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INTEREST EQUALIZATION TAX EXTENSION ACT OF 1967

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HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETIETH CONGRESS

FIRST SESSION

ON

H.R. 6098

AN ACT TO PROVIDE AN EXTENSION OF THE INTEREST EQUALIZATION TAX, AND FOR OTHER PURPOSES

JULY 14 AND 17, 1967

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CONTENTS

	Page
Text of H.R. 6098 (as passed by the House)	3
Text of H.R. 6098 (containing amendments recommended by the Treasury Department)	113

WITNESSES

Calvin, Donald L., vice president, New York Stock Exchange, accompanied by— Lyons, Sam B., Washington consultant; and West, Stan, director of research	171
Cohen, Paul C., partner, Stein Roe & Farnham	91
Deming, Hon. Frederick L., Under Secretary of the Treasury, accompanied by— Knowlton, Hon. Winthrop, Assistant Secretary for International Affairs; and Surrey, Hon. Stanley S., Assistant Secretary, Department of the Treasury	25
Froy, Henri L., chairman, foreign committee, National Association of Securities Dealers, Inc., accompanied by— Wilson, Frank J., associate general counsel, National Association of Securities Dealers, Inc	99
Investment Bankers Association of America, Robert F. Seebeck, former chairman, foreign investment committee	161
National Association of Securities Dealers, Inc., Henri L. Froy, chairman, foreign committee, accompanied by— Wilson, Frank J., associate general counsel	99
New York Stock Exchange, Donald L. Calvin, vice president, accompanied by— Lyons, Sam B., Washington consultant; and West, Stan, director of research	171
Purvis, Ralph E., Bremerton, Wash	85
Seebeck, Robert F., former chairman, foreign investment committee, Investment Bankers Association of America	161
Stein Roe & Farnham, Paul C. Cohen, partner	91

COMMUNICATIONS

American Stock Exchange, letter of Ralph S. Saul, president, to the chairman	240
Anderson, B. M., vice president and counsel, Connecticut General Life Insurance Co., letter to the chairman	238
Association of Stock Exchange Firms, statement of, submitted by Sam B. Lyons	208
Bankers' Association for Foreign Trade, Alfred H. Von Klemperer, president, letter with attachments, to the chairman	195
Bankers Trust Co., Robert H. Brome, senior vice president and general counsel, statement	206
Brandes, Bernard E., Stroock & Stroock & Lavan, letter to the chairman	220
British-American Oil Co., statement	235
British Assets Trust Ltd., James Gammell, statement	224
Brome, Robert H., senior vice president and general counsel, Bankers Trust Co., statement	206
Carter, Roger M., attorney, statement	239
Chamber of Commerce of the United States, statement submitted by Don A. Goodall, general manager, legislative action	232
Chrysler Corp., letter of Edward A. Sigler, tax affairs, to the chairman	236

	Page
Connecticut General Life Insurance Co., letter of B. M. Anderson, vice president and counsel, to the chairman	238
First Boston Corp., the, letter of Arthur R. Taylor, vice president, to Will E. Leonard, Jr., professional staff member, Committee on Finance	218
Fitchen, Paul R., executive vice president, New York Clearing House Association, statement	226
Fuchs, Harry B., letter to the chairman	219
Funston, G. Keith, president, New York Stock Exchange, statement	176
Gammell, James, British Assets Trust Ltd., Edinburgh, Scotland, statement	224
Goodall, Don A., general manager, legislative action, Chamber of Commerce of the United States, statement	232
Hill Samuel & Co., Ltd., telegram of Peter Kirwan-Taylor, director, to Tom Vail, chief counsel, Committee on Finance	242
International Federation of Stock Exchanges, letter and enclosure of August Ribi, president, to the chairman	219
Jenks, Thomas E., Lee, Toomey & Kent, statement	200
Kirwan-Taylor, Peter, director, Hill Samuel & Co., Ltd., telegram to Tom Vail, chief counsel, Committee on Finance	242
Lee, Toomey & Kent, Thomas E. Jenks, statement	200
Lyons, Sam B., statement submitted for the Association of Stock Exchange Firms	208
Martin, Justin M., statement filed on behalf of Justin Martin & Co	242
McClure, William P., McClure & Trotter, letter to the chairman	217
National Foreign Trade Council, Inc., statement submitted by Robert T. Scott, director, tax-legal division	227
New York Clearing House Association, Paul R. Fitchen, executive vice president, statement	226
New York Stock Exchange, statement of G. Keith Funston, president	176
Reinhardt, George, letter to the committee, with attachments	202
Ribi, August, president, International Federation of Stock Exchanges, letter and enclosure to the chairman	219
Saul, Ralph S., president, American Stock Exchange, letter to the chairman	240
Schenck, Charles N., III, Wiggin & Dana, letter to the chairman	226
Scott, Robert T., director, tax-legal division, National Foreign Trade Council, Inc., statement submitted	227
Sigler, Edward A., tax affairs, Chrysler Corp., letter to the chairman	236
Stroock & Stroock & Lavan, letter of Bernard E. Brandes, to the chairman	220
Surrey, Hon. Stanley S., Assistant Secretary, Department of the Treasury, letters to the chairman: dated July 17, 1967	157
Taylor, Arthur A., vice president, the First Boston Corp., letter to Will E. Leonard, Jr., professional staff member, Committee on Finance	218
Von Klemperer, Alfred H., president, Bankers' Association for Foreign Trade, letter with attachments, to the chairman	195
Wiggin & Dana, letter of Charles N. Schenck, III, to the chairman	226
Woloch, Michael, Montreal, Canada, letter to the chairman	199

ARTICLES

"A Serious Error of Policy," London Times, June 27, 1967	169
"Congress Seems Likely To Change Tax Law on Foreign Stock Purchases by Americans," Wall Street Journal, July 3, 1967	192
"Foreign Stocks Yield a Fast Buck," Business Week, July 15, 1967	108
"Stock-Tax Dodge," Wall Street Journal, June 30, 1967	190
"Tax Credit Loophole Plug Sought," Journal of Commerce, July 5, 1967	194

ADDITIONAL INFORMATION

Amendments to H.R. 6098, to effect recommendations of the Treasury Department with respect to compliance procedures	80
Recommended amendments to the proposed Interest Equalization Tax Extension Act of 1967 (Attachment A)	41
Summary of H.R. 6098 as passed by the House, prepared by the staff of the committee	1

INTEREST EQUALIZATION TAX EXTENSION ACT OF 1967

FRIDAY, JULY 14, 1967

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

The committee met, pursuant to notice, at 10:10 a.m., in room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Smathers, Talmadge, and Williams.

The CHAIRMAN. The hearing will come to order.

This hearing was called to enable interested parties to inform the committee with respect to the proposal to extend the interest equalization tax and to increase its rate. The President has recommended that this be done, and that he be empowered to vary the rates of tax in such a way as to best achieve the balance-of-payments objective of the United States.

The House bill continues the tax for 2 additional years until July 31, 1969. It also temporarily increases the tax on foreign stock purchases from 15 percent to 22½ percent and makes corresponding increases in the rates applicable to foreign debt obligations. Finally, it authorizes the President to vary the tax rates between these ranges by Executive order.

Since the bill passed the House earlier this year, the Treasury Department has detected instances in which foreign securities have been sold to U.S. persons in avoidance of the interest equalization tax through the use of false certificates of prior American ownership. Since detecting this avoidance, the Treasury Department has been devising procedures to deal with it.

(A summary and the bill, H.R. 6098, follow:)

SUMMARY OF H.R. 6098, INTEREST EQUALIZATION TAX EXTENSION ACT OF 1967, PREPARED BY THE COMMITTEE STAFF

Present Law.—The interest equalization tax is imposed on purchases of foreign stocks and debt obligations by U.S. persons (i.e., U.S. citizens and residents, domestic corporations, and domestic partnerships). In the case of stock the tax is 15 percent of the value of the stock; in the case of debt obligations (including bank loans) it ranges upwards from 1.05 percent if the maturity is between one and one-and-a-quarter years to 15 percent if the maturity is 28½ years or longer.

There are exemptions for purchases by U.S. persons of stock and debt obligations held by other U.S. persons. Also there are exemptions for less- developed country securities, and for securities acquired in connection with U.S. imports of raw material and U.S. exports. Finally, there are exemptions for certain new issues of Canadian and Japanese securities marketed in this country.

This tax, which was enacted in 1964 (but effective as of July 19, 1963), to deter the outflow of U.S. capital and thereby help the U.S. balance of payments, is scheduled to terminate as of July 31, 1967.

Extension of Tax.—H.R. 6098 continues the interest equalization tax for two additional years, until July 31, 1969.

Increase in Rates.—The bill also increases the interest equalization tax rates by about 50 percent for the period beginning January 26, 1967 (when the President's message was received) and ending 29 days after the date of enactment of

the bill. Instead of ranging between 1.05 percent for debt obligations with maturities of 1 year and 15 percent if the maturity is 28½ years or longer, the rates during this interval would range between 1.58 percent and 22.5 percent depending on the maturity. In the case of stock the rate would be increased from 15 percent of the value of the stock to 22.5 percent of such value.

At the end of this period the original rates would again apply.

Executive Authority to Vary Rates.—H.R. 6098 delegates to the President authority to vary the interest equalization tax rates by increasing them up to 50 percent above the present rates—and by lowering them back down to the levels of present law—if he determines that such changes are necessary "to limit the total acquisition by United States persons of stock of foreign issuers and debt obligations of foreign obligors within a range consistent with the balance of payments objectives of the United States." This authority (effective 30 days after enactment of the bill) would be exercised by Executive Order. In the case of stock the tax rate could be varied between 15 percent and 22.5 percent. For debt obligations the tax rates could be varied between 1.05 percent and 1.58 percent if the maturity is 1 year and between 15 percent and 22.5 percent if the maturity is 28½ years or longer.

Foreign Real Property Sales.—The bill provides an exemption from the interest equalization tax where foreign debt obligations are acquired by a U.S. person in connection with the sale of foreign real property which he held on July 18, 1963. (Debt obligations acquired in connection with a sale of tangible property held for personal use are already exempt from the tax.) This new exemption would apply only to debt obligations acquired on or after the date of enactment of the bill.

Resident Aliens.—The bill provides an exemption from the interest equalization tax for foreign stock or debt obligations acquired by resident alien during the first 90 days he is a resident of this country. (Resident aliens are U.S. persons for purposes of the tax.) Under the provision in the bill securities acquired tax-free during this 90-day period could not be resold to a U.S. person without payment of the tax. This exemption applied to acquisitions after July 18, 1963.

