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EXTENSION OF EXISTING DUTY SUSPENSION ON CERTAIN CLASSIFICATIONS OF YARNS OF SILK

NOVEMBER 5, 1975.—Ordered to be printed

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

REPORT

[To accompany H.R. 7727]

The Committee on Finance, to which was referred the bill (H.R. 7727) to extend for an additional temporary period the existing suspension of duties on certain classifications of yarns of silk, having considered the same, reports favorably thereon with an amendment and an amendment to the title and recommends that the bill as amended do pass.

I. SUMMARY OF THE BILL

House bill.—Subsection (a) of the House bill would amend the termination date for items 905.30 and 905.31 in the appendix to the Tariff Schedules of the United States (TSUS) from November 7, 1975, to June 30, 1978, to extend the existing suspension of duties on certain classifications of silk yarns for an additional temporary period.

Subsection (b) of the House bill would apply the amendment to articles entered, or withdrawn from warehouse, for consumption after November 7, 1975.

The committee did not modify the text of the House bill, but added an amendment containing two provisions.

Railroad rolling stock.—The first Committee provision would permit a reciprocal tax exemption for payments received by Canadian railroads for the temporary use of their rolling stock. Present law provides that payments received by Canadian railroads for the use of their rolling stock in the U.S. on trips between the U.S. and Canada are subject to a 15% withholding tax on the gross amount received. Canada now imposes a similar tax, but has indicated its willingness to grant a reciprocal exemption if the U.S. adopts an exemption. Similar reciprocal exemptions now exist for air, ship, and truck transportation. The Committee amendment provides for an exemption for

payments by a common carrier for the temporary use (i.e., one which is not expected to exceed 90 days a year) of railroad rolling stock owned by a corporation of a foreign country if the foreign country grants an equivalent exemption to U.S. corporations.

American Falls Dam, Idaho.—The second Committee provision would clarify the tax-exempt status of obligations the proceeds of which are to be used to reconstruct the American Falls Dam in Idaho.

Present law provides that an industrial revenue bond whose proceeds are used to build a dam to store water for irrigation purposes may be eligible for tax exempt status. Where, however, the water also has a subordinate use in generating electricity, the status of the bonds is not clear under existing law. The American Falls Dam is used principally for irrigation purposes, but the water has a subordinate use in generating electricity. The Committee amendment provides that industrial revenue bonds issued in such a case may qualify for exempt status if substantially all of the stored water is contractually available for irrigation purposes and the water is available on reasonable demand to members of the general public.

II. Suspension of Duties on Silk Yarns

The existing suspension of duties on spun silk yarns has been extended by various public laws since it was originally enacted by Public Law 86–235 on September 8, 1959. The suspension of duties was last extended on October 29, 1974, by Public Law 93–499 for a 2-year period from November 7, 1973, to November 7, 1975.

Both the column 1 rates of duty (applicable to imports from countries accorded nondiscriminatory (MFN) tariff treatment) and the column 2 rates (applicable to imports from countries not accorded MFN treatment) are suspended. Silk yarns covered by the suspension are imported under two items of the TSUS. The column 1 rate of duty on silk yarn singles under TSUS item 308.40 is 8.5 percent ad valorem and is 12.5 percent ad valorem on plied silk yarns provided for in TSUS item 308.50. The corresponding column 2 rates are 40 percent ad valorem and 50 percent ad valorem, respectively.

Spun silk yarns are of two principal types: Standard spun silk (schappe) yarns are for general textile use such as for making sewing thread, decorative stripings for fine worsteds, lacing cord for cartridge bags, and, in combination with other fibers, certain types of necktie fabrics, shirtings, dress, and suiting fabrics, upholstery and drapery materials. Standard yarns are manufactured from long parallelized silk fiber stock recovered from waste cocoons and silk filature waste. Silk noil (bourrette) yarn is made from shorter length, and hence cheaper, silk fiber stock than schappe. The material used consists of silk noils discarded as byproducts in preparing silk waste for spinning in standard spun silk yarns.

