Kragen.

(The prepared statement of Mr. Kragen follows:)

STATEMENT OF ADRIAN A. KRAGEN, PROFESSOR OF LAW, BERKELEY, CALIF., ON BEHALF OF NATIONAL FOREIGN TRADE COUNCIL, INC.

The President's tax program relative to the income of foreign corporations which originally was directed at the twofold purpose of strengthening the balance-of-payments position of the United States and eliminating the use of tax havens (Hearings Before the Committee on Ways and Means, House of Representatives, 87th Cong., 1st sess., p. 84)[1] has in the Revenue Act of 1962 been narrowed in H.R. 10650 to what purports to be an elimination of the use of tax havens (CCH staff explanation, p. 58). I therefore consider it unnecessary to comment in this discussion on the validity of the arguments in the Treasury memorandum of June 10, 1961 (Hearings, p. 818, commencing at p. 818), that the proposed legislation is constitutionally defensible under article I, section 8, clause 3, of the Constitution on the ground that a major purpose of the legislation is to adjust the balance of international payments.

The proposals relative to the foreign corporation which are now before this committee raise certain basic but individually independent questions which I would like to comment on in this opinion. These questions are:

A. Can undistributed corporate profits which are not actually received by a taxpayer-shareholder be considered as income to such taxpayer for U.S. income tax purposes on—

(1) the theory that accretion without more is income?
(2) the theory of constructive receipt?

[1] Hereinafter referred to as "Hearings."

B. Is ownership by U.S. shareholders of more than 50 percent of the shares of a foreign corporation legal justification for the treatment of the pro rata share of undistributed corporate income as constructively received by each of the U.S. shareholders holding 10 percent or more of the shares?

A.(1) Accretion

The answer to the question A(1) is fundamental to the entire consideration of the validity of the legislation. In the event that an accretion to wealth in and of itself can be considered as income for U.S. income tax purposes, we would only need to consider whether the proposal to measure an income tax by such accretion accorded the taxpayer due process of law. In essence this is the much considered and discussed question of whether "realization" is necessary in order to have "income" within the meaning of that word in the 16th amendment of the U.S. Constitution. The Treasury memorandum discusses this matter at some length, and comes to the conclusion that there is a strong possibility that the Supreme Court would, if faced with the direct issue, override the "realization doctrine" as expressed in *Eisner* v. *Macomber* (1920) 252 U.S. 189. My examination of the decisions has led me to doubt the validity of this conclusion.

The focal point for any discussion of the doctrine of realization is the classic *Eisner* v. *Macomber* case. In that case, the Court defined income as (p. 207):

"'* * * the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets * * *

"* * * Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value in the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being '*derived*,' that is, *received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit, and disposal;—*that* is income derived from property. Nothing else answers the description." [Emphasis added.]

In *Eisner* v. *Macomber* there was, in my opinion, a clear and unequivocal statement that income of a corporation could not be taxed to the shareholder without a receipt of that income by the shareholder, i.e., that realization in some measure is essential to the definition of income for Federal income tax purposes.

The Treasury over a long period has attacked that concept and has consistently urged the overruling of *Eisner* v. *Macomber*. Despite such urging the Supreme Court of the United States has never seen fit to overrule the fundamental doctrine enunciated in the case. In fact, even where the Court has distinguished *Eisner* v. *Macomber*, it has actually or impliedly recognized the continuing validity of the definition insofar as realization is concerned. Thus, in *Commissioner* v. *Glenshaw Glass Co.* (1955) 348 U.S. 426, the Court in distinguishing *Eisner* v. *Macomber* stated (pp. 430–431):

"* * * The Court was there endeavoring to determine whether the distribution of a corporate stock dividend constituted a realized gain to the shareholder, or changed 'only the form, not the essence,' of his capital investment. Id., at 210. It was held that the taxpayer had '*received nothing* out of the company's assets *for his separate use and benefit*.'* * *

"Here we have instances of *undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion*." [Emphasis added.]

In *Helvering* v. *Griffiths* (1943) 318 U.S. 371, the court specifically declined to rule on the question and the Treasury Department finds comfort in this negative determination. However, the pronouncement quoted above from *Glenshaw Glass* appears to me clearly to set forth the present vitality of the realization rule of *Eisner* v. *Macomber*.

Helvering v. *Brunn* (1940) 309 U.S. 461, is used by the Treasury Department and some legal scholars as a harbinger of the demise of the realization requirement for income inclusion. It is my opinion that the *Brunn* case does not derogate from the basic doctrine enunciated in *Eisner* v. *Macomber*. In *Brunn* there was an actual realization in the receipt by the taxpayer of something of actual value. Prior to the cancellation of the lease, all that the lessor had was a fee in land. The building on that land, having a useful life less than the life of the lease, was for the purposes of the lessor nonexistent. When the lease was canceled, it resulted in the receipt by the lessor of a building with a then value in excess of $50,000. This was a clear realization of something new which constituted income under the *Eisner* v. *Macomber* definition. It was property separate and apart from the land itself whether or not it was practical at the

moment to sever it physically. Nowhere in the *Bruun* opinion is there any indication that the realization test is abandoned or even weakened (see Roehner & Roehner, "Realization: Administrative Convenience or Constitutional Requirement?" 8 Tax L. Rev. (1953) 173).

The Treasury in its memorandum while conceding that the "question of the need for the realization of the income has not yet been squarely met by the Court" (p. 815, House Hearings) relies on *Helvering* v. *Horst* (1940) 311 U.S. 112 as another indicia of the loss of vitality of *Eisner* v. *Macomber*. In my opinion the *Horst* case strengthens rather than weakens the requirement of realization. The Court throughout its opinion emphasizes the necessity for realization and for something more than mere enhancement in value of a capital asset held by the taxpayer. It simply recognizes that the actual exercise of the power to dispose of a right to income is in itself a realization even though the tangible receipt of the income is by another. It nowhere indicates that mere accretion in value is realization or that the power to dispose of a right to income is the equivalent of the exercise of that power.

My examination of the decisions of the Supreme Court of the United States has resulted in my opinion that *Eisner* v. *Macomber* is still the controlling authority on the issue of the necessity for realization for the purpose of the determination of income under our income tax laws. Therefore, I must conclude that an attempt to tax a shareholder in general on the undistributed profits of the corporation on the theory of accretion is of very dubious constitutionality under article 1, section 2, clause 3, and article 1, section 9, clause 4.[2]

A. (2) Constructive receipt

The Treasury Department attempts to support the proposed legislation upon the ground that it will tax income which can be considered as constructively received by the shareholder.

Since 1871[3] Congress with certain exceptions[4] has levied a tax upon the income of corporations at the corporate level and has treated the shareholders as separate and distinct from the corporate entity. Since 1921, the only legislation imposing a compulsory tax on the shareholders of a corporation based on a prorata share of corporate income, whether distributed or not, is the Foreign Personal Holding Company Act.

The Treasury Department relies on these provisions as a precedent for the present proposal. In my opinion there is no authority specifically supporting the constitutionality of the foreign personal holding company provisions. Even if there were such authority, I do not believe it could be considered as controlling in regard to the present statutory proposal.

I have found four cases which consider the foreign personal holding company provisions. In two of these, *Alvord* v. *C.I.R.* (4 Cir. 1960) 277 F. 2d 713 and *Marsman* v. *C.I.R.* (4 Cir. 1953) 205 F. 2d 335, no constitutional issue appears to have been raised or discussed. In one, *Rodney* v. *Hoey* (S.D.N.Y. 1944) 53 F. Supp. 604, the plaintiff apparently argued that it was unconstitutional to tax constructive receipt of income without discussing the question of realization and the court rejected the contention merely by citing *Eder* v. *Commissioner of Internal Revenue* (2 Cir. 1943) 138 F. 2d 27. The *Eder* case discusses the constitutionality in a single sentence. Actually the only allegation of unconstitutionality raised by the plaintiff was on the ground that the inability to distribute in dollars due to blockage rules precluded taxability. The constitutionality of the foreign personal holding company provisions was not presented to the court. This decision cannot be considered to be a definitive upholding of the statute even by the circuit court. The *Eder* case was not taken to the Supreme Court probably because on remand the Tax Court valued the blocked pesos at about one-half of the amount determined by the Commissioner.

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[2] *Pollock* v. *Farmer's Loan & Trust Co.* (1895), 158 U.S. 601.

[3] The Civil War Revenue Acts taxed the shareholder on corporate profits whether distributed or not. *Collector* v. *Hubbard* (1870), 79 U.S. 1, sustained this legislation without passing upon its constitutionality. In *Eisner* v. *Macomber*, supra, the Supreme Court stated (pp. 218–219) that the *Hubbard* case had been overruled.

[4] The Revenue Acts of 1913, 1916, 1917, and 1918 levied a tax on shareholders measured by their prorata share of undistributed corporate profits in the case of "personal service corporations" and when corporate income had been accumulated in order to avoid taxes. In 1921, Congress, doubting the constitutionality of this procedure, levied the tax on the corporation (see Ways and Means Committee Report No. 350, 67th Cong., 1st sess., p. 13; Senate Finance Report No. 275, 67th Cong., 1st sess., pp. 16–17).

All of the cases involving the foreign personal holding company sections discuss the purpose of the legislation, that is, the closing of a loophole that allowed the widespread evasion of income taxes by the device of the "incorporated pocketbook." The section did not purport to and was not intended to cover bona fide operating companies engaged in the sale of goods.

The presence of the tax evasion factor in the enactment of the foreign personal holding company provisions is clear from the legislative history. It is also clear that this tax evasion factor was the major argument of the Treasury Department against the contention of constitutional invalidity. For example, Arthur H. Kent, then General Counsel of the Treasury, testified before the House Committee on Ways and Means, House of Representatives, 75th Congress; August 9 and 10, 1937, p. 76), as follows:

"Mr. REED. Have you considered the constitutional question involved?

"Mr. KENT. We have given a good deal of thought to that, Mr. Reed, and we believe that if the courts appreciate, as they well do if the facts are properly presented to them, that this does not represent any attempt to avoid in any general way the principles laid down in past decisions, but is simply a bona fide effort by the Congress of the United States to prevent its citizens, residents of this country, from resorting to foreign laws to beat our taxes, that it will be sustained.

"Mr. REED. In view of previous decisions of the courts in relation to the tax on incomes and the tax on capital?

"Mr. KENT. If those decisions were applied according to their letter, the plan might fail. But the courts have always shown a quite different attitude where you are dealing with a tax evasion situation and this situation can hardly be described in any other way" (testimony of Arthur H. Kent, General Counsel of the Treasury before Joint Committee on Tax Evasion and Avoidance, 75th Cong., hearings Aug. 9 and 10, 1937, p. 76).

Although the protection of the revenues against tax evasion has not been determined by the Supreme Court to be an adequate justification for the taxing of corporate income to the shareholders, the present proposal does not purport to rely for important provisions on the presence of widespread or flagrant tax evasion. The committee report on H.R. 10650 states that certain types of income, namely, foreign corporate income from the insurance of American risks and income from patents, copyrights, etc., developed in the United States have tax avoidance aspects but the committee report equally indicates that income of foreign corporations from other sources does not fall within that category. However, it determines that such income should be taxed to American shareholders unless used in certain ways, one of which is "in accord with the policy enunciated by the President," i.e., invested in business in less-developed countries. Even if we assume that widespread tax evasion would justify the action proposed, this premise is not available in relation to shareholders of bona fide operating corporations whose income is from activities falling outside those classified in the tax evasion category by the Ways and Means Committee.

The doctrine that the corporate entity is an entity distinct and apart from that of its shareholders is one of long standing in Anglo-American law and in our revenue system.[5] The Supreme Court in *Eisner* v. *Macomber* placed this doctrine on a constitutional footing when it stated that the income of a corporation was not income to a shareholder within the meaning of that term in the 16th amendment. The court stated (p. 219):

"* * * the amendment [16th amendment] applies to income only, and what is called the stockholder's share in the accumulated profits of the company is capital, not income. As we have pointed out, a stockholder has no individual share in accumulated profits, nor in any particular part of the assets of the corporation, prior to dividend declared."[6]

The Supreme Court has indicated that this constitutional prohibition does not exist when the corporate entity is not a real entity, when the corporate entity is in effect a mere form without substance. Thus, in *Moline Properties* v. *Comm'r.* (1943) 319 U.S. 436, the Supreme Court stated (p. 438–439):

"The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the State of incorporation or to avoid or to comply with the demands of creditors or to serve

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[5] See, e.g., *Klein* v. *Board of Supervisors* (1930), 282 U.S. 19, 24; *Burnet* v. *Commonwealth Imp. Co.* (1932), 287 U.S. 415; *New Colonial Ice Co.* v. *Helvering* (1934), 292 U.S. 435, 442; *National Carbide Corp.* v. *Commissioner* (1949), 336 U.S. 422.

[6] See also, e.g., *Lynch* v. *Hornby* (1918), 247 U.S. 339, 344.

the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entitiey. * * *

"In general, in matters relating to the revenue, the corporate form may be disregarded where it is a *sham or unreal*. In such situations the form is a bald and mischievous fiction"[7] [emphasis added].

In 1939, a distinguished committee established by the National Tax Association to study the taxation of domestic corporations concluded that application of the partnership method of taxation to a corporation whereby the shareholders would be required to include in their income the undistributed corporate profits would probably require an amendment to the Constitution (1939 proceedings of the National Tax Association, pp. 534, 548).[8]

The Treasury memorandum takes the position that when the U.S. shareholders of a foreign corporation have such power over the corporate income that they can either distribute it to themselves in the form of dividends or use it for their benefit, the corporate entity may be disregarded for tax purposes without regard to whether that entity is bona fide or is "sham and unreal." The Treasury believes that this is a theory of constructive receipt and that *Eisner* v. *Macomber* would be no bar to its utilization.

I would submit that this position is by no means clearly correct and that there is a serious constitutional question under the 16th amendment in a situation where the shareholders in a bona fide operating corporation have the actual power over the income unless and until the Supreme Court overturns *Eisner* v. *Macomber*.

If, however, we assume that in such a situation *Eisner* v. *Macomber* does not constitute a bar, we still must find, as the Treasury memorandum recognizes, an actual command of income in order to avoid the consitutional doctrine of due process of law to the effect that A cannot be taxed on the income of B.[9]

B. 10-percent shareholder—51-percent majority

The Treasury relied in its presentation on the proposition that the income of a "controlled corporation" could be considered for Federal income tax purposes as constructively received by its shareholders. The provisions of section 13 of H.R. 10650 implement this contention. It proposes to tax any U.S. shareholder who holds 10 percent or more of the voting stock or of the total value of the shares of a foreign corporation over 50 percent of whose voting stock is owned by U.S. persons. (In regard to "foreign base company income" as defined in sec. 952(d), the requirement is that five or fewer U.S. persons own more than 50 percent of the voting power.)[10]

The Treasury memorandum, written in support of the original proposal that a 10-percent share interest would be sufficient "control" to support a legislative determination that income was constructively received by the shareholder, relied on a group of cases under the Securities and Exchange Act and the Public Utility Holding Company Act. These authorities are not pertinent to the present situation. We are dealing in the area of taxation with a constitutional definition of income enunciated by the Supreme Court and with the apparently established right of the taxpayer under the due process clause of the Constitution to be free from compulsory taxation on that which is not and cannot be obtained or enjoyed by him. Whether the shareholder has sufficient "control" to be an "insider" for the purposes of the Securities and Exchange Act or has

[7] See, generally, Cleary, "The Corporate Entity in Tax Cases," 1 Tax L. Rev. (1945) 3; Case, "Disregard of the Corporate Entity and Federal Taxation, the Modern Approach," 30 Va. L. Rev. (1944), 398.

[8] See also, "Ballantine, Corporate Personality in Income Taxation," 34 Harv. L. Rev. (1920), 573, 586; cf., *Long Poultry Farms* v. *Commissioner of Internal Rev.* (4 Cir. 1957), 249 F. 2d 726, 731.

[9] See *Hoeper* v. *Tax Commission* (1931), 284 U.S. 206; *Heiner* v. *Donnan* (1932), 285 U.S. 312, 326–327.

[10] The original Treasury proposal attributed the income of foreign corporations to American shareholders with respect to corporations in existence prior to the passage of the bill only if there were 10 or fewer shareholders who owned more than 50 percent of the corporate shares. With respect to corporations established after the bill, any American shareholder who owned 10 percent of the shares, whether or not the majority of the shares were held by American shareholders, was taxable on his pro rata share of the undistributed profits. The second Treasury draft eliminated the distinction between corporations in existence on the date of the bill's enactment and those to be set up thereafter and attributed the income of foreign corporations to American shareholders only when 5 or fewer American shareholders owned 50 percent or more of the total corporate shares.

sufficient "control" to be considered as falling within the reach of the Public Utility Holding Company Act[11] is not relevant in the instant situation where established specific constitutional questions must be resolved.

In the cases decided since *Collector* v. *Hubbard*, *supra*, which have determined that the corporate entity should be disregarded and corporate income attributed for tax purposes to the shareholders, there was no doubt that actual command of the corporate income existed in the shareholders.[12]

This actual command of the income is the essence of the Treasury's own regulation on constructive receipt of income (regulation 1–452.2(a)). However, the provisions of section 13 of H.R. 10650 would allow the taxation of income to shareholders who had no command of the income and no possibility of acquiring actual control of it. Under the provisions of section 13, a shareholder who owned 10 percent of the voting power[13] of a foreign corporation and who had no relationship with the other shareholders, no representation on its board of directors and no actual power to determine its policies would be considered to have constructively received income of the corporation which as a matter of actual fact he might never receive or have command over. Further, this attribution might occur even though the corporation could not have distributed the income to its shareholders by reason of the law of the country of its organization. The fact that the shareholder happened to be an American and that 51 percent of the total corporate shares were held by Americans is hardly a sufficient basis upon which to conclude that he had actual control over the corporate income. It cannot be logically reasoned that the remaining American shareholders were subject to his domination and control as if they were members of his family for it is manifest that shareholders who possess only a common nationality do not have the same common economic interests as do members of a natural family group. With respect to the 10-percent American shareholder, there is, in my view, no difference between a situation where 41 percent of a 51-percent American majority is in the hands of unrelated Americans and one where all the shares other than his 10 percent are in the hands of foreign shareholders. The requirement of a 51-percent majority by American shareholders appears to have been inserted in the bill in order to arrive at a more satisfactory definition of an actual control situation. Upon close analysis it will be seen that this provision adds nothing.

The attribution of the income of a bona fide operating corporation as provided in section 13 of H.R. 10650 would appear to attribute the income of A to B in violation of constitutional principles discussed hereinabove.

Should the present bill be changed and limited to foreign corporations with a small group of American shareholders, there is further question in my opinion as to the constitutionality under the fifth amendment to the U.S. Constitution of the application of this special treatment to the shareholders of one class of bona fide corporations. Congress admittedly has a broad discretion when it engages in classification under the taxation power. We are dealing here, however, in the main with bona fide foreign corporations that are being singled out for special treatment solely because they cannot be jurisdictionally taxed by the United States. These words of the Supreme Court with reference to the power of classification are appropriate:

"There are, however, limits to the power of Congress to create a fictitious status under the guise of a supposed necessity" (*Helvering* v. *City Bank Co.* (1935) 296 U.S. 85, 92).

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[11] The presumption in that act is prima facie only. See *Electric Bond & Share Co.* v. *S.E.C.* (2 Cir. 1937), 92 F. 2d 580, 590, affirmed (1938), 303 U.S. 419.

[12] See e.g., *Hay* v. *Commissioner of Internal Revenue* (4 Cir. 1944), 145 F. 2d 1001, certiorari denied (1945), 324 U.S. 863 (sole stockholder); *Commissioner of Internal Revenue* v. *Smith* (2 Cir. 1943), 136 F. 2d 556 (sole stockholder); *Paul Plunkett & Co.* (1940), 42 B.T.A. 464 (sole stockholder); *G. M. Jackson* (1939), 39 B.T.A. 937; *Kaspare Cohn Co. Ltd.* (1937), 35 B.T.A. 646 (sole stockholder); cf. *Advance Machinery Exch.* v. *Commissioner of Int. Rev.* (2 Cir. 1952), 196 F. 2d 1006 (corporation had actual control over the income of two other corporations and a partnership); *Shaw Construction Company* (1961), 35 T.C. 1102 (corporation had actual control over the income of other multiple corporate entities); *Munson S.S. Line* v. *Commissioner of Int. Rev.* (2 Cir. 1935), 77 F. 2d 849 (sole stockholder); *Southern Pacific Co.* v. *Lowe* (1918), 247 U.S. 330 (sole stockholder); *Gulf Oil Corp.* v. *Lewellyn* (1918), 248 U.S. 71 (sole stockholder except for qualifying shares); *Asiatic Petroleum Co.* v. *Commissioner of Int. Rev.*, 2 Cir. (1935), 79 F. 2d 234, certiorari denied (1935) 296 U.S. 645 (corporation had actual control over income realized by sister subsidiary); Rev. Rule 54–596, C.B. 1954–2, 51.

[13] A shareholder who had no voting power but owned shares valued at 10 percent of the total share value would have income attributed to him under section 13.

This memorandum indicates at least in my opinion that there are serious doubts as to the validity under the Constitution of the basic provisions of section 13 of H.R. 10650. The testimony before the House Ways and Means Committee and, I assume, before this committee indicates considerable difference of opinion as to the efficacy of this legislation to meet the problem, if one exists. In other sections of the bill, H.R. 10650 has taken steps to tighten up the tax treatment given to income from foreign sources and to preclude the use of devices to attribute improperly income to foreign sources. The bill also provides for the Treasury request for more extensive reporting requirements with respect to certain foreign corporations. These new weapons in the hands of the Treasury may enable it to meet adequately the problem to which its request is directed without plunging into the doubtful and exceedingly controversial area of the attribution to shareholders of the income of bona fide operating corporations organized under the laws of foreign countries.

The CHAIRMAN. The next witness will be Mr. G. Kenneth Crowell of the American Paper & Pulp Association.

Mr. Crowell, if you will take a seat, sir, and proceed.

STATEMENT OF G. KENNETH CROWELL, EXECUTIVE VICE PRESIDENT AND A DIRECTOR OF KIMBERLY-CLARK CORP., IN BEHALF OF THE AMERICAN PAPER & PULP ASSOCIATION

Mr. CROWELL. Mr. Chairman, it may well be welcome news to you that my formal statement is exceedingly short.

My name is G. Kenneth Crowell. I am executive vice president and a director of Kimberly-Clark Corp., of Wisconsin.

I am appearing today in behalf of the American Paper & Pulp Association, which is the overall national association of the paper and pulp industry.

Appearing with me on my right is Mr. George Boyd, Jr., counsel for the association.

My own company, Kimberly-Clark Corp., manufactures and distributes, both here and abroad, a variety of paper and paper products for industrial and commercial uses.

We employ in all about 21,000 people here and abroad and maintain plants in over 20 U.S. locations and in 8 foreign countries.

Kimberly-Clark has more than 20,000 shareholders residing in all of the 50 States and in many foreign countries.

Last year I appeared for my company before the House Ways and Means Committee in opposition to the President's proposals for the taxation of foreign income, and also endorsed a like statement presented to the committee on behalf of the American Paper & Pulp Association by Mr. Boyd.

I submit that this association and its members have a substantial stake, by any standard, in the sale of paper products abroad. Thirty-five companies in the paper and pulp industry have built up their investment over a period of years to close to $900 million in foreign operating subsidiaries and affiliates in 30 foreign countries. Exports of our domestic paper and pulp industry in the last 3 years alone have amounted to more than $1,190 million. We are greatly concerned with certain features of H.R. 10650 which would drastically change the rules with respect to the taxation of foreign source income. It is with that portion of the bill that my remarks today are concerned.

For the past several months, the President has been espousing freer trade through a bold new approach to the matter of tariffs and trade.

Our industry has also been supporting this view, and appeared before the House Ways and Means Committee in March at the hearing on H.R. 9900 (the Trade Expansion Act of 1962), and advocated that the President should be given the power to negotiate with the Common Market upon a basis which would assure the industry a mutual reduction of tariffs, in arriving at identical tariffs for the Common Market group and for the industry, item by item.

It seems to us that section 13 of H.R. 10650 would have the practical effect of destroying competitive praticipation by American enterprise in world trade at the very time the President is urging the Congress to grant new tariff cutting authority to the Chief Executive. We submit that section 13 is completely inconsistent with the broad objectives of the Trade Expansion Act for the liberalization of international trade. That measure is designed to insure American industry the right to meet foreign competition on a basis of equality and to promote exports. The long-range effect of H.R. 10650, we submit, would be exactly the opposite.

Since the end of World War II, the expansion of American business in world markets has been universally accepted as essential to the security and survival of the free world. "Trade, not Aid" has been the consistent policy during this entire period.

We are experiencing an era of fierce competition between U.S. and foreign business for world markets. This is as it should be. But if U.S. business is to compete effectively in this struggle, it must, in part, at least in our own industry, do so from foreign locations. Business will not be induced to venture abroad in any substantial way if the investment and risks involved are not justified by the expected economic return. The provisions of H.R. 10650, if enacted into law, would seriously deter responsible corporate management in the future from committing their companies to foreign ventures.

It has been stated that a tax loophole permits these companies to defer payment of U.S. taxes on income earned abroad.

These arguments are utterly without foundation and are incorrect, in our opinion. Under our present tax laws, and, indeed, ever since we have had an income tax, there has been no loophole, no subsidy, no deferral with respect to this foreign earned income.

There is not now, nor has there ever been, any gimmick which permits American corporations to receive income without paying U.S. tax on it.

With the growing trend abroad to compel substantial local ownership and participation in U.S. business ventures, and the fact that in some countries the remission of funds is proscribed wholly or in part, U.S. business would be placed in the unenviable position, if 10650 is enacted into law, of paying taxes on earnings which it has no legal right to get.

It has been asserted that restricting private foreign investment, which would be the inevitable effect of H.R. 10650, would contribute to the solution of the balance-of-payments problem. On a short-range basis, it might. But in the long term, the U.S. balance of payments obviously suffers. The record clearly shows the overall monetary results of U.S. investment. Department of Commerce figures for 1950–60 disclose net capital outflow of over $12 billion. During the same period, $20.5 billion was returned to this country in dividends, interest and profits, a net inflow of roughly $8.5 billion.

In the pulp and paper business we cannot ignore the adverse effect which this bill and the proposals of the Secretary of the Treasury would have upon American exports. In this industry, exports by domestic companies to their foreign affiliates in the form of raw materials and partially finished products have created thousands of jobs in this country.

The proposed pricing formula in section 6 could force export prices upward, thus actually placing a high asset value, efficient plant in a noncompetitive position.

American companies have been investing abroad, thus far with Government encouragement, relying upon some semblance of consistency in U.S. tax policy.

As this committee knows, expansion in the paper industry entails extremely heavy capital commitments on a long-term basis. There is always the inevitable lag between spending for capital additions and the realization of increased sales and, in turn, profits. We at Kimberly-Clark, which I am sure is typical of other companies in the industry, have favored the policy of growth from within as particularly appropriate to oversea developments and commitments because of the relatively higher cost of capital and increased investment risk in most foreign countries. We are now asked to alter our business philosophy with respect to our oversea interests, and to finance developments there principally through the remission of additional U.S. dollars.

The proposals of H.R. 10650 and Secretary Dillon raise grave doubts in the minds of the management of corporations considering future foreign investments, as to how long the ground rules remain fixed. The mere fact that this proposed legislation is seriously presented can only have a detrimental effect upon future investments.

As late as October of 1958, Assistant Secretary of the Treasury, Mr. Stanley S. Surrey, took an eminently reasonable position on the deferral principle. In discussing the present method of taxation of foreign source income only when received in the United States, he wrote:

> Thus, two important issues of tax policy arise. First, should the rule that our tax may be deferred by use of a foreign subsidiary be continued? On this question, tax history, the fact that the organization of so much of our foreign investment is built on this rule, and the desirable accommodation to international relationships which it produces, all favor continuance of the rule.

And, in the same paragraph, quoting further:

> Further, a deferral approach is an inducement to continued foreign activity, since the reinvestment of foreign profits in effect extends the period of deferral.[1]

I earnestly submit, Mr. Chairman, that the provisions of this bill dealing with the taxation of foreign income compel us, frankly, to appraise our attitudes with respect to the foreign business activities of U.S. corporations. If it is our desire that they remain essentially at home and abdicate the mushrooming commerce of the rest of the world to eager foreign competitors, no measure could be better suited to achieve the result. If, on the other hand, we believe it is for the good of mankind that the unique achievements of U.S. industry should be freely available to others on a business basis, then H.R. 10650 has no place in the scheme of things.

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[1] "The United States Taxation of Foreign Income," Journal of Law and Economics, vol. I, p. 94, October 1958, published by the University of Chicago.

We subscribe fully to the remarks of the Honorable John W. Byrnes, member of the Committee on Ways and Means, to the effect that:

Section 13 (of H.R. 10650) contains an attack on American-owned business in foreign countries unprecedented in its harshness, its complexity, and its irrationality.[3]

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Crowell.

The committee will adjourn until 10 o'clock tomorrow morning.

(By direction of the Chairman, the following is made a part of the record:)

HAMILTON CO., INC.,
Whittier, Calif., April 24, 1962.

Reference: H.R. 10650—Section on domiciliary corporations.

COMMITTEE CHAIRMAN,
Senate Finance Committee Hearings,
Washington, D.C.

HONORED GENTLEMEN: In talks with European bankers, lawyers, and accounting firm executives between April 7 and April 20, these facts come to light which I wish to recount. A leading Dutch industrial attorney made this statement: "I'm willing to bet anything this law will not be on the books in 2 years—of course it could be longer, as bad laws often take a long time to get off the books."

A Swiss Price-Waterhouse executive opinion was: Switzerland cannot, by space or population, provide manufacturing facilities required by U.S. manufacturers to qualify under this law. Twenty percent of the population in Switzerland is now foreign. Grievous educational problems for their children already exist. Switzerland has devalued her money to support the U.S. dollar. This proposed law is not good for Switzerland.

So, an American wishing to serve a European market can think of it as this illustration. Two identical firms both identical in market and products. One difference exists—the U.S. firm pays 52 percent taxes, the Dutch firm pays 47 percent taxes now, and 42 percent later. The Dutch firm has a 10-percent tax advantage, then later 20 percent. The end result is the U.S.-owned firm goes out of business. Part of the U.S. dollars invested are lost, and people are thrown out of work.

The general opinion I found was this section of the law is bad. It depresses the European business at a time when we need their prosperity, their wage-price spiral to support our export sales and our dollar.

May I suggest your committee poll the opinion of Swiss and Dutch bankers, lawyers, and accounting firms. I'm sure the boomerang hidden in this law, hurting the United States and Europe, will become readily apparent.

Very truly yours,

CLARK H. HAMILTON.

P.S.—I am part owner of a Swiss domiciliary, have a Dutch sole agent for merchandising, and am beginning manufacturing in Holland in June.

NEW YORK CITY, *April 17, 1962.*

Re H.R. 10650.

Hon. HARRY F. BYRD,
Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I am taking the liberty of calling your attention briefly to three provisions of the pending tax bill, H.R. 10650, which appear to work an unintended hardship, particularly in the case of U.S. shareholders of foreign industrial corporations.

1. Definition of controlled foreign corporation

The proposed section 954 defines "controlled foreign corporation" to mean any foreign corporation "of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned, directly or indirectly

[3] Remarks of John W. Byrnes, Member of Congress, Wisconsin, before the Tax Executives Institute on Mar. 19, 1962.

(within the meaning of section 955(b)), by United States persons." Section 955(b) prescribes the attribution rules to determine whether the ownership requirements of section 954(a) are met.

The result of this provision is to make it possible that a foreign corporation whose stock is widely held, and even listed on a U.S. stock exchange, may be technically a controlled foreign corporation, even though no single U.S. stockholder owns any appreciable percentage of the stock. A U.S. stockholder owning 10 percent or more of the stock of a controlled foreign corporation is, under the proposed bill, required to include in his income the income of the corporation attributable to his share to the extent set forth in the complicated provisions of proposed sections 951, 952, and 953 of the bill. Moreover, such a stockholder would, under Section 16 of the bill, be required to treat a gain on the sale of the stock as a gain from the sale of a noncapital asset to the extent of the earnings accumulated during his ownership of the stock. This last provision would apply if the taxpayer was a 10-percent stockholder of a controlled foreign corporation at any time during the 5-year period ending with the sale.

I believe that these provisions place an impossible burden on U.S. stockholders who may be subject to their provisions. A stockholder may well not be in a position to know from day to day whether the corporation is a controlled foreign corporation, whether he is deemed to own 10 percent of its stock under the complicated attribution rules, or whether more than 50 percent of the stock of the corporation is held by five or less U.S. stockholders, so as to require him to include his share of the foreign base company income of the company. The problem of having some of this information over a 5-year period on a day-to-day basis, as would be required under section 16, is even more burdensome.

This could be corrected by either changing the definition of controlled foreign corporation so as to include only corporations where there is a much greater concentration of U.S. ownership, or by not requiring stockholders to include any portion of the corporation's income in their own income, unless their holdings in the corporation were much greater than 10 percent, so that they would be in a position to control the corporation.

2. Treatment of foreign taxes under section 6

Section 6 amends section 482 to provide for a formula for allocation of income in the case of sales between related corporations, one of which is a foreign corporation. Proposed section 482(b)(3) provides that where the application of the formula results in increase in taxable income of the domestic corporation and a decrease in the taxable income of the foreign corporation, the taxes paid with respect to such transferred income by the foreign corporation shall be treated as having been paid by the domestic corporation, and not by the foreign corporation. This provision, however, does not go far enough, since the domestic corporation will not be able to receive a credit for the taxes which it is deemed to have paid under the provision, unless it has income from the foreign country. Accordingly, the section should provide that the transferred income should be considered for the purposes of the foreign tax credit to be income from the country from which transferred. If the foreign tax deemed to be paid is available only as a deduction, it will mean that the domestic corporation in a case where the foreign tax rate was 50 percent would be paying a tax of over 75 percent on the income transferred to it, even though this transfer may have resulted only from a difference of opinion between it and the Service as to the proper application of the allocation formula.

3. Exclusion of dividends as foreign base company income in the case of foreign corporations operating through subsidiaries

A controlled foreign corporation may operate abroad both as an operating company and through wholly owned operating subsidiaries. To the extent that either the parent corporation or its subsidiaries reinvest their earnings in the trade or business which they respectively carry on, the reinvestment will constitute an investment in qualified property under section 953(b). If, however, dividends are paid by the subsidiary to the parent and then invested by the parent in its business, the dividends will constitute foreign base company income to the parent and the parent will not receive the benefit of a reduction under section 952(d)(2) unless it is operating in a less developed country. This result seems unwarranted in the case where the parent and its wholly owned subsidiaries are carrying on an integrated business, and I believe that section 952(d)(1) should exclude from its scope dividends paid by a wholly owned subsidiary to its parent

and invested in the trade or business of the parent where both parents and subsidiaries are carrying on an active trade or business.

Yours very truly,

JOSIAH WILLARD.

KOEHRING CO.,
Milwaukee, Wis., April 10, 1962.

Hon. HARRY S. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: As a member of America's industrial community, we are deeply concerned about H.R. 10650, the Revenue Act of 1962, which has recently been passed by the House of Representatives. Our comments on a number of major points of this bill are taken up point by point in the material which follows.

CONTROLLED FOREIGN CORPORATIONS

We are opposed to tax haven operations involving sham or paper corporations that are set up solely for the purpose of avoiding U.S. taxes, and that lack substance. However, situations involving this type of tax evasion are limited and can be dealt with administratively under present laws and regulations. Under section 482, the Treasury Department has the right to allocate income between the controlled corporations. This is a tremendous power, and one that the Treasury can use to prevent sham or paper corporations from operating in a way to siphon off what would otherwise be taxable U.S. income.

The Treasury contends that section 482 does not give it the practical power to properly allocate income because it doesn't have the manpower to analyze the thousands of transactions that take place between domestic companies and controlled foreign corporations. In fact, it doesn't need this kind of manpower because these transactions may be, and are, classified and summarized and dealt with on an overall basis. Any reasonably competent agent can do this work. The Treasury is then in a position to, and in the past has, settled some of these issues on an overall or a relatively broad basis after analyzing and determining what the total profits were and how it would be logical to divide them based upon the contribution made by each of the entities to the generation of the profit. Let this sound and logical approach continue.

The proposed law goes far beyond providing for clear-cut taxation of sham or paper corporations.

As you know, foreign operations are becoming increasingly important to the U.S. manufacturers. Our own situation illustrates this. Right now, we are forming a French subsidiary for the manufacture and sale of our construction equipment in the Common Market.

We believe that American maufacturers operating in Europe and other foreign places should be able to arrange their affairs there so as to minimize the taxes that they have to pay to the various countries. If this involves setting up a sales company in Switzerland to handle the sales of products produced, for example, in Belgium, so that high Belgian taxes can be partially avoided, doesn't this arrangement benefit America and American citizens? The less taxes paid to high tax countries, such as Belgium, France, United Kingdom, etc., the more money there will be available to be distributed to the American owners and hence, the more money available for U.S. tax collections.

If Congress passes a law which eliminates the advantage of a base company by trying to levy U.S. taxes on its undistributed income, many base company operations will be discontinued. The extra income formerly realized because of the low taxes of the base company operations will not accrue to the American owners and will not be available for U.S. income taxes, but rather will end up being paid in the form of higher taxes to the high tax European countries, thus swelling their revenues at the expense of ours. Take the example just mentioned, of the U.S.-owned Belgian factory operating with a Swiss-based sales company. Since it is more difficult to do business from Switzerland because of the commercial isolation and language difficulties, once the tax advantages of being in Switzerland are removed, the Swiss operation would be discontinued and moved either to the offices where the factory is located or to a place such as London, where there is no language problem and commercial facilities are excellent. Thus, the income which formerly was largely tax free and accumulated

to the benefit of American citizens (and to the ultimate benefit of the U.S. Treasury when it was distributed to its U.S. owners) now will be paid currently in the form of taxes to countries such as Belgium and the United Kingdom.

Under these circumstances, what has the proposed law accomplished? Nothing constructive for the United States. American citizens have been further harassed by an unfair tax law of questionable constitutionality and of great complexity; American citizens have been harmed financially by having to pay high taxes to foreign countries; and the U.S. Treasury has lost revenue because of this increased foreign taxation burden suffered by American business abroad.

What possible motivation can there be for such a harmful law? The administration says its purpose is to end tax "deferral." Thus, the administration seems to think that by passing this law, taxes will be collected now rather than being deferred when actually passing this law wil cause taxes which were formerly deferred to simply evaporate completey, and never be available to the U.S. Treasury.

We are all concerned about our continued gold drain and balance-of-payments deficit. Why then should we pass a law which will reduce the earnings abroad of the U.S. citizens and that will increase the tax revenues of foreign countries at the expense of the U.S. Treasury?

As you can see, we believe that passage of this provision will result in an ultimate loss of revenue to the U.S. Treasury. Even the proponents of the bill do not think much of it as a revenue producer—estimating it to bring in from $50 to $85 million. It is my opinion that this amount could be collected under the present tax laws through the effective use of section 482.

According to Treasury estimates, tihs amendment to the law would be a relatively poor revenue producer (and we believe actually a net revenue loser). We believe this proposed law would do great harm to Americans operating abroad; subject them to taxes on income having no connection with the United States of America; and be detrimental to the best interests of the United States of America. For these reasons we solicit your support and ask that you help defeat this provision of the proposed law.

DIVIDENDS AND INTEREST WITHHOLDING

We understand that the self-assessment tax system under which we work in the United States operates admirably well with something like 97–98 percent of taxes due being self-assessed and paid. With respect to taxes on dividends and interest, we understand that the self-compliance record is good at the higher levels, but that for the lower income groups, there is a relatively higher percentage of noncompliance. It has been estimated by the Treasury Department that to require reporting or information returns from corporations and, under its A.D.P. system, match these up with tax returns, would cost as much as the additional revenue from dividends and interest would provide. For this reason, the Treasury advocates withholding of dividends and interest under a system that would automatically provide for massive overwithholding with refunds to those who requested and were entitled to refunds. No exemption from this withholding is provided for tax-exempt organizations, such as profit sharing and retirement trusts or pension plans. Although such organizations hold great amounts of assets, by law they would be denied the use of the income from these assets for a period of months during which time the refund was being made.

It has been said that if it is fair for a wage earner to have taxes withheld from his income, then it is also fair that those who receive divdend and interest payments should have taxes withheld from that income. This statement gives no regard to the impracticality of such a massive withholding arrangement. It fails to recognize the multiple sources for this income. It fails to recognize exemptions, deductions, types of dividend, or the fact that no tax may be due at all. This provision deliberately legislates massive overwithholding, clearly an inequitable arrangement for those who are denied the use of their lawful income.

Specifically, for Koehring Co., we have approximately 12,000 stockholders. About 9,000 of these own less than 100 shares each. The maximum dividend paid to this group during the past year would have amounted to less than $10 per quarter from which we would withhold, under this proposed law, a maximum amount of $2, generally less. Thereupon, each eligible stockholder

receiving the net amount of his dividend would be entitled to make a claim for a refund. This means thousands and thousands of refund claims. Does the Senate of the United States of America intend to legislate such an unnecessary burden and such social injustice?

DISALLOWANCE OF CERTAIN ENTERTAINMENT EXPENSE, ETC.

We believe that the present law and regulations are adequate to deal with the abuses in this area. The great majority of American businessmen admittedly are honest and the great majority of publicly held corporations closely control this kind of expense. There have been abuses. It would seem to me that we could arrange to correct the abuses under existing laws without providing again for such a massive overcorrection and additional paperwork burden upon the great bulk of American business which already is confronted with an unduly large paperwork burden. This new law would require detailed accounting which is now available to revenue agents making examinations but which would require substantial reorganization of the recordkeeping function in order to set out in the tax return as separate items. Furthermore, it sets arbitrary limits and makes universal decisions where the standards that should apply need to be set based upon the circumstances in each particular case.

INVESTMENT CREDIT

We believe the investment credit is wrong in principle. It is a subsidy. Furthermore, we are concerned about the seemingly overly complicated provisions regarding the application of this credit. It legislates the need for item or unit accounting for fixed assets where group accounting may otherwise be adequate. The desired results can be obtained in simpler ways.

The administration has promised that they do not intend the credit to be a substitute for depreciation reform which we believe to be an urgent matter. We would recommend the system of initial allowances with taxpayers being permitted to exercise judgment as to amount of depreciation taken but with limits only on the maximum.

We appreciate the opportunity to present our views and hope that you will give them recognition in the bill that may finally be passed.

Very truly yours,

ORVILLE R. MERTZ,
Vice President, Finance.

THE COLLEGE OF WOOSTER,
Wooster, Ohio, April 3, 1962.

Hon. FRANK J. LAUSCHE,
U.S. Senator, Senate Office Building,
Washington, D.C.

DEAR SENATOR LAUSCHE: It is not my custom to write letters to Washington, and I may have been shirking my duty as a citizen by not doing so. I wish to address myself to the tax law now being considered in the U.S. Senate.

First, I wish to point out that I am a strong advocate of a comprehensive tax reform, one of the scope discussed in the recent past by members of the administration and by Chairman Mills. Since this letter is to touch upon the current bill, however, the point just made will have to suffice as an introduction.

Second, my concern is with the withholding proposal as it will affect dividends and interest earned. To my great surprise, I have not noticed anyone suggest that such a withholding tax will seriously affect the compounding principle, and therefore the size of the GNP itself. A few calculations made here in a seminar shows that a withholding tax on dividends and interest will have a GNP contracting effect. Now, granted, this effect need not be substantial in the recession sense. However, a tax policy with respect to these two income sources might be expected to yield a different economic impact, especially from an administration which prides itself on a progrowth philosophy.

From the point of view of balancing the budget, the tax yield would no doubt be, as expected, of more than just marginal scope. At the same time, an interest and dividend reporting system (into this marvel of data processing now in force anyway), would not only give the Treasury a record of the taxable sums available, but also a larger income from which to tax, since the tax computation would

be based on income to which the compounding principle can now be again fully applied. Do you realize what the new law will do to all the computing tables used in finance to the savings policies, etc.? I assume that it was felt that the cost of reporting by those paying dividends and interest would be too great, and so, since they have loud enough voices, the consumer is once again penalized.

In a similar vain, my third point. At the moment I do not earn dividends from stocks. I sold my holdings a few years ago to finance a property. Therefore, I feel that I can speak with at least some impartiality. When I had stock, I felt that the small tax exemption on dividends was a blessing in disguise, in that it, so it seemed to me, encouraged private ownership by small investors in private American enterprise. Now why get rid of this incentive to save and invest in private corporations? Sometimes I wonder who suggests some of the changes which go before our elected and appointed officials. The Secretary of the Treasury should know how important it is for us in this country (and I am only a naturalized citizen, at that) to own a share of private business and to show the rest of the world that we all can be capitalists. But then some expedient way of collecting taxes must be found, and down the drain goes the small but useful incentive. We need a small dividend exemption; as a matter of fact, if you want incentive taxation, you increase the dividend exemption instead of eliminating it.

Finally, a comment about the balanced budget, in the name of which all this will probably be passed anyway. Why does the Senate and the administration not try out a new idea, for instance this one: In each balanced budget enough income should be provided for the gradual withdrawal during prosperity of some $4 to $5 billion in the national debt, plus a margin for errors. How can any responsible representative stand up and say what so many of them say in favor of the kind of balanced budget which they talk about. They must really take the people for a lot less astute than they are. Any person who has ever seriously tried to balance a budget knows that it is fine to live in debt as long as you keep paying some of it off and that you need a contingency fund. Why not ask for such a budget? You might be surprised to find out that the people will buy it, especially if you explain real hard what you are doing. As things stand now, I wonder whether communications with the people are breaking down while the pressure groups keep toiling along.

To sum up, please give some thought to the matter of whether you should break into the compounding principle and upset that whole phase of private saving for the sake of tax income. The long-range costs of so doing will be much greater in lost national income than would be the inconvenience of a more detailed reporting system (let the banks and business report at the end of the year; it's all on IBM anyway by now). Let us have the dividend tax exemption for the sake of incentives to own private enterprise, for the sake of the small stockholder. This is more potent in the fight against Russia than all the slogans put together. And finally, give the people of this country a sensible balanced budget instead of slogans by those who know full well that what they ask for is impossible. Instead of playing politics with the concept of the balanced budget, let's practice some sound economics.

If you have read this far, I certainly owe you my deepest thanks for your patience. I am aware of the fact that one voice will not make much difference, especially if that voice does not have a string of publications to its name. If you should find time, maybe you will be kind enough to reply.

Very respectfully yours,

HANS H. JENNY,
Professor of Economics, Director of Institutional Research.

STATEMENT BY RAY H. MULFORD, PRESIDENT OF OWENS-ILLINOIS GLASS CO.

Owens-Illinois Glass Co. wishes to register with the Senate Finance Committee its strong opposition to the foreign tax provisions of H.R. 10650 passed by the House on March 29. The foreign tax provisions now in the bill would have a serious, direct, damaging effect on our operations in Latin America, Europe, and elsewhere. However, we are equally concerned, as an American corporation, with the adverse effect these misguided provisions would have on the economy of the United States.

One very important way we can keep our U.S. economy in vigorous health is to have strong representation of American business overseas—American business which either sells American-made goods competitively with foreign companies or, in those cases where made-in-America goods cannot compete, American-owned subsidiaries which make and sell goods in the Common Market, Latin America, and elsewhere.

The foreign tax provisions of the bill are damaging to the U.S. economy because they will place American corporations doing business overseas through foreign subsidiaries at a competitive disadvantage with foreign-owned corporations operating in the same markets. The long-range result of the bill's foreign provisions would be the very opposite of the effect said to be intended. Instead of more revenue for the U.S. Treasury, there would be less, because of the severe handicap imposed by the bill upon companies and their foreign subsidiaries in competing with foreign corporations unfettered by the bill's provisions. Instead of stimulating American business to invest more money in the so-called undeveloped countries, it would cut down the amount of risk capital available for such ventures. Profits from subsidiaries in developed countries make it possible to take the much greater risks in undeveloped countries. This bill not only discourages further investment in the countries which supply the risk capital, but it also puts an unreasonably short time limit on investment of oversea earnings in undeveloped countries before they are eroded by U.S. taxes.

Specific provisions of the new bill which would have a particularly adverse effect on both the U.S. economy and U.S. companies doing business overseas are:

I. THE ATTEMPT TO CHANGE FOREIGN TAX CREDIT

The gross-up method used in the bill looks fair and equitable at first glance, but its requirement that an American corporation report on the basis of the pretax earnings of a foreign subsidiary overlooks three things: (1) Only that portion of the after-tax earnings paid in dividends is available to the American company. (2) This in turn places an American-owned corporation at a competitive disadvantage with foreign competitors. In order not to penalize the parent company's domestic earnings, a foreign subsidiary would have to provide the funds with which to pay its proportion of the U.S. income tax, thereby giving competitors who pay only the income tax of the country concerned an even greater competitive advantage. (3) In many instances, the total tax burden on foreign subsidiaries already is heavier than the total tax burden of U.S. companies. In most countries, the indirect tax cost is much bigger than in the United States, with income taxes a relatively small portion of the total tax bite compared to this country.

The attached tables from a recent issue of Business International, with accompanying text, illustrate in more detail what the gross-up method would actually do.

II. PROVISIONS CONCERNING ROYALTIES, TECHNICAL ASSISTANCE, ETC.

These provisions are particularly inequitable. The one providing for "deemed royalties" would be especially burdensome to the undeveloped countries of the world, and actually discriminatory against U.S. subsidiaries in them, since of necessity U.S. subsidiaries in those countries must depend to a far greater extent on U.S. patents, processes, and equipment. These undeveloped countries, therefore, are the primary beneficiaries of U.S. patents, technical assistance, etc. This provision of H.R. 10650 also would allow the Treasury arbitrarily to establish and tax income which is entirely fictitious.

III. DISREGARDS THE RIGHTS OF FOREIGN SHAREHOLDERS

The foreign tax portion of H.R. 10650 disregards the rights of foreign shareholders. In many American-owned subsidiaries, including some of those in which Owens-Illinois has a majority interest, foreign shareholders hold substantial ownership and under the law of the foreign country in which the subsidiary is operating the rights of these foreign shareholders cannot be disregarded or ignored even though an American company has a majority interest. In other words, majority ownership does not necessarily give control.

IV. UNFAIRLY RESTRICTS OVERSEA EXPANSION

Manufacturing subsidiaries of American companies would be severely restricted in their operations by a provision of the law which makes them subject to U.S. income tax if they enter a line of activity in which they are not engaged domestically or established a product line in which they are not so engaged as of December 31, 1962. This would completely stifle growth of new product lines, retard research and development through which product innovation occurs and this would prove especially burdensome to companies which must continue to expand in order just to keep pace competitively. It could even destroy companies with dwindling markets by excluding them from the opportunities to switch to new products.

Owens-Illinois has been engaged in foreign commerce for more than 30 years and we export American-made products to more than 80 countries. Our exports have been especially high in Latin America, where Owens-Illinois glass containers have been for many years the standard of excellence by which all others are judged. As the market grows in each Latin American country, however, there is a corresponding growth in intense national pressure for its own glass container plant. A few years ago we were almost completely shut out of Colombia and the handwriting was on the wall in Venezuela, to mention just the two Latin American countries in which we now have glass container manufacturing plants.

Owens-Illinois prefers to export American-made products rather than establish foreign operations, as do most American companies. In Europe, however, we have been unable to develop any significant export market, primarily because it is not economical to ship most of our products to Europe in competition with the strong European glass companies. The only way we can compete effectively is by operations within those countries. In 1960 Owens-Illinois obtained, largely through an exchange of stock, slightly over 50 percent of the stock of Gerresheimer Glass Works, of Germany, one of the leading glass companies on the continent, and most of the stock of Durobor, a Belgian glassware firm.

This year we completed organization with Italian partners of an Italian company which will make glass tubing near Milan, Italy. Although we own a majority interest in this company, under our plan not $1 will have to be exported from the United States to establish this plant. On the contrary, some of the machinery used in the plant will be bought in the United States with funds developed in Europe.

When Owens-Illinois opened its first foreign plants in 1958 in Venezuela and Cuba (the latter was expropriated in 1960 by the Castro regime, illustrating one of the special hazards of foreign investment), we had a total of 32,500 employees in the United States. Today we have approximately 36,000 employees in the United States, plus more than 900 in new Owens-Illinois plants in Canada, Venezuela, and Colombia. Our foreign operations have directly created jobs for Americans, both in this country and overseas. We expect our employment to continue rising both in the United States and other countries as we build new plants and enlarge existing ones, but these plans will have to be completely reconsidered and perhaps abandoned if the present foreign tax provisions in H.R. 10650 become law.

American business would be left in a state of complete uncertainty should these objectionable provisions be enacted into law. The provisions of the bill are so broad and general that definitions, and the applications of taxes, can change at the will of the Treasury. In fact, Congress would be handing a blank check to the Treasury to legislate as it wishes. No business can make long-range development plans in such a climate. Instead of helping the U.S. balance of

payments, as urged by its Treasury proponents, this bill would have a very adverse effect on our balance of payments. It would discourage the efforts already proven most effective; viz, increasing exports through foreign operations and would stifle the type of foreign investment mainly responsible for the increasingly large flow of dollars back to the United States in the form of dividends.

We respectfully urge, in the interest of the general welfare, that the Senate Finance Committee delete the objectionable and damaging provisions.

[From Business International, Mar. 9, 1962]

CROSS-UP PROPOSAL HURTS UNDERDEVELOPED COUNTRIES, FAILS TO ACHIEVE TAX EQUALITY

A superb study by a major U.S. international firm demonstrates conclusively that the Kennedy administration's proposal to "gross up" the earnings of foreign subsidiaries (i.e., to calculate the U.S. tax on profits before—not after—payment of the foreign tax) seriously conflicts with two of the Treasury's supposedly cardinal aims: Tax equality and more U.S. investment in Latin America, Asia, and Africa. Grossing up would reduce the effectiveness of the foreign tax credit in preventing double taxation and equating U.S. tax treatment of U.S.-owned subsidiaries and branches overseas, and create an arbitrary disincentive to U.S. investment in underdeveloped countries.

Table I breaks down the total tax revenues of 31 foreign countries and the United States into their various components. While the United States secures 83.6 percent of its total revenues from direct taxes, the maximum analogous percentage elsewhere is Colombia's 60.4 percent; among developed countries, it is Japan's 59.5 percent. Even the United Kingdom obtains only slightly more than half its revenue from direct taxes. The figures for France are 28.3 percent, for India 26.2 percent, and for Argentina 35.8 percent.

The present U.S. tax credit system—now over 40 years old—credits only direct taxes; U.S. firms now operating through foreign subsidiaries face significant double taxation wherever they operate. In testimony before the Ways and Means Committee last year, the president of International Telephone & Telegraph, Harold S. Geneen, demonstrated that the real tax burdens of the company's three French subsidiaries in 1960 amounted to 78 percent, 82 percent, and 78 percent, while U.S. foreign tax credit only applied to 20 percent, 19 percent, and 16 percent respectively (under the present system). The percentages for the company's German subsidiary were 65 percent and 55 percent respectively and for the Italian affiliate 59 percent and 36 percent. Yet the Treasury talks as if the United States were providing tax incentives for investment abroad, and advocates curtailing the present illiberal tax credit system.

Table II shows the specific effect of the present credit and of the gross up credit system. Gross up can lead to spectacularly varying results that hardly qualify it as a rational method of achieving tax equality. In many countries, it would not increase the U.S. take at all; in others, it would boost the effective take by more than 6 percentage points. The firms that would face the biggest additional tax bites would be those investing in underdeveloped markets. Gross up would raise the average take on earnings in Europe by 2 points, in Latin America by 4.4 points, in underdeveloped Far Eastern States by 3.1 points. It would also, in the judgment of the authors of this study, violate 18 U.S. double-tax treaties.

TABLE I.—*Corporate tax rates and breakdown of tax revenue in 32 countries*

[In percentages]

Country	Year ending	Corporate income taxes	Personal income taxes	Total income taxes	Turnover, sales production taxes	Excise, custom duties	Other taxes	Corporate income tax rate
United States	June 30, 1960	28.9	54.7	83.6	----------	13.8	2.6	52.00
Western Europe:								
Austria	Dec. 31, 1960	10.4	8.2	18.6	32.8	30.2	28.4	32.00
Belgium	do	(1)	(1)	35.5	16.6	10.0	37.9	(2) 40.00
Denmark	Mar. 31, 1960	6.2	31.2	37.4	----------	56.3	6.3	44.00
Finland	Dec. 31, 1960	7.8	10.9	18.7	27.8	32.0	21.5	50.50
France	do	10.3	18.0	28.3	37.9	19.2	14.6	50.00
Germany	do	23.3	26.1	49.4	23.5	20.8	6.3	(3) 58.00
Great Britain	Mar. 31, 1961	(1)	(1)	50.5	9.2	34.3	6.0	53.75
Ireland	Mar. 31, 1960	20.1	10.6	30.7	----------	54.7	14.6	40.00
Italy	June 30, 1960	(1)	(1)	35.1	41.1	15.2	8.6	(4) 37.00
Netherlands	Dec. 31, 1960	12.2	41.7	53.9	19.4	20.9	5.8	47.00
Norway	June 30, 1960	5.9	18.0	23.9	35.9	36.3	3.9	59.50
Spain	Dec. 31, 1960	15.3	7.5	22.8	38.3	15.0	23.9	37.50
Sweden	June 30, 1960	8.8	31.6	40.4	6.9	40.4	12.3	48.00
Switzerland	Dec. 31, 1960	(1)	(1)	30.9	25.5	34.5	9.1	(5) 33.00
Average	----------	(1)	(1)	34.0	22.5	29.3	14.2	46.45
Latin America:								
Argentina	Dec. 31, 1959	(1)	(1)	35.8	19.7	31.8	12.7	(6) 42.00
Colombia	Dec. 31, 1960	(1)	(1)	60.4	----------	24.7	14.9	(7) 45.00
Costa Rica	do	(1)	(1)	13.0	5.1	75.0	6.9	30.00
Guatemala	June 30, 1960	8.0	----------	8.0	----------	80.9	11.1	30.00
Mexico	Dec. 31, 1960	(1)	(1)	34.4	10.4	51.8	3.4	(8) 32.00
Panama	do	(1)	(1)	23.8	7.2	48.8	20.2	34.00
Peru	Dec. 31, 1958	35.4	16.0	51.4	----------	45.7	2.9	35.00
Venezuela	Dec. 31, 1959	(1)	(1)	55.1	----------	44.9	----------	45.00
Average	----------	(1)	(1)	35.2	5.3	50.5	9.0	39.13

Far East:								
Australia	June 30, 1960	18.2	35.0	53.2	13.0	26.7	7.1	40.00
India	Mar. 31, 1961	20.2	6.0	26.2	----------	72.4	1.4	45.00
Japan	do	36.3	23.2	59.5	----------	35.9	4.6	50.00
Malaya	Dec. 31, 1960	(1)	(1)	23.1	----------	70.4	6.5	40.00
New Zealand	Mar. 31, 1961	(1)	(1)	58.9	8.2	25.5	7.4	50.00
Philippines	June 30, 1960	28.7	17.2	45.9	14.6	38.2	1.3	30.00
Thailand	Dec. 31, 1960	5.0	6.0	11.0	33.2	50.2	5.6	25.00
Average		(1)	(1)	39.7	9.9	45.6	4.8	40.00
Canada	Mar. 31, 1960	24.1	34.5	58.6	15.5	24.1	1.8	50.00
Republic of South Africa	Mar. 31, 1961	33.9	15.0	48.9	13.2	33.0	4.9	35.00
Average for listed countries		(1)	(1)	36.9	14.7	38.4	10.0	42.85

[1] Not available.

[2] Assuming no distribution; 34 percent if half of profits are distributed; 28.5 percent if all profits are distributed.

[3] Assuming no distribution; 50 percent if half of profits are distributed; 38 percent if all profits are distributed.

[4] Includes about 8 percent for excess profits tax levied at 15 percent of profits over 6 percent of capital and certain reserves.

[5] Federal tax of 8 percent plus 25 percent for cantons.

[6] Includes about 9 percent for excess profits tax levied at 10 to 30 percent of profits over 12 percent of capital and certain reserves.

[7] Includes about 9 percent for excess profits tax levied at 20 to 56 percent of profits over 12 percent of capital and certain reserves.

[8] Approximate combined income, excess profits and distributable profits taxes.

NOTE.—State and local taxes are not included either for United States or others, but their inclusion would not affect the findings materially.

TABLE II.—*The impact of "gross up"—Schedule showing actual additional U.S. income tax impact of "gross up" on full dividend distributions*

Country	Foreign subsidiary's income before foreign tax	Foreign income taxes (including State and local)	Income available for dividend	Foreign withholding tax on dividend		U.S. tax on dividend under present system			U.S. tax on dividend after "gross up"			Percentage point increase in U.S. tax
				Rate (percent)	Amount	Taxable at 52 percent	Less foreign tax credit	Net U.S. tax	Taxable at 52 percent	Less foreign tax credit	Net U.S. tax	
Western Europe:												
Austria	100	52.0	48.0	5	2.4	25.0	27.4	----	52	54.4	----	----
Belgium	100	28.5	71.5	31.5	22.5	37.2	42.9	----	52	51.0	1.0	1.0
Denmark	100	44.0	56.0	----	----	29.1	24.6	4.5	52	44.0	8.0	3.5
Finland	100	50.5	49.5	5	2.5	25.7	27.5	----	52	56.0	----	----
France	100	50.0	50.0	15	7.5	26.0	32.5	----	52	57.5	----	----
Germany	100	38.0	62.0	15	9.3	32.2	32.9	----	52	47.3	----	(3)
Great Britain	100	53.75	46.25	----	----	24.05	24.86	----	52	53.75	----	----
Ireland	100	40.0	60.0	----	----	31.2	24.0	7.2	52	40.0	12.0	4.8
Italy	100	37.0	63.0	----	----	32.8	23.3	9.5	52	37.0	15.0	5.5
Netherlands	100	47.0	53.0	----	----	27.6	24.9	2.7	52	47.0	5.0	2.3
Norway	100	59.5	40.5	5	2.0	21.1	26.1	----	52	61.5	----	----
Spain	100	37.5	62.5	15	9.4	32.5	32.8	----	52	46.9	5.1	5.1
Sweden	100	48.0	52.0	10	5.2	27.0	30.2	----	52	53.2	----	----
Switzerland	100	33.0	67.0	5	3.3	34.8	25.4	9.4	52	36.3	15.7	6.3
Average	100	44.2	55.8	8.06	4.5	29.0	28.5	2.4	52	48.8	4.4	[2]2.3
Latin America:												
Argentina	100	42.0	58.0	8	4.6	30.2	29.0	1.2	52	46.6	5.4	4.2
Brazil [1]	100	30.0	70.0	25	17.5	36.4	38.5	----	52	47.5	4.5	4.5
Chile	100	25.0	75.0	25	18.75	39.0	37.5	1.5	52	43.75	8.25	6.75
Colombia	100	45.0	55.0	12	6.6	28.6	31.3	----	52	51.6	.4	.4
Costa Rica	100	30.0	70.0	20	14.0	36.4	35.0	1.4	52	44.0	8.0	6.6
Guatemala	100	30.0	70.0	----	----	36.4	21.0	15.4	52	30.0	22.0	6.6
Mexico	100	52.0	48.0	----	----	25.0	25.0	----	52	52.0	----	----
Panama	100	34.0	66.0	----	----	34.3	22.4	11.9	52	34.0	18.0	6.1
Peru	100	35.0	65.0	20	13.0	33.8	35.8	----	52	48.0	4.0	4.0
Venezuela	100	40.0	60.0	----	----	31.2	24.0	7.2	52	40.0	12.0	4.8
Average	100	36.3	63.7	11.77	7.5	33.1	30.0	3.9	52	43.8	8.3	4.4

Far East:												
Australia	100	40.0	60.0	15	9.0	31.2	33.0		52	49.0	3.0	3.0
India	100	45.0	55.0	20	11.0	28.6	35.8		52	56.0		
Japan	100	50.0	50.0			26.0	25.0	1.0	52	50.0	2.0	1.0
Malaya	100	40.0	60.0			39.2	24.0	7.2	52	40.0	12.0	4.8
New Zealand	100	50.0	50.0			26.0	25.0	1.0	52	50.0	2.0	1.0
Philippines	100	30.0	70.0	30	21.0	36.4	42.0		52	51.0	1.0	1.0
Thailand	100	25.0	75.0			39.0	18.75	20.25	52	25.0	27.0	6.75
Average	100	40.0	60.0	10	6.0	31.2	29.1	4.2	52	46.0	6.7	2.5
Canada	100	50.0	50.0	15	7.5	26.0	32.5		52	57.5		
Republic of South Africa	100	35.0	65.0	7.5	4.9	33.8	27.6	6.2	52	39.9	12.1	5.9

[1] Foreign tax rate of 30 percent includes 23 percent income tax and 7 percent for excess profits tax levied at 20 to 50 percent on profits in excess of base amounts.