Substitute Contracts.—The bill permits foreign debt obligations to be acquired tax-free in connection with the sale by a U.S. person of foreign ores and minerals under a contract which substitutes for an original contract existing on July 18, 1963. (The acquisition would be tax-free under existing law if the sale occurred under the original contract.) This provision applies only to acquisitions on or after the date of enactment of the bill.

Penalties.—H.R. 6093 relaxes the penalty for failure to timely file notices of acquisitions of new Canadian issues during the period July 18, 1963 through October 9, 1965. These securities are tax free under Executive Order but failure to file a timely notice in effect cancels the exemption and thereby imposes a 100-percent penalty. Since October 9, 1965, the penalty for failure to timely file the required notice is 5 percent of the exemption for each 30 days delay, up to a maximum of 25 percent.

The House bill makes this same lower penalty applicable for the period before October 10, 1965. In addition, State and local governments which acquired these securities in the past, but failed to file the required notices, are given 60 days after the date of enactment to file such notice and makes the penalty inapplicable.

U.S. Dealers.—At present a U.S. dealer who acquires foreign debt obligations and sells them to another U.S. dealer may obtain credit or refund of the interest equalization tax if the second dealer resells them to a foreigner on the same day or the next business day. The bill increases the period the second dealer may hold the debt obligations from 1 day to 30 days, effective January 26, 1967.

Lending or Finance Business.—Under the bill, a U.S. corporation engaged abroad in the business of making personal-type loans with maturities up to 4 years, may elect to be treated as a foreign corporation and thus not be subject to the interest equalization tax with respect to such loans. Presumably, these loans are made in foreign currency derived from foreign sources and do not affect the U.S. balance of payments. The election would apply as of January 26, 1967.

Financing of Export Transactions.—Under the bill, a U.S. corporation engaged in the business of making loans to foreigners to finance the purchase of property or services from the U.S. may elect to be treated as a foreign corporation and thus not subject to the interest equalization tax with respect to such loans if the money it uses in making its loans is acquired solely from the sale of its own debt obligations to foreigners. An election must be made within 60 days after the date of enactment of the bill and would be effective from the date it is made.

90TH CONGRESS
1ST SESSION

H. R. 6098

IN THE SENATE OF THE UNITED STATES

MARCH 16, 1967
Read twice and referred to the Committee on Finance

AN ACT

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

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. SHORT TITLE, ETC.**
4 (a) SHORT TITLE.—This Act may be cited as the "In-
5 terest Equalization Tax Extension Act of 1967".
6 (b) AMENDMENT OF 1954 CODE.—Except as other-
7 wise expressly provided, whenever in this Act an amend-

1 ment is expressed in terms of an amendment to a section or
2 other provision, the reference is to a section or other provi-
3 sion of the Internal Revenue Code of 1954.

4 **SEC. 2. EXTENSION OF INTEREST EQUALIZATION TAX.**

5 Section 4911 (d) is amended by striking out "July 31,
6 1967" and inserting in lieu thereof "July 31, 1969".

7 **SEC. 3. IMPOSITION OF TAX.**

8 (a) AMOUNT OF TAX.—Section 4911 (b) is amended
9 to read as follows:

10 "(b) AMOUNT OF TAX.—

11 "(1) RATES OF TAX.—Except as provided in para-
12 graphs (2) and (3)—

13 "(A) STOCK.—The tax imposed by subsection
14 (a) on the acquisition of stock shall be equal to 15
15 percent of the actual value of the stock.

16 "(B) DEBT OBLIGATIONS.—The tax imposed
17 by subsection (a) on the acquisition of a debt obli-
18 gation shall be equal to a percentage of the actual
19 value of the debt obligation measured by the period

3

1 remaining to its maturity and determined under
2 column II (A) of the following table:

"I "If the period remaining to maturity is—	II The tax, as a percentage of actual value, is—	
	(A)	(B)
At least 1 year, but less than 1¼ years	1.05	1.58
At least 1¼ years, but less than 1½ years	1.30	1.95
At least 1½ years, but less than 1¾ years	1.50	2.25
At least 1¾ years, but less than 2¼ years	1.85	2.78
At least 2¼ years, but less than 2¾ years	2.30	3.45
At least 2¾ years, but less than 3½ years	2.75	4.13
At least 3½ years, but less than 4½ years	3.55	5.33
At least 4½ years, but less than 5½ years	4.35	6.53
At least 5½ years, but less than 6½ years	5.10	7.65
At least 6½ years, but less than 7½ years	5.80	8.70
At least 7½ years, but less than 8½ years	6.50	9.75
At least 8½ years, but less than 9½ years	7.10	10.65
At least 9½ years, but less than 10½ years	7.70	11.55
At least 10½ years, but less than 11½ years	8.30	12.45
At least 11½ years, but less than 13½ years	9.10	13.65
At least 13½ years, but less than 16½ years	10.30	15.45
At least 16½ years, but less than 18½ years	11.35	17.03
At least 18½ years, but less than 21½ years	12.25	18.38
At least 21½ years, but less than 23½ years	13.05	19.58
At least 23½ years, but less than 26½ years	13.75	20.63
At least 26½ years, but less than 28½ years	14.35	21.53
28½ years or more	15.00	22.50

3 "(2) MODIFICATION OF TAX RATES BY EXECU-
4 TIVE ORDER.—
5 "(A) IN GENERAL.—If the President of the
6 United States determines that the rates of tax im-

1 posed by paragraph (1), or provided in any prior
2 Executive order issued pursuant to this paragraph,
3 are lower or higher than the rates of tax necessary to
4 limit the total acquisitions by United States persons
5 of stock of foreign issuers and debt obligations of for-
6 eign obligors within a range consistent with the
7 balance-of-payments objectives of the United States,
8 he may by Executive order (effective as provided
9 in subparagraph (C)(ii)) increase or decrease
10 such rates of tax.

11 "(B) MAXIMUM AND MINIMUM RATES.—No
12 change in the rates of tax which is prescribed in an
13 Executive order issued under subparagraph (A)
14 shall (i) cause the rate applicable to the acquisi-
15 tion of stock to be higher than 22.5 percent or lower
16 than 15 percent, or (ii) cause the rates applicable
17 to debt obligations to be higher than the rates set
18 forth in column II(B) of the table in paragraph
19 (1)(B) of this subsection or lower than the rates
20 set forth in column II(A) of such table.

21 "(C) APPLICATION OF EXECUTIVE ORDERS.—

22 "(i) Each increase and each decrease in
23 the rates of tax which is prescribed in an Execu-
24 tive order issued under subparagraph (A) shall
25 provide for the same proportionate increase or

1 decrease in each rate of tax, except that any
2 such rate may be rounded to the nearest 0.01
3 percent.
4 "(ii) Any Executive order issued under
5 subparagraph (A) shall apply with respect to
6 acquisitions made after the date on which such
7 order is issued (or, if later, after the 29th day
8 following the date of the enactment of this para-
9 graph); except that in the case of any such
10 order which increases the rates of tax (as in
11 effect without regard to such order), to the
12 extent specified in such order, rules similar to
13 the rules prescribed by paragraphs (2), (3),
14 and (4) of section 3(c) of the Interest Equali-
15 zation Tax Extension Act of 1967 shall apply.
16 "(3) RATES DURING INTERIM PERIOD.—In the
17 case of acquisitions of stock and debt obligations made
18 after January 25, 1967, and before the thirtieth day
19 after the date of the enactment of this paragraph, the
20 tax imposed by subsection (a) shall be 22.5 percent
21 in the case of acquisition of stock, and shall be deter-
22 mined under column II(B) (rather than column II
23 (A)) of the table in paragraph (1)(B) in the case
24 of acquisition of a debt obligation.
25 "(4) REGULATIONS.—The Secretary or his dele-

1 gate may prescribe such regulations (not inconsistent
2 with the provisions of this section or of any Executive
3 order issued and in effect under this section) as may be
4 necessary to carry out the provisions of this section."
5 (b) APPLICATION OF EXECUTIVE ORDER 11198,
6 ETC.—
7 (1) The table in section 4931 (c) (relating to debt
8 obligations with maturity from 1 to 3 years) is amended
9 to read as follows:

"If the period remaining to maturity is:	The tax, as a percentage of actual value, is:
"At least 1 year, but less than 1¼ years	1.58 percent
At least 1¼ years, but less than 1½ years	1.95 percent
At least 1½ years, but less than 1¾ years	2.25 percent
At least 1¾ years, but less than 2¼ years	2.78 percent
At least 2¼ years, but less than 2¾ years	3.45 percent
At least 2¾ years, but less than 3 years	4.13 percent."

10 (2) Section 3(e)(1)(A) of the Interest Equali-
11 zation Tax Extension Act of 1965 is amended to read
12 as follows:
13 "(A) by striking out subsection (c) (as
14 amended by the Interest Equalization Tax Exten-
15 sion Act of 1967) and redesignating subsections
16 (d) and (e) as subsections (c) and (d), respec-
17 tively;".
18 (c) EFFECTIVE DATE AND SPECIAL RULES.—
19 (1) GENERAL RULE.—The amendments made by
20 subsection (a) shall apply only with respect to acquisi-

1 tions of stock or debt obligations made after January 25,
2 1967. The amendment made by paragraph (1) of
3 subsection (b) shall apply only with respect to acquisi-
4 tions of debt obligations made after January 25, 1967,
5 and before February 21, 1967 (the date on which the
6 amendments made by section 3(e)(1) of the Interest
7 Equalization Tax Extension Act of 1965 became effec-
8 tive).
9 (2) PREEXISTING COMMITMENTS.—Such amend-
10 ments shall not apply to an acquisition—
11 (A) made pursuant to an obligation to acquire
12 which on January 25, 1967—
13 (i) was unconditional, or
14 (ii) was subject only to conditions con-
15 tained in a formal contract under which partial
16 performance had occurred; or
17 (B) as to which on or before January 25,
18 1967, the acquiring United States person (or, in a
19 case where 2 or more United States persons are
20 making acquisitions as part of a single transaction,
21 a majority in interest of such persons) had taken
22 every action to signify approval of the acquisition
23 under the procedures ordinarily employed by such
24 person (or persons) in similar transactions and had