The duty was suspended originally to enable domestic producers of fine yarn fabrics to import fine silk yarns free of duty and thereby make it more economical to produce fine yarn fabrics in competition with imported similar fabrics. Due to the limited supply of all types of silk, fine silk yarns are being used presently at a premium price for the same purposes as other silk yarns. There is no domestic production of these silk yarn items. In recent years imports have been substantially below imports during the latter part of the 1960's when

they averaged about 165,000 pounds annually. There have been no imports of silk yarn singles under TSUS item 308.40 since 1966. Imports of plied silk yarns under item 308.50 were about 22,000 pounds valued at $253,000 in 1974. Japan and the People's Republic of China are the principal suppliers.

Favorable reports have been received by the Committee from the Departments of Treasury, Commerce, and the Office of the Special Representatives for Trade Negotiations. No objection to this provision has been received from any source.

III. Temporary Rental of Railroad Rolling Stock by Foreign Corporations

Under present law, the income of a foreign corporation which is effectively connected with the conduct of a trade or business within the United States is subject to the normal U.S. corporate income tax (sec. 882 of the code). In determining the amount of its effectively connected taxable income, a foreign corporation is allowed those deductions which are related to that income. On the other hand, there is a 30 percent tax on amounts (such as interest, dividends, rents and other fixed or determinable annual or periodical gains) from sources within the United States by a foreign corporation, if these amounts are not effectively connected with a U.S. trade or business (sec. 881).[1] The 30 percent tax is imposed on the gross amount received.

An exemption from U.S. tax is provided to a foreign corporation on earnings derived from the operation of foreign registered ships or aircraft which are documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States. In addition, the United States has treaties in force with a number of countries modifying the provisions of the Internal Revenue Code. Briefly, these treaties modify what income may be subjected to the regular corporate income tax of the source country and provide for reduced rates of tax or exemption on payments which are not subject to the regular corporate income tax.

The committee's attention has been drawn to the fact that the interchange of railroad rolling stock between U.S. railroads and Canadian railroads is being hindered by the imposition of a tax on the gross amount of the per diem payments which are paid by the user of the railroad rolling stock. The interchange of railroad rolling stock takes place when the rolling stock of one railroad is transferred to a second railroad for the continued shipment of the goods. The interchange per diem is set by the Interstate Commerce Commission and is intended to compensate the owner of the rolling stock for his costs (depreciation, maintenance, etc.), and a slight return on investment. Thus, the size of the per diem varies with the cost and useful life of the rolling stock.

Under this system, when a Canadian railroad ships goods to the United States, a U.S. railroad uses the Canadian railroad's rolling stock for that part of the transportation which is in the United States and pays the Canadian railroad a daily per diem for the use of the rail-

[1] This tax is generally collected by means of a withholding tax by the person making the payment to the foreign recipient of the income (secs. 1441 and 1442 of the code).

road car. If the Canadian railroad is engaged in a trade or business within the United States and the per diem payments are effectively connected with that trade or business, the Canadian railroad files a normal U.S. corporate tax return showing the income and deductions with respect to the per diem rentals along with its other effectively connected income and deductions. On the other hand, if the per diem is not effectively connected with a trade or business in the United States, the payments are subject to a 15-percent tax on the gross amount of the payments (the 15-percent rate of tax is provided for in the United States-Canadian Income Tax Convention and is a reduction from the 30-percent rate which is imposed under the Internal Revenue Code). Since the per diem system basically compensates a railroad for its cost with respect to the rolling stock, a 15-percent tax on the gross amount of the per diem quite often is a larger amount than the net income (if any) which the Canadian railroad derives from the use of the rolling stock by the U.S. railroad.

It is noted that until the end of last year the Canadian Government did not impose any tax upon the payment by a Canadian railroad to a U.S. railroad for the use of the U.S. railroad's rolling stock in Canada. While the Canadian Government has changed its law in this respect, it has indicated its willingness to grant a reciprocal exemption in this area.