[2] In the case of Germany a dividend distribution in excess of approximately 75 percent is necessary in order for any additional U.S. tax to result from the "gross up" principle, therefore no increase in U.S. tax is shown for Germany.

[3] As adjusted for 75 percent distribution in Germany.

THE B. F. GOODRICH CO.,
Akron, Ohio, April 23, 1962.

Re H.R. 10650 (revenue bill of 1962).

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: We express our opposition to the enactment of this bill. Generally speaking, the bill in a number of respects departs from heretofore well-established tax principles, creates many problems of interpretation, accounting, compliance, administration, and collection. Some of these provisions will add needlessly to the present burden of individuals and organizations in their collection and payment of taxes to the Government.

We shall now comment briefly on some of the principal features of the bill.

Taxation of foreign income.—Our Government, under both Democratic and Republican administrations, for a number of years has actively promoted investments abroad. Now, suddenly, this policy is to be reversed and our Government proposes to penalize those investments by taxing their income even before it is transmitted to the United States unless the income is reinvested in the country of origin or in an underdeveloped nation. American investments abroad have in fact been helpful to the United States through the increase of our exports, the earning of foreign exchange, and the creation of jobs in the United States. This part of the bill will erect a trade barrier to American investment abroad and ultimately reduce the U.S. taxes collected from that income source.

Withholding of tax on dividends and interest.—This provision will work a hardship on many individuals and companies, and therefore should not be adopted unless it is absolutely necessary to solve the problem of underreporting of dividends and interest. There is reason to believe that the data processing and numbering approaches of the Internal Revenue Service will solve this problem. An example of what this section of the bill will do—it would result in a permanent loss of $600,000 to our B. F. Goodrich pension trust earnings and assets.

Deductible business expenses.—It seems to us that neither the Congress nor the Bureau should substitute its judgment for that of a business enterprise in determining what is and is not ordinary and necessary business expense. The cost controls already imposed upon themselves by businessmen as a matter of competitive necessity is ample protection for the tax collector. No one wastes 100 percent of his own money simply to avoid paying 52 percent of it in tax.

The tax credit.—Most people who have studied the matter recognize a serious need for depreciation reform which would be available to all taxpayers. This would encourage plant improvement and expansion and stimulate our business economy. However, the proposed tax credit will not accomplish this objective. It would simply grant a bonus to those few who by chance currently need to expand or modernize their plants. The granting of a tax credit of $7 will furnish no motivation for business to invest $100 in manufacturing facilities. The motivation must come from a reasonable expectation that there will be an opportunity to earn profits. This proposal is unsound.

Not to be completely overlooked is the Government's estimate that this tax bill would result in a loss of revenue in excess of one-half billion dollars annually at a time when the Government is already operating with increasingly greater deficits.

It is reported that next year Congress will consider a comprehensive tax bill dealing with the entire Federal tax structure. In view of what has been said above, should not action on H.R. 10650, which is quite limited in its application, be deferred until next year? At that time the proposals in this bill may be given careful and thoughtful study in the light of the entire Federal tax structure.

We hope that your consideration of H.R. 10650 will result in your voting against this bill.

Sincerely yours,

R. G. JETER.

CRAVATH, SWAINE & MOORE,
New York, N.Y., April 9, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance, U.S. Senate,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Enclosed herewith is a memorandum prepared with respect to the foreign income provisions of H.R. 10650.

We have concentrated on (1) the provisions of the bill relating to taxation of foreign business income, that is, sections 6, 13, and 16; and (2) the reporting requirements of section 20, which, as more fully developed in the accompanying memorandum, are going to impose a severe hardship upon many individual U.S. citizens by presenting them with the unattractive choice of giving up their jobs or their citizenship.

A brief summary of the conclusions indicated by the enclosed memorandum may be helpful:

1. As to sections 6, 13, and 16, they come as a distinct surprise to most tax practitioners, as it had generally been thought that the present bill would be directed primarily at the closing of loopholes and the curbing of abuses. The bill, however, goes way beyond those limited objectives, and it is not an exaggeration to say that it will adversely affect virtually every U.S. business operation abroad. The technical defects, the complexity, the possibilities for double taxation, and the punitive attitude of the bill, moreover, are most alarming. In addition, serious constitutional questions arise which will require years of litigation for their solution. It is vital that American business hold its own in the international community, and that it be able to withstand the challenge of the Common Market. Business should not be shackled with the ill-considered legislation embodied in H.R. 10650.

2. Section 20 requires every U.S. citizen who is an officer or director of a foreign corporation to file whatever elaborate information returns may be required by the U.S. Treasury. Such returns may be required even though the foreign corporation is beneficially owned by foreigners and derives little or no income from the United States. On the other hand, many U.S. citizens working for foreign corporations are prohibited by laws of the pertinent foreign country or by their employers from transmitting such information. Such citizens, accordingly, will either have to give up their positions and, perhaps, their livelihood, or their U.S. citizenship. Either result seems to us to be intolerable.

I hope that the fundamental defects that we have noted can be corrected before the bill is reported by the Committee on Finance.

Sincerely yours,

ROSWELL MAGILL.

MEMORANDUM ON H.R. 10650—TAXATION OF FOREIGN INCOME

The foreign income provisions of H.R. 10650 have been heralded as having the principal purposes (1) to close loopholes relating to the taxation of foreign income and (2) to prevent the artificial diversion of essentially U.S. income into tax-haven subsidiaries.

No one can legitimately quarrel with such objectives. It is difficult, for instance, to take serious issue with section 4 of the bill relating to dividends in kind by foreign corporations to U.S. corporate stockholders; or with section 10 which requires "grossing up" in connection with the derivatives credit for foreign income taxes under section 902.

An examination of sections 13 and 16 of the bill, in particular, as well as section 6, indicates, however, that the bill has gone far beyond the closing of tax loopholes and the prevention of abuses, which had been thought to be its primary objectives. The provisions of the bill relating to the taxation of foreign business income will affect adversely virtually every U.S. business operation abroad, however, legitimate. They are punitive in nature, and will frequently result in double taxation. They appear to be designed to make as difficult as possible the expansion and development of American industry in foreign countries. They attain a degree of complexity hitherto unequaled in the code, except perhaps in section 341(e). Finally, their constitutionality is very doubtful, even under a very liberal view of congressional power under the Constitution.

Section 20 of the bill, relating to reporting requirements, will itself impose severe hardships on many U.S. citizens working for foreign corporations and in many cases will operate to deprive them of their livelihoods.

We shall not attempt in this memorandum to discuss the many technical defects and problems contained in the bill. We shall concentrate, rather, on setting forth what we regard as more basic objections. Since the heart of the bill is in section 13, we shall start with it.

Section 13. Controlled foreign corporations

1. *Definition of controlled foreign corporation.*—At the outset, we note that it will often be impossible to determine whether a particular foreign corporation is a "controlled foreign corporation." A U.S. person owning 10 percent or more of the stock of a foreign corporation must ascertain whether there are other U.S. stockholders of the corporation owning, actually or constructively, an amount of stock sufficient to bring the total owned by U.S. persons (albeit wholly unrelated to one another) to more than 50 percent. Foreign corporations frequently issue bearer shares, and it will be difficult or impossible to ascertain the identity of the other stockholders. Even if that bridge is crossed, the shareholders may turn out to be other foreign corporations, and it will be necessary, in turn, to find out who are the stockholders of such other foreign corporations, and so on. Let us suppose, for instance, that a U.S. corporation and two publicly held foreign corporations create a foreign corporation of which each owns one-third of the stock. The U.S. corporation will have to find out who are the beneficial owners, giving effect to the attribution rules, of each of the other two publicly held foreign corporations. Moreover, under the bill, this determination must be made for every day of each taxable year. In a case such as that stated, probably it would be impossible for the U.S. stockholder ever to be sure that the new foreign corporation were not a "controlled foreign corporation."

The attribution rules are, moreover, so drawn as to sweep as many foreign corporations as possible into section 12. For instance, a U.S. corporate stockholder of a foreign corporation is considered a U.S. person even though it may be beneficially owned by foreigners. On the other hand, a foreign corporate stockholder of a foreign corporation is considered a U.S. person to the extent that such foreign corporate stockholder is beneficially owned by U.S. persons.

2. *Taxation of subpart F income.*—Section 13 provides that certain kinds of income, known as subpart F income, realized by a controlled foreign corporation shall be taxed directly to any U.S. person actually or constructively owning 10 percent or more of the stock of the foreign corporation, subject to a limited exception if the income is invested in property that is ordinary and necessary for the active conduct of a trade or business in a less-developed country. Subpart F income, in general, consists of income thought by the drafters of the bill to be "passive," that is, dividends, interest, rent, and capital gains from the sale of stock or securities; and income apparently thought by the drafters to be peculiarly susceptible to being diverted from the United States to tax havens, such as export sale income and certain types of patent or copyright royalties. Unlike the personal holding company provisions of our law, the bill would treat as "passive" all rent, even rent derived from an active leasing business.

The requirement that undistributed subpart F income of a controlled foreign corporation be taxed directly to any U.S. person owning, actually or constructively, 10 percent or more of its stock cannot fail to raise grave constitutional questions. It is far from clear that Congress can constitutionally tax the income of a foreign corporation earned abroad to a U.S. stockholder who, by virtue of his stock ownership, is in a position to control the dividend policy of the corporation. But the bill goes far beyond that. It contemplates taxing a minority stockholder of a foreign corporation upon his "share" of undistributed income even though the stockholder may not have any effective control over the dividend policy. It seems evident that such a proposal will raise constitutional questions of the most serious character, and that years of litigation will be required before the constitutionality, or a lack thereof, of section 13 can be established.

The bill contemplates, moreover, that U.S. stockholders of controlled foreign corporations shall be taxed on the subpart F income determined in accordance with the U.S. standards for determining taxable income and earnings and profits. Tax and book accounting procedures employed by foreign corporations often differ radically from the methods followed in this country. The detailed information required to establish the taxable income and the earnings and profits of the foreign corporation by our standards will, as a practical matter, frequently be unavailable to the U.S. stockholders, and they may have no means of requiring its disclosure. How, then, are they to determine their share of such undistributed income?

The provisions of the bill relating to the taxation of subpart F income may leave the U.S. stockholder in a much worse position than if he had conducted his operations in the foreign country directly. For instance:

a. Capital gains realized by a controlled foreign corporation will be taxed to the U.S. stockholders as ordinary income.

b. Blocked foreign income apparently will be taxed directly to the U.S. stockholders of a controlled foreign corporation without the deferral privilege accorded to U.S. taxpayors conducting direct operations in a foreign country.

c. Individual U.S. stockholders of a controlled foreign corporation will get no credit for foreign income taxes; nor will a corporate U.S. stockholder unless it satisfies the stock ownership requirements of section 902 relating to the derivative credit.

d. A U.S. stockholder of a controlled foreign corporation will get no credit or benefit from losses incurred by that corporation except as an offset to the current income thereof. No operating loss carryover or carryback provisions are contemplated. Moreover, a U.S. stockholder owning two or more controlled foreign corporations will not be permitted to offset the losses of one against the incme of another. For instance, if a U.S. corporation owns a foreign subsidiary which loses $100 and if that subsidiary, in turn, has a subsidiary of its own which earns $100, the income of the subsidiary will be taxed directly to the U.S. stockholder without offset for the loss of the intermediate company.

e. Double taxation can easily result. A U.S. stockholder of a foreign controlled corporation will be taxed on its subpart F income without reduction of such income by reason of distributions to foreign stockholders, even though there is no relationship between the U.S. stockholder and the foreign stockholders. For instance, if a controlled foreign corporation pays out of its subpart F income for the year a dividend on preferred stock held by unrelated foreign stockholders, the income used to pay such dividend will nevertheless be taxed to the U.S. stockholders.

It is no answer to the foregoing to say that U.S. stockholders can avoid the punitive consequences of section 13 by conducting their operations abroad directly rather than through foreign corporations. The exigencies of the corporate, tax or customs law of foreign countries often will make mandatory the use of a foreign corporation.

The practical problems that will be caused by the subpart F income provisions will be tremendous. For instance, if a U.S. corporation establishes a manufacturing subsidiary in a foreign country, and, as is customary, contributes know-how to that subsidiary, the bill would require the determination of a hypothetical royalty each year to be taxed to the U.S. stockholder, that is, the amount that could have been obtained as a royalty for the know-how had it been transferred to an unrelated third party. Many, if not most, operating corporations do not license their know-how to third parties, so that it will be difficult, if not impossible in many cases, to ascertain what kind of a royalty would have been paid by an unrelated third party.

Another practical problem will be caused by the necessity for tracing shares of a controlled foreign business corporation. Once subpart F income is taxed directly to a U.S. person, that person is supposed not to be taxed again when such income is actually distributed in the future. If, in the meantime, the shares are transferred to other persons, the exemption is supposed to be applicable to the transferees as well. This will require setting up some elaborate procedures for tracing the identity of shares of stock, and will have the anomalous result that, at any given point of time, some shares of stock of a controlled foreign business corporation may be worth more than others because some shares may carry with them the right to a tax-free withdrawal of future income, whereas others may not.

3. *Taxation of increase in nonqualified assets.*—As troublesome as are the defects in the proposed taxation of subpart F income, the provisions that contemplate taxing U.S. stockholders of controlled foreign corporations upon increases in nonqualified assets raise even more serious problems. We must, in this connection, remember that in this area we are discussing only the taxation of income which is not "tainted" as subpart F income is supposed to be, that is, income from operations presumably deemed "legitimate" by the drafters of the bill.

We have had considerable experience in this country with preventing unreasonable accumulations of income by corporations. Thus, we have had for many years the foreign personal holding provisions, the personal holding company

provisions, and the unreasonable accumulations tax. So far as we are aware, however, the present bill, if enacted, would for the first time tax in a given year more than the income earned in that year. Suppose, for instance, that a controlled foreign corporation earned "legitimate" income in 1963 and invested such income in "qualified" assets. If, in 1965, the qualified assets became "unqualified," or if they were sold and the proceeds reinvested in "unqualified" assets, the accumulation of 1963 legitimate income would be taxed in 1965 to the stockholders of the foreign-controlled corporation as of that time even though the controlled foreign corporation might not have earned any income in 1965. Are the abuses in the area of legitimate foreign business income so much greater than those present in this country as to require in that area a rule so much more drastic and revolutionary than has ever been applied domestically in relation to unreasonable accumulations of income?

The problem posed in the preceding paragraph becomes more serious when consideration is given to the fact that the stockholders of the foreign-controlled corporation in 1965 might not be the persons who were the stockholders in 1963 when the income was earned; that the 1965 stockholders might have paid for such earnings when they purchased their stock from the persons who were stockholders during 1963; that the 1963 stockholders might already have paid ordinary income tax upon their share of the 1963 earnings at the time they sold their stock to the persons stockholders in 1965 (see Sec. 15 of the bill); and that, therefore, the 1965 stockholders would be taxed on an amount of earnings which had already been taxed to the 1963 stockholders.

The provisions of the bill in this area are evidently designed to make as difficult as possible future development of American business abroad. A "qualified" business in a developed country is one that has been conducted for 5 years (except in the case of a business that was conducted at December 31, 1962, and continues to be conducted by the same interests). Thus, no reinvestment of earnings whatever will be permitted during the first 5 years of a new venture abroad, even though it is during this period that reinvestment of earnings normally is most necessary. Even after the 5-year period has passed, reinvestment of earnings will be permitted only to the extent that they are "ordinary and necessary" for the continued conduct of the same business by the same corporation. The purpose of this provision is quite frankly to prohibit the reinvestment of funds in order to diversify or expand foreign business operations. If the ultimate objective of the bill is to discourage the growth and development of American business abroad, this is certainly the way to do it.

Another anomalous feature of the bill is that a controlled foreign corporation engaged in business both in the United States and abroad will not be permitted to reinvest its U.S. earnings in furtherance of the U.S. business (even though such earnings will already have been subject to U.S. tax) without having such earnings taxed directly to the stockholders of the foreign corporation.

Another difficulty is that the bill requires that the earnings of a particular year be invested in "qualified property" before the close of such year. In the case of subpart F income reinvested in a qualified business in less-developed countries, a 75-day grace period is allowed following the close of the taxable year, but no similar provision is applicable with respect to investment of nonsubpart F income. It would seem that requiring an investment of earnings in qualified assets either by the end of the taxable year, or within some relatively short period thereafter, is unrealistic and will have the effect of requiring hasty and unsound business decisions to avoid the penalties of the bill.

Section 16. Sale of stock or liquidation of controlled foreign corporation

Section 16 of the bill, in general, provides that upon the sale or exchange, in liquidation or otherwise, of the stock of a controlled foreign corporation, the earnings of such corporation shall be taxed as ordinary income to U.S. stockholders owning 10 percent or more of the stock to the extent that such earnings have not previously been taxed to such stockholders under section 13. The bill will thus repeal as to foreign investments the rule of long standing that gain realized upon the liquidation of a bona fide business corporation is capital gain. Section 16 would extend the new principle to all earnings of controlled foreign corporations. Indeed, in conjunction with the provisions of section 13, the principal earnings subject to the new rule will either be those accumulated prior to 1963, or those earned thereafter in a legitimate business and legitimately reinvested in furtherance of such business. If so basic a change is to be made in our traditional income tax rules, it is open to question whether the way to make

it is by a provision in a bill hitherto throught to be a loophole-closing bill rather than after full discussion and consideration of the basic policy factors involved.

Section 16 requires that upon liquidation of a controlled foreign corporation, the U.S. stockholders must include in their income as a dividend the accumulated earnings of that corporation since February 28, 1913. That will frequently result in double taxation of the same earnings. The earnings which the stockholder must include as a dividend upon liquidation may well have already been taxed to a prior stockholder, either under section 13 or under this very section 16 at the time that the prior stockholder sold his stock. The gain realized on liquidation by the successor stockholder would not in such cases be attributable to the prior earnings, but rather to good will or unrealized appreciation. Nevertheless, the very same earnings would once again be taxed as ordinary income to the successor stockholder.

How, moreover, is the U.S. stockholder to determine the earnings and profits of the controlled foreign corporation accumulated since February 28, 1913, bearing in mind that those earnings and profits are to be determined by U.S. standards? It is difficult enough to determine the accumulated earnings of a U.S. corporation. To determine the earnings and profits of a foreign corporation by our standards back to 1913 would literally be an impossible task in many cases. Following its usual punitive approach, section 16 provides that the entire gain shall be taxed as ordinary income in such cases.

If the stock of the controlled foreign corporation is sold, rather than exchanged in liquidation, the U.S. stockholder is taxed at ordinary income rates only on the earnings accumulated during the period that he held his stock. In the case of liquidation, the gain is treated as a dividend so that a foreign tax credit may be available, but no foreign tax credit will be allowed in the case of a sale of stock in a controlled foreign corporation. The result may well be double taxation by the foreign country and by the United States of the same earnings. Suppose, for instance, that a U.S. corporation owns 25 percent of the stock of a French corporation and that the latter earns $100 before French income taxes, and pays a French income tax of $50. The U.S. corporation share of the after tax earnings of the French corporation would be $12.50. If it then sells its stock in the French corporation at a gain of $12.50, that gain will be taxed to it as ordinary income, leaving it a net gain after all taxes of only $6.25. Thus, the U.S. corporation will have ended up paying an effective tax of 75 percent upon its share of the pretax earnings of the French corporation.

Section 16 continues the "heads I win, tails you lose" approach adopted by the bill as a whole toward foreign investments. Any gain realized by a U.S. person upon a foreign investment is to be taxed as ordinary income, sooner or later. On the other hand, any loss realized by a U.S. person upon the sale or liquidation of his foreign investment normally will be allowable only as a capital loss. We have difficulty in understanding how such an approach can be said to equalize the tax consequences accorded to domestic and foreign investments.

To turn to a somewhat more technical point, section 16, as drafted, would apply to any sale or liquidation after enactment of the bill. The foreign income provisions of the bill are, in general, effective after December 31, 1962, and it is difficult to see why the same rule should not apply to section 16. Indeed, the House Ways and Means Committee previously had announced publicly that the new rules on sales and liquidation would only apply after December 31, 1962. No explanation has been given, so far as we are aware, for this reversal. Considering the drastic nature of the changes that would be effected by the bill, it seems obvious that U.S. taxpayers should be given some reasonable period of time after the enactment to determine whether or not to liquidate their investments in controlled foreign corporations. We strenuously urge, therefore, that, at the very least, the provisions of section 16 should apply only to sales or liquidations after December 31, 1962.

Section 6. Allocation of income

Section 482 of the present law authorizes the Commissioner of Internal Revenue to reallocate income arising from intercompany sales between members of a controlled group. Such reallocation is for the purpose of arriving at arm's length prices, that is, the prices which would have been charged had the dealings taken place between unrelated persons. Apparently, however, the Commissioner has encountered difficulty in determining what are arm's length prices. Hence, section 6 would authorize the Commissioner to reallocate income from intercompany transactions by the use of a three-factor formula, somewhat analogously to the three-factor formulas traditionally used by States in allocat-

ing income for franchise tax purposes. The new approach, however, is to be inapplicable if the taxpayer can establish that the intercompany transactions were carried out at arm's length prices. It will be necessary, therefore, in most cases, to determine arm's length prices. It is difficult to see, accordingly, how the present bill will greatly reduce the problems which the Internal Revenue Service professes to encounter in applying section 482 of the existing law.

As stated, the approach of section 6 is to allocate income from intercompany transactions by the use of a three-factor formula based on property, wages, and advertising, and selling expenses. Superficially, this approach is similar to that used by the States for franchise tax purposes. There is, however, a basic difference which renders the whole approach questionable. In franchise tax cases, one is normally concerned with allocating the taxpayer's entire income within and without the State. Suppose, for instance, that the parent has a plant in the United States at which it produces a whole variety of products, some portion of which are sold to a foreign subsidiary abroad for resale by the latter. For the purpose of the first factor, how is the plant to be treated? In a franchise tax case, where one would be concerned with allocating the corporation's entire income, the plant would be simply taken at its cost. This obviously would be improper under section 482, however, because, to a large extent, the plant would have been used to produce income which was not to be allocated. How, then, would it be determined what proportion of the parent's investment in the plant was attributable to the articles sold abroad, rather than to those sold domestically? Neither the bill nor the committee report shed any light on this problem. If the purpose of introducing a three-factor allocation under section 482 is to simplify the application of the section, it would seem that it should be possible to tell from the statute how the factors would be determined and applied. That is not the case, however. Far from simplifying the application of section 482, section 6 of the bill would simply create additional problems.

Another defect is that section 6 does not indicate the relative weight to be accorded to each factor.

There is even a more basic flaw to the approach taken under section 6. Section 482 of the code is concerned with allocation of income between companies in order to reflect a fair return to each company in relation to its activities. Section 6, however, contemplates an allocation between companies on the basis of territorial factors. If, for instance, the domestic manufacturing parent has a plant abroad, that would count in favor of allocating more income to the selling subsidiary. If, on the other hand, the selling subsidiary had property in the United States, that property would result in more income being allocated to the domestic parent. That is illogical in applying a statutory section designed at allocating income between related companies. Allocating income on a territorial basis might make sense if the objective were to change the source of income rules of the code. It makes no sense, however, as applied to section 482 which is not concerned with source of income, but only with allocation of income between particular entities.

Section 20(b). Information as to organization or reorganization of foreign corporations

Section 6046 of the present code requires U.S. citizens or residents who are officers or directors of a foreign corporation at any time within 60 days after the creation, organization, or reorganization thereof to file a return on or before the 90th day after such creation, organization, or reorganization. That provision is designed to be effective, however, only with respect to newly organized foreign corporations; that is, foreign corporations created, organized, or reorganized after September 14, 1960. As it now exists, the section (as its heading implies) is clearly intended to obtain the necessary information as to such creation, organization, or reorganization and form 959 prescribed by the Commissioner of Internal Revenue thereunder is consistent with that purpose.

Section 20(b) of the bill, however, completely amends and changes the substance of section 6046 in a manner which neither the heading of the section nor the committee report indicates. Under section 20(b) as amended by the bill, a U.S. citizen officer or director of a long-established foreign corporation not engaged in trade or business within the United States will be compelled under penalties of U.S. law to submit to the U.S. Treasury any information which the Secretary of the Treasury or the Commissioner of Internal Revenue by forms or regulations shall require that he submit.

Many Americans are directors and officers of reputable foreign corporations of long standing, to which the present provisions of section 6046 are inapplicable. Many of such corporations have little or no income from American sources; and thus at present have little or no concern with American revenue laws. Further, many of such corporations are organized under the laws of foreign countries which make it a crime for directors or officers to disclose information about the business or financial affairs of such corporations to persons who are not stockholders, officers, or directors thereof.

The amendments to section 6046 will place many such American citizens in a most unhappy dilemma, while serving no useful purpose so far as the United States is concerned. The American officer or director of a foreign corporation may not disclose the information which the Secretary may require without violating applicable foreign law. On the other hand, he will violate section 6046, as proposed to be amended, if he does not disclose such information. His only recourse, it seems, is either to resign his corporate position or to give up his American citizenship. In either event, the collection of American income taxes is not aided; and the status of American citizens is severely penalized.

Section 21. Treaties

Section 21 of the bill purports to abrogate all treaties with foreign nations to which the United States is a party to the extent that the provisions of the bill are contrary to the provisions of such treaties.

This provision is a complete reversal of our long-established policy to the effect that treaties are the supreme law of the land. In accordance with such long-established policy, section 7852(d) of the Internal Revenue Code specifically states that no provision of the income tax law shall apply in any case where its application would be contrary to any treaty obligation of the United States. If a treaty provision may be abrogated the next day by the unilateral act of one of the parties in enacting legislation contrary to the provisions of the treaty, then the treaty is indeed only a "piece of paper." In the recent past, our Government has complained bitterly of the unilateral actions of foreign governments in violation or disregard of the provisions of existing treaties. It is hard to find any justification whatever for the adoption by the United States of such a policy, which is as dishonorable as it is shortsighted.

ROSWELL MAGILL.

CHICAGO ASSOCIATION OF COMMERCE AND INDUSTRY,
Chicago, Ill., April 26, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I am writing to express the views of the Chicago Association of Commerce and Industry with respect to certain sections of the revenue bill of 1962 now being considered by the Finance Committee. It will be appreciated if this letter may be made a part of the record.

Sections relating to the taxation of foreign source income

The association strongly opposes any revision of the tax laws which will place U.S. controlled corporations or U.S. citizens at a competitive disadvantage in the development of foreign trade. The association, accordingly, opposes section 6 of the bill wherein certain foreign source income would be treated as distributed income for U.S. tax purposes. It opposes section 12 relating to the taxation of U.S. citizens with bona fide foreign residences. It opposes section 13 by which the treatment of so-called base companies would be so drastically changed, and it opposes section 16 under which ordinary income would be recognized upon the liquidation of a foreign subsidiary. A full statement of the position of the association relative to the taxation of foreign source income is appended to this letter. We urge its careful consideration.

Section 2. Credit for investment in certain depreciable property

The association opposes section 2 of the bill and urges that it not be adopted. The investment credit is a subsidy and in the opinion of the association the tax laws should not be used to subsidize a particular industry or group of taxpayers. If a subsidy is adopted, other taxpayers will, quite naturally, urge the passage of parallel relief legislation of benefit to them.

The investment credit is discriminatory in application since it benefits only taxpayers investing in qualified depreciable property as contrasted with taxpayers increasing investments in inventories and accounts receivable, and taxpayers who must acquire additional personnel instead of machinery and equipment to expand their business. Moreover, the investment credit would not be an incentive to taxpayers who have just completed modernizing their machinery and equipment or to those who are planning a modernization with or without the credit. The former would be discriminated against; the latter would receive a windfall.

The association believes very strongly that the allowance of more liberal depreciation by statute would encourage business expansion and additional investment in machinery and equipment. Whether or not this can be provided for now, however, it believes that the investment credit is unwise and undesirable.

If the investment credit, nevertheless, is enacted, it is the consensus of the directors of the association that it should apply equally to public utilities, and that its purpose should be spelled out clearly in the bill or in the Senate Finance Committee report for appropriate guidance to management and their accountants.

As to the first point, there is no logical basis for treating utilities less favorable than other businesses, especially where the utilities are competing actively and continuously with nonregulated industry that would qualify for the investment credit. As to the second point, it should be made clear, assuming this is the view of the Finance Committee, that the tax credit is not intended artificially to increase profits from operations in the year the investment is made and the credit taken thus distorting profits, and presumably stock values, by overstating them.

Section 3 Appearances, etc., with respect to legislation

The association supports the view of the House Ways and Means Committee that "the present bar on deductions with respect to legislative matters must be modified to place presentations to the legislative branch of Government on substantially the same footing in this respect as that with the other two coordinate branches of Government." The association also agrees with the committee that, "It is desirable that taxpayers who have information bearing on the impact of present laws, or proposed legislation, on their trades or businesses not be discouraged in making this information available to the Members of Congress or legislators at other levels of government."

To the extent that section 3 liberalizes the deductibility of expenses in the lobbying area, it is commended. However, the association believes that the format of section 3, with its requirement of proving that legislation is "of direct interest to the taxpayer," is apt to give rise to controversy and hair-splitting definitions entirely unnecessary due to the long-established rules as to what constitutes an "ordinary and necessary" business expense. The addition of a new test will serve only to confuse the taxpayer and the individual Internal Revenue agent, promote confusion, and foster unequal administration of the tax laws.

Further, the association is opposed to the concept that any taxpayer who pays dues to a business organization must determine what portion of its activities are of "direct interest" to him and what portions are of only indirect interest to him, though of "direct interest" to some other member of the organization, with only a proportionate part of such dues being deductible. If the language of the present section 3 contains any implication that this is, or would become the law, the association strongly opposes such language.

The association recommends that the approach of section 3 be modified. If the section, rather than attempting to define what lobbying expenses are deductible, took the position that no ordinary and necessary business expense would be disallowed as a deduction merely because paid or incurred to support or oppose or otherwise influence legislative action, the intent of section 3 would be carried out within well understood guidelines. Taxpayers are familiar with the meaning of "ordinary and necessary" business expenses and any so-called lobbying expense which falls within such category should be allowable as a deduction.

Section 4. Disallowance of certain entertainment, etc., expenses

The association opposes section 4 in its entirety. In particular, the association is opposed to the proliferation of tests to be met in determining whether a given expenditure is deductible or not. Under the proposed legislation, not only must an expenditure constitute an ordinary and necessary business expense, but it must also, if related to an activity, be directly related to the active conduct of the taxpayer's trade or business. If related to a facility used in connection with an activity, the taxpayer must show that the facility was used primarily for the furtherance of the taxpayer's trade or business and also that "the item was directly related to the active conduct of such trade or business." Traveling expenses must not only be ordinary and necessary but reasonable.

The association urges that the addition of the above and other tests embodied in section 4 will introduce into the law new requirements, standards, and distinctions which will be extremely difficult of administration, will prove a fertile source of litigation, and will almost certainly give rise to unequal treatment of taxpayers by revenue agents with different understandings of the scope of the tests.

The association believes that the existing statutory requirement that an expenditure be ordinary and necessary, when accompanied by improved reporting under rules promulgated by the Secretary, can best serve the business community of the Nation by eliminating the abuses which may have occurred under loose standards of reporting and recordkeeping, while at the same time avoiding the introduction of numerous new, confusing, and, in all probability, unworkable standards, and distinctions into the law. Certainly the effect of the new reporting standards and of automatic data processing should be fully known before a radical change be made in the established law.

Section 14. Gain from dispositions of certain depreciable property

While the profit on the sale of depreciable personal property is in many cases due as much to inflation as to an excess amount of depreciation deductions, the association, subject to the qualification noted below, does not oppose the enactment of section 14, so long as it is not modified to apply to real estate. It urges, however, that concurrent with the enactment of section 14, depreciation rates should be liberalized by statute so the distorting effect of future inflation will be minimized.

The association is opposed to that provision in section 14 which would tax gain from the sale of assets following the adoption of a plan to liquidate a corporation within 12 months under section 337 of the Internal Revenue Code. This section was adopted to facilitate corporate acquisitions, particularly where the acquiring corporation wished to have the purchase price reflected in the depreciation base for such assets. Smaller taxpayers will be hurt by the enactment of this provision. While it may not be reasonable to recapture at ordinary income rates the gain resulting from the sale of depreciable personal property in the ordinary operation of a business, there is no reason to extend this provision to the point of destroying the usefulness of section 337.

Section 19. Withholding on interest, dividends, and patronage dividends

The association is opposed to the provisions of this section and urges that it not be adopted.

The detailed withholding proposals place substantial burdens on corporations, banks, and other paying agencies, persons holding securities as nominees, investment dealers, stockbrokers, and others performing vital functions in the securities market. Taxpayers now conscientiously filing complete and proper returns would have added burdens, not only in return preparation, but in securing refunds. Taxpayers entitled to refunds would, for a time at least, be deprived of funds which are properly theirs and should be available for their use. These additional burdens upon the Nation's economy would not be negligible and should not be imposed.

Even if some dividend and interest income is improperly escaping taxation, the withholding proposals would not assure correction of the problem. The proposals would accelerate cash collections by the Government, but the amount of net increase in tax revenue is seriously to be questioned. Detection of improperly unreported dividend and interest income will continue to be dependent upon enforcement procedures now in existence, or improved procedures such as automatic data processing.

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If, however, the withholding proposals should be enacted, the association urges that provision be made for reimbursement of the various withholding agents for the heavy additional costs which would thereby be imposed upon them. It is serious enough that a person be required, without compensation, to act as a tax collector for the Government; it is obviously unjust that he also be compelled to incur unreimbursed expenses while so acting.

Repeal of dividend exclusion and credit

In his statement to the Senate Finance Committee on April 2, 1962, Secretary Dillon recommended repeal of the $50 dividend exclusion and 4 percent dividend credit.

The association is strongly opposed to this Treasury proposal.

The sections of the Internal Revenue Code providing for special treatment of dividend income were enacted in 1954 after extensive study. The purpose was to recognize, thought to a limited extent, the inequity of subjecting income of corporations to double taxation—the corporate tax when the income is earned and the individual tax when distributed as a dividend. The $50 exclusion and 4 percent credit do not eliminate, but do somewhat alleviate this double taxation of income, and are sound in principle. Their repeal would be equivalent to a tax-rate increase for all shareholders, which cannot be justified under the objective of H.R. 10650 stated as being "to eliminate certain defects and inequities." Repeal would further accentuate an inequity which now exists.

Sincerely and respectfully yours,

EDWARD C. LOGELIN, *President.*

APPENDIX TO STATEMENT OF THE CHICAGO ASSOCIATION OF COMMERCE AND INDUSTRY RELATIVE TO THE TAXATION OF FOREIGN INCOME

The Chicago Association of Commerce and Industry has always been vitally interested in foreign trade and over a long period of time has engaged in many activities to promote foreign trade and investment. Recently an Export E was awarded to the association by President Kennedy in recognition of the association's activities in promoting exports.

As part of its interest in foreign trade, the association has reviewed those provisions of H.R. 10650 which relate to foreign source income. The association feels that the proposals whereby subpart F income would be treated as income under section 482, the treatment of so-called base companies, the imputation of a dividend to the extent of earnings and profits when a foreign subsidiary is liquidated, and the provisions relating to the taxation of U.S. citizens with a bona fide foreign residence, are unsound. The association feels that these proposals are unsound for a number of reasons:

(1) From a technical tax standpoint, the proposals break with the principle that the separate entity of a bona fide foreign corporation with substantial operations should be recognized.

(2) Investments by U.S. concerns in foreign companies results in increased American exports and jobs and facilities keeping abreast of foreign technical developments.

(3) The competitive position of U.S. corporations will be weakened in relation to the position of corporations of other industrial nations.

(4) The balance of payments of the United States will be affected adversely by the discouragement of foreign investments and trade.

(5) Retaliation by other countries is inevitable because the provisions violated the spirit of many tax treaties and many foreign countries will feel that American tax laws are being given extraterritorial effect.

(6) There are many administrative difficulties which will be created by the proposals.

(7) The change in the method of taxing income of U.S. citizens who are bona fide foreign residents will force the control of many U.S. investments into the hands of foreigners.

The association does not wish to make detailed statements in connection with all of these points, but does wish to summarize its thinking briefly.

CHANGE OF LONGSTANDING TAX PRINCIPLES

For almost 50 years the separate existence of all corporations, domestic and foreign, has been recognized for U.S. tax purposes, except in a few isolated situations which were peculiarly abuse areas. However, the effective disregard

of the separate existence of a foreign corporation has now been carried over and applied by H.R. 10650 to legitimate operating companies which have substantial activities and employees and which over the years have produced substantial dividend, royalty, interest income, and other benefits to the United States. These principles, if adopted, inevitably would be extended to domestic corporations as well.

The somewhat fantastic suggestion has been made by the Treasury Department that many of the activities now conducted by foreign corporations could just as easily be conducted by a U.S. corporation through branch activities. The short answer to this suggestion is that the overwhelming majority of American businessmen experienced in foreign investments and trade have chosen to utilize a foreign corporation for sound business reasons, including, among other things, limited liability, facilitation of dealing with foreign governments, and participation by foreign capital where desirable. Many of the comparatively few branch operations of U.S. corporations are in the extractive field and many of these result from U.S. tax considerations relative to percentage depletion.

Many foreign countries require use of corporations formed under their laws and even where there are no legal requirements, there are many intangible and nationalistic reasons why a corporation formed in a foreign country is more desirable than a branch operation. Boards of directors of U.S. corporations, including large publicly held corporations, do not wish their U.S. assets subjected to liabilities incurred in a foreign country and adjudicated by foreign courts.

BALANCE OF PAYMENTS

Foreign investments by U.S. corporations produce many foreign sales which would not otherwise result because the foreign subsidiaries buy products manufactured by either the domestic parent or by unrelated U.S. concerns. Foreign subsidiaries may pay royalties to the U.S. parent for know-how and patents, as well as making payment of dividends to their U.S. parents. All of these items return substantial amounts of dollars to the United States in excess of any dollar drain caused by foreign investments.

H.R. 10650 ignores the facts that when a dollar comes into the United States by way of a foreign purchase generated through a foreign subsidiary, the full dollar is added to the U.S. balance of payments and that the profit element therein is a small proportion of the rollar. The Treasury proposals are concentrated on taxing the profit element, which might be 5 cents, while ignoring the remaining 95 cents of dollar earnings which represent goods or services of U.S. origin. In the Treasury's zealousness to protect the revenues and tax the 5 cents of profits in the example, it loses sight of the 95 cents which is added to the U.S. balance-of-payments position.

COMPETITION OF FOREIGN CORPORATIONS

If the proposals embodied in H.R. 10650 be enacted, American industry will be at a substantial disadvantage in international trade and business. Foreign activities of the U.S. corporations, whether they be sales, licensing agreements, royalties, or direct investments in manufacturing enterprises, are governed by sound business considerations. These business considerations relate to obtaining or retaining access to a large foreign market, facilitation of keeping up with foreign technological developments, and many other factors. It seems clear, for example, that over the next 20 years many technological improvements will be made in Europe and American corporations will want to be on the scene to keep up with these developments, as well as take advantage of the rising European standard of living and trade.

However, in all these activities U.S. corporations will be placed at a substantial disadvantage by the punitive tax system imposed by H.R. 10650. The latter is based on the premise that most foreign investments are dictated by tax considerations, something which is not true in the experience of the Chicago Association of Commerce and Industry. One very important factor in maintaining a competitive position is the raising of capital and H.R. 10650 would make it extremely difficult for a U.S. corporation to raise capital because it will be competing with foreign concerns which pay a much lower tax burden and thus have more of their earnings free for reinvestment.

No other major industrial country in the world relies as heavily on income taxation as does the United States. Under the tax systems of our principal industrial competitors, sales or other excise taxes tend to form a larger part

of the tax base. This is particularly true of France and Italy, but is also true of such high income tax countries as West Germany and the United Kingdom, which derive substantial revenue from turnover and purchase taxes. A foreign affiliate of a U.S. corporation will, of course, be subjected to all of the sales and other excise taxes of the foreign countries in which it operates. At this point the U.S. corporation can compete with corporations of other countries who are subjected to the same burdens. However, on the income tax level the foreign corporations will pay only the corporate income tax levy in that country, whereas the American corporation will, in most instances, have to pay a full 52 percent tax rate. This will mean that the foreign competitor will have available as free capital the difference between the foreign income tax rate and the U.S. income tax rate.

Foreign countries recognize, and in many instances, encourage the use of what has been described by the Treasury as "base" corporations, either as such or through domestic tax laws. For example, the United Kingdom has a category of United Kingdom corporations called world trade corporations which are corporations engaged in foreign trade and investment and which are completely free of the United Kingdom taxes as long as the funds are used abroad. Incidentally, it may be noted that the United Kingdom has had a severe balance-of-payments problem for many years and is a very experienced country in foreign trade and investments. The United Kingdom authorities and Parliament recognize the importance of not only not taking any punitive tax measures against foreign source income, but of doing just the reverse, i.e., giving substantial tax benefits because of the overall gain to the entire United Kingdom economy.

In addition to the United Kingdom, other European countries recognize base companies and/or have special tax provisions. For example, the French, the Dutch, the Belgians, the Italians, and the Germans all recognize that Swiss corporations can be formed which purchase the production from a manufacturing enterprise in one of these countries and sell it in other countries with part of the profit going to the Swiss selling company, where it is taxed at a comparatively low rate. The Swiss selling company can use its profits to build up the productive facilities in any part of the Common Market area. Substantially all European countries have some benefits for foreign source income. For example, Belgium has a maximum tax of 12 percent on income from foreign sources and the Dutch have a complete exemption for any foreign source income which has been taxed in the foreign country. Here again the Dutch and the Belgians are very heavily dependent on foreign trade and investments and very experienced in these fields. It would seem folly for the U.S. Congress to adopt a policy directly the opposite of the most experienced of the western democracies in the foreign trade and investment area.

In its mistaken zeal to overprotect the U.S. Government revenues, the Treasury will in fact be benefiting the tax collectors of various foreign countries. In the example of the base company listed above, the Swiss base company would save taxes and ultimately when the funds of the Swiss company are remitted to its U.S. parent, the U.S. Government would receive more in taxes because of the lesser foreign tax credit. It seems unrealistic for the U.S. Treasury to force members of the Chicago Association of Commerce and Industry to pay higher taxes to foreign governments and lower taxes in the long run to the U.S. Government. At all times the members of the Chicago Association of Commerce and Industry have arranged their foreign affairs to minimize foreign taxes and thus increase U.S. taxes after consideration is given to the foreign tax credit, even though some foreign government officials have suggested that the U.S. corporation should "not care" what the foreign tax rate is as long as it does not exceed 52 percent.

RETALIATION INEVITABLE

The provisions of H.R. 10650 violate the spirit of tax treaties executed by the United States with many other countries. In addition, the provisions relating to allocation of income, information reporting, and recordkeeping will be resented by many foreign corporations as extraterritorial U.S. laws. For example, where a U.S. businessman has a foreign partner, the activities of the foreign corporation may be covered in part by the provisions of H.R. 10650, something the foreign partner inevitably will resent.

The thrust of H.R. 10650 is to impose U.S. tax accounting principles on foreign corporations, again a principle which the host country may and almost inevitably will resent.

H.R. 10650 goes so far as to provide that if there is any conflict between its provisions and any tax treaty, that H.R. 10650 is to prevail. This is a provision which even the Treasury does not now support. However, the fact that such a provision had to be inserted indicates how serious a problem will be created in dealing with our European NATO allies, the Canadians, and other friendly nations.

ADMINISTRATIVE DIFFICULTIES

The enforcement of H.R. 10650 in many ways will be a "nightmare" for both the Treasury and taxpayers. As noted above, H.R. 10650 purports to impose U.S. tax accounting principles on foreign corporations which in many instances will require the foreign corporation to keep a second or even a third set of books. The methods by which this is done and how the Revenue Service will examine such second set of books is not apparent.

The provisions of H.R. 10650 relative to allocation of income are fraught with many dangers. It would appear that they invite numerous disputes between the Revenue Service and taxpayers, in which the taxpayers will feel that the Revenue Service is being arbitrary and capricious. It should be noted that the allocation problem is by no means limited to the foreign area because the amendments to section 482 are general in nature and could be applied in any context, including a domestic one.

Another administrative difficulty relates to the necessity of "grossing up" with all of its attendant difficulties. In many instances it will be difficult for the U.S. corporation to execute the various information returns which are required by H.R. 10650 of U.S. citizens abroad.

TAXATION OF U.S. CITIZENS RESIDING ABROAD

Members of the Chicago Association of Commerce and Industry have learned by very painful experiences that if an American corporation is to have substantial foreign sales and activities, it must have reliable employees on the spot abroad. These employees produce many benefits for the U.S. economy as a whole, including the increase of sales of U.S. products, obtaining technological information in the foreign area which may be useful to its U.S. parent, etc. However, to operate any foreign business the problem faced domestically of obtaining competent personnel is increased many times over. It seems naive to believe that the United States can have substantial foreign sales and activities without having many American citizens residing abroad.

However, H.R. 10650 limits the tax benefits previously accorded to the earned income of bona fide foreign residents in a number of ways both by applying a dollar ceiling and by taxing pension benefits received by American citizens, even though the benefits relate to foreign service. The benefits presently accorded recognize that U.S. citizens living abroad do not receive the same benefits as citizens living in the United States. Such citizens do receive some benefits from the U.S. Government and do pay some tax; i.e., a tax on their unearned income. No reason has been advanced as to why the citizens residing abroad in 1963 will receive any greater benefit from the U.S. Government for which a tax should be imposed than they did in any earlier year.

The Chicago Association of Commerce and Industry feels that it is extremely unwise for the U.S. Government to take steps which will inevitably result in placing control of many of the foreign activities of American corporations in the hands of foreigners who will occupy key positions because it is not practical to employ American citizens in view of the limitations on the tax benefits heretofore applied.

As noted above, all foreign countries rely to a much greater extent than the United States on sales and excise taxes. American citizens residing abroad pay, of course, all excise and sales taxes and in addition pay the foreign income tax. H.R. 10650 will in large part force such a citizen to pay U.S. income taxes as well. It seems unwarranted to impose such harsh burdens on those living abroad who promote the best interests not only of their corporate employer, but of the United States as a whole.

Another factor which should be noted is that many industrial countries provide benefits to their citizens who reside abroad and again the fact that the U.S. corporation will have a more difficult time obtaining American citizens who will work abroad will place the U.S. employer at a considerable disadvantage.

STATEMENT OF THE COMMITTEE ON TAXATION OF THE MANUFACTURERS ASSOCIATION OF THE CITY OF BRIDGEPORT, CONN., INC.

To the Chairman and Members of the Senate Finance Committee:

The Manufacturers Association of the City of Bridgeport, Conn., Inc., is comprised of about 100 manufacturers in the Greater Bridgeport labor market area.

Its committee on taxation has been one of its most active policy formulating and policy implementing committees and has appeared before your honorable committee periodically since its formation in 1950.

Member manufacturers of this association are engaged primarily in the production of machine tools, machinery, raw materials such as copper, brass, stainless, tool and other specialty steels, wire and cable, metal components for other manufactured items, and a sprinkling of hard and soft consumer goods.

As passed by the House, the Revenue Act of 1962, now the subject of consideration by your committee, seems to provide primarily for increased taxation rather than for "a credit for investment in certain depreciable property."

Tax incentives for modernization and expansion

The bill before you today fails to provide any really useful or valid formula of tax incentives which would genuinely stimulate modernization and expansion of American industry or other types of business enterprise.

Due to the threatened loss of Federal income deviously calculated by the Treasury Department, the original formula has been so emasculated as to be virtually meaningless.

It has shrunk from the initially proposed 15 percent plus to a mere 7 percent with certain restrictive limitations.

It is now only a "gimmick"—a snare and a delusion.

The Treasury Department and business management have long recognized the urgent need for providing adequate depreciation geared to modern industrial progress.

This tax credit is more of a "one shot"—"hit or miss"—variable. It does not provide for sufficiently liberal depreciation allowances essential to substantive economic growth.

It certainly further complicates present tax laws, which are in dire need of clarification, and might well result in long years of frustration and litigation.

Extension of tax withholding to dividend and interest income

In view of the impact of this proposal to tax all savings and investment income on all who practice thrift—regardless of their economic circumstances—it is questionable indeed as to whether it is necessary to burn down the barn to kill the rats.

This proposed tax strikes at the basic American freedom of the right of the individual to freely, accumulate, own, hold, and enjoy the benefits of private property.

Such taxation would result in the confiscation of income which may never be due the Government and for which no records are supplied the payee.

All too many average citizens would suffer permanent loss of withheld income due to their lack of comprehension of the procedures for the computation of amounts over withheld and for filing claims for refund.

Despite proposed exemptions for those under 18 years and those having no tax liability, and for quarterly refunds for those with limited incomes, the practical result would still be the 1962 version of robbing the widows and orphans and denying the poor the needed crumbs from their own loaf of bread.

We would cite an actual example of the effect upon a retired man—age about 70—based upon his 1961 tax return.

Income:	
Dividends received	$2,800
Dividend credit	100
Total	2,700
Interest	800
Pension	1,200
Total income	4,700

Deductions:	
Contributions	$200
Taxes: Real and personal property, sales, gasoline, auto registration, etc	900
Medical	100
Total deductions	1,200
Taxable income	3,500
Exemptions: Man and wife over 65	2,400
Base for tax computation	1,100
Tax at 20 percent	220
Credits:	
Dividends received credit	108
Retirement credit	100
Total credits	208
Tax payable	12

Applying the proposed withholding provisions we find the $3,600 total of dividend and interest income would be reduced initially by $720.

To retrieve this needed $720—of which only $12 is due to the Government—he would have to file four quarterly claims for refund. If the income was due in equal amounts each quarter he would have to file a claim for refund of $177 every 3 months.

Almost any slight misfortune due to illness and medical expense or increased property taxes would put this retired taxpayer in a nontaxable status and to terminate all withholding he would have to file 20 exemption certificates with 15 sources of dividends and with 5 banks where his savings draw interest.

With the new electronic computer facilities of the Treasury Department now in sight, there is no valid reason for the mass withholding of dividends and interest.

Financial institutions could report accurately on those to whom interest and dividends were paid—just as employers report employee earnings—and the Treasury could then accurately determine the amount of taxes justly due from each taxpayer.

Individual freedoms would be protected and the honor of our American Government would not be sacrificed to satisfy the insatiable appetite of expanding Federal Government expenditures.

Eliminating tax deferral on subsidiary operations in industrialized countries and of tax haven corporations

In earlier testimony before the House Committee on Ways and Means we clearly stated our reasons for opposing the taxation of certain undistributed earnings of controlled foreign corporations by the so-called elimination of deferral provision devised by the Treasury Department.

Briefly, opposition was based on the fact that: (1) U.S. individual and corporate taxpayers would be taxed for undistributed earnings of foreign industrial enterprises from which there had been no constructive receipt of dividend payments, and (2) there is an inherent danger too grave to be overlooked that this same principle might also be applied to the undistributed earnings of domestic American corporations.

However, there is another serious problem posed in the proposed amendment to section 482 of the 1954 revenue code.

In the course of conduct of legitimate international operations, domestic corporations often find it necessary, in complying with duty impositions of those countries in which foreign subsidiary corporations are domiciled, that to price merchandise in such foreign market competitively, it is essential that they supply certain materials and goods at other than "arms length prices."

The proposed amendment would leave the final determination of "arms length prices" to the Internal Revenue agent and could easily result in not only endless controversy but in the double taxation of so-called shifted income resulting from wholly legitimate foreign transactions.

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We appreciate your consideration of these observations and trust that your committee will not approve temporary expedients which may impair the adoption of vitally needed fundamental tax law revisions.

ROCKWELL MANUFACTURING CO.,
Pittsburgh, Pa., April 13, 1962.

Hon. HARRY FLOOD BYRD,
Chairman, Finance Committee,
Old Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: I have just finished many, many hours of study on those sections of House bill 10650 which affect foreign earnings and investments and I have spent numerous hours attempting to explain to our management the impact of this bill on our foreign investment programs. I relate this fact not in any attempt to establish my expertise in this matter but to emphasize that this bill is so difficult, so complicated, and so fraught with hidden dangers that if it becomes law it will be impossible for business to invest and operate in foreign markets with any realistic degree of freedom or certainty.

This bill represents either the most purposeful but insidious attempt of the Government to regulate and control a large segment of American business or else it represents a complete lack of realism in failing to recognize the impossible burdens put upon the owners and managers of legitimate American businesses in making day-to-day decisions in the field of foreign operations.

Before commenting on specific sections of the bill, I first want to reiterate our basic belief that any tax legislation which takes away the tax advantages of doing business through foreign subsidiaries located in low tax rate countries will adversely affect our company's planned program of investing in manufacturing plants in so-called less developed countries as well as in Common Market and other foreign countries.

There are many legitimate business reasons why we operate in foreign countries through foreign subsidiaries rather than through branches of a U.S. company. The development of our foreign market is like the development of any new business. In the beginning every dollar of earnings is needed to reinvest in the business to build a strong financial foundation to weather lean years. The stronger this foundation the greater the growth and the quicker the return on investment to the owners.

To assure the continued sound growth of our company, it is absolutely necessary to develop the world market for our products as quickly as possible. The rate and method of development are not the same in all parts of the world. In some areas we are ready to develop manufacturing and sales facilities, in other areas licensing arrangements, in other areas more extensive distribution outlets, and in other areas joint local participation is one or several of these activities. The Department of Commerce figures on inflow and outflow of capital reveal that this sort of world market development returns a greater inflow or return of capital than what was originally expended.

Instead of developing better administrative enforcement techniques for existing adequate tax legislation this bill creates a legislative straitjacket by developing arbitrary mechanical tests that may have little or no relation to actual business realities. In addition to sacrificing broad concepts of reasonableness (inherent to some degree in the present tax code) in favor of arbitrary mechanical guide lines for purposes of administrative efficiency, other provisions of the bill are out-and-out vindictive and penal in nature.

It is completely unrealistic to assume that any business can operate with reasonable certainty and decision in the international field when it is confronted with the proliferate and esoteric guide lines of sections 6 and 13 of the bill. There is an insurmountable burden placed upon a U.S. investor to know the nationality or residence of all shareholders on every day of the year of all companies with which the U.S. investor may have any direct or indirect investment.

This bill also invites the U.S. investor to make unwise investment decisions, in order to avoid or take advantage of the tax deferral concept, by investing in less-developed countries prematurely. Any time investment decisions are made due to artificial economic stimulants we are inviting investment disaster.

Equally artificial, is the formula device for determining the allocation of income between a controlled foreign subsidiary and its U.S. parent. Section 482 of the Internal Revenue Code gives the Commissioner ample authority to adjust any

distortion of income resulting from a "controlled" position. Under present section 482 the Commissioner may look at all factors to determine whether a controlled taxpayer is on a tax parity with an uncontrolled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer. This standard has no relation to the relative financial strength or size of the contracting parties. Just as competitive conditions in U.S. markets may require a selling corporation to reduce its profits in a particular transaction or conversely require a buying corporation to pay more for the product purchased than it might otherwise, competitive conditions in foreign markets may require the same marketing concessions. A taxpayer should be given the opportunity to justify his intercompany pricing in any particular transaction questioned without being bound to an arbitrary formula which may or may not have any logical relation to the transaction involved. Proposed section 6, as a practical matter, effectively eliminates any ad hoc determination of allocation except under the guide lines of the mechanical standards set forth in the bill. It is interesting to note that the standards set forth in section 6 do not even mention competition as one factor to be considered and yet competition is the mainstay in any business determination in establishing prices.

Even assuming arguendo that it is desirable to stop certain abuses in so-called tax haven countries, there is absolutely no justification to penalize the present legitimate foreign business operations by changing our total concept of capital gains in order to tax accumulated earnings of our foreign companies at ordinary income tax rates whenever the earnings are distributed or realized by the sale or exchange of the stock or by the liquidation of the foreign company.

I would hope that Congress would feel morally obligated to recognize the fact that for many years our present tax system permitted the type of foreign investments which have been made. Within this tax and corporate framework our Government encouraged and solicited American business to invest abroad. At that time there was no indication that the ground rules would be changed retroactively. Anyone who has a sense of fairplay would recognize the unjustifiable decision to treat the distribution of past earnings as ordinary income. This provision of the law has nothing to do with discouraging future foreign investment; it is a penalty for past legitimate investments encouraged in no small part by the present and past administrations.

Even conceding, for the purpose of discussion, both the constitutionality of the proposed legislation and that it is in the public interest to tax so-called unreasonable earnings for foreign subsidiaries, the criterion to be used should be that which is presently in the Internal Revenue Code; namely, whether or not there has been an accumulation beyond the reasonably anticipated needs of the business. This criterion is fair, equitable, and has both legislative and judicial precedence. It does not, however, arbitrarily eliminate the planning of new product lines or conglomerate business expansion.

I respectfully disagree with the legislative drafting philosophy exemplified in this bill that predictability and certainty can only be achieved by statutory proliferation and detail. The attempt to limit the area of judicial interpretation and administrative discretion will create more problems than it will solve. I sincerely believe that the passage of House bill 10650 will only lay the ground work for continued Government interference and control in our free enterprise system not for the purpose of correcting abuse but purely for the sake of control itself. I also believe that passage of House bill 10650 will have a detrimental effect on this country's ability to compete in foreign markets. I urge, therefore, the defeat of House bill 10650.

Very truly yours,

JEROME A. EARLEY,
Manager, Tax Planning.

NEW YORK COUNTY LAWYERS ASSOCIATION,
New York, N.Y., April 13, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The Committee on Taxation of the New York County Lawyers' Association has considered H.R. 10650, revenue bill of 1962, and encloses herewith, in duplicate, a copy of its report thereon.

We respectfully ask that your committee consider the comments incorporated in this report and request that it be inserted in the printed record of the hearing before your committee on the bill.

May I ask that a copy of the printed hearing be mailed to me when it is available.

Respectfully submitted.

HARRY JANIN,
Chairman, Committee on Taxation.

NEW YORK COUNTY LAWYERS' ASSOCIATION REPORT NO. F-2—H.R. 10650 REVENUE BILL OF 1962

Report of committee on taxation on H.R. 10650, revenue bill of 1962, which seeks to amend the Internal Revenue Code, in relation to credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes

RECOMMENDATION: DISAPPROVAL, IN PART, AS TO FORM

The committee on taxation expressly refrains from comment on the considerations of national tax policy which underline many provisions of H.R. 10650. Attention however is directed to the following ambiguities and apparently unintended results:

1. The term "foreign trust created by a United States person" as defined in subdivision (d) added to section 643 Internal Revenue Code by section 9 of the bill, may be interpreted to include a foreign trust not created by a U.S. person but to which a U.S. person has made a contribution, however minimal. In such case, it may be more equitable to have only a pro tanto portion of the distribution treated as an accumulation distribution within the meaning of proposed section 655(e).

2. Section 11 of H.R. 10650 would require a U.S. parent corporation claiming a foreign tax credit to include in its income, not only the dividend it receives from its foreign subsidiary, but also the foreign income taxes paid by the subsidiary on the profits from which dividend is derived.

(*a*) Where the effective foreign rate exceeds the U.S. rate, the amendment would operate to reduce the revenues. In such cases the amount by which the gross U.S. income tax of the domestic parent is increased by the proposal would be less than the amount of the increase in credit. The credit limitation is, of course, intended to deny credit for foreign tax in excess of the U.S. tax. However, where the taxpayer receives from one country both dividends and other income, such as royalty income, bearing little or no foreign tax, the limitation is increased, so that the "grossing up" proposal would result in larger credits than under present law. This side effect of the "grossing up" proposal would have growing practical importance as an increasing number of U.S. corporations elect the overall limitation instead of the per-country limitation in order to average their credits for high and low foreign taxes.

(*b*) The "grossing up" proposal would have very adverse effects upon other taxpayers having operating loss carryovers. For example, in 1962 a U.S. corporation has a net operating loss carryover of $800,000 from 1961 and no current income from U.S. sources. Its wholly owned foreign subsidiary pays a 1962 dividend of $600,000 representing the subsidiary's income of $1 million reduced by its foreign income tax of $400,000. Under present law, the U.S. corporation will have both (*a*) a net operating loss carryover to 1963 of $200,000 (i.e., its carryover of $800,000 from 1961 less the 1962 dividend of $600,000) and (*b*) a foreign tax credit carryover to 1963 of $240,000 (i.e., the foreign tax rate of 40 percent times the dividend of $600,000).

Under the "grossing up" proposal, the U.S. corporation would have to choose between (i) a net operating loss carryover of $200,000 and (ii) a foreign tax credit carryover of $296,000. More specifically, if the U.S. corporation does not elect the foreign tax credit (and thereby avoids "grossing up"), it would preserve its operating loss carryover of $200,000 but would lose all of the foreign tax credit carryover of $296,000. If the U.S. corporation does elect the foreign tax credit (and thus "grosses up" the $600,000 dividend to $1 million), it would have a net income of $200,000 (i.e., $1 million less its $800,000 operating loss carryover from 1961) and thus would have no loss to carry over to 1963. The U.S. corporation would then be deemed to have paid a foreign tax of $400,000 which would wipe out its 1962 U.S. tax of $104,000 (i.e., 52 percent of its $200,000

net income) and would produce a foreign tax credit carryover to 1962 of $200,000 (i.e., $400,000 foreign tax deemed paid less $104,000 thereof credited against U.S. tax for 1962).

Faced with these alternatives under the "grossing up" proposal, the U.S. corporation would presumably choose the enlarged foreign tax credit carryover of $200,000 in preference to the operating loss carryover of $200,000, since, the latter could result in a maximum tax saving of only 52 percent or $104,000. However, this choice is by no means inevitable, particularly where the U.S. parent uses the percountry limitation and therefore can use the credit carryover only to reduce the U.S. tax on future income from the one country which generates the excess foreign tax. If that country is a high-tax country, the credit carryover may have such uncertain value that it will be sacrificed to preserve the $104,000 tax benefit from operating loss carryover. Regardless of the choice made, however, it is apparent that the adverse effect of "grossing up" is far more severe than the mere elimination of an alleged rate differential.

(*c*) Inclusion of the foreign subsidiary's income may move the U.S. parent corporation from a 30 percent bracket into a 52 percent bracket.

(*d*) By increasing the U.S. parent's income, "grossing up" will affect the limitation on its charitable contributions under section 170(b)(2) of the code.

(*e*) The U.S. parent's accumulated earnings and profits will be increased by the amount of the foreign taxes paid by the subsidiary with respect to its dividends. This may change the character of the parent's distributions.

(*f*) Since the subsidiary's foreign tax is treated as a dividend to the U.S. parent, "grossing up" may adversely affect the parent's qualification as a Western Hemisphere trade corporation or as a subchapter S corporation.

(*g*) "Grossing up" may subject the U.S. parent to personal holding company surtax by increasing the percentage of its income from dividends. However, the bill makes technical changes in section 535(b)(1) which allow deductions for the foreign taxes deemed to have been paid under section 902 (a) and (b) and thus prevent an increase in either "undistributed personal holding company income" or "accumulated taxable income."

The foregoing anomalies serve to illustrate the capricious consequences of attempting to alter the foreign tax credit under section 902 by treating taxes paid by a foreign subsidiary as dividends to its U.S. parent corporation.

(*h*) In conclusion, it may be noted that section 21 of H.R. 10650 provides that section 7852(d) of the code shall not apply in respect of any amendment made by the bill, thus making it clear that the bill is to prevail over any treaty with which it may conflict. Accordingly, the "grossing up" amendments will prevail over the provisions of those income tax conventions, such as article XV(1)(a) of the convention with Finland, in which the United States undertook to allow credits for foreign income taxes "subject to provisions of section 131, Internal Revenue Code, as in effect on the date of the entry into force of this convention * * *."

3. Proposed code section 953 provides several new terms of less than crystal clear meaning. Among other things, the definition of "qualified property" includes in proposed code section 953(b)(2)(B)(iii) the amount of any loan arising in connection with the sale of property which does not exceed the amount which would be ordinary and necessary had the sale been made between unrelated persons. Similar references appear in other parts of the bill. It would appear to be undesirable to sprinkle this type of standard throughout the bill in the light of the provision in the existing code which gives the commissioner the authority to reallocate in the case of transactions between related persons.

4. In proposed code section 953(b)(2)(C)(i) the reference to the active conduct of a trade or business by a controlled foreign corporation is stated in terms of "only if *substantially*, all of the property * * * is ordinary and necessary for the active conduct of a trade or business engaged in by it *almost wholly within* a less developed country * * *." [Italic supplied.] The use of the term "almost wholly" is new phraseology and its meaning is not too clear.

5. Subdivision (a)(2) of proposed section 952 added to the Internal Revenue Code by section 13 of the bill, excludes from the definition of subpart F income, items includible in gross income as income derived from sources within the United States of a foreign corporation engaged in trade or business in the United States. There is no similar exclusion in proposed section 953 for earnings invested in nonqualified property.

6. Proposed section 1248 added to the Internal Revenue Code by section 16 of the bill taxes as ordinary income gain realized upon the sale, exchange, or liquidation of stock of a foreign corporation. There is no exclusion for stock

of foreign corporations engaged in trade or business in the United States whose income is derived from sources within the United States.