1 sent or deposited for delivery to the foreign person
2 from whom the acquisition was made written evi-
3 dence of such approval in the form of a commitment
4 letter, memorandum of terms, draft purchase con-
5 tract, or other document setting forth, or referring
6 to a document sent by the foreign person from whom
7 the acquisition was made which set forth, the princi-
8 pal terms of such acquisition, subject only to the
9 execution of formal documents evidencing the ac-
10 quisition and to customary closing conditions.
11 (3) PUBLIC OFFERINGS.—Such amendments shall
12 not apply to an acquisition made on or before March 27,
13 1967, if—
14 (A) a registration statement (within the
15 meaning of the Securities Act of 1933) was in
16 effect with respect to the stock or debt obligation
17 acquired at the time of its acquisition;
18 (B) the registration statement was first filed
19 with the Securities and Exchange Commission on
20 January 25, 1967, or within 90 days before that
21 date; and
22 (C) no amendment was filed with the Securi-
23 ties and Exchange Commission after January 25,
24 1967, and before the acquisition which had the ef-
25 fect of increasing the number of shares of stock or

1 the aggregate face amount of the debt obligations
2 covered by the registration statement.
3 (4) OPTIONS, FORECLOSURES, AND CONVER-
4 SIONS.—Such amendments shall not apply to an acquisi-
5 tion—
6 (A) of stock pursuant to the exercise of an
7 option or similar right (or a right to convert a debt
8 obligation into stock), if such option or right was
9 held on January 25, 1967, by the person making
10 the acquisition or by a decedent from whom such
11 person acquired the right to exercise such option
12 or right by bequest or inheritance or by reason of
13 such decedent's death, or
14 (B) of stock or debt obligations as a result of a
15 foreclosure by a creditor pursuant to the terms of an
16 instrument held by such creditor on January 25,
17 1967.
18 (d) RETURNS.—If, by reason of the enactment of this
19 Act, a person incurs additional liability for interest equaliza-
20 tion tax with respect to acquisitions of stock or debt obliga-
21 tions made after January 25, 1967, for which a return has
22 been filed under section 6011 (d) (1) of the Internal Reve-
23 nue Code of 1954 before the date of the enactment of this
24 Act, such person shall make an amended return showing

1 such additional liability. If liability for interest equalization
2 tax with respect to such acquisitions is initially created by
3 reason of the enactment of this section, the person incurring
4 such liability shall make a return. The returns required to be
5 made by this paragraph shall be filed on or before the last
6 day of the month following the close of the calendar quarter
7 in which the date of the enactment of this Act occurs or at
8 such later time as the Secretary or his delegate may prescribe.

9 **SEC. 4. OTHER AMENDMENTS.**

10 (a) EXCLUSION OF ACQUISITIONS ARISING OUT OF
11 SALES OF CERTAIN FOREIGN REAL PROPERTY.—
12 (1) Section 4914 (b) (14) is amended to read as
13 follows:
14 "(14) FOREIGN PROPERTY.—Of debt obligations
15 arising out of the sale of—
16 "(A) tangible property located outside the
17 United States which was held by the person acquir-
18 ing such obligation for his personal use, or
19 "(B) real property (other than property to
20 which subparagraph (A) applies) located outside
21 the United States and owned, on July 18, 1963, by
22 the person acquiring such obligation."
23 (2) The amendment made by paragraph (1) shall

1 apply only with respect to acquisitions made on or after
2 the date of the enactment of this Act.
3 (b) EXCLUSION OF CERTAIN ACQUISITIONS BY RESI-
4 DENTS NOT CITIZENS.—
5 (1) Section 4914 (b) is amended by adding at the
6 end thereof the following new paragraph:
7 "(15) CERTAIN ACQUISITIONS BY RESIDENTS NOT
8 CITIZENS.—Of stock or debt obligations by an individual
9 who is a resident but not a citizen of the United States,
10 during the 90-day period beginning on the date such
11 individual first became a resident of the United States."
12 (2) Section 4914 (j) (2) is amended by adding at
13 the end thereof the following new sentence: "For pur-
14 poses of this chapter, if, after February 27, 1967, a
15 United States person sells or otherwise disposes of stock
16 or a debt obligation to the acquisition of which subsec-
17 tion (b) (15) applied, such person shall not, with
18 respect to that stock or debt obligation, be considered
19 a United States person."
20 (3) The amendment made by paragraph (1) shall
21 apply with respect to acquisitions made after July 18,
22 1963.

1 (c) CERTAIN SALES OF ORES OR MINERALS BY
2 UNITED STATES PERSONS.—
3 (1) Section 4914 (c) (5) is amended by adding at
4 the end thereof (after and below subparagraph (B))
5 the following new sentence:
6 "For purposes of clause (iii) of subparagraph (A)
7 (and for purposes of determining whether a debt obliga-
8 tion arises out of a loan described in subparagraph (B)
9 in a case where the ores, minerals, or derivatives in-
10 volved are obtained under a contract described in such
11 clause), a contract shall be deemed to have been entered
12 into on or before July 18, 1963, if it is entered into after
13 such date and before January 26, 1967, and is a substi-
14 tute for a contract, which has been canceled or termi-
15 nated, between the same parties which was entered into
16 on or before July 18, 1963; except that the total amount
17 of the acquisitions excluded by this paragraph on the
18 basis of a contract entered into after July 18, 1963,
19 which is deemed by this sentence to have been entered
20 into on or before such date shall not exceed the total
21 amount of the acquisitions which could have been ex-
22 cluded by this paragraph on the basis of the earlier con-
23 tract for which such contract was substituted."
24 (2) The amendment made by paragraph (1) shall

1 apply with respect to acquisitions made on or after the
2 date of the enactment of this Act.
3 (d) INTERNATIONAL MONETARY STABILITY EXCLU-
4 SION.—
5 (1) Section 4917 (d) is amended by striking out
6 "after the date of the enactment of the Interest Equal-
7 ization Tax Extension Act of 1965".
8 (2) The amendment made by paragraph (1) shall
9 apply with respect to acquisitions made after July 18,
10 1963.
11 (3) If, with respect to an acquisition after July 18,
12 1963, and before the date of enactment of this Act, by
13 a State or political subdivision, or by any agency or
14 instrumentality thereof, of stock or a debt obligation
15 which is all or part of an original or new issue to which
16 an Executive order issued under section 4917 (a) is
17 applicable (other than an Executive order which is
18 applicable to a limited aggregate amount of such issues),
19 the notice of acquisition required by section 4917 (a) is
20 filed on or before the 60th day after the date of enact-
21 ment of this Act, such notice shall be considered as filed
22 on or before the last day specified in the regulations
23 prescribed by the Secretary or his delegate under sec-
24 tion 4917 (a).

1 (4) No interest shall be paid with respect to any
2 credit or refund allowed or made by reason of the appli-
3 cation of this subsection.
4 (e) RESALES OF DEBT OBLIGATIONS BY UNITED
5 STATES DEALERS.—
6 (1) Sections 4919(a)(2)(A)(ii) and 4919
7 (a)(2)(B)(ii) are each amended by striking out "on
8 the same or the next business day" and inserting in lieu
9 thereof "within 30 days after the day of purchase".
10 (2) Section 4919(b)(3) is amended—
11 (A) by striking out in subparagraph (A)(ii)
12 "on the day of purchase or the next business day"
13 and inserting in lieu thereof "within 30 days after
14 the day of purchase";
15 (B) by striking out in the sentence following
16 subparagraph (A)(ii) "on the day on which it
17 was purchased or the next business day" and insert-
18 ing in lieu thereof "within 30 days after the day of
19 purchase";
20 (C) by striking out "or" at the end of sub-
21 paragraph (B)(i);
22 (D) by striking out "or debt obligation" in
23 subparagraph (B)(ii) and by adding "or" at the
24 end of such subparagraph;

1 (E) by adding after subparagraph (B) (ii)
2 the following:
3 "(iii) purchased a debt obligation which
4 he resold within 30 days after the day of pur-
5 chase to a person other than a United States
6 person,"; and
7 (F) by striking out in the matter following
8 subparagraph (B) (iii) (as added by subparagraph
9 (E) of this paragraph) "on the day of purchase
10 or the next business day" and by inserting before
11 the period at the end of subparagraph (B) the fol-
12 lowing: "on the day of purchase or the next bus-
13 iness day in the case of stock, or within 30 days
14 after the day of purchase in the case of a debt ob-
15 ligation".
16 (3) The amendments made by this subsection shall
17 apply only with respect to an acquisition by a dealer of
18 a debt obligation which is resold by such dealer to an-
19 other dealer (whether such acquisition by the former
20 dealer occurs before or after such resale) after January
21 25, 1967.
22 (f) FOREIGN LENDING AND FINANCE BUSINESSES.—
23 (1) Section 4920(a)(3) is amended by striking
24 out the period at the end of subparagraph (B) and in-

1 serting in lieu thereof "; or", and by adding after sub-
2 paragraph (B) the following new subparagraph:
3 "(C) a domestic corporation which together
4 with its subsidiaries (if any)—
5 "(i) is primarily engaged in the lending
6 or finance business through offices located out-
7 side the United States, and
8 "(ii) holds itself out, in the course of such
9 business outside the United States, as lending
10 money to the public generally,
11 and which elects to be treated as a foreign issuer or
12 obligor for purposes of this chapter. The election
13 under the preceding sentence shall be made on or
14 before the 60th day after the date of the enactment
15 of this subparagraph or the 60th day after the or-
16 ganization of the corporation, whichever is later,
17 under regulations prescribed by the Secretary or his
18 delegate. Any such election shall be effective as of
19 January 26, 1967, or the date of the organization
20 of the corporation, whichever is later, and shall re-
21 main in effect until revoked. If, at the close of any
22 succeeding calendar quarter, the corporation ceases
23 to meet the requirement of clause (i) or clause (ii),
24 the election shall thereupon (with respect to quar-
25 ters after such calendar quarter) be deemed revoked.