The committee recognizes that it is difficult to allocate income with respect to activities or services where the activities and services are performed across the border of two countries. Further, the committee believes that it is unfair to impose a tax on the gross amount of a payment where the payee is incurring substantial costs in connection with earning of the income. These problems have been eliminated in connection with other transportation industries. For example, the Internal Revenue Code, as well as the U.S.-Canadian Tax Convention, provides for a reciprocal exemption of earnings from air and ship transportation. In addition, the U.S.-Canadian Tax Convention provides for a reciprocal exemption for truck transportation. At the time that the reciprocal exemption for truck transportation was added to the U.S.-Canadian Tax Convention no provision was made for railroad transportation since at that time there was no problem.[2]

The committee believes it is appropriate that the interchange of rolling stock take place without the imposition of tax impediments which unduly restrict the interchange. Accordingly, the committee eliminates on a reciprocal basis the gross tax on payments made for the use of railroad rolling stock.

The committee amendment adds a reciprocal exemption (similar to the one for ships and aircraft) for earnings derived from payments by a common carrier for the use on a temporary basis of railroad rolling stock which is owned by a corporation of a foreign country which grants an equivalent exemption to U.S. corporations. The exemption is to apply only for rentals on a temporary basis which are not expected to exceed a total of 90 days in any taxable year. The term "rolling stock" means locomotives, freight and passenger train cars, floating equipment, miscellaneous transportation equipment on wheels

[2] Hearings before the Committee on Foreign Relations, United States Senate, 85th Congress, 1st Session, on income tax convention with Canada (Ex. B., 85th Cong., 1st Session) on July 30, 1957, at page 5.

and containers which are used for shipping purposes, the expenditures for which are chargeable (or, in the case of leased property, would be chargeable) to the equipment investment accounts in the uniform system of accounts for railroad companies prescribed by the Interstate Commerce Commission. In order to make this provision fully reciprocal with the provisions of Canadian law, the committee amendment is to apply to payments made after November 18, 1974.

IV. Tax-Exempt Status of Obligations Used To Provide Certain Irrigation Facilities

Present law provides that interest on obligations of State and local governments generally is exempt from Federal income tax. In 1968 tax-exempt status was withdrawn from industrial development bonds which State and local governments were using to finance and attract private industrial development within their jurisdictions.

Industrial development bonds are generally considered to be State or local obligations, a major portion of the proceeds of which are to be used in, and repaid by, a taxable trade or business. Such bonds are normally issued to acquire a facility for private business in which the beneficial ownership of the facility remains in the private trade or business, although (in order to secure repayment of the bonds) legal title normally remains with the State or local unit issuing the obligations.

When the industrial development bond limitation was enacted, exceptions were provided for certain small issues (sec. 103(c)(6)) and for certain specified public activities (sec. 103(c)(4)) in which cases tax-exempt status was continued. As initially enacted, one of the public activities for which an exemption was provided (sec. 103(c)(4)(E)) was "sewage or solid waste disposal facilities or facilities for the local furnishing of electric energy, gas or water."

In 1971, Congress amended the exception in subparagraph (E) to delete "water" and added the present law subparagraph (G) which extends the exception to "facilities for the furnishing of water, if available on reasonable demand to members of the general public."

As a result, in those cases where obligations are issued for facilities for the furnishing of water which meet the exception (under sec. 103(c)(4)(G)) but where the water is also used to generate electricity, it is uncertain as to whether the obligations would qualify for exempt status unless the use of the electric energy meets the "local" furnishing test (under sec. 103(c)(4)(E)), which has been interpreted to cover an area of two contiguous counties.

The American Falls Reservoir District applied to the Internal Revenue Service in June 1974 for a ruling that bonds to be issued to finance the replacement and rehabilitation of the American Falls Dam would qualify as a tax-exempt issue under section 103(c)(4)(G). The Internal Revenue Service, however, had questions of interpretation with respect to the interrelationship of the exceptions for facilities for furnishing of water and the local furnishing of electric energy and their application to the specific facts of this case. The committee reviewed the facts involved, as described below, and believed it is appropriate to specifically except the bond issue in this case as a result of the special circumstances.

The original American Falls Dam was constructed in 1927 by the Bureau of Reclamation. The dam was restricted to two-thirds of its 1.7 million acre foot capacity in 1972 by the Bureau of Reclamation of the Department of the Interior for safety reasons because of excessive pressures on the dam which were caused by an alkali-aggregate reaction and deterioration in the concrete.