7. Section 7852(d) of the code provides that nothing in the code shall be deemed applicable which would be contrary to any treaty obligation of the United States in effect on the date of enactment of the code. Section 21 of H.R. 10650 amends that section to provide that it shall not apply in respect of any amendment made by the act.

It is questionable whether section 21 is as complete as it should be, since it does not refer to treaties which became effective after the enactment of the 1954 code or to secttion 894 of the code. Section 894 provides that income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under subtitle A, relating to income taxes. That section is somewhat broader than section 7852(d), which as heretofore noted refers only to treaties in effect at the date of enactment of the code.

Section 9(a) of the bill, relating to distributions by foreign trusts, specifically makes section 894 inapplicable. However, section 894 is not specifically made inapplicable by section 13, relating to foreign base companies, which leaves an ambiguous situation. For example, although a number of treaties including some which became effective after the enactment of the 1954 code, provide for the exemption of shipping profits, section 952(e)(3), as added by section 13 of the bill, requires rent (which includes charter fees) to be included in the foreign base company income without regard to whether it exceeds 50 percent of the total gross income. Section 883 of the code which grants an exemption to shipping profits along the lines of the treaty exemption also is not referred to in section 13 of the bill. Thus there is an ambiguity as to whether a foreign corporation, substantially all of whose income arises from charter fees, is brought under section 952.

If this failure to refer to either section 883 or section 894 was inadvertent and it was intended that section 952 would override the exemption, the fairness of that policy is open to serious question. In view of the policy reflected by section 883 of the code and the similar exemption granted under numerous treaties, foreign shipping companies had good reason to believe their charter fees would not be subject to tax in the United States. Accordingly, such companies made irrevocable commitments for the amortization of the principal of ship mortgages or other obligations which require the payment of a greater amount of cash than will be available after the payment of the U.S. taxes which will be incurred under the bill.

If treaty obligations are to be ignored under such circumstances, minimal standards of fairness require that section 13 allow a deduction for such amortization of indebtedness as is required by outstanding commitments; cf. section 545(b) of the code allowing a personal holding company a deduction for amounts used to retire indebtedness incurred before the date of the enactment of the personal holding company tax.

Respectfully submitted.

COMMITTEE ON TAXATION,
HARRY JANIN, *Chairman.*

CORAL GABLES, FLA., *April 11, 1962.*

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I have been advised that the revenue bill of 1962 includes a change in the present section 72(f) of the U.S. Internal Revenue Code covering pension or annuity plans for employees resident abroad.

For more than 30 years I lived abroad and earned an annuity under an arrangement that was tax free in the United States. I strongly urge that the proposed bill take no action that will modify or change what has already been earned.

During the last 14 years of foreign residence I lived in Cuba. Here, along with many others, I saw and felt the impact of a confiscatory government when Castro took over, and I, along with others, lost personal possessions through retroactive confiscatory changes by a communistic government.

If changes are provided in the code affecting pension and annuity payments, these changes should not affect what has gone before, because this is just another part of income tax and income tax changes are not made retroactive. The same philosophy should apply to annuity and pensions earned and they should not be retroactive.

I sincerely hope that your committee will reflect carefully any actions that you may take.

Very truly yours,

L. J. BREWER.

EDMONT, INC.,
Coshocton, Ohio, April 5, 1962.

Hon. FRANK J. LAUSCHE,
U.S. Senate, Washington, D.C.

DEAR SENATOR LAUSCHE: We would like to express to you our great concern about the proposed tax legislation included in tax bill H.R. 10650 involving foreign subsidiaries controlled by U.S. companies. We are specifically concerned about section 18 of this bill which provides for immediate corporate tax on much of the profits of these subsidiaries. This proposed taxation would be made whether or not the profits had already been committed for other business needs. This legislation would greatly affect a relatively small company such as ours.

We are at the present time building a manufacturing plant in Belgium as we could appreciate the great potential in the Common Market. At the time we made this decision our Government gave us every encouragement toward making an investment in the Common Market. We recognize this as a risk venture but one that could mean greater security for our stockholders and our employees in the United States.

Immediate taxation of our profit in Belgium could prevent early retirement of our debts and further expansion into world markets. Our competitive position would suffer and we would be at a disadvantage with competitors in Germany and England who are already expanding far beyond the Common Market countries and into the United States.

Our expansion into further world markets could be curtailed by this tax legislation over the years ahead and so reduce profits on which taxes would ultimately be paid. American business would suffer from competition from foreign companies who have and will have more incentive to expand in world markets.

We strongly oppose this tax legislation since it will put American business at a disadvantage in world markets and could actually decrease potential tax income for our Government.

We know that you will give very careful consideration to this proposed legislation and make a decision with your vote that will be for the best interest of all American business.

Sincerely,

R. L. PRINDLE.

EDMONT, INC.,
Coshocton, Ohio., April 3, 1962.

Hon. FRANK J. LAUSCHE,
U.S. Senate, Washington, D.C.

SIR: We are very much concerned about the proposed tax legislation included in the new omnibus tax bill, H.R. 10650, which involves foreign subsidiaries controlled by U.S. companies. Section 18 of this bill provides for an immediate corporate tax on much of the profits of these subsidiaries whether or not they have already committed such earnings for repayment of debt, further expansion, or other business needs. I'm sure you are acquainted with many of the implications of this legislation which have been pointed out by business organizations and those who are being heard before the Senate Finance Committee. However, I would like to put down how this legislation would affect a relatively small company such as our own.

1. A few years ago we began to appreciate the significance of the Common Market, how it would affect our growing export business on industrial gloves, and what it might mean to us in the future promotion of worldwide business. Our Government certainly gave us every encouragement toward making an investment in the Common Market and we proceeded to negotiate for property in Belgium, the building of a plant, and a loan from the Belgium Government.

It was recognized that this was a risk venture but one that could mean greater security for the stockholders as well as the employees of our business here in Ohio.

2. We strongly believe that this operation in the Common Market of Europe will lead to more business for our plants in the United States. This venture should increase our total business so much that we will be exporting many more specialized products from our plant here along with those which are made and sold in foreign countries.

3. If immediate taxation of our profits in Belgium prevent the early retirement of our debts and further expansion into world markets, our competitive position will suffer and we will be discriminated against in favor of competitors in Germany and England who are already expanding far beyond the Common Market and into the United States. For instance, a formidable competitor in England is already expanding on the European continent, Japan, Australia, South America, and Canada. They are negotiating now for an operation in the United States.

4. This tax legislation over a period of years would curtail our expansion in world markets and therefore reduce profits on which taxes would ultimately be paid. Most American business would suffer from the competition of foreign companies who will have more incentive to expand in world markets.

We strongly believe that this tax legislation is extremely shortsighted. It will put American business at a disadvantage in competing for world markets. Eventually it will insure our balance-of-payments problems and actually decrease potential tax income for our Government.

Surely those who have promoted this legislation have not looked very far into the future. We hope that you will give this serious consideration and make a decision with your vote that will be for the best interests of American business.

Very truly yours,

E. E. MONTGOMERY, *Chairman.*

(Whereupon, at 1:35 p.m., the hearing was adjourned, to reconvene at 10 a.m., Friday, April 27, 1962.)

REVENUE ACT OF 1962

FRIDAY, APRIL 27, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Senator Robert S. Kerr presiding.

Present: Senators Kerr, Douglas, Gore, Williams, and Carlson.

Also present: Elizabeth B. Springer, committee clerk; and Colin F. Stam and L. N. Woodworth of the Joint Committee on Internal Revenue Taxation.

Senator KERR. The committee will come to order.

We are happy to have with us to start our hearings this morning Dr. Dan Throop Smith, who, as one of the former Assistant Secretaries of the Treasury, worked with our committee for many years, in a very effective and able manner.

He is an example of the fact that not all great mental talent moves from Harvard to Washington. He returned from Washington to Harvard.

Mr. SMITH. Thank you, Mr. Chairman. It is very nice to have an excuse to be back in Washington, even on tax matters.

Senator CARLSON. Mr. Chairman, I would like to state that I, too, am glad that Dr. Smith is with us. We always did appreciate his testimony. He is a very able taxman and I know I am going to enjoy the statement very much.

Mr. SMITH. Thank you, Senator Carlson.

STATEMENT OF DAN THROOP SMITH, PROFESSOR OF FINANCE, HARVARD GRADUATE SCHOOL OF BUSINESS ADMINISTRATION

Mr. SMITH. Mr. Chairman and members of the Senate Finance Committee, I appreciate this opportunity to appear before you in connection with H.R. 10650, especially as it relates to the taxation of foreign income. Needless to say, I do not appear on behalf of any company or group; I am here solely as an individual concerned with matters of tax policy, as the chairman's remarks have indicated, least of all do I appear as a representative of Harvard University.

I am not here to defend the law as it stands. Changes are desirable in the taxation of foreign income, as in many other parts of the tax law.

But I am satisfied that in spite of several desirable provisions, the bill before you would, on balance, be bad legislation. This, I believe, is true, both in respect to the sections dealing with foreign income and the bill as a whole.

The proposed taxation of cooperatives and mutual financial institutions are among the very desirable provisions in the bill, though in each instance the changes are a bare minimum; they both should be stronger.

Section 14 which would tax as ordinary income, instead of capital gain, the profit from the sale of depreciated property up to the original purchase price is desirable as part of a general reform in the depreciation area. However, there seems to be no reason to exclude real estate from this new treatment; it is in real estate that the abuses are especially great.

Though the objective of the investment credit is good, it is generally undesirable to give a deduction in excess of cost. The investment credit is even worse than a deduction in excess of cost. It is simply a 7-percent Government rebate on qualified purchases of capital equipment with the payment made through an adjustment in taxes.

It has no proper place in tax legislation, especially when the same objective could better be achieved by giving a larger depreciation in the year of purchase of new equipment, with total depreciation confined to total cost.

What I have in mind there, of course, is, I believe, section 179, which was adopted in 1958, giving 20 percent of the first $10,000 investment for small business. If that ceiling were to be removed with perhaps an adjustment of percentage to another figure with the same revenue impact, it would avoid the problems that seem to bother many people under the investment credit.

There is no satisfactory evidence that a Government subsidy for capital investment is needed. It would be a poor substitute for funds secured in ordinary ways in a free economy. The principles stated in the recent excellent Presidential message on transportation should be generally applied; the investment credit seems inconsistent with them.

Tax reform is needed in the individual income tax rates and in various ways to permit more business investment. Many of the provisions in H.R. 10650 which would increase revenues might better be used in connection with the revision of individual rates, through reform in both areas is so important that available increase in revenues should be used for reform in one way or another. Further consideration of the entire subject of tax reform should produce a more balanced program than that embodied in the present bill.

When one turns to the sections of the bill dealing with foreign income, again several provisions seem desirable. Rules on foreign investment companies should be tightened. A change was first proposed by the Treasury in 1956; the specific change now in the bill is, if anything, not tight enough.

The exemption of foreign real estate from the present estate tax is an anomaly with no apparent justification. Even though we may deplore the level of estate tax rates, as I do, the exemption of foreign real estate is hardly a good way to give relief.

The section on foreign trusts also has merit. But in my limited time I want to concentrate on the principal section, that dealing with the undistributed income of foreign subsidiaries.

Section 13, I believe, is extremely bad. It seems to be based on a misconception, in fact on several misconceptions. The attempt to

extend our tax jurisdiction over the undistributed income of foreign operating subsidiaries is, I submit, unsound in principle, extremely difficult in application, and very much against the long-run national interest if the United States is to participate freely in the world's trade and income.

Many considerations are relevant to a decision on the taxation of foreign income. I know of no single area where it is so difficult to balance the conflicting objectives of policy.

I have already written a fair amount on the subject, but in recent months have become increasingly interested and concerned with it. I have recently returned from a trip to Western Europe which I took, in connection with current research activities, to determine attitudes and practices regarding the taxation of foreign income in some of the industrial countries there. I shall try to state here as concisely as possible what seem to be the most significant points, pending preparation of a longer article on the subject.

Foreign operating subsidiaries are in no sense artificial or unnatural legal entities. Contrary to many foreign holding companies, foreign operating companies are used as the natural and normal means of participating in a foreign economy.

They were used long before we ever had an income tax; in some instances they are required by foreign governments. They are necessary when joint ventures are developed with local capital. It is a misconception to think that they are established primarily for tax advantages.

Furthermore, operating subsidiaries abroad are in competition with other companies located abroad. American parent companies usually establish foreign subsidaries to maintain a position in foreign markets or to secure a position in new markets.

They do not establish foreign operating subsidiaries as an alternative to expansion at home for production of export commodities. When foreign markets become large enough and foreign conditions for production good enough, production is going to take place abroad.

There are plenty of local companies able and anxious to expand to meet domestic requirements in foreign countries, and plenty of large corporations in other major industrial countries able and anxious to set up their own foreign subsidiaries, and active in doing so.

If our country is to get its rightful competitive share in the expanding income of the world, our business firms must be free to compete where production is taking place.

This point cannot be overemphasized. Someone is going to produce abroad; it is the very essence of economic development abroad that production will take place there. It is a serious misconception to believe that if American firms cannot produce abroad, no one will do so and that foreign demands will remain unsatisfied until filled by American exports.

Now, it is perfectly true that if a foreign corporation income tax rate is lower than the U.S. rate, there is a lower tax burden and a greater chance to expand through retained earnings in a foreign subsidiary than there is in domestic production, insofar as the corporate income tax burden is concerned.

But there is a misconception even in this statement, because it refers only to income tax burdens. Other countries have chosen to place greater reliance on other forms of business taxation. This may be

wise or unwise, but whether it is wise or not (and I happen to be among those who think it is wise), it is a fact. And since it is a fact, a comparison of income tax burdens gives only a part of the true picture of the total tax burden on production in various countries.

When these other taxes which are not allowed as a credit against the U.S. income tax are included in a comparison, the picture of total tax costs is substantially changed. Total tax burdens abroad may be greater even though income taxes are lower.

But even if total tax burdens on business are lower abroad, what is the significant comparison? As Secretary Dillon has stated, we cannot have tax neutrality both in comparison with domestic activities and in comparison with foreign competition.

It is a misconception, I believe, to think the significant comparison is with domestic production. This is the basic fallacy underlying the administration proposal to tax undistributed income of foreign subsidiaries.

The reasons why it is a misconception to try to achieve neutrality with domestic production have already been given. American-owned subsidiaries abroad are in competition with other businesses abroad; they are not primarily in competition with domestic production in the United States.

The importance of income from foreign business has by now been generally recognized. I do not propose to try to review balance-of-payment figures by continents, or industries, or for different periods. You have already had much testimony along those lines which has shown the importance not only of the repatriated profits from foreign subsidiaries, but also the commodity exports in the form of machinery and component parts which are tied in with foreign subsidiaries. But even when these facts are admitted, it is sometimes argued that we should have a short-term restriction on foreign investment to meet a short-term problem in our balance of payments. This brings us to the fourth misconception in the administration proposal.

Investments by foreign subsidiaries of U.S. corporations cannot be turned on and off by some external force, if the U.S. subsidiaries are to remain effective competitors abroad.

Investments must be made when required by market conditions or new technology. A postponed investment is very likely a lost opportunity, especially when competitors are not subject to artificial restraints.

As markets grow with the rapidly expanding standards of living in the Common Market, it is important to be in on the ground floor, as it were, to have brand names known, to establish distribution channels, and to act promptly in improving products and processes.

If a company falls behind, it can catch up, if at all, only with increased outlays. If it tries belatedly to secure entry into an established market, it can probably do so, if at all, only at greatly increased cost.

These are familiar facts of business which I shall not elaborate, but they should not be overlooked if an argument is made that we need only temporarily to restrain investment, or that old investment is good but new investment is bad, because it is not immediately recouped in repatriated profits.

Business investment must be a continuing dynamic process; if it is not continued as required, the value of old investments, and the

possibility of continued repatriated income from them, will wither away.

To the best of my knowledge, and I have inquired carefully, no other country in any way taxes their own companies on the basis of undistributed income of foreign subsidiaries.

Furthermore, on the basis of extensive inquiries in Europe in recent weeks, there is no indication whatsoever that other countries would follow our example. There is some concern abroad about pricing on transactions between parent companies and foreign subsidiaries—the sort of problem covered by section 482—and in some instances about foreign personal holding companies.

But I found no indication that there was any concern about the undistributed income of foreign subsidiary operating companies or any likelihood that other countries would impose taxes on their own companies similar to those proposed here.

Nor does there seem to be any political controversy or even thought to the contrary on this subject. In one place when I asked if there were arguments to the effect that foreign subsidiaries might lead to a loss of domestic employment the answer was: "No; it is recognized that we must have worldwide activities to support the cost of research and development to meet intense international competition. The ability to spread costs over the business of foreign subsidiaries helps assure continued domestic employment."

This reflects the same high degree of sophistication found in most of the European labor groups which support, instead of opposing, liberal depreciation as a basis for increased productivity, which in turn leads to higher standards of living and increased employment.

But though other countries will not follow our example in taxing their own corporations on the basis of undistributed income of their foreign operating subsidiaries, it seems very likely that they will be tempted to impose their own special taxes on the U.S.-owned subsidiaries located in their countries.

Does it not seem probable that on practical grounds if there is to be any extra tax on undistributed income of U.S.-owned subsidiaries, the countries where the subsidiaries are incorporated and where the earnings are located will want to exercise their primary right to tax them?

I was asked more than once in my recent trip, by Europeans, if I did not think that the countries where the subsidiaries were located would adopt their own laws to secure for themselves the revenue to be derived by new tax burdens imposed by the United States on undistributed income of foreign subsidiaries.

And, of course, I had to admit that I supposed they would.

The actions of many of our States in imposing soak-up estate taxes to absorb the credit allowed in the Federal estate tax is a perfect precedent. The adoption of anything like section 13 will invite foreign countries to impose their own new taxes and it seems likely that many of them will accept the invitation.

To the extent that foreign countries do impose their own soak-up taxes, any expected revenue to the U.S. Treasury will disappear. Increased taxes imposed by our Congress would end up in foreign treasuries, not in the U.S. Treasury.

Even more important, I believe, would be the acceptance of the idea that foreign countries could impose selective taxes on U.S.-owned businesses within their own borders. We would certainly protest as a nation if the action were taken at the initiative of the foreign countries; it seems a strange, even a fantastic, tax policy which would put other countries in a negligent position in protecting their own interests by failing to enact soak-up taxes on U.S.-owned subsidiaries.

One may presume, I think, that other countries will, in a variety of ways, take full advantage of the competitive disadvantage which the United States is about to impose on its own business. I respectfully urge that this action not be taken.

The bill before you, in section 13, goes only part way in accepting the administration proposal for taxation on the basis of all undistributed income of foreign subsidiaries, but the full proposal was urged again in the administration's statement before this committee.

The principal is bad, whether adopted in full or in part. Administratively the bill before you raises problems which are little short of appalling. An attempt to determine what part of a foreign operating subsidiary's income is attributable to the use of "patents, copyrights, and exclusive formulas and processes," would open the door to great differences of opinion and doubtless lead to extensive litigation. I shall not attempt to elaborate on this because others, more closely in touch with specific operations, can do so much better than I.

I have already indicated that, in spite of several desirable features in the present bill, all tax legislation might better go over to another year when it will be possible to develop a better balanced program. But if anything is to be done, now or later, regarding foreign subsidiaries, I urge that the legislation be confined to foreign holding companies.

Mr. Chairman, I have been very critical of this point and now I am going to try to be constructive.

Foreign subsidiary holding companies are frequently, though not exclusively, organized for tax advantages. They are not necessary and natural organizations in the conduct of foreign business, as are the foreign subsidiary operating companies.

To be sure some foreign holding companies have been established to secure better access to foreign capital markets, to provide a better basis for regional management, or to permit withdrawals of profits and reinvestment in the same country with advantages under the tax or currency control laws of some of the less-developed countries. None of these actions work to the disadvantage of our own tax revenues.

But in spite of these objectives, in general it appears that foreign subsidiary holding companies are formed primarily to secure advantages under the U.S. tax laws. They are generally unnatural taxhaven devices and as such they may be legitimate targets for new legislation.

In a sense they are analogous to the foreign personal holding companies which were the subject of special legislation some 30 years ago.

A law to impute to the parent corporation the undistributed income of foreign business holding companies would be relatively simple. It would get at any real tax abuses which exist. It would not violate generally accepted principles of taxation or be regarded by

other countries as an unjustified extension of our tax jurisdiction into their affairs in which we have no right to trespass. It would leave foreign operating subsidiaries free to meet their foreign competitors without a penalty tax imposed by the U.S. Government.

Specifically, U.S. parent corporations might have imputed to them the undistributed income received by foreign holding companies from third countries in the form of dividends, interest, royalties, and fees. This should apply only to amounts received from third countries; the use of a holding company to consolidate all the activities within a single foreign country is not a tax gimmick, since what is deductible to a subsidiary is taxable to the local parent, presumably at the same rate.

Senator KERR. I want to interrupt right there.

Would you regard a foreign company, for instance a foreign insurance company, whose business is to write reinsurance policies, an operating company in this country who either owned an interest in all of the foreign company and who received premiums from the domestic companies for the reinsurance provided by the foreign company in amounts that took all of the profit out of the domestic operation as a holding company or as a foreign subsidiary operating company?

Mr. SMITH. I didn't specifically cover that.

I would certainly regard it as a tax haven device that ought to be covered in legislation. I don't speak with reference to particular language in the bill because I don't pretend to know the insurance business well enough. But what you describe is an unnatural creation, not necessary to carry on the insurance business in the United States.

I regard that as a tax haven device. I am sorry I did not mention it but I would certainly include it among those things that needed to be covered.

Senator KERR. Of course, if they were insuring their own equipment abroad that would be a subsidiary operating an insurance business abroad.

Mr. SMITH. Well, if a——

Senator KERR. But if they were reinsuring risks insured in this country on a basis that siphoned off all of the profit on the business here, would you call that a foreign holding company?

Mr. SMITH. Well, I am afraid it wouldn't come within the technical definition of holding company, but it comes within the scope of activities that need to be covered by the restrictive legislation.

Senator KERR. A similar situation to the one you referred to as a holding company?

Mr. SMITH. Yes, if it is reinsuring of American business risks. If it were a business insuring risks abroad, then it would be an operating company there.

Senator KERR. Now, you say specific U.S. corporations might have imputed to them the undistributed income received from third countries in the form of dividends, royalties, and fees. This should apply only to amounts received from third countries. But it would seem to me that a situation such as I described or any other that might be similar to that would operate on the basis of leasing equipment which would have been purchased by the foreign company and owned by it and leased to either a parent company or a subsidiary operating

in this country would be producing amounts which would not be received in the third countries.

Mr. SMITH. Well, on the basis of your question, and I am delighted that it came, Senator, I would like to expand my statement here to add to my reference to the foreign holding companies, those distinctive and unusual activities—insurance is the only one that I know exists, where American profits, U.S. profits are in effect siphoned out and converted into foreign profits.

Senator KERR. There are other operations where an American company or American investors own a foreign company which owns equipment or property and leases it to those operating in this country on a basis where the rentals paid to the foreign country soak up or siphon off all of the profit of the local operation but which result in a very profitable income to the foreign-owned company.

Mr. SMITH. Which company is presumably in a tax haven country where there are negligible taxes.

Senator KERR. Where there are no taxes.

Mr. SMITH. That certainly ought to be legislated against.

Senator KERR. While I do not believe that technically they apply to either of those situations or such a situation—I wonder if your observations would not be equally applicable in principle to such illustrations.

Mr. SMITH. They would very definitely be equally applicable. But those, I submit, though important in particular areas, are relatively minor as compared to the total of American operating businesses abroad.

Those are the ones that I was pointing to.

Senator KERR. They might not be relatively minor with reference to the total amount of holding company operations abroad.

Mr. SMITH. That is correct.

Senator KERR. I think their relation to the total is increasing.

Mr. SMITH. Yes, I would say the two situations you have described is where the source of the income is in the United States and is being artificially being converted into——

Senator KERR. Siphoned off.

Mr. SMITH. An artificial creation of foreign income as compared to a business which has its plants abroad or its distribution activities abroad or is manufacturing or selling abroad there the income in whole or in part really arises abroad. That is the distinction that I should like to make.

Senator GORE. Would the Senator yield?

Senator KERR. Yes.

Senator GORE. It might not remain so minor either if the opportunity to avoid taxes is not removed by changing the law.

In other words, where a few may be doing it now, the example may be followed by a great many later.

Mr. SMITH. Senator Gore, just before you came in, I had indicated I was trying to make a constructive suggestion. I believe the law should be very drastically tightened in a variety of ways, but not so far as in the bill before you is the distinction I am trying to draw.

Senator GORE. Thank you, Mr. Chairman.

Senator KERR. Yes.

I wish you would make it a little plainer what you means there when you say this should apply only to amounts received from third countries.

Mr. SMITH. What I am referring to is a situation there if, just to pull a country out of the air as it were, an American company operating in West Germany, has two or three West German subsidiaries, and then sets up a German parent company that holds only the West German subsidiaries, that I would not regard as a tax gimmick holding company because as I tried to say here——

Senator KERR. I see.

Mr. SMITH. The deductions from the German operating subsidiaries would be income to the German parent subsidiary. It is where the holding company——

Senator KERR. Where the holding company in Germany that owned the German operating company also owned operating companies in other foreign countries.

Mr. SMITH. That is it.

Senator KERR. And from them received income in the form of rentals and dividends and so forth.

Mr. SMITH. Exactly so.

Senator KERR. All right.

Mr. SMITH. Where the holding company would typically be in a tax haven country.

Senator KERR. Yes.

Mr. SMITH. Thank you for letting me try to clarify that point.

Senator CARLSON. Dr. Smith, before you leave that is there any reason why we should not consider the Common Market countries as one unit in this discussion?

Mr. SMITH. I am hesitating because I don't know whether Switzerland is ever going to get into the Common Market. I know it is undiplomatic to mention a single country, but there are peculiar provisions in the Swiss laws that would not have the effect of having the deductions of an operating company fully taxable to the holding company.

Senator KERR. I would believe the principle you have enunciated would apply on an individual country basis although all of them were within the Common Market.

Mr. SMITH. Yes.

Senator KERR. In other words, a company in England which is a subsidiary of an American company that owned a subsidiary in England in the textile business, might even though England goes into the Common Market, own a textile mill in Germany and synthetic fiber operation in Italy, and chemical operation in France, and the English subsidiary of the American company which was an English holding company received not only the profits from its company that it owned in England in the textile business, but also dividends from its own companies in the other of the Common Market countries, and I think that would be just as much income received from third countries as though they were not within the Common Market.

Mr. SMITH. Yes.

But it certainly would and that was my intent. Senator Carlson raises an interesting question as to whether the Common Market

countries are sufficiently uniform in their approach and tax level so that might be considered as a unit.

Perhaps, sometime it would, Senator Carlson.

I would think for the moment the safer thing might be to take a fairly strict and literal rule and confine or put on the tax penalty.

Senator KERR. Apply the rule where the income is received from the third country?

Mr. SMITH. I think that would probably be safer for the time being.

Senator CARLSON. Isn't it the intention, however, of the Common Market country to eventually drop out the tariff walls?

Mr. SMITH. They are that. They are doing that. They also are having some very useful discussions on trying to get substantial uniformity in their domestic tax laws.

If they had uniformity in their domestic tax laws then it might be reasonable to lump them together for our considerations. But that time is perhaps a few years in the future.

To avoid unnecessary complications, foreign subsidiaries should be classified as holding companies only if some specified fraction of their income constitutes holding company income. This is, of course, the way domestic and foreign personal holding companies are treated; it would avoid complications for foreign operating subsidiaries which have a small amount of holding company income.

It seems unreasonable, and against our own interests to try to impute to the U.S. parent corporations income arising from international sales made through an intermediate corporation when the United States is not involved in either production or sale, as attempted by section 13(e)(2) of the bill.

If other countries are willing to let income from international sales be transferred to third countries, that is if they are not concerned about the sort of problem which we cover under section 482, it should not be any concern of ours.

Senator GORE. Mr. Chairman, may I ask a question there?

Mr. SMITH. Yes.

Senator GORE. It seems to me you are applying an unusual test, a geographic test. The test is citizenship. The test is the advisability of the United States, in equity and fairness, requiring all of its citizens, corporation entities or individuals, to pay taxes on their income.

Mr. SMITH. Well, this matter of definition——

Senator GORE. So you are really drawing a distinction between whether the income is earned in the United States or earned abroad. I don't quite get your reasoning.

Mr. SMITH. Senator, I think the distinction I am trying to make is the one you stated of citizenship and as I see it the foreign corporations are not citizens of the United States in any sense.

Senator GORE. But the foreign corporation is an incident of ownership of a corporation that is domiciled here.

Mr. SMITH. If it is domiciled here then, of course, it should be taxed and it will be taxed here. I am referring here to, let's say, a subsidiary in a third country by choice.

Senator GORE. But it all comes back to the parent corporation.

Mr. SMITH. Eventually it will come back to the parent corporation.

Senator GORE. I mean the ownership traces back.

Mr. SMITH. The ownership traces back. But no other country and this country never has——

Senator GORE. I don't know that that adds anything to it.

Mr. SMITH. My feeling is when we go off on a completely new departure we ought to think very carefully.

Senator GORE. What is wrong with a new departure?

Mr. SMITH. If it is a good departure there is nothing wrong with it.

Senator GORE. We departed from one just a few days ago.

Mr. SMITH. I am sorry. I am not aware of the allusion. I suppose we have been departing from a good many things.

Senator GORE. An instrumentality was placed on the moon yesterday, I believe.

Mr. SMITH. I am sorry, I was slow.

Senator KERR. That was an arrival, not a departure. [Laughter.]

Senator GORE. I said we departed a few days ago.

Senator KERR. And I don't think it will depart.

Senator GORE. Excuse me for interrupting, Mr. Chairman. I don't believe you can justify that stand, Mr. Smith.

Mr. SMITH. Well, I am not abashed to assert it in any sense at all and I should like to, if I may, Senator, refer to the fact that as I see it the American companies operating abroad, I said this earlier, are primarily in competition with other companies operating abroad, and if the other industrial countries do not try to tax their—to extend their tax net in this very unusual and, in my opinion, strained way, we are going to put the American companies competing for their share of the world's markets under a very serious tax disadvantage.

Senator GORE. Well, it is a strange position for you to take, with the experience you have had, and the service you have rendered.

Mr. SMITH. I do not consider it the least bit strange.

Senator GORE. Well, I do.

Income taxation does not impair the ability to compete; it seeks only to levy a tax on the profits earned in successful competition.

Mr. SMITH. Taxes, to an appreciable extent, are an element of cost, even income taxes.

Senator GORE. You do not have income taxes unless you make a profit, do you?

Mr. SMITH. Yes.

Senator GORE. And unless you compete successfully, you would not make a profit, would you?

Mr. SMITH. But you cannot compete unless you make a normal return. And if your taxes are higher than the other fellow's taxes, you have to be more efficient or charge higher prices in order to get the same return that he gets.

Senator GORE. Then are you arriving at the conclusion that we ought not to tax our citizens on the income they earn abroad because some other country does not do so?

Mr. SMITH. I think there is a real question as to whether it is sound national policy for us to impose higher taxes on American firms competing abroad than other countries do.

Senator GORE. Then I say that is a strange position for you to take.

Mr. SMITH. I cannot quarrel with your subjective judgment but I assure you I am not the least bit abashed.

Senator GORE. I would not want you to be, sir.

Mr. SMITH. Might I, on this very point, Senator, note that the effect of these sales companies abroad works out in this way:

To the extent that total foreign taxes can be reduced, there will be that much more net income to be repatriated to the United States and that much less foreign tax to be applied to our own net incomes.

Both our balance of payments and revenue will benefit.

Senator GORE. You are taking such a strange position this morning that I am delighted that you are in private life.

Mr. SMITH. I missed the last words.

Senator GORE. I say you are taking such strained and strange positions this morning that I am pleased you are in private life.

Senator KERR. Do you regard being a Harvard professor as being in private life?

Senator GORE. Yes. Yes.

Senator KERR. As I understand your position, Doctor, it is this:

An American company owns a subsidiary, we will say in Germany, engaged in the manufacture of chemicals which, if sold, must be sold either in Germany or in countries to which it has access from its manufacturing facility in Germany.

At the same time, there is a German company engaged in a similar operation and a competing operation.

That German company owes certain taxes or taxes at a certain rate to the German Government, as does the American-owned subsidiary.

Let us say they are both paying 45 percent, or let us say they are both paying 50 percent of their net taxable income in taxes to the German Government, which leaves them the remainder as a part of their corporate fund or working capital with which they can either pay dividends, accumulate reserves, or expand their operation either in volume or by improving the quality of their operation through the installation of materials and equipment more efficiently.

Now, up to that point, they are on an equal and a competitive basis of equality insofar as their tax liabilities are concerned.

Now, under the present law, when that American-owned subsidiary declared a dividend, it comes back to this country; it is taxable either to the corporate owner or to an individual stockholder.

Over there, I presume that when the German company declares a dividend to a local corporate or personal identity, it is taxable by the German Government.

If, however, that German company is not taxable on its earnings retained after it pays its corporate tax until they are distributed, what you are saying is that it would have a very distinct competitive advantage over this American-owned subsidiary in the event that we now pass a law which would make the retained earnings of that American subsidiary taxable to the American corporate or individual owner as they are earned, but before they are distributed?

Mr. SMITH. That is exactly my point, Senator.

Senator KERR. Because, in the first place, if not distributed to the owner in this country, at that time they could be lost in the following year and not available for distribution.

In the second place, not having been received by the corporate owner or individual owner here, he would owe tax on income which he had not received and might never receive.

Yet if, as an owner here and controller here, he was compelled to pay taxes on that income as it was earned and retained after having paid the German tax, that would compel him to siphon it back here in order to have the money with which to pay the taxes here and thereby leave the subsidiary there in a disadvantageous position from the standpoint of being able to improve its machinery, modernize it or expand it to compete with the German-owned-and-operated company that would be doing just that with its retained earnings.

Mr. SMITH. Exactly that.

Perhaps, adding one additional point, that the company might not even bring back the profits to pay the taxes. They might pay the taxes out of domestic earnings and have that much less available for domestic expansion.

Senator KERR. Here?

Mr. SMITH. Yes.

Senator GORE. Or might sell stock and raise some more money?

Mr. SMITH. But if the returns are not competitive——

Senator KERR. It would not have a very good market for its stock?

Mr. SMITH. It would have difficulty in selling stock.

Senator KERR. If it had to sell stock to pay taxes on earnings it had not received, it might not find a very responsive market for the sale of stock.

Mr. SMITH. Exactly that, and, to use Senator Gore's phrase, I find the idea of extending our tax jurisdiction in this way so strange and strained that if I were still here, I would have at my initiative returned to private life, rather than participate in the proposal. [Laughter.]

Senator GORE. You took a little time to come back on that one. [Laughter.]

Mr. SMITH. Senator——

Senator GORE. While Senator Kerr was talking, you cooked that one up.

Mr. SMITH. With you, Senator, I need time.

Senator GORE. It was good. [Laughter.]

I have had experience a number of times of thinking, the day after, what I should have said.

Mr. SMITH. I welcomed Senator Kerr's question. [Laughter.]

Senator KERR. All right.

Mr. SMITH. Two months ago I was satisfied that taxation——

Senator GORE. Incidentally, I would like to withdraw that remark.

Mr. SMITH. All right, I withdraw mine, sir.

Senator GORE. Let us leave it in the record. I think it would be good.

Senator KERR. You mean you would leave it in the record, but you withdraw it?

Senator GORE. Yes.

Senator KERR. I think the Senator from Tennessee is a little strange this morning. [Laughter.]

A withdrawal without deletion is like selling stock with which to pay dividends. [Laughter.]

Mr. SMITH. Two months ago——

Senator GORE. That is also a little like borrowing money to pay your taxes. I have had to do that every year since I have been in Congress.

Senator KERR. No comparison. No comparison. I do that every year, but it is in order that I might have the money without selling investments which are productive and which will produce more than enough to enable me to repay that borrowing that I make to pay current taxes, and that is the reason, I am sure, the Senator from Tennessee does it.

But if I had to sell more stock to get the money with which to pay the taxes of a corporation in the first place, I would not know where to sell it, because the SEC would compel you to disclose that fact.

And that would be a great deterrent on the sophisticated American investing public as they looked at it and saw the purpose for which the stock was being sold.

I want to tell you right now, I remember a very famous remark made here before this committee which the Senator from Tennessee took up and had a lot of fun with, and I enjoyed it, and that was when a certain distinguished representative of the previous administration said that would be like trying to sell woolen underwear in August.

Senator GORE. I remember it, but I think you are overlooking in this analogy the fact that the parent company has a very profitable asset in its foreign subsidiary.

Whether it sells stock or borrows money at the bank, the analogy, I think, is very similar to the one that the Senator stated from his own experience.

It does not seem to me to follow at all that we should not require the payment of taxes on profits earned abroad merely because the earnings have not been returned to the United States.

Senator KERR. We do not even do that here, do we?

Senator GORE. They are accumulated assets.

Senator KERR. We do not even do that here.

Senator GORE. I recognize——

Senator KERR. We do not require a stockholder here to pay taxes on the earnings of the company in which he owns stock until he gets his dividends.

Senator GORE. I recognize that.

Senator DOUGLAS. Mr. Chairman, may I make an irregular request?

Senator KERR. That would be par for the course. Certainly. [Laughter.]

Senator DOUGLAS. I shall have to leave shortly before 11:15, and I wondered if I might ask the witness a question dealing with the taxation of individual incomes and earnings.

Senator KERR. Yes.

Senator DOUGLAS. Thank you.

Mr. Smith, as I understand it, an American citizen living abroad, when he declares himself to be a bona fide resident of a foreign country and has in the past lived there for a certain amount of time, he is completely exempted from taxation of his income in the United States?

Mr. SMITH. There is—it takes a little bit more than a declaration, but if he establishes he is a resident abroad, yes, sir.

Senator DOUGLAS. And, in general, a declaration is sufficient?

Mr. SMITH. Well, the facts have to support the declaration, I believe. It can be arranged easily. I am not quarreling about your conclusion at all.

Senator DOUGLAS. Would you look at exhibit 3, which exhibit Secretary Dillon presented when he testified?

Mr. SMITH. And I do not recall it at all by number.

Senator DOUGLAS. It is on page 222.

Mr. SMITH. Yes, I do remember it.

Senator DOUGLAS. I would invite your attention to page C-33 and C-34. Let us start with C-34.

Mr. SMITH. Yes.

Senator DOUGLAS. Here is an actor who declares himself to be a bona fide resident of Switzerland in the year 1960. He has an income of $1,099,791, upon which no American tax is paid.

In the line above is another individual, also living in Switzerland, declaring herself to be with an occupation of housewife, who also has an excluded income of $1,099,791, identical down to the last dollar.

The presumption is, therefore, I would think that several million times to one, that this is husband and wife with a combined income of approximately $2,200,000.

We are trying to find the rate of taxation of individual incomes in Switzerland. I know you have given some study to this, and before we get the information from the Treasury, could you tell us roughly from your memory what the rate of taxation is in Switzerland and whether such an income would be taxable in Switzerland?

Mr. SMITH. I wish I could, Senator.

All I would be confident in saying is it would be substantially lower than ours and it would vary with the particular canton where they would be living.

Senator DOUGLAS. Mr. Woodworth, have you been able to get it?

Mr. WOODWORTH. Not as yet.

(The information regarding Switzerland individual income taxes, as subsequently furnished by Mr. Woodworth, follows:)

Switzerland individual income taxes

1. Federal income tax:

Income		Rate (percentage)	Remarks
Francs	Dollars		
7,500	1,732	0.13	Graduating to rate below.
85,000	19,640	12.0	Do.
120,000	27,720	8.0	

2. Federal tax of 0.05 to 0.35 percent of the value of an individual's total estate, including real and personal property, is imposed on property located in Switzerland.

3. Canton income tax: For example, Zurich: 1 percent up to 1,000 francs ($231) graduating to 7½ percent over 90,000 francs ($20,790).

4. Apparently, a person in Zurich will pay roughly a 20-percent tax on a $20,000 salary, plus a property tax.

Source: U.S. Treasury.

Senator DOUGLAS. I would like to call attention to other Swiss cases, if I may, because I think this is a very real situation.

Here is another actor in the year 1959, and he had excluded income of $156,000.

Here is a producer-director who also declared himself a resident of Switzerland, and who in 1959 had an excluded income of $160,000; and, in 1960, $172,142.

Here is an actor who declared himself a total resident of Switzerland who in 1960 had excluded income of $108,336.

Now, lest it be thought that I am picking on the profession of the movies and of the stage exclusively, here is an executive—this is case C-13-J, 1959, who had income excluded of $117,556; 1960, $179,912; and numerous other cases with which I will not burden the record, but which look much alike to me.

Do you not think that the law should be tightened?

Mr. SMITH. I do, sir, very definitely.

Senator DOUGLAS. You do?

Mr. SMITH. Yes.

Before you came in, Senator, I believe I indicated in the foreign area several things should be done, the foreign investment companies, the foreign real estate, the foreign trusts.

Senator KERR. Foreign holding companies.

Mr. SMITH. Foreign holding companies.

Senator DOUGLAS. Would you favor the provision in the projected bill that only a $20,000 credit be allowed for income earned abroad?

Mr. SMITH. I think so.

I do it with some regret. May I take just a moment to describe the balance of judgment as I see it here?

For those American citizens who are bona fide residents, salaried people with relatively small or medium-sized incomes working abroad, in high tax jurisdictions, there is a lot of annoyance, they are resentful; I have talked with them abroad; they consider it harassment to file returns and pay a tax.

But I have reached the position, Senator, the abuses are great, and I will describe them in a profession you and I were both involved in, the academic world. In fact, I have been involved in rescheduling courses in university faculties when professors went abroad a year and began to look at this 17 out of 18 months and decided they had better do some research, and somebody else had to pick up their courses, so I think the law needs tightening.

Senator DOUGLAS. I do not think there are many professors over $20,000 a year, but then I have never taught at Harvard. [Laughter.]

Mr. SMITH. Nor with us, sir. But the 17 out of 18 months, you see, applies without limitation, or did. And, as a matter of fact, if I may go all the way back to 1953, the first recommendation of the previous administration on tightening was to wipe out completely the exemption of the 17 out of 18 months.

Senator DOUGLAS. What did you do on the bona fide residents?

Mr. SMITH. I would cut it way back.

Senator DOUGLAS. Did the previous administration advocate cutting it way back?

Mr. SMITH. No. What we did first was to put in the information return.

Senator DOUGLAS. I am very glad to give you the credit for all the virtue you have, but I do not want to give you an extra bonus on what you do not have.

Mr. SMITH. It was out of order for me to make that point.

The other thing was the information return required in 1958, was the basis for this information, I believe. I think the law should be tightened in this respect.

Senator DOUGLAS. Mr. Smith, there seems to be an affinity of these gentlemen for certain countries—Brazil, Venezuela.

Mr. SMITH. I do not know why Monaco does not show up here, unless it is harder to get in there, or Liechtenstein.

Senator DOUGLAS. South Vietnam—that is an extraordinary one. Here is a man, a taxpayer, occupation unknown, who had an excluded income in 1960 of $110,687.

Here is an interesting one: Dominican Republic, 1959, $159,059 excluded.

Then here is another interesting one: Lebanon, 1959, excluded income, $151,167.

So you favor tightening it?

Mr. SMITH. I favor tightening it.

Senator DOUGLAS. You think the provision in the bill is probably correct at $20,000?

Mr. SMITH. I might go further, Senator. I would look at this matter of the 17 out of 18 months.

If I may give an incident: At a cocktail party here in Washington some years ago, a society correspondent, when I was identified with my former activity at the Treasury, once backed me into a corner and said: "I understand so-and-so"—a columnist who is familiar to all of us——

Senator GORE. Male or female?

Mr. SMITH. Male.

"I understand he is now traveling abroad. He is doing the same syndicate. He is getting the same fees, but he is a foreign correspondent now, and he is getting tax exemption on part of his income, and is that true or not?"

And I said: "I have no idea, and if I did, I, of course, could not say, but it might be true." The law should be tightened.

Senator DOUGLAS. Would you prepare a memorandum on how you think the law should be tightened on the 17 out of 18 months, sir?

Mr. SMITH. I have not looked into that in any detail here. Maybe it is adequately done in this bill, but I think that is an area that also needs attention.

Senator DOUGLAS. Subject to correction, I think what the bill does is to extend to so-called bona fide residents the same provisions which exist in connection with 17 out of 18 months.

Is that correct, Mr. Woodworth?

Mr. WOODWORTH. There is a $20,000 limit under the 17 out of 18 months' rule at the present time. What the bill does is to extend that same $20,000 limit to taxpayers qualifying as bona fide residents during the first 3 years they are abroad; thereafter, the limit is to be $35,000 under the bona fide resident rule.

Senator DOUGLAS. So a person—could a person, by shifting from country to country, have successive exemptions?

Mr. WOODWORTH. Yes, but only one per year.

Senator KERR. They would not be cumulative?

Mr. WOODWORTH. No, they would not be accumulative; there would be only one each year.

Senator KERR. If he did shift from country to country, he would be the loser, because after 3 years he would have $35,000.

And if he was going to stay abroad for that period of time, I would presume he would want to do so in such a manner as to receive the benefit of the $35,000 instead of the $20,000.

Mr. SMITH. The 17 out of 18 months works in such a way if they keep moving, do not stay long enough in a jurisdiction to become subject to the tax there, they fall between all jurisdictions.

Senator DOUGLAS. Now, Mr. Smith, my curiosity is excited in the case of the so-called Greek shipping magnate, Onassis.

Mr. SMITH. Yes.

Senator DOUGLAS. I was in Athens a few years ago and one of these gentlemen came into harbor in his yacht but did not land.

Would it endanger the friendly relations between ourselves and the people of Greece by asking this question: Is it true these gentlemen evade Greek taxation by the fact they do not come back to Greece?

Mr. SMITH. I have no idea as to what the Greek rules may be.

Senator DOUGLAS. You do not know the Greek rules?

Mr. SMITH. I do not know the Greek rules. I do recall there was a newspaper story some years ago about a very prominent English actor crossing on one of the *Queens*, and the interesting item was whether the boat would go into Southhampton before it went to Cherbourg; typically, it went to Cherbourg, where he got off.

If the weather was bad, it would go to Southhampton, which would subject him to United Kingdom taxes, so there was a standby tug to take him off if the weather was bad. That was the newspaper story.

Senator DOUGLAS. Is it not true the English have a number of "tax havens" such as the Channel Island and the Bahamas?

Mr. SMITH. The British are remarkably generous with their own citizens—subjects, they call them—because British subjects living outside of the United Kingdom are not subject to United Kingdom tax.

Senator DOUGLAS. Is he subject to taxation here in this country?

Mr. SMITH. Of course, if he is a resident here.

Senator DOUGLAS. Even though a British citizen?

Mr. SMITH. Surely.

If he is a resident here, he is taxable on all his income, Senator.

Senator DOUGLAS. But if they lived in an independent sovereignty?

Mr. SMITH. Or even in the British colonies.

Senator DOUGLAS. Yes.

Which does not have an income tax, then they are not subject to tax?

Mr. SMITH. Our rule is——

Senator DOUGLAS. Is it not true the Channel Islands have a degree of independent sovereignty and, therefore, if you live in the Channel Islands, you have sanctuary?

Mr. SMITH. I have heard something vaguely about that, but I don't know. I know it applies to Bermuda and the Bahamas; that is, British subjects living there; it has nothing to do with us.

Senator DOUGLAS. And an American who has declared himself to be a bona fide resident of the Bahamas would be exempt from American taxes?

Mr. SMITH. Only on his earned income.

Senator DOUGLAS. Yes, I understand.

Mr. SMITH. Only on his earned income, and one of the problems, of course, is to police the determination when is it earned income and when is it investment income.

If he has a personal corporation and he is the president, he retains a salary.

Senator DOUGLAS. I am somewhat surprised that within this list here there is no one listed as a resident in Monaco. I had always thought this was——

Senator GORE. I do not think the list is inclusive at all.

Senator DOUGLAS. I wonder if we could ask the Treasury to go into the question of Monaco.

Senator KERR. You mean the tax question in Monaco?

Senator DOUGLAS. Yes, the tax question.

I am not going to ask them to go into the relationship of the problem of Monaco and France and the problems of the Prince and Princess of Monaco.

Senator KERR. Is the Treasury here? Would you note the question of the Senator and provide the answer.

(According to the information supplied the Treasury Department by the French Embassy, there are no direct taxes in Monaco. The principality derives the major portion of its revenue from sales taxes and the operation of the gambling casinos.)

Senator DOUGLAS. I wondered if you would also be willing to provide us with a schedule of the income taxes in these various countries.

Do I understand that——

Senator GORE. I would like the same with respect to the Bahamas.

Senator DOUGLAS. Yes, if I may itemize.

(The information regarding individual income taxes in the Bahamas as subsequently furnished by the staff follows:)

The Treasury Department states that the Bahamas have no income taxes.

Senator DOUGLAS. Very good.

Does the same provision apply in the case of individual income, as in the case of corporate income, namely that taxes paid in the country of residence where earned are credited against the tax in this country?

Mr. SMITH. Oh, yes, sir.

So if the foreign tax is as high as our tax, there is no net U.S. tax.

Senator DOUGLAS. So there would be really no net gain of a person living in the United Kingdom, which I am told has a higher income tax?

Mr. SMITH. Except at the very, very top it is a little lower than ours, but, in substance, that is correct.

Senator DOUGLAS. What is the "very top"?

Here is a man living in the United Kingdom who has an income of around $100,000 a year.

Mr. SMITH. Well, the United Kingdom tax would be higher on that income. I think it stops somewhat short of 91 percent is all I recall.

Senator DOUGLAS. So that really people resident in the United Kingdom cannot be accused of being tax-dodgers?

Mr. SMITH. Not under the general operation of the law, Senator.

Senator DOUGLAS. American taxpayers.

But you think the burden is pretty heavy on those residents of Switzerland, Venzuela, Brazil, and Lebanon and the Bahamas?

Mr. SMITH. I do not pretend to know the rates of all the countries you have mentioned, but I would think so.

Senator DOUGLAS. Let me ask you this:

Are the Channel Islands regarded as part of the United Kingdom?

Mr. SMITH. I do not know, Senator.

Senator DOUGLAS. It may be that some people are residents of the Channel Islands.

Can you tell me if the residents of the Island of Man are excluded from the British——

Mr. SMITH. I am not informed.

Senator DOUGLAS. I wonder if the Treasury would look up the status of the Island of Man and also of the Channel Islands. I have a feeling they are part of the United Kingdom, but not subject to the tax laws of Great Britain.

I thank the chairman.

(The following was later received for the record:)

INFORMATION RECEIVED RELATIVE TO TAXES IN THE CHANNEL ISLANDS AND THE ISLE OF MAN

The public revenue of the Channel Islands is raised by import duties on drink, tobacco, and petrol (these are light compared with mainland rates), by income tax and by other taxes imposed by the State with the permission of the Crown, e.g., harbor dues. The standard rate of income tax is 4 shillings 0 pence in the pound; no surtax is payable and no death duties are levied in the Channel Islands. Local rates are payable, on a relatively moderate scale, by owners and occupiers of property. No purchase tax is payable on goods purchased in the shops.

Something like two-thirds of the Isle of Man's annual revenue is derived from the customs duties. The rate of income tax is 4 shillings 0 pence in the pound for taxable incomes over £250 per annum and 4 shillings 6 pence in the pound for taxable incomes over £750 per annum, and surtax is at present levied on incomes over £2,000 per annum. There are no death duties. Local rates are payable. A purchase tax is imposed which in all essential respects is similar to that imposed in the United Kingdom.

Source: Prepared by the Treasury Department from British Information Service Pamphlet I.D. 1378, dated March 1961.

Senator KERR. Fine, Senator.

All right, Doctor.

Mr. SMITH. I have one more page.

Two months ago I was satisfied that taxation on the basis of undistributed income of foreign holding companies could be adopted to protect the revenue and without penalizing legitimate business abroad. One of the purposes of my recent trip was to secure what information I could on the use of holding companies by large European business concerns. If they are extensively used by large European international companies then, though justified in principle, restrictive legislation here might not be in our own national interest unless other countries were to adopt similar measures.

Observations abroad led to two conclusions. First, the use of foreign business holding companies by European companies is less extensive than their use by U.S. corporations. This suggests that legislation could be adopted here without imposing serious competitive burdens on U.S. business abroad. But the second conclusion was that the failure to use foreign holding companies is to a considerable extent

due to the fact that laws in some countries are so liberal in the taxation of foreign business income that a foreign holding company gives little additional advantage.

For instance, in the Netherlands income being brought in from a Netherlands-owned subsidiary abroad is not subject to Netherlands tax, if it has paid no income tax abroad, even though the rate is only 1 percent.

We need a more thorough analysis of the nature and extent of comparative tax burdens on international business before we can be sure that legislation would not significantly handicap our participation in the expanding world economy, with long-run adverse effects on our employment, trade, and balance of payments.

Senator KERR. Right there, Doctor, if our purpose is to accomplish a number of objectives among which we give very considerable significance to that of improving our balance-of-payments position and of improving the position of an American company operating abroad with reference to its competition with other enterprises in other countries. Might it not be wise to give consideration to making it easier rather than more difficult to bring back into this country the earnings achieved abroad?

Mr. SMITH. I think it might. I think very definitely it might.

Senator KERR. That certainly would have a significant effect on our balance-of-payments situation, could it not?

Mr. SMITH. It certainly could.

Senator KERR. It would seem to me that it would have considerable significance in our objective to make it possible for American-owned foreign companies to successfully compete in the world market.

Mr. SMITH. I think it could have great significance. And, if I might interject here, I would just like to describe an incident that occurred after I prepared this statement the first of the week.

On Wednesday of this week I was asked to have lunch with the investment officers and some of the trustees of one of the very large regulated investment companies. I meet with them once in a while; I know them all; I did not know what the purpose was.

What they wanted to talk about was the effect of this legislation on the growth prospects of American companies in which they had large investments or were considering making investments. That was the first part of the conversation.

The second part was to consider direct investments in European companies if this legislation were adopted, this legislation having presumably——

Senator KERR. You mean investments of American funds in foreign corporations?

Mr. SMITH. I mean in foreign-owned corporations.

Senator KERR. Which would mean the sending of American dollars abroad to buy stock in foreign companies?

Mr. SMITH. That was what impressed me about it.

Senator KERR. I say that is what he was talking about.

Mr. SMITH. That is exactly what he was talking about, what they were talking about.

Senator KERR. And that certainly would have a direct—and to the extent it was carried out—significant effect on our balance of payments adversely.

Mr. SMITH. A very significant adverse effect on the balance of payments, and it would mean that the American market would not have the benefit of the exports that are tied in with the operations of American subsidiaries abroad.

There would be no export of machinery and equipment to the foreign corporations in which Americans owned stock. There would be no export of component parts for those operations.

All that would come back would be the dividends.

I was much impressed with the seriousness of this.

Senator KERR. So that if our real purpose is to improve the competitive position of American industry abroad, and to create an environment in which the earnings achieved abroad would be more likely to quickly find their way back here, which would benefit our balance-of-payments situation, the way to do it would be reduce the difficulties, rather than to increase either, or both?

Mr. SMITH. Exactly so, sir, and that leads exactly to my next paragraph.

Senator KERR. Proceed.

Mr. SMITH. In which I state, as follows——

Senator GORE. Before proceeding, you do not contend that the Government of the United States would be helpless to protect the public interest in such an operation?

Mr. SMITH. You mean on portfolio investment?

Senator GORE. Yes.

Mr. SMITH. I submit the Government of the United States would not be powerless, but if the Government of the United States acts, we are off the gold standard, sir.

If we have currency controls to the point of denying the right of citizens to buy foreign securities, we have left it.

Senator KERR. You have eliminated the actuality or myth, whichever one is the case, of redeeming our foreign dollars upon demand with gold?

Mr. SMITH. Yes, sir.

And, sir, I further submit, if that were done, then the foreign banks and foreign inevstors would really have reason for concern about their present holdings of dollars.

If we are in such a desperate situation that we would have to limit the convertibility of dollars of our own citizens, the implications, I think, are frankly appalling.

Senator GORE. You picture this as such a desperate situation here. Great Britain has been an international banker a long time, has it not?

Mr. SMITH. With much less success since 1932. Only within the sterling bloc, and they got back to convertibility a few years ago.

Senator GORE. There are other reasons for the relative decline of the British Empire.

Mr. SMITH. Of course, sir.

Senator GORE. Is it not a fact that Great Britain has effected a system of licensing of capital exports?

Mr. SMITH. They have, sir, and that is the reason that Britain—that means the British pound is not a freely convertible currency, and that has had very serious repercussions.

Senator GORE. This, of course, is a subject in and of itself.

Mr. SMITH. I am trespassing, I know.

Senator GORE. I do not wish to probe for the moment, but I did not want you to pass on as if the United States, the Government, would be utterly helpless to exercise some control over the export of capital.

Mr. SMITH. I am sure the Government has the power.

Senator GORE. You realize that the Government does exercise some licensing power over the export of goods?

Mr. SMITH. With reference to defense purposes only, I believe, sir.

Senator GORE. Well, for whatever purpose, such licensing power is exercised?

Mr. SMITH. Yes.

Senator GORE. You are aware that it exercises control over the departure even of a person; but when it comes to money, there seems to be something sacrosanct; than there must be no export control.

Mr. SMITH. I hope, for the sake of the future of the dollar, it continues to be sacrosanct.

Senator GORE. I knew that was your view, but I did not want you to pass on without your recognizing it.

Senator KERR. Let me get back into this.

The Senator asked you if it was not a fact that England for a long time had been the international banker of the world. Was that your question?

Senator GORE. I did not say "for the world," but I used the phrase "international banker."

Senator KERR. As a matter of fact, outside of the United Kingdom, has it not been a long time since England was an international banker?

Mr. SMITH. That is what I tried to say, since the early 1930's they were only for the sterling bloc.

Senator KERR. That is a considerable part of the world.

Mr. SMITH. They were stuck with England when it went off.

Senator KERR. For all practical purposes, if there is an international banker in the world today, it is this country?

Mr. SMITH. Yes, sir; and, depending upon free convertibility——

Senator KERR. That became a fact, regardless of what other reasons might have played a part, solely on the premise of unrestricted convertibility?

Mr. SMITH. The very essence of free banking.

Senator KERR. And the fact about the business is that not only is the maintenance of convertibility an absolute necessity for our continuing to be such, but the assurance of the continuance is just as necessary for our being able to continue as such to an equal degree that assurance of availability of deposits is necessary for the continued operation of the private banks?

Mr. SMITH. Certainly so, sir.

Senator KERR. I did not regard the balance of payments as being an unrelated matter in this discussion. So far as I am concerned, it is the most important matter in this discussion. You say you are about to address yourself to that matter. I think therein you may make your most valuable contribution to this discussion, because I think it is a problem of such compelling importance that its solution is one of the primary necessities for our being able to maintain our position of leadership in the free world.

If we do not have the confidence of our allies and of, for that matter, the respect and confidence of our enemies, our position as the leader of the free world will not only be jeopardized, but gravely endangered.

Since we have put ourselves out as being the No. 1 world international banker, or having ourselves maneuvered into the position, whichever is the cause of it, the reality is evident and of definite existence. Since we are in that state, if we are to continue our position of world leadership, we have to do so on a basis that will let us protect this dollar and its convertibility. The means whereby we may better do that in the changing environment of the world, in my judgment, is one of the most important problems confronting our Government and, for that matter, this committee. It has a very significant relationship to this legislation.

Mr. SMITH. I had not realized how significant it was until this recent luncheon meeting that I have described. It brought home to me in a way that I had not in abstract theory appreciated.

What is proposed here, purporting to help the balance of payments temporarily, might well have the effect of giving an immediate adverse effect.

Senator KERR. Of being disastrous?

Mr. SMITH. Yes.

Senator KERR. Proceed.

Senator GORE. Mr. Chairman, before proceeding to what I believe will be a significant contribution by Dr. Smith. I would like to observe that it appears to me that in this colloquy, Professor, you have considered convertibility of dollar holdings and portfolio foreign investments as synonomous, is that true?

Mr. SMITH. Well, only insofar as I picked up your phrase about the power of the Government to restrict foreign investment. I know of no way in which the power to restrict foreign portfolio of investment could be exercised without restricting the convertibility of the dollar.

Senator GORE. But you do recognize, then, they are different problems—convertibility of dollar holdings, and portfolio foreign investments or direct foreign investments? They are three different things?

Mr. SMITH. Sir, I do not see how they can be disassociated.

Senator GORE. I did not say "disassociated," but you seem to be treating them as synonomous problems.

Mr. SMITH. Well, I wish I was a phrasemaker, simultanials or corollary events, something of that kind.

Senator GORE. All right.

Mr. SMITH. As one looks further ahead—here I am picking up the possible modification of the law to make it easier to bring dollars——

Senator KERR. Provide greater incentive?

Mr. SMITH. Provide greater incentive.

Senator KERR. All right.

Mr. SMITH. As one looks further ahead, it may be that our traditional use of credits for foreign taxes to prevent double taxation of international income will turn out to be inadequate. For the past 40 years, efforts have been made to prevent tax penalties on international income.

This goes all the way back to the League of Nations after World War I.

It has been thought that this could be accomplished by giving a credit in the country to which the income went for the income taxes paid in the country where the income was earned. In this way, the combined tax, however divided between the countries, would be equal to but not exceed the tax in whichever country had the higher rates. This method was satisfactory when tax structures were substantially similar, though it produced an unfortunate effect in inducing countries where income was earned to raise their tax rates to the level existing in the countries to which income was paid.

Parenthetically, it should be noted that the foreign tax credit is necessary to avoid prohibitive penalties against international income, so long as more than one country taxes international income. The specific formula in section 6, which would be likely to impute to the United States a greater share of income than would be recognized by general international standards of allocation, is disturbing because it would weaken the credit system. Yes, sir, I am a little bit fearful of this particular formula. But that is a minor point.

The proposal to segregate credits by categories of incomes is also questionable on the same grounds, though the problem it is designed to deal with is a real one. But it is encouraging that Secretary Dillon recommends repeal of section 21 to maintain the integrity of our very important tax treaty program.

The variation among national tax systems has already been indicated. I am referring there to the fact some place great reliance on indirect and great reliance on direct. We place great reliance on income and minor reliance on indirect.

Many countries place much greater reliance on indirect taxes on business than we do, and we do not give credit against our income tax for high foreign indirect taxes, nor do they give credit against their indirect taxes for our high income taxes. The result is that a combination of high income taxation in one place and high indirect taxation in another will give a greater total tax burden on international income than the tax burden in either of the two countries alone. Tax penalties arising in this way are not consistent with other policies designed to reduce barriers to international trade and investment.

It has been argued that as a matter of principle, a country has no right to tax income coming into it from foreign sources. That was often argued with me when I was down here in another capacity, and I never accepted it as a matter of principle. I said, of course, we have the right to tax income of our citizens including our corporations.

Senator GORE. Good. I misunderstood you.

Mr. SMITH. But not the corporations that are foreign corporations until it comes here.

Senator GORE. You mean not the subsidiaries?

Mr. SMITH. I would not trace——

Senator GORE. Not a subsidiary of a foreign subsidiary?

Mr. SMITH. I would not trace that far, sir. I would confine it to American citizens, corporate and individuals.

Senator GORE. Then, Mr. Smith, all you need do to escape your formula completely is just to organize an additional subsidiary.

Mr. SMITH. It will come back and more will come back if it has had a chance to earn more, in my opinion, sir.

Senator GORE. Very well. We have discussed that.

Mr. SMITH. It has been argued as a matter of principle that a country has no right to tax income coming into it from foreign sources. When advanced as a principle, this proposition has not seemed to me to be acceptable. But, as a practical matter, and as a policy to further national objectives, there may be a good deal to be said for taxation of international income in only one country. The more one examines the combined tax burdens on international income, the more difficult it becomes to avoid tax penalties on international income and perverse effects under the credit for foreign taxes.

The problems seem clearly to call for more thorough and extensive consideration than it has yet received. There is a very good momentum in such analysis among the countries of Western Europe through the fiscal committee of the OECD, in which I hope we are actively participating. Pending clarification and the further development of what one hopes may be a more uniform approach to the subject, it seems desirable to proceed cautiously in tightening our present tax laws with respect to foreign business income. In conclusion, I respectfully urge that there be no new legislation concerning foreign operating companies and now even question the desirability of legislation concerning foreign holding companies.

The committee has been very patient, sir.

Thank you.

Senator KERR. Thank you very much, Dr. Smith.

Are there any questions, Senator Gore?

Senator GORE. I would like to observe in connection with your closing remarks, Doctor, that the question of comparative treatment and equity arises as among our own States.

A corporation operating in the State of Louisiana pays a State income tax. That corporation is not given a tax credit by the U.S. Government, but rather that tax paid in Louisiana is treated as an operating expense. Some other of our States do not have State income taxes. The foreign tax credit permits a credit against U.S. taxes for income taxes paid by a foreign corporation.