1 When an election is revoked no further election may
2 be made."
3 (2) Section 4920(a) is further amended by insert-
4 ing after paragraph (3) the following new paragraph:
5 "(3A) For purposes of paragraph (3)(C)—
6 "(A) the term 'lending or finance business'
7 has the meaning given it by section 542(d)(1);
8 except that for such purposes the term '60 months'
9 appearing in subparagraph (B)(i) of such section
10 shall be deemed to read '48 months', and the sub-
11 sequent portion of such subparagraph (B)(i) shall
12 be disregarded;
13 "(B) a corporation shall be considered a 'sub-
14 sidiary' of another corporation only if stock pos-
15 sessing at least 50 percent of the voting power of
16 all classes of its stock is directly or indirectly owned
17 by such other corporation and the two corporations
18 are affiliated with each other; and
19 "(C) a corporation primarily engaged in lend-
20 ing money to one or more other corporations each
21 of which is affiliated with it and satisfies the require-
22 ments of clauses (i) and (ii) of paragraph (3)(C)
23 shall itself be deemed to satisfy such requirements.
24 For purposes of this paragraph, two corporations are
25 'affiliated' with each other if they are members (or

1 would be members if they were both domestic corpora-
2 tions) of the same affiliated group (within the meaning
3 of section 1504)."
4 (3) Section 4920(a)(4)(C) is amended by
5 striking out "paragraph (3)(B)" and inserting in lieu
6 thereof "subparagraph (B) or (C) of paragraph (3)".
7 (g) CERTAIN EXPORT-RELATED TRANSACTIONS.—
8 (1) Section 4920(a)(3) is amended by striking
9 out "or" at the end of subparagraph (B) and the period
10 at the end of subparagraph (C) (as added by subsec-
11 tion (f)(1) of this section), by inserting in lieu of such
12 period "; or", and by adding after subparagraph (C)
13 the following new subparagraph:
14 "(D) a domestic corporation if—
15 "(i) substantially all of the business of
16 such corporation consists of the acquisition from
17 foreign obligors of debt obligations, arising out
18 of loans made to such obligors, all of the pro-
19 ceeds of which are to be used by such obligors
20 to pay part or all of the purchase price in sales
21 to such obligors of tangible property or property
22 described in section 4914(c)(3)(A) or serv-
23 ices (or any combination thereof) by one or
24 more includible corporations in an affiliated

1 group, as defined in section 1504, of which such
2 corporation is a member,
3 "(ii) at least 15 percent of the purchase
4 price of each such sale is attributable to the sale
5 of property manufactured, produced, grown, or
6 extracted in the United States by one or more
7 such includible corporations, or to the perform-
8 ance of services by one or more such includible
9 corporations, or to both,
10 "(iii) such corporation establishes that such
11 debt obligations are acquired solely out of the
12 proceeds of the sale by such corporation (or
13 by a domestic corporation described in section
14 4912(b)(3) which owns all of the stock of
15 such corporation) of debt obligations of such
16 corporation (or such other domestic corpora-
17 tion) to persons other than United States per-
18 sons (including such a sale in a transaction
19 described in section 4919(a)(1)),
20 "(iv) the actual value and period remain-
21 ing to maturity of the debt obligations acquired
22 by such corporation do not exceed at any time
23 the actual value and period remaining to matu-
24 rity of the debt obligations the proceeds of the

1 sale of which are established, in accordance with
2 clause (iii), to have been used to make such
3 acquisitions,
4 "(v) such corporation does not acquire
5 any stock or debt obligations of foreign issuers
6 or obligors (other than debt obligations de-
7 scribed in clause (i)) which would have been
8 subject to the tax imposed by section 4911 had
9 such corporation not elected to be treated as a
10 foreign issuer or obligor under clause (vii),
11 "(vi) such corporation maintains, in a
12 manner satisfactory to the Secretary or his dele-
13 gate, such records and accounts as may be
14 necessary to establish that the requirements of
15 the foregoing clauses have been met, and
16 "(vii) such corporation elects to be treated
17 as a foreign issuer or obligor for purposes of
18 this chapter.
19 The election under clause (vii) shall be made on
20 or before the 60th day after the date of the enact-
21 ment of this subparagraph or the 60th day after the
22 organization of the corporation, whichever is later,
23 under regulations prescribed by the Secretary or his
24 delegate. Any such election shall be effective as of
25 the date thereof and shall remain in effect until

1 revoked. If, at any time, the corporation ceases to
2 meet any requirement of clause (i), (ii), (iii),
3 (iv), (v), or (vi), the election shall thereupon be
4 deemed revoked. When an election is revoked, no
5 further election may be made. If an election is re-
6 voked, the corporation shall incur liability at the
7 time of such revocation for the tax imposed by
8 section 4911 with respect to all debt obligations
9 described in clause (i) (and all stock and debt
10 obligations described in clause (v)) which were
11 acquired by it during the period for which the elec-
12 tion was in effect and which are held by it at the
13 time of such revocation; and the amount of such tax
14 shall be equal to the amount of tax for which the
15 corporation would be liable under such section if it
16 had acquired such stock or debt obligations im-
17 mediately after such revocation. For purposes of
18 sections 4912 and 4915, a corporation which has
19 made an election under clause (vii) shall, during
20 the period for which such election is in effect, be
21 treated, with respect to acquisitions from such cor-
22 poration, as a foreign corporation which is not
23 formed or availed of for the principal purpose
24 described in section 4915(c)(1)."
25 (2) Section 4920(a)(4)(C) (as amended by sub-

1 section (f) (3) of this section) is amended by striking out
2 "subparagraph (B) or (C) of paragraph (3)" and by
3 inserting in lieu thereof "subparagraph (B), (C), or (D)
4 of paragraph (3)".

Passed the House of Representatives March 15, 1967.

Attest: W. PAT JENNINGS,

Clerk.

The CHAIRMAN. This morning we are pleased to have as our first witness the Honorable Frederick D. Deming, Under Secretary of the Treasury for Monetary Affairs.

Mr. Secretary, we are glad to have you with us today. I hope you will put this tax avoidance situation in perspective for us and indicate whether you can deal with it under existing law or whether an amendment to the law will be required.

You may proceed.

STATEMENT OF HON. FREDERICK L. DEMING, UNDER SECRETARY OF THE TREASURY, ACCOMPANIED BY HON. STANLEY S. SURREY, ASSISTANT SECRETARY, AND HON. WINTHROP KNOWLTON, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. DEMING. Mr. Chairman and members of the committee, I am here today to request your approval for the President's recommendations regarding the interest equalization tax. These recommendations have been, to a large extent, incorporated in H.R. 6098 as passed by the House of Representatives. The bill, if amended in accordance with the remaining recommendation, would—

As in the present H.R. 6098, extend the interest equalization tax from its current expiration date of July 31, 1967, to July 31, 1969;

Revise the tax rates applicable to foreign borrowing in the United States to range between the equivalent of zero and 2 percent per annum, and give the President discretionary authority to vary the effective annual interest cost to foreign borrowers within this range—the current statutory rate is fixed at 1 percent, and the range of discretionary authority in the present H.R. 6098 runs from 1 to 1½ percent; and

As in the present H.R. 6098, set the tax rate equivalent to 1½ percent per annum for the period January 26, 1967, through the 29th day after enactment of the legislation. On the 30th day after enactment, the tax rate would revert to the current statutory rate of 1 percent unless the President exercised his authority with respect to the schedule of rates.

The prime and immediate reason necessitating extension and revision of the interest equalization tax is the U.S. balance-of-payments problem. The U.S. trade position is improving. The trade surplus in the first 5 months of 1967 is running at an annual rate of $4.4 billion as against $3.7 billion for the full year 1966 and $2.9 billion, annual rate, in the fourth quarter of last year. Unfortunately, the foreign exchange costs of our military presence abroad have been rising, reflecting primarily the Vietnam war. In such a situation we have no recourse but to continue to moderate the flow of our capital exports. The IET helps us to do this.

When we appeared before the House Ways and Means Committee on February 15, 1967, we were able to report that interest rates both here and abroad had declined. A month earlier, Secretary Fowler had met with several of his European colleagues at Chequers, in England. They agreed that the prevailing high level of interest rates was

a barrier to the pursuit of their respective national economic policies; they further recognized the desirability of working toward a general reduction of these high rates. Their efforts met with success. But by February the spread between rates here and abroad had widened even though there were absolute declines in rates in both areas. That prompted us to stress the fact that rate spreads could both widen and narrow and that future interest rate developments in the United States and in Europe could not be predicted with any precision. Thus we believed it would be well to have some flexibility in the IET rates so as to protect against both types of development.

Since mid-April we have seen one of the most rapid rises in long-term rates in our history. Rates on long-term Treasury bonds jumped from about 4.60 percent in mid-April to more than 5 percent by late June, while rates on high grade new corporate utility bond issues rose from about 5.57 percent to 6.11 percent in late June. Recently there have been equally dramatic increases in short-term rates —in the 30 days between June 5 and July 5 the yield on Treasury bills jumped from 3.37 to 4.29 percent. In the last few days, a steadier atmosphere has prevailed in the markets but the rate changes of recent weeks and months are striking.

The rate differential between the United States and Europe now is narrower than it was 3 months ago. But there are some indications that even with slower European growth in prospect rates in Europe may be ready to move up and again widen the differential.

The differential, however, could also widen if interest rates in the United States recede from their current levels which at the long end of the market are almost as high as in the summer of 1966. It is our hope that such a development will occur. We also hope that rates in Europe will go down rather than up, but we obviously cannot be certain that this will take place.

What is clear is that the general movement of interest rates in the United States and in Europe since the IET was proposed in 1963 has led to a widening of the differential. In 1963, the spread between the average yields on outstanding U.S. Treasury and West European government bonds was only 86 basis points. Table 1 shows those differences. Since then, the differential has widened—it reached 150 basis points in February 1967. Today, despite a relatively larger rise in U.S. rates than those abroad in recent weeks, the spread still exceeds 100 basis points, as compared with 86 in 1963.

The importance attached to the spread between yields on Government bonds reflects the fact that the governments of countries now subject to the IET were borrowing here at a seasonally adjusted annual rate of over $200 million just prior to announcement of the tax in mid-1963. Securities of these potential borrowers compete for available investment funds with U.S. Government and high-grade U.S. corporate issues.

Another important differential is that between the yields on new issues of foreign bonds, government and corporate, and the yields on new issues of U.S. corporate bonds. A rough measure of this differential is obtained from a comparison of the average of the yields on new dollar bond issues in international markets by countries subject to the IET and on new U.S. Aa-rated corporate bond issues in the U.S. market.