Legislation was enacted on December 28, 1973, to permit replacement and rehabilitation of the American Falls Dam by the American Falls Reservoir District, which is a political subdivision of the State of Idaho. Replacement of the existing dam by the American Falls Reservoir District is an action to be taken in lieu of waiting for a Federal appropriation that would enable the Bureau of Reclamation to build the replacement dam.

The Act of December 28, 1973, also provides that upon completion of construction the United States shall take title to the dam as a feature of the Minidoka Project, located in the upper Snake River basin, Idaho.

As the constructing agent, the American Falls Reservoir District was authorized to contract with an electric utility for the use of the falling water at the dam for hydroelectric power generation. Revenues from such a contract will help defer the costs of constructing the dam. Prior to the adoption of the Act of December 28, 1973, the Idaho Power Company, which is a spaceholder in the reservoir and which owns and operates a powerplant below the existing dam, expressed interest in the execution of a falling water contract. Subsequent to the adoption of the Act, the District, as the constructing agency, entered into negotiations with the Secretary of the Interior, the Idaho Power Company and the other water users for the preparation of various contracts including a contract for the use of falling water.

It was intended that in normal circumstances substantially all of the falling water would be made available to the Power Company only when water was released from the dam for irrigation purposes. There has been no intention to release water specifically for use by the Idaho Power Company to generate electricity, except for 45,000 acre-feet (2.65 percent of the storage capacity) whose release the power company, in its capacity as a space holder in the irrigation district, can schedule for the purpose of generating electric energy. Thus, the use of water for electric energy would be subordinated to the use of the water for irrigation.

Although the Federal Government might well eventually completely finance the reconstruction of the American Falls Dam, the American Falls Reservoir District is undertaking the reconstruction now in order to make the dam fully operational for the spaceholders (rather than the present restricted two-thirds capacity). If it were not for the use of the water by the Idaho Power Company for hydroelectric power generation, any bonds issued by the Reservoir District would presently qualify for tax-exempt status. In this case the Idaho Power Company has a limited spaceholder right (under 3 percent) and is financing a large portion of the debt to assist the reconstruction of the dam and has use of the falling water for its hydroelectric power generation purposes. In addition, since the dam is to be turned over to the Federal Government after its reconstruction for ownership and operation, in effect, this financing can be viewed as saving the Federal Government

the expenditure it would have had to make to reconstruct the dam several years in the future. In view of these special circumstances, the committee believes it is appropriate to extend tax-exempt status to the bonds to be issued to finance the reconstruction of the dam.

The committee amendment adds a new exception to industrial development bond treatment to specifically allow tax-exempt status for the bonds issued to reconstruct the American Falls Dam. This exception is to apply to obligations for a dam which furnishes water for irrigation purposes which has a subordinate use in connection with the generation of electric energy by water if substantially all of the stored water is contractually available for release from the dam for irrigation purposes and if the water released is available on reasonable demand for members of the general public.

The committee intends that subordinate use of water for generating electric energy means that less than 10 percent of the normal supply of stored water may contractually be scheduled for release by the power company and used for generating electric energy. Normal refers to conditions that generally prevail in the service area of this reservoir, and it is recognized that unusually wet or dry weather can cause a significant distortion in the 2.65 percent of water contractually scheduled for release to be used for generating electric energy. The committee intends that such unusual circumstances not be guiding in determining the subordinate use of water. In addition, normal use does not include a temporary increase in water released for the power company following contractual default by a spaceholder and his water share being made available to other spaceholders under the terms of the contract for the construction and operation of the dam and its facilities.

Thus, the provision applies the requirements of subsection (c)(4)(G) where substantially all of the stored water (under normal weather and climatic conditions) is available for release to be used for irrigation in the American Falls Reservoir District. The requirement that the released water be available on reasonable demand to members of the general public is retained in the new subsection (e). The committee understands that the American Falls project conforms with this requirement.

The committee amendment is to apply to obligations issued after the date of the enactment of this Act.

V. Costs of Carrying Out the Bill and Effect on the Revenues of the Bill

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made relative to the costs to be incurred in carrying out this bill and the effect on the revenues of the bill.