Therefore, as between a U.S. corporation operating in Louisiana, and a U.S.-owned corporation in England, for instance, there is a discrimination in that the income taxes paid in England are treated as a credit against taxes, but the income paid in the State of Louisiana is treated as an operating expense.

Mr. SMITH. But, sir, the local rates paid in England which are in a sense comparable to the Louisiana taxes, the local taxes, are not allowed as a credit against the Federal tax in this country. It is only the national tax, in fact, it is only the national income tax in England.

So the purpose here, as I understand it—I thoroughly agree with the purpose—is to avoid having two levels of national tax imposed upon the same income.

Senator GORE. Well, let's take the case of a country in which there is no local tax.

Mr. SMITH. I don't happen to know of any but I presume there may be some places.

Senator GORE. Well, I think you will find that some of the Cantons in Switzerland have at least negligible income taxes.

Mr. SMITH. There are some interesting negotiations there.

Senator GORE. Yes, I understand that.

Now, in the case of a U.S. corporation with a subsidiary in England there is no substantial U.S. tax on income earned in England because the England tax rate approximates our own.

Mr. SMITH. That is right.

Senator GORE. Now, as I understood it, you said you would tax holding company income, for example, dividends coming into Switzerland from a German operation.

Mr. SMITH. Right.

Senator GORE. As I see it, it is at this point that the foreign tax advantage really appears. An operating subsidiary in England has practically no additional U.S. tax to pay on its profits, as you will agree.

When those profits are funnelled into a tax haven, however, combined with the deferral privilege, it is then that the tax advantage really appears.

Mr. SMITH. That is when I would get it when it is funneled in a tax haven but I would stop right there.

Senator GORE. How would you define a tax haven?

Mr. SMITH. I don't think it is necessary to define a tax haven country, if one adopts the holding company concept. I would simply provide that wherever incorporated a foreign holding company, a subsidiary of an American company which is itself a holding company, which receives income from other corporations in third countries would have its undistributed income imputed to its parent and then you don't have to specify countries.

Senator GORE. I don't think it is practical to specify countries; I think you don't either.

Mr. SMITH. Neither do I, that is the reason I don't want to.

Senator GORE. Well, I certainly cannot match the knowledge and experience that you have had; I wouldn't attempt to and would not pretend to try to do so. I must say that after studying this question for some 3 years, I have reached the conclusion that the only practical way to attack the tax haven problem successfully is to withdraw the deferral privilege.

If taxes are paid to the United States annually then you don't hurt the corporation operating in England; you don't hurt that corporation whether the U.S. tax is paid annually or every decade.

Annual assessment of U.S. tax liability and annual payment of taxes by U.S. taxpayers based on earnings of their foreign holdings will reach the tax haven dodge. I haven't been able to devise any other way to do it.

Now, you say you would do it but I haven't understood you to say how.

Mr. SMITH. Well, my concern with that proposal, Senator, is that that goes beyond the tax haven and it gets the operating company which is in active competition with other operating companies, where it is located. Of course——

Senator GORE. We had an exchange about that.

Mr. SMITH. I know. I think that is the difference between us, sir. I would define a tax haven as a situation where there is some unnatural corporate device or some unnatural transaction created——

Senator GORE. Must the Government prove in each case there is an unnatural——

Mr. SMITH. No, I think the holding company would be an objective test. To me it satisfies me. I am concerned about this tax haven device but I think if you confine it to holding companies which I am urging, it will get at the things that are commonly talked about as the havens, it will get at the Monacos, the Liechtensteins, the Swiss and Bahamas, et cetera.

Senator GORE. We had an example before the committee this week of a corporation that had some 40 foreign subsidiaries and about 20 branches, and earlier we had an example of a corporation that had two subsidiaries in Switzerland and one in Liechtenstein, in which case, I believe, one of those in Switzerland was owned by the one in Liechtenstein or vice versa.

Mr. SMITH. That sounds awfully suspicious and the holding company would get at it.

Senator GORE. Well, despite—you recognize this as a problem?

Mr. SMITH. I most certainly do, sir.

Senator GORE. If you have any suggestions as to specifically how we could reach the problem, I will certainly appreciate, and I am sure the committee would appreciate, your suggestions.

As I have said the only practical way I have found to get at the problem is from the standpoint of deferral. You have been an able witness, and if I ever have the opportunity to appoint you to a high-paying Federal position we will certainly talk about it.

Mr. SMITH. Thank you, sir.

Senator CARLSON. Doctor, before you leave, do you not feel that we should proceed with great caution in this foreign tax field having in mind the need for increasing our gross national production, and taking care of some of our unemployment problems?

Mr. SMITH. I do, Senator. And I feel there is much under consideration and going on among the major European industrial countries in terms of thinking in this area. I think we should take account of what is being done there and what may be done there to make sure we do not put an unintended burden on the bona fide activities of American business in the world economy.

Senator CARLSON. Might it not be well for us to keep in mind in the very near future we are going to consider some international trade legislation and an expanded trade program and that the action taken at that time might even be injured by action that we could possibly take in a foreign taxation—taxation of foreign income?

Mr. SMITH. I feel that very strongly, Senator. It seems to me what would result from this would be inconsistent and incompatible with what is proposed there, most of which I am very sympathetic to, incidentally.

Senator CARLSON. Would it not then be advisable to delay action on this particular section, so far as I am concerned, on the whole bill, until we have time to look at the overall tax picture and also keep in mind the international trade agreements that we are to enter into, I assume, or action taken on expanded international trade before we do something that might be damaging?

Mr. SMITH. I feel very strongly that it would.

Senator CARLSON. Thank you.

Senator KERR. Thank you very much, Doctor.

Mr. SMITH. Thank you, Mr. Chairman.

Senator KERR. Mr. W. M. Adams, Sprague International, Ltd. All right, Mr. Adams.

STATEMENT OF WILLIAM M. ADAMS, PRESIDENT OF SPRAGUE INTERNATIONAL, LTD.

Mr. ADAMS. My name is William M. Adams. I am president of Sprague International, Ltd., and I am responsible for handling the foreign business of Sprague Electric Co., North Adams, Mass., a manufacturer of electronic components and equipment.

Our company wishes to express its appreciation for the opportunity to present its views with respect to the foreign income provisions of H.R. 10650.

This statement will not attempt to present a technical analysis of section 13 of H.R. 10650 because this task has been ably undertaken by others appearing before this committee. Rather, the purpose is to focus on the foreign operations of our company and, by so doing, acquaint you with the actual problems which we will encounter under section 13 of the proposed bill, as well as their probable consequences.

Our company is engaged in the research, development, manufacture, and sale of electronic components and equipment and is currently one of the world's largest producers of capacitors and other components vital to the electronic industry worldwide. At present we have 14 plants in the United States and 7 manufacturing facilities situated in various countries throughout the world to supply our customers. This statement, however, will be restricted to the European phase of our international operations because we believe it demonstrates best the serious effects of H.R. 10650.

Our early attempts after World War II to compete effectively in European markets by direct exports of U.S. manufactured products were seriously hindered by currency controls and import restrictions. Additionally, in recent years European technological advancement has been rapid, especially in the electronics industry, making it even harder to develop direct exports. It eventually became apparent that if our products were to receive market acceptance in Europe, the establishment of manufacturing facilities within Europe was imperative. Without such facilities our products could not be priced competitively with our European counterparts. Accordingly, plant facilities were established in Milan, the center of the Italian electronics industry, which enabled us to sell not only in Italy but throughout Europe.

Sales outside Italy of products manufactured in Milan were made through Sprague World Trade Corp., located in Zurich. The use of this trading company, a mode of distribution also employed by our European competitors, greatly minimizes the impact of Italian taxes. The profits accumulated in Zurich as a result of the Italian tax savings were subsequently utilized to finance the organization of another manufacturing facility in Belgium. This Belgian plant which manufactured highly specialized components for the computer industry affords us an opportunity to have our design engineers readily available for consultation with European design engineers, which is indispensable when selling to computer companies.

The purpose of this bill as described by the Treasury is to stimulate direct exports and restrict the flow of U.S. dollars abroad. However, we submit that our situation dramatically illustrates that it will have just the opposite effect. Let me give an illustration:

Our line of products is far too broad to consider establishing facilities to manufacture anything but a limited line abroad. By locally manufacturing a limited line we can, thus, compete with our local competitors, in that line at least. Our products and quality of workmanship thereby become known and accepted by local manufacturers.

I might parenthetically say that we are a manufacturer's manufacturer.

Senator KERR. Let me interrupt the witness at this point. It is my purpose to continue until we have completed the testimony of the witnesses scheduled for today, if it is possible to do so.

But, in order to avoid any technicalities at this point, I want to make a part of the record the statements of all of the other witnesses scheduled to be heard today. It will be my purpose to continue the hearings, however, in order that they might have the opportunity to make such other observations as they desire.

At the proper place in the record the statement of all the other witnesses scheduled to appear today will be made a part of the record.

You may proceed, Mr. Adams.

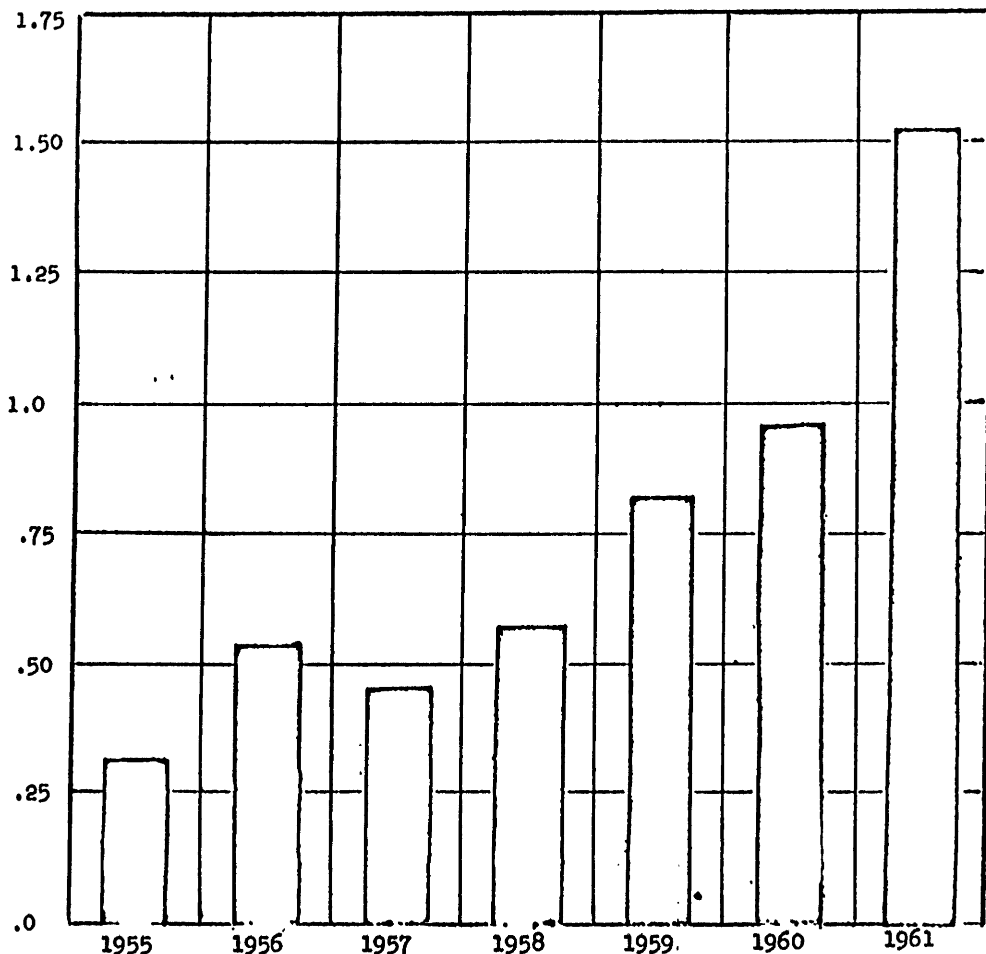
Mr. ADAMS. Our products and quality of workmanship thereby become known and accepted by local manufacturers. As a consequence, these local manufacturers begin to seek other products we manufacture in the United States and not locally.

Prior to the formation of our operation in Italy we had virtually no export sales to that country. In the intervening period our export sales to Italy of products manufactured by us in the United States, including products which are also presently manufactured by our Italian plant, has increased dramatically year by year. Similarly, the utilization by the European computer industry of our components which are produced in Belgium has precipitated numerous orders on our domestic company for other products.

It is manifest and can be easily documented that the substantial growth in our export sales from the United States shown on the following chart would not have occurred but for the acceptance and utilization of our products by European manufacturers which resulted from the establishment of local manufacturing facilities in Europe. This stimulation of exports, to say nothing of export of capital goods in the form of machinery, and so forth, results directly from the establishment of a local factory, and is a phenomenon that every company has experienced and recognizes.

(The chart referred to is, as follows:)

EXPORT SALES *

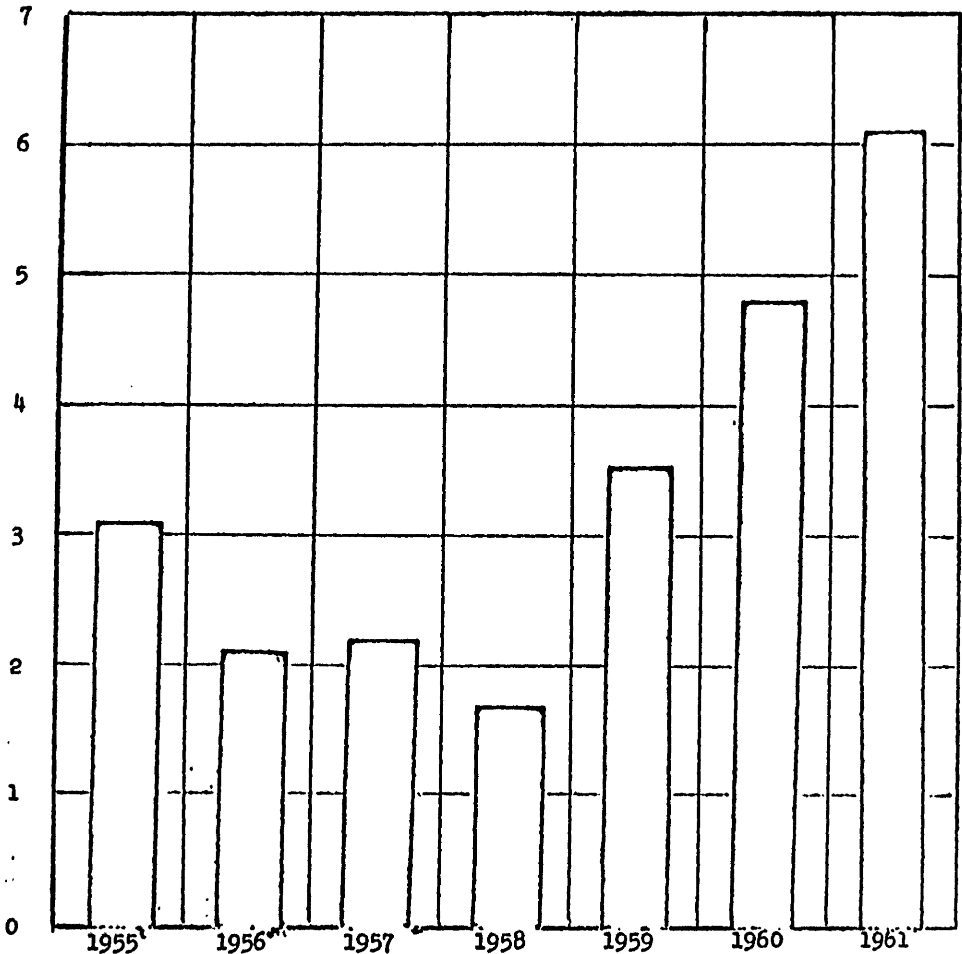


* Excludes Canada

Mr. Adams. Although the argument has been propounded that the establishment of foreign manufacturing facilities exports U.S. jobs, our experience indicates that this is just not so. I cannot give you an accurate figure of how many of our employees owe their jobs directly to export, but I can tell you that, in many instances, lines would have been temporarily closed or restricted and employees laid off had it not been for the welcome export business that came into the house at that time. In other words, foreign plants stimulate exports and exports tend to cancel out the slack periods that occur from time to time domestically.

The recent growth in our export sales and the manufacturing efficiencies emanating from such growth have contributed to the corresponding increases in the profits of our company, which are shown on the chart below.

(The chart referred to is as follows:)



Mr. ADAMS. The proposed legislation would have a profound influence upon the future of our company, both domestic and foreign. It is obvious that the objective of section 13 of H.R. 10650 is not to collect taxes but to eliminate or greatly retard investment in foreign manufacturing operations. In our case, the undeniable consequences of eliminating Sprague World Trade Corp. from our international corporate structure would be a 50-percent reduction in the funds available for development and expansion of our Belgian and Italian operations because of higher Belgian and Italian income and excise taxes. As a consequence of such depletion of funds, our foreign operations would not be able to keep pace with their European competitors, resulting in irreparable injury. Furthermore, if we are unable to maintain the position we have attained in European markets, the subsequent loss would also be reflected in our export sales, reversing their present growth trend. Moreover, this potential disaster would be accompanied by no increase whatsoever in U.S. tax revenue but a substantial increase in Belgian and Italian tax revenue.

As a business grows, more working capital is needed. At present, this is supplied from foreign sources in local currency that has been earned abroad. Therefore, if this bill passes, the parent company will have to supply this capital from U.S. dollars instead of foreign currency and, furthermore, will have to earn twice as many dollars as would be the case using local funds. How this is going to help the balance of payments is beyond me.

We submit that when a U.S. corporation motivated by sound business reasons goes abroad and establishes, through a subsidiary, manufacturing facilities in a developed country with a tax rate comparable to the U.S. rate, the subsidiary formed under the laws of that foreign country should be permitted to compete on equal terms with other domestic corporations of that country. This encompasses utilization of a trading company to effect tax savings on sales outside the manufacturing country, as do all our foreign competitors.

It is apparent that without a trading subsidiary the manufacturing company operating in this posture does not defer U.S. taxes because the U.S. tax due, if any, would be minimal as a result of the operation of the foreign tax credit provisions. Conversely, the minimization of foreign taxes through a trading company operation does, in fact, increase the amount available for U.S. taxation. Legislation, however, which imposes an immediate tax on these foreign tax savings before they are remitted as dividends to the parent, is discriminatory with respect to the U.S. subsidiary since the United States is without jurisdiction to place a similar handicap on other non-U.S. corporations in the foreign country which compete directly with the subsidiary.

We cannot believe that it is the intention of Congress to hamstring American business, as this bill proposes, particularly at a time when European competition by reason of the Common Market advantages is becoming so increasingly severe. Unless the bill is amended, the famed American know-how and business ability will be replaced by that of others, both friends and enemies, since the American business community will be confined to our own shores, there to fade away into industrial and international insignificance.

Senator KERR. Thank you, Mr. Adams.

Are there questions?

Senator GORE. Yes.

Mr. Adams, how many foreign subsidiaries does Sprague own?

Mr. ADAMS. I think I said seven, did I not?

Senator GORE. Do any of those subsidiaries have subsidiaries?

Mr. ADAMS. Yes, the Belgian company is wholly owned by the World Trade Corp. In other words, it is financed by the World Trade Corp. out of profits of sales and such and such.

Senator GORE. Would you name the seven and any additional subsidiaries of the seven, or branches?

Mr. ADAMS. There are only two subsidiaries of one other, so to speak.

One is the Belgian and one is the Hong Kong, which is a very small operation.

All the others are directly owned or——

Senator GORE. Where are they located?

Senator KERR. Operating subsidiaries?

Mr. ADAMS. Yes, all operating, manufacturing.
Senator GORE. Where are they located?
Mr. ADAMS. One is in Mexico. One is in Italy, as I said; one is in Belgium; one is in Hong Kong.
We have recently acquired a Canadian subsidiary, which we do not own wholly; we own the majority.
How many is that?
Senator KERR. That is five.
Is the World Trade Corp. a Zurich corporation?
Mr. ADAMS. It is a sales corporation. The other two are in Puerto Rico, making eight factories in all, including Canada, plus one selling subsidiary; Sprague World Trade.
Senator GORE. Liechtenstein?
Mr. ADAMS. No. Liechtenstein, I will explain how this happened. I am glad you brought it up.
Senator GORE. If you did not, I intended to.
Mr. ADAMS. Well, I thought you might.
When we first started this idea of a sales company——
Senator GORE. What is in Liechtenstein, a subsidiary?
Mr. ADAMS. Let me explain, if I may.
When we first started out by having a sales subsidiary to handle the Italian and any other subsidiaries we have in Europe, we first established it as a Liechtenstein corporation. Then we found this was not particularly practical, because we could not operate out of Liechtenstein anyway.
Senator GORE. Why did you establish it in Liechtenstein?
Mr. ADAMS. Because there we would pay the lowest tax and have more savings to eventually return to the United States, Senator.
Senator GORE. That is one of the frankest statements which has been made in this hearing.
Mr. ADAMS. It is perfectly true.
Senator GORE. Congratulations.
Do you still have it?
Mr. ADAMS. We have it, but we do not use it. In other words, Zurich is classed as a branch office, but, actually, it is the operating office.
Does this clarify it to you?
Senator KERR. Zurich is the operating office of the World Trading Corp.?
Mr. ADAMS. Yes, and World Trade was originally incorporated in Liechtenstein, but actually it has practically no funds at all there. We pay the taxes in Zurich.
Senator GORE. Is it owned by the Liechtenstein subsidiary?
Mr. ADAMS. Yes; it is.
Senator GORE. In other words, the Zurich office is a branch of your Liechtenstein subsidiary?
Mr. ADAMS. Yes; but it is doing all its work in Zurich and paying its taxes in Zurich and paying some minimal tax, I forget how much, in Liechtenstein.
Senator GORE. Where are the profits or assets accumulated?
Mr. ADAMS. In Zurich.
Senator GORE. No fees are paid to the Liechtenstein company?
Mr. ADAMS. We pay a small accounting fee.

Senator GORE. What are the assets of your Liechtenstein subsidiary?

Mr. ADAMS. Well, they do not have any assets as such. I mean the bank account is in Zurich and it belongs to the Sprague World Trade account in Zurich.

Senator GORE. It is an asset of——

Mr. ADAMS. There is a small amount that was left over, I think it is a few hundred dollars, in Liechtenstein.

Senator GORE. Even your bank account in Zurich is an asset of the Liechtenstein subsidiary?

Mr. ADAMS. That is correct. That is being used and coming back bit by bit to the United States. We pay dividends or return money just as soon as we can get it.

Senator GORE. What are the assets of your Leichtenstein subsidiary?

Mr. ADAMS. I cannot give you the exact figure of how much money we have in the bank at this moment.

Senator GORE. Are there no assets except cash?

Mr. ADAMS. No.

Senator GORE. No real estate in Switzerland?

Mr. ADAMS. No.

We rent an office.

Senator GORE. All the assets——

Mr. ADAMS. We have a lot of people working out of it.

Senator GORE. All of the assets are liquid?

Mr. ADAMS. Yes.

Senator GORE. Is it in the amount of half a million or a quarter of a million?

Mr. ADAMS. Not net. It is a trading company. We sell a certain amount of stuff, and we pay for it, and we make a profit. We return the money to the States as often as we can, insofar as we do not need operating capital for the Belgian company or the Italian company.

Senator GORE. Now, is the Telegraph Condenser Co., Ltd., United Kingdom, an affiliate?

Mr. ADAMS. It is an affiliate. We have a 25 percent interest there.

Senator GORE. Well, as I understand it, there are certain patent rights involved, and there is to be a payment of something more than a million dollars.

Mr. ADAMS. That is correct.

Senator GORE. Now, is that paid directly to Sprague or is that——

Mr. ADAMS. It was paid directly to Sprague.

Senator GORE. It comes directly to the United States?

Mr. ADAMS. Yes, sir.

Senator GORE. Is it an annual payment or what?

Mr. ADAMS. Yes, but it is paid in installments over a period of 5 years. The whole transaction will be completed by March 31, 1965.

Senator GORE. What royalties, licensing charges, or other fees are paid to your Liechtenstein corporation?

Mr. ADAMS. The Liechtenstein corporation collects for the Sprague Electric Co. a royalty from Italy and transmits it to the States. It has not transmitted all of it; it has transmitted quite a bit of it.

Senator GORE. Would you furnish for the record—I do not have any right to require this—but would you be willing to furnish for the record of the hearing the financial statement of your Liechtenstein affiliate?

Mr. ADAMS. I am waiting for the latest balance sheet right now.

Senator GORE. All right.

Both the first one and the most recent ones?

Mr. ADAMS. Yes.

Senator GORE. If you do not wish to do so, sir——

Mr. ADAMS. I do not see any particular objection. There is nothing hidden in this operation.

Senator GORE. I was not suggesting that.

Mr. ADAMS. I am sure you were not, but I am just making the statement so we understand each other. (The data referred to was subsequently submitted for the use of the committee.)

Senator GORE. Your foreign investment seems to have jumped quite considerably in 1960, from some $600,000 in 1959 to some $3 million, has it not?

Mr. ADAMS. Honestly, I do not know the figure.

Senator GORE. Well, you know whether I am in the neighborhood of being right, do you not?

Mr. ADAMS. Well, we have invested in Italy $600,000, I know. We had the investment in our affiliate which you are talking about in London. We also have invested substantially in the Canadian company.

Senator GORE. I am not suggesting it is wrong. But from the point of view of investment, your company shows a very rapid increase in foreign investment in 1960.

Mr. ADAMS. That is fine, I am glad it does.

Senator GORE. Pardon?

Mr. ADAMS. I am glad it does, because it shows we are doing business.

Senator GORE. I am not suggesting it is wrong. But since we are discussing this subject, would you be willing to insert in the record a breakdown of your foreign investment?

If there is some trade secret involved, or otherwise, I will not ask you.

Mr. ADAMS. I would like to reserve "Yes" or "No" on that one, Senator.

Senator KERR. You have that right.

Mr. ADAMS. Thank you, sir.

Senator GORE. Sure.

Senator KERR. He made it clear to you that this committee has no power to—if it does, it is not exercising it—to subpena you for your records.

He asked you if you would willingly submit certain information.

Mr. ADAMS. Sure.

Senator KERR. And you reserved the right to submit it or not.

Mr. ADAMS. Yes, please.

Senator KERR. All right.

Senator GORE. Well, as a matter of fact, since the question was raised, if the committee thought there was something wrong that it wanted to uncover, it would have the power of subpena.

Mr. ADAMS. No, there is not, you can be sure of that, Senator.

Senator GORE. Your records in Liechtenstein, we have no way of knowing about that unless you submit it.

Mr. ADAMS. I can tell you it is aboveboard.

Senator GORE. Thank you very much.

You suggested that your exports increased dramatically to Italy. I wondered if you would give us some indication on how your exports to Italy increased—what exports, how much?

Mr. ADAMS. Well, it is a fact I struggled with this Italian business for a long time before we had a factory there and got nowhere. However it is a fact that that the moment we started having a manufacturing interest, we began to be able to sell at first a little, and then more of our other products, and it amounted to a substantial amount.

I cannot give you the figure because I do not have it, Senator.

Senator GORE. Well, can you supply that?

Mr. ADAMS. I think I can dig it up.

Senator GORE. What do you manufacture in Italy?

Mr. ADAMS. Capacitors of one family. Capacitors are—that is a big term—it is like components are capacitors or capacitors are components and there are many, many different kinds of capacitors.

Some use one manufacturing technique and have to be manufactured in one factory and cannot be the same factory as another one.

We manufacture one type at the moment in Italy.

Senator KERR. One what?

Mr. ADAMS. One type of the family of capacitors.

Senator GORE. How do you spell that word?

Mr. ADAMS. Capacitors used to be called condensers many years ago.

Senator GORE. I understand.

Mr. ADAMS. The name was changed after World War II, I believe.

Senator GORE. Is all of the product of your Italian factory sold in Italy?

Mr. ADAMS. Oh, yes.

I am glad you brought this up, too; you are bringing up some fine points. Another point I want to make for the record——

Senator GORE. You have made a very good witness.

Mr. ADAMS. I want to make a point that nothing we make comes back to the United States from any foreign subsidiary or affiliate in any way, shape, or form. That is a strict policy.

Senator GORE. Why do you have a policy? If you could do so profitably, why do you have a policy?

Mr. ADAMS. Because we believe these foreign factories should stand on their own feet and supply their own markets.

Senator GORE. Now, back to this question of exports to Italy.

Would it be possible that your exports to Italy have been principally of machinery to your factory?

Mr. ADAMS. No, I am not speaking of that. None of these figures have to do with capital equipment at all.

Senator GORE. All of them are export of products?

Mr. ADAMS. Of products made in the States.

Senator GORE. In the States?

Mr. ADAMS. Of our type, of our manufacture.

Senator GORE. Then your operation seems to have been very helpful to the United States from what I have learned of it.

Mr. ADAMS. It has.

Senator GORE. And your objection, then, to the bill is that if you are required to pay taxes annually on your profits, you will not have enough money to grow as fast?

Mr. ADAMS. No, that is not the point.

It is morally wrong, as it has been brought out by many people, to tax somebody on something which they have not got, No. 1.

I am not a tax expert, but you heard excellent testimony today, and I think I stand on that.

Senator GORE. Thank you, Mr. Chairman.

Senator KERR. Is that all, Senator?

Senator GORE. That is all; yes.

Senator KERR. Thank you very much, Mr. Adams.

Senator KERR. Mr. Eugene P. Grisanti, International Flavors & Fragrances, Inc.

STATEMENT OF EUGENE P. GRISANTI, GENERAL ATTORNEY AND ASSISTANT SECRETARY OF INTERNATIONAL FLAVORS & FRAGANCES, INC., ACCOMPANIED BY LEROY FRANTZ, JR., TREASURER

Mr. GRISANTI. My name is Eugene P. Grisanti, and I am general attorney and assistant secretary of International Flavors & Fragrances, Inc.

As its' name implies, International Flavors & Fragrances, Inc., is in the business of manufacturing flavor and fragrance products. We have plants in New York, New Jersey, Texas, and Oregon, and we have offices in Illinois and California.

Our company, while a leader in its field is, comparatively speaking, a small- to medium-sized American corporation.

Its gross sales on a consolidated basis are approximately $36 million annually. About half of these sales, however, are made outside the United States. Our company is representative of the smaller American corporation which today finds itself deeply involved in doing business, primarily through subsidiaries, in many foreign markets. We have, at present, 17 such foreign subsidiaries throughout the world.

This is the first time, to my knowledge, that our company has appeared before any committee of the Congress to make its views known with respect to a specific piece of legislation. We are opposed to this bill because of the serious consequences which will befall us, and companies such as ours, if this bill becomes law. I would like to explain briefly why this is so.

Section 951 proposed by the bill provides, among other things, that there shall be included in the gross income of the U.S. shareholder, in our case the U.S. parent company, the earnings of all controlled foreign corporations owned by it, directly or indirectly, unless these earnings are invested in "qualified property."

Under section 954(a) of the proposed bill, as long as more than 50 percent of the voting stock of the foreign corporation is owned directly or indirectly by the U.S. shareholder, that foreign corporation is considered to be a controlled foreign corporation, regardless, apparently, of how far removed it is from the U.S. shareholder.

Using our corporation as a typical example, all of the foreign earnings of all of our subsidiaries will be considered to be taxable income of the U.S. parent unless these earnings are invested in a business in a less developed country, in the business of the controlled foreign corporation itself, or in an 80-percent owned subsidiary of the controlled foreign corporation.

It is my understanding that the foreign earnings provisions of the proposed tax bill were originally a result of the Treasury Department's concern over the so-called tax haven abuse.

Now, I can understand that some companies would, for one reason or another, use a corporation in a low-tax country for the purpose of accumulating funds for capital expansion in a certain area, or otherwise.

It just so happens that we did not. Our company has subsidiaries in countries having relatively high and relatively low income tax structures. Some of our subsidiaries are located in the less-developed countries, while others are located in those countries whose economies are considered to be highly developed. In every case, the decision to form a subsidiary was based upon business and commercial, not tax, reasons.

It is clear, however, that we are here confronted with a bill which subjects to taxation, the U.S. parent or shareholder, indiscriminately, and regardless of whether the earnings of any of its foreign subsidiaries are so-called tax haven earnings or not.

Every American company, including those which like ourselves feel that they have been above board in their operations, now suddenly find themselves subject to an additional tax burden unless their subsidiaries in foreign countries do with their earnings what the U.S. Government tells them to do with their earnings.

If it is a worthy objective to foster investment in the less developed countries, must an American company be penalized by an extra tax burden, unless it does so?

This is, in essence, what the tax bill does. U.S. businesses were once encouraged to assist in rebuilding and investing in the devastated economies of Western Europe after World War II.

Will the American companies who now respond to the call to invest in the less developed countries, after a decade or more has passed, be penalized for their initiative, as this tax bill seeks to penalize those who have responded to a previous call?

Let us also consider the following facts with respect to this bill:

1. Apart from the chaotic effect which these provisions will have under existing and pending tax treaties, we think that these proposed provisions are unconstitutional.

The Secretary of the Treasury in his statement to this committee used the phrase "the privilege of tax deferral" in describing the present system. This phrase is erroneous in concept, legally and constitutionally.

We are dealing here with earnings of a separate foreign corporate entity. The U.S. shareholder is taxed with respect to property which he has not received, actually or constructively.

It is one thing to tax all the U.S. shareholder's property which is kept out of the country by means of some sham or transparent device.

It is quite a different matter to tax property which is owned by another bona fide manufacturing foreign corporation outside the U.S. taxing jurisdiction. This is precluded by the decision of the Supreme Court in *Eisner* v *Macomber* (1921) 252 U.S. 189, 64 L. Ed. 561, which has never been overruled.

2. The proposed bill appears to be based upon the assumption that all countries, like the United States, rely to the same extent as we do on the income tax for the great bulk of their revenue.

In actuality, the tax structures vary widely.

Some countries rely more heavily on excise, turnover and other taxes, rather than on the income tax. These taxes are not taken into consideration in computing the U.S. foreign tax credit under this bill.

I might say, parenthetically, that the Secretary of the Treasury has made it a point in his statement before the committee to say they seek to equalize the tax burden and bring it up to the 52-percent rate. But in these cases the additional U.S. tax resulting from this bill will be far in excess of the U.S. 52-percent rate.

This, alone, is sufficient to show that the Treasury Department's professed objective to subject foreign earnings to a uniform maximum U.S. rate is in reality a phantom argument as long as the tax credit is not altered accordingly.

3. There is another inequity implicit in the bill, which may, perhaps, be overlooked. While the U.S. taxpayer is required to have its controlled foreign corporations invest their earnings in a certain manner, concurrently, the country in which the foreign corporation is domiciled may, through exchange restrictions or other controls, forbid such earnings to be so invested.

In these cases, to the U.S. shareholder's plight of being told by his Government what to direct a certain foreign subsidiary to do with its money, is added the dilemma of not being able to invest the earnings in the manner directed even if it wished to do so.

4. Spokesmen for the Treasury Department insist that these provisions are required to assist in remedying our country's deficit in its balance of payments.

It was our impression that the voluminous statistics presented last spring before the House Ways and Means Committee had satisfactorily refuted this contention showing, among other facts, that in every year since World War II more U.S. dollars had come into the country from foreign business operations than had gone out, taking into consideration not only dividends but also dollars received from exports, royalties, fees, et cetera; in other words, that the foreign investment program of U.S. business has actually prevented the deficit, caused in reality by our generous foreign aid program, from being much worse.

I will leave this subject to the experts who are far better qualified than I to speak concerning it.

I would, however, like to allude for a moment to the logic of the proposed bill in this respect. What these provisions in effect do is to compel the U.S. corporation to make a decision concerning the earnings of its subsidiaries before the end of any given tax year.

It can either take the position that (*a*) the money is going to be subject to a U.S. tax so it might as well bring it home and have the use of it, or (*b*) the U.S. parent may direct its subsidiary to reinvest its earnings in qualified property as defined under the bill, and so escape the tax.

If this bill is passed in its present form, it would seem far more likely that such funds, in the majority of cases, would be reinvested, and not necessarily in new business in the less-developed countries where so many uncertain risks are faced, but in the expanding businesses where the existing subsidiaries are already situated.

Funds which may well have been kept idle until the time was ripe to make a decision whether to repatriate them as dividends, or to invest in plant expansion, will be forced into plant expansion instead before the end of the tax year to escape the tax. It would seem to me, in this respect, that the proposed bill has all of the elements necessary to aggravate rather than alleviate the balance of payments problem.

Senator GORE. I am hopeful that provision can be stricken from the bill.

Mr. GRISANTI. In effect, the foreign earnings provisions of the tax bill place a competitive burden on the U.S. subsidiary in a foreign country, which is not borne by any other company, foreign or local, doing business in that country.

To that extent, these provisions represent a divisive force between American companies and all other free business enterprises of the Atlantic community.

The President, in his message to the Congress on the administration's Trade Expansion Act stated:

> The two great Atlantic markets will either grow together or they will grow apart. The meaning and range of free economic choice will either be widened for the benefit of free men everywhere or confused and constricted by new barriers and delays.

It would seem that the foreign earnings provisions of the proposed tax bill run at cross purposes with the very spirit enunciated by the President to unify and strengthen the free economies of the Atlantic community.

I am grateful to the members of the Senate Finance Committee for giving me this opportunity to state on behalf of our company why we feel that the foreign earnings provisions of the proposed tax bill should not be enacted.

Accompanying me also today are Mr. Leroy Frantz, Jr., our treasurer, and Mr. Herbert G. Reid, our controller, and we would be happy to answer any questions which you may have for us.

Senator KERR. Thank you, Mr. Grisanti.

Are there any questions?

Senator GORE. How long has your company been organized?

Mr. GRISANTI. Our company was organized at about the turn of the century.

Senator GORE. Will you furnish for the record the names and locality of each of your subsidiaries and when they were organized?

Mr. GRISANTI. Yes, I would be happy to do that.

(The information referred to follows:)

Subsidiaries of International Flavors & Fragrances, Inc.

Name of company	Location	Date of establishment
International Flavors & Fragrances I.F.F. (Nederland) N.V.	The Netherlands	1905
International Flavors & Fragrances I.F.F. (Belgique) S.A.	Belgium	1934
Societe Commerciale Agens S.A. Belge	do	1948
International Flavors & Fragrances I.F.F. (Deutschland) G.m.b.H.	West Germany	1953
International Flavors & Fragrances I.F.F. (Great Britain) Ltd.	England	1926
International Flavors & Fragrances I.F.F. (Norge) A/S	Norway	1949
International Flavors & Fragrances I.F.F. (Oesterreich) G.m.b.H.	Austria	1951
International Flavors & Fragrances I.F.F. (Reinach) A.G.	Switzerland	1946
International Flavors & Fragrances (Mexico) S.A. de C.V.	Mexico	1961
International Flavors & Fragrances I.F.F. (South Africa) (Pty.) Ltd.	South Africa	1953
International Flavors & Fragrances I.F.F. (Sverige) A.B.	Sweden	1946
International Flavors & Fragrances I.F.F. (France) S.a.r.l.	France	1933
N. V. Handelmaatschappij Agens	The Netherlands	1948
I.F.F. Essencias E Fragrancias S.A.	Brazil	1947
International Flavors & Fragrances I.F.F. (Italia) S.r.l.	Italy	1949
International Flavors & Fragrances S.A.C.I.	Argentina	1947
International Flavors & Fragrances (Canada) Ltd.	Canada	1956

Senator GORE. Are your subsidiaries, generally speaking, of some maturity or are they newer organizations?

Mr. GRISANTI. Well, I should say this in explanation: The bulk of our subsidiaries were the result of an acquisition in 1958 of a Dutch company which was equivalent in size to our own.

Now, this company had existing foreign subsidiaries throughout the world. I might add that that acquisition was made with stock of our company so that not a dollar was spent on it, and it has resulted since in the return to the United States from exports, dividends, and royalties of almost $4 million.

So in our case, I think we have been a sterling example of helping out in this balance-of-payments deficit problem.

Senator GORE. Are your foreign subsidiaries uniformly profitable?

Mr. GRISANTI. No. I don't think they are uniformly profitable. Some are more profitable than others.

Senator GORE. Where is your loss?

Mr. GRISANTI. I think we perhaps have a loss, Mr. Frantz may help me, our most recent subsidiary in Mexico may be operating this first year at a loss. I know of no other company which is operating at a loss.

Senator GORE. If the parent corporation is required to pay taxes on its foreign earnings, the consequences to you, you say, will be serious?

Mr. GRISANTI. Yes.

Senator GORE. My own taxes are of serious consequence. I suppose taxes are a serious consequence to most of us. You didn't identify these consequences other than to say they were serious.

Mr. GRISANTI. Well, I can say this: Our two largest world competitors, for instance, are both Swiss companies. We can compete with these companies if we compete with them on their own grounds. I don't know whether we can compete successfully if we are put at a disadvantage by heavy U.S. tax payments.

Senator KERR. You refer to heavy U.S. tax payments on undistributed earnings.

Mr. GRISANTI. That is right, that is correct.

Senator GORE. Then you make the same point which has been made here so many times, that if you are required to pay taxes, can't have as large a working capital, you would have less money to keep or less money with which to grow.

Mr. GRISANTI. And I would add much less money with which to compete in markets which we might otherwise lose.

Senator GORE. You know I suffer from that same problem and so do millions of American taxpayers. It is just perfectly remarkable to me how many businessmen come before this committee and put up the plea that they ought not pay any taxes because if they do they don't have much money left.

Mr. GRISANTI. We don't have objections, Senator, to paying what are just taxes. But we think this tax is not a just tax.

Senator GORE. It is not up to the taxpayer to determine what is just. He must pay the tax which the law requires.

Mr. GRISANTI. That is correct, and we are coming here today to have our views heard and we are happy that we have this opportunity because we feel it is only this way that in a democracy proper laws can be legislated.

Senator GORE. Well, I am glad you have exercised that right and we are pleased to hear you.

Thank you, Mr. Chairman.

Senator KERR. I will say this to you, you and other taxpayers are not without remedies. While you are subject to the laws your representatives pass, you are free to change those representatives at regular fixed opportunities, and maybe one of the wholesome things in connection with our history is that the American taxpayers have exercised that privilege.

Senator GORE. Do you have a branch in Tennessee? [Laughter.]

Mr. GRISANTI. No, we do not, Senator.

Senator KERR. Well, I noted with some degree of care that neither Oklahoma nor Tennessee were mentioned.

Thank you very much, Mr. Grisanti.

Mr. GRISANTI. Thank you.

Senator GORE. Your statement was very clearly given.

Senator KERR. I wonder if I understood you to say that yours was a sterling example of a beneficial balance of dollar payments?

Mr. GRISANTI. Yes. Did I use the word sterling?

Senator KERR. That was my understanding and I thought it was very apt and I wondered if it was intentional.

Mr. GRISANTI. It wasn't.

Senator KERR. All right.

Mr. Kenneth Sprague, American & Foreign Power Co.

STATEMENT OF KENNETH SPRAGUE, VICE PRESIDENT, AMERICAN & FOREIGN POWER CO., INC.

Mr. SPRAGUE. I am Kenneth B. Sprague, vice president of American & Foreign Power Co., Inc., and I appreciate this opportunity to present the viewpoint of my company on that part of H.R. 10650 which deals with foreign income and investments.

Our company is a domestic corporation with subsidiaries, both foreign and domestic, operating in 10 Latin American countries. From its inception in 1923 until 1960, the company, through its subsidiaries has been engaged in the supplying of electric services abroad.

Senator KERR. Are you still in that business?

Mr. SPRAGUE. In all but three of the countries.

Senator KERR. I noticed you said "until 1960." I wondered if——

Mr. SPRAGUE. Well, you will find, after I get on that, we have sold our electric utility business in two countries, and in the other country we have had our properties expropriated by Mr. Castro.

Senator KERR. But insofar as you are still operating, the situation is current and not one that terminated in 1960?

Mr. SPRAGUE. That is true, Senator Kerr.

Senator KERR. All right.

Mr. SPRAGUE. When we commenced operations in Latin America, electric utilities generally consisted of small isolated properties. Service was generally inadequate, and electric utility costs were extremely high. It is generally recognized that we have made a major contribution to the development of Latin America, not only by increasing the availability of electricity, but also by improving the operations, by consolidating smaller plants into more economic units, and by training a large number of electrical and mechanical engineers, accountants, and other essential personnel. During this period these operations provided our main source of funds to meet interest and dividend payments to our U.S. creditors and stockholders.

In recent years, because of the great demand for electricity in the countries served and our inability to finance adequately this growth by reason of local rate policies which at times prevented the private companies from raising capital, the governments of the countries entered into the electric utility business. In many of the countries, these government enterprises are now the principal suppliers of electricity, and the momentum is increasing for complete nationalization of the private power industry.

I am not referring here, to such situations as Cuba, where properties of our subsidiary, having a value in excess of $300 million, were seized by the Government with no compensation whatever. I am referring rather to countries such as Argentina and Mexico, where the Governments have acquired existing privately owned electric companies through negotiations at prices either mutually agreed to or determined by independent appraisal. I am also referring to the recent joint communique issued by President Kennedy and President Goulart, wherein President Goulart indicated that the Government of Brazil is desirous of acquiring the remaining privately owned utilities, with compensation to be paid over a period of time and with a requirement that part of the proceeds be reinvested in other industries in Brazil.

The contracts of sale of the properties of our foreign subsidiaries in both Mexico and Argentina provide for payment of the purchase price over a period of 15 years. As a condition of the sale, we must reinvest in other local industries within these countries. This has brought about a change in our investment policy which heretofore was limited to public utility operating companies. It is this mandatory transition to investments in other industries in Latin America

that makes our objectons to H.R. 10650 somewhat unique but of vital importance to our thousands of U.S. stockholders.

The obligation under the agreements with Mexico and Argentina is evidenced by U.S. dollar interest-bearing notes of these Governments. As these notes are paid, the proceeds must be invested within these countries in either new or established enterprises which contribute to their economic development. If the properties of our Brazilian subsidiaries are nationalized with compensation, the contract of sale would presumably carry a similar provision for reinvestment of some portion of the purchase price.

Since the dipsosal of our properties in Argentina and Mexico, we have made studies of potential investment opportunities in those countries to provide for local investment of the approximately $7 million each year generated under those agreements.

Our aim in making these investments is to protect the investments of our security holders and to encourage local private capital to join with established U.S. know-how and capital in developing industries which would carry out our commitment to remain as permanent investors in these countries. In order to participate in these joint ventures, we must, because of the insistence of local investors, invest in both common stock and debt obligations. Indeed, under certain laws we may own no more than 49 percent of the equity. In other instances, where the law does not require us to be in a minority position, it is still the preference of local investors for us to hold both debt and equity.

In other words, under the agreements involved, while we are required to reinvest the proceeds, our freedom of choice as to the type of security we may acquire is necessarily circumscribed.

As an example of the type of investment we hope to be able to continue to make, is one made in an aluminum shelter in Mexico. The total cost of the project was $16.5 million. It was proposed to raise $6.5 million of this cost through a loan from the Export-Import Bank to purchase materials in the United States. The sponsors raised $6 million which left approximately $4 million of additional capital required for the construction of the plant.

Our company agreed to purchase $3.5 million of junior debentures and $420,000—14 percent—of the common stock. We could not have acquired the common stock in this case without the purchase of the debentures. The Mexican banking group acquired 51 percent of the stock.

This investment is of the type envisaged in our contract with the Mexican Government. It will aid in the economic development of Mexico, will increase employment, and, through the distribution of the common stock among Mexican nationals, it will foster the development of Mexican capital markets. At the same time, it is consistent with and promotes U.S. commercial and industries policy by making possible the exportation of at least $6.5 million of American manufactured products.

COMMENTS RELATING TO SECTION 13

Although this investment in debt and stock meets the requirements of the Mexican Government and, at the same time, serves U.S. policy on the export of manufactured products, it would be termed an invest-

ment in nonqualified property under H.R. 10650. As such, U.S. income tax would be payable on the earnings of the foreign subsidiary to the extent they are invested in debt. If the investment was made entirely in stock, the earnings of the foreign subsidiary would qualify for the present U.S. tax treatment of foreign income. This differentiation between debt and stock investments in Latin America does not seem right or consistent with the statements of the administration, issued in connection with H.R. 10650, to the effect that investment in developing areas will continue to be encouraged.

The interest received by our foreign subsidiaries from the Argentine and Mexican Governments would be deemed taxable income to this company, unless such interest was reinvested in "qualified property" as defined in section 13 of the bill. Since we cannot reinvest in the "same trade or business," our investments in "qualified property" will be limited to the following provisions of section 953(b)(2) (C) and (D):

(1) Stock acquisitions in which the foreign corporation owns at least 10 percent and not more than five U.S. persons own more than 50 percent and the company must be carrying on an active trade or business and be incorporated in a less-developed country; and

(2) Any investment required because of restrictions imposed by a less-developed country.

Senator KERR. Mr. Sprague, what is the term of the debt you refer to as having been created by your purchase of debentures or other evidence of indebtedness?

Mr. SPRAGUE. We——

Senator KERR. What is the term of the loan—I mean the duration of time?

Mr. SPRAGUE. The loans that we have accepted from the Mexican and Argentine Governments, is that what you are referring to?

Senator KERR. You said here, you gave the example of a company where you borrowed $6.5 million from the Export-Import Bank; the sponsors raised $6 million, which left approximately the——

Mr. SPRAGUE. Fifteen years.

Senator KERR. And your company agreed to purchase $3.5 million of junior debentures.

Mr. SPRAGUE. I think that—I am not sure—I think it was a 10-year term.

Senator KERR. Ten-year term?

Mr. SPRAGUE. That is my understanding and recollection, Senator.

Senator KERR. All right.

The reason I ask is there has been a suggestion of an amendment that would recognize loans of extended terms as though they were investments.

Mr. SPRAGUE. That would be helpful, Senator Kerr.

Senator KERR. All right.

Mr. SPRAGUE. The requirement that the investment must be in stock only is a limitation which will preclude our full participation with local capital in Argentina and Mexico. Of course, this will become necessary in Brazil, if we are also successful there.

This is a limitation imposed on the use of investment funds which does not take into consideration the high risks involved in investing in less developed countries.

The requirement that a stock investment in a less developed country must be in a corporation more than 50 percent controlled by five or fewer U.S. persons should be liberalized. In a small enterprise with less than, say, a million dollar investment this requirement might be reasonable.

On the other hand, it could present serious problems where an enterprise requires several million dollars of investment which could not be raised from such a limited group of U.S. investors.

This ceiling on the number of U.S. investors appears to serve no purpose. It should be sufficient if the controlled foreign corporation holds at least 10 percent of the voting stock of the second foreign corporation, and the second foreign corporation is engaged in an active trade or business carried on almost wholly within a less developed country or countries.

We have grave doubt as to whether our commitment to reinvest in Mexico and Argentina, which was based on a contractual obligation, would meet the test used in section 953(b) (2) (D); that is, "any investment which is required because of restrictions imposed by a less developed country." We urge that the Finance Committee clarify this section to cover a situation where a trade or business has been sold to a national government or a subdivision thereof under circumstances which require reinvestment within those countries and where such sale tends to eliminate friction between the United States and such foreign country.

These proposed changes in section 13 would go a long way toward conforming the bill to the policy declaration of the administration to stimulate U.S. proviate investment in the less developed areas.

COMMENTS RELATING TO SECTION 11

There is one major change relating to foreign income in H.R. 10650 that would have its greatest impact on companies investing in the less developed areas of the world. Section 11 dealing with the so-called gross-up of income in computing allowable foreign tax credits would add the amount of foreign income taxes paid by a foreign subsidiary to the actual dividend income received by the U.S. shareholder.

It seems generally agreed by both proponents and opponents of this change that the full tax effect of this revision will be felt, not by investors in the developed areas, but by those in the developing areas of the world. Since all our investments and earnings are in a less developed area, this change is of particular concern to us.

Foreign income tax rates vary from country to country, but when they are lower than the U.S. tax rate or in the median range, an additional U.S. tax will be payable under this proposal. Generally, the less developed areas of the world have lower income tax rates than the U.S. tax rate and tend to rely more heavily for revenues on taxes other than income taxes.

The need for the continuation of our present method of tax credits on foreign income is more pressing today than 40 years ago when this method was first adopted. This is especially true where U.S. private enterprise goes into or remains in the less developed areas of the world and subjects itself to the risks of seizure, expropriation, nationalization, and exchange devaluations, all of which our company has experienced during the past years.

Because the gross up will have its principal impact on investment in the less developed countries, this change will deter rather than encourage U.S. private enterprise from doing its part to advance the program envisaged in the Alliance for Progress. Here, too, the proposal to increase the tax on U.S. investors in less developed countries does not comport with policy declarations of the administration.

We earnestly request that your committee amend section 11 of H.R. 10650 to exclude its application from income earned in the less developed areas of the world.

COMMENTS RELATING TO SECTION 16

As previously stated, our foreign subsidiaries in Argentina and Mexico have disposed of their properties to these Governments. In carrying out the reinvestment program in these countries, some of the subsidiaries will have to be merged or liquidated. Section 16 of H.R. 10650 proposes to tax the gain on the liquidation of controlled foreign corporations as a dividend to the extent of their accumulated earnings and profits. Although the earnings and profits under this proposal would be subject to the full U.S. tax rate, no provision is made in section 16 to recognize also any losses sustained by the U.S. taxpayer on liquidation of controlled foreign corporations. This, then, is a one-sided provision. Earnings would be taxed while losses would not be recognized.

Section 16 would also tax as ordinary income the gain on the sale of stock of a foreign corporation to the extent of earnings accumulated by the foreign corporation during the period the stock was held by the U.S. taxpayer. This converts what would ordinarily be a capital gain to ordinary income taxable at the full U.S. rate.

It is also my understanding that in this situation we would not be able to avail ourselves of the foreign tax credit.

This section does not contain the logical counterpart to this proposal, that is, an ordinary loss on the sale of a controlled foreign corporation stock. This is not equitable.

Moreover, this section will apply to earnings accumulated since March 1, 1913, a period of 49 years.

Senator KERR. Do you know you get the tax credit on——

Mr. SPRAGUE. In the first instance, we get it, yes.

Senator KERR. But not——

Mr. SPRAGUE. Not in the second.

Senator KERR. Yes.

Mr. SPRAGUE. This is clearly a retroactive change. It is unfair and unwarranted. If this provision is enacted, it should not be effective until after enactment, or December 31, 1962, whichever is later.

It would appear that Treasury would not oppose a change of this nature. We understand that in his testimony before your committee, Secretary Dillon recognized the retroactive feature of this provision and stated:

> The committee may want to consider whether it wishes to retain the applicability of this provision to earnings heretofore accumulated.

SECRETARY OF THE TREASURY DILLON'S PROPOSAL ON FOREIGN TAX CREDITS

The Secretary recommended that the computation of the allowable foreign tax credits on income from foreign sources be further complicated by having the taxpayer segregate taxable income into two classes, investment income and other income. This proposal was intended to cut down the flight of capital to Canada in the form of short-term funds and temporary interest producing investment. However, the wording of this proposed amendment would extend this complicated procedure to all interest income whether from temporary loans or long-term investment. In addition, it would discriminate against investments in the stock of U.S. corporations operating abroad since the exemption, provided for stock investments of 10 percent or more, is limited to stock of foreign corporations.

This proposal fails to recognize that permanent and substantial foreign investments are often made in the form of interest-bearing long-term debt to foreign subsidiaries. For example, it is customary that when the Export-Import Bank advances funds to a foreign company, it also requires that the U.S. parent company participate in the financing through loans to meet local construction costs.

It is recommened that if this proposal is accepted by your committee, it should be amended to exclude from its application interest income received from all corporations in which at least a 10 percent stock ownership is held by the U.S. company.

CONCLUSION

In conclusion, we believe that a corporation should remain a separate and distinct entity from its shareholders for all purposes, including U.S. taxation. If overwhelming evidence is produced at these hearings indicating that this principle has been abused by U.S. taxpayers, then this change should only be made to assist the U.S. Treasury Department to eliminate those situations. This radical change in the law should not be directed at U.S. industries operating abroad which can prove by their past history that they are legitimate foreign investors contributing to the economic development of the countries wherein they operate.

We believe that if the aims of the United States to extend help to the less developed areas of the world are to be successful, the financial and technical assistance of U.S. private enterprise in those areas must continue to be encouraged. Therefore, we believe and strongly urge, that the changes in the present tax law imposed by sections 11, 13 and 16 should be removed to the extent they relate to investments in the less developed areas of the world.

Thank you very much.

Senator KERR. Thank you, Mr. Sprague, for your statement.

Mr. J. J. Gibbons, Blaw-Knox Co.

STATEMENT OF JOSEPH J. GIBBONS, ASSISTANT TREASURER OF THE BLAW-KNOX CO., PITTSBURGH, PA.

Mr. GIBBONS. My name is Joseph J. Gibbons. I am assistant treasurer of Blaw-Knox Co., Pittsburgh, Pa. I have asked for an appearance before your group to protest the unfairness of sections 13 and 16 of the revenue bill as passed by the House of Representatives.

In section 13 of the bill, it is provided that Subpart F: Income of Controlled Foreign Corporations, will be taxed immediately to the American parent. If the income is going to be taxed immediately, I believe it logically and equitably follows that a loss would be deductible.

In addition, it will be extremely difficult in many cases to determine what is the subpart F income or loss and what is the nonsubpart F income or loss of a controlled foreign corporation.

I would propose, therefore, that the American parent be allowed an election to have the entire income or loss of the controlled foreign corporation included immediately in the tax return of the American parent. By such an election, the American parent would have the option of having the income or loss of its controlled foreign corporation taxed as though it were a branch.

Under section 13 of the bill, the investment in qualified property in less developed countries is allowed as a reduction in the computation of net foreign-base company income. One of the items included in qualified property is stock in another foreign-controlled corporation, in which the acquiring foreign-controlled corporation owns at least 10 percent of the stock, and in which more than 50 percent of the stock is owned by not more than five U.S. persons.

I believe that the policy of our administration to encourage investment in, and industrialization of, these underdeveloped countries would be enhanced by allowance of any investment in stock of a company in a less developed country for the purpose of the qualified property investment allowance in the determination of net foreign-base company income.

In addition, I feel that any such investment which exceeds the foreign-base company income in any given taxable year should be allowed as a carryover to reduce the net foreign-base company income of subsequent years.

Under section 16, the gain from the sale, exchange, or liquidation of a controlled foreign corporation is taxable as dividend income. No provision is made in section 16 for allowance of the deduction as an ordinary loss in the event that the sale, exchange or liquidation results in a loss rather than a profit. I believe it is quite essential to equitable treatment that losses upon disposition of stock in controlled foreign corporations be handled in a manner consistent with the gains—namely, that losses should be deductible.

Senator KERR. Thank you very much, Mr. Gibbons, for an intelligent statement.

STATEMENT OF ROBERT J. McDONALD, ATTORNEY

Mr. McDONALD. Senator Kerr, my name is Robert J. McDonald. I am here today representing a group of New York lawyers who felt they might perform a useful service by making a study of the provisions of H.R. 10650 relating to the taxation of income from foreign sources.

We have submitted a long brief for the record, and I propose to deliver an oral summary, in the interests of saving time.

Senator KERR. You refer to the document headed "Proposed Taxation of Foreign Income Under H.R. 10650"?

Mr. McDonald. Yes, sir.

Senator Kerr. May I ask you, sir, if these New York lawyers did this on the basis of representation of clients interested in this legislation by reason of how it might affect them?

Mr. McDonald. No, sir; we did not; although most, if not all, of us do have clients who are engaged in foreign operations.

This was an endeavor that we took on by ourselves. To the best of my knowledge, it had not been discussed with any clients by any single one of the lawyers participating.

Senator Kerr. The brief may be made a part of the record following your oral presentation.

Mr. McDonald. Our group recognizes that much conscientious work has gone into the preparation of this bill, and we, too, favor appropriate legislation to curb tax-avoidance devices.

We believe, however, that the present bill does not effectively distinguish between avoidance devices and legitimate business operations conducted outside of the United States.

Further, we believe the foreign income provisions are unworkable, are unduly penal in their impact on the foreign business of the U.S. persons, and may have many consequences that are clearly adverse to the interests of the United States.

The foreign income provisions are unworkable because they are so complex that they cannot reasonably be understood or administered, and because their application depends upon detailed historical and current information that will often be impossible or impracticable to obtain.

They are unduly harsh and, in many cases, penal in effect in imposing burdens of taxation and of administrative compliance that are much more extensive than in the case of domestic operations, particularly in their impact on the individual foreign investor. Moreover, no opportunity is provided to adjust legitimate business arrangements established in reliance upon existing law and, indeed, at the urging of our Government.

These provisions would have numerous consequences that are clearly undesirable and often unintended. They substantially favor foreign competitors who are not subject to similar burdens, even though the committee report notes that one of its guiding policies is to avoid weakening the competitive power of American business abroad.

They favor U.S. businesses that are currently entrenched in foreign markets against new U.S. competitors.

They encourage U.S. persons to take minority rather than controlling interests in foreign businesses, with the possible consequences, among others, of loss of a favored position with respect to the sale to such businesses of domestic products.

Senator Kerr. Let me interrupt you there.

Mr. McDonald. They encourage——

Senator Kerr. I say, let me interrupt you.

Mr. McDonald. I am sorry.

Senator Kerr. You have just said that, in your judgment, this bill would encourage American investors to take minority positions in foreign corporations rather than American corporations creating subsidiaries in foreign areas.

Mr. McDonald. We believe it might have that tendency.

Senator KERR. That was one of the points that Dr. Dan Throop Smith made with reference to the investment company which asked for the conference with him and discussed the probability of their increasing foreign stocks in their portfolios of investments, although they are American investment companies, I believe.

Mr. McDONALD. Generally speaking, an American investment company, assuming it is an investment company with wide distribution of its stock, would tend not to have a controlling position, and when I say controlling I mean more than a 50-percent interest in the foreign corporation.

Senator KERR. And to the extent that it encouraged investment in minority positions in foreign corporations, it would adversely affect our balance of gold payments rather than favorably affect them.

Mr. McDONALD. It may or may not. I think that is a complicated question. I think that——

Senator KERR. If a situation arose whereby Americans took American dollars and bought stocks from foreign owners and paid for them in American dollars that went over there, that would be adverse in our balance of payments, would it not?

Mr. McDONALD. Temporarily it might.

Senator KERR. Well, the only way that those dollars could come back would be for those sellers to send them back.

Mr. McDONALD. That is correct. And if you did not have controlling positions in those companies there would be less tendency for them to find their way back.

Senator KERR. It would seem to me you were making a point which, I think, is of some significance, and I was asking you the questions only to let the record clearly reflect that as your judgment, if that is your judgment.

Mr. McDONALD. I believe it is.

Senator KERR. Proceed.

Mr. McDONALD. They encourage the export from the United States of research and development operations. Paradoxically, they may discourage investment in underdeveloped countries, which always tended to be speculative, by providing ordinary income treatment for gains from profitable operations, and by retaining capital loss treatment for losses.

Because of the tax impact on liquidation or sale of stock, they discourage in many instances the repatriation of capital that is no longer desired to be employed abroad.

I would like to go into some of these points in more detail.

The bill taxes income of a controlled foreign corporation to a U.S. person, whether or not distributed. This term is defined as meaning—

> any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned, directly or indirectly by U.S. persons on any day during the taxable year of such foreign corporation.

There will, of course, be many situations where the percentage of U.S. ownership cannot be ascertained. In the first place, many foreign corporations use bearer shares and the ownership of such shares cannot be determined.

Others may be registered in street names. Some shares may be held in numbered accounts, and the laws of some countries prohibit

the disclosure of the beneficial ownership of such shares even to other governments.

Again, the U.S. ownership may result from complex attribution rules. Thus, many situations must develop where the facts of control may be difficult or impossible for U.S. persons to obtain.

Further, the existence of control as defined in the bill may not assure practical control even if the group of U.S. persons has been identified.

The theory apparently is that ownership by U.S. persons or more than 50 percent of the voting power in a foreign corporation would enable such persons to require the corporation to furnish the information and declare the dividends that U.S. persons would need to meet their newly imposed U.S. obligations, even though the interests of such U.S. persons may be entirely related.

However, the fact that U.S. persons in the aggregate own over 50 percent of a particular foreign corporation's voting stock gives no assurance whatsoever that they may have common interests that permit them together to control effectively any foreign corporation in a related chain of corporations. This is one of the vital organs of the bill.

If effective control does not, in fact, exist, compliance with other parts of the bill becomes impossible.

For section 13 to be effective, a separate determination must be made each year for each controlled corporation, among others, of its subpart F income. This is a new concept, and a separate determination must be made of the increase in the earnings invested in the nonqualified property, also a new concept, of each foreign corporation, that is, a controlled foreign corporation on any day of the year.

This must be done to determine the income to be taxed to each U.S. person having the requisite stockownership.

Now, in determining the pro rata share of a corporation's increase in earnings invested in nonqualified property, not only must there be a determination of the earnings and profits for the year and the earnings and profits accumulated since December 31, 1962, but there must also be a review of the financing, business needs and underlying nature of the business of the foreign corporation and of any changes made therein.