TABLE I.—*Comparison of yields on U.S. and various foreign government long-term bonds*

[Percent per annum; monthly average]

	Yield				Foreign differential over U.S. Treasury bond yield as of—			
	June 1963	September 1966	February 1967	May 1967	June 1963	September 1966	February 1967	May 1967
Western Europe (average)	4.86	6.15	5.95	5.87	0.86	1.36	1.48	1.11
Belgium	4.00	5.84	5.88	5.86	0	1.05	1.41	1.10
Denmark	6.54	8.05	8.24	7.95	2.54	3.26	3.77	3.19
France	5.09	5.45	5.58	[1] 5.71	1.09	.66	1.11	.95
Germany	6.03	8.11	7.40	[1] 6.90	2.03	3.32	2.93	2.14
Italy	5.06	5.90	5.55	[2] 5.62	1.06	1.11	1.08	.86
Netherlands	4.12	6.45	5.89	5.81	.12	1.66	1.42	1.05
Norway	4.66	4.45	4.41	4.38	.66	−.34	−.06	−.38
Sweden	4.52	5.85	5.37	5.26	.52	1.06	.90	.50
Switzerland	3.15	4.25	4.74	4.67	−.85	−.54	.27	−.09
United Kingdom	5.44	7.12	6.40	6.51	1.44	2.33	1.93	1.75
Other developed:								
Australia	4.50	5.25	5.25	5.25	.05	.46	.78	.49
New Zealand	5.17	5.38	5.43	[2] 5.49	1.17	.59	.96	.73
U.S. Treasury bonds	4.00	4.79	4.74	4.76				

[1] April data.
[2] March data.
Source: International Financial Statistics, IMF.

Table II shows that yields on new U.S. corporate bonds reached a peak in September 1966. By the end of 1966, they had declined to a level close to that of year-end 1965. While the yields in international markets on foreign dollar issues, subject to the IET, peaked at about the same time as comparable U.S. issues, they did not decline as quickly. As a result, the rate differential widened substantially and in March 1967 stood at 120 basis points. Since then, the rates have converged until they were separated by about 50 basis points in June—a differential that may grow again if rates in Europe stiffen. The magnitude and swiftness of these recent swings in the differential also emphasize the need for flexible authority to vary the rate of tax.

TABLE II.—*Comparisons of average yields on new issues of long-term bonds in U.S. and international markets*

[Percent per annum]

	Yield on new dollar bond issues in international markets by foreign issuers subject to IET [1] (1)	Yield on new U.S. Aa-rated corporate issues (2)	Difference (1)—(2)
June 1963	(2)	4.32	(2)
September 1966	7.17	6.14	1.03
December 1966	6.82	5.98	.84
March 1967	6.75	5.55	1.20
May 1967	6.42	5.90	.52
June 1967	6.55	6.06	.49

[1] Foreign issuers subject to the IET include foreign governments, government-owned enterprises, and private corporations.
[2] Not available.

The above comments compared average yields here and abroad. The differentials between yields on particular U.S. and foreign securities of similar type and quality would in some cases show even wide differentials than the average yields quoted above.

In the case of long-term bank loans, it is difficult to ascertain actual interest rate differentials between here and abroad, partly because of lack of information about banks' policies regarding maintenance of minimum balances by foreign as compared with domestic customers. Overdraft loan rates in a number of European countries, however, have been ranging from 1 to 2 percent higher than the U.S. prime rate—and this differential probably also exists for longer term bank loans.

Furthermore, it is of interest to note that between February 10, 1965, and May 31, 1967, with the 1-percent rate of IET tax, private firms and Government agencies in developed countries drew down an estimated $290 million of long-term funds, gross, under U.S. bank commitments made during that period. Their willingness to use funds on which the IET had to be paid suggests that there was an interest rate inducement for foreigners to borrow from U.S. banks. It also suggests that the IET is a mechanism to moderate the demands on our market, not to abolish these borrowings.

The interest equalization tax, as you will recall, was proposed in July 1963. At that time, the U.S. balance of payments was continuing to show substantial deficits as it had during previous years and the dollar was weak in the foreign exchange markets. A rapid acceleration in the outflow of private capital from the United States was making this situation even worse; for the first half of that year portfolio and long-term bank investments abroad reached an annual rate of $2.4 billion compared with an average of $0.9 billion for the period 1960–1962. At midyear the outflow of funds threatened to continue, if not increase.

When, on July 18, 1963, President Kennedy proposed the interest equalization tax, this alarming outflow of capital was promptly halted. Careful consideration of the capital outflow problem at that time led to the judgment that the IET was a more desirable and appropriate corrective measure for the United States than an imposition of direct capital controls or an increase in the domestic levels of interest rates. That remains our judgment today. Advantages of the IET over alternative policies are—

It operates through the free market price mechanism;

It does not interfere with domestic economic programs of full employment and growth; and

It is in accordance with the U.S. long-term objective of encouraging the development of a more effective European capital market.

The IET was not designed to halt completely the outflow of portfolio capital from the United States, but rather to return the rate of outflow to a more normal level and, in view of the failure of countries in balance-of-payments surplus—principally continental European countries—to reduce the size of their surpluses, to restrain the outflow of portfolio capital to these countries.

In discussing the success of the IET in helping the balance of payments, let me first note the effects of the tax on new foreign security issues marketed in the United States. New issues subject to the tax began to fall off almost immediately after its proposal in July 1963 and remained at a minimum level after the legislation was passed in September 1964. (See table III.)

TABLE III.—*New issues of foreign securities purchased by U.S. residents, by area, 1962–1966*

[In millions of dollars]

	1962	1963		1964	1965	1966	1967, 1st quarter [1]
		1st half [1]	2d half [1]				
Total new issues	1,076	999	251	1,063	1,206	1,210	332
IET countries:							
West Europe	195	219	53	20	80	15	....
Japan	101	107	57	....	52	4	....
Other [2]	60	17	....	....	....	....	....
Subtotal	356	343	110	20	132	19	....
Of which—							
1. Subject to IET	....	....	....	....	80	9	....
2. Exempt from IET	....	....	110	20	52	10	....
Reason:							
(a) Commitments made prior to July 18, 1963	....	....	(110)	....	....	....	....
(b) U.S. exports related	....	....	....	(9)	....	....	....
(c) Japanese exemption	....	....	....	....	(52)	....	....
(d) Other	....	....	....	[3] (11)	....	[4] (10)	....
Other countries:							
Canada	457	608	85	700	709	[5] 922	256
Latin America [6]	102	13	23	208	37	69	34
Other countries	77	35	33	131	149	120	24
International institutions	84	....	....	4	179	80	18
Subtotal	720	656	141	1,043	1,074	1,191	332

[1] Not seasonally adjusted.
[2] Australia, New Zealand, South Africa.
[3] Issue had maturity less than 3 years, which was lowest maturity to which tax had applied prior to Feb. 11, 1965.
[4] Issue by United Kingdom subsidiary of Canadian firm.
[5] Before deducting $162,000,000 of Canadian Government purchases from U.S. residents of outstanding Canadian and other foreign securities in accordance with Canada's agreement not to let its foreign exchange reserves rise as a result of borrowing in the United States.
[6] Includes Latin American Development Bank issue of $145,000,000 in 1964.

All of the issues marketed during the second half of 1963—$110 million—had been arranged before the tax was proposed and were exempt from the tax.

The two issues marketed in 1964 totaled $20 million in value and were also exempt from the tax under various provisions of the law.

In 1965, U.S. residents purchased $80 million of taxable new securities. All of these reflected a special situation of United Kingdom firms borrowing in the United States in order to finance direct investment expenditures here.

In 1966, there were only $9 million of taxable issues.

In the first quarter of 1967, there were no new issues subject to IET.

The results with respect to trading in outstanding issues of foreign securities have been equally beneficial to the U.S. balance of payments. (See tables IV and V.) From the middle of 1963 through 1966, U.S.

residents were net sellers of foreign securities—bonds and stocks—at an average rate of $200 million. By contrast, in the 3½ years preceding announcement of the IET in July of 1963, U.S. residents were net purchasers of outstanding foreign stocks and bonds at an average annual rate of $275 million. The shift from net purchases to net sales had a favorable effect of almost $500 million in our balance of payments. In the first quarter of this year there were net purchases by American residents of $6 million of outstanding foreign issues.

TABLE IV—*Net transactions in outstanding foreign securities by U.S. residents, 1960–66 ($ million; minus sign indicates net purchases by U.S. residents and no sign before a figure indicates net sales by U.S. residents)*

	U.S. transactions with residents of all countries
1960	−309
1961	−387
1962	−96
1963 1st half annual rate	−302
Average annual rate 1960–June 1963	−274
1963 2d half annual rate	204
1964	193
1965	226
1966	323
Average annual rate July 1963–66	238
1967 1st quarter annual rate	−24

Source: Survey of Current Business, Department of Commerce.

TABLE V.—*U.S. transactions in new and outstanding foreign bonds and stocks 1959–67*

[In millions of dollars]

Period	New issues (net purchases by Americans (−))			Net transactions in outstanding issues (net purchases by Americans (−))		
	Total	Stocks [1]	Bonds	Total	Stocks	Bonds
1959	−625	−3	−622	−140	−194	+54
1960	−555	−13	−542	−309	−82	−227
1961	−523	−36	−487	−387	−324	−63
1962	−1,076	−74	−1,002	−96	−25	−71
1963, total	−1,250	−53	−1,197	−49	+113	−162
1st half	−999	−32	−968	−151	−3	−148
2d half	−251	−21	−229	+102	+116	−14
1964, total	−1,063	−4	−1,059	+193	+210	−17
1965, total	−1,206	−4	−1,202	+226	+297	−71
I	−302	−3	−299	+49	+108	−59
II	−329		−329	+130	+76	+54
III	−304	−1	−303	+53	+67	−14
IV	−271		−271	−6	+46	−52
1966,[2] total	−1,225	−46	−1,179	+323	+253	+70
I	−466	−34	−432	−9	+2	−11
II	−305	−6	−299	+122	+75	+47
III	−241	−6	−235	+155	+96	+59
IV [2]	−213		−213	+55	+80	−25
1967: I [2]	−332		−332	−6	+34	−40

[1] Excluding direct investment transactions.
[2] Preliminary.

Note.—Detail may not add to totals because of rounding.

The net sales of foreign securities by Americans since mid-1963 have been almost entirely in foreign stocks. During most of this period there continued to be small net purchases of foreign outstanding bonds, although in greatly reduced amounts as compared with the period before the middle of 1963. The same situation prevailed in the first quarter of this year. Americans continued to liquidate foreign stocks in an amount of $34 million while purchasing foreign bonds in a net amount of $40 million.

The effect of the IET on U.S. capital outflows in the form of bank loans is equally impressive. Long-term commercial bank loan commitments, shown in table VI, have fallen markedly for countries subject to IET—by more than 50 percent. This compares favorably with a small reduction in commitments to non-IET countries.