The extension of the existing suspension of duties on certain silk yarns provided by the bill would not result in any additional loss in revenues or administrative costs. The committee estimates that the reciprocal exemption for railroad rolling stock will result in an annual revenue loss of less than $2.5 million. The committee also estimates that the provision relating to the tax-exempt status of obligations used to provide certain irrigation facilities will result in an annual revenue loss of about $1 million in each of the five fiscal

years following the current fiscal year. No revenue loss is expected in the current fiscal year.

VI. Vote of Committee in Reporting the Bill

In compliance with section 133 of the Legislative Reorganization Act, as amended, the following statement is made relative to the vote of the committee on reporting the bill. This bill was ordered favorably reported by the committee without a rollcall vote and without objection.

VII. Changes in Existing Law

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in *italic*, existing law in which no change is proposed is shown in roman):

TARIFF SCHEDULES OF THE UNITED STATES

APPENDIX TO THE TARIFF SCHEDULES

Item	Articles	Rates of duty		Effective period
		1	2	
	PART 1.—TEMPORARY LEGISLATION			
*	* * *	*	*	* *
	Subpart B.—Temporary Provisions Amending the Tariff Schedules			
*	* * *	*	*	* *
905.30	Yarns, wholly of noncontinuous silk fibers (provided for in part 1D, schedule 9): Singles, not bleached and not colored, measuring over 58,050 yards per pound (not over 308,400)	Free	Free	On or before [11/7/75] *6/30/78*
905.31	Plied, not bleached and not colored, measuring over 29,400 yards per pound (item 308.50)	Free	Free	On or before [11/7/75] *6/30/78*
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INTERNAL REVENUE CODE OF 1954

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Chapter 1—Normal Taxes and Surtaxes

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Subchapter B—Computation of Taxable Income

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Part III—Items Specifically Excluded From Gross Income

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Sec. 103. Interest on Certain Governmental Obligations.

(a) General Rule.—Gross income does not include interest on—

(1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia;

(2) the obligations of the United States; or

(3) the obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States and if under the respective Acts authorizing the issue of the obligations the interest is wholly exempt from the taxes imposed by this subtitle.

(b) EXCEPTION.—Subsection (a) (2) shall not apply to interest on obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit, to the extent they represent deposits made before March 1, 1941), unless under the respective Acts authorizing the issuance thereof such interest is wholly exempt from the taxes imposed by this subtitle.

(c) INDUSTRIAL DEVELOPMENT BONDS.—

(1) SUBSECTION (a) (1) NOT TO APPLY.—Except as otherwise provided in this subsection, any industrial development bond shall be treated as an obligation not described in subsection (a) (1).

(2) INDUSTRIAL DEVELOPMENT BOND.—For purposes of this subsection, the term "industrial development bond" means any obligation—

(A) which is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not an exempt person (within the meaning of paragraph (3)), and

(B) the payment of the principal or interest on which (under the terms of such obligation or any underlying arrangement) is, in whole or in major part—

(i) secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or

(ii) to be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.

(3) EXEMPT PERSON.—For purposes of paragraph (2) (A), the term "exempt person" means—

(A) a governmental unit, or

(B) an organization described in section 501(c)(3) and exempt from tax under section 501(a) (but only with respect to a trade or business carried on by such organization which is not an unrelated trade or business, determined by applying section 513(a) to such organization).

(4) CERTAIN EXEMPT ACTIVITIES.—Paragraph (1) shall not apply to any obligation which is issued as part of an issue substantially all of the proceeds of which are to be used to provide—

(A) residential real property for family units,

(B) sports facilities,

(C) convention or trade show facilities,

(D) airports, docks, wharves, mass commuting facilities, parking facilities, or storage or training facilities directly related to any of the foregoing.

(E) sewage or solid waste disposal facilities or facilities for the local furnishing of electric energy or gas,

(F) air or water pollution control facilities, or

(G) facilities for the furnishing of water, if available on reasonable demand to members of the general public.

(5) INDUSTRIAL PARKS.—Paragraph (1) shall not apply to any obligation issued as part of an issue substantially all of the proceeds of which are to be used for the acquisition or development of land as the site for an industrial park. For purposes of the preceding sentence, the term "development of land" includes the provision of water, sewage, drainage, or similar facilities, or of transportation, power, or communication facilities, which are incidental to use of the site as an industrial park, but, except with respect to such facilities, does not include the provision of structures or buildings.