To make these determinations requires the application of a series of imprecise concepts, and the availability of information extremely difficult to obtain.

The determination of earnings and profits for the year or for the period since December 31, 1962, of foreign corporations presents problems which will be insurmountable in a substantial number of cases.

These determinations are dependent not only on U.S. concepts of tax accrual, tax deferments, tax elections, basis, tax exempt income, amortization and depreciation, and numerous other items completely alien to the foreign corporation and foreign accountants, but it is also affected by reorganizations, liquidations, exchanges, and distributions in kind which may or may not be tax free by American standards.

There are no provisions whatsoever under the bill for making these determinations or provisions establishing the machinery therefor.

With respect to tax basis, for example, which is one of the ingredients of earnings and profits, section 6 of the bill explicitly recog-

nizes for other purposes that the adjusted basis of property may not be available, and provides for the use of book values, and I quote: "Adjusted to approximate their adjusted basis," whatever that means.

In this connection, the House report states:

> However, in the case of some foreign corporations, a U.S. concept of adjusted basis for assets may be difficult, if not impossible, to compute.

Now, the objectives of the foreign income provisions of the bill have been stated generally as follows:

(*a*) To improve the U.S. position with respect to the balance of payments;

(*b*) To eliminate any tax incentives which would cause American industry to produce abroad rather than at home;

(*c*) To achieve tax neutrality or equity by imposing equal tax burdens on foreign and domestic income of U.S.-controlled enterprises; and

(*d*) To eliminate the use of foreign corporations for avoidance of tax on items which should properly be subjected to U.S. tax.

As a group we have not attempted to analyze whether the proposed bill will, in fact, materially aid the U.S. balance of payments picture, and to the extent to which such effects, if any, will be short run or long run.

However, even without detailed economic analysis, it seems evident that certain of the provisions of the bill, particularly section 16, may have the effect of freezing U.S.-owned foreign investments by discouraging the eventual return of such capital to the United States because of the harsh tax effect at the time of sale or liquidation of this new tax bill.

Similarly, no detailed comments are offered on the question whether foreign income provisions will induce American industry to produce at home goods that would be produced abroad if the bill were not enacted. However, the group experience in planning for an operation with businessmen indicates that businessmen seldom have a choice between establishing business outside the United States, on the one hand and, on the other hand, of establishing the same business within the United States or expanding an existing business, so it may export abroad.

The choice which an American entrepreneur generally faces is whether he desires to serve a particular foreign market by establishing his business in that market or whether he will leave that market to be exploited by foreigners.

This bill may result in more business opportunities being abandoned to foreign interests.

In exhibit III to Secretary Dillon's statement before this committee, the concept of neutrality underlying the foreign income provisions is stated to be as follows:

> One of the most fundamental of the guiding principles in American income taxation is that there should be equality in the tax treatment of similar groups of taxpayers. Applied to corporations, this principle must be interpreted to mean that income of any branch or subsidiary of an American corporation operating overseas should as far as possible be subject to the same corporate income tax rates as the income of any branch or subsidiary operating at home.

Assuming this is a sound interpretation, which is, perhaps, arguable, a careful study of the proposed bill indicates that its provisions will not achieve this type of neutrality.

In an effort to create tax neutrality between a domestic corporation operating overseas through a branch and a foreign corporation, the bill would require U.S. shareholders to pay U.S. income taxes at ordinary income tax rates with respect to certain income or earnings of U.S.-controlled foreign corporations.

In a number of important respects, however, this treatment does not result in neutrality but results in foreign corporations being treated more unfavorably than domestic corporations.

This is especially disheartening in situations where the foreign investment was made at the urging of the U.S. Government which, in the past, has been fostering foreign investments.

In the case of a related group or chain of U.S. controlled corporations, the bill would tax the U.S. shareholder directly on the profits of each of the controlled foreign corporations, but does not make any provision for offsetting such groups by the losses incurred by other foreign corporations within the group or chain as would be the case if the foreign corporations were branches of a domestic corporation.

This will often result in taxing U.S. shareholders with hypothetical income where, in fact, no income or other economic advantage was earned or enjoyed by the shareholders.

Let me give an example. Assume A, a United States individual, owns all of the stock of foreign corporation B, which, in turn, owns all of the stock of foreign corporation C. In 1963 C earns $60,000 of subpart F income, or tainted income, and no other income. In the same year B, its parent corporation, incurs $100,000 of losses. As a result, the value of A's investment in B, the very corporation in which he owns shares, has been reduced in 1963 by $40,000. Under the bill, A is taxed with hypothetical income of $60,000.

Unlike the Treasury's draft bill of January 1962 and unlike the case of a domestic corporation under present law, H.R. 10650 does not make any provision for permitting those businesses which have losses in some years and profits in others to offset their losses against their profits.

Capital gains derived by a controlled foreign corporation from the sale of plant and equipment or other assets used in its business, would apparently be taxed to the U.S. shareholder at ordinary income tax rates and not at capital gains rates. In the case of a domestic corporation the gains derived by the corporation from such sales would be taxed at capital gains rates.

Under sections 13 and 16 of the bill, an ordinary income tax is imposed on U.S. shareholders with respect to certain earnings of the controlled foreign corporation, either currently or upon the sale or liquidation. But if the investment should result in a loss the investor receives no ordinary deduction for the loss and will be granted only a capital loss upon the sale or liquidation irrespective of the amount of undistributed earnings that may have been taxed currently as ordinary income. The U.S. investor in a U.S. corporation ordinarily receives the benefit of capital gains upon the sale of stock of a domestic corporation at a profit.

Now, one method chosen by the bill for achieving tax neutrality is to treat the undistributed income of a controlled foreign corporation as if it had been earned directly by the U.S. shareholder.

Where the shareholders are individuals, trusts, or partnerships, rather than corporations, this would impose severe hardships, and certainly would not be equal to the tax treatment afforded U.S. stockholders of domestic corporations where the income is not taxes though until distributed.

Under the bill the corporate income would be taxed to the individual shareholder at individual rates rather than at corporate rates.

Domestic corporations are allowed to credit against the U.S. income tax on foreign dividends such foreign income taxes as were paid by the foreign corporation with respect to the earnings which it distributed.

On the other hand, an individual shareholder who receives a dividend is not allowed a tax credit by taxes paid or with respect to taxes paid by a declaring corporation.

As a result, the impact of the hypothetical dividends created by the bill will be much more severe in the case of the individual shareholder.

He may find himself with the obligation to pay a U.S. tax on his hypothetical income at individual rates, notwithstanding the fact that his foreign corporation had already paid foreign corporate taxes at a rate equal to or even greater than the U.S. corporate rate and, therefore, under the Treasury Department's concept of neutrality is already in a state of grace.

In many instances, the U.S. shareholder may be taxed on an amount greater than that which can be distributed to him. This situation is particularly acute with respect to individuals where there is a chain of corporations.

Assume A, a U.S. individual, owns all of the stock of a foreign corporation B which, in turn, owns all the stock of foreign corporation C. In 1963 C has $100,000 of subpart F income which it distributes to B——

Senator KERR. Of what?

Mr. McDONALD. In 1963 C has $100,000 of subpart F income—that is the tainted kind of income—which it distributes to B, after deduction of a foreign 30-percent withholding tax on dividends, B then distributes $70,000 to A as a dividend. Under section 951 A has $100,000 of taxable income even though only $70,000 was distributed to him. He receives no foreign tax credit with respect to the $30,000—none whatsoever—with respect to the $30,000 of withholding tax withheld by corporation C on its distribution to corporation B.

Individuals or small groups of individuals now have the privilege generally of doing business in corporate form and eventually realizing on their investments at capital gains rates. But section 16, when taken together with section 13 of the bill withdraws this privilege with respect to foreign investments.

Whether the privilege of being taxed this way on a business venture is correct tax policy or not may, perhaps, be open to debate. However, it seems inequitable, and it is certainly less than neutral to withdraw the privilege only as to those who do business abroad.

Surely it is undesirable to do so through the technical mechanism of a complex bill when this important change of policy has never been stated frankly as a policy decision by the Congress.

H.R. 10650 would impose upon U.S. businesses operating abroad a whole series of complex and unprecedented tests of taxability.

It would seem essential that adequate provision be made for equitable treatment of existing bona fide business operations entered into in reliance upon existing law. Unfortunately this has not been done except in one respect: No provision is made for relief from tax on subpart F income which has been assigned or otherwise committed to meet obligations incurred in reliance on the tax provisions of existing tax law.

For example, a foreign real estate corporation may have financed the construction of a hotel by assigning to the lending bank the rent to be received under the long-term lease, or a foreign mining or manufacturing corporation may have entered into construction commitments that were to be financed out of future profits.

Under the bill, the U.S. shareholders will be granted no deduction from taxable income for subpart F income necessarily applied to meet these preexisting commitments.

The acute inequality of this result is best illustrated by the foreign investment which was made at the encouragement of the U.S. Government.

Where U.S.-controlled foreign corporations are presently engaged in manufacture abroad or in the purchase or sale of foreign goods between one foreign country and another, or in other foreign marketing activities having no connection with the United States, the bill is designed to prevent the foreign corporation from conducting its activities in such a way as to save foreign taxes, and this, despite Secretary Dillon's statement that it was the guiding policy to avoid weakening the competitive power of U.S. businesses abroad.

For example, if a German manufacturing corporation A wishes to sell its product in, say, France, it is common practice to organize, say, a Swiss subsidiary to sell in France. This mechanism saves German or French taxes.

If a U.S.-controlled foreign corporation saves foreign taxes in this matter, it is wrong under this bill because the bill imposes its own U.S. standards of taxation. Thus, on any purchase or sale between any related companies the bill requires payment currently in the United States on certain foreign income except where the foreign corporation is organized under the law of the country from which it purchases or to which it sells.

In this way, Americans would be subject to a competitive disadvantage by being forced to pay foreign taxes or of paying foreign taxes or obtaining foreign tax exemption with which their foreign competitors need not concern themselves.

Thus, while a German manufacturing company that is not controlled by U.S. persons may sell its products in countries outside Germany through the use of a Swiss sales company without special tax burdens on the sales company, a U.S.-controlled German manufacturing company may not, unless, of course, it is invested in a less developed country. This is so, even through the only tax avoidance is avoidance of German taxes rather than avoidance of U.S. taxes.

The Puerto Rican company is also subject to the punitive provisions of many sections of the bill.

It is submitted that it is unreasonable for the U.S. revenue laws to attempt to deal with this type of avoidance of foreign taxes, and a unilateral effort to force the payment of foreign taxes would substantially damage legitimate U.S.-owned businesses.

If, for example, the German Government believes that such avoidance should be eliminated, it is the Germany Government that should provide legislation for this purpose, not the United States.

In short, the effect of this bill is, in an economically developed foreign market, to impose upon the foreign businesses of U.S.-controlled foreign corporations, either foreign or U.S. taxes to which their foreign competitors are not subjected.

In accordance with Secretary Dillon's statement before this committee that "the deferral privilege should be retained for income earned in less-developed countries, in line with our general foreign policy objectives," the bill contains provisions purporting to encourage investments which would benefit the economy of such less-developed countries. On analysis, this encouragement offered by the bill is illusory.

In order to qualify a business must be one which is carried on almost wholly within one or more less-developed countries. This would eliminate tax deferral for any business which, though beneficial to the economy of the less-developed country, involves substantial activities outside its borders.

The only businesses which could clearly come within the statutory language would appear to be local enterprises of a type which would not normally be attractive to outside capital.

Even assuming that a new business activity in a less-developed country qualified initially, its U.S. shareholders would run the risk of being subjected to U.S. income tax on all of its post-1962 earnings if at any time in the future the particular country should be removed from the Treasury's list of less-developed countries.

In the case of an individual this would pyramid all such income into 1 taxation year.

Even assuming that the investment qualified when made and the country in question continued to be less developed, section 16 of the bill would ultimately impose an ordinary income tax upon the gain derived from the liquidation or from the sale or exchange of the investor's stock, to the extent of certain earnings and profits not previously taxed.

In the case of a domestic corporation, of course, such liquidation or sale or exchange would result in a capital gains treatment.

In return for engaging in the risk of an investment in a less-developed country, the investor will in the usual case be limited to a capital loss in the event his investment should become valueless, but would ultimately be subjected to an ordinary income tax in the event his investment proves successful and he attempts to realize upon it.

To sum up, the less-developed country provisions of the bill offer little practical incentive for investments apparently desired to aid such countries.

The whole area of the taxation of foreign income is seriously complicated by the fact that treaties, foreign statutes, foreign methods of financing and marketing, foreign administrative controls as well as domestic law and the public policy of the United States are involved.

The complexities of the general problem make it difficult to reach adequate and fair solutions and fair legislative solutions.

The first stage, that of defining tax policy, has been handicapped by the use of broad phrases such as "tax havens," "the privilege of tax deferral," "equity" and "neutrality" which cannot serve as a substitute for a thorough analysis of problems of economics and tax policy.

These broad phrases very often turn out to be completely misleading when the technical product drawn from them is applied to a concrete business situation.

Working out a reasonable solution for the problem of preventing U.S. tax avoidance through the use of foreign corporations may take considerable time if it is done in a systematic fashion by moving from policy decisions, settled with reasonable clarity and publicly announced, to technical solutions upon which comment can be offered after a suitable period of study.

However, any loss of time which may be involved would seem preferable to the administrative confusion, the disruption of legitimate business transactions, the unjustified tax penalties and the cost of litigation which would result from enacting the foreign provisions of the bill.

Thank you very much.

Senator KERR. Thank you very much, Mr. McDonald.

(The brief previously referred to follows:)

April 27, 1962

PROPOSED TAXATION OF FOREIGN INCOME UNDER H. R. 10650

These comments reflect a joint study conducted by a group of lawyers of some of the principal provisions of H. R. 10650 which relate to the taxation of income from foreign sources (Sections 5, 6, 7, 13, 16 and 20).

This memorandum is divided into two parts. Part I discusses these provisions generally, with reference to certain policy considerations which apparently underlie these provisions, the extent to which the Bill implements these policies and certain substantive aspects of the provisions. Part II contains more detailed technical and substantive comments on each of Sections 5, 6, 7, 13, 16 and 20.

These comments deal only with the principal problems that have occurred to the undersigned and are not intended to be exhaustive. The Bill, which was introduced in the House March 12, 1962, contains many new, unusual and complex provisions, and has been available for study and analysis for only a relatively brief period.

PART I

General Statement

The provisions of the Bill relating to the taxation of foreign income present many serious problems. The group recognizes that much conscientious work has gone into the preparation of the Bill in an effort to serve the best interests of the nation and its citizens. The group would favor appropriate legislation to curb tax avoidance devices, but believes that the present Bill does not effectively distinguish between such devices and legitimate business operations conducted outside the United States. In the opinion of the group, the foreign income provisions are unworkable, are unduly penal in their impact on the foreign business of United States persons, and would have many consequences that are clearly adverse to the interests of the United States.

The foreign income provisions are unworkable because they are so complex that they cannot reasonably be understood or administered, and because their application depends upon detailed historical and

current information that will often be impossible or impracticable to obtain.

The provisions are unduly harsh, and in many cases penal in effect, in imposing burdens of taxation and of administrative compliance that are much more extensive than in the case of domestic operations, particularly in their impact on the individual foreign investor. Moreover, no opportunity is provided to adjust legitimate business arrangements established in reliance upon existing law.

These provisions would have numerous consequences that are clearly undesirable. They substantially favor foreign competitors who are not subject to similar burdens. They favor United States businesses that are currently entrenched in foreign markets against new United States competitors. They encourage United States persons to take minority rather than controlling interests in foreign businesses, with the consequence, among others, of loss of a favored position with respect to the sale to such businesses of domestic products. They encourage the export from the United States of research and development operations. Paradoxically, they may discourage investment in underdeveloped countries, which always tends to be speculative, by providing ordinary income treatment for gains from profitable operations, and by retaining capital loss treatment for losses. Because of the tax impact on liquidation or sale of stock, they discourage in many instances the repatriation of capital that is no longer desired to be employed abroad.

Workability of the Bill

The Bill's provisions in respect of foreign income are so complex, overlapping and replete with unprecedented tests, that it is difficult to analyze them. The members of this group submitting this report are experienced in matters of tax law; they have spent over forty hours in group discussion and countless hours of individual study reviewing the contents of the aforementioned sections. Despite this, the practical problems of working with the proposed legislation are so immense that the group has found it difficult to understand the Bill and impossible to measure its full impact.* So many new concepts are included in the

* In this respect, it should be noted that the Bill passed by the House is substantially different from the discussion draft previously circulated.

Bill that a definitive technical analysis by tax practitioners has been virtually impossible. The complexity of its provisions can only cause uneven and arbitrary enforcement and administration of the Bill. Skilled tax practitioners will undoubtedly find technical loopholes. On the other hand, many United States entrepreneurs will by chance find themselves caught by extremely harsh provisions of the Bill which by proper planning could have been avoided. Revenue agents cannot be reasonably expected to understand the provisions or to enforce them uniformly. Thus, the impact of the Bill will be haphazard.

A few provisions, examples and concepts under the Bill are referred to here to illustrate these difficulties. Part II of this memorandum refers to many other technical difficulties.

(a) Controlled Foreign Corporation.

The Bill taxes income of a "controlled foreign corporation" to a United States person, whether or not distributed. The term "controlled foreign corporation" is defined under proposed Code Section 954 as meaning "any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned, directly or indirectly (within the meaning of Section 955(b)), by United States persons on any day during the taxable year of such foreign corporation." The workability in practice of these sections of the Bill depends almost entirely upon their being effective control of the foreign corporation in a United States group and the power and ability to ascertain easily and without undue expense that such control does, in fact, exist.

There will be many situations where the percentage of United States ownership cannot be ascertained. In the first place, many foreign corporations use bearer shares and the ownership of such shares cannot be determined. Others may be registered in street names. Some shares may be held in numbered bank accounts; the laws of some countries prohibit the disclosure of the beneficial ownership of such shares even to other governments. Again the United States ownership may result from "attribution" under proposed Code Section 955. It is no answer to say that this problem has existed for many years with respect to foreign personal holding companies; there one is dealing primarily with

closely-held companies where the income test eliminates most, if not all, large publicly-held companies; this is not true under the controlled foreign corporation provisions, and perhaps under the new definition of foreign personal holding company.

The control definition in the Bill applies also if United States persons acquire more than 50% of the voting stock on "any day" of the year. Since the tax under Section 951 is imposed only with respect to that portion of the year during which the foreign corporation is a controlled foreign corporation, determination of control may in some cases have to be made on a daily basis. But, as a practical matter, it will be impossible to ascertain the ownership position of a foreign corporation with more than a few stockholders on each and every day of the year, particularly after taking into account equitable interests and the complex attribution rules.

The existence of control as defined in the Bill may not assure the practical control that the application of the provisions of the Bill requires. The theory apparently is that ownership by United States persons of more than 50% of the voting power in a foreign corporation would enable them to require the corporation to furnish the information and declare the dividends that United States persons would need to meet their newly-imposed United States obligations, even though the interests of such persons may be entirely unrelated. However, the fact that United States persons in the aggregate may own over 50% of a particular foreign corporation's voting stock gives no assurance that they have common interests that permit them together to control effectively any foreign corporation in a related chain of corporations, even assuming that the United States persons who are shareholders can be ascertained. These difficulties are particularly burdensome to a United States individual shareholder owning stock in a "controlled foreign corporation", who may have no relationship with any other shareholders. Similar difficulties apply with respect to individual shareholders, no matter how small their interest, in a foreign personal holding company, which under the new definition in Section 7 of the Bill might embrace publicly-held companies.

Moreover, as noted above, the definition requires that the 50% test be met on only one day during the year. Even if more than 50% of the

ownership crosses over the line to United States persons on "any day", there is no assurance that such persons will still have a controlling vote when the time comes to obtain the information needed to file their United States returns or to compel the payment of dividends to meet their United States taxes.

Under the attribution rules of proposed Section 955(b), more than 50% of the vote may be attributed to United States persons even though they lack actual voting control. For example, assume a foreign company is owned equally by an American corporation and a foreign corporation, each of which is publicly held. The subsidiary will be deemed to be "controlled" by United States persons if there is a single American shareholder of the foreign parent.* Indeed, the same result might even follow in a situation where the United States publicly-hold parent had only a minority interest of, say, 40% of the subsidiary's stock and the foreign publicly-held parent had the majority interest of 60%. If American stockholders owned 20% of the stock of the foreign parent, it would appear that the subsidiary would be treated by the Bill as "controlled" by United States persons, even though it is in fact controlled by foreigners. Here, too, it would be extremely difficult, if not impossible, for a particular United States person to obtain information with respect to the United States ownership of the foreign publicly-held parent.

(b) Determination of the Amount of Income.

Under Section 13 of the Bill, a separate determination must be made each year of its "Subpart F income" and of the increase in the earnings invested in "nonqualified property" of each foreign corporation that is a controlled foreign corporation on any day of the year. This must be done to determine the income to be taxed to each United States person having the requisite stock ownership. Regardless of whether Americans have effective voting control, it will generally be impossible for them to obtain the type of United States tax accounting information which the Bill requires to compute the income to be taxed to United States persons under Section 13.

* On the other hand, where a foreign corporation is owned by a domestic corporation controlled by non-resident aliens, the shareholders of the domestic corporation are disregarded. This seems anomalous in the context of United States "controlled foreign corporation".

To determine Subpart F income of the controlled foreign corporation for the year, the income must be divided into three parts: net foreign base company income, other Subpart F income and other income. The net foreign base company income is the foreign personal holding company income of the corporation, with substantial adjustments in accordance with proposed Code Section 952(e), less the "increase in investment in qualified property in less developed countries". To determine such increase, determinations must be made as to the amount invested in qualified property in less developed countries at the beginning of the year and the amount invested at the end of the year. This involves a detailed review of the underlying properties, method of financing and nature of the business in the less developed countries, since only property which is ordinary and necessary for the active conduct of a trade or business carried on "almost wholly within" the less developed countries can be qualified property.

In determining the pro rata share of a corporation's increase in earnings invested in nonqualified property, not only must there be a determination of the earnings and profits for the year and the earnings and profits accumulated since December 31, 1962, but there must also be a review of the financing, business needs and underlying nature of the business of the foreign corporation and of any changes made therein. To make these determinations, requires the application of a series of imprecise concepts. There must be a determination of the amount invested in qualified property, which in most instances will be limited to property that is ordinary and necessary for the active conduct of a trade or business carried on by the controlled foreign corporation while controlled by "substantially the same" United States persons since December 31, 1962 or for the preceding five years, or carried on within a less developed country. Since any change in makeup of the so-called United States controlled group and any change in the underlying nature of the trade or business affects what is qualified property, complete analysis must be made of who is in control of the foreign corporation and what changes, if any, have been made in this business. It is doubtful whether these determinations can ever be made with precision.

The determination of earnings and profits for the year or for the period since December 31, 1962 for a foreign corporation presents

problems which will be insurmountable in a substantial number of cases. Such a determination is difficult enough even in the United States, because the term has never been defined with particularity either in the Internal Revenue Code or the regulations thereunder. "Earnings and profits", in United States terms, cannot be readily computed (if at all) from the accounting records kept by many foreign corporations or foreign accounting firms, even if they are branches of or related to American accounting firms.

The determination of earnings and profits is dependent not only on United States concepts of tax accrual, tax deferments, tax elections, basis, tax exempt income, amortization and depreciation, and numerous other items completely alien to the foreign corporation and foreign accountants, but is also affected by reorganizations, liquidations, exchanges and distributions in kind which may or may not be tax-free by American standards. There are no provisions whatsoever under the Bill for making these determinations or provisions establishing the machinery therefor. With respect to tax basis, for example, which is one of the ingredients of earnings and profits, Section 6 of the Bill explicitly recognizes for other purposes that the adjusted basis of property may not be available, and provides for the use of book values "adjusted to approximate their adjusted basis" (whatever that may mean).*

There are sufficient difficulties in determining earnings and profits where there are actual distributions from a foreign corporation, but in such a situation a determination only has to be made in respect of the distributing corporation and the amount of income is limited by the distribution. Where one deals with hypothetical distributions, as under the Bill, from a group of controlled corporations which may be only partially owned, or takes into account exchange fluctuations and major currency devaluation, the problems so multiply as to be incapable of intelligent solution.

Moreover, in addition to the insoluble problems in determining the corporation's aggregate earnings and profits, "it will be necessary to maintain separate balances of earnings and profits with respect to

* The House Report states: "However, in the case of some foreign corporations, a U. S. concept of adjusted basis for assets may be difficult, if not impossible, to compute." (pp. 29-30).

different shareholders during the year" (House Report, p. 60). With the addition of numbered accounts, bearer shares, and street names, the burden becomes insuperable.

(c) Other Provisions.

If income not distributed is taxed to United States persons under the Bill, the shares with respect to which such income was taxed carry the right to receive this income free of tax if ultimately distributed. The provisions defining this right, especially in relation to the very complicated foreign tax credit provisions, are most difficult to comprehend. Assuming they can be understood and applied, these shares then carry this right to tax-free income upon transfer to successive United States holders. How can successive shareholders ever keep track of these rights?

Other complex provisions require determinations and information that will be difficult to make and obtain, e.g., the provisions with respect to the use of patents and the additional complexities added to foreign tax credits because of the taxation of undistributed earnings. These problems are not solved by the Bill's approach of putting an impossible burden of proof upon the United States shareholders.

Failure to Meet Stated Objectives of the Bill

The objectives of the foreign income provisions of the Bill have been stated to be as follows: (a) to improve the United States position with respect to the balance of payments; (b) to eliminate any tax incentives which would cause American industry to produce abroad rather than at home; (c) to achieve "tax neutrality" or "equity"* by imposing equal tax burdens on foreign and domestic income of United States controlled enterprises; and (d) to eliminate the use of foreign corporations for avoidance of tax on items which should properly be subjected to United States tax.

As lawyers, we shall not attempt to analyze whether the proposed Bill will in fact materially aid the United States balance of payments

* These are merely labels which are largely meaningless until defined precisely in context, but which are often used as slogans to orient others in favor of the particular argument or provision being espoused. The practical question is not whether "equity" or "tax neutrality" should be favored, but rather with what, if any, other situations or particular provisions of the Internal Revenue Code comparison should be made.

picture, and the extent to which such effects, if any, will be short-run or long-run. However, even without detailed economic analysis, it seems evident that certain of the provisions of the Bill, particularly Section 16, may have the effect of freezing United States owned foreign investments by discouraging the eventual return of such capital to the United States because of the harsh tax effect at the time of sale or liquidation.* Other provisions of the Bill impose tax handicaps upon United States investments which can be expected to reduce profits available for future distribution to United States shareholders, such as those which will tend to cause United States persons to give up control of foreign corporations.

Similarly, no detailed comments are offered on the question whether foreign income provisions will induce American industry to produce at home goods that would be produced abroad if the Bill were not enacted. However, it should be pointed out that economic factors apart from tax considerations (labor costs, marketing factors, tariffs, and transportation costs, for example) may make it feasible to conduct a particular business outside the United States, although it would be impossible to conduct the same business within the United States. The experience of the undersigned in planning foreign operations with business men indicates that business men seldom really have a choice between establishing a business outside the United States on the one hand and, on the other hand, establishing the same business within the United States (or expanding an existing business so that it can export abroad). The choice which an American entrepreneur generally faces is whether he desires to serve a particular foreign market by establishing his business in that market or whether he will leave that market to be exploited by foreigners.

In Exhibit III to Secretary Dillon's statement before the Senate Finance Committee, the concept of "neutrality" underlying the foreign income provisions is stated to be as follows: "One of the most fundamental of the guiding principles in American income taxation is that there should be equality in the tax treatment of similar groups of taxpayers. Applied to corporations, this principle must be interpreted

* Proposed Section 1248(a) and (b) may, according to Secretary Dillon, be changed to apply only to earnings and profits accumulated hereafter, in which event the comment in the text would apply only to freeze investments in the future.

to mean that the income of any branch or subsidiary of an American corporation operating overseas should as far as possible be subject to the same corporate income tax rates as the income of any branch or subsidiary operating at home.'' Assuming this is a sound interpretation (which is perhaps arguable), a careful study of the proposed Bill indicates clearly that its provisions will not achieve this type of ''neutrality''. Instead the foreign income provisions of the Bill will impose upon the shareholders of United States controlled foreign corporations discriminatory burdens in comparison to shareholders of United States corporations. Moreover, the Bill will impose so heavy a tax burden on the individual entrepreneur as distinguished from the large corporate investor as to force his withdrawal in many cases from direct participation in international commerce.

Lack of Parity Between United States and Foreign Corporations

In an effort to create "tax neutrality" between a domestic corporation operating overseas through a branch and a foreign corporation, the Bill would require United States shareholders to pay United States income taxes, at ordinary income rates, with respect to certain income or earnings of United States controlled foreign corporations. In a number of important respects, however, this treatment does not result in neutrality but results in foreign corporations being treated more unfavorably than domestic corporations. This is especially disheartening in situations where the foreign investment was made at the urging of the United States government which in the past has been fostering foreign investments.

In the case of a related group or chain of United States controlled foreign corporations, the Bill would tax the United States shareholders directly on the profits of each of the controlled foreign corporations, but does not make any provision for offsetting such profits by the losses incurred by other foreign corporations within the group or chain as would be the case if the foreign corporations were branches of a domestic corporation.* This will often result in taxing United

* In the case of domestic corporations in such a related group, the distributed profits are taxed up the chain of corporations and not directly, or in proper cases where the requisite corporate ownership exists and the taxpayer so elects, as a consolidated group. If either of such concepts were used in the Bill, some of the harsher provisions of the Bill could be eliminated.

States shareholders with hypothetical income where in fact no income or other economic advantage was earned or enjoyed by the shareholders.

Example 1

A, a United States individual, owns all of the stock of foreign corporation B, which in turn owns all of the stock of foreign corporation C. In 1963 C earns $60,000 of Subpart F income and no other income. In the same year B incurs $100,000 of losses. As a result, the value of A's investment in B, the very corporation in which he owns shares, has been reduced in 1963 by $40,000. Under the Bill, A is taxed with hypothetical income of $60,000.

Unlike the Treasury's draft Bill of January 1962 and unlike the case of a domestic corporation, H.R. 10650 does not make any provision for permitting those businesses which have losses in some years and profits in others to offset their losses against their profits.

Example 2

A, a United States owned foreign corporation, suffers losses of $1,000,000 in 1963, and earns Subpart F income of $1,000,000 in 1964. The United States shareholders receive no deduction for A's 1963 loss and are taxed with $1,000,000 in 1964.

Capital gains derived by a controlled foreign corporation from the sale of plant and equipment or other assets used in its business would apparently be taxed to the United States shareholders at ordinary income rates and not at capital gain rates. In the case of a domestic corporation, the gain derived by the corporation on such sales would be taxed at capital gain rates.

In the case of a controlled foreign corporation, the Bill would impose a United States tax upon United States shareholders irrespective of whether the income or earnings of the foreign corporation are or can be distributed. The Bill makes no provision for cases where distribution is impracticable or even impossible by reason of currency exchange controls, foreign law requirements, loan agreements, etc.

Example 3

In 1963 corporation B, a United States owned foreign corporation engaged in manufacturing abroad, earns a profit in foreign currency equal to $1,000,000. The earnings are not needed in the business and B desires to declare such earnings as a dividend to its shareholders but is unable to do so because of local currency exchange restrictions. The United States shareholders of B apparently are taxable in 1963 with $1,000,000 of hypothetical income.

A foreign business is frequently carried on through many corporations for reasons which have nothing to do with taxation.* For all practical purposes, a group of such foreign corporations carrying on what is primarily one business should be viewed as branches of that business and if so viewed, intercompany transactions would be without tax effects. When separate U. S. corporations carry on one business this result is afforded through the consolidated return privilege or the dividends received deduction, or because items of intercompany income may be offset by concomitant deductions. In the case of a group of foreign corporations, however, intercompany transactions may have substantial adverse tax effect under the Bill. This certainly should not be the case where the arrangements are not tax motivated.

Example 4

Company A, a United States controlled German corporation engaged in manufacturing in Germany, acquires title to German real estate to be occupied by it and used in its business through a wholly-owned subsidiary, B, another German corporation, rather than directly to avoid mortgage liability. B leases the real estate to A and uses its rental income to discharge its mortgage indebtedness. The income of the subsidiary would be Subpart F income taxable to United States shareholders of Company A.

Under Sections 13 and 16 of the Bill, an ordinary income tax is imposed on United States shareholders with respect to certain earnings of the controlled foreign corporation, which tax is payable either currently or upon the sale or liquidation of the United States share-

* These non-tax reasons would include limitation of liability, participation of minority shareholders, exchange control problems, national prejudices and attitudes, title considerations, restrictions in loan agreements and separation of related but competing lines.

holders' investment (to the extent of any gain realized). On the other hand, in the event the investment should result in a loss, the investor receives no ordinary deduction for the loss and will be granted in the usual case only a capital loss upon the sale or liquidation of his investment irrespective of the amount of undistributed earnings that may have been taxed currently as ordinary income. In short, the formula offered to the investor in a foreign corporation is to pay ordinary income taxes if he succeeds, but take only capital losses if he fails. The United States investor in a United States corporation ordinarily receives the benefit of a capital gain upon sale of stock of a domestic corporation at a profit.

To summarize: The Bill does not establish parity of treatment as between controlled foreign corporations and domestic corporations, between United States shareholders in a domestic and foreign corporation, or between a United States corporation with a foreign branch and a foreign corporation. Instead, it subjects controlled foreign corporations and their United States shareholders to disadvantages which would in many cases make the foreign investment much less attractive from an income tax viewpoint than a domestic investment or even impossible as a business matter, particularly where such investment involves risk of loss.

Discriminatory Treatment of Non-Corporate Shareholders

One method chosen by H.R. 10650 for achieving tax "neutrality" is to treat the undistributed income of a controlled foreign corporation as if it had been earned by its United States shareholders. Where the shareholders are individuals, trusts or partnerships, rather than corporations, this would impose severe hardships and would certainly not be "equal" to the tax treatment afforded United States stockholders of domestic corporations.*

The corporate income would be taxed to the individual (or other non-corporate) shareholders at individual rates of tax on ordinary

* The existing foreign personal holding company provisions, which cause certain "passive" income of foreign corporations to be taxed to United States shareholders whether or not distributed, have had quite limited applicability to situations believed to be created primarily for tax avoidance and do not afford a reasonable precedent for the sweeping provisions of the Bill and their application to operating businesses.

income rather than at corporate rates. If such individuals were to form a United States corporation to act as shareholder, it appears that such a corporation, in the absence of other gross operating income of more than 20% of its total gross income, might be treated as a personal holding company by reason of hypothetical dividends under H.R. 10650.

Similarly, where the non-corporate shareholders liquidate or sell their investment in the controlled foreign corporation, under Section 16 of the Bill they would be required to report the gain (to the extent of earnings and profits previously untaxed) as ordinary income taxable at their individual rates rather than at corporate rates.

Example 5

A, a Puerto Rican corporation, which has been exempt from Puerto Rican tax because of the Puerto Rico industrial incentive program, is owned equally by B, a United States individual, and by C, a United States corporation. (B is single and has $20,000 of income from other sources.) A corporation has accumulated, since 1913, earnings of $200,000. Immediately after the enactment of H.R. 10650 A corporation liquidates and distributes $110,000 each to B and C, who each realize a gain of $100,000. The United States tax imposed is as follows:

on B — $83,696

on C corporation — $52,000.*

Domestic corporations are allowed to credit, against their United States income tax on foreign dividends, such foreign income taxes as were paid by the foreign corporation with respect to the earnings which it distributed. On the other hand, an individual (or other non-corporate) shareholder who receives dividends is not allowed a tax credit with respect to taxes paid by a declaring corporation. As a result, the impact of the hypothetical dividends created by H.R. 10650 will be much more severe in the case of the individual (or other non-corporate) shareholder. He will find himself with the obligation to pay a United States tax on his hypothetical income (at individual rates)—notwithstanding the fact that his foreign corporation has already paid foreign

* Even if the Bill is amended in accordance with Secretary Dillon's suggestion to limit the ordinary income treatment on liquidation to earnings accumulated hereafter, results similar to those of the example would apply with respect to subsequent earnings and a later liquidation.

corporate taxes at a rate equal to, or even greater, than the United States corporate rate and therefore, under the Treasury Department's concept of neutrality, is already in a state of grace.

Example 6

C, a Canadian real estate corporation, is owned equally by A, a United States corporation, and by B, a United States individual. (B is single and earns $20,000 per year.) In 1963 C derives net income of $100,000 from rental of its Canadian realty, and pays Canadian corporate income tax of $50,000 (at the 50% Canadian rate). All of C's funds are applied to meet its expenses and mortgage debt; no dividends are distributed by C. Under the Bill A corporation and B each have $25,000 of hypothetical income under Section 951. The following additional United States taxes would be imposed on each:

on A corporation — $500*

on B — $15,370.

In many instances, the United States shareholder may be taxed on an amount greater than that which can be distributed to him. The situation is particularly acute with respect to individuals where there is a chain of corporations.

Example 7

A, a United States individual, owns all of the stock of foreign corporation B, which in turn owns all of the stock of foreign corporation C. In 1963, C has $100,000 of Subpart F income which it distributes to B, after deduction of a foreign 30% withholding tax on dividends, B then distributes $70,000 to A as a dividend. Under Section 951, A has $100,000 of taxable income even though only $70,000 was distributed to him. He receives no foreign tax credit with respect to the $30,000 of withholding tax withheld by corporation C on its distribution to corporation B.

Individuals or small groups of individuals now have the privilege generally of doing business in corporate form and eventually realizing

* If the "gross-up" provisions of Bill Section 11 are enacted, the additional tax to A would be $1,000 instead of $500.

on their investment at capital gain rates. When Section 16 of the Bill, which taxes gains from the sale of foreign corporate stock at ordinary income rates, is taken together with Section 13 of the Bill, it seems clear that the net effect of the Bill is to withdraw this privilege with respect to foreign investment. Whether the privilege of being taxed this way on a business venture is correct tax policy or not may perhaps be open to debate. However, it seems "inequitable", and is certainly less than "neutral", to withdraw the privilege only as to those who do business abroad. Surely it is undesirable to do so through the technical mechanism of a complex bill when this important change of policy has never been stated frankly as a policy decision by the Congress.

Existing Businesses

H.R. 10650 would impose upon United States businesses operating abroad a whole series of complex and unprecedented tests of taxability. Under these circumstances, it is essential that adequate provision be made for equitable treatment of existing bona fide business operations entered into in reliance upon existing law. Unfortunately, this has not been done except in one respect.* Most provisions contained in the Bill with respect to the continuation of existing businesses are inadequate and unfair.

No provision is made for relief from tax on Subpart F income which has been assigned or otherwise committed to meet obligations incurred in reliance on the tax provisions of existing law. For example, a foreign real estate corporation may have financed the construction of a hotel by assigning to the lending bank the rent to be received under a long-term lease, or a foreign mining or manufacturing corporation may have entered into construction commitments that were to be financed out of future profits. Under the Bill, the United States shareholders would be granted no deduction for Subpart F income necessarily applied to meet these pre-existing commitments. The acute inequity of this result is best illustrated by the foreign investment which was made at the encouragement of the United States government.

* As noted below, a business existing on December 31, 1962 may, subject to certain limitations, reinvest its earnings in the same business.

Indeed, in such a situation the corporation might ultimately experience a loss on the disposition of its assets, which were taxed as ordinary income but were not distributed, but the United States shareholders would never receive the benefit of such loss as a deduction against the ordinary income taxes paid by them in previous years with respect to their hypothetical Subpart F income.

The House Committee Report indicates (p. A98) that the definition of an existing trade or business will be relatively narrow, and that any new "lines of activity" entered after December 31, 1962 in other than less developed countries will be subject to tax on accumulated earnings during their first five years of operation. This would tend to freeze business to patterns existing on December 31, 1962, irrespective of subsequent obsolescence, inefficiency or changes in the foreign concepts of business forms.*

With respect to the tax on accumulated earnings, the Bill expressly permits accumulation in foreign business carried on continuously since December 31, 1962 under the control of substantially the same United States persons. This means that companies now entrenched abroad will have a substantial advantage under this provision in fending off competition from other United States controlled enterprises which seek to enter their existing foreign business areas.

Even in the case of a business continued since December 31, 1962, where control subsequently passes into the hands of a United States group not substantially the same as the group in control at the end of 1962, the Bill would impose a tax on accumulated earnings arising after 1962 and retained subsequent to the date when control changes (apparently whether realized before or after the change in control occurs). This would mean that the remaining United States shareholders might become liable, retroactively, for a tax on all such accumulated earnings, unless they disposed of their interest prior to the close of the taxable year. In the case of the individual owning 10% of the stock of the controlled foreign corporation, this provision would result in a pyramiding of income into one taxation year with a corresponding increase in his tax bracket.

* The test of a new business is apparently made separately with respect to the particular foreign corporation. This would bar the use of a separate corporation organized after 1962 even where it was essential in order to obtain a mortgage, to limit liability, or for other business purposes of an existing business.

Under these circumstances, if for any reason it should become necessary after 1962 for any substantial United States stockholder to dispose of his stock in an existing United States controlled foreign corporation, all the United States shareholders would be taxed upon the earnings accumulated since December 31, 1962 either under Section 951, if they continued to hold through the end of such year, or under Section 16 if they sold before the end of such year; any further problems for the future could be avoided only if all United States shareholders were, after the sale by the first, to sell to foreigners or to United States persons owning less than 10% of the stock. This is an extremely difficult situation in which to place stockholders who may have inconsistent interests with respect to possible sale of their stock.

The Bill makes no provision for permitting tax-free reorganizations of the kind now permitted to domestic corporations, to the extent required in order to bring existing foreign businesses within the format of the new law. The differences between a taxed and untaxed operation may be only accidental—e.g., organization, rather than qualification, in a particular country—but the foreign corporation will nevertheless be unable to reorganize to come within the law. Some amnesty provision or provisions would seem to be essential.

In short, the Bill's provisions with respect to existing businesses are arbitrary and incomplete. Moreover, to the extent that the Bill attempts to deal with existing businesses, it has introduced rules which would, by freezing present overseas business, tend to favor big business over small and to encourage and to perpetuate any existing monopolistic trends since new ventures bear the full impact of the Bill.

Competition with Foreigners

Where United States controlled foreign corporations are presently engaged in manufacture abroad, or in the purchase or sale of foreign goods between one foreign country and another, or in other foreign marketing activities having no connection with the United States, the Bill is designed to compel the foreign corporation to conduct its activities in such a way as to pay the "tax imposed by the foreign country" in which it is dealing (House Committee Report, p. 58). Thus, on any

purchases or sales between related companies the Bill requires payment currently of United States tax on foreign sales income except where the foreign corporation is organized under the laws of the country from which it purchases or to which it sells (proposed Section 952(e)(2)). This would presumably require the United States controlled foreign corporation to be so organized as to subject itself to the foreign taxes imposed in one or the other of such foreign countries unless it can obtain a tax exemption from one of them. If sales are made in more than one country, the practical impact of the Bill may well be to encourage the organization of separate marketing companies in each of such countries, with substantial resulting costs and complexities.

In this way Americans would be subjected to a competitive disadvantage by being forced to pay foreign taxes or obtain foreign tax exemption with which their foreign competitors need not concern themselves. Thus, while a German manufacturing company that is not controlled by United States persons may sell its products in countries outside Germany through the use of a Swiss sales company without special tax burdens on the sales company, a United States controlled German manufacturing company may not (unless, of course, it is invested in a less developed country). This is so, even though the only tax avoidance is avoidance of German taxes rather than avoidance of United States tax.

It is submitted that it is unreasonable for the United States revenue laws to attempt to deal with this type of avoidance of foreign taxes, and a unilateral effort to force the payment of foreign taxes would substantially damage legitimate United States-owned businesses. If the German Government believes that such avoidance should be eliminated, it is the German Government that should provide legislation for this purpose, not the United States Government. The arrangements between a manufacturing company and a sales company are often made with the full knowledge and approval of the government of the country in which the manufacturing company is located. To impose a United States standard of tax avoidance in this particular instance would cause American controlled foreign companies to operate under a disadvantage in competing with foreign controlled enterprises.

In the case of new businesses or "lines of activity" (House Committee Report, A98) entered subsequent to December 31, 1962, the Bill

goes beyond forcing United States controlled foreign corporations to pay heavier foreign taxes than do their foreign competitors. In this case the Bill would impose a current United States tax on all earnings accumulated during the first five years of operation even though such accumulation was ordinary and necessary for the active conduct of the foreign business in an economically developed country (proposed Sections 951(a)(1)(B), 953(a)(2), 953(b)(2) and 953(b)(3)(A)(i)). Thus, the new United States controlled business could not expand its operations through the use of retained earnings for the first five years. Moreover, the United States tax would be imposed irrespective of whether the new line of activity involved purchases from or sales to the United States, manufacture within the United States, dealings with the United States parent, or competition of any kind with United States producers. As a practical matter, therefore, the Bill would tend to enable foreign competitors—who pay no such taxes—to drive United States controlled corporations out of the developed foreign markets—such as the European Common Market.

In short, the effect of the Bill in economically developed foreign markets is to impose upon the foreign business of United States controlled foreign corporations either foreign or United States taxes to which their foreign competitors are not subjected.

Less Developed Countries

In accord with Secretary Dillon's statement before the Senate Finance Committee that "the deferral privilege should be retained for income earned in less developed countries, in line with our general foreign policy objectives", the Bill contains provisions purporting to encourage investments which would benefit the economy of such less developed countries. On analysis, however, the encouragement offered by the Bill is illusory.

In order to qualify, a business must be one which is carried on "almost wholly within" one or more less developed countries. This would eliminate tax deferral for any business which, though beneficial to the economy of the less developed country, involves substantial activities outside its borders. Thus, if a manufacturing business in a less

developed country purchases machinery or supplies from the United States or any other developed country, the business might be disqualified. Similarly, the sale in Western Europe of products manufactured in a less developed country might disqualify the business as one carried on "almost wholly within" the less developed country. The transportation of goods by air or by sea to or from a less developed country, or between two or more such countries over any substantial distance, might disqualify a business. Where engineering services and other technical assistance are rendered from offices located in other foreign countries, the business might not qualify. The only businesses which would clearly come within the statutory language would appear to be local enterprises of the type which would not normally be attractive to outside capital.

Even assuming that a new business activity in a less developed country qualified initially, its United States shareholders would run the risk of being subjected to United States income tax on all its post-1962 earnings if at any time in the future the particular country should be removed from the Treasury's list of less developed countries.

Example 8

On January 1, 1963, Ghana is listed by the President as a less developed country. In 1964, G, a Ghana corporation owned by a United States partnership, invests $5,000,000 in a dam located in Ghana, which produces electricity solely for distribution in Ghana. In 1964, 1965, 1966, and 1967, the profits of G (which is on a calendar year) are $100,000, $200,000, $300,000, and $800,000, respectively. All profits are used for debt amortization, pursuant to a loan agreement which prohibits any payment of dividends until 1974. On December 1, 1966, as a result of improvements in the Ghana economy or for other reasons, Ghana is removed by Executive order from the list of less developed countries. As a result, on December 31, 1967 the United States shareholders are liable for a United States tax, at ordinary income rates, on $1,400,000 of hypothetical dividends.

Even assuming that the investment qualified when made and that the country in question continued to be less developed, Section 16 of the Bill would ultimately impose an ordinary income tax upon the gain

derived from liquidation or from sale or exchange of the investor's stock, to the extent of earnings and profits not previously taxed. (In the case of a domestic corporation, of course, such liquidation or sale or exchange would result in capital gains treatment.) In return for engaging in the risk of an investment in a less developed country, the investor will in the usual case be limited to a capital loss in the event his investment should become valueless but would ultimately be subjected to an ordinary income tax in the event his investment proves successful and he attempts to realize upon it.

Example 9

Same facts as in Example 8, except that in 1968 Ghana expropriates the dam and seizes the stock of G corporation. The United States shareholders are allowed to deduct the loss in 1968, but only as a capital loss. It is not even available as an offset against their 1967 tax on hypothetical dividends never in fact received.

In view of the development programs of Puerto Rico and the Virgin Islands, special consideration should be given to excluding corporations of those countries from the term "foreign corporation" for purposes of Sections 13 and 16 of the Bill.

To sum up: The less developed country provisions of the Bill offer little practical incentive for investments apparently desired to aid such countries.

Constitutionality

The provisions of the Bill taxing income to those who do not actually receive it go far beyond legislation which produces somewhat related results in other areas of the Internal Revenue Code. In some instances, technical provisions of the Bill as they now stand may result in taxation although there is no realization of income or other economic benefit, or income may be taxed twice or in an amount in excess of the economic benefit.* These aspects of the Bill, and perhaps others as well, raise serious questions as to the constitutionality of some parts of the Bill.

* *E.g.*, see Examples 1 and 7, *supra*, and the discussion of Bill Section 13(b) in Part II, *infra*.

If the Bill were a technically workable expression of a series of consistent policy decisions, it might be appropriate to enact it into law even though it was recognized that constitutional issues under the law would have to be faced. However, the Bill reflects inconsistencies in policy, and policies which are not in fact implemented by the Bill; it is seriously defective in purely technical respects, and may, in large part, be administratively unworkable. In this context, the constitutional issues inherent in the Bill provide an additional and compelling reason why it should not be enacted into law in its present form.

Conclusion

The undersigned attorneys are aware that there are instances in which foreign corporations or foreign trusts have been improperly employed to avoid United States taxes. In the limited time within which these comments have been prepared, they have been unable to do more than analyze the provisions of the Bill and their impact upon business operations reasonably undertaken for business purposes and not for tax avoidance purposes.

The attempts to frame legislation to prevent United States tax avoidance through the use of foreign corporations have suffered from the fact that two processes have been carried on concurrently. There are, first, the process of defining precisely what foreign activities are to be discouraged or penalized and, second, the process of drafting legislation which is technically adequate to meet the needs of a clearly defined policy and does not cause other undesirable consequences.

The whole area of the taxation of foreign income is seriously complicated by the fact that treaties, foreign statutes, foreign methods of financing and marketing, foreign administrative controls as well as domestic law and the public policy of the United States are involved in it. The complexity of the general problem makes it difficult to reach adequate and fair legislative solutions. The first stage—that of defining tax policy—has been handicapped by the use of broad phrases such as "tax havens", "the privilege of tax deferral", "equity" and "neutrality" which cannot serve as substitutes for a thorough analysis of problems of economics and tax policy. These broad phrases very often

turn out to be completely misleading when the technical product drawn from them is applied to a concrete business situation.

Working out a reasonable solution for the problem of preventing United States tax avoidance through the use of foreign corporations may take considerable time if it is done in a systematic fashion by moving from policy decisions (settled with reasonable clarity and publicly announced) to technical solutions upon which comment can be offered after a suitable period for study. However, any loss of time which may be involved would seem preferable to the administrative confusion, the disruption of legitimate business transactions, the unjustified tax penalties and the cost of litigation which would result from enacting the foreign provisions of the Bill.

PART II

Technical Discussion of Sections 5, 6, 7, 13, 16 and 20 of H.R. 10650.

Sections 5, 6, 7, 13, 16 and 20 of the proposed Revenue Act of 1962, H.R. 10650, relate to the taxation of foreign income. The following is a brief discussion of certain problems and technical deficiencies believed to exist in these sections. All section references are to proposed or amended sections of the Internal Revenue Code unless otherwise indicated.

BILL SECTION 5

Amount of Distribution Where Certain Foreign Corporations Distribute Property in Kind.

Section 301(b)(1)(C). This section should be amended by inserting the word "domestic" before the first reference to the word "corporation" so that this section will not apply in the case of a distribution from one foreign corporation to another foreign corporation. The application of the proposed section to foreign distributees receiving distributions from foreign distributors so that distributions in kind received by foreign distributees are measured by market value rather than by tax basis seems unrelated to the purposes of the provision as

outlined in the House Committee Report (pp. 26 to 27). If the amount of distributions in kind made by domestic corporations to corporate distributees continues to be limited to the tax basis of the property, there would seem to be no tax reason for the application of a different principle in the case of distributions from one foreign corporation to another foreign corporation. This problem is particularly important in view of other provisions of the Bill imposing current taxes based upon a domestic stockholder's pro rata share of the earnings and profits of foreign corporations and also because of various other provisions which require computations of taxable income in relation to earnings and profits of foreign corporations (*e.g.*, determinations of the amount of a distribution taxable as a dividend or of a foreign tax credit).

Section 301(b)(1)(C)(i) and (ii). These clauses should be revised to make it clear whether the proportions of the adjusted basis or fair market value of property distributed in kind referred to in clauses (i) and (ii) as "properly attributable" to gross income from sources respectively within and without the United States are to be determined solely by reference to gross income ratios or are to be determined in appropriate cases by tracing the property distributed in kind to operations either within or without the United States. It would appear advisable to use gross income ratios although this is not wholly without difficulties.

Bill Section 5(d). This section, which amends Section 902(a), provides that for the purpose of computing the foreign tax credit in respect of property distributed in kind to a United States stockholder entitled to a foreign tax credit under Section 902(a), the amount of the dividend shall be the lower of basis to the distributing corporation or value. It would seem equitable to amend this Section 5(d) so that the amount of the distribution used in calculating the foreign tax credit is the same as the amount subjected to United States taxes. The superficial justification of the present form of the section, which effectively denies any "deemed paid" tax credit with respect to the excess of market value of property distributed in kind over its tax basis, is that such amount would not have been included in the computation of a foreign corporation's earnings and profits under United States law

(except to the extent that special provisions such as Sections 312(b) or (j) should apply). However, the computation of an equitable "deemed paid" credit does not require that the foreign tax paid be identified with particular earnings and profits; the credit is available even though the foreign tax is imposed with respect to a substantially different income base than is used for United States tax purposes so long as it is out of earnings and profits.

The inequitable operation of the above section may be illustrated as follows: Assume that F, a Canadian corporation, has accumulated earnings of $50 with respect to which $50 in Canadian income taxes have been paid. F distributes to an American corporation owning 10% of F's stock depreciable property which has an original cost of $100, an adjusted basis of zero and a market value of $50. Disregarding the Canadian dividend withholding tax, Section 5(d) would mean that $26 in United States taxes would be payable with respect to this distribution and there would be no credit for taxes "deemed paid", even though F had generally been subjected to Canadian income taxes on its earnings at a 50% rate and even though there would have been no significant United States tax on the distribution of a similar amount of cash because of the credit for Canadian taxes. The problem is aggravated by the fact that under Canadian law (or under similar laws of other countries) the provisions for recapture of depreciation might have resulted in the collection of an additional $26 in Canadian taxes from the Canadian corporation as a result of the distribution which would not have been payable upon a cash distribution. In such an event, the earnings and profits of the Canadian corporation would have been reduced to $24, with respect to which $76 in taxes would have been paid. It would be of no consolation to the United States corporation that has received no "deemed paid" credit under these circumstances that there is a highly theoretical possibility of its obtaining future benefits with respect to the aggregate of Canadian taxes paid.

Basing the foreign tax credit on market value would require an amendment to Section 902 of the Code to provide assurance that particular foreign taxes are not credited twice. Section 902 might be amended so that, for the purpose of computing the "deemed paid" credit, the amount of the excess of market value over the tax basis of

property distributed in kind would first be included in the distributing corporation's earnings and profits and then deducted therefrom upon its distribution (compare Section 312(b) of the Code in which the suggested procedure is followed).

BILL SECTION 6

Amendment of Section 482.

Section 482(b). Section 482 presently authorizes the Secretary to reallocate items of gross income and deductions arising from intercompany sales between members of a controlled group for the purpose of arriving at arm's length prices; that is, the prices which would have been charged if the intercompany transaction had occurred between parties dealing at arm's length. The suggested approach of Section 482(b) would authorize the Commissioner to reallocate the taxable income from intercompany transactions by the exercise of a three-factor formula; however, the formula is specifically inapplicable if the taxpayer can establish that the intercompany transactions were carried out at arm's length prices. Consequently, it will continue to be necessary in most cases, as under present Section 482, to attempt to determine arm's length prices.

Section 482(b)(2)(A). This section provides that the allocation shall be made by the Secretary or his delegate taking into account the portion of the allocation formula items attributable to the United States and not attributable to the United States. This section, or regulations to be issued thereunder, must establish rules of general applicability for determining the relative weight to be accorded to each of the various allocation factors and how each of the factors is to be determined. Such rules might be developed by regulations with different formulae applicable to different industries, with a right in each taxpayer to show that a special formula rather than the formula for his industry should apply in his case. It is recognized that the development of appropriate industry formulae will require a substantial amount of time and experience. For example, assume that a domestic parent has a plant in the United States at which it produces a variety of products some portion of which are sold to a foreign subsidiary abroad for resale by the latter. For pur-

pose of the asset factor, how is the plant to be treated? Normally, in the situation of state franchise taxes, where the concern is with allocating a corporation's *entire* income, the plant would be simply taken at its cost. Such an approach would obviously be improper under Section 482, however, because, to a large extent, the plant would have been used to produce income which was not to be allocated.

Bill Section 6, in the absence of a finding of an arm's length price, contemplates an allocation between organizations on the basis of factors which are essentially territorial in nature. Such allocation on a territorial basis (*i.e.,* "attributable to the United States") might be logical in connection with an amendment of source of income rules, but seems inappropriate in view of the purpose of Section 482 to allocate income between related persons. For example, if a domestic manufacturing parent has a plant abroad, that would apparently result in allocating more income to a foreign subsidiary. This provision presumably should refer to factors "attributable to the domestic organization or organizations".

Section 482(b)(2)(B). This section provides for the use of alternative methods of allocation if the taxpayer "establishes to the satisfaction of the Secretary" that such method clearly reflects income of the group. The section implies that the Secretary has complete discretion as to whether an alternative method may be used. Since an alternative method can not be used unless it "clearly reflects income", and since the taxpayer always has the burden of proof, it is essential that the words "to the satisfaction of the Secretary or his delegate" be deleted from this subsection in order to give it any real meaning.

Section 482(b)(3). This is an enigmatic provision which provides that the value to be assigned to the assets in the asset factor of the allocation formula is "the adjusted basis in the hands of the taxpayer or, if such basis is not available in the case of a foreign organization, then their book values, adjusted to approximate their adjusted basis". The adjustment of book values to "approximate" adjusted basis if the adjusted basis is not available gives recognition to a serious practical problem, but requires further refinement to indicate what adjustments

for depreciation and other factors are to be taken into account. Perhaps book value should be prima facie evidence of adjusted basis. The section also includes "leased property" in the asset factor, yet there are no provisions whatsoever for determining the adjusted basis of leased property.

BILL SECTION 7

Distribution of Foreign Personal Holding Company Income.

Bill Section 7(a). This section reduces the gross income test of a foreign personal holding company under Section 552 of the Code from 60% (or 50%) to 20%. In almost every case, a foreign personal holding company will also be a controlled foreign corporation under Section 13 of the Bill. As a foreign controlled corporation, the United States shareholders having a 10% interest would be taxed on their pro rata share of Subpart F income (which includes all foreign personal holding company income). However, the treatment under this section and under Section 13 of the portion of Subpart F income which is foreign personal holding company income will differ in each of the following ways: (1) foreign personal holding companies will receive no credit for qualified investments in less developed countries whereas a controlled foreign corporation can so invest certain portions of its Subpart F income; (2) if a foreign personal holding company is doing business in the United States, its United States source income will not be exempted from the effects of Section 13 as in the case of foreign controlled corporations under Section 952(a)(2) of the Code; and (3) foreign personal holding company income will be passed through to each shareholder while, under Section 13, shareholders owning less than 10% of the stock will not be required to include in income any deemed distribution.

In view of Section 13 of the Bill, there is either no need for amendment of the foreign personal holding company sections, or the foreign personal holding company provisions should be eliminated and reliance placed solely upon Section 13 of the Bill. A reduction of the gross income test to 20% will have the effect of treating as foreign personal holding companies many substantial operating companies with oper-

ating subsidiaries. To the extent that such companies have Subpart F income, Section 13 causes such income to be taxed only to 10% United States shareholders. By treating such companies as foreign personal holding companies, many other individual United States shareholders owning small percentages of stock will be taxed on undistributed income, and all shareholders will be subjected to the punitive treatment resulting from Section 1014(b)(5) of the Code, which disallows a step-up in basis at death for shares of a foreign personal holding company even though the value thereof is included in the gross estate.

Bill Section 7(b). The discrepancy between the deemed distribution under this section and the deemed distribution under Section 13 with respect to Subpart F income, where the pass through is only of the passive income less the deductions allocable thereto, leads to confusing discrepancies between the foreign personal holding company provisions and the Subpart F provisions. For example, assume that a corporation has $1,000,000 of gross income from manufacturing operations which produces $200,000 of net income and has $250,000 of gross rental income producing $10,000 net income. For foreign personal holding company purposes, the amount taxed through the United States shareholders, assuming all stock is owned by United States shareholders, would be $42,000 (*i.e.*, $250,000/$1,250,000 times $210,000), although with respect to Subpart F income, the amount taxed through to United States shareholders owning 10% or more of the stock, assuming all stock is owned by such United States shareholders, would be only $10,000, the net rental income. Also, in the case of a manufacturing operation which is classified as a foreign personal holding company, any dividend which is paid will be deemed to be partly paid out of passive and partly paid out of manufacturing income. That results from the fact that under the formula of Bill Section 7(b), dividends paid are deducted from net income before the resulting net figure is multiplied by the percentage of passive income. The result of this method of computation is that if any dividend is paid it does not reduce foreign personal holding company income dollar for dollar. Consequently, such a corporation may practically be faced with two alternatives, either to take down no dividend or to take down the entire income of the

company, manufacturing and passive alike. This differs from a foreign controlled corporation, where pursuant to Section 956 any dividend is first considered to be made out of income previously taxed under Section 951. This difference in the case of the foreign personal holding company seems irrational.

BILL SECTION 13

Controlled Foreign Corporations.

Taxation of Subpart F Income
(Section 951(a)(1)(A))

Section 951(a)(1). It is not clear whether the amount includible in gross income of a United States corporate shareholder under this section is treated as a dividend for personal holding company purposes.

Section 951(a)(2). This section provides in general that the "pro rata share" in the case of any United States person is the amount which would have been distributed with respect to the stock which such person owns which bears the same ratio to its Subpart F income for the taxable year as the part of such year during which the corporation is a controlled foreign corporation bears to the entire year, reduced by the amount of any distribution received by any *other* United States person during such year as a dividend with respect to such stock. The meaning of "pro rata share" in this provision is not clear. If, for example, an affected United States person owned only preferred stock, would the imputed Subpart F income be limited to his preferred dividend? Similarly, what is the effect if the United States person owns a class of common which is not entitled to full dividends, or on which dividends have been waived?

Section 951(a)(2)(B). This provision reduces the income taxable to a United States person owning particular shares of stock of a controlled foreign corporation only by dividends paid to another United States person in respect of such shares. It is questionable why distributions during the year to persons who are not United States persons should be disregarded for purposes of this clause. Also, it would seem appropriate to exclude any earnings and profits of the year taxed as ordinary income under section 1248(b) (Bill Section 16).

Section 952(a)(1)(C). This section, unlike Section 552(a)(2) of the Code which provides for the determination on any day during the taxable year, does not indicate whether the test of this section is to be applied as of any day during the year, on the last day of the taxable year, or at some other time. This section should specifically provide that net foreign base company income is Subpart F income only during the period in which 5 or fewer United States persons have the requisite stock ownership. This problem could be alleviated by a more equitable provision consistent with Section 552 of the Code by providing that a controlled foreign corporation is one in which more than 50% of the voting power is held by 5 or fewer United States persons.

Section 952(a)(3). In designing the controlled foreign corporation provisions of the Bill, the choice was made to rely on the concept of earnings and profits rather than taxable income. Each posed many of the same problems, but several serious problems would have been eliminated by using the concept of taxable income. For example, in providing that Subpart F income shall not exceed the earnings and profits, rather than taxable income, of the controlled corporation for the year, this section does not take account of net operating loss carry-forwards or carry-backs since in computing earnings and profits a net operating loss deduction would not be allowed. The section does not indicate whether earnings and profits for the year are to be reduced by distributions during the year. In computing Subpart F income separately for each controlled foreign corporation, a United States stockholder owning two or more foreign corporations is not permitted to offset the losses of one such corporation against the income of another.

Section 952(c). This section includes in Subpart F income from United States patents, copyrights and exclusive formulas and processes including income derived from licensing of such property and also income deemed to arise from the use by the controlled corporation of such property in its own business. This section seems unnecessary. In many instances, patents and other intangible property have been transferred to operating companies in Section 351 transactions with respect to which the Secretary has ruled that the transfer was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes. In other situations, where there has been a

sale or taxable transfer to the controlled foreign corporation, a tax will have been paid by the United States corporation in respect of any gain realized. In situations where a related United States person continues to own the patent, copyright, formula or process, Section 482 may be used to allocate income properly between the United States corporation and the foreign corporation.