TABLE VI.—*Long-term U.S. commercial bank loan commitments to foreign countries, by area, 1964–67*

[In millions of dollars]

	1964	1965			1966	1967, 1st quarter
		Total	Jan. 1, Feb. 10	Feb. 11,[1] Dec. 31		
Total, all countries	2,227	1,885	768	1,117	898	158
IET countries, total	1,246	1,014	574	434	207	37
West Europe [2]	718	396	234	162	101	25
Other [3]	528	617	339	272	106	12
Of IET countries, total:						
Subject to IET [4]				189	138	8
Exempt from IET				245	67	29
Reason:						
U.S. export financing				198	67	29
Raw material extraction				47		
Other countries	981	871	194	683	690	121

[1] Date when IET made applicable to long-term U.S. commercial bank loans.
[2] Includes Ireland and Portugal from May 5, 1965.
[3] Includes Australia, New Zealand, South Africa; also Bahamas and Bermuda from May 5, 1965; also Iran, Libya, and Saudi Arabia from June 11, 1966. Excludes Canada beginning Sept. 12, 1966.
[4] To extent of amounts actually disbursed.

NOTE.—Detail may not add to totals because of rounding.

Since 1963, our effort to improve the balance of payments has been reinforced by the addition of the voluntary cooperation program as well as other measures. Under that program, as you know guidelines have been suggested both for direct investment abroad by business firms and also for foreign lending by banks and by other financial institutions. The function of the IET in this overall policy is critical, and the relationship of the tax to other parts of the program is of great importance. For example, the IET deters some potential borrowers in developed countries from even applying for long-term loans at U.S. banks or other financial institutions and, by reducing the pressure of foreign demand on these institutions, it has thereby made it easier for them to observe the guidelines. In addition, the tax has deterred foreign borrowing from U.S. persons not covered by the voluntary cooperation program.

Thus, the interest equalization tax and the voluntary cooperation program have worked in tandem and have complemented each other as measures for correcting the balance-of-payments deficit. The same factors which led the administration to strengthen and extend the voluntary cooperation program last December indicate that a similar need now exists for strengthening and extending the interest equalization tax. Failure to extend the interest equalization tax would have adverse balance-of-payments consequences and would place undue strain on other elements of the administration's economic program.

To summarize at this point:

Pressures on the U.S. balance-of-payments position are likely to continue into the future.

Present interest rates are too high and it is our hope that they will recede to a level more in keeping with the healthy operation of our economy.

It is not possible to predict precisely future changes in the interest rate differential between the United States and abroad; the differential may narrow or it may widen, and, as we have seen in recent months, the change may occur with lightning speed. If it widens, we would face the threat of additional capital outflows.

In view of these pressing needs and uncertainties, we recommend, as H.R. 6098 presently provides, that the interest equalization tax be extended for 2 years beyond its current expiration date of July 31, 1967.

The IET must be adequate to its task, and it is for this reason that we have requested that the tax rates be revised so that they may be fixed within a range of zero to approximately 2 percent per annum equivalent extra cost to foreign borrowers. The tax rates under existing law and under the proposed amendment are shown in table VII.

TABLE VII.—*Interest equalization tax rates*

	Rates of tax under existing law (percent)	Rates of tax under proposed amendment (percent)
If the period remaining to maturity is:		
At least 1 year, but less than 1¼ years	1.05	0 to 2.10
At least 1¼ years, but less than 1½ years	1.30	0 to 2.60
At least 1½ years, but less than 1¾ years	1.50	0 to 3.00
At least 1¾ years, but less than 2¼ years	1.85	0 to 3.70
At least 2¼ years, but less than 2¾ years	2.30	0 to 4.60
At least 2¾ years, but less than 3½ years	2.75	0 to 5.50
At least 3½ years, but less than 4½ years	3.55	0 to 7.10
At least 4½ years, but less than 5½ years	4.35	0 to 8.70
At least 5½ years, but less than 6½ years	5.10	0 to 10.20
At least 6½ years, but less than 7½ years	5.80	0 to 11.60
At least 7½ years, but less than 8½ years	6.50	0 to 13.00
At least 8½ years, but less than 9½ years	7.10	0 to 14.20
At least 9½ years, but less than 10½ years	7.70	0 to 15.40
At least 10½ years, but less than 11½ years	8.30	0 to 16.60
At least 11½ years, but less than 13½ years	9.10	0 to 18.20
At least 13½ years, but less than 16½ years	10.30	0 to 20.60
At least 16½ years, but less than 18½ years	11.35	0 to 22.70
At least 18½ years, but less than 21½ years	12.25	0 to 24.50
At least 21½ years, but less than 23½ years	13.05	0 to 26.10
At least 23½ years, but less than 26½ years	13.75	0 to 27.50
At least 26½ years, but less than 28½ years	14.35	0 to 28.70
28½ years or more	15.00	0 to 30.00

H.R. 6098, as passed by the House, would establish an effective range of rates from 1 to 1½ percent per annum. But this range is not broad enough to make the IET effective under the potential economic situations which may occur following enactment of the legislation. To forestall any possible policy conflict between our balance-of-payments goals and the needs of our domestic economy, I strongly urge you to approve the request for rates that would involve a range from zero to 2 percent per annum. The Presidential discretionary authority provided in the House bill could then be exercised to vary the rates so that the annual cost of the tax to the foreign borrower might vary between zero and 1 percent.

Given the facts—

That we want to restrain capital outflows without prohibiting them;

That considerable uncertainty exists concerning how the differential between interest rates between here and abroad will move in the period ahead; and

That we want to phase out the restraining effect of the IET on capital outflows as our balance-of-payments position permits, we believe the range I have indicated is full waranted.

The provision for flexible Presidential authority, within the range finally determined upon, is included in H.R. 6098 and is supported by five major factors:

(1) The IET was not designed as a source of revenue but as a regulatory measure. The Congress is not being asked to set a precedent for discretionary Presidential tax authority.

(2) The problem with which the IET is designed to cope is really a problem involving capital flows, not tax matters in the usual sense. The tax, therefore, should be flexible enough to enable the President to respond to changes in international capital flows brought about by changes in foreign monetary policies.

(3) The tax is concerned with an international as contrasted with a domestic situation and hence must respond to the wide variety of factors outside the United States that can affect its impact.

(4) If the interest equalization tax had been intended either as a revenue measure or as an absolute deterrent to the purchase of foreign securities, it would have been possible to establish an appropriate tax rate (either low or high) and never deviate from this rate. In fact, the IET is designed to reduce the rate of capital outflow from the United States to a level consistent with current balance-of-payments requirements. As these economic conditions change, the tax rate must be susceptible to some adjustment.

(5) Congress, in passing the original IET and in subsequent amendments, has recognized the need for delegating flexible authority to the President.

You gave the President authority to reclassify as "developed" countries which were originally designated as "less developed."

You gave the President authority to exempt "developed" countries from the tax in certain exceptional cases.

You granted authority to the President to extend its provisions to bank loans.

You gave the President authority to exempt from the tax dollar loans by foreign branches of U.S. banks.

Careful consideration has been given by the President to the discretionary provisions of the law, and his use of this authority has resulted in substantial gains for the balance of payments. In the light of the need to guard against the contingency of an adverse international rate differential, the present request adds one reasonable, but limited, form of flexibility to enable this tax to achieve its regulatory objectives more efficiently. I can assure you that the discretionary authority will be used to set the rate at a level appropriate to current economic conditions.

The United States normally earns a current account surplus. A part of this surplus is used for defraying balance-of-payments drains resulting from the exercise of our global political and military responsibilities; a further part is used—and quite properly should be used—for the export of capital. Within this framework, good balance-of-payments adjustment policy requires flexible means for restraining capital flows in order that neither overall balance-of-payments deficits nor surpluses should become chronic. To achieve this goal and to maximize the usefulness of the interest equalization tax, it is important that the flexible authority be applicable within the full zero to 2 percent range.

Use of such authority would not, of course, be linked mechanically to changes in relative interest rates here and abroad; it would also be based on the development of our balance-of-payments situation. We would not anticipate using such authority to change the IET rate every month or even with every minor change in the monetary indicators. The frequency of its use would depend on events for which no regular time pattern is foreseeable.

Finally, such authority also insures that when it becomes desirable to lower the tax, gradual and flexible action can be taken without fear that speculative or anticipatory pressures would develop. Investors would be quick to realize that development of such pressures would be met by an immediate reinstitution of the higher rate. In contrast, failure to grant Presidential authority to adjust the rate would necessitate its being set at a level which, under certain economic conditions, would be arbitrarily high.

Let me now turn to two matters which we think warrant legislative action. The first involves the definition of a less developed country shipping corporation. Residents of industrial countries have been forming corporations in less developed countries to engage in the operation of ships registered under the laws of a less developed country. While such ships are engaged in foreign commerce, they have no particular connection, other than registration, to any less developed country. Yet, under the existing exemption, such corporations have been raising funds in the United States free of the tax. It is therefore, proposed that in addition to the existing requirements, a foreign corporation may qualify as a less developed country shipping corporation only if 80 percent or more of each class of its stock is owned by residents of less developed countries, U.S. persons, or both.

The second matter involves the export exemption applicable where an agency or wholly owned instrumentality of the United States, such

as the Export-Import Bank, insures or guarantees the payment of a foreign debt obligation. Under current law, the exemption is applicable only if the debt obligation is issued by the foreign importer. In a number of cases, however, the debt obligation may be issued by a company affiliated with the importer, the importer's bank or a semipublic credit institution. Where a U.S. Government agency or instrumentality is involved, the export nature of the transaction can be relied upon because of its participation. Therefore, the requirement that the importer and the issuer of the debt obligation be the same person seems unnecessary. An amendment to this effect is therefore proposed.

Before concluding my remarks, I would like to invite your attention to an important and beneficial consequence of the interest equalization tax. The growth of the European capital market has been a priority goal of U.S. policy for many years. There has been general recognition that this market could not be developed to handle all of Europe's needs overnight. But, by restraining foreign access to capital and money markets in the United States, the IET in conjunction with the voluntary cooperation program for corporations and financial institutions has operated as one of the primary causes of an important and exciting change in the size and structure of the European market.

The growth of the international capital market—shown in table VIII—has been striking. In 1962, the volume of new international bond issues sold in European markets was $360 million. The flotation of such issues accelerated during the second half of 1963 and, in 1964 reached a level of $991 million. In 1966 the amount of new flotations was $1,286 million, an increase of more than 200 percent over the most recent pre-IET year. And, in the first quarter of this year, new international issues were at an annual rate of $1.8 billion. I am happy to say that the U.S. investment banking houses have shared in this development by heading many of the underwriting syndicates.