(6) EXEMPTION FOR CERTAIN SMALL ISSUES.—

(A) IN GENERAL.—Paragraph (1) shall not apply to any obligation issued as part of an issue the aggregate authorized face amount of which is $1,000,000 or less and substantially all of the proceeds of which are to be used (i) for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation, or (ii) to redeem part or all of a prior issue which was issued for purposes described in clause (i) or this clause.

(B) CERTAIN PRIOR ISSUES TAKEN INTO ACCOUNT.—If—

(i) the proceeds of two or more issues of obligations (whether or not the issuer of each such issue is the same) are or will be used primarily with respect to facilities located in the same incorporated municipality or located in the same county (but not in any incorporated municipality),

(ii) the principal user of such facilities is or will be the same person or two or more related persons, and

(iii) but for this subparagraph, subparagraph (A) would apply to each such issue,

then, for purposes of subparagraph (A), in determining the aggregate face amount of any later issue there shall be taken into account the face amount of obligations issued under all prior such issues and outstanding at the time of such later issue (not including as outstanding any obligation which is to be redeemed from the proceeds of the later issue).

(C) RELATED PERSONS.—For purposes of this paragraph and paragraph (7), a person is a related person to another person if—

(i) the relationship between such persons would result in a disallowance of losses under section 267 or 707(b), or

(ii) such persons are members of the same controlled group of corporations (as defined in section 1563(a), except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein).

(D) $5,000,000 LIMIT IN CERTAIN CASES.—At the election of the issuer, made at such time and in such manner as the Secretary or his delegate shall by regulations prescribe, with respect to any issue this paragraph shall be applied—

(i) by substituting "$5,000,000" for "$1,000,000" in subparagraph (A), and

(ii) in determining the aggregate face amount of such issue, by taking into account not only the amount described in subparagraph (B), but also the aggregate amount of capital expenditures with respect to facilities described in subparagraph (E) paid or incurred during the 6-year period beginning 3 years before the date of such issue and ending 3 years after such date (and financed otherwise than out of the proceeds of outstanding issues to which subparagraph (A) applied), as if the aggregate amount of such capital expenditures constituted the face amount of a prior outstanding issue described in subparagraph (B).

(E) FACILITIES TAKEN INTO ACCOUNT.—For purposes of subparagraph (D)(ii), the facilities described in this subparagraph are facilities—

(i) located in the same incorporated municipality or located in the same county (but not in any incorporated municipality), and

(ii) the principal user of which is or will be the same person or two or more related persons.

For purposes of clause (i), the determination of whether or not facilities are located in the same governmental unit shall be made as of the date of issue of the issue in question.

(F) CERTAIN CAPITAL EXPENDITURES NOT TAKEN INTO ACCOUNT.—For purposes of subparagraph (D)(ii), any capital expenditure—

(i) to replace property destroyed or damaged by fire, storm, or other casualty, to the extent of the fair market value of the property replaced,

(ii) required by a change made after the date of issue of the issue in question in a Federal or State law or local ordinance of general application or required by a change made after such date in rules and regulations of general application issued under such a law or ordinance, or

(iii) required by circumstances which could not be reasonably foreseen on such date of issue or arising out of a mistake of law or fact (but the aggregate amount of expenditures not taken into account under this clause with respect to any issue shall not exceed $1,000,000),

shall not be taken into account.

(G) LIMITATION ON LOSS OF TAX EXEMPTION.—In applying subparagraph (D)(ii) with respect to capital expenditures made after the date of any issue, no obligation issued as a part of such issue shall be treated as an obligation not described in subsection (a)(1) by reason of any such expenditure for any period before the date on which such expenditure is paid or incurred.

(H) CERTAIN REFINANCING ISSUES.—In the case of any issue described in subparagraph (A)(ii), an election may be made under subparagraph (D) only if all of the prior issues being redeemed are issues to which subparagraph (A) applies. In applying subparagraph (D)(ii) with respect to such a refinancing issue, capital expenditures shall be taken into ac-

count only for purposes of determining whether the prior issues being redeemed qualified (and would have continued to qualify) under subparagraph (A).