Section 952(c)(1)(A) and (B). These provisions because of their harsh effect would seem to encourage the conduct of research and development outside the United States so that any patents, formulas, etc., would not be considered as United States developments. Since controlled foreign corporations will not be able for practical reasons to acquire patents, copyrights, etc., from unrelated persons if substantially developed, created or produced in the United States, the result will be that many United States companies will have no choice but to sell United States developments to foreigners. There is no policy reason why this section should have any application to United States created inventions which are sold to unrelated persons, or if sold to related persons for a fair price and the gain taxed.

Section 952(c)(2). It is not clear whether a controlled foreign corporation will be entitled to a deduction with respect to the basis in a patent which is contributed to it by its parent corporation which developed the patent.

Section 952(c)(3). Under this provision, United States persons are taxed on income from the "use" or "exploitation" of United States inventions by the controlled foreign corporation in its own business operations, even where the property interest in the patent or process has been transferred by the United States person in a transaction resulting in tax on the full value of the property. The imposition of further taxes on such person under Subpart F with respect to the same property values seems indefensible. This provision requires a revaluation of "use" each year. While many of the valuation problems currently exist in this area under Section 482, the extension of these problems to additional situations adds unwarranted complexities.

Section 952(e)(1). Under this provision "foreign base company income" is defined as foreign personal holding company income, mod-

ified and adjusted as provided in this section. This provision raises the problem of a substantial overlapping application between the foreign personal holding company provisions of Bill Sections 7 and 13. In view of the inclusion in Subpart F income of foreign personal holding company income, there is little reason for the amendments proposed by Section 7 in the definition of a foreign personal holding company. In fact, as indicated above in the comments with respect to Bill Section 7, it might appear appropriate if Section 13 of the Bill is enacted that the foreign personal holding company provision be deleted and handled entirely through Section 13 of the Bill.

Section 952(e)(2). This section taxes as foreign base company income certain types of sales income involving related persons. Where there has been an avoidance of United State tax in transactions between a United States parent and a foreign company, Section 482 should be employed to allocate such sales income properly. The requirement of incorporation of a trading business in each territory of business operations apparently is intended to penalize the maintenance of a trading operation (other than by the manufacturing company) in areas outside of the place of incorporation, presumably to prevent avoidance of foreign tax. Where the use of a foreign sales company results in the diversion of income from a foreign manufacturing company to the sales company, if there is any tax avoidance it is avoidance of foreign taxes (as in a Swiss sales company handling sales of a German manufacturing company), with respect to which the United States obtains advantages in the form of larger net earnings available to United States stockholders and lower foreign tax credits to offset United States tax liabilities.

Section 952(e)(3). For the purpose of computing foreign base company income, rents are included without regard to the 50% limitation contained in Section 553 of the Code with respect to the inclusion of rental income in foreign personal holding company income. The removal of this 50% limitation seems unjustified. The purpose of the removal appears to be to prevent rental income from sheltering other foreign base company income. If this is the purpose of the limitation, the exclusion of rent from the computation of "gross income" under

Section 952(e)(6) would be a means of preventing rental income from sheltering from tax other foreign base company income. It is questionable whether the category of foreign base company income should include the income derived from active management of an apartment house or office building, especially where it is owned by a corporation incorporated under the laws of the country where the apartment house or office building is located, or income received from a charter of a ship, especially where such rent may be committed to the long-term financing of the purchase price of a ship. Consideration must be given to alleviating the impact of this provision on existing financing.

Section 952(e)(7). This provision, allowing deductions properly attributable to foreign base company income as deductions therefrom, raises serious questions with respect to expenses which cannot be directly attributed to a particular source of income such as general overhead expenses, finance expenses, and factory burden. Also, it is not clear what deductions may be taken into account or whether a net operating loss deduction will be allowed.

Section 952(f). This provision covers the reduction in net foreign base company income by investments in qualified property in less developed countries. The exclusion from foreign base company income with respect to investments in less developed countries is apparently intended to spur United States investments in less developed countries. It seems clear that it will not accomplish this purpose since the only effect of the Bill is to allow a temporary deferral of tax in respect of such investments. If a loss results from such investments, it will be a capital loss in the usual case; on the other hand, if a gain results, it will be taxable as ordinary income upon liquidation or sale of the investment under Bill Section 16. Furthermore, this section does not give a controlled foreign corporation any carryover for investment in less developed countries. If in one year the investment in such countries exceeds Subpart F income, that excess investment does not offset Subpart F income in later years. It may be desirable that the amount of investment in qualified property in less developed countries be computed on a cumulative basis. The practical result of this section is not to encourage investments in less developed countries, but to limit such investments to the amount of Subpart F income.

Section 952(f) does not deal with the problem of what happens when there is a change in classification of a country as a "less developed country" from year to year. This section should specifically state that once an investment is made in a less developed country, that investment will always be considered an investment in a less developed country. Otherwise, a change in classification of countries could cause all earnings invested in a less developed country to be taxed in the year of change. However, the foregoing change would still not alleviate the problem where commitments are made for a period of several years and the status of a country changes before the commitments are fulfilled.

Section 952(f)(1)(A). A reference should be made to the property located in the United States which is specified in Section 953(b)(2)(B). Such property, if ordinary and necessary for the active conduct of a trade or business carried on in a less developed country, should be taken into account in arriving at net foreign base company income.

Section 952(f)(3). The reduction of the increase in an investment in a less developed country by any liability to which the property is subject gives too much weight to a particular method of financing. For example, if during a taxable year, the method of financing is shifted from mortgage financing to debenture financing (*i.e.*, from specific liens to the general credit of the corporation), is there an increase in investment in qualified property as a result of that shift?

Taxation of Increase in Earnings Invested in Nonqualified Property (Section 951(a)(1)(B))

Section 953(a)(1). The overall structure of Section 13 of the Bill is to tax to a United States person owning 10% or more of the stock of the controlled foreign corporation certain "tainted" income of the controlled foreign corporation, as set forth above, and other income which has been earned by the controlled foreign corporation and invested in non-qualified property. The intention of taxing this latter type of income is to prevent deferment of the United States tax thereon. In making the determination of earnings invested in non-qualified prop-

erty there is the problem, as there is in respect of other provisions of Section 13, of computing earnings and profits. Section 953(a)(1) should make it clear whether the amount of earnings is to be determined by applying United States tax and accounting concepts. As indicated above, rules should be established for the exercise of certain rights of election relating to items such as depreciation, depletion, deduction of intangible drilling expenses, deduction of organization expenses, amortization of research expenses and general accounting methods (including determination of fiscal periods).

Section 953(a)(2). It is assumed that by virtue of Section 956(a)(2) Subpart F earnings, if invested in nonqualified property, will not again become taxable under Section 951(a)(1)(B); however, since there is no cross reference in Sections 953(a)(1) and (2) to Section 956(a), it is uncertain how investments of Subpart F income are to be traced to nonqualified property.

Section 953(a)(3). Under this section, the amount taken into account in determining the investment in non-qualified property is its adjusted basis, reduced by any liability to which the property is subject. Thus, this provision penalizes the repayment of secured debt even if made out of funds derived from equity financing or from borrowing on the basis of unsecured indebtedness by considering it an investment in non-qualified property. This section also penalizes a purchaser for not securing the purchase price by lien on the purchased property. (*Cf.* Section 952(f)(3)).

Section 953(b)(2)(A). Under this section, the term "qualified property" includes "property" which is "ordinary and necessary for the active conduct of a qualified trade or business." The test of "ordinary and necessary for the active conduct of a qualified trade or business" is new and substantially different from the test of "reasonable needs of the business" contained in Sections 532 and 537 of the Code, and as such will inevitably lead to a flood of litigation.

Section 953(b)(2)(B)(iii). What is the meaning of the term "unrelated persons" as used in this section?

Section 953(b)(2)(C)(i) and (ii). Qualified property includes certain investments in businesses, or corporations, engaged "almost wholly" within less developed countries. Terminology in these provisions like "almost wholly within" and "substantially all" is bound to lead to controversy and extensive litigation. As pointed out in Part I, the requirement that business be conducted almost wholly within the less developed country in effect might prohibit purchasing activities and selling activities outside the less developed country. The test in clause (ii) that a foreign corporation must be organized under the laws of the less developed country in which it is engaged in business is illogical and will often be impractical. It is not repeated in Section 953(b)(3)(A)(ii).

Section 953(b)(2)(D). This section provides in general that an investment will qualify if required because of restrictions imposed by a less developed country, and "any investment which, when made [in a less developed country], was so required and which would result in substantial losses if withdrawn". This provision has a highly limited application since it would not apply, for example, to a requirement of a country which is not less developed that earnings be invested in government bonds of such country. It would seem more equitable if the provision were to apply to any investment required by foreign law. It is not clear whether this provision is intended to impose income taxes in the United States if a foreign controlled corporation fails to sell certain properties unless it could do so only at a substantial loss. What does the term "substantial losses" mean in this context? The provision does not deal with the problems of a foreign corporation (whether or not in business in a less developed country), which cannot distribute its earnings because of foreign exchange controls.

Section 953(b)(3)(A). This provision defines the trade or businesses in which earnings, if ordinary and necessary thereto, may be retained without the income therefrom becoming "tainted". It raises numerous questions such as (a) whether controlled foreign corporations which are currently building plants but have not commenced manufacturing and selling prior to December 31, 1962, are engaged

in business, (b) whether both manufacturing and selling must commence prior to that date, and (c) what will be considered to be the "same" trade or business or "substantially" the same trade or business. The result of this section will be to limit the qualified trade or business in which property may be invested to become "qualified property" in a manner so that (a) foreign corporations existing on December 31, 1962, will be entrenched in the business pattern then prevailing, and (b) a new foreign corporation formed after such date may not for five years use its earnings for working capital, payment of debt, reasonable reserves, etc. Restriction (b) will apply to subsidiaries of existing corporations which are formed after December 31, 1962. Furthermore, since the business must be carried on by the foreign corporation while controlled by substantially the same United States persons, if there is a partial change in the ownership of an undefined amount the business will be treated as a "new business", and earnings previously accumulated after December 31, 1962 would be considered nonqualified property. In the case of the individual owning 10% of the stock, this will result in pyramiding these earnings into one tax year. While, as indicated above, the meaning of "controlled by substantially the same person" is not precisely defined as in Section 382(a) of the Code there seems to be no reason why the nature of the investment as a "qualified investment" should be affected by any change in control, including a total change in control, since Section 16 of the Bill taxes any gain upon sale as ordinary income to the extent of earnings accumulated while the stock is owned by the shareholder selling.

Section 953(b)(3)(A)(ii). This section covers qualified investments in less developed countries. The provision requires that the investment be in a business carried on "almost wholly within" the less developed country. The meaning of the words "almost wholly within" is not clear.

Section 953(b)(5). This section defines countries which cannot be "less developed". It should be noted that if any less developed country should fall under Soviet or Sino domination, the United States taxpayer will be subject to United States income tax by losing credits with respect to investments theretofore made and qualified in such

countries. It should also be noted that the present list substantially differs from the list which was given in the Treasury Explanations of the President's Tax Message dated May 3, 1961. What changes, for example, must occur in the political philosophy of Yugoslavia to exempt it again from the list of less developed countries or to make it a country within the Sino-Soviet bloc and how may American businessmen reasonably anticipate such developments? How is the effect of pyramiding in tax rates to be avoided if the country's status changes and an individual stockholder is involved?

Definition of Controlled Foreign Corporations (Section 954)

Section 954(a). Under this section, a "controlled foreign corporation" is any foreign corporation "of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned, directly or indirectly (within the meaning of section 955(b)), by United States persons on any day during the taxable year of such foreign corporation". As indicated above, it will be impossible in many cases for United States stockholders ever to be certain that a foreign corporation is not a "controlled" foreign corporation. How is ownership to be determined where foreign corporations have issued bearer shares, where shares are held by nominees, where shares are in street names or in numbered accounts? How effectively will United States stockholders be able to determine who are the stockholders of other foreign corporations, especially when extensive attribution rules must be applied to ascertain ownership? Finally, how effectively can the foregoing determination be made with respect to *every day* of the taxable year of a foreign corporation as required by this section?

Rules for Determining Stock Ownership (Section 955)

Section 955(a). This section sets forth the rules for determining the amount of stock a United States person is to be charged with in

computing his pro rata share of tainted income under Section 951(a). Under this section a United States person is taxed not only with respect to stock he actually owns, but with respect to stock he indirectly owns through a foreign corporation, foreign partnership, foreign trust or foreign estate. In the case of foreign trusts and estates, a United States person who is a beneficiary may be taxed with respect to income which he may never receive, since under the terms of the controlling will or indenture, the income may be distributable to a life beneficiary.

This section does not indicate that the same stock ownership may not be utilized twice for purposes of determining stock ownership. Presumably such a result would be barred in the manner that the regulations presently bar double counting under Section 318, but the provision is not clear because of the use of language referring to stock owned "indirectly" by a foreign corporation. The meaning of the word "indirectly" should be clarified. Although the House Committee Report indicates that attribution stops at the first United States person in a chain of ownership, such persons may be at different levels in the chain. For example, assume that a United States corporation owns stock in a foreign corporation which in turn owns stock in a second United States corporation. If the second United States corporation owns all the stock of a controlled foreign corporation which has Subpart F income, is the controlled foreign corporation's Subpart F income also to be included in the gross income of the first United States corporation? Is it to be allocated between the two United States corporations? Is its inclusion to be limited to the second United States corporation?

Section 955(b). This section sets forth the rules for determining stock ownership for the purposes of determining whether a foreign corporation is a controlled foreign corporation, who is a 10% owner, and for the separate control test with respect to net foreign base company income. Even though this section states that Section 318(a) is to apply "to the extent that the effect" is to give rise to control in certain situations, Section 318(a) is always to be applied with certain modifications. Among those modifications is a new rule contained in Section 955(b)(2) that in certain situations ownership by

an entity of more than 50% of a corporation's stock shall be considered 100% ownership. The result in many cases may be to consider as a controlled foreign corporation one that is clearly not controlled by United States interests but is controlled by foreign interests. For example, assume that D, a United States corporation, owns 30% of FX, a foreign corporation, and 25% of FY, a foreign corporation. Assume that FY in turn owns 70% of the stock of FX. If the rules of Section 318 are applied without the 100% (total ownership) rule contained in Section 953(b)(2), D would be considered as owning 17.5% of FX through its stock ownership of FY, in addition to the 30% of FX owned directly. FX would not be considered a controlled foreign corporation, since D, the only United States person involved, owns only 47.5% thereof. Literally, however, Section 953(b)(2) states that FY owns 100% of FX. On that theory, D would be treated as owning, for the purposes of computing control, 55% of FX, 30% directly and 25% through FY, and FX would be treated as a controlled foreign corporation.

Under Section 955(b)(2), if a foreign corporation is owned equally by a domestic corporation and a publicly held foreign corporation, the fifty-fifty foreign corporation will be treated as United States controlled, if the publicly held foreign corporation has one United States shareholder. It is difficult to understand the rationale of this result. On the other hand, the foreign subsidiaries of a domestic corporation are treated as United States controlled even though the entire stock of such domestic corporation is held by non-resident aliens. This result will cause non-resident aliens owning controlling stock interests in United States corporations with foreign corporate subsidiaries to liquidate such United States corporations (which generally can be done without tax to the non-resident aliens); any such consequence hardly seems to be in the best interests of the United States.

Exclusion From Gross Income of Previously Taxed Earnings and Profits (Section 956)

Section 956. This section is designed to prevent earnings and profits which have been taxed once to a United States person, under

Section 13 of the Bill, from being taxed again. The provisions offer no guidance as to whether the "earnings and profits" of a controlled foreign corporation are to be determined under United States tax and accounting principles or under the tax and accounting principles of the corporation's domicile.

The application of this section, which permits an exclusion from taxation with respect to distributions of previously taxed earnings and profits, will lead to intricate problems of identification of shares of stock which are entitled to different exclusions.

Section 956(b). In order that earnings and profits of a controlled foreign corporation, taxed to a United States person, will not when distributed to another foreign corporation be foreign personal holding company income, Section 956(b) should specifically provide that such distributions are not gross income for purposes of Section 551 as well as for 951 purposes.

Special Rules for Foreign Tax Credit
(Section 957)

Section 957. This section sets forth the rules for integrating the complex foreign tax credit problems arising as a result of taxing foreign income to United States persons when such income is not distributed with the already complex problems of foreign tax credits. It is recognized that these problems are of unusual difficulty and the comments here are far from exhaustive.

Section 957(a). The "deemed payment" rules of Section 957 with respect to foreign income taxes applicable to amounts included in the gross income of a domestic corporation under Section 951(a) are, as are those of Section 902, not available to individual United States stockholders in controlled foreign corporations. In the case of Section 957, however, this may lead to particularly harsh results. For example, assume that A, a United States individual who is in the 75% income tax bracket, owns all the stock of a United States corporation. The United States corporation in turn holds rental real

estate and pays a corporate tax. If A some day liquidates the United States corporation, his total effective tax burden will then be approximately 64% (52% of the United States corporation's total earnings plus 25% of its earnings after the 52% tax). If A continues the United States corporation in existence, the effective additional 12% tax may be postponed indefinitely so long as the corporate earnings are reinvested for the reasonable needs of the business. However, compare A's situation with that of B, who is a United States individual in the 75% income tax bracket and who owns all the stock of a controlled foreign corporation. Assume that the foreign corporation derives its income from rental real estate in a foreign country where it pays a 40% corporate tax. Under Section 951(a)(1)(A) the remaining 60% of the foreign corporation's income will be taxed directly to B unless he chooses to have the foreign corporation risk its earnings by investing in less developed countries in which case there will merely be a deferral in the United States tax on those earnings. The result will be, in the absence of such an investment in a less developed country, that B will effectively bear a total and current tax of 85% (40% corporate tax plus 75% of 60%). B will, of course, pay no tax upon the sale or liquidation of the foreign corporation on earnings already taxed under Section 951(a) and his stock basis will have been increased under Section 958(a).

Section 957(a)(1). The rules contained in this section for determining a taxable corporate stockholder's eligibility to credit taxes paid by a controlled foreign corporation are, generally, those incorporated in present Section 902. Thus, the United States corporation must own directly at least 10% of the first tier foreign subsidiary and, if the taxes of a second tier foreign subsidiary are to be credited by a United States corporation, the first tier subsidiary must own at least 50% of the second tier foreign subsidiary. Since attribution rules are used to impute income under Section 951, but are not used to determine eligibility for the foreign tax credit, inequities are certain to result. For example, assume that a United States corporation is a 90% partner in a French partnership that owns 100% of the stock of a French corporation. 90% of the Section 951(a) income of the French corporation will

be taxed to the United States corporation, but none of the French corporate taxes will be creditable by the United States corporation. Similarly, no foreign tax credit is given with respect to third or fourth tier subsidiaries, even though they may be foreign controlled corporations and their income taxed directly to a United States person. The attribution provisions of Section 955 should be made applicable to this section to correct this situation.

Section 957(a)(3). This section should be correlated with Section 11 of the Bill adding Section 78 to the Code covering gross-up of foreign dividends paid for tax credit purposes, for otherwise a domestic parent may be required to include income of a foreign controlled corporation in its gross income twice in order to obtain a foreign tax credit. Assume, for example, that in 1965 a second tier foreign subsidiary of a United States corporation has gross Subpart F income of $120 and pays a foreign tax on that income of $20, leaving net Subpart F income of $100. The United States corporation will be required to include in gross income $120 ($100 pursuant to Section 951(a)(1)(A) and $20 pursuant to the gross-up provisions of Section 78) and, for purposes of the foreign tax credit, will be deemed by reason of Section 957(a)(1) to have paid $20 in foreign taxes. If, in 1966, the second tier foreign subsidiary pays the $100 to the first tier foreign subsidiary, which pays an additional tax of $15 and passes on the remaining $85 to the United States parent, the tax results will be as follows: (a) the United States parent will not be taxed on the $85 by reason of Section 956(a); (b) the United States parent will be deemed to have paid, by reason of Section 957(a)(3) the $15 tax actually paid by the first tier foreign subsidiary and may credit such tax under Section 902(a); (c) however, due to the lack of correlation with Section 78, the United States corporation will be required to include the $15 in gross income in order to use it as a tax credit. The reason for the foregoing is that Section 78 provides that if the domestic parent claims a credit for the $15 tax, an amount equal to such tax shall be treated as a dividend, and that is true even though the $15 has already found its way into the gross income of the United States parent in 1965 as part of the $100 included pursuant to Section 951(a)(1)(A). If $15 is included in 1965 pursuant

to Section 78, the domestic parent will have included in gross income $135 with respect to pre-tax foreign earnings of $120. This is most inequitable.

Section 957(a)(4). This section provides that for the purposes of Section 902(b) of the Code covering foreign tax credits, amounts included in income of a United States person shall be considered as dividends. It is not clear whether this section means that inclusions in gross income are not ordinarily to be considered as dividends. It is essential that this point be clarified, for nowhere in Section 13 is there any definitive indication whether inclusions in gross income are to be considered as dividends. (*Cf.* Section 951(a)(1).)

A conforming amendment should be added to Section 901(a) to specify that the foreign tax credit includes taxes deemed to have been paid under Section 957(a).

Section 957(b). In prescribing increases in the Section 904 limitation with respect to taxes paid or deemed paid in the year tax-free distributions are made pursuant to Section 956, this provision should be extended to apply to successors in interest. Such an approach would be consistent with the policy expressed in Sections 951 and 956.

Section 957(b)(2)(A). This section should be clarified so as to include appropriate amounts grossed-up under Section 78 in determining the amount of increase in the Section 904 limitation. Otherwise this section may be interpreted as including only amounts included in income by virtue of Section 951(a).

Technical and Clerical Amendments
(Bill Section 13(b))

Bill Section 13(b). This section, by amending Section 551(b), is intended to relieve the stockholders of foreign personal holding companies from imposition of a second tax under Section 551 with respect to any Subpart F income on which they will be taxed under Section 951. However, this section fails to accomplish the foregoing purpose, as

illustrated below (which is particularly troublesome because the scope of the foreign personal holding company provisions has been broadened by Bill Section 7).

Bill Section 13(b) grants a deduction only for income taxable to shareholders under Section 951(a)(1)(A) and not under Section 951(a)(1)(B). This may produce anomalous results. For example, assume that X owns all of the stock of A, a foreign controlled corporation that is also a foreign personal holding company. A receives $500 foreign personal holding company income and $500 operating income. It invests $500 of its income in investments which qualify as a deduction in arriving at "net foreign base company income" under Section 952(d) and $500 in nonqualified property. There will be taxed to X the entire $1,000 of A's income, $500 under Section 551, which no investments will reduce, and $500 under Section 951(a)(1)(B), even though under either Section 551 or Section 951 alone the maximum amount taxed would be $500. If such a result was intended, it is difficult to see how it may be justified. If there had been no deductible investments under Section 952(d), $500 would have been taxed under Section 951(a)(1)(A), and there would have been no tax imposed under Section 551.

Bill Section 13(b) only grants a deduction in an amount equal to the Subpart F income taxed to the stockholder in the year in question. This apparently might result in the taxation of the same income twice. For example, assume that X owns all the stock of A, a foreign controlled corporation that is also a foreign personal holding company. A owns all the stock of B, a corporation which receives $50,000 Subpart F income (but is not a foreign personal holding company) in 1963 and another $50,000 in 1964, and pays a single dividend of $100,000 in 1964. X would have to include in his income $50,000 in 1963 under Subpart F, $50,000 in 1964 under Subpart F, and the dividend of $100,000 would be includable in 1964 under Section 551 except as reduced by a deduction for the $50,000 of Subpart F income for the 1964 taxable year. Moreover, even that $50,000 deduction may be questionable under the literal terms of the statute since the deduction granted by Section 551(b) is only for "subpart F income of the company" and technically the foreign personal holding company A had no such income. The

Subpart F income was that of B. Presumably such double taxation was intended to be avoided under the exclusions of Section 956. However, the exclusion from gross income for all income tax purposes under Section 956(a) would not apply since United States person X receives no distribution, directly or indirectly. Section 956(b), which provides for exclusions from income of foreign subsidiaries, applies only for the purposes of Section 951(a). Since Section 956 does not preclude the $100,000 dividend from being foreign personal holding company income, that dividend would be taxable under Section 551 except to the extent that $50,000 thereof represented Subpart F income of B for the taxable year, as noted above.

Even though the result described in the foregoing paragraph might be avoided by having the foreign personal holding company make an actual distribution of $100,000 in 1964 to the United States stockholder X, which under Section 956(a) would not be subject to tax and would result in a dividends paid deduction under Section 556, there is no valid purpose in forcing a distribution simply to ameliorate a double tax based on a lack of correlation between Section 551 and Subpart F.

Bill Section 13(b) grants an exclusion from income only to the particular stockholder who is credited with the Section 951 income. Generally, the stockholder credited with the Subpart F income will also be the one credited with the foreign personal holding company income. However, if a corporation which is both a foreign personal holding company and a controlled foreign corporation ceases to be the latter but not the former during the course of the taxable year, and a stockholder dies between the date of such change and the end of the year, such stockholder would be subject to tax on his share of the Subpart F income while his estate apparently would be subject to tax on its share of the foreign personal holding company income without any Section 551(b) exclusion. Here again the problem might be avoided if a distribution were made within the year, since the exclusion under Section 956(a) applies to subsequent owners of the same stock.

Bill Section 13(b) provides a reduction from the amount otherwise includable in gross income under Section 551 for that portion of the

income included as Subpart F income under Section 951(a)(1)(A) which is "undistributed personal holding company income" (presumably meaning "undistributed foreign personal holding company income"). The fact that the amounts included in income under Sections 551 and 951 respectively are determined in entirely different ways and may be only remotely related to each other is disregarded, although these differences may be important in correlating the provisions. For example: (a) the amount included under Section 551 is a proportionate part of undistributed foreign personal holding company income, which is based on taxable income as adjusted, while the amount included under Section 951 is Subpart F income, which includes additional types of gross income and has special provisions for deduction of expenses attributable thereto; (b) the amount included under Section 551 is reduced by the dividends paid deduction but this is not true with respect to the amounts included under Section 951; (c) there is excluded from Subpart F income but not from amounts included under Section 551 certain income from sources within the United States; (d) rental income is included in Subpart F income in all events but will appear in the numerator in the computation of the amount taxable under Section 551 only if less than 50% of gross income; and (e) Subpart F income may be reduced by investments in less developed countries but no such adjustment is made under Section 551. Some method should be provided for the allocation of the respective types of income and expenses and deductions in order to determine what part of the Subpart F income is undistributed foreign personal holding company income for purposes of Section 551.

Additional Technical Amendments. Section 367, which requires advance Treasury rulings in order for certain nonrecognition provisions of the Code to apply with respect to foreign corporations, should be amended so that it applies only with respect to a foreign corporation that has United States shareholders, and not to the reorganization or liquidation, for example, of a subsidiary of a foreign corporation. The foreign corporation's earnings and profits taxable under the Bill ought not to be increased by a failure to apply such nonrecognition provisions.

BILL SECTION 16

Gain from Certain Sales or Exchanges of Stock in Certain Foreign Corporations.

Section 1248. This section provides that gain on the liquidation of a controlled foreign corporation or sale of its stock that is realized by a stockholder who owns (or has owned within a 5-year period) 10% or more of the voting stock will be treated as ordinary income rather than capital gain to the extent of an allocable part of the earnings and profits. The present form of the Bill would take into account for this purpose all earnings and profits accumulated since 1913. In his statement before the Senate Finance Committee, Secretary Dillon suggested that this section might be modified to apply only to earnings and profits accumulated hereafter. Such change is clearly required to avoid a serious retroactive effect. Even with such amendment, the ordinary income tax impact upon termination of a foreign investment will in many cases tend to discourage the repatriation of capital, and this problem would be substantially more serious if the application of the section is not limited to subsequent earnings and profits.

Section 1248 taxes gain upon liquidation or sale as ordinary income without regard to whether the accumulation of earnings has been for reasonable business purposes and without altering the rule that any loss resulting would be a capital loss. Consideration should be given to limiting the application of such inconsistent principles to tax avoidance contexts.

Section 1248(a). This section, which provides ordinary income treatment for gains on stock redemptions and liquidations, should apply only to earnings and profits accumulated during the period that the stock was held by the particular stockholder. Prior earnings may already have been taxed to a prior stockholder under Section 1248(b) upon his sale of stock.

Section 1248(b). This section taxes gain on a sale of stock as ordinary income without allowance for foreign tax credits that would have been available if the earnings had been distributed currently or

that would have been available to a corporate shareholder if the gain were on a liquidation taxable under Section 1248(a). Although the problem is complicated, some provision should be made for reducing the tax impact by foreign tax credits.

Section 1248(b) fails to make clear whether the determination of the "proportionate share of the earnings and profits" accumulated during the period the stock was held by the stockholder shall be made on a pro rata basis for the period or on an unworkable theory of computing day-to-day earnings.

Section 1248(b) also fails to provide methods for making elections under the Code (*e.g.*, with respect to items such as depreciation, organization expenses) for purposes of determining the "earnings and profits" of a foreign corporation that is not itself a United States taxpayer. The computation of earnings and profits under the laws of foreign countries (if made thereunder) will often differ radically from United States concepts.

Section 1248(b) should be amended to prevent taxation of the same earnings and profits to two United States persons as a result of the application of both Section 1248 and Section 951 where stock has been sold by one United States person to another prior to the end of the taxable year.

Section 1248(c)(1)(B). This section should be limited so that the ordinary income treatment of Section 1248 will apply only if the status of a "controlled foreign corporation" existed during that period when the United States person in question owned the stock of such corporation (including constructive ownership). Also, the section should be clarified to assure that it applies only if the corporation is a "controlled foreign corporation" after December 31, 1962.

Section 1248(c)(2). This section should be limited so that the ordinary income treatment will apply only if the requisite 10% own-

ership existed during the period that the corporation was a "controlled foreign corporation" rather than at any time within 5 years.

Section 1248(c)(4). The purpose served by exclusion from ordinary income tax treatment of gains on redemptions of stock to pay death taxes would apply equally to gains on sales of stock to pay death taxes. Unless this exclusion is so extended, a minority stockholder's estate will be greatly prejudiced in trying to raise cash for death taxes, as compared with a controlling stockholder's estate which can use its control to cause a redemption.

Section 1248(c). Consideration should be given to limiting the effective rate of tax payable by an individual on gains under Section 1248 to a rate which comports with the rate paid upon gains realized by individual stockholders in a domestic corporation with foreign investments. Such a rate would be at a maximum of 64% (the domestic corporate tax rate of 52%, computed without regard to credit for foreign taxes paid, plus an additional effective rate of 12% determined by multiplying the remaining 48% of after tax earnings by the capital gains tax of 25%), or, more properly, a rate lower than 64% which would reflect the foreign tax credit available to a domestic corporation with respect to its foreign investments. Also, consideration should be given to providing relief to individuals from the bunching of income in a single year.

Section 1248(d). The purpose and effect of this section is unclear. If it is intended only to create a presumption that the amount of gain recognized by the taxpayer is not in excess of accumulated earnings and profits, the provision is unnecessary in view of the presumption that applies to all determinations of such nature made by the Commissioner. If, however, the provision is intended to require presentation of extraordinary and convincing evidence by the taxpayer, it is highly objectionable. The section would set forth an evidentiary test that cannot practicably be met in many meritorious cases, and therefore to a substantial extent the provision would make meaningless the other provisions of the section that are intended to measure taxes by earnings and profits.

BILL SECTION 20

Information with respect to Certain Foreign Entities.

Section 6038(d). This section provides that for purposes of determining ownership of stock the rules prescribed by Section 318(a) shall apply. Section 6038(d) should be amended to state that clause (ii) of Section 318(a)(2)(C), which treats a United States subsidiary corporation which is 50% or more owned by its parent corporation as owning the stock owned directly or indirectly by its parent, shall not be applied for purposes of determining ownership of stock. Unless the foregoing change is made, a United States corporation which, for example, is 100% owned by a foreign corporation will be required to file information returns with respect to all foreign subsidiaries in which the parent corporation has a 50% direct or indirect interest or else lose 10% of its foreign tax credit. This section, unless amended, will impose upon many corporations the requirement of filing numerous information returns containing information with respect to the business, accumulated profits, assets, liabilities, capital, stock and transactions of corporations which it, as a subsidiary corporation of a common parent, does not control and which information it will be generally impossible to obtain. The result will be arbitrarily to deprive many United States corporations which are subsidiaries of foreign corporations of 10% of their foreign tax credit and possibly to criminal penalties.

Section 6046. This section extends the provisions of existing law requiring that information as to the organization or reorganization of foreign corporations and as to acquisitions of their stock be supplied by officers and directors of the foreign corporation who are United States citizens or residents and by United States persons owning 5% or more of its stock. The Treasury is of course entitled to cooperation from foreign investors in obtaining the information required to enforce the revenue laws. However, statutory requirements that may result in the imposition of civil and criminal penalties necessitate careful consideration of the difficulties faced by the persons on whom the requirements are imposed. These difficulties are not faced in a statute which

requires the supplying of "such information as the Secretary or his delegate prescribes" without reference to the availability and control of such information by such persons.

For example, this section eliminates the effective date provisions of present law which restrict its application to foreign corporations created or organized, or reorganized after September 14, 1960. Thus, a United States citizen who becomes an officer or a director of a long-established foreign corporation, whether or not it has any United States stockholders or is engaged in business in the United States, would become subject to the information requirement. As discussed above, much of the information that the Treasury is likely to request will not be available, and many of the persons who might be subject to the requirements of the statute will be in no position to require action by the foreign corporation to obtain the information. The submission of the prescribed information may, under the laws of a number of foreign countries, subject the officer or director to criminal penalties in those countries. As a practical matter, the proposed form of the statute could present many United States citizens with a choice of terminating their employment by foreign corporations or surrendering their United States citizenship.

Proposal for Amendment to Section 904 of the Internal Revenue Code

Secretary Dillon's statement before the Senate Finance Committee recommends the amendment of Section 904 of the Code so that the limitations on the foreign tax credit are separately computed with respect to "foreign investment income" and other taxable income from sources without the United States. The amendment is intended to eliminate an incentive for the transfer of bank accounts or investments abroad so that foreign income would be produced subject to a low foreign tax rate to offset other foreign income where the effective foreign tax rate is higher than the United States rate. The proposed amendment excludes from "foreign investment income" dividends received by a domestic corporation from a foreign corporation in which it owns at least 10% of the voting stock.

If the proposed amendment to Section 904 is adopted, the exclusion referred to should be amended so as also to exclude interest on debt of such a foreign corporation where the debt is created for the reasonable business purposes of the corporation. Such debt of a subsidiary is not created for the tax avoidance purposes to which the Secretary referred. It would be highly undesirable if the proposed amendment to Section 904 should tend to force United States corporations to provide the capital required by their foreign subsidiaries entirely in the form of stock rather than partly in the form of debt, without regard to business and foreign tax considerations to the contrary.

The following persons have participated in the preparation of these comments, and respectfully submit them for consideration:

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Senator KERR. Our next witness is Mr. Robert W. Coyne, president of the Distilled Spirits Institute, Inc.

Please proceed, Mr. Coyne.

STATEMENT OF ROBERT W. COYNE, PRESIDENT, DISTILLED SPIRITS INSTITUTE, INC.

Mr. COYNE. This statement is respectfully submitted on behalf of the Distilled Spirits Institute, Inc., 1132 Pennsylvania Building, Washington, D.C., a trade association of domestic distilling companies, some of them large, most of them small. We address ourselves to the provisions of H.R. 10650 concerning the deductibility of business and trade expenses incurred in influencing legislation (sec. 3) and of business expenditures for entertainment and related purposes (sec. 4).

We believe that the provisions of section 3 are inadequate and that those of section 4, if enacted into law, will seriously injure large groups of American businessmen and will destroy the jobs of hundreds of thousands of workers in many industries directly affected, including those for whom and on whose behalf we are privileged to speak. The impact upon the confidence and stability of American business generally will be deleterious and depressing and the unemployment problem, now confronting the country in distressing dimensions, will be further exacerbated should section 4 become law.

We recommend, therefore, that your honorable committee amend the language contained in sections 3 and 4 so as to make it accord with sound principles of taxation and the traditional American dedication to free speech and the freedom of private enterprise.

EXPENDITURES FOR INFLUENCING LEGISLATION (SEC. 3)

Although the Congress is entrusted exclusively with the authority to formulate public policy and although Congress has never determined expressly that public policy should proscribe business expenditures for legislative purposes, such proscription has attained the effectiveness, if not the dignity, of law through coordinate action of the executive branch (Treasury Department Regulations) and the judicial branch (the decisions of the Supreme Court of the United States in *Cammarano* and *Strauss*, 358 U.S. 498).

H.R. 10650 seeks to revalidate, reinvigorate and reinstall a basic concept of our form of government, namely, that it is essential that legislators at all levels of government have open, unencumbered lines of communication through which to acquire information as to pending or proposed legislation without the effective restraints posed by a tax penalty.

H.R. 10650 recognizes, as shown by the Ways and Means Committee report, that "it is * * * desirable that taxpayers who have information bearing on the impact of present laws, or proposed legislation, on their trades or businesses not be discouraged in making this information available to the Members of Congress or legislators at other levels of government. The presentation of such information to the legislators *is necessary to a proper evaluation* on their part of the impact of present or proposed legislation." (Emphasis added by us.) These open lines of communication were maintained unimpaired from the time of

our early history until the Treasury Regulations and Supreme Court decisions closed them. Paradoxically, they were impaired at a time when, because of the constantly increasing complexity of American business and the proliferation of its interrelationships with international competition, it was most important that they be kept completely open, unfettered and unobscured.

Legislative determinations affecting businesses or industries cannot in good conscience be approached by legislators without the benefit of searching inquiry and the full acquisition of pertinent facts, nor can they be consummated in justice to the community and to business without evaluation of their consequences upon the business community and the body politic. In other words, the full and free comment by the businessman is a sine qua non of an informed legislative body in passing upon proposals to amend old, or adopt new, laws affecting business. It is, therefore, in the public interest that all avenues of communication between business and legislatures be kept open and the obligation to keep them open devolves equally upon Government officials and businessmen. We are responding to this sense of obligation in making this submission to your committee.

The foregoing observations appear to us to justify the wisdom and understanding of the Ways and Means Committee in reopening the channels of communication between businessmen and legislatures, legislative committees and individual legislators.

We endorse the provisions of section 3 as worthy of our—and, if you please, of your—support because they are good as far as they go. Unfortunately, however, they fail to get to the roots of the shortcomings of the status quo in that they do not open channels of communication to the public even where the voters are charged with the exercise of legislative functions.

Assuming that it is clear that it is urgent and necessary to keep open and unimpaired the avenues of communication between businessmen and legislators, what should be done about the maintenance of such avenues in such condition between businessmen and the public? Has not the public an equal right to know the facts, pro and con, as to legislation under consideration by its duly elected representatives? Does not the genius of our form of government postulate the need of an alert, interested, and informed electorate?

Specifically, what about those public referendums where the voters, in the words of the Supreme Court of the United States, perform a legislative function? Is it not of paramount public importance in those instances that the voters have full information? To paraphrase a section of the report of the Ways and Means Committee on H.R. 10650, is not the presentation of such information to the public necessary to a proper evaluation on the part of the voters of the impact of present or proposed legislation?

We believe that logic, experience and a deep concern for the public welfare jointly and severally impel the conclusions that the public does, indeed, have an equal right to know; that the genius of our form of government does require an alert, interested, and informed electorate; and that, specifically in those instances where the voters perform a legislative function, it is of paramount public interest that they have the full, precise and detailed information necessary to form right judgments after proper evaluation on the part of the

voters, themselves, of the impact of the legislation, present or proposed. These truths we verily believe and their acceptance by you gentlemen we advocate with full confidence and conviction.

The true dimensions of the threat to freedom of speech created and sustained by the Treasury regulations forbidding deductions for "sums of money expended for * * * the promotion or defeat of legislation * * *" have been fully apprehended neither by Government nor business. Significantly, section 3 fails to reflect legislative comprehension even now of the ominous implications and the grave nature of the peril thus created and so sustained.

Basically, the press is fully subject to the provisions quoted and when, through its treatment of the news, editorially or otherwise, it seeks, directly or indirectly "to promote or defeat legislation," its costs of operation are proportionately nondeductible for tax purposes. Campaigns for public improvements, for schools, for education, for the needy and the oppressed, if they are aimed at remedial legislation all bear the "verboten" tag of the Internal Revenue Service, regardless of the fact that the expenses incurred have been spent as truly ordinary and necessary costs of operation of the newspaper business. In instances where the press spends large sums of money to suppress racketeering, to destroy criminal syndicates and to rescue communities from the clutches and control of the underworld, the money so spent is deemed contaminated by the Revenue Service if, and to the extent that, the promotion of legislation is part of the campaign.

We need paint no picture for you gentlemen of the flood of outrage and indignation that would arise from the wellsprings of public opinion were the public to comprehend the grave disservice to the noble cause of freedom of speech inherent in the Treasury regulations of which we speak—a defect neither recognized nor corrected by section 3. Anyone harboring the illusion that the first amendment guarantee of a free press will protect newspapers from this taxation will stand corrected by the concurring opinion of Mr. Justice Douglas in 358 U.S. 498. It may be said that the Government will not ride herd on the press and will not enforce these restrictions strictly against editorial comment. But surely that begs the question and implies a lack of evenhanded justice of which no one can be either proud or tolerant.

We make no suggestion that anyone who is part of or connected with the administration would even think of using this potent weapon to regiment or punish the press out of anger, resentment, vindictiveness, or for any ignoble purpose. But we do emphasize that a power of harassment and punishment has been created which, in our view, is indefensible and which poses a clear and present danger to the preservation of freedom of speech and of the press.

The alcoholic beverage industry, more frequently than any other, it would seem, is involved directly in public referendums on which the voters are called upon to legislate. Such referendums, in the form of local option elections, have, since repeal of national prohibition, averaged somewhat more than 1,000 annually throughout the United States. The issues involved not infrequently so excite the electorate as to bring out the voters in numbers surpassing those who participate in primary and general elections.

Who will gainsay the point that in these plebiscites, where emotional factors often receive inordinate emphasis, there is not a need—

a compelling and overriding need—of full, factual, and detailed information on the part of the voters?

Or who will deny that in these public referendums, where the very existence of established businesses is at stake, the money spent in furnishing fiscal, economic, and employment data, together with moral and social analyses, to the public through paid advertisements and by other equally costly and legitimate means—who with intellectual honesty can deny, we repeat, that such obligations are ordinary and necessary business expenses?

In its present form, section 3 would create an anomaly under certain conditions. For instance, if a bill to prohibit the sale of alcoholic beverages throughout the State should be considered by the State legislature, our industry could claim, as deductible, moneys spent in bringing pertinent information to the legislature or to committees or individual members thereof. If, however, the legislature should pass along to the voters through a referendum measure the responsibility to make the determination, the expenses of the industry in furnishing the identical information to the public, as the voters prepared to exercise a legislative function, would be nondeductible in their entirety. This would seem to confront the supporters of section 3 as it now stands with a dilemma: either the legislature and the public both need full information before legislating, or neither the legislature nor the public has such need. The first horn, in our opinion, is the logical and sensible choice and we urge you earnestly to amend section 3 accordingly.

Specifically, we urge you to amend section 3 through the adoption of the language of the Hartke-Kerr bill—S. 467—and in the spirit of the purpose of that bill as conceived by the two distinguished Senators whose names it bears. This same language appears in the amendment intended to be proposed by Senator Hartke to H.R. 10650 and it would, we believe, accomplish his stated purpose "to eliminate certain defects and inequities."

ENTERTAINMENT FOR BUSINESS PURPOSES (SEC. 4)

The hope and expectation that every citizen will pay in full the taxes he owes to his government permeate all strata of society. Taxpayers, no less than tax assessors and tax collectors, are insistent that cheating, evasion, and other abuses be dealt with in a forthright, vigorous, and thoroughgoing manner. Regardless of business, employment, occupation, or profession, all good citizens make common cause on this question.

We join with the community of businessmen across the country and with the generality of our fellow citizens in all walks of life in supporting the proposition that the Treasury Department should have the power and tools reasonably necessary for the protection of the revenue and the extirpation of cheating, evasion, and other abuses however contrived or accomplished.

In our dedication to these ideals, we yield to no man, in or out of government. But we are equally dedicated to the principle that the end does not justify the means, in the application of which we have no choice but to oppose the provisions of section 4 of H.R. 10650. We believe that on the grounds of naked expediency, advocates of these provisions seek to deny deductibility for funds spent for good

will entertaining regardless of the demonstrable fact that such expenditures were clearly ordinary and necessary.

From statements repeatedly made by Government officials, it must be inferred that the difficulties encountered by the Internal Revenue Service in the fields of administration and enforcement have precipitated the current attempt to remove good-will spending from the lexicon of American business. Horrible examples of abuse have been exposed to public view with an emphasis which, intentionally or not, has created in the minds of many the belief that abuses are commonplace and represent the rule rather than the exception. The incidence of such abuses must be calculated in the light of the fact that taxpayers number tens of millions and that most of the abuses were curable by vigorous and rigid enforcement. As to those not so curable, we believe that the Internal Revenue Service will be equipped to handle similar abuses which may arise in the future if the provisions of H.R. 10650, abrogating the Cohan rule and limiting the use of "facilities," are enacted into law.

The fallacy that good-will spending is astronomical and that only the vigilance and dedication of the tax collector places any damper on its expansion makes good copy for the scandal sheets and provides fuel for the fires of those constantly seeking to blacken, char, or burn the structure of private enterprise. Although only the gullible and those ignorant of the anatomy of American business will readily accept as true any such rash and defamatory characterizations, there is danger lest constant repetition of these canards should blur the vision and confuse the judgment of even well-informed observers.

Businessmen know very well that within most business organizations there are many built-in checks on the spending of funds which are exacting and efficacious. Those who do the spending are confronted with requirements of explanation, verification, and justification that often seem unduly demanding to those who seek reimbursement for expenses incurred for business purposes.

Business management has been, is now, and, hopefully, always will be, the No. 1 watchdog of business funds. Long before the Internal Revenue Service has lifted a finger or sharpened a pencil, the business functionaries have been at work. The sales manager checked the salesman; the comptroller checked the sales manager; the president or proprietor checked the comptroller; and the stockholders, usually with the professional assistance of an independent organization of certified public accountants, has checked all the processes of spending and accounting. The concept of Mr. Moneybags, the corporate executive, handing out largesse to corporate employees through liberal expense account treatment just does not ring true for the overwhelming majority of the employees of business who do the predominant share of good-will entertaining.

If otherwise legitimate business expenditures are to be denied because of the difficulties of audit and investigation encountered by the Government, then it must be understood that there are other areas in which the same principle can be applied. By way of illustration, we may point out that the Internal Revenue Service has found that many taxpayers overstate the number of dependents; that some have included the names of deceased or fictitious relatives and others their

house pets, such as cats and dogs.[1] Yet, to the extent of our knowledge and information, no one has suggested that in consideration of problems of audit and investigation, credit for dependents henceforth should be eliminated in tax calculations.

If the Internal Revenue Service is to be granted authority to judge the business potential and value of entertainment expenditures, it would seem that by the application of the same rules of logic, the Service should be authorized to judge the business acumen displayed by management in fixing the number of its employees and their qualifications; in choosing and installing its machinery and equipment; and in making determinations as to the efficacy and timeliness of advertising and sales promotion campaigns.

According to an ancient legend, the Arab who, taking pity on his camel being buffeted by a sandstorm, permitted the beast to put his head inside the tent, was rewarded for this act of kindness by being ejected from the tent and being forced to endure the hardships of the storm while the camel enjoyed the comforts of the tent. The lesson of this story comes to mind when we see the tax collector moving into the realm of business management and, in that area, exercising discretion which in this country has belonged traditionally and exclusively to management itself. Permitting the tax collector to assume the role of Monday morning quarterback, passing judgment on decisions of business management, will establish a precedent which will lead ultimately and inexorably to the expansion of his role to the point that he will become the dominant partner in the management of the enterprise.

The standard laid down by the bill for determining the deductibility of entertainment expenses, that is, whether the taxpayer can establish that they were "directly related to the active conduct of the taxpayer's trade or business," is undeniably ambiguous and undoubtedly will be a prolific source of misunderstanding, controversy, and litigation. We find a wide diversity of opinion among tax experts as to the meaning of the quoted words and an almost universal hesitancy among them to express opinions as to the application of the standard to specific circumstances. Beyond peradventure of doubt, this ambiguity and uncertainty will discourage these expenditures by businessmen with consequences disastrous to numerous businesses and countless employees.

Good-will entertaining by its very nature is not measurable in value by immediate results. It may be that some of it is improvident from another person's viewpoint. Yet, like institutional advertising, good-will entertaining has for its purpose the creation of a favorable climate for doing business. We submit that the criterion for determining the deductibility of good-will entertaining should be: Has the taxpayer had a bona fide purpose of creating business good will as distinguished from the satisfying of the personal needs of the taxpayer or his representative?

In our analysis, the administrative problems connected with travel and entertainment expenses, as outlined in a speech by Commissioner Caplin before the University of Chicago Tax Conference, boil down

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[1] According to an article appearing in the Apr. 1, 1962, issue of This Week magazine, the Internal Revenue Service reports that 20 percent of the returns listing dependent relatives other than spouse and children are in error.

primarily to a single factor: the inadequacy of taxpayer records, and resort to the Cohan rule. We suggest, therefore, that the provision of the bill requiring substantiation of expenditures—thereby abolishing the Cohan rule—and the provision relating to "facilities" will provide new teeth which will be adequate for Treasury enforcement purposes. No law will cure all the fraudulent practices of taxpayers who disguise travel and entertainment expenses in their records, as recounted by Mr. Caplin. In fact, as to cheaters, experience seems to show that the more restrictive the law, the more prevalent such practices will become.

Interestingly, in that same speech, Mr. Caplin gave the results of a study of a 3 months audit made by the Government in 1960. In brief, by reason of the audit, $28.3 million in claimed travel and entertainment deductions was disallowed; a total of $29.5 million in unreported income to individuals was disclosed; and $20 million in additional tax was thereupon assessed. The significant feature of this audit is that under existing law, using existing tools in the hands of the Service, it was able to detect these malpractices and to benefit taxwise from such detection. This would seem to support further the conclusion that the basic objective of Treasury in advocating denial of deductibility of good-will entertaining is to relieve itself of audit difficulties, without regard to the fact that this step will punish the honest taxpayer whose number is legion, because of the malpractice of the cheater, whose number is few.

The Government itself pays obeisance to the value and propriety of good-will spending, although we have searched the record in vain to find any acknowledgment of this fact from those who have advocated, drafted, and explained the objectives, language, and meaning of H.R. 10650.

The Honorable Dean Rusk, Secretary of State, testified before the House Committee on Appropriations on March 7, 1961: [2]

> Any officer of the Department of State, whether overseas or in Washington, expects to reinforce his official duties in the office with a great variety of informal and social contacts with those with whom he is dealing. His value as an officer is enhanced by such contacts and his ability to support U.S. objectives is strengthened. His situation is no different in this regard than those in any other profession or vocation who deal regularly with other people.
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> There are, however, other occasions when officers are called upon to entertain or undertake other representation activities which are important to their duties and which cost money. It seems to me appropriate that such costs be considered a public charge and not an invasion of the salary of men and women who are pressed to meet their personal and family obligations.

Obviously, Secretary Rusk recognized the value of money spent for the promotion of good will and was forthright in urging the Congress to appropriate funds for this purpose because the Foreign Service officer's "situation is no different in this regard than those in any other profession or vocation who deal regularly with other people." We doubt if many dollar appropriated by Congress and spent by Government were allocated to a better purpose or spent more advantageously for the country than are those for whose appropriation the eminent gentleman now serving as Secretary of State made his plea on March 7, 1961.

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[2] Hearings before the Subcommittee of the Committee on Appropriations, House of Representatives, 87th Cong., 1st sess., p. 13.

Supplementing Secretary Rusk's plea for these funds, his Assistant Secretary for International Organization Affairs, Harlan Cleveland, on March 20, 1961, made these, among other, statements:[3]

> I think one of the best statements on the use and need for representation was made by the Secretary when he appeared before the committee. * * * In addition to this type of personal representation, we do have this request for funds to reimburse the officers abroad for certain official representation activities. The representation we are asking for is very similar to the expense-type claims that American business pays its representatives and salesmen. The same type of activity is carried on by American business.

Although modest in total amount in the light of the responsibilities of Foreign Service officers and the scope and gravity of our international relations, "representation expense" is at an all-time high, reflecting the obeisance to the value of entertainment spending to which we referred.

Just as the State Department, in word and in deed, has certified to the propriety, need, and necessity of spending public funds to promote good will, so, also, have all the Departments of the executive branch of the Federal Government endorsed the principle and engaged in the practice of spending public funds for active lobbying.

It is hardly necessary to remind your committee that lobbying by departments and agencies of the Federal Government is in high gear and that when the administration advocates a bill in Congress, the full force of these agencies is directed not only toward individual Members of the Congress but at the public, as well. Manifestly, the expenses of this application of force in all its aspects and orientation are borne exclusively by taxpayer dollars.

With the thesis that Federal departments and agencies have a duty at public expense to make available to Congressmen and to the public all pertinent facts and information in their possession or at their disposal with reference to existing or proposed legislation, we have no quarrel. In fact, we should consider them derelict in their duty were they to fail to do so.

But businessmen have a like obligation to make available to Congress, to all legislators, and to the public all pertinent facts and information in their possession or at their disposal with reference to existing or proposed legislation and, to the extent that such facts and information concern their businesses, they should be permitted to deduct the costs incurred thereby as a necessary and ordinary business expense.

Any other tax policy would create for government an unchallengeable monopoly in the lobbying field. This muting and stifling of the voices of private business would be bad for business, bad for government, and bad for the people. Thus has autocracy ever been born and thus does dictatorship constantly seek to justify and maintain itself.

In your consideration of sections 3 and 4, you will, we feel certain, keep in mind that the subject matter is the expenditure of funds by business enterprises for business purposes. Throughout the tax statutes and implementing Treasury regulations, the business taxpayer is treated as such and the tax liability which he incurs is based upon the profits which his business generates as a result of all his business activities.

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[3] Ibid., p. 1148.

Equating the propriety of the deductions from gross revenue of a business in the calculation of its net income for tax purposes with those of a person in his individual capacity is a false premise the use of which will lead to erroneous conclusions. Misunderstanding of this distinction has been demonstrated by some testimony given to this committee both as to sections 3 and 4 and has caused no little confusion in the minds of the public.

CONCLUSIONS

1. The provisions of section 3 of H.R. 10650 provide substantial legislative relief which is in the public interest. These provisions, however, do not do full justice in the matter of informing the public concerning existing or proposed legislation, and this section should be amended by including the principles and language of the Hartke-Kerr bill (S. 467), which is to be proposed by Senator Hartke as an amendment of H.R. 10650.

2. Section 4 of H.R. 10650 should be amended by deleting all provisions except those relating to facilities and to the maintenance of substantiating records. We suggest, also, that because of the widespread confusion and apprehension caused by section 4 and the report thereon by the Ways and Means Committee, and presently operating to undercut and depress many industries and to threaten the employment of countless workers, consideration be given to the inclusion of language to clarify the intent of Congress to treat the maintenance and promotion of good will as an integral phase of the operation of a business and to authorize specifically the deduction of expenditures for goodwill purposes as an ordinary and necessary business expense.

We regret that our efforts to do justice to the subject of this discussion within the compass of fewer pages were in vain. We hope, however, that despite the demands upon your time and patience implicit in your consideration of this statement, you will find somewhere in these pages material that will help you in your determination of the issues involved.

We thank you sincerely for your interest and courtesy.

Senator KERR. Thank you Mr. Coyne.

Mr. Don A. Ellis, Tektronix, Inc.

STATEMENT OF DON A. ELLIS, TREASURER, TEKTRONIX, INC., BEAVERTON, OREG.

Mr. ELLIS. Senator Kerr, I am Don Ellis, from Beaverton, Oreg., a suburb of Portland, Oreg. I am treasurer of Tektronix, Inc., a precision measuring instrument manufacturer.

Because of the nature of my presentation I do not have a prepared manuscript. We did send written statements to each member of the committee and I turned in a few this morning which I would like to see included in the record.

Senator KERR. That has already been ordered. It will appear at the end of your testimony.

Mr. ELLIS. I don't feel qualified to point out the technicalities of the bill. That is being very ably done by others here.

I would like to make two observations and spend the balance of my time illustrating the first.

The first observation is that anything which is done to reduce the ability of U.S. corporations and their subsidiaries to compete with foreign companies will be detrimental to the United States.

This includes parts of the tax bill under consideration.

I would also like to encourage support of efforts to reduce trade barriers and more toward freer trade which I think will do even more good for the United States.

The second is if you were to reverse your roles with your counterparts in other countries, particularly European, and so-called tax haven countries, I am sure you would retaliate with higher tax rates to counteract this country's attempt to tax earnings of foreign subsidiaries of U.S. companies before the earnings are remitted.

Higher foreign tax rates would increase the tax credit and reduce the amount of tax the United States would be able to collect either as earned or when the earnings are remitted.

Also if the foreign subsidiaries were in no position to make remittances to the parent in this country, and the tax had to be paid, it would be paid out of money that might very well otherwise be invested in this country to create more jobs.

Now, to illustrate how hampering our ability to compete with foreign countries will hurt U.S. jobs: to do this I have to do something the associates in my company don't like—sort of toot our own horn.

We are one of the new technology companies. We manufacture sophisticated electronic measuring instruments. I brought one with me, to illustrate to some extent.

This is the baby of our line. It is similar to a TV set except that it is very precise. A variety of measurements can be made with it. To the electronic and electrical engineer and researcher this instrument performs the same function that a chemical balance or a microscope does for a chemist, in other words, makes the very basic measurements.

I might point out also that this instrument contains some of the capacitors that the man from Sprague was talking about earlier in this session.

The electronics industry is particularly advantageous to some localities in this country, and I am sure is the type of industry we would like to keep strong in this country.

It is a mobile industry. It is not dependent on its location for markets or for materials. It is primarily based upon intelligence or brain power for developing the instruments, on productive careful workers to manufacture the instruments and very particularly upon good selling effort.

Our company started after World War II in 1946. The first sale was made in 1947.

The first instrument that was developed sold for around $800, where the competing instruments on the market at that time sold for around $1,900 to $2,000.

We rapidly became prominent in the industry, selling instruments all over this country, and very few companies remained in competition with us.

We are located in Oregon, which is unusual for a company of this type, but is very valuable to Oregon. Oregon has an economy dependent mostly on forest products and agriculture, both of which are highly seasonal.

Our company is considered quite an asset because while we started out with no employees in 1946, and had only 75 in 1950, by the end of 1951, as a result of the instruments used related to the Korean defense effort, we had 320 employees. By the end of 1954, 500; 1956, 1,200; 1958, 2,000; 1959, 3,000; 1960, 4,000; and at the end of 1961, about 4,600.

Of these, 250 are in our field offices providing the selling effort which I will emphasize in a minute.

We also have about 200 employees overseas.

In our business we have found personal marketing is highly important. These instruments are very technical. In order for a customer to make good use of them he needs to have considerable instruction and demonstration. There are now 43 different oscilloscopes in our line. This sample, as I mentioned, is the baby. It is a transistorized portable scope that can be used anywhere. We have some that are fairly large weighing as much as 150 pounds that cost $3,500 each.

We do a lot of training of our field engineers. It takes a man who has a good background to become one and then we have in-plant training of 6 months just so he is capable of helping the customers learn to use our products.

I have a couple of examples of letters here that illustrate what our customers think of our marketing efforts. One is from our Encino office, where, to quote, recently a chief engineer disclosed his counsel to his young engineers. "If your system doesn't operate and you don't know what is wrong, blame is on the oscilloscope. The Tektronix field engineer, to defend his equipment, will show you what to do."

I have another letter dated April 11, 1962, from a company called Nytronics, Inc., in Berkeley Heights, N.J., which says:

> Several days ago we found ourselves dangerously near cancellation on a Government contract resulting from the inability to read our present 545 scopes with sufficient accuracy to insure operation of the components within the close tolerances required. At that time we phoned Mrs. H. De Long of your Union, N.J., office who went to work on our problem, contacting your Mr. R. Herdman who was at an out-of-town meeting. Mr. Herdman continued the effort and by the next morning your Mr. F. Lenczynski called from your Philadelphia office and by that afternoon had arranged a loan for a few hours of the new digital read-out scope.
>
> Your Mr. J. Griffin arranged to be here upon the arrival of the scope and stayed well into the night helping with the use of the scope.
>
> We were and are extremely grateful to all the aforementioned persons and to any others of whose identity we are unaware for their cooperation and unstinting efforts on our behalf, and I would like to take this opportunity to personally compliment you on the apparent high caliber of your personnel.

We established ourselves in this country and then found that there were customers in other countries that wished our products. From an insignificant amount in 1950, our export has expanded to take more than one-third of our output. Of course, from Oregon's viewpoint all our output is export.

Almost none of our sales are made to Oregon, but for the United States one third of our output is now outside this country and Canada. We consider Canada domestic.

Obviously with instruments of this sort none of this goes to underdeveloped countries, all of it is to highly developed countries, those

that use technology. We decided our marketing in the foreign field was inadequate, and in 1957 sent a man over to Europe to circulate among our distributors there to make sure they were kept up to date on the nature of our products and the ability to demonstrate them to our customers.

From 1959 to 1962 our export sales averaged an increase of 40 percent per year, at the same time our domestic market was averaging an increase of only 20 percent a year.

In the United Kingdom our sales in 1955 were $80,000; in 1956, $180,000; then in 1957, with our new field engineer, $320,000; 1958, $530,000; in 1959, $980,000; 1960, $1,800,000, almost double 1959; in 1961, only $2 million, and it is the slowdown I want to stress.

The United Kingdom has more competition than most of the other countries in Europe at the present time. I have furnished members of the committee with copies of a letter to Mr. Ullman, from Mr. Brooks Hays of the State Department.

It describes part of our difficulty in the United Kingdom. The United Kingdom has a 33⅓-percent ad valorem duty on our type of instrument. However, when there is no competing instrument available in their country, they allow our instruments to come in without the payment of a tariff. But whenever an English competitor claims he has an instrument like this, a deposit has to be made with the customs people until it is proved that within 9 months the competitor did not supply the instrument.

We at one time had $200,000 invested in deposits with the customs people in the United Kingdom waiting for the competitors to fail to deliver.

Had the competitors been able to deliver, of course, our price would immediately have gone up one-third to the British customers. This would give our competition an almost insurmountable advantage.

We saw the handwriting on the wall, and in 1959 started a manufacturing branch on the island of Guernsey, one of the channel islands. I noted that Senator Douglas asked a question about the tax rates on the channel islands and I could have answered for this one.

Now, in 1959, as I mentioned, we had sales of $980,000 in the United Kingdom; 45 percent of these were instruments manufactured on the island of Guernsey.

In 1960 sales were $1,800,000, with 50 percent from the island of Guernsey. In 1961, of the $2 million sales, 60 percent was from our plant in Guernsey.

This amounted to an actual decrease in the amount that came from this country. Guernsey manufactures only 5 out of our 43 types. We would not have been able to sell any of these five types made in this country; by manufacturing on the island of Guernsey, we are able to continued satisfying the United Kingdom market.

Thus, we did not abdicate to their companies, the right to make our instruments.

I have another example to show where we have failed to prevent the growth of competition.

In Japan we have not sent over our own field people. We do not furnish marketing assistance there and I think it is a big mistake.

In 1959, we had 11 competitors in Japan that we know about, and we still had about two-thirds of the Japanese business.

In 1960, we believe we satisfied only about one-half of that market. In 1962, there are at least 20 competitors in Japan and we feel we are doing less than one-third of the business there.

We are, I think, sorely in need of field engineering in that country, as well as manufacturing.

However, seeing the handwriting on the wall in the United Kingdom, we also see it in the Common Market. Competition is developing there, so in May we will open a manufacturing facility in the Netherlands to manufacture the instruments threatened with competition.

We will continue sending to Europe from production in Portland the other 38 scopes plus the allied instruments.

However, as I mentioned, our marketing is a problem. It is complex, it requires considerable competence. We will be selling instruments from three different companies. The efforts need to be not only coordinated but our field distributors need to be informed, kept up to date at all times.

We, therefore, formed a marketing subsidiary [1] to unify all of these efforts, to coordinate the instruction and demonstration, and to do the repair work. We selected a Swiss company. There are several reasons why we did it and we did not ignore the fact that the taxes would be less.

However, we went to Switzerland because it has a good record of stability—economic, political and money stability—of reliability, of easy transfer of funds, of respect, a good set of treaties, and, in particular, it is multilingual. The Swiss people are adept at dealing with the variety of countries. But as I said, we didn't ignore the fact that by forming this company in Switzerland we would have less taxes over there, therefore, less credit and when the money is remitted back here and pay a larger U.S. tax.

In summary, our satisfying the world market instead of defaulting it to foreign competitors:

1. Expands exports of U.S.-made instruments because we are increasing demand by providing proper instruction in the use of the instruments.

2. It prevents the loss of foreign and eventually domestic market to our foreign competitors. We have no doubt that as Japan is able to make these instruments they will try to sell them in this country.