TABLE VIII.—*New international bond issues floated in Europe* [1]

[In millions of dollars]

Borrower	1962	1963	1964	1965	1966	1967, 1st quarter
Western Europe	190	362	662	660	686	271
Japan	25	64	209	25		
Other Developed	54	90	42	83	40	45
Total, developed countries	269	516	913	768	726	316
All other countries	14	14	41	24	34	20
International institutions	63	4	37	83	36	8
Total	346	534	991	875	796	344
U.S. subsidiaries [2]	14			306	[3] 490	117
Grand total	360	534	991	1,181	1,286	461

[1] Including issues denominated in foreign currencies as well as in dollars; also including portion of foreign issues made in New York and sold to foreigners.

[2] Domestic based as well as foreign based.

[3] Excludes $127,000,000 exchange of convertible debentures for stock by a U.S. corporation to obtain major interest in a foreign enterprise.

One of the particularly attractive features of a well-developed European capital market is illustrated by the increased use of this market by affiliates of U.S. corporations in the financing of their investment needs. Although there were no sales of new long-term securities abroad for the financing affiliates of U.S. companies during 1963 or 1964, by 1966 the amount of such issues had reached the level of $490 million.

There are other welcome developments. The Common Market countries are giving a great deal of consideration to capital market problems and some reforms are being instituted. The Organization for Economic Cooperation and Development is actively working to stimulate improvements. Some liberalization of international capital movements has taken place—for example, the recent French measures reducing some of their remaining restrictions on capital flows.

Unfortunately, progress in this area is not always easily achieved, and there have also been some setbacks. The disparity between the capital export capacity of the U.S. market and that of capital markets abroad remains too wide to permit us to remove the IET now. One indication of the problem that would be faced is suggested by the 8- to 9-percent interest rates which for some time prevailed in Germany, and by the fact that even with the substantial—and welcome—decline of recent months, the yield on German public authority bonds has only recently fallen below 7 percent.

Another indication of the problem is the inability of national markets in Europe to satisfy even their own nationals. The list of borrowers in international bond markets in recent months has included major companies from Italy, Germany, and France. Borrowings by such firms, along with frequent borrowings by Scandinavians and a few others, have led to an increase in international bond issues by Western Europeans from less than $300 million in 1962 to over $700 million last year. Some—perhaps many—of these borrowers would forsake the international bond market in Europe and return to New York if the disincentive of the IET were removed.

These are compelling reasons for the extension and reinforcement of the interest equalization tax along the lines we have proposed. In this new form the interest equalization tax will continue to make a vital contribution to the current U.S. balance-of-payments program. In addition, it will serve as an adaptable policy instrument for dealing with likely changes in the world economic situation and changes in the international payments position of the United States.

Our payments position still requires corrective measures. I, therefore, earnestly request prompt action on the foregoing recommendations.

I have a supplementary statement of recommendations for tightening certain provisions of the tax so as to meet a problem of evasion that has become significant in recent months.

Thank you, Mr. Chairman.

I would like now to discuss with you the interest equalization tax evasion problem.

As you know, the IET does not apply to purchases of foreign securities by Americans from American sellers. We have found that tax evaders are selling foreign securities in the United States with false representation as to American ownership.

The evidence does not indicate widespread individual noncompliance with IET laws but rather that a limited number of unscrupulous persons have operated to evade the IET. Indications are that the fraud became sizable toward the end of 1966, perhaps stepping up in the first part of 1967, and probably substantially cut back by the end of last month as a result of our investigations. The Internal Revenue Service investigations of evasions over the past 6 months have identified, on a projected annual basis, illegal security transactions in the order of $100 to $150 million, an annual rate. If left unchecked, the amounts involved in evasions could go considerably higher. We are concerned by any evasion and I want to describe in some detail both the manner in which evasion has been taking place and our proposals for stopping it.

Senator WILLIAMS. Just to get it straight, the statement you just made is in support of the bill as passed by the House, is that correct?

Mr. DEMING. No, Senator; it is in support of the bill passed by the House with three amendments that are suggested, for the less developed shipping corporation and dealings with a foreign importer but more importantly with a change in the range of flexibility from zero to 2 percent.

Senator WILLIAMS. Are those the amendments that you are going to discuss in the supplementary statement?

Mr. DEMING. No.

Senator WILLIAMS. What are you going to discuss in that?

Mr. DEMING. Amendments that will deal with this problem of evasion that has received some publicity.

Senator WILLIAMS. Are we discussing two bills here?

Mr. DEMING. No, sir.

Senator WILLIAMS. Are you going to rewrite this bill or suggest a rewriting of the bill?

Mr. DEMING. Suggesting additional amendments in this bill to deal with the evasion problem.

Senator WILLIAMS. Are those amendments in written form before us at this time?

Mr. DEMING. Yes, sir. I have a supplemental statement here which is attached, recommended amendment to the IET Extension Act of 1967.

Senator WILLIAMS. Have they been drafted so that they can be put in the record at this point?

Mr. SURREY. They are in the form of a detailed explanation attached to Mr. Deming's supplementary statement where they are fully explained.

Senator WILLIAMS. When will the amendments be drafted in a form in which they can be made available?

Mr. SURREY. When the committee desires to take them up in executive session.

Senator WILLIAMS. I insist that they be ready before that so we can put them in the record and so industry can look at them and then we can let them testify. If we are going to hold hearings on a new bill it ought to be available. Surely, you have had time to draft these. I know you approach this ofttimes that it is sacrilegious to suggest an amendment to a House bill, but I see you have converted to the idea that

they can be improved upon. I would like to ask you, When can you get these amendments printed, and would you be available to come back and answer questions in public or testify to them, if necessary?

Mr. SURREY. Certainly, Senator. I do think when you come to Mr. Deming's statement you will see how detailed the explanation is. It is in such detailed form that I think people will be fully aware of the nature of the amendments and be able to comment on them.

Senator WILLIAMS. I still think the amendments should be drafted.

Mr. SURREY. We will try to have them up next week.

Senator WILLIAMS. If not next week we will postpone action to give you the time you need.

Mr. SURREY. They will be ready next week. I think when you come to Secretary Deming's supplementary statement you will see the nature of the detail that is available there.

Senator WILLIAMS. All right, you can proceed, then.

The CHAIRMAN. I would think that the Secretary could talk about anything. That does not mean we ought to vote on it until we see what it looks like.

Senator WILLIAMS. I have no objections to his talking about it. But I do have objections to going into an executive session on a whole new bill that has not been available either to members of the committee, the Treasury Department or anyone else. If these issues which have been raised here are important enough to be considered by the committee, they are important enough to have a solution in advance.

Mr. DEMING. We can have them by Monday, Senator.

Senator WILLIAMS. Fine.

The CHAIRMAN. I would suggest they be made available as soon as they are drafted.

Senator WILLIAMS. And made a part of the record Monday.

The CHAIRMAN. You can release the draft or we could. We would hope that the draft of these amendments should be available to industry witnesses before they testify on Monday. If that is possible we would like to do that, otherwise we will do the best we can.

Senator WILLIAMS. Maybe we could postpone Monday's hearings until Tuesday. I think all parties concerned have a right to know what we are testifying on.

The CHAIRMAN. I suggest we play it by ear and see where we stand. I think it is impossible to predict how long drafting sessions take on these very complicated measures.

Mr. SURREY. I think when you come to Mr. Deming's statement you will see the wealth of detail that is available there.

Senator SMATHERS. I would like to go ahead and hear what he has to say and we will know a little bit better what we are talking about, and how much more detail we want.

Senator WILLIAMS. I want to hear the statement, but what gives me concern, is that any proposal that is so complicated, it takes 3 months to draft, is too complicated for me to understand in 1 hour's executive session.

Mr. DEMING. It hasn't taken 3 months to draft it. We have been doing an investigation and proceeding as rapidly as we could, seeing what the problem was and what the operation entails and I don't think it will take us that much longer to draft it, to draft the amendments.

The CHAIRMAN. You may proceed.

Mr. DEMING. Since the law went into effect, the Internal Revenue Service has conducted an educational campaign about its requirements, primarily for the benefit of security brokers. Delinquency checks were initiated to determine whether the tax was being paid on taxable purchases. Reports of alleged fraudulent transactions have been investigated. A special grand jury established in the southern judicial district of New York has returned indictments against six individuals and one corporation. The cases are awaiting trial for IET offenses and are scheduled for hearings in September.

Although considerable publicity has resulted from these legal actions, they have not achieved the degree of deterrence hoped for at the time of the establishment of the grand jury. This spring, the Securities and Exchange Commission provided the Internal Revenue Service with information obtained from a study of foreign securities trading which indicated that IET violations were taking place, possibly on a substantial scale.

For example, there appeared to be a large volume of transactions in which foreign-owned stocks were channeled through foreign broker-dealers into the United States as if they were American-owned foreign stocks. In many cases, the certificate of American ownership, which was arranged to accompany the stock, was signed by an American citizen of unsubstantial means, residing outside of this country. These certificates were false. In some cases, documentation was arranged to make the American signing the certificates appear as the bona fide owner and seller of the stock. In some other cases, the American simply signed a certificate of American ownership in blank in exchange for a "fee" which sometimes amounted to $10 per certificate.

The foreign broker-dealer would generally sell the foreign stocks, accompanied by the false certificates, to a small American over-the-counter broker-dealer. Typically, this dealer, in turn, would then resell the stock in the United States to larger broker-dealers specializing in foreign securities, confirming to them that the stock was American owned. In the case of over-the-counter trading, a written confirmation received from a member of the National Association of Security Dealers, an association covering almost all American broker-dealers, is accepted as conclusive proof of prior American ownership, unless the confirmation is qualified, or unless the person making the acquisition has actual knowledge that the confirmation is false in any material respect. The largest broker-dealers presumably rely on this "clean confirmation" procedure, as it is called. In some cases, involving substantial volumes of stock, the foreign broker-dealers would sell directly to large American broker-dealers, some of whom are members of the major national securities exchanges.

These transactions appear to have been concentrated in foreign stocks with special appeal. The prices of these stocks abroad are generally several points or more below the price of the same shares when they are sold by one American to another on a tax-free basis. This spread of several points furnishes the profit resulting from these tax-evading transactions.

I come now to the possible solutions. At one end of the range of alternatives would be application of the interest equalization tax to transactions in foreign stocks between Americans, as well as to the

purchase of such stocks by an American from a foreigner. To take this action would mean penalizing many legitimate transactions which do not hurt our balance of payments, in order to catch those fraudulent transactions which do hurt our balance of payments. This does not seem an appropriate solution.