(7) EXCEPTION.—Paragraphs (4), (5), and (6) shall not apply with respect to any obligation for any period during which it is held by a person who is a substantial user of the facilities or a related person.

(d) ARBITRAGE BONDS.—

(1) SUBSECTION (a)(1) NOT TO APPLY.—Except as provided in this subsection, any arbitrage bond shall be treated as an obligation not described in subsection (a)(1).

(2) ARBITRAGE BOND.—For purposes of this subsection, the term "arbitrage bond" means any obligation which is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly—

(A) to acquire securities (within the meaning of section 165(g)(2)(A) or (B)) or obligations (other than obligations described in subsection (a)(1)) which may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue which is materially higher (taking into account any discount or premium) than the yield on obligations of such issue. or

(B) to replace funds which were used directly or indirectly to acquire securities or obligations described in subparagraph (A).

(3) EXCEPTION.—Paragraph (1) shall not apply to any obligation—

(A) which is issued as part of an issue substantially all of the proceeds of which are reasonably expected to be used to provide permanent financing for real property used or to be used for residential purposes for the personnel of an educational institution (within the meaning of section 151(e)(4)) which grants baccalaureate or higher degrees, or to replace funds which were so used, and

(B) the yield on which over the term of the issue is not reasonably expected, at the time of issuance of such issue, to be substantially lower than the yield on obligations acquired or to be acquired in providing such financing.

This paragraph shall not apply with respect to any obligation for any period during which it is held by a person who is a substantial user of property financed by the proceeds of the issue of which such obligation is a part, or by a member of the family (within the meaning of section 318(a)(1) of any such person.

(4) SPECIAL RULES.—For purposes of paragraph (1), an obligation shall not be treated as an arbitrage bond solely by reason of the fact that—

(A) the proceeds of the issue of which such obligation is a part may be invested for a temporary period in securities or other obligations until such proceeds are needed for the purposes for which such issue was issued, or

(B) an amount of the proceeds of the issue of which such obligation is a part may be invested in securities or other ob-

ligations which are part of a reasonably required reserve or replacement fund.

The amount referred to in subparagraph (B) shall not exceed 15 percent of the proceeds of the issue of which such obligation is a part unless the issuer establishes that a higher amount is necessary.

(5) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this subsection.

(e) CERTAIN IRRIGATION DAMS.—A dam for the furnishing of water for irrigation purposes which has a subordinate use in connection with the generation of electric energy by water shall be treated as meeting the requirements of subsection (c)(4)(G) if—

(1) substantially all of the stored water is contractually available for release from such dam for irrigation purposes, and

(2) the water so released is available on reasonable demand to members of the general public.

[(e)] (f) CROSS REFERENCES.—

For provisions relating to the taxable status of—

(1) Bonds and certificates of indebtedness authorized by the First Liberty Bond Act, see sections 1 and 6 of that Act (40 Stat. 35, 36; 31 U.S.C. 746, 755);

(2) Bonds issued to restore or maintain the gold reserve, see section 2 of the Act of March 14, 1900 (31 Stat. 46; 31 U.S.C. 408);

(3) Bonds, notes, certificates of indebtedness, and Treasury bills authorized by the Second Liberty Bond Act, see sections 4, 5 (b) and (d), 7, 18 (b) and 22(d) of that Act as amended (40 Stat. 290; 46 Stat. 20, 775; 40 Stat. 291, 1310; 55 Stat. 8; 31 U.S.C. 752a, 754, 747, 753, 757c);

(4) Bonds, notes, and certificates of indebtedness of the United States and bonds of the War Finance Corporation owned by certain nonresidents, see section 3 of the Fourth Liberty Bond Act, as amended (40 Stat. 1311, § 4; 31 U.S.C. 750);

(5) Certificates of indebtedness issued after February 4, 1910, see section 2 of the Act of that date (36 Stat. 192; 31 U.S.C. 769);

(6) Consols of 1930, see section 11 of the Act of March 14, 1900 (31 Stat. 48; 31 U.S.C. 751);

(7) Obligations and evidences of ownership issued by the United States or any of its agencies or instrumentalities on or after March 28, 1942, see section 4 of the Public Debt Act of 1941, as amended (c. 147, 61 Stat. 180; 31 U.S.C. 742a);