3. It brings to the United States earnings of the foreign manufacturing and marketing subsidiaries and allows us to continue our expansion there.

I might also say that our manufacturing companies over there pay a technical service fee for every instrument they make to the domestic parent directly and that, of course, is taxable income to the United States.

Our marketing company pays a license for the right to use the name.

So, if provisions to tax earnings of foreign subsidiaries remain in the tax bill, they will hamper our ability to compete. They will endanger our employment in the United States and particularly Oregon.

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[1] Our marketing subsidiary is definitely a necessary operating company.

We feel sure such provision will invite other countries to raise their tax rates and thereby nullify the effects of the bill.

Thank you.

Senator KERR. Thank you very much, Mr. Ellis, for a very interesting statement and presentation.

(The statement referred to follows:)

TRADE BARRIERS AND TAXATION OF FOREIGN SUBSIDIARIES

Statement of Tektronix, Inc., Beaverton, Oreg., by Don A. Ellis treasurer, February 28, 1962

Tektronix, Inc., strongly favors every effort which can be made to reduce tariffs and to eliminate trade barriers in international business operations.

Tektronix as strongly opposes any U.S. efforts to tax foreign subsidiaries of American corporations differently than foreign companies in the same situation are taxed.

To elaborate, some background is essential:

Tektronix, since it sold its first instrument in 1947, has developed a line of precision oscilloscopes, highly complex electronic measuring instruments, which have become necessities in most fields of research and scientific development.

Tektronix, which employs some 4,500 Oregonians, is the world's outstanding manufacturer of these instruments. Our oscilloscopes are so widely accepted that more than one-third of company production is now sold abroad. Potential competitors pay is our greatest compliment by trying to copy our instruments.

Many of our competitors are outside the United States. In their countries, we face threats of increasing protective trade barriers. Not only does this indicate a potential reduction in our market overseas; it also might allow our competitors to gain strength and invade other markets—eventually even our domestic market.

To avoid trade barriers and to keep our competitive position overseas, we chose to assemble, then to manufacture our instruments abroad—first as a branch assembly operation, then as a manufacturing subsidiary.

The idea of using branch operations in these countries—as we have learned painfully and expensively—is impractical. Experience taught us it's wiser to work through subsidiaries.

We therefore incorporated our branch on the Isle of Guernsey, in the English Channel, to handle our Commonwealth market. Also, when our new building is completed this spring, we can start manufacturing in our new Netherlands subsidiary for the Common Market countries.

We have done this to avoid the threat of trade-barrier-protected competition. It is not motivated by lower cost labor. (High U.S. productivity is hard to attain elsewhere. The building in the Netherlands is essentially the same construction and design as those in Oregon. It is even more costly.)

A large part of our success has resulted from a high level of technical service to customers throughout the world. For the customer to get the most value from our complex instruments requires that we have competent people to demonstrae their use; to instruct in their application and maintenance, and to coordinate new developments and modifications (because of rapid technical obsolescence).

Because our success does depend so greatly on a highly skilled marketing organization, and because we are marketing the products of three manufacturing plants, it seemed natural (1) that we coordinate our marketing in the European area through one overseas marketing subsidiary; (2) that our manufacturing operation be subsidiaries of that company, since marketing coordinates manufacturing.

We chose Switzerland for our marketing headquarters because of the advantages it offers. The U.S. Government, when its own rights were in jeopardy, has itself turned to Switzerland because of its custodial integrity; respect for personal and property rights; political stability, and moral courage.

Switzerland has one of the largest networks of international-commercial treaties, and a record of stable and convertible currency. It is sound business to use these Swiss advantages; we resent having this business judgment condemned.

With the growth in the European Common Market and the United Kingdom's application to join, President Kennedy seemingly has two alternatives:

1. Applying to join ECM. (This might be politically unpalatable; however, the writer, personally, would favor this plan.)
2. Trying to reduce present and potential future applications of trade barriers. Tektronix, Inc., endorses this program.

If we were sure the Kennedy program to reduce trade barriers would succeed promptly, we would have less need to manufacture overseas. We far prefer that Tektronix expand inside rather than outside the United States. But, unfortunately, we can't bank on eliminating world trade barriers in the near future.

Since we must manufacture abroad, we feel that recurrent proposals to tax our foreign marketing subsidiaries prior to remission of profits are unfair, in that they tend to make us noncompetitive with other nations' companies operating overseas.

Our foreign subsidiaries are wholly owned to insure the absolute quality control our instruments require, in customer relations as well as manufacturing. Continuous service contact is our best guarantee of performance.

Operation through these foreign corporations is essential to our international business.

In fact, Department of Commerce qualifications to simplify certain controls over strategically sensitive products in the interest of American firms competing abroad can be met only by "controlled foreign corporations."

Doing business internationally is complicated. Native industry in each country has a real advantage. So does a foreign competitor from a neighboring country, if the countries' economies are complementary and as interwoven as they are in much of Europe.

Other governments have gone out of their way to ease the path of foreign investors—not to favor them against native competitors, but to help them get an even footing with that competition. No major European country now taxes the undistributed export earnings of foreign companies controlled by its nationals.

The U.S. Government, although recognizing that manufacturing abroad is legitimate, is attempting to condemn using another corporation to market these products overseas.

Under proposed restrictions, Tektronix Holland could manufacture its products, but would be handicapped if it distributed them through a related subsidiary in Germany, France, Italy or other Common Market countries. The same would be true of Tektronix Guernsey in dealing with EFTA and Commonwealth countries.

In theory, this distribution could be done by straight export trade from Holland and Guernsey, or through a system of branch operations. But in practice, this is an unrealistic and often detrimental approach. Tektronix paid for this knowledge very dearly, in earlier attempts at branch operation on Guernsey. We concluded that incorporation in the foreign country was the logical solution.

Using separate corporate forms, subject to separate governments' sovereignties, has protective features. Having a structure of first- and second-tier subsidiaries offers other practical advantages. For example, by using our Swiss distributing company as a "parent" for our Dutch and Guernsey manufacturing plants, we kept our equity investment abroad within reasonable limits.

Part of our Dutch construction is financed through a municipal credit line that will become a 20-year amortization mortgage—a financial operation that would be hard to duplicate in the United States. To accomplish this, the Swiss company furnished the "parent" company guarantee. This freed Tektronix, Inc., from restrictive involvement.

When the Government condemns such setups of related companies, it indicates it doesn't clearly understand the organizational steps which success in the international field requires. If this misunderstanding became official American policy, it could be disastrous.

Dishonest operations probably do exist, using legitimate organizational forms. But we believe present auditing rules provide protection enough for U.S. revenue interest.

Any governmental attack on integrated international operations may have other, more serious political consequences: Retaliation by foreign tax, exchange, and customs authorities.

European governments have indicated they will not let the American Treasury siphon off tax and other advantages which U.S. concerns now enjoy in their countries.

By special withholding taxes, freezing of balances, special customs duties or similar retaliatory charges, any return on American investments abroad will be subject to 52-percent foreign taxes.

The fact that this is discrimination against American investments will not deter these governments. They feel they are defending their economies against U.S. fiscal "aggression." Nor could we protest; our own tax and customs laws provide for the same sort of punitive retaliation against foreign discrimination.

It is easy to see how American business would fare if it were singled out for such taxes and its competitors were not.

As our international organization expands and strengthens while our manufacturing abroad progresses, we expect our foreign business to increase and, particularly, to diversify faster than Portland export efforts alone would have allowed.

Our strong technical organization and marketing consulting staff abroad can solve customer problems that the best foreign distributor couldn't hope to tackle. By being there in force and learning firsthand the intricacies and special needs of foreign markets, we gain the information we need to modify and refine our instruments.

This ability translates itself into orders for more complicated and more specialized instruments, which can only be supplied by our domestic operations. This assures an export business for Portland that would have escaped us except for the greater penetration of the European market which our oversea manufacturing operations allow.

Also there will be an increased demand (already begun) in customer service and replacement parts from Portland. This is aside from the equipment and the components and other parts which foreign assembled or manufactured instruments require.

Greater penetration not only means more export business now, but also opens up the prospect of continued increase. On this basis, our management promised its Oregon employees that manufacturing abroad wouldn't mean "exporting jobs," but rather would increase the export business from Portland. It also assures that we will not "force" the development of effective foreign competition—first in markets abroad, then in domestic markets—by failing to bid for a position in the European electronics industry as strong as the one we occupy in this country.

Any governmental action to impose an unfair tax on our oversea subsidiaries probably would mean cutting back our foreign distributing and customer service operations. Exports from Oregon would suffer most because, on a trading basis, we would not be competitive in Europe if subject to this additional American tax burden—or to equivalent foreign retaliation—while competitors there continue to enjoy the support of their governments.

Because of the reasons we've summarized—and because the individual health of each American business contributes to the overall health of the entire American economy—we ask that you support reduction of tariffs and elimination of trade barriers, and oppose U.S. efforts to unjustly tax American corporations operating overseas.

DEPARTMENT OF STATE,
Washington, July 10, 1961.

HON. AL ULLMAN,
House of Representatives.

DEAR MR. ULLMAN: Thank you for your letter of June 9, 1961, concerning the imposition of tariffs by other countries on certain electronic measuring devices. With your letter you enclosed a copy of a letter from Mr. Don A. Ellis, treasurer, Tektronix, Inc.

As to the situation described in Mr. Ellis' letter relating to the imposition of customs duties by the United Kingdom on electronic laboratory measuring devices, the general practice is to apply the legal rate of duty of 33⅓ percent on such instruments. These duties must be paid by the importer at the time of entry. There are, however, Treasury provisions for remission of duties upon application by the importer. The remission of duties is granted under certain conditions, for example if a specialty product is not manufactured in the United Kingdom. It appears that the British importer of Tektronix instruments, and

therefore the American producer, is benefiting by these provisions and that these instruments are entering duty free, subject, however, to the requirement that the importer must deposit funds in escrow to cover the amount of duty which would be charged if duty-free entry were denied. This requirement of deposit of duty pending clarification of dutiable status is usual in the customs practice of many countries, including the United States.

We realize that the legal rates of duty may be imposed at some time, subjecting the American instruments to a substantial assessment of duty. During the GATT tariff conference taking place at Geneva the United States is requesting concessions on many items from more than 20 nations including the United Kingdom and in return, the United States will have to grant tariff concessions to these countries. We are requesting reductions in duty on electronic measuring instruments from several nations. If we are successful in obtaining tariff concessions on these items a domestic manufacturer such as Tektronix should have wider access to the world markets.

I hope this information will be helpful to you. If the Department can be of further assistance please do not hesitate to write.

Sincerely yours,

BROOKS HAYS,
Assistant Secretary.
(For the Secretary of State).

Senator KERR. That concludes the list of witnesses scheduled for today. The committee will recess until 9:30 Monday.

(By direction of the chairman, the following is made a part of the record:)

Statement of
COMMERCE AND INDUSTRY ASSOCIATION OF NEW YORK, INC.
Concerning
The Revenue Act of 1962 [H. R. 10650]

Submitted by Ralph C. Gross, Executive Vice President
99 Church St., New York 7, N.Y.

Prepared for presentation to
The Committee on Finance
of the
United States Senate
April 17, 1962

Commerce and Industry Association is the largest service chamber of commerce in the East. Its more than 3500 members collectively embrace almost every kind, size and level of business endeavor. The New York Times has referred to the Association editorially as "The Voice of New York Business." As such we speak not only for the major corporations doing business in New York State but also for the 75% of our members employing twenty or fewer persons.

Introduction

We have reviewed some thirteen sections of H.R. 10650 as passed by the House of Representatives. In them, the goals sought to be achieved are apparent: (1) encouragement of investment in new equipment; (2) elimination of areas charged with providing opportunities for abuse, for unfair tax avoidance and for outright tax evasion; and (3) reversal of national policy on investment of United States capital in foreign countries.

We are in accord with the first two of these aims, but even if we were in complete agreement, we do not believe that the bill provides desirable methods for their accomplishment. The weaknesses and fallacies of the bill sections reviewed are particularized below. Considered generally, however, they would make drastic changes which would raise taxes in some respects, increase administrative burden, bar or inhibit normal business practices under threat of unusual tax consequences, or necessitate the further substitution of tax considerations for business judgment.

Under these circumstances we urge that unless there are substantial excision and revision the bill should be defeated.

Investment Credit [Section 2]

Outline: A credit of 7% (3% for utilities) of investment in qualified property placed in service during the taxable year would be allowed on the first $25,000 of net tax (after other credits) and 25% of the balance. Qualified property would include depreciable personal property and other tangible property (buildings excepted) used in manufacture, production, extraction and for furnishing transportation, communications or other utility services. The property would have to have a useful life of at least eight years to obtain a full credit. Property with as little as a four-year useful life would qualify for a fractional credit.

Limitations would be provided in the case of husband and wife and affiliated groups of corporations. Property used for lodging purposes other than for hotels and motels would not qualify. If qualified property for which a credit is taken is disposed of before the end of its qualifying useful life a tax equal to the unearned credit would accrue.

The credit for investment in depreciable property, designed to encourage the expansion and replacement of the American industrial plant, is not the best means for obtaining the desired result. In many instances, taxpayers would adopt uneconomic expansion programs in violation of good business judgment in order to take advantage of the credit provision. Over-extension in this direction could lead to business failures, particularly in the case of small business. Additionally, its cost measured both in terms of revenue dollars and in terms of other measures, with which it is coupled and which would produce presumed revenue gains, is excessive.

Enactment of this provision would be a bonanza for those businesses which would embark on plant expansion programs whether or not a tax credit could be gained. Nor should it be otherwise, for equality of treatment should prevail. However, comparison of such a business with one whose expansion is only credit-inspired points up the error of this legislation. Five years from now, where will A corporation be at the conclusion of its tax reduction-motivated expansion program in relation to B corporation whose expansion was based on considered evaluation of the market and the demand for production?

The credit provision is intended as a part of permanent law, but nothing would prevent repeal if the Congress be so advised. This real threat is proved by provisions of the bill which would change long-standing law concerning income derived from foreign sources. No reasonable escape would be provided for the tax-

payer who in good faith invested in a foreign country under the encouragement of favorable tax law. What would happen then, upon repeal of the credit, to the taxpayer with an incomplete but possibly over-ambitious expansion program? And would the revenue-producing provisions of H.R. 10650 be repealed at the same time?

Instead of a tax credit, we recommend adoption of statutory liberalized depreciation as a means to encourage expansion of the American industrial plant. One method for accomplishing this alternative is to provide a flexible bracket system of useful lives for broad classes of depreciable property. Under the bracket system, the taxpayer could elect any useful life within the bracket provided. A shorter period also could be used, but the taxpayer would be required to sustain the propriety of the lifetime selected. The election (within the bracket) once made would be binding on the taxpayer and could not be upset on audit. With regard to salvage the taxpayer would be permitted to elect any amount or none if he be so advised.

Adoption of depreciation reform would be a realistic force for expansion based on business judgment rather than tax-compulsion. By permitting the taxpayer to obtain full tax recovery of his investment in equipment closer to the time of the investment, the obsolescence factor would be given appropriate weight. Moreover, the effect of inflationary forces would be less during the shorter periods involved.

<u>Gain on Disposition of Tangible Property [Section 14]</u>

Outline: To the extent of depreciation deducted for taxable years beginning after December 31, 1961, gain on disposition of tangible property other than livestock or a building would not be treated as capital gain. The deduction for charitable contribution of such property would be reduced by such depreciation. Salvage value could be adjusted by the taxpayer by not more than 10% of basis.

This proposal is approved on condition that liberal depreciation reform is enacted and provided that safeguards are incorporated to prevent bunching of income or taxation of recovered depreciation resulting from price level rises. Its adoption would eliminate any undue advantage a taxpayer could obtain by using accelerated depreciation and later disposing of the property at a price in excess of basis.

Disallowance of Entertainment Expenses [Section 4]

Outline: To be deductible, entertainment expense would be required to be directly related to the active conduct of business. The cost of maintaining a facility for entertainment purposes (including social club memberships) would have to be primarily for business use. Exceptions to these requirements would be provided for business meals, reimbursed expenses, expenses treated as wages, food for employees and meetings of employees, stockholders and business leagues.

Gifts would not be deductible in excess of $25 per person per annum. Travel expense, entertainment expense and gifts would be required to be substantiated by records, and expenses while in travel status would be limited to "reasonable allowance" instead of "entire amount" as presently provided.

While recognizing that certain abuses in travel and entertainment expense would be reduced or eliminated by the bill, which also would provide greater uniformity of treatment, Commerce and Industry Association opposes the proposal. Expanded audit procedures based on new reporting requirements contained in the 1960 and 1961 returns will prove that changes of statutory law are not necessary. Furthermore, many of the restrictions are arbitrary and unrelated to business needs. They are aimed at a minor segment of the community, but will inconvenience and restrict many.

The proposal would create unwarranted difficulties for taxpayers. For example, it might be extremely difficult for them to prove their entertainment expenses to have been directly related to active conduct of business. Also the reasonableness rule for subsistence while in travel status could give rise to the establishment of arbitrary limitations. On the other hand, it is doubtful that the adoption of the proposal would in fact have any substantial deterrent effect upon taxpayers who are abusing the present rules.

In disapproving the proposal we reaffirm the principle that a proper expense should be deducted in full and an improper one not at all.

Tax Withholding on Dividends and Interest [Section 19]

Outline: Withholding of income tax at a rate of 20% would be required with respect to dividends, investment-type interest and patronage refunds paid. The bill provides for exemption certificates, quarterly refunds, and offsets and credits.

While the proposal would reduce tax evasion through failure to report dividend and interest, it would impose high administrative costs on both the government (quarterly refund claims) and withholding agents (exemption certificates). Meanwhile, it would impose an unnecessary penalty on those taxpayers who properly report such income and would introduce a confusing complication in the preparation of millions of individual income tax returns.

The bill would exempt stock dividends from its requirements but make no provisions for dividends in stock of another corporation or other dividends in kind. In this respect the bill is defective, for it would make it virtually impossible for a corporation to pay such a dividend.

The government has adopted a taxpayer numbering system to be applied to information returns. These returns, processed through the government's electronic data processing machines, could eliminate tax evasion in this area. Furnishing of a copy of the information report to the taxpayer as a reminder would reduce the importance of such income as an audit problem. We concur in the desire to eliminate tax evasion in the dividend-interest area, but we do not agree that the government's problem should be shifted to taxpayers in this manner. The proposal is opposed.

Deduction of Lobbying Expenses [Section 3]

> Outline: Ordinary and necessary expenses in direct connection with appearances, statements and communications to legislatures with respect to legislation or proposed legislation of direct interest to the taxpayer would be deductible whether incurred directly or through payment of dues to an association. Expenses related to political campaigns or to attempts to influence the general public, or segments thereof, would not be deductible.

The bill does not go far enough to be considered even a step in the right direction. The limitations to expenses in connection with legislation of direct interest to the taxpayer and barring deduction of expenses related to attempts to influence the general public would restrict severely the activities of businessmen in regard to legislation which may affect their businesses.

In explaining the reasons for the proposal, the Ways and Means Committee's report says, "It also is desirable that taxpayers who have information bearing on

the impact of present laws, or proposed legislation, on their trades or businesses not be discouraged in making this information available to the Members of Congress or legislators at other levels of government." The requirement of direct interest and the exclusion of expenses related to attempts to influence the general public both would limit the achievement of this goal. Obviously, the businessman who is well-informed on the effect of a legislative proposal might be reluctant to present his opinion to a legislator or legislature if he feels the measure might be held not to be of direct interest to him. Furthermore, efforts by business to influence the general public concerning legislation would produce for the benefit of legislators information which might not be forthcoming in cases where the general public is otherwise uninformed.

In place of Section 3 of the bill, we recommend an amendment which would permit deduction of all legitimate lobbying expenses that are "ordinary and necessary." A rule along this line would encourage business not only to express its opinions on legislation but also to furnish valuable information on matters on which it may be held not to have a direct interest. Such a provision would not place a stamp of approval on abusive practices.

Related Group Income Allocation [Section 6]

Outline: Sales and purchases within a related group including a foreign organization could be allocated by a three-factor formula - property, payroll and sales expense. The formula would not apply if the taxpayer could establish a proper arm's-length price. Alternative allocation methods would be permitted with the Treasury's approval.

This proposal is intended to provide a method for subjecting a share of the income of a foreign corporation in a related group to taxation as domestic income in cases where the domestic taxpayer limits its profits by charging a low price to a related foreign corporation. Existing law permits the transfer and revision of income of related corporations in appropriate cases. The new section would provide guide lines for allocation. However, problems of interpretation would not be eliminated; instead new problems would arise.

Because existing provisions of the law [Section 482] are adequate to prevent

the avoidance of tax by transfer of income to a related foreign corporation and because the proposed change would cause more difficulty than it would eliminate, the proposal is disapproved.

Foreign Income of Nonresident Citizens [Section 12]

Outline: Income earned abroad by a U.S. citizen who is a bona fide resident of a foreign country would be excludable to the extent of $20,000 during the first three years of such foreign residence and $35,000 thereafter. This would replace the present unlimited exclusion.

Employee pensions or annuities provided by an employer for those employed abroad would be taxable on retirement except with respect to contributions by the employer made on or prior to December 31, 1962 or applicable to service on or before such date.

Existing law permits a United States citizen residing in a foreign country to exclude all of his income earned from foreign sources. An individual who does not establish a foreign residence but remains abroad for a period of 17 out of 18 consecutive months may exclude from gross income up to $20,000 each year of his income earned in foreign countries. No change would be made in the latter rule.

The proposed change with respect to citizens residing abroad would be contrary to national interest because it would discourage qualified American citizens from taking employment in foreign countries. Because such an individual in a foreign country forfeits to a considerable extent the benefits and protections afforded in the United States it is reasonable to grant reduced tax. Accordingly, the proposal is disapproved.

Assumed Distributions from Controlled Foreign Corporations [Section 13]

Outline: Where more than 50% of the voting stock of a foreign corporation is owned directly or indirectly by United States individuals or corporations, each United States owner of 10% or more of the stock would be taxed on his proportionate share of certain classes of the corporation's income whether or not distributed. Foreign tax credits would be allowed to corporate shareholders as if the earnings had been distributed.

A proposal to tax earnings of foreign corporations as if distributed to their American shareholders is directly in line with an apparent change in government policy concerning the taxation of foreign income. In general, this proposal and others included in the bill would impose a tax on income from foreign operations of foreign corporations whether or not it is distributed to domestic taxpayers and

whether or not it will ever be received by domestic taxpayers.

In addition to the extensive complications and administrative burden that would be involved in proposals such as this one, the change would require that tax considerations be substituted for business judgment with regard to the operations and income of controlled foreign corporations.

This proposal would be an improper burden on business and a breach of faith in respect to existing provisions which were meant to encourage foreign operations and employment. Accordingly, it is disapproved.

Sales of Controlled Foreign Corporation Stock [Section 16]

Outline: Gain on the sale of stock in a controlled foreign corporation by an owner of 10% or more of the voting power would be treated as gain from sale of a non-capital asset to the extent of the corporation's earnings accumulated during taxpayer's holding period.

In the case of a redemption or a complete or partial liquidation, the gain to the extent of the proportionate share of accumulated earnings of a foreign corporation would be included in such a stockholder's gross income as a dividend. In this situation, the amount treated as a dividend is not limited to earnings accumulated while the taxpayer held the stock.

The eagerness of the government to obtain taxes on income of foreign corporations, underlined by several sections of the bill, emerges in this proposal in its most distorted form. Adoption of Section 16 would apply rules to sales of stock in controlled foreign corporations and receipts from their redemption or liquidation which are not applicable in the case of controlled domestic corporations. The general overreaching in the bill is best exemplified in this section which seeks to pick up tax retroactively on accumulated earnings of controlled foreign corporations from which existing law would exact a much lower tax. Section 16 is disapproved

Information Concerning Controlled Foreign Corporations [Section 20]

Outline: Information now required to be furnished by corporations with respect to controlled foreign corporations would be required to be furnished by an individual stockholder owning directly or through attribution more than 50% of the voting power or value of all classes of stock in a corporation. The reporting requirements for corporations would also be extended to any number of tiers of foreign subsidiaries and tightened in other respects.

The present requirements with respect to information returns to be filed re-

garding foreign corporations are extremely burdensome, expensive to enforce and in relation to the demands placed upon the taxpayer, of negligible value to the government. The tightening of the provisions of existing law and the extension to individual taxpayers would compound existing administrative burden, the value of which has not been proved.

In the absence of demonstrable utility of information reports now required and for which the first filing is required in 1962, no extension should be made. The proposal is disapproved.

Estate Tax Treatment of Real Property Outside the United States [Section 18]

Outline: Real property situated outside the United States would be includible in the gross estate of a resident decedent who dies after the enactment date except in the case of death before July 1, 1964 with respect to property acquired before February 1, 1962. Such property would not be includible in the estate of a decedent dying before July 1, 1964 who acquired the property by gift, devise, inheritance or form of ownership after January 31, 1962 if the donor or prior decedent acquired his interest prior to February 1, 1962.

Existing law is discriminatory in providing an exclusion from gross estate of real property situated outside the United States. The discrimination applies both in respect to intangible investments in foreign countries and real property located within the United States.

No reason exists for continuing the discrimination nor for providing a means for United States residents to place funds beyond the purview of United States estate tax. Existing provisions of the Internal Revenue Code, by providing for credit for foreign inheritance taxes paid, permit the adoption of this proposal without imposing an inequity on the estate of a United States citizen owning real property in a foreign country. Section 18 is approved.

Tax Treaties [Section 21]

Outline: Tax treaty provisions would be set aside if they are in conflict with the revenue act.

The making of treaties between the United States and foreign countries is the responsibility of the President of the United States and the United States Senate. Accordingly, we disapprove the proposal and recommend instead that conflicts with treaties to the extend that they may arise under the bill should be

adjusted by taking appropriate action in the same manner in which the treaty was negotiated and confirmed.

Tax Treatment of Cooperatives and Patrons [Section 17]

Outline: Tax on the income of cooperatives engaged in business would be assured under the proposed change. Existing law, adopted in 1951, was intended to subject such earnings of cooperatives to tax, either to the cooperatives or to the patrons. The proposed change would correct the existing exemption accorded non-cash allocations of patronage dividends held non-taxable by court decisions.

To the extent that cooperatives are engaged in business pursuits in competition with private business, which is subject to all the taxes imposed by the United States government, the cooperatives should obtain no unfair competitive advantage by exemption from tax. The proposal with respect to the taxation of cooperatives is approved.

STATEMENT OF E. MARSHALL NUCKOLS, JR., VICE PRESIDENT, ADMINISTRATIVE SERVICES, CAMPBELL SOUP COMPANY, CAMDEN 1, N.J., TO THE SENATE FINANCE COMMITTEE CONCERNING PROPOSED AMENDMENTS TO SECTION 13 OF THE REVENUE BILL OF 1961 (H.R. 10650) TO RECOGNIZE NET OPERATING LOSSES

Under Section 172 of the Internal Revenue Code, losses from the operation of a business can be carried back to the three years immediately preceding the loss year and if not used to offset income in those years can be carried forward for as many as five years succeeding the loss year. Section 13 of the Revenue Bill of 1962 (H. R. 10650) in its present form would have the inequitable and probably unintended effect of denying recognition to unrecouped net operating losses by foreign subsidiaries in two important types of situations.

The amendments which we are proposing to overcome this effect are technical in nature and do not involve any issues of tax policy or philosophy. They are based on the simple grounds that the long standing and uncontroversial provisions of Section 172 recognizing net operating losses should be consistently applied to avoid discriminations based on the time when a loss occurs or whether it is suffered by a domestic or a foreign corporation.

I.

Section 13 of the Bill requires a U. S. corporation with a foreign subsidiary to include in its gross income the subsidiary's "increase in earnings invested in non-qualified property" for the taxable year. In general, non-qualified property means property neither required in the taxpayer's trade or business nor invested in a less developed country. The amount of such earnings is limited to those which accumulate on and after the effective date of the proposed legislation, January 1, 1963.

Since only profits and losses after December 31, 1962, are used to determine "earnings", the effect of these provisions if enacted without change will be to deny recognition to net operating losses incurred before the effective

date. Thus, if a foreign subsidiary lost $1,000,000 in 1962 and made $1,000,000 in 1963, the U. S. corporation would have to pay a tax on the $1,000,000 of 1963 earnings even though there actually was no money that could ever be made available to it or its stockholders. However, if this sequence of events were moved either backward or forward one year -- i. e., if the loss was in 1961 and the recoupment in 1962, or if the loss is in 1963 and the recoupment in 1964 -- no taxable income would be recognized.

This capricious effect of the Bill will result in many inequitable discriminations. For example:

(a) It will penalize newer foreign subsidiaries which have not yet achieved profitable operations and had an opportunity to recoup their starting up losses as compared with established foreign subsidiary companies which have already recouped their starting up losses.

(b) It will penalize foreign subsidiaries of U. S. companies as compared with their foreign competitors in countries where loss carry-overs are allowed.

(c) It will penalize foreign source income as compared with U. S. source income.

The avowed purpose of this part of the Revenue Bill is to reach unrepatriated foreign earnings. A foreign corporation can hardly be said to have such earnings until its losses have been recouped.

II.

Section 13 of the Bill also requires a U. S. corporation with a foreign subsidiary to include in its gross income the subsidiary's "subpart F income" for the taxable year. Subpart F income includes, among other things, the subsidiary's "net foreign base company income" which in turn includes "foreign base company sales income". This means income from the purchase and sale of property where no appreciable value is added to the product by the selling corporation.

While the Bill provides that foreign base company income "shall be reduced so as to take into account deductions (including taxes) properly allocable to such income", it is not clear that the net operating loss deduction is to be allowed.

The problem can be illustrated by assuming that a U. S. company has a Swiss sales subsidiary with a Belgian manufacturing subsidiary, and that under agreements with Belgian tax officials a percentage of the ultimate sales price is recognized as a selling commission to the Swiss company. The Swiss tax on the commissions is less than the Belgian tax rate. The purpose of the Bill is to impose a U. S. tax on what had been the saving of Belgian taxes by use of a Swiss sales company. However, the Swiss company may have incurred or may incur losses which it should be permitted to recoup as a deduction. In this situation there is the possibility that, unless the Bill is clarified, net operating losses both before and after the effective date might be denied recognition.

If the U. S. company were carrying on through a branch the operations performed by the Swiss company, it would clearly be entitled to the net operating loss deduction for losses from its Swiss operations. It seems difficult to justify a different result because the losses are suffered by a foreign subsidiary.

* * *

To correct the two problems outlined above, it is respectfully urged that H. R. 10650 should be amended as follows:

I.

In proposed Section 953(a)(1), page 116, strike lines 24 and 25, and page 117, strike lines 1 and 2, and substitute therefor:

"does not exceed the lesser of (A) the sum of the earnings and profits for the taxable year plus the earnings and profits accumulated

for prior taxable years beginning after December 31, 1962, or (B) the earnings and profits at the close of the taxable year."

II.

In proposed Section 952(e)(7), page 115, line 13, after the word "taxes" and within the parentheses, insert:

"and the net operating loss deduction"

Respectfully submitted,

CAMPBELL SOUP COMPANY

Statement
on behalf of the
Standard Oil Company (New Jersey)
on
H.R. 10650, the Revenue Act of 1962

Submitted by Emilio G. Collado, Director
30 Rockefeller Plaza, New York 20, N.Y.

It is the judgment of the Standard Oil Company (New Jersey) that Section 13, Controlled Foreign Corporations, of the proposed Revenue Act of 1962 as it was adopted by the House of Representatives would prove harmful to the economic future of the United States and detrimental in particular to the legitimate interests of the approximately three-quarters of a million shareholders in the Standard Oil Company. The damage would be increased if the Senate were to adopt the proposal of the Secretary of the Treasury to impose on U. S. companies and individuals additional taxation measured by the undistributed earnings of foreign corporations in which they have invested.

These proposals would tend to weaken the dollar, make the maintenance of high employment levels in the U. S. more difficult, result in less productive allocation of U. S. resources, deliver economic opportunities abroad to foreign competitors, and conflict with traditional American support for increased trade and economic cooperation among the nations of the Free World.

Weakening the Dollar

The proposals would tend to weaken the dollar by deterring U. S. private investors from earning prompt and substantial contributions to our balance of payments strength over the difficult years to come through investments in the most rapidly growing economic areas abroad. In testimony before the Senate Finance Committee on April 2nd the Secretary of the Treasury contended that "the immediate balance of payments drain of new investment in the industrialized countries is not made up for at least 10 to 15 years." Yet his own figures when properly analyzed suggest that the average dollar invested abroad in the developed countries repays its balance of payments cost in two to five years and then continues to add strength to our balance of payments position for many years to come. As explained in Attachment I this conclusion is supported by evidence of various types, including the fact that for any representative period during the last decade the reported outflow of U. S. funds for investment in manufacturing subsidiaries in the developed areas has been exceeded by the inflow of dividends and interest from those subsidiaries. We know, moreover, that the activities abroad of the Standard Oil Company have in recent years contributed about $300 million annually in net inflow to the U. S. balance of payments, and the figure has been growing.

Reducing U. S. Employment

To the extent the new tax proposals would weaken the U. S. payments position, they would also increase the likelihood of situations in which the Government would be constrained to limit expansionist, job-creating policies for fear of their effect on a weak balance of payments position. It should be realized that a substantial part of the contribution of private investment abroad to our balance of payments is made through the encouragement of the export of items produced in the U. S. In his recent testimony the Secretary of the Treasury suggested, by the particularly selective use of statistics discussed in Attachment I, that private investment generates as much in imports as in exports. This testimony appears to be at variance with the recent remarks of the Secretary of Commerce that "U. S. investment abroad is important to our export expansion program." The Treasury testimony is not easy to square with the 1961 special Department of Commerce study indicating that in 1959 and 1960 total exports to, or developed by, subsidiaries of U. S. manufacturing concerns in Western Europe and Canada were more than 3-1/2 times imports from subsidiaries in those countries. Within the Standard Oil Company it is also clear that foreign investment has had a more substantial effect in making exports possible than in encouraging imports.

Preventing More Productive Investment

The proposed tax changes would increase the effective burden of U. S. taxation on the income from foreign operations in the developed countries by imposing that taxation earlier, that is, before that income has been received by a U. S. investor. No comparable change is being proposed to tax U. S. corporations and individuals on the undistributed earnings of domestic corporations in which they have invested. The proposed change would tend to deter foreign investment. Theoretically, an investment deterred could be one which would otherwise have been favored over an alternative domestic investment only because a low foreign income tax rate permitted temporary reinvestment of funds destined eventually to be paid in U. S. tax. We have not encountered such a case in our own experience. We have observed, however, that the effective burden of total taxation on income from the average investment project abroad appears to be higher than the burden on a comparable domestic project when account is taken of both U. S. and foreign taxes and in particular of the non-creditable indirect taxes upon which most foreign jurisdictions place greater reliance than does the U. S. In these circumstances, as illustrated in Attachment II, increasing the burden of U. S. taxation can only place an additional barrier in the way of American investors placing their funds in the

economically most productive uses. The Secretary of the Treasury has contended that the present tax system provides an "artificial tax inducement" to investment abroad. Our observation is just the opposite, that, quite apart from the proposed investment credit which will be available only on domestic investment, the proposed tax changes would make our tax system even more "un-neutral" against investment abroad.

Delivering Opportunities to Foreign Competitors

We have also observed--as detailed in Attachment III--that none of the other major developed countries attempts to tax parent companies on the undistributed earnings of foreign subsidiaries. Enactment of the Treasury's proposal to impose just such a tax on parent companies organized in the U. S. would, therefore, handicap U. S. investors in the increasingly severe competition which they are meeting abroad from the strong international companies organized in the other developed countries. Although the competition in the developing nations is not the primary issue it is worth noting as an evidence of the strength of foreign competition that a recent OECD study indicated that the flow of private investment to the developing nations from the other developed countries now exceeds substantially the flow from the U. S. The only answer of the Secretary of the Treasury to this competitive threat has been to point out that some European countries impose direct controls on foreign investment. We certainly agree with the Secretary that the introduction of such controls in the U. S. would be most unwise; yet we must report our observation that European governments even in times of balance of payments strain have generally authorized legitimate long-term business investments abroad. The existence of such technical control would not in our opinion offset the restraints which the new tax proposals would place on U. S. firms in the competition in the market places abroad. It should be realized that direct investment abroad cannot be just turned on and off. Opportunities must be grasped when they occur, and once a venture is begun it cannot be thereafter ignored in the expectation that it will, without further investment, continue to earn the same returns year after year. Competition abroad does not permit such an easy life. Yet the new tax proposals would not only handicap U. S. firms in meeting direct competition abroad, there would be created in addition the danger of an indirect handicap for U. S. firms; in the future U. S. individual investors might choose to take part in the developing of the more rapidly growing markets of the world by buying--perhaps on the stock exchanges in New York--the shares of the more lightly taxed holding companies in Europe rather than the shares of their American competitor companies. This would not seem a legitimate objective for U. S. legislation.

Undermining the Traditional U. S. Policy of Economic Cooperation

The objectives of the new tax proposals are not consistent with either the spirit or the letter of the Administration's new trade expansion program. There is no economic logic in arguing that our economy will benefit from the

international exchange of goods but will be harmed by the international exchange of ideas, initiative, and resources involved in private investment across national boundaries. By dividing the world into two parts, one of which is to have more onerous taxation applied to it, the new proposals seem to be embarked on a perilous diplomatic course inconsistent with our efforts to realize the economic potential of the North Atlantic community and contrary to the traditional U. S. policy of encouraging economic cooperation on the broadest possible basis among the nations of the free world. Although some of the proposed tax changes would be applied directly only to income from developed countries, it seems likely that the proposed changes will indirectly reduce appreciably the flow of U. S. private capital and initiative into development projects in the lesser developed lands.

Legitimate Legislative Objectives

These various considerations do not prove that no legislation is needed. Apparently there have been abuses through the underpricing of exports of goods and services from the U. S. and through the overpricing of sales to the U. S. Such practices are already illegal but there should be no objection to any reasonable additional legislation to assist in the administration of the law in this regard. This objective can be achieved, however, without sacrificing the long-standing principle of U. S. law that income is taxable only when received. The objective can be achieved without introducing the complex provisions of the present draft bill which will in many cases introduce serious inequities and base U. S. taxation on arbitrary distinctions of form rather than of economic substance. Particularly defective in this respect--as shown in a separate Attachment IV--is the suggested wording of the Treasury's last minute suggestion of a new provision to increase the taxation of interest from abroad.

We recommend, therefore, that the Treasury's new proposals be rejected and that Section 13 of the bill now before the Senate be amended to a form along the lines of the proposals originally approved by the House Ways and Means Committee on February 1st. A bill so amended would accomplish the legitimate objective of preventing the avoidance of U. S. tax on income properly taxable in the U. S. The objective would be achieved without the damage to our economic future which would follow from the broad and blunt tax proposals now before the Senate.

ATTACHMENT I

The Balance of Payments Effect of Private Investment Abroad

In his testimony before the Senate Finance Committee on April 2 the Secretary of the Treasury stated, "In every year since 1953 the new capital outflow to Canada and Western Europe exceeded the new increases in inflows associated with the capital outflow in these years. It is clear that the catching up period will take at least ten to fifteen years and much longer if capital outflow keeps growing." From this statement the unwary might have gained the impression that U. S. foreign investment during this period involved an actual balance of payments drain to manufacturing subsidiaries in Europe and Canada, the sector toward which the Secretary's remarks were directed, but this was not in fact the case. Only in the year of the Ford purchase of the minority holdings in its U. K. subsidiary, 1960, did the outflow of new funds for investment exceed the inflow of interest and dividend income. Over the period 1952-1960 the total inflow of interest and dividends from U. S. investments in manufacturing subsidiaries in Europe and Canada exceeded by $.8 billion the outflow of new investment into such subsidiaries during the period. The Secretary was not, however, denying these figures; in his testimony and in a detailed statistical attachment he was using the actual investment outflow figures but substituting calculated figures of his own for the inflows, with the contention that much of the actual inflow resulted from investments of years prior to 1952.

The Secretary's calculated inflow figures were derived from the first of two theoretical models contained in the Treasury's analytical attachment. The first of these models was based on the assumptions that the average investment earned about 14.7% per year and generated exports of goods and services of 10.3% per year. Properly analyzed such assumptions suggest that the average foreign investment project has a most beneficial effect on our balance of payments. The average investment project would have shown a return on its balance of payments cost of 25% per annum and an average period of only two and one-half years until the average dollar invested were effectively returned to the U. S., with continuing contributions to our balance of payments thereafter as shown in the following tabulation:

Year		Balance of Payments Effect
0	Investment	- $100
1	Earnings / Export Receipts	25
2	" " "	25
3	" " "	25
4	" " "	25
5	" " "	25
6	" " "	25
etc.		etc.

This is the way one would normally look at an investment to determine its worth. The Secretary's presentation did not follow this procedure, however, but obtained a pessimistic result by cancelling the inflows from a project initiated in one year by the outflows of unrelated projects of later years. Clearly, as shown in the following example, if a rapid enough rate of growth of new investment is assumed the result of such addition of unrelated projects can be an apparent long continued outflow in the combined results.

Year	Projects					Annual Net Balance of Payments Effect
	A	B	C	D	E	
0	-$100					-$100
1	25	-$110				- 85
2	25	27.5	-$121			- 68
3	25	27.5	30.2	-$133		- 50
4	25	27.5	30.2	33.2	-$146	- 30
etc.	etc.	etc.	etc.	etc.	etc.	etc.

The table above assumed the outflow of new investment to grow at 10% a year, the rate which the Treasury assumed in the second of the theoretical models in its attachment. The first model was based on the actual outflow figures for the period 1952 through 1960.

In both models, however, the Treasury actually assumed a more rapid rate of growth in the size of foreign investment projects by assuming that only 45.4% of each year's earnings were remitted and that the remainder were reinvested along with the new capital outflow. On the combined assumptions of 10% annual growth in outflows and 54.6% reinvestment, the resulting series of projects would be represented by the following table:

Year	Projects					Annual Net Flow
	A	B	C	D	E	
0	-$100					-$100
1	25	-$118				- 93
2	25	29.5	-$138.4			-83.9
3	25	29.5	34.6	-$161.6		-72.5
4	25	29.5	34.6	40.4	-$187.8	-58.3
etc.	etc.	etc.	etc.	etc.	etc.	etc.

It was by tabulations of this sort that the Secretary concluded that private investment in the developed countries places a ten-to-fifteen-year drain on the U. S. balance of payments. In the Treasury's second theoretical model an estimate of the balance of payments effect of the new tax proposals is made by starting with a model such as that represented in the table above and arbitrarily assuming a 10% reduction in the rate of

capital outflow and a reversal in the proportions of earnings remitted and reinvested. The answer is then determined to the question of how many years would it be after the tax deterrents were introduced before the cumulative effect of the changes would add to the net U. S. balance of payments inflow. The analysis is restricted to that horizontal slice of years. The effect of the investments after that time period is ignored. Such reasoning would seem to represent an inadequate evaluation of the process of investment. It can accurately represent the combined effect of different projects over a part of their life, but it is partial analysis which leaves out of account the bulk of the inflows to come from the investments made in the selected time period. The inflows after the ten-to-fifteen-year period are ignored, and the effect of the individual investment is hidden. This approach could be used to argue against any investment, domestic or foreign, however great the return and however great the attraction for the U. S. economy. It could, for example, be used to argue that the U. S. standard of living was harmed by the growth of the American Telephone and Telegraph Company because over the years 1947 through 1961 that company was able to develop increasing opportunities for attractive investment at such a rate that over the period the company drew in funds from shareholders and lenders in amounts exceeding in every year but one the outpayments of dividends, interest and amortization. This would be a peculiar position to be taken by an administration which professes concern over inadequate investment by Americans and inadequate growth in our national income.

The Treasury's approach to foreign investment analysis seems not unlike condemning an entire orchard on superficial evidence without examining the individual trees. When the average individual foreign investment project or the total of the projects to be initiated in a year are separately analyzed, the returns revealed are sufficiently high to make clear that the absence of any Governmental deterrent will permit the private investment to generate desired strength for our balance of payments. This consideration alone should arouse suspicion of a general approach which appears to present such pessimistic results. But why does the Treasury's general approach provide such results? Because projects are judged collectively on the basis of only a portion of their lives. In the Treasury's ten-to-fifteen-year period the earliest project may include a substantial portion of its life but necessarily the last project will include only its outflow and its promised inflows will be totally disregarded.

The Treasury's statistical presentation was developed, as reported by the Secretary, in consultation with industry representatives but, as he did not report, despite their expressed disagreement with the methods and the conclusions. It is believed that the defect in basic approach alone invalidates the complex statistical models submitted to the Senate by the Treasury. It may nonetheless be useful to mention several other aspects of the Treasury's economic presentation.

The Treasury analyses assumed that an investment project once made would continue indefinitely to earn the same return. In today's competitive situation this is a drastically unrealistic assumption. Investments must be made when the time is ripe or the brief period when profits may be expected will be gone forever.

With respect to the effect of foreign investment on the exports and imports of the U. S. the Treasury's reasoning is to some extent based on the special 1961 study by the Department of Commerce of 155 U. S. manufacturing companies with plants and other facilities abroad representing at least 80% of all U. S. manufacturing investments abroad. That study showed in 1960 exports and services, patent rights, etc., to Europe and Canada equal to 2.3% of the book value of the manufacturing investment in subsidiaries in Europe and Canada, and in addition the study showed the following exports and imports of goods:

	Europe		Canada	
	1959	1960	1959	1960
Exports to, or developed by				
Manufacturing subsidiaries	195	291	749	746
Trading and other subsidiaries	193	420	58	60
	388	712	808	805
Imports other than paper, pulp, and foodstuffs from subsidiaries	212	96	119	124

It is admitted by all that these numbers are unsatisfactory. They do not reveal exports to foreign subsidiaries arranged without reference to parent companies; they do not indicate how much of these imports and exports might have taken place in the absence of the foreign subsidiaries. Yet it would appear that the Treasury followed questionable techniques in the use of this unsatisfactory data.

In his testimony the Secretary of the Treasury stated that a dollar invested in Europe today generates a continuing annual flow of about ten cents worth of U. S. exports and about six cents worth of U. S. imports from the foreign subsidiaries. He then went on to suggest, with no evidence, that the net export factor of four cents is probably cancelled by sales made abroad by the foreign subsidiaries in displacement of sales that would otherwise have been made directly from the U. S. This was particularly selective use of the available data. The figures shown above for Canada reveal net exports substantially larger as a percentage of investment in place than those for Europe. In the bulk of his testimony the Secretary spoke of Canada and Europe on a combined basis, but when he came to his separate export exposition he did not combine the Canadian and European figures but spoke only of the European ones. Within the European

area he chose to leave out of account that portion of the exports made through so-called trading subsidiaries abroad, although industry officials had informed the Treasury that a substantial proportion of the exports through the trading subsidiaries would not have been achieved without the investment and activity of the related manufacturing subsidiaries. The Treasury's attachment acknowledged these omissions, but, without evidence, assumed they would be cancelled by exports displaced by the foreign activity.

In a footnote the Treasury presentation also took note of the very apparent fact that there was a strong favorable trend toward an increase in the reported exports and a decrease in the reported imports over the two-year period for Europe. On the Treasury basis, leaving out exports to and imports from trading subsidiaries and multiplying the residual number by 1.25 to take into account that the figures relate, to an 80% sample, there was a movement from net imports of $16 million in 1959 to net exports of $251 million in 1960. For its calculations the Treasury ignored this trend and averaged two-year figures to get the 4% net export estimate, stating in a footnote that using just the 1960 figures would not have made much difference, despite the fact that the figures for 1960 alone would have given a 8.7% net export figure to Europe. In fact, if the 1960 trade figures for both Europe and Canada had been used, without omitting the trade through the related trading subsidiaries, then instead of the average net export figure to the developed areas of 8% used in the Treasury's large statistical model, there would have resulted a 25.1% figure. This figure may possibly be high in relation to the total of existing investment, although it is probably closer to the truth than the Treasury's calculatedly low estimate.

It also seems likely that a percentage of total investment is not the proper percentage to be used in judging the effect on trade of new investments during the first few years of their life. The exports of recent years probably were induced in large part by the investments in those years rather than by the older matured investment in place. This would suggest that investments in coming years would similarly result in net exports larger in proportion to the investments than the historic proportion of net exports to the total stock of investment in place. This tendency is perhaps best illustrated by the fact that an appreciable portion of investment literally takes the form of exports; yet the Treasury assumes investment generates no exports at all until the year after the investment.

The importance of the net export calculation is its effect on the size and promptness of the beneficial influence of foreign investment on our balance of payments. Even on the Treasury's restrictive assumptions, it is clear that the average investment project which might be deterred would have a beneficial effect on our balance of payments. Such strengthening of our balance of payments would also have a beneficial effect on employment opportunities in the U. S. by decreasing the likelihood of situations arising in which the Government would feel obligated to limit expansionist, job-creating policies for fear of their effect on the balance of payments. The Treasury has, however, sought to contrast the assumed 10-cent export and employment effect of a dollar invested in Europe with an

estimated 40 cents worth of continuing production arising from a dollar invested at home. Apart from any doubts about the accuracy of these percentages, this would seem to be an economically unsophisticated and partial approach. It seems to assume that the U. S. must rely on external factors to generate sufficient demand to provide employment in the U. S. Yet we know in practice that the U. S. has no difficulty in producing any desired increase in effective domestic demand; the problem is normally the reverse, that of insuring that inflation is not caused by too rapid growth in monetary demand.

Another questionable assumption in the Treasury's model is that for at least the next fifteen years the capital outflow to manufacturing subsidiaries in the developed countries will grow at a rate of 10% per annum. This growth in the new injection of funds implies an even greater growth both in the book value and total capital expenditure of the U. S.-owned manufacturing subsidiaries. By historical standards, such a growth rate seems most unlikely to be maintainable. Even in the favorable circumstances of the last decade the real rate of growth in capital expenditure in Western Europe has been only about 6-1/2%. To study the effect of the lowering of that rate, calculations have been prepared on the assumption that in a chosen year the rate of growth in book value falls to 9%. The result is striking. Capital outflow, instead of continuing at a 10% per annum increase, falls sharply and immediately and disappears completely within a few years. Meanwhile, earnings and dividends continue to grow and continue to benefit the balance of payments.

Another interesting aspect of the Treasury's presentation is its inconsistency with the approach taken by the Administration on so many occasions in the past year in urging more onerous taxation on income from abroad. The approach was to compare investment outflow and inflow of a particular year. The President stated before the N.A.M. last December, for example, that for 1960 "we see that the outward investment into the developed countries, such as Western Europe, was $1,500,000,000, and the return was only $1,000,000,000." These figures were based on misleading use of the flows related to extractive investment, which if properly treated would have reversed the President's conclusions. Yet the basic defect was that which apparently the Treasury has now to some extent come to realize, that is, trying to add apples and oranges, trying to relate unrelated items, new investments today and inflows from investments of previous years. It is to be hoped that the Treasury will soon come to realize that it is also improper to lump together new investments today and inflows from past investments for comparison with the investments made in the past periods.

The proper approach is to relate an investment outflow to all the inflows related to that outflow. It may still constitute a useful reminder of the tendency of such analysis to note that in any representative period in recent years, whether the analysis is solely in terms of manufacturing subsidiaries in Europe and Canada or in terms of the total of direct investment in all areas, the annual inflows have substantially exceeded the outflows.

And it may be worth noting that the trend is strongly favorable. The statistics for investment outflow and income from investment by industry sectors have not yet been published for 1961. Yet the published figures for all industries show a favorable movement of $648 million between 1960 and 1961 in the balance of investment outflow and income inflow for Canada and Western Europe. When 1959 and 1961 are compared, to avoid the impact of the 1960 Ford transaction, there is still revealed an improvement of $88 million in the net balance. These numbers are, however, strictly speaking, only confirmatory to the conclusion reached by analysis of the effect of specific investments. That conclusion is strongly to the effect that foreign investment, if not deterred, can continue to be a source of strength to the U. S. balance of payments.

In failing to reach this conclusion, the Treasury neglected to study the average individual investment project over its full life, assumed an improbably high rate of growth for future investment, and left out of account important export-inducing aspects of private investment abroad.

Attachment II

"Neutrality" Analysis

The following example has been prepared in an effort to explore rigorously the meaning of the Treasury's contention that the U.S. tax system departs from "neutrality" and "subsidizes" foreign investment because the U.S. does not impose taxation currently on the undistributed profits of U.S.-owned subsidiaries incorporated abroad.

Suppose an American corporation were considering investment in a new subsidiary to build a widget plant in one of three countries with the following tax rates:

	Income Tax Rate	Indirect Tax Rate on Widgets
"The U.S."	52%	6.1%
Country B	25%	8-1/4%
Country C	20-22%	10.53%

The assumption of greater reliance on indirect taxes in the foreign countries is representative of the typical situation. Study of 1960 figures on total tax revenue at national, state, and local levels reveal that in that year income taxes comprized the following percentages of total direct and indirect tax revenues: U.S. - 58%, France - 31%, Germany - 33.5%, Italy - 30%, Netherlands - 54%, and Belgium - 39%.

Suppose further that, again typically, Countries B and C impose an effective total burden of tax somewhat less than that of the U.S. but that B and C are identical countries in terms of total tax revenue, national budget, national income, etc., and differ only in their emphasis on different methods of tax collection. (The income tax assumed in Country C is a variable figure to make the total tax burden, i.e. excise and income taxes, the same in Country C as in Country B for ease of comparison.) Assume that in Countries B and C widgets are an "average" product whose sales are neither more nor less under one type of tax regime than under another when the price to the consumer is the same in each country. Assume international transport costs make possible some variation of before-excise-tax prices in different countries and that it just by chance happens that it is estimated that the output of one additional plant could be sold in the U.S. and in each of the two foreign countries at the same price to the consumer, that is $1.05 a widget.

If in these circumstances the optimum sized widget plant were, again for ease of comparison, assumed to be short-lived and were to involve:

	Years					
	0	1	2	3	4	5
Capital Expenditures	$1020	$1020	$1020			
Out of Pocket Operating Costs	-	150	225	$ 300	$ 300	$ 150
Production of Widgets	-	1000	1500	2000	2000	1000

then the following might be the financial results of investment, assuming U.S. tax law to have been revised to require calculation of foreign tax credit on the "gross-up" basis but to continue as now to impose taxation on income from foreign subsidiaries only when the income is received.

Plant in the U.S.

	Years				
	1	2	3	4	5
Retail Sales Receipts	$1050	$1575	$2100	$2100	$1050
Less: Excise Taxes (6.1%)	60	90	120	120	60
Depreciation	340	680	1020	680	340
Cash Costs	150	225	300	300	150
Net Profit before Income Taxes	500	580	660	1000	500
U.S. Income Taxes (52%)	260	301.60	343.20	520	260
Net Income after Income Taxes	240	278.40	316.80	480	240

Discounted Cash Flow Rate of Return = 23.32%

Plant in Country B

	Years				
	1	2	3	4	5
Retail Sales Receipts	$1050	$1575	$2100	$2100	$1050
Less: Excise Taxes (8-1/4%)	80	120	160	160	80
Depreciation	340	680	1020	680	340
Cash Costs	150	225	300	300	150
Net Profit before Income Taxes	480	550	620	960	480
Local Income Taxes (25%)	120	137.50	155	240	120
Net Income after Local Income Taxes	360	412.50	465	720	360
Dividends	0	0	1237.50	720	360
Earnings Subject to U.S. Income Taxes	0	0	1650	960	480
Tentative U.S. Income Tax (52%)	0	0	858	499.20	249.60
Foreign Tax Credit	0	0	412.50	240.00	120.00
Actual U.S. Income Tax	0	0	445.50	259.20	129.60
Net Income after All Taxes	360	412.50	19.50	460.80	230.40

Discounted Cash Flow Rate of Return = 23.75%

Plant in Country C

	Years				
	1	2	3	4	5
Retail Sales Receipts	$1050	$1575	$2100	$2100	$1050
Less: Excise Taxes (10.53%)	100	150	200	200	100
Depreciation	340	680	1020	680	340
Cash Costs	150	225	300	300	150
Net Profit before Income Taxes	460	520	580	920	460
Local Income Taxes (20-22%)	100	107.50	115	200	100
Net Profit after Local Income Taxes	360	412.50	465	720	360
Dividends	0	0	1237.50	720	360
Earnings Subject to U.S. Income Taxes	0	0	1560.00	920	460
Tentative U.S. Income Tax (52%)	0	0	811.20	478.40	239.20
Foreign Tax Credit	0	0	322.50	200.00	100.00
Actual U.S. Income Tax	0	0	488.70	278.40	139.20
Net Income after All Taxes	360	412.50	(23.70)	441.60	220.80

Discounted Cash Flow Rate of Return = 22.78%

The examples assumed that to the extent possible the required second and third year investments in the foreign plants were financed by retained earnings of the foreign subsidiaries. On this basis the results show a plant in Country B to be a more attractive investment than the plant in the U.S. and the plant in Country C to be a less attractive investment than the plant in the U.S. In view of the fact that the investment and the price to consumers are assumed the same in the analysis for each country, it would seem reasonable to conclude that the combined working of the tax systems is "unneutral" toward favoring investment abroad when the U.S. and Country B are compared but "unneutral" toward investment in the U.S. when the U.S. and Country C are compared.

Clearly both types of result are possible. The statistics quoted above, indicating that income taxes account for a much larger proportion of tax revenue in the U.S. as compared to Europe, suggest that the Country C case is normal. Since the Treasury contends that it is desirable to apply more onerous U.S. taxation on investments in foreign subsidiaries to increase the neutrality of the U.S. tax system, it would seem incumbent upon the Treasury to demonstrate that the Country B set of circumstances is more prevalent than the Country C circumstances. Nothing is proved by the Treasury's oft-repeated assertion that indirect taxes are passed on to the consumer; of course, they are, just as income taxes are, in the sense that the citizens of a country provide the revenue of their government just as they provide the payment for imports and the remuneration of capital attracted into their country.

One can wonder, however, whether the citizens of B and C would need to pay the amount of remuneration shown in the examples above. In both cases the return to an investor after local taxation was appreciably greater in both B and C than in the U.S. Presumably there would be a tendency for local investors and for investors from countries, such as Canada and The Netherlands, which do not superimpose additional tax on the foreign taxes paid by their investors, to move in and by their competition lower the consumer prices, earn adequate returns, and exclude U.S. investors. In this connection it is worth noting

that the flow of private investments to the developing nations from other developed countries already substantially exceeds the flow of such private investment from the U.S.

The position of the U.S. private investor would, of course, be weakened if the Treasury's proposal to tax undistributed foreign subsidiary income were adopted. In the Country C case the "unneutral" treatment of the U.S. tax system would be worsened. In the Country B case any advantage of foreign investment would be reduced or, as in the present example as illustrated below, would be converted into a disadvantage.

Plant in Country B

	Years				
	1	2	3	4	5
Retail Sales Receipts	$1050	$1575	$2100	$2100	$1050
Less: Excise Taxes (8-1/4%)	80	120	160	160	80
Depreciation	340	680	1020	680	340
Cash Costs	150	225	300	300	150
Net Profit before Income Taxes	480	550	620	960	480
Local Income Taxes (25%)	120	137.50	155	240	120
Net Income after local Income Taxes	360	412.50	465	720	360
Dividends	0	0	1237.50	720	360
Earnings Subj. to U.S. Income Taxes	480	550	620	960	480
Tentative U.S. Income Tax	249.60	286	322.40	499.20	249.60
Foreign Tax Credit	120	137.50	155	240	120
Actual U.S. Income Tax	129.60	148.50	167.40	259.20	129.60
Net Income after All Taxes	230.40	264	297.60	460.80	230.40

Discounted Cash Flow Rate of Return = 22.3%

Plant in Country C

	Years				
	1	2	3	4	5
Retail Sales Receipts	$1050	$1575	$2100	$2100	$1050
Less: Excise Taxes (10.53%)	100	150	200	200	100
Depreciation	340	680	1020	680	340
Cash Costs	150	225	300	300	150
Net Profit before Income Taxes	460	520	580	920	460
Local Income Taxes (20-22%)	100	107.50	115	200	100
Net Income after local Income Taxes	360	412.50	465	720	360
Dividends	0	0	1237.50	720	360
Earnings Subj. to U.S. Income Taxes	460	520	580	920	460
Tentative U.S. Income Tax (52%)	239.20	270.40	301.60	478.40	239.20
Foreign Tax Credit	100	107.50	115	200	100
Actual U.S. Income Tax	139.20	162.90	186.60	278.40	139.20
Net Income after all Taxes	220.80	249.60	278.40	441.60	220.80

Discounted Cash Flow Rate of Return = 21.29%

ATTACHMENT III

Competitiveness of American Industry Abroad and of the U. S. Tax System

There seems to be general agreement that American industry must be competitive. In testimony before the Senate Finance Committee on H. R. 10650, the Secretary of the Treasury urged enactment of the Administration's proposed tax credit for investment in certain depreciable property. The theme of this testimony was that "American industry must compete in a world of diminishing trade barriers, in which the advantages of a vast market, so long enjoyed here in the U. S., are now being or are about to be realized by many of our foreign competitors." There is not, however, complete agreement on what the U. S. Government can do to permit American industry to be competitive. The three pillars of the Administration's program to accomplish this are (1) the new Trade Bill (H. R. 9900), (2) a tax credit for investment in certain depreciable property, and (3) more realistic depreciation allowances. Jersey Standard has supported the principles of the Trade Bill. It does not, however, support H. R. 10650 because that bill's provisions relating to taxation of foreign income are in direct contradiction to the objectives of the Trade Bill. It is hoped that depreciation reform promised by the Administration will facilitate needed modernization and contribute to the growth of our productivity and output and thus increase the competitiveness of American exports in world markets.

The Administration is to be commended for its recognition of the need to improve our tax system so that our plants at home will be more competitive. However, it is clear to us that if American industry is to be competitive abroad, our U. S. tax system as it applies to business operations abroad must be competitive with the tax system of other capital exporting countries. In support of the investment tax credit, the Administration has placed great emphasis on the fact that in this respect our tax system would be made competitive with the tax systems of other nations, particularly those in Europe. We should be concerned with the competitiveness of our tax system on operations at home, but we should be equally concerned with the competitiveness of our tax system as it applies to business operations abroad. When viewed in the light of whether American business operating abroad will be subject to a competitive tax system, the sections of H. R. 10650 pertaining to foreign business operations go in precisely the wrong direction. Two sections of the bill involve basic tax policy changes that will seriously weaken the foreign competitiveness of our tax system. They are Sections 12, pertaining to earned income from sources without the U. S., and Section 13, pertaining to controlled foreign corporations. In an effort to determine how these proposals compare with the tax systems of other countries two studies have been made, the results of which are attached hereto.

The first study, "Taxation Provisions Affecting Individuals in Economically Advanced Countries", involves a review of the tax laws of 12 economically advanced foreign countries to determine whether any of them would impose income tax on employment income earned abroad by their citizens who are bona fide residents of another country. The tax laws of the following countries are included in this study: Australia, Belgium, Canada, Denmark, France, Germany, Italy, Japan, Netherlands, Norway, Sweden and the United Kingdom. This study discloses that Section 12 would impose restrictions on the ability

of American companies to staff operations abroad with Americans while their competitors have no such restrictions imposed by their home country.

The second attachment, "Taxation Provisions Affecting Corporations in Economically Advanced Countries", is a study of the taxation provisions of the same 12 countries to determine whether they impose income tax on parent companies on the undistributed earnings of foreign subsidiaries owned by such companies. This study shows that the type of taxation proposed by Section 13 is without precedent in any of these countries and would make our tax system noncompetitive.

In testimony before the Senate Finance Committee on this bill the Secretary of the Treasury has recommended changes in both Sections 12 and 13 which would make our tax system still less competitive. These same recommendations were made to but rejected by the House Ways and Means Committee.

With respect to Section 12, we are concerned that the proposed restriction on the earned income exclusion will have a serious and adverse effect on our ability to find qualified U. S. nationals to work in foreign lands. The $20,000 a year limitation for the first three years of overseas service is not realistic and is below the amount generally required today to induce technical and highly skilled personnel to accept overseas assignments. If any monetary limitation on this exclusion is to be enacted, it should not be less than $35,000 for any year. Furthermore, any unused annual exclusion during service should permit exclusion after retirement of any pension purchased with such unused amount.

The Ways and Means Committee Report on H. R. 10650 pertaining to Section 13 recognizes that to impose U. S. tax currently on U. S. shareholders of American-owned business operating abroad would place such firms at a disadvantage with other firms located in the same areas not subject to U. S. tax. It seems fair to conclude from all that is said in this report, that the Committee was convinced that it would be a mistake to make our tax system noncompetitive. On the other hand, the Committee stated that it was convinced "that many have taken advantage of the multiplicity of foreign tax systems to avoid taxation by the U. S. on what could ordinarily be expected to be U. S. source income." (Page 58) The correction of this condition is merited but it is not necessary to go as far as Section 13 does in imposing tax penalties on legitimate business operations abroad through its extremely complex provisions and administrative burdens.