At the other end of the range of alternatives would be an amendment of the IET law to exempt from the tax the purchase of outstanding foreign stocks from foreigners. This was suggested when the IET was first considered. The suggestion was discarded at that time, and I think properly so. The reasons are as follows:

Failure to tax outstanding equities at the same rate as new issues would lead to their substitution for the new issues as a means of raising capital in the United States. No one can distinguish new shares of stock from old once they are issued, and a sizable potential would be opened for the movement of American funds to Europe through secondary distribution of unissued stock, or stock assembled for sale from a group of foreign stockholders.

These techniques are well known. It would not be much of a problem for a potential European borrower to exchange new stock for outstanding blocs of foreign stock in his own stockholder's hand and then offer the latter to American customers as a means of raising funds tax free in the United States. American-owned foreign companies could be formed to do the same thing.

On the demand side, American investors have in the past and may again, in the absence of a tax on purchases of outstanding foreign stocks, become heavy buyers of such stocks with consequent adverse effect on our balance of payments. We simply cannot afford a weakening of this important legislation during this period of substantial balance-of-payments deficits.

Instead of either of the extreme solutions mentioned above, we are proposing one aimed, essentially, at eliminating the possibility of tax-free transactions among Americans in foreign securities based on false American certificates of ownership.

The Treasury recommends the establishment, effective Saturday, July 15, 1967, of a new system with respect to transactions between American buyers and sellers of foreign securities. The new system is designed to prevent evasion of the interest equalization tax.

In the past, sellers of foreign securities to American buyers could exempt the purchaser from payment of the interest equalization tax by assertion, on their part, of U.S. citizenship and ownership of the securities in question. Proof of American ownership was evidenced by an American ownership certificate signed by the seller.

Under the new system, the seller must, in addition to establishing his U.S. citizenship and ownership, establish that he obtained the securities "validly."

The seller can satisfy this requirement in the following manner:

(1) He can obtain a "validation" from an eligible broker-dealer.
(2) He can obtain a "validation" from an eligible bank.
(3) He can obtain a "validation" from the Internal Revenue Service.

The effect of the new requirements is to replace a system under which certificates of American ownership signed by any U.S. person exempted the buyer from payment of the tax with a new system under

which certificates issued by a limited number of institutions and the Internal Revenue Service are required to provide the buyer with this exemption.

To insure compliance at the "eligible" broker-dealer and bank level new reporting and recordkeeping requirements are being established, involving segregation of transactions in foreign securities from transactions in domestic securities.

To effect the transfer to the new system, the list of eligible broker-dealers will initially encompass all members of the New York Stock Exchange, the American Stock Exchange, and those members of the National Association of Security Dealers with net worth of over $750,000 or who engaged in 300 or more transactions in foreign securities either during the week beginning July 2, 1967, or the week beginning July 9, 1967. The list of these firms will be set forth in the Federal Register and in attachment A.

The list of eligible banks will initially encompass Federal Reserve member banks classified as Reserve city banks.

Additional firms and banks will be added to these lists on appropriate indications that they will meet the reporting and recordkeeping requirements.

Eligible broker-dealers and banks may validate foreign securities held in their custody for American owners as of July 14, 1967. The Internal Revenue Service will establish by Monday, July 17, 1967, validation procedures with respect to other foreign securities.

The new procedures, described in detail in attachment A, have been prepared in consultation with industry experts in order to minimize technical problems when trading commences on the basis of these new rules on July 17, 1967. In addition, we are making special efforts to disseminate information on the new procedures as quickly and broadly as possible; material is being distributed to the financial community at this moment, giving all the necessary information.

I urge upon this committee the necessary legislative action on the amendments which will make these new procedures effective so that this evasion ends.

(The attachment to the statement follows:)

ATTACHMENT A

RECOMMENDED AMENDMENTS TO THE PROPOSED INTEREST EQUALIZATION TAX EXTENSION ACT OF 1967

EXEMPTION FOR PRIOR AMERICAN OWNERSHIP; DUE DATE OF INTEREST EQUALIZATION TAX

On July 14, 1967 the Treasury Department recommended that the Senate act favorably on H.R. 6098, 90th Congress, 1st Session (the proposed Interest Equalization Tax Extension Act of 1967) as passed by the House of Representatives but with amendments, effective with respect to acquisitions of stock or debt obligations made after July 14, 1967, which would:

(a) Replace the exemption for prior American ownership with an exemption for "prior American ownership and compliance". The new exemption would apply to the acquisition of stock or a debt obligation of a foreign issuer or obligor if it is established that the person from whom such stock or debt obligation was acquired (the "seller") (i) was a United States person throughout the period of his ownership or continuously since July 18, 1963, (ii) had not acquired such stock or debt obligation under an exemption which made him ineligible to sell such stock or debt obligation as a United States person, and

(iii) had complied with his interest equalization tax obligations with respect to such stock or debt obligation (i.e., the seller acquired such stock or debt obligation in an acquisition which was not subject to the interest equalization tax or the seller paid the tax).

(b) Provide that if stock of a foreign issuer or a debt obligation of a foreign issuer or obligor was acquired by a United States person in a transaction subject to the interest equalization tax, the United States person is required to file an Interest Equalization Transaction Tax Return accompanied by proper payment prior to any disposition of the stock or debt obligation if the acquisition had not been reported on the appropriate Interest Equalization Quarterly Tax Return accompanied by proper payment.

(c) Specify the manner, described below, under which the exemption for prior American ownership and compliance can be established.

(d) Amend the provisions with respect to "regular market" trading on certain national securities exchanges and "clean comparison" trading in the over-the-counter market set forth in section 4918 of the Internal Revenue Code so that they are applicable only to those members and member organizations of national securities exchanges or national securities associations registered with the Securities and Exchange Commission, which have agreed to comply, and do comply, with the amended statutory provisions and with the documentation, record-keeping and reporting requirements established by the Secretary or his delegate (referred to in this Notice as "Participating Firms"). During the period beginning July 15, 1967 and until a notice or notices to the contrary are published by the Internal Revenue Service, it will be presumed that (i) all members or member organizations of the New York Stock Exchange, (ii) all members and member organizations of the American Stock Exchange, and (iii) those members or member organizations of the National Association of Securities Dealers, Inc., which either reported a net capital (as defined in Rule 15c3-1 under the Securities Exchange Act of 1934) of $750,000 in the latest financial statement filed with the Securities and Exchange Commission on Form X-17A-5 prior to July 13, 1967, or which have affected 300 or more transactions in foreign securities during either the week commencing July 2 or commencing July 9, 1967 (which members or member organizations of the National Association of Securities Dealers, Inc., are listed below) have agreed to comply, and are complying, with such amended statutory provisions and with the documentation, record-keeping and reporting requirements and shall be Participating Firms.

Participating Firms As Of July 15, 1967

The Participating Firms as of July 15, 1967, are as follows:

All members and member organizations of the New York Stock Exchange.

All members and member organizations of the American Stock Exchange.

The following members and member organizations of the National Association of Securities Dealers, Inc., not members or member organizations of the New York Stock Exchange or the American Stock Exchange:

1. A. E. Ames Co., Inc., New York New York
2. Allen & Co., New York, New York
3. Allison-Williams Company, Minneapolis, Minn.
4. B. C. Ziegler & Co., West Bend, Wisc.
5. Bankers Securities Corp., Philadelphia, Pa.
6. Barrow, Leary & Co., Shreveport, La.
7. Calvin, Bullock Ltd., New York, New York
8. Carl Marks & Co., Inc., New York, New York
9. Cartwright, Valleau & Company, Chicago, Ill.
10. Childress & Co., Jacksonville, Fla.
11. City Securities Corp., Indianapolis, Ind.
12. Collett & Co., Inc., Indianapolis, Ind.
13. Cumberland Securities Corp., Nashville, Tenn.
14. Dayton Bond Corp., Dayton, Ohio
15. Dempsey & Co., Chicago, Ill.
16. Distributors Group, Inc., New York, New York
17. Donald B. Litchard, Boston, Mass.
18. Dreyfus Corp., New York, New York
19. E. L. Villareal Co., Inc., Little Rock, Ark.
20. E. M. Warburg & Co., Inc., New York, New York
21. Eaton & Howard, Inc., Boston, Mass.

22. Equitable Securities Corp., Nashville, Tenn.
23. Excelsior Option Corp., Boston, Mass.
24. F. Eberstadt & Co., New York, New York
25. F. I. duPont, A. C. Allyn, Inc., New York, New York
26. First Boston Corp., New York, New York
27. First Investors Corp. of New York, New York, New York
28. First Southwest Co., Dallas, Tex.
29. Glover & MacGregor Inc., Pittsburgh, Pa.
30. Gordon B. Hanlon & Co., Boston, Mass.
31. Gross & Co., Los Angeles, Calif.
32. H. S. Kipnis & Co., Chicago, Ill.
33. Halsey, Stuart & Co., Inc., Chicago, Ill.
34. Hamilton Management Corp., Denver, Colo.
35. Henry Spiegel, New York, New York
36. Hettleman & Co., New York, New York
37. Hickey & Co., Chicago, Ill.
38. Hirsch & Co., Inc., New York, New York
39. IDS Securities Corp., Minneapolis, Minn.
40. Insurance Securities Inc., Corp., Houston, Tex.
41. J. C. Bradford & Co., Inc. Nashville, Tenn.
42. J. S. Strauss & Co., San Francisco, Calif.
43. John Nuveen & Co., Inc., Chicago, Ill.
44. John W. Clarke & Co., Chicago, Ill.
45. Kalman & Co., Inc., St. Paul, Minn.
46. Kenower, MacArthur & Co., Detroit, Mich.
47. Loomis, Sayles & Co., Inc., Boston, Mass.
48. M. A. Schapiro & Co., New York, New York
49. National Securities & Research Corp., New York, New York
50. National Variable Annuity Co. Fla., Jacksonville, Fla.
51. Parsons & Co., Inc., Cleveland, Ohio
52. Paul Revere Variable Annuity Ins. Co., Worcester, Mass.
53. Pflueger & Baerwald, San Francisco, Calif.
54. R. S. Dickson & Co., Inc., Charlotte, N.C.
55. Richard W. Clark Corp., New York, New York
56. Second District Securities Co., Inc., New York, New York
57. Stephens, Inc., Little Rock, Ark.
58. Stern Brothers & Co., Kansas City, Mo.
59. Stetson Securities Corp., Fairfield, Conn.
60. Stone & Youngberg, San Francisco, Calif.
61. Stryker & Brown, New York, New York
62. The Crosby Corp., Boston, Mass.
63. Thomas, Haab & Botts, New York, New York
64. Thomas McDonald & Co