(8) Commodity Credit Corporation obligations, see section 5 of the Act of March 8, 1938 (52 Stat. 108; 15 U.S.C. 713a-5);

(9) Debentures issued by Federal Housing Administrator, see sections 204(d) and 207(i) of the National Housing Act, as amended (52 Stat. 14, 20; 12 U.S.C. 1710, 1713);

(10) Debentures issued to mortgages by United States Maritime Commission, see section 1105(c) of the Merchant Marine Act, 1936, as amended (52 Stat. 972; 46 U.S.C. 1275);

(11) Federal Deposit Insurance Corporation obligations, see

section 15 of the Federal Deposit Insurance Act (64 Stat. 890; 12 U.S.C. 1825);

(12) Federal Home Loan Bank obligations, see section 13 of the Federal Home Loan Bank Act, as amended (49 Stat. 295, § 8; 12 U.S.C. 1433);

(13) Federal savings and loan association loans, see section 5 (h) of the Home Owners' Loan Act of 1933, as amended (48 Stat. 133; U.S.C. 1464);

(14) Federal Savings and Loan Insurance Corporation obligations, see section 402(e) of the National Housing Act (48 Stat. 1257; 12 U.S.C. 1725);

(15) Home Owners' Loan Corporation bonds, see section 4(c) of the Home Owners' Loan Act of 1933, as amended (48 Stat. 644, c. 168; 12 U.S.C. 1463);

(16) Obligations of Central Bank for Cooperatives, production credit corporations, production credit associations, and banks for cooperatives, see section 63 of the Farm Credit Act of 1933 (48 Stat. 267; 12 U.S.C. 1138c);

(17) Panama Canal bonds, see section 1 of the Act of December 21, 1904 (34 Stat. 5; 31 U.S.C. 743), section 8 of the Act of June 28, 1902 (32 Stat. 484; 31 U.S.C. 744), and section 39 of the Tariff Act of 1909 (36 Stat. 117; 31 U.S.C. 745);

(18) Philippine bonds, etc., issued before the independence of the Philippines, see section 9 of the Philippine Independence Act (48 Stat. 463; 48 U.S.C. 1239);

(19) Postal savings bonds, see section 10 of the Act of June 25, 1910 (36 Stat. 817; 39 U.S.C. 760);

(20) Puerto Rican bonds, see section 3 of the Act of March 2, 1917, as amended (50 Stat. 855; 48 U.S.C. 745);

(21) Treasury notes issued to retire national bank notes, see section 18 of the Federal Reserve Act (38 Stat. 268; 12 U.S.C. 447);

(22) United States Housing Authority obligations, see sections 5(e) and 20(b) of the United States Housing Act of 1937 (50 Stat. 890, 898; 42 U.S.C. 1405, 1420);

(23) Virgin Islands insular and municipal bonds, see section 1 of the Act of October 27, 1949 (63 Stat. 940; 48 U.S.C. 1403).

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SUBCHAPTER N—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

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PART II—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

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Subpart B—Foreign Corporations

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SEC. 883. EXCLUSIONS FROM GROSS INCOME.

(a) INCOME OF FOREIGN CORPORATIONS FROM SHIPS AND AIRCRAFT.—The following items shall not be included in gross income of a foreign corporation, and shall be exempt from taxation under this subtitle:

(1) SHIPS UNDER FOREIGN FLAG.—Earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(2) AIRCRAFT OF FOREIGN REGISTRY.—Earnings derived from the operation of aircraft registered under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(3) RAILROAD ROLLING STOCK OF FOREIGN CORPORATIONS.—Earnings derived from payments by a common carrier for the use on a temporary basis (not expected to exceed a total of 90 days in any taxable year) of railroad rolling stock owned by a corporation of a foreign country which grants an equivalent exemption to corporations organized in the United States.

(b) EARNINGS DERIVED FROM COMMUNICATIONS SATELLITE SYSTEM.—The earnings derived from the ownership or operation of a communications satellite system by a foreign entity designated by a foreign government to participate in such ownership or operation shall be exempt from taxation under this subtitle, if the United States, through its designated entity, participates in such system pursuant to the Communications Satellite Act of 1962 (47 U.S.C. 701 and following).

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