It is hoped that the Senate will reject this section of H. R. 10650 in favor of a more limited approach that will keep our tax system competitive for actual business operations abroad.

ATTACHMENT III-A

TAXATION PROVISIONS AFFECTING INDIVIDUALS IN ECONOMICALLY ADVANCED COUNTRIES

A review has been made of the tax laws of twelve economically advanced foreign countries to determine whether any of them would impose income tax on employment income earned abroad by citizens who are bona fide residents of another country.

The tax laws of Australia, Belgium, Canada, Denmark, France, Germany, Italy, Japan, Netherlands, Norway, Sweden and the United Kingdom were examined. Confirmation of the results of the study has been obtained from tax advisers in each country.

None of the countries tax employment income of their citizens who are bona fide residents of, and working in, a foreign country. The only income of nonresidents that is taxed is domestic source income.

Attached are brief outlines of the applicable provisions of the tax laws of the twelve countries.

AUSTRALIA
(Individuals)

The incidence of Australian tax is determined primarily on whether the taxpayer is a resident or nonresident of this country. The question of residence is one to be determined from the facts of each particular case. An Australian citizen, however, is not necessarily a resident for tax purposes although a person domiciled in Australia is regarded as a resident unless he satisfies the authorities that his permanent place of abode is outside Australia.

Under the general provisions of the Income Tax and Social Services Contribution Assessment Act, residents of Australia are subject to income tax on income derived from all sources while nonresidents are subject to tax only on income derived from sources in Australia. However, income, other than dividends, derived by residents from sources outside Australia is specifically exempted from tax provided the income is not exempt from tax in the country of source or the taxpayer is liable to pay royalty or export duty in any country outside Australia in respect of goods from the sale of which the income is derived.

It will be seen from the foregoing that earned income from sources outside Australia is exempt from Australian tax in the hands of:

(a) A nonresident, irrespective of whether the income is subject to tax in the country of source.

(b) A resident of Australia, provided the income is not exempt from tax (or in certain cases royalty or export duties) in the country of source.

BELGIUM
(Individuals)

Belgian citizens who are not residents of the country but rather are bona fide residents of a foreign country and working in a foreign country (whether or not for a Belgian employer) are not subject to tax in Belgium on earned income providing that they have no fiscal domicile in Belgium.

If such citizens maintain in Belgium a dwelling place, they are only subject to "Impot Complementaire Personnel" (a surtax on income from all sources) established on the minimum of five times the annual rent (not including any rental charges for heating or similar services) paid for the dwelling place. If the citizen is the owner of the dwelling place, the rent used as a basis for this purpose will be that normally payable for such a dwelling.

If the citizen maintained his address in Belgium, which would be the case if he maintained his inscription in the municipal records, or if his family continued to reside in Belgium, he would become taxable on the income earned and taxed abroad

(a) to Taxe Professionnelle reduced to one-fifth of the amount computed at the normal rates
(b) to Impot Complementaire Personnel.

In the latter case and in conformity with the regulations of the convention between Belgium and the United States for the avoidance of double taxation, the Impot Complementaire Personnel is reduced to one-fourth, insofar as it relates to income collected and taxed in the United States.

CANADA
(Individuals)

As a general rule, Canada does not impose income tax on employment income earned abroad if the individual is not resident or deemed to be resident in Canada at the time he receives the income. The application of the rule is not affected by the person's being or not being a Canadian citizen and even investment income paid from within Canada to a Canadian residing abroad is subject only to the normal 15% nonresident withholding tax and need not be reported by him on an income tax return. The word "resident" is not defined in the Canadian Income Tax Act.

The exclusion of employment income earned and received during actual nonresidence is complicated somewhat by Canada's "deeming" provisions regarding residence. Citizenship plays no direct part in these provisions, but certain individuals, such as ambassadors and high commissioners, who are normally required to be Canadian citizens, are deemed by these provisions to be resident in Canada regardless of where they are posted and are accordingly taxed on their world income. Others who are deemed to be resident in Canada throughout or during part of a taxation year and hence may be taxed on employment income earned outside Canada during residence abroad include the following: persons who sojourn in this country for 183 days or more in the taxation year, members of the armed forces, and persons who are ordinarily resident in Canada.

Individuals who are resident or deemed to be resident in Canada may take a credit for foreign income taxes paid which is limited to the proportion of their Canadian tax before the credit that their income from the foreign country imposing the tax is of their total income for the year.

It is apparent that the Canadian tax law on foreign earned income of Canadian citizens residing abroad and not resident or deemed to be resident in Canada differs considerably from United States law. Canada makes no distinction between a citizen who is resident outside the country and any other nonresident. There is no formula in the Canadian Income Tax Act which provides a different tax treatment for income earned abroad according to the actual length of time during which residence or physical presence abroad is maintained (aside from the 183-day rule mentioned above) nor is there any dollar limitation such as the $20,000 limit which applies to U.S. citizens in some cases. Again, there is no distinction between earned and unearned income except, as noted above, where dividends, interest and some other forms of investment income are received from Canadian sources, in which case they are subject to the normal withholding of nonresident tax.

The question of residence, in cases where the above-mentioned deeming provisions of the Income Tax Act do not apply, is determined according to common law rules which have evolved in the Canadian and English courts. The substance of these rules is that there is residence within a jurisdiction if the individual is using or maintaining a dwelling place there and appears, from whatever evidence is available (such as the presence of his family and other indications of the relative permanence of his presence), to be planning to keep this dwelling place as a permanent home or as a home for an indefinite or lengthy period of time. The mere ownership of realty within Canada does not establish residence unless the property is actually a home.

DENMARK
(Individuals)

Individuals domiciled in Denmark are taxed on their world-wide income unless they are staying permanently abroad, in which case they are not taxable in Denmark. In practice, a stay abroad is considered permanent if it can be anticipated to exceed three years. Individuals physically present in Denmark on April 1, July 1, October 1 or January 1 are considered to be domiciled in Denmark providing that they have been present in Denmark for an aggregate of three months during the previous six months. If an individual is taxable in Denmark on income earned abroad, he may claim a credit for the foreign taxes against the Danish taxes limited to that part of the Danish taxes appropriate to the foreign income.

FRANCE
(Individuals)

The criterion of taxation in France on income earned abroad is fundamentally based on the concept of domicile in France. Accordingly, French citizens who perform personal services in a foreign country and receive compensation therefor are not subject to taxation in France on this compensation, providing they are considered to have their domicile abroad. The question of where a French citizen has his domicile is somewhat controversial. Until recently it was generally admitted that a French citizen has his domicile in France if he maintained his personal and family home in France. Under a High Court decision of December 8, 1960, however, it was handed down that a French citizen who clearly has the center of his professional and financial interests abroad should not be regarded as domiciled in France even though his family habitually live there and he himself spends the greater part of his time there.

Although the length of his stay in a foreign country is not taken into consideration in determining the center of interests abroad, the activity which the taxpayer carries on abroad must have a certain permanency. A French citizen employed by a firm established in France who is sent to a foreign country merely to carry out a casual or temporary mission and not to occupy a permanent position there would not be considered as having his center of interests abroad.

In the absence of any double tax treaties, if a French citizen working in a foreign country cannot prove to the French tax authorities that he has his de facto domicile abroad, he is taxable in France on his earned income and he is not granted a credit for foreign taxes paid against his French tax.

If a French citizen, on the other hand, is considered to have a de facto domicile abroad, he is not subject to French income tax on his earned income irrespective of the amount of the income.

GERMANY
(Individuals)

According to the German Income Tax Law tax liability is not based on the citizenship of the taxpayer but solely on whether the taxpayer has his residence or "usual stay" in Germany, or whether he receives income from German sources.

Persons having a residence in Germany or "usual stay" in Germany are subject to unlimited tax liability, i.e., they must pay tax on income no matter what the source. A person has a residence where he maintains a dwelling under circumstances which indicate that he will maintain and use the dwelling. A person has a "usual stay" at a place where he stays under circumstances which indicate that he will not stay temporarily only. Unlimited tax liability applies only if his stay in the country lasts more than six months. It does not matter whether he stays for a period longer than six months at the same place; it is sufficient that the time be spent anywhere within the Federal Republic.

If the above conditions for unlimited tax liability have been met, the taxpayer's entire income is subject to taxation. However, in cases where there exists a double taxation agreement, unlimited tax liability is restricted to the extent that certain income is not subject to German taxation. In other cases income tax paid abroad is creditable against German income tax.

Persons who are not resident in Germany are subject to income tax only with respect to income from German sources. This includes income from trade or business for which a business establishment is maintained in Germany or for which a permanent representative has been appointed, or income for services which are performed inside Germany. In addition income from capital and income from leasing property located in Germany is subject to limited tax liability. However, the incidence of taxation is restricted to some extent by double taxation agreements.

ITALY
(Individuals)

In Italy, individual citizens are subject to the following taxes on earned income:

(1) Income Tax (due to the National Government),

(2) Complementary Tax (due to the National Government, and

(3) Family Tax (due to the municipality where the citizen or his family resides).

Income Tax

Employment income of Italian citizens living abroad, even though temporarily, is not subject to Income Tax in Italy provided the income is for personal services rendered abroad:

(a) for the account of a foreign employer, or

(b) for a foreign establishment of an employer resident in Italy.

In the latter case, the foreign establishment must be a working organization with separate management and accounting to which the compensation is charged. Employment income earned abroad by persons located or living in Italy is not subject to Income Tax when such income is taxable in the other country in accordance with a tax treaty.

Complementary Tax

The following income is not subject to Complementary Tax:

(a) Employment income earned abroad by Italian citizens, even though living in Italy, provided such income is not consumed in Italy.

(b) Employment income earned abroad by Italian citizens living in Italy but which is taxed by another country in accordance with a tax treaty.

Family Tax

Family Tax is not applicable to income earned abroad unless the Italian citizen has his family living within the municipality, in which case the income subject to the Family Tax is that which is consumed in Italy.

JAPAN
(Individuals)

The earned income of a Japanese citizen employed in a foreign country is not subject to Japanese income tax. This exemption does not apply to personnel of the Japanese national and local public service serving or being employed abroad.

NETHERLANDS
(Individuals)

A citizen of the Netherlands who is a bona fide resident of a foreign country and working in a foreign country (whether or not for a Dutch employer) is not subject to Dutch tax on his earned income.

Residents of the Netherlands are liable to tax on their entire net income, including income from sources abroad. Nonresidents are liable to tax only on income from sources within the Netherlands.

NORWAY
(Individuals)

Persons domiciled in Norway are taxed in Norway on all personal income. Residence lasting at least six months is regarded as domicile even though it is only temporary.

The taxability by Norway is not affected by temporary residence abroad unless such residence has lasted at least four years. The taxability ceases however if the individual proves that he has been abroad at least one year, and is liable to pay ordinary taxes in the foreign country [illegible]ace.

SWEDEN
(Individuals)

A Swedish citizen who is a bona fide resident or physically present in foreign countries during an entire taxable year is not subject to income tax in Sweden in respect of income earned from personal services regardless of in which foreign countries services are performed. As far as Swedish tax law is concerned, no difference is made between the concepts of "bona fide resident" and "physically present" in foreign countries.

Individuals resident in Sweden are subject to Swedish income tax in respect of income earned from personal services, regardless of whether the services are performed in Sweden or abroad.

A Swedish citizen resident abroad is subject to Swedish income tax on income earned from personal services rendered in Sweden.

UNITED KINGDOM
(Individuals)

Where an individual ceases to be a resident in the United Kingdom and performs services wholly abroad, any income earned from such services is not subject to United Kingdom tax. The position is the same whether the individual is employed by a United Kingdom or by a foreign employer. In order to qualify as a nonresident, the individual must be absent from the United Kingdom for a minimum period of a tax year (i.e., the absence must cover at least a period from April 6 in one year to April 5 in the next year).

Where an individual performs services wholly abroad, but is not absent from the United Kingdom for a complete tax year and therefore remains a United Kingdom resident, his liability for United Kingdom tax on his earnings would depend upon whether he was employed by a United Kingdom or foreign employer. If he is on a United Kingdom payroll, he is subject in full to United Kingdom tax with double taxation relief granted for foreign taxes paid on his earnings. If he is on a foreign payroll, he is not subject to United Kingdom tax except to the extent of any earnings remitted to the United Kingdom; again, to the extent that he is subject to tax, he is allowed double taxation relief in respect of any foreign tax attributable to the remittances.

ATTACHMENT III-B

TAXATION PROVISIONS AFFECTING CORPORATIONS IN ECONOMICALLY ADVANCED COUNTRIES

A review has been made of the tax laws of twelve economically advanced foreign countries to determine whether any country would impose income tax on the undistributed earnings of a subsidiary which is incorporated outside of the country of incorporation of the parent company.

The tax laws of Australia, Belgium, Canada, Denmark, France, Germany, Italy, Japan, Netherlands, Norway, Sweden and the United Kingdom were examined. Confirmation of the findings was received from local tax advisers in all countries. None of these countries tax the undistributed earnings of a foreign subsidiary to the parent company under any circumstances.

If the "mind and management" of a corporation is located in certain countries, it will be taxable on all of its earnings even though incorporated outside of such country. These countries are: Australia, Belgium, Canada, Germany, Japan, Netherlands, Norway and the United Kingdom. However, it must be recognized that, generally, the "mind and management" will not be held to be located in these countries if the principal administrative office, board of directors meetings and general managerial functions are conducted outside of the country. In cases where the "mind and management" concept is used to assess tax, such tax is, except as noted above, levied on the foreign corporation and not the shareholder.

Our study has established that income derived from sources outside of the country is subject to the following unilateral tax relief.

1. Foreign Operating Income:

   (a) Complete exemption in Australia, France and Netherlands.
   (b) Tax reduction in Belgium, Denmark, Italy and Norway.
   (c) Credit for income taxes in Canada, Germany, Japan and the United Kingdom.

2. Dividend Income From Foreign Subsidiaries:

   (a) Complete exemption in Canada and the Netherlands.
   (b) Tax reduction in Belgium, France and Norway.
   (c) Credit for foreign income tax in Australia, Denmark, Germany, Japan and the United Kingdom.

In addition to the relief granted as shown, the United Kingdom grants complete exemption to Overseas Trade Corporations until the income is distributed to a resident of the United Kingdom. No United Kingdom tax is suffered on the distribution of trading profits earned by an O.T.C. insofar as they are distributed to shareholders who are not resident in the United Kingdom. The United Kingdom grants a tax credit for "taxes spared" by foreign governments.

Under some of the tax treaties between the foreign governments covered herein further concessions are granted in certain situations. For example, Italy grants a tax exemption for dividends received from a corporation incorporated outside Italy.

There are attached summary analyses of the pertinent provisions of the tax laws of these twelve countries.

AUSTRALIA
(Corporations)

A. A corporation is subject to tax liability on its entire income, whether earned within or without Australia, provided it is resident in Australia.

A corporation is resident in Australia if it is incorporated there, or if its central management and control (mind and management concept) are situated there, or if it carries on business there and its voting power is controlled by resident shareholders.

If a subsidiary of an Australian parent corporation is incorporated outside Australia, carried on its business activities outside Australia, managed its own operations outside Australia, and its board of directors held their meetings outside Australia, it would not be subject to Australian tax. If the subsidiary's "mind and management" is located in Australia, it is the subsidiary who is liable for the Australian tax and not the shareholder.

B. Income Tax Rate:

Graduated Income Tax rate to 40% (non-private companies).

C. Double Taxation Relief:

1. Income from sources outside Australia is exempt from tax if:

a. Such income is not exempt from income tax where derived, or

b. The taxpayer is liable to pay an export duty or royalty to a foreign country in respect of goods from the sale of which the income is derived.

This exemption does not apply to dividends.

2. Foreign income taxes paid by resident corporation on dividends paid by a nonresident corporation from profits derived outside Australia are allowed as a credit against Australian tax. In addition a resident corporation may reduce its Australian tax on dividends received (domestic and foreign) by an amount computed by applying the average rate of recipient corporation's tax to the dividend received. This reduction is called a "dividend rebate".

BELGIUM
(Corporations)

A. A corporation is subject to tax liability on its entire income, whether earned within or without Belgium, provided it is registered under the laws of Belgium (incorporated) or has its principal administrative office in Belgium (mind and management).

If a subsidiary of a Belgian corporation is incorporated outside Belgium and has its principal administrative office (mind and mangement) located outside Belgium, its earnings would not be subject to Belgian tax.

B. Income Tax Rates:

Taxable profits are fiscally split into:

1. Undistributed profits (retained by Company), and

2. Distributed profits (dividends paid).

Both portions are liable to separate taxations at different rates as follows:

1. Undistributed profits:

Corporate Income Tax (Taxe Professionnelle) at graduated rates from 25% to 40%, deductible for Corporate Income Tax purposes in the year in which the tax is assessed. Additional tax of 20% of the basic rate is imposed but can be partly or completely eliminated through prepayment of the Corporate Income Tax. Temporarily for the tax years 1961 and 1962 (income of calendar years 1960 and 1961 or of book years ending in 1961 and 1962) an exceptional tax of 5% of the Corporate Income Tax before application of additional tax. The exceptional tax is nondeductible.

2. Distributed profits:

a) National Crisis Tax	20%	
b) Exceptional Tax	1%	(Temporary for 1961 and 1962, not deductible)
	21%	of the gross distribution (absorbed by company)
c) Movable Capital	30%	(withheld from shareholders)
d) Exceptional Tax	1.5%	(Temporary for 1961 and 1962, deductible, at choice of interested parties may be borne by shareholders or by company)
	31.5%	of the gross distribution.

Summary:

1. Results in effective rate for undistributed profits of approximately 32.7% taking into account a practical average of the additional tax of 20%.

2. Results in effective rate for distributed profits of approximately 42.6%.

C. Double Taxation Relief:

1. Income taxes paid to a foreign country are allowed as a deduction for Belgian income tax purposes. No credit is allowed to the Belgian parent for any foreign income taxes paid by its foreign subsidiary appropriate to the dividend distributed by the subsidiary.

2. (a) Trading income from abroad (which means income from a branch, taxed in the country of residence of such branch) is subject to one fifth of the normal Income Tax rate. Any dividend distributed from such trading income from abroad will only be subject to Movable Capital Tax at the rate of 10% plus additionals 2%, together 12% instead of 30% and National Crisis Tax at the rate of 4% instead of 20%. The exceptional tax will in that event be levied at the rate of 5% on these reduced taxes before additionals.

(b) Investment income (dividends, interest, etc.) is subject only to a reduced Investment Income Tax rate of 12%. Investment income from abroad (dividends, interest, etc.) which has been subjected to the reduced Investment Income Tax rate of 12% is taxwise treated as definitely taxed income and the amount thereof, after deduction of a participation in general expenses, can be distributed in the form of dividends without being further subject to Movable Capital Tax or National Crisis Tax.

CANADA
(Corporations)

A. If a corporation is resident in Canada, it is subject to tax liability on its entire income, whether earned within or without Canada (a Foreign Business Corporation and a personal corporation are two exceptions to this general rule).

A corporation's residence is at the place where its management and central control actually abide (mind and management concept). The place where central control and management is located is purely a question of fact. It is the place where all or most of the fundamental decisions regarding the operations of the company are made - normally the place where directors' meetings are held. Under a recent amendment which is applicable to the 1962 and subsequent taxation years, a company incorporated in Canada is deemed to have been resident in Canada throughout a taxation year if it carried on business in Canada at any time in the year.

If a subsidiary of a Canadian parent corporation carried on all of its business activities outside Canada, managed its own operations outside Canada, and its board of directors held their meetings outside Canada, it would not be subject to Canadian tax, even if it were incorporated in Canada. If the subsidiary's "central control and management" is located in Canada, or if it is incorporated in Canada and carries on business in Canada during the year it is considered to be resident there and is liable to tax in Canada. In such case it is the subsidiary who is liable for Canadian tax on the profits of the company and not the shareholders.

B. Income Tax Rates:

Corporation Income Tax.

Federal	-	50% (includes Old Age Security Tax of 3%)
Provincial	-	Ontario - 11%, Quebec - 12%, others - 9% (credit of 9% of taxable income earned in a province may be claimed against Federal tax)

C. Double Taxation Relief:

A credit for income taxes paid to foreign countries is allowed as a credit against the Canadian corporation's Federal tax liability on the foreign income.

Dividends received from a nonresident corporation are exempt from Canadian tax provided more than 25% of the voting stock of such corporation is owned by the receiving corporation.

D. Foreign Business Corporations:

Corporations incorporated in Canada but whose business is carried on outside Canada and whose assets are located outside Canada are not subject to Canadian income tax if they file a return within the prescribed time and pay the required fee of $100.

The privilege of qualifying as a Foreign Business Corporation is no longer available for newly-formed companies.

E. Personal Corporation:

A personal corporation is a corporation, wheresoever incorporated, that during the whole of the taxation year was controlled by an individual resident in Canada or by such an individual and members of his family who were resident in Canada or by any other person on his or their behalf, which derived at least one-quarter of its income from rents, royalties, interest, dividends and/or certain other prescribed types of income, and which did not carry on an active financial, commercial or industrial business.

A personal corporation is not subject to Canadian income tax but its income, whether distributed or not, is deemed to have been received by the shareholders as a dividend on the last day of the taxation year and is subject to tax in their hands.

DENMARK
(Corporations)

A. A corporation is subject to tax liability on its entire income, whether earned within or without Denmark, provided it is resident in Denmark.

A corporation is considered to be resident in Denmark when it has been entered in the Danish Joint Stock Companies Register as a Danish company.

If a subsidiary of a Danish corporation is incorporated outside Denmark, and its operations are carried on outside Denmark, its earnings would not be subject to Danish tax.

B. Income Tax Rate:

Company Income Tax - 44% (50% of Income Tax is deductible in the year in which it is paid).

The tax rate is applied to the "reduced taxable income", i.e., the taxable income reduced by the lower of (a) 50% of the taxable income and (b) 2.5% of the capital stock.

C. Double Taxation Relief:

1. Branch Income - corporation granted (i) a tax credit of 50% of the Danish tax appropriate to the net foreign income, and (ii) a credit for tax paid by the branch in the foreign country equal to the lower of (a) tax paid in the foreign country, and (b) that proportion of the Danish tax less the amount of the tax credit computed in (i) above, which the net foreign income bears to the corporation's "reduced taxable income" in Denmark.

2. Dividend Income:

(i) Where a foreign subsidiary is at least 25%-owned by a Danish parent, credit is granted to the Danish parent equal to the lower of (a) tax paid by foreign subsidiary appropriate to the dividend distributed to the Danish parent and (b) the Danish tax appropriate to the dividend received.

(ii) If a dividend withholding tax is levied on dividends paid from a foreign country the Danish corporation can claim the following tax credits:

(a) the lower of the dividend tax withheld and the Danish tax appropriate to the net dividend received, and
(b) where a foreign subsidiary is at least 25%-owned by a Danish parent and where the Danish tax appropriate to the net dividend exceeds the dividend tax withheld, a further credit equal to the lower of the tax paid by the foreign corporation appropriate to the dividend distributed to the Dansih corporation and that proportion of the Danish tax less the credit computed under (a) above, which the net dividend received bears to the Danish corporation's "reduced taxable income".

3. Income taxes paid by a Danish corporation to a foreign country are allowed as a deduction for Danish income tax purposes.

4. Where a treaty allows credits which are more advantageous than those described above, a Danish company is entitled to claim credit under the provisions of the treaty.

FRANCE
(Corporations)

A. A corporation is subject to tax liability on its profits earned in France irrespective of where it is incorporated. A company incorporated outside France which has a branch or permanent establishment in France is, in addition, liable itself to the dividend tax on a proportion of the dividends distributed by it.

If a subsidiary of a French corporation has no income earned within France, it would not itself be subject to French tax - even if it were incorporated within France. If incorporated in France, it would withhold French dividend tax from cash dividends.

B. Income Tax Rates:

1. Tax on Companies (Profit Tax) - 50%.

2. Dividend Tax - 24%.

C. Double Taxation Relief:

1. Foreign operating income of a French company is exempt from the 50% company profits tax. However, upon distribution by the French company as cash dividends such income is subject (a) to the 24% withholding dividend tax, with possible treaty exemption or reduction in the rate where the dividends are paid to nonresident persons or companies and (b) to personal income tax payable by the shareholders who are residents of France, with a credit for part of the 24% dividend tax withheld at source.

2. Investment income - Where treaty relief is not available, no allowance to the French parent company is made for any foreign tax paid on dividends from foreign subsidiaries. However, French parent company's Profit Tax Liability is reduced to only 12.5% on net dividends from foreign subsidiaries.

Unless treaty relief is available, no allowance to the French parent is made for any foreign income tax paid by its foreign subsidiary appropriate to the dividend distributed by the subsidiary.

GERMANY
(Corporations)

A. A corporation is subject to corporation tax liability if it has its seat in Germany or it is managed or controlled from within Germany. In such cases, its entire income is subject to corporation tax regardless of whether it is earned within or without Germany.

The seat of a corporation for German tax purposes is the place where the corporation is incorporated (listed with the commercial registry). The management of a corporation is the place where the important decisions of the corporation are made (not necessarily where the directors meet). In both of the aforementioned instances, it is the corporation that is subject to the Germany income tax and not the shareholder. A foreign corporation will be considered to be controlled in Germany if it is economically, financially and organizationally dependent on the Germany parent so that it is the equivalent of a division of the parent. Nowadays, however, this latter rule is rarely, if ever, applied to foreign corporations by the German tax authorities; in any event it would be the foreign corporation and not the German parent that would be taxed.

Based on the foregoing, it can be said without reservation that if a German corporation owned 100% of the stock of any foreign corporation, the earnings of the foreign corporation would not be subject to German income tax provided it was an independently-operated business enterprise incorporated outside of Germany, and its management made all of its own major decisions.

B. Income Tax Rates:

1. Corporation Profits Tax - 51% on undistributed profits, 15% on distributed profits.

2. Municipal Trade Tax - Averages 12.5% (deductible for Corporation Profits Tax purposes).

C. Double Taxation Relief:

Where treaty relief is not available, income taxes paid to a foreign country are allowed as a credit against German Corporation Profits Tax.

No credit is allowed to the German parent for any foreign income taxes paid by its foreign subsidiary appropriate to the dividend distributed by the subsidiary.

ITALY
(Corporations)

A. A corporation is subject to tax liability on its profits earned in Italy irrespective of where it is incorporated.

If a subsidiary of an Italian corporation has no income earned within Italy, it would not be subject to Italian income tax. If it were incorporated within Italy, the income earned abroad would be taxable in Italy only if such income were exempted from foreign tax by virtue of an international tax convention or if the subsidiary did not have a permanent establishment abroad operating and accounting separately.

B. Income Tax Rates:

1. Income Tax:

(a) Category A (income from capital) - National, provincial, communal, etc., totals approximately 26%.

(b) Category B (income from business) - National, provincial, communal, etc., totals approximately 30%.

2. Company Tax (excess profits) - 16.5% of all company income (including profits, dividends, etc.) which, after deduction of "Income Tax" assessed, is in excess of 6% of the total of capital and free reserves.

C. Double Taxation Relief:

1. Operating Income - Income earned through a permanent establishment abroad is exempt from Income Tax but subject to the Company Tax.

2. Dividend Income - Where treaty relief is not available, the foreign tax paid on dividends from foreign subsidiaries is allowed as a deduction in assessing taxable income.

No allowance to the Italian parent is made for any foreign income taxes paid by its foreign subsidiary appropriate to the dividend distributed by the subsidiary.

JAPAN
(Corporations)

A. A corporation is subject to tax liability on its entire income, whether earned within or without Japan, provided its main office or principal place of business is in Japan.

If a foreign subsidiary of a Japanese parent company had its main office outside Japan and had no business activities in Japan, it would not be subject to Japanese tax.

B. Income Tax Rates:

1. National - Corporation Tax - graduated rates 33% - 38%.

2. Local - (a) Enterprise Tax - graduated rates 7% - 12% (deductible for Corporate Tax purposes when paid)

(b) Prefectural and Municipal (Metropolitan) Inhabitants Tax:

Standard rates 13.5% of the Corporation Tax

Maximum rates allowed by Local Tax Law:

Standard		Maximum
5.4%	Prefectural Inhabitants Tax	6.5%
8.1%	Municipal Inhabitants Tax	9.7%
13.5%	Metropolitan Inhabitants Tax	16.2%

C. Double Taxation Relief:

Income taxes paid to a foreign country are allowed as a credit against Japanese tax. No credit is allowed to the Japanese parent for any foreign income taxes paid by its foreign subsidiary appropriate to the dividend distributed by the subsidiary.

NETHERLANDS

(Corporations)

A. A corporation is subject to tax liability on its entire income, whether earned within or without the Netherlands, provided it is established in the Netherlands.

A corporation is considered established in the Netherlands if it is organized under Netherlands law or if it has its center of management in the Netherlands.

If a subsidiary of a Netherlands corporation is incorporated outside the Netherlands and has its "mind and management" located outside the Netherlands, its earnings would not be subject to Netherlands tax.

B. Income Tax Rate:

Company Tax - graduated rates from 44% to 47%.

C. Double Taxation Relief:

Netherlands corporation can obtain relief from the Company Tax on foreign income on which an income tax (similar to Netherlands income tax) had been paid in a foreign country as follows:

1. Branch Income - this relief consists in the deduction from the Netherlands tax on the taxpayer's world income, not of the foreign tax actually paid, but of the amount of Netherlands tax which bears the same proportion to the tax payable on the taxpayer's total taxable income as the income taxable abroad bears to that total taxable income.

2. Dividend Income - complete exemption from Netherlands tax provided the Netherlands parent has a "considerable interest" in the subsidiary distributing the dividend. A "considerable interest" generally exists only if at least 25% of the paid-up share capital is directly owned. Expenses connected with a "considerable interest" do not constitute admissible charges against the taxable income of the Netherlands parent company. An example of such inadmissible expenses is interest on a loan contracted to finance the acquisition of the shares.

NORWAY

(Corporations)

A. A corporation is subject to tax liability on its entire income, whether earned within or without Norway, provided it is resident in Norway.

A corporation is deemed to be resident in Norway if its main office is situated there.

If a subsidiary of a Norwegian corporation is incorporated outside Norway and has its main office located outside Norway, its foreign earnings would not be subject to Norwegian tax.

B. Income Tax Rates:

1. State Income Tax - 30%

2. Municipal Income Tax

a) Levied by State - Graduated rate to 5%.
b) Levied by Municipality - Varying rates from 15% to 18%.

C. Double Taxation Relief:

Only 50% of the net income is included in taxable income in Norway if the income is derived from fixed property abroad or from trade or industry connected with such property. This rule also applies when the fixed property is owned by a company abroad, provided 95% of the shares is owned by a Norwegian parent company. Whether foreign taxes are paid on this income is of no importance.

Where treaty relief is not available, any foreign tax paid is allowed as a deduction for Norwegian tax purposes. No credit is allowed to the Norwegian parent for any foreign taxes paid by its foreign subsidiary appropriate to the dividend distributed by the subsidiary.

SWEDEN
(Corporations)

A. A corporation is subject to tax liability on its entire income, whether earned within or without Sweden, provided it is of Swedish nationality.

A corporation is deemed to be of Swedish nationality if it is registered as such in Sweden according to Swedish law. If registration is not required (e.g., certain Swedish societies), the company is deemed to be a Swedish company if the board of the company has its seat in Sweden or if the company's main activity is carried on in Sweden.

If a subsidiary of a Swedish corporation is incorporated outside Sweden, and its operations are carried on outside Sweden, its earnings would not be subject to Swedish tax.

B. Income Tax Rates:

1. National Income Tax - 40%.

2. Local Income Tax - Rates vary between 10% and 18% (deductible for National Income Tax purposes)

C. Double Taxation Relief:

Except as otherwise provided in treaties, income taxes paid to a foreign country are allowed as a deduction for Swedish income tax purposes. Generally, no credit is allowed to the Swedish parent for any foreign income taxes paid by its foreign subsidiary appropriate to the dividend distributed by the subsidiary. A variety of special tax reliefs exist in certain given situations under the conventions which Sweden has entered into with certain countries.

UNITED KINGDOM
(Corporations)

A. A corporation is subject to tax liability on its entire income, whether earned within or without the United Kingdom, provided it is resident in the United Kingdom. (Overseas Trade Corporation is exception to this general rule.) A corporation's residence is at the place where the central control and management actually abide (mind and management concept).

The place where central control and management is located is purely a question of fact. It is the place where all fundamental decisions regarding the operations of the company are made - normally the place where directors' meetings are held.

If a subsidiary of a U.K. parent corporation carried on its business activities outside the United Kingdom, managed its own operations outside the United Kingdom, and its board of directors held their meetings outside the United Kingdom, it would not be subject to U.K. tax -- even if it were incorporated in the United Kingdom. If the subsidiary's "mind and management" is located in the United Kingdom, it is the subsidiary who is liable for the U.K. tax and not the shareholder.

B. Income Tax Rates:

1. Standard Income Tax - 38-3/4%.

2. Profits Tax - 15%.

C. Double Taxation Relief:

Foreign income taxes both paid and "deemed paid" are allowed as a credit against U.K. tax subject to statutory requirements and limitations.

D. Overseas Trade Corporations:

A corporation resident in the United Kingdom, but which operates entirely abroad and meets certain statutory requirements, is relieved from U.K. income and profits taxes on its profits until they are distributed to a resident of the United Kingdom. No U.K. tax is suffered on the distribution of trading profits earned by an O.T.C. insofar as they are distributed to shareholders who are not resident in the United Kingdom.

ATTACHMENT IV

Foreign Tax Credit and Investment Income

On April 2, 1962, the Secretary of the Treasury proposed to the Senate Finance Committee in connection with H.R. 10650 that an amendment be made in the foreign tax credit provisions of the Internal Revenue Code. The proposed change in general would deny the right to use any income tax paid abroad on "business income" as a credit against a U.S. tax due on foreign "investment income." This would change a rule which has existed practically since the beginning of the U. S. income tax law.

The sole reason given by the Secretary for this new proposal is to "remove an unwarranted stimulus now provided by the foreign tax credit provisions to the flow of short-term capital abroad..."

To require credit for foreign income taxes to be computed by types of income -- which is in substance what this proposal would do -- would be a serious departure from the principle of applying the U. S. tax law and rates uniformly to all types of income. We urge that it not be adopted. The fact that this idea has been proposed at the very last minute gives little time to establish its real merit. It therefore should at the least be postponed for thorough study.

We understand the Secretary's concern with any flow abroad of short-term investments. There is, however, nothing in the material submitted to the Senate Finance Committee showing either the flow of such short-term investments or the amount that can be reasonably attributed to the present method of computing foreign tax credit. We believe and submit that the vast majority of such short-term investments are dictated by the higher interest rates available abroad. The fact is that the Canadian interest rate on short-term investment, where the immediate problem seems to have arisen, has normally been above the U. S. rate. Thus reasons other than tax are at work.

The Treasury proposal of April 2 was accompanied by suggested statutory language. The "investment income" category, were its language to prevail, would include income which is obviously not from short-term investment. The category would include investments which would never be made to utilize excess tax credits in the manner described by the Secretary. For example, the "investment income" would include:

(1) Interest on securities of affiliates operating abroad whether incorporated in the U. S. or elsewhere;

(2) Interest on long-term loans to affiliates operating abroad;

(3) Interest on compulsory investments in securities of foreign governments;

(4) Interest on loans to customers made in the ordinary course of business;

(5) Dividends from a less than 10% owned foreign incorporated affiliate on permanent equity investment;

(6) Dividends from a U. S. incorporated affiliate operating abroad, and not U. S. tax consolidated, on the permanent equity investment therein regardless of what percentage of the company is owned.

There are listed below some examples of income producing items which would be included as short-term investments:

a. Brazil - Economic Re-equipment Bonds issued to cover a compulsory loan generally equal to 15% of tax on income;

b. Colombia - Housing Bonds which may be purchased in lieu of paying 66% of the Special Housing Tax (6% of income);

c. Chile - Investments in Chilean companies building low-cost homes made in lieu of paying a Housing Authority Tax (generally 5% of income);

d. Income from local government securities such as those purchased by companies operating in Venezuela (both U. S. and foreign) to finance road building and middle income housing;

e. Income from minority investments such as our affiliate in Venezuela is now making in local business ventures to aid in the industrialization of Venezuela and quicken its economic development - the proposed language would make an exception only for dividend income where 10% control of a foreign incorporated company exists. In evaluating and developing possible investments, particular attention is paid to those projects which contribute to increased productive capacity of the country, create additional employment opportunities, are technically sound and have reasonable prospects for financial success. Certainly this is not the type of investment that the Secretary wishes to discourage;

f. Interest on long-term loans made in connection with long-term crude supply contracts to help foreign refiners add refining capacity. Competition for markets abroad have caused loans to customers to become more common.

Under existing law the foregoing types of income are not segregated but are combined with other income in computing the limitation on the credit for foreign taxes. This is proper. Nothing in the material filed by the Treasury indicates otherwise. In fact, the suggested languages specifically proposes to retain the present method for computing tax credit on dividends where 10% or more of a foreign corporation is owned by the recipient.

This proposal must also be considered in the light of our tax treaty commitments. The U. S. has in effect 21 treaties with other nations

dealing with taxation. These treaties mutually promise the application of tax credit procedure in respect of each other's income taxation in order to avoid double taxation. To enact the proposal of the Secretary would run counter to the mutual undertaking and spirit of all of these treaties. In any event, we believe that this provision would be inapplicable under 14 of these treaties. They are the treaties with Australia, Austria, Belgium, Finland, Germany, Honduras, Ireland, Japan, New Zealand, Norway, Pakistan, Switzerland, Union of South Africa and United Kingdom. Under these treaties the foreign tax credit machinery in effect at a given date, i.e., then existing law, was made to apply. Thus the Secretary's proposal could not apply in any event to these countries unless the treaties were in effect abrogated. We doubt that all the effort and wisdom which has gone into the tax treaty program would warrant any wholesale abrogation without which such a provision as suggested would not have universal application. Congress would hardly want to put such a provision into effect.

Despite the foregoing view which is held by many tax practitioners the Secretary testified that the Treasury sees no treaty conflict with respect to any of the Treasury proposals. He therefore urged the elimination of Section 21 of H.R. 10650 which would unilaterally end any inconsistent treaty positions. We agree that Section 21 should be rejected but for different reasons. The proper way to amend a treaty is by negotiation between the countries party thereto. We believe that enactment of Section 21 would be a serious mistake in that it would encourage other countries to abrogate their treaties with us which could well be detrimental to both U. S. taxpayers and the Treasury.

To summarize, we urge that the Secretary's recommendation be rejected because:

(1) The proposed change in this tax credit rule, which has existed practically since the beginning of our tax law, would be a serious departure from the principle of applying the U. S. tax law and rates uniformly to all types of income.

(2) Nothing in the material filed with the Finance Committee shows either the flow of short-term investments or the amount that can be reasonably attributed to the present method of computing foreign tax credits. Certainly, nothing that was submitted warrants the radical global change proposed by the Secretary.

(3) The proposed language submitted by the Treasury would apply to income from operations abroad through affiliated companies in a manner that is clearly not warranted by anything in the Secretary's testimony.

(4) The proposal is contrary to the spirit of all of our tax treaties, to the letter of many of them, and could not be fully effective without renegotiating some treaties or abrogating them unilaterally. The latter alternative is too abhorrent to be seriously considered.

(5) The proposal would have little effect except to penalize legitimate foreign operations since the real cause of the flow of short-term funds to foreign areas is the higher return available. Under these circumstances it would be a serious mistake to enact what we are convinced is an unsound tax provision in an attempt to correct this problem which is of limited incidence and not a tax matter.

STATEMENT OF

MARVIN K. COLLIE

Attorney-at-Law
Houston, Texas

MR. CHAIRMAN AND MEMBERS OF THE FINANCE COMMITTEE OF THE UNITED STATES SENATE:

My name is Marvin K. Collie, a member of the law firm of Vinson, Elkins, Weems & Searls Houston, Texas.

This statement concerns two suggestions as to Section 16 of H. R. 10650, 87th Congress, 2nd Session, now pending before this Committee. Speaking generally, this proposed section provides for taxing as ordinary income the proceeds from a redemption or sale of the stock of a controlled foreign corporation to the substantial stockholder who so transfers such stock, to the extent of a proportionate part of the earnings and profits of such foreign corporation This proposed section is applicable to all of the earnings of the corporation after 1913 and is made effective with respect to sales or exchanges occuring after the date of the enactment of the Bill.

First, since the entire concept of the taxation of foreign income has been radically changed in the H. R. 10650

from the present law, it is particularly unfair and unjust to tax as ordinary income all of the earnings and profits of the foreign corporations upon the sale or exchange of the stock under the conditions specified in Section 16. This constitutes an unwarranted penalty on substantial stockholders of foreign corporations who not only have been following the present law but who have been attempting to follow what it understood to be the trend of Congressional proposals. (Cf. H. R. 5, 86th Congress, 1st Session, the "Boggs Bill".) It is understood that the suggestion of the Secretary of the Treasury at his appearance before this Committee on April 2, 1962, reflects his concern in this area.

Therefore, it is respectfully suggested that the ordinary income treatment of Section 16 should only apply to earnings and profits accumulated after an effective date that would be the same as that specified with respect to the related Section 13, that is, taxable years of foreign corporations beginning after December 31 1962, and to the taxable years of United States persons within which or with which such taxable years of such foreign corporations end.

Secondly, it is respectfully suggested that Section 16 should be amended at least to permit an averaging of the income from the sale or exchange of the stock of the controlled foreign corporation.

For example, suppose a bona fide manufacturing foreign corporation is organized and operated in an underdeveloped part of the world by a single United States individual, on January 1, 1963. At the end of five profitable years of expansion of the business, such stockholder desires to sell a substantial part of his stock to his key employees to give them an equity position in the corporation for valid business reasons. However, under the present Bill he would be effectively prevented in most cases from making such sale because of the extraordinarily high income taxes he would have to pay upon such a sale at ordinary income rates.

With Section 13 presumably eliminating in a most complicated fashion the cases of pure tax avoidance and recognizing tax deferral is proper at least in underdeveloped countries, it should be logical to continue the use of the capital gain provisions of the Code with respect to the sale

or liquidation of all or a part of such foreign corporations. In view of the restrictions in the provisions of Section 13, and the meeting of the customary rationale for a capital gain, Section 16 in its entirety should be eliminated.

However, assuming that this justification is not satisfactory to this Committee, then an income averaging device should be permitted to the taxpayer at his option.

A precedent for such action may be found in the Bill. In Section 9 of the Bill (Sec. 669) there are special rules for certain foreign trusts, limiting the amount of the income taxes on an accumulation distribution therefrom. This is achieved by an averaging of the beneficiary's income from the trust over a three year period. A similar provision at least should be inserted as to the situation contemplated in Section 16 except that the averaging should be done over a ten year period (or the life of the corporation) because, through the restrictive provisions of Section 13, one usually would find a bona fide business transaction caught by Section 16.

SUMMARY

STATEMENT OF FINLEY J. GIBBS ON BEHALF OF
THE AMERICAN CHAMBER OF COMMERCE OF THE PHILIPPINES

220 BUSH ST., SAN FRANCISCO 4, CALIF.

PROTESTING AGAINST SECTIONS OF
THE REVENUE BILL OF 1962 INVOLVING
FOREIGN SOURCE INCOME

A. Past policy of the United States has correctly been to encourage investment of private American capital in underdeveloped countries as the cheapest and most mutually beneficial form of foreign aid.

B. There are basic inequities in Sections 7, 12, 13, 16 and 20 which penalize American investors in American controlled foreign companies as compared with investors in other companies. Section 16 is particularly oppressive in that it subjects to eventual taxation at confiscatory rates gains from reinvestment of earnings in such American controlled companies.

C. As applied to American businesses in the Philippines, many of which were founded while the Philippines were under the American flag, the above sections of the Revenue Bill of 1962 would not only be bad foreign and economic policy but would perpetrate a gross injustice.

BEFORE THE FINANCE COMMITTEE OF THE SENATE

STATEMENT OF FINLEY J. GIBBS ON BEHALF OF
THE AMERICAN CHAMBER OF COMMERCE OF THE PHILIPPINES

PROTESTING AGAINST SECTIONS OF
THE REVENUE BILL OF 1962 INVOLVING
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I am Finley J. Gibbs, of San Francisco. Since 1951 I have been a partner in the law firm of Gibbs & Gideon. Previous to that time I practiced law in the Philippines. I am still actively interested in Philippine matters and am fully familiar with conditions there. The American Chamber of Commerce of the Philippines, comprised of over two hundred American business and professional men, as well as firms in which Americans are investors, has asked me to present this statement in protest against certain sections of the Revenue Bill of 1962 involving foreign source income.

At the outset, let me state that the American Chamber of Commerce of the Philippines is in full sympathy with the announced purpose of the bill insofar as it attempts to eliminate certain "tax havens" abroad. It wishes to point out, however, that in a shotgun attempt to eliminate these tax havens the bill strikes a punishing blow against legitimate American businesses abroad. In this regard the legislation not only violates sound foreign and economic policy but is basically unjust.

A. BILL VIOLATES SOUND FOREIGN POLICY

Heretofore, the foreign policy of the U.S. has given

due recognition to the importance of encouraging the development of American business enterprises abroad, particularly in the so-called "underdeveloped" countries. Direct Government aid has not only proved expensive but difficult to administer effectively. The investment of private American capital abroad, on the other hand, has benefitted foreign countries in more ways than the mere influx of capital. It has spread American know-how, American business methods, American culture and American ideals. At the same time, it has benefitted the United States directly by stimulating exports and increasing the assets and income of its citizens. Much of this increase is now finding its way back into this country. It has also made available to the United States sources of raw materials which might otherwise have fallen into unfriendly hands. To stifle this economical and mutually beneficial form of aid to underdeveloped countries -- now so important in the race with the Communists in the cold war -- would be the worst kind of short-sightedness.

These general considerations of policy would dictate a relaxation of tax burdens on American enterprise in underdeveloped countries, rather than an increase in such burdens. Yet the basic inequities in certain sections of the proposed bill -- far from equalizing tax burdens -- will penalize American investors in American controlled foreign companies as compared with investors in other companies.

B. BILL CONTAINS BASIC INEQUITIES PENALIZING AMERICAN BUSINESS ABROAD

(1) Section 7 -- Definition of Foreign Personal Holding company.

This section amends provisions in the Code which were

meant to subject stockholders in foreign personal holding companies to approximately the same treatment as stockholders in domestic personal holding companies, by taxing such stockholders directly on undistributed income. Section 7 goes far beyond the prior law and discriminates against foreign investments since it classifies foreign companies as personal holding companies where only 20% of their income is derived from rents, interest, royalties, dividends, etc., whereas a domestic company must have at least 80% of its income in such category before it is treated as a holding company. As a result, American investors in foreign companies are penalized if a relatively small portion of the company's income is from these sources. Because of the small percentage involved a company could fall into a foreign personal holding company category for any one year even though it was primarily an operating company. It is often impossible in foreign countries where exchange control is the rule rather than the exception, for corporations to distribute dividends to American stockholders, particularly those who have become residents of this country. As a result, American shareholders may be taxed on income which they cannot receive. In the case of a minority shareholder whose interests may be different from the management, there may be no way in which he can obtain the income even in the absence of exchange control so that this section can easily be a tax trap. No reason is seen for treating American investors in American controlled foreign companies so much more severely than investors in other companies in this regard.

(2) Section 12 -- Earned Income From Sources Without the United States.

This section of the bill substantially reduces the tax benefits enjoyed by Americans who reside and work abroad by limiting

in various ways the existing tax exemption on earned income. In most underdeveloped countries, such as the Philippines, businessmen who are citizens of such countries, or citizens of countries other than the United States, pay only the local income taxes. For example, the British businessman in the Philippines pays no taxes to the British Government, but only to the Philippine Government. The same is true of the Chinese and so far as we know, the Swiss and most other nationalities. Under the proposed Section 12 an American businessman in the Philippines attempting to accumulate capital from his personal earnings to develop his business will be at a severe disadvantage since he will be subjected to the higher U. S. rates with regard to part of his earnings. Should he organize his business as a local corporation Section 16 of the proposed bill imposes even more catastrophic penalties.

Larger American enterprises are also disadvantaged because the bill reduces one of the few inducements they can offer to talented executives to come to foreign countries. It is a popular illusion in this country that the American businessman abroad lives in kingly luxury and that money there grows on bushes like tropical fruit. The fact that he faces many discomforts, risks and disadvantages which he does not encounter at home is largely ignored. This is particularly true in underdeveloped countries where climatic conditions are apt to be unhealthy and the American faces substantially poorer sanitary conditions and serious diseases unknown at home. He must also cope with local nationalistic tendencies, political instability, a dearth of adequate higher educational facilities for children, and isolation from friends and business associates in this country. While these conditions may not

be as acute in the Philippines as in some of the other underdeveloped countries, they are nevertheless present. The cost of living for an American in the Philippines is substantially higher than the cost of living in this country. Consequently, if the remainder of his earnings is subjected to high tax brackets, the cumulative erosion on his savings is far greater than in this country. While the highly publicized and highly transient movie stars and other celebrities sojourning in Europe may not be faced with these difficulties, the American businessman living in tropical and subtropical countries in the Orient and Central and South America has them in abundance. Exemption of his earned income from U. S. taxes is essential to permit him to compete with foreign businessmen and to compensate him in some way for the advantages which he gives up when he leaves this country.

Section 12 not only limits the amount of the earned income which is exempt but provides that the exemption will be lost with regard to any amounts received after the taxable year in which the income was earned. There is no reason for this arbitrary distinction. A delay in payment may be purely accidental or may be required because of the conditions of the business.

Section 12 also taxes pensions earned while in a foreign country even though such earnings could have been received by the employee currently without any tax. In this country payments into pension plans are encouraged by giving such payments more favorable tax treatment than direct payments to employees. There is no reason why in the case of American employees of foreign businesses this treatment should be reversed.

(3) Section 13 -- Controlled Foreign Corporations.

This section in effect still further enlarges the existing category of foreign personal holding companies. It includes income from certain foreign trade transactions in the class of income which will be taxed directly to the stockholder. The provisions are so complex that no one but a tax specialist could understand them. The same criticisms apply to this section as to Section 7 discussed above, particularly the danger that a minority stockholder who cannot control management may find himself in a tax trap where he is taxed on income which he may never receive. It is also highly unlikely that such a stockholder will know when he is subject to this tax.

(4) Section 16 -- Gain From Disposition of Stock in Foreign Corporations.

This section proposes to tax at rates applicable to ordinary income all gains from the sale, liquidation or other disposition of stock in foreign corporations which are at least 50% owned by Americans provided the taxpayer owns at least 10% of the stock. There is a limitation that the gain taxable at such rate will not exceed the amount corresponding to the undistributed profits earned by the corporation since 1913.

Section 16 makes the use of foreign corporations by an American businessman a tax trap, particularly if the corporation is successful and reinvests its profits. Far from equalizing the effect of U. S. and foreign taxes, Section 16 imposes a burden which is catastrophically greater than the tax on businesses in this country. For example, a single American in the Philippines who owned a Philippine corporation which earned and plowed back into its business $25,000.00 a year for fifteen years would, under Section 16,

be taxed as follows, upon liquidation of his business or sale of his stock:

Taxable income for 15 year period	$375,000.00
Philippine corporate taxes at existing rate of 22%	82,500.00
	$292,500.00
U. S. income tax at ordinary income tax rates on balance	240,995.00
Net left to taxpayer	$ 51,505.00

(Note: Any additional profit would be taxed at 91% and any other income the taxpayer had in the year of sale would also be taxed at 91%).

On the other hand, had he operated in corporate form in the United States his taxes would have been as follows:

Taxable income	$375,000.00
U. S. corporate taxes (32%)	120,000.00
	$255,000.00
U. S. capital gains tax on balance	63,750.00
Net left to taxpayer	$191,250.00

(Note: Any additional profit would be taxed at a maximum of 25% and the tax on taxpayer's other income would not be increased).

It is obvious that this provision will effectively deter American businessmen from initiating any new businesses in foreign countries in the form of local corporations. Since a local corporation is the most logical and sometimes the only practicable way that a small businessman can operate in a foreign country, this deterrent will stifle most small businesses. As to existing American owned foreign corporations which are continuing to make profits, Section 16 will put an end to their growth by requiring the annual distribution of profit rather than its reinvestment.

As to past profits already reinvested in such businesses, the application of Section 16 will result in the worst kind of retroactive taxes, the penalties increasing with the length, thrift and success of the business. In view of our Government's past policy of encouraging investment in foreign businesses such a retroactive penalty is truly iniquitous. And it seems incomprehensible that an American investor who owns stock in a foreign corporation which is controlled by Americans must pay a higher rate of tax when he sells than an American who owns stock in such a corporation controlled by foreign associates.

(5) Section 20.

Section 20 of the Bill establishes requirements as to information returns which are so complicated and so difficult to comply with that the small businessman who cannot afford to hire an expert legal and accounting staff almost certainly faces severe penalties.

C. CONCLUSION

Although there are admittedly a few Americans who have taken advantage of foreign tax havens to escape their obligations to the Government, and although some adjustment of our revenue laws may be needed to prevent such abuses, the shotgun provisions of this Revenue Bill will punish, if not throttle, many legitimate American businesses abroad. As applied to existing American businesses in the Philippines, many of which were founded while the Philippines was still under the American flag, the Revenue Bill would not only be bad foreign and economic policy but would perpetrate a gross injustice.

The American abroad occasionally encounters the Communist

inspired slogan "Yankee, go home!" In the past he has been able to ignore it. If the above sections of the Revenue Bill are enacted this slogan will be effectively enforced.

Respectfully submitted,

/s/ Finley J. Gibbs

Finley J. Gibbs, on Behalf of
THE AMERICAN CHAMBER OF COMMERCE
OF THE PHILIPPINES

THE AMERICAN INSTITUTE OF ARCHITECTS

The Octagon • 1735 New York Avenue, N.W. • Washington 6, D.C. • EXecutive 3-7050

STATEMENT OF

PHILIP WILL, JR., PRESIDENT

THE AMERICAN INSTITUTE OF ARCHITECTS

to the

COMMITTEE ON FINANCE

UNITED STATES SENATE

concerning the REVENUE ACT OF 1962 (H.R. 10650)

Mr. Chairman and Gentlemen:

My name is Philip Will, Jr. and I am engaged in the practice of Architecture in Chicago, Illinois. My statement to your Committee is being made in my capacity as President of The American Institute of Architects. The Institute, now celebrating its 105th birthday, is a professional association composed of some 170 regional, state and local components representing 15,000 members of our profession in all states of the Union.

Members of The American Institute of Architects serve in the construction industry in the vital professional rôle of research, programming, design, execution of contract documents, construction bid procedures and general administration of the work. You gentlemen of the Finance Committee are certainly aware of the vital impact of the construction industry with respect to our national economy and the gross national product. From the construction reports of the Bureau of the Census, U. S. Department of Commerce, the value of new construction in these United States in the year 1961 amounted to over

fifty-seven (57) Billion Dollars. Even when the figure of seventeen (17) Billion Dollars for public construction (including military facilities, highways, sewer and water systems, etc.) is deducted, a very respectable figure of over forty (40) Billion Dollars remains as the effort of private investment in new construction

You gentlemen of the Finance Committee can see from these statistics that private investment is imperative to generate and continue this rate of new construction. Private investors, the backbone of the construction industry, must have the tax and return incentives to invest in this vital industry if we are to secure a high rate of economic growth as a nation, create jobs and stabilize the dollar both at home and abroad.

As AIA members we are concerned with the design aspects of this industry, but we are also keenly concerned with the related influence of new construction in the manufacture of the allied products of steel, concrete, glass, electrical systems, air conditioning and heating equipment. The health of new construction also influences the availability of jobs in the various skills and crafts of the building industry, as an extension of the growth and welfare of our great Nation.

The American Institute of Architects is concerned with two portions of the Revenue Act of 1962, passed by the House of Representatives on March 29 of this year, that affect the construction industry:

1. Limitations of the Tax Incentives for Modernization and Expansion.

2. Gain on Sale of Depreciable Property.

My first comment will have to do with the TAX INCENTIVES FOR MODERNIZATION AND EXPANSION. The expressed purposes behind the tax incentive plan for modernization and expansion are objectives in which every American is in accord. However, the proposal contains limitations that exclude incentives in residential real estate investment and depreciable furnishings and equipment installed in connection with such real estate. The theory is that investment in residential properties represents property used directly by consumers rather than in production. Excluded as residential real estate are homes, apartments, hotels, motels, resort facilities and other properties built primarily for lodging. The limitations of the Tax Incentive will handicap housing as opposed to traditional manufacture and actually produces no incentive that will contribute to the national housing programs.

My second comment will have to do with GAIN ON SALE OF DEPRECIABLE PROPERTY. The Treasury's proposal is to tax the gain on disposition of depreciable property to the extent of prior depreciation allowance as ordinary income. It is said that such gain reflects prior depreciation allowances in excess of the decline in actual value of the asset. Under existing laws, the gain on the sale of depreciable business property is taxed at capital gains rates.

The American Institute of Architects is aware of the few well publicized examples of real estate transactions wherein the owners have acquired properties to be utilized as so-called "depreciation shelters." These are cases wherein tax-free distributions are made and then properties are disposed of when depreciation deductions fail to wipe out rental income. The Institute

does not speak on behalf of these individuals and corporations that participate in this scheme, but rather believes that these parties represent a minority as compared to the many small investors and syndicates that truly seek the incentives and climate to invest in real estate that can afford an equitable and fair return on their invested dollars.

There are many factors that impede investment in real estate at this very time. Some of these factors include the owner's inability to rapidly dispose of these properties such as in the case of stock investments. Another factor is the very real and often rapid depreciation of components of an improved property such as the roof, elevators, electrical systems, mechanical systems and building materials. Still another factor embraces the human relations aspect of maintaining a satisfied tenant.

One of the major incentives for investing in real estate and new construction is the owner's capability to hope for an ultimate realization of a capital gain when and if he <u>can</u> or <u>must</u> dispose of the property under favorable terms. The motive here of the real estate investor is absolutely no different from the motive of the investor that makes his investment in securities purchased on the stock exchange. Capital gains on the sale of securities are practically guaranteed under the law. To eliminate this advantage in the field of real estate investment can surely have the effect of diverting investment dollars from real estate and into more <u>liquid</u> investments. This should have great adverse effects upon the general welfare and economic growth of our Nation, our profession, and the construction industry.

Renewal of the urban areas of our Nation has been well begun by government programs in the renewal and rehabilitation of obsolete real property.

But the magnitude of the problem will require participation in these areas on a tremendous scale by private initiative. Any diminution of private investment interest could be critical.

I very much appreciate the opportunity to submit this statement on behalf of The American Institute of Architects. As you gentlemen of the Finance Committee ponder this piece of legislation, we hope that you will study the possible effects of this legislation upon our profession and the construction industry. We particularly hope that you will study the projected revenue as a source of this legislation in relation to the potential loss of revenue should such legislation stifle real estate development, sales and investment, including new construction, conservation, rehabilitation and modernization.

SUN LIFE INSURANCE CO. OF AMERICA,
Baltimore, Md., April 26, 1962.

Hon. JOHN MARSHALL BUTLER,
New Senate Office Building, Washington, D.C.

DEAR SENATOR: Under present law, life insurance companies and mutual fire and casualty companies are the only taxpayers denied capital gains treatment on market profits from bonds purchased at less than par value. They must accrue a portion of the bond discount (the difference between cost and par value) as investment income each year.

Section 10 of H.R. 10650, now awaiting the consideration of the Committee on Finance, contains provisions which would give mutual fire and casualty companies capital gains treatment on their market profits from bonds. In the Finance Committee's consideration of H.R. 10650, we believe that it would be proper for the committee also to consider an amendment which would give similar treatment to life insurance companies. The inclusion of such an amendment in H.R. 10650 in conjunction with the provisions applying to mutual fire and casualty companies would thus correct the inequity existing under present law for both life insurance companies and mutual fire and casualty insurance companies.

I am enclosing a copy of a proposed amendment with a more detailed explanation of the question. This amendment would eliminate the requirement that life insurance companies must accrue bond discount and thus would permit life insurance companies to treat their bond profits as capital gains like other taxpayers.

We would very much appreciate your calling this matter to the attention of the Committee on Finance so that consideration can be given to it at the appropriate time when the committee is reviewing the same question with regard to mutual fire and casualty insurance companies. It is our hope that the committee would believe that life insurance companies and mutual fire and casualty companies are both entitled to treat their bond profits as capital gains.

Sincerely,

WALTER ROTHSCHILD.

PROPOSED AMENDMENT TO SECTION 818(b) OF THE INTERNAL REVENUE CODE OF 1954

Section 818(b) of the Internal Revenue Code of 1954 should be amended by adding at the end of paragraph 2 thereof the following:

"(C) ACCRUAL OF DISCOUNT.—For taxable years beginning after December 31, 1962, no accrual of discount on any bond (as defined in section 171(d)) shall be required."

This amendment would equate the tax treatment of market gain on bonds realized by life insurance companies with that accorded other taxpayers. Like stocks, bonds fluctuate in value and successful investors may sell or redeem their bond investments at more than their cost. Except for mutual fire and casualty companies, life insurance companies are the only class of taxpayers who are required to accrue annually as investment income a ratable portion of the difference between the purchase price of the bond and its par value. All other taxpayers are entitled to treat the difference between the cost of the bond and its par value as capital gain when the bond is sold or redeemed at a profit.[1]

Since the Revenue Act of 1942, mutual fire and casualty companies and life insurance companies have been required to accrue a ratable portion of bond discount as investment income. The reason for this difference of treatment, as explained in the committee reports,[2] is that these companies follow this accounting practice in reporting to State insurance departments. Stock fire and casualty companies are also required to follow this method of accounting and accrue bond discount for State insurance department purposes. Nevertheless, even though

[1] Upon the sale of a bond, which is a capital asset, the ordinary capital gains rules generally apply. Sec. 1232(a)(1) of the code specifically provides that any gain realized upon the retirement of a bond described therein is also to be taxed as capital gains. However, sec. 1232(a)(2) denied capital gains treatment on profits realized from the sale of certain bonds which are issued with "original issue discount" as defined in sec. 1232(b).

[2] S. Rept. 1631, 77th Cong., 2d sess., p. 147, states (inter alia): "This treatment of bond discount and premiums will coincide exactly with the existing accounting practice in the life insurance business."

stock fire and casualty companies follow the accounting practice of accruing bond discount, they are entitled to treat as capital gains any profits realized from the sale or redemption of bonds purchased at a discount.

In Rev. Rul. 60-306 (1960-2 C.B., 211), the Internal Revenue Service has specifically ruled that the accounting treatment of bond discount by stock fire and casualty companies does not prevent them from treating bond discount as capital gains. The reason for the difference of treatment in the case of stock fire and casualty companies is that they are not specifically required, under the Internal Revenue Code, to accrue bond discount as life insurance companies are in section 818(b)(1) and mutual fire and casualty companies are in section 822 (d)(2). The proposed amendment would eliminate this requirement from section 818(b) for life insurance companies.

In section 10 of H.R. 10650, now pending before the Finance Committee, the tax treatment of mutual fire and casualty companies is being revised to bring it in conformity with the tax treatment of stock fire and casualty companies. While this revision does not amend section 822(d)(2) (which requires mutual fire and casualty companies to ratably accrue bond discount), it would appear, because new section 823 in the bill requires mutual fire and casualty companies to use gross income under section 832 (which is the gross income starting point for stock fire and casualty companies and, therefore, excludes bond discount), that mutual fire and casualty companies would be entitled to treat bond discount as capital gains when their bonds are sold or redeemed. This construction, however, is not entirely clear. In response to a question on this point at the Senate Finance Committee hearings, John J. Wicker, spokesman for the mutual fire and casualty industry, stated that the bill should be technically clarified so as to make it absolutely clear that mutual fire and casualty companies received capital gains on bond discount. Since 1959, life insurance companies have been subject to tax on their capital gains under the Life Insurance Company Income Tax Act of 1959. Prior to 1959, there may have been good policy reasons to deny capital gains treatment to bond discount of life insurance companies as a means of taxing these profits. However, since life insurance companies are now subject to tax upon their capital gains like other taxpayers, this reason no longer exists, and, therefore, it seems entirely appropriate that life insurance companies should be entitled to treat bond discount profits as capital gains like other taxpayers. After the elimination of required accrual of bond discount for mutual fire and casualty companies in H.R. 10650, life insurance companies alone will be the only class of taxpayers denied capital gains treatment on market profits from bonds purchased at less than par value.

The effective date of the amendment to section 818(b) is for taxable years beginning after December 31, 1962, the same effective date as the amendments affecting the mutual fire and casualty insurance provisions on bond discount. No amendment to section 818(b) with respect to the amortization of bond premium is necessary to bring the treatment of bond premium by life insurance companies into general conformity with that accorded other taxpayers under section 171. Section 818(b)(2) was specifically added by the Life Insurance Company Tax Act of 1959 to conform the bond premium amortization rules for life insurance companies with those applicable to other taxpayers in section 171.

(Whereupon, at 1:40 p.m., the committee stood in recess, to reconvene at 9:30 a.m., Monday, April 30, 1962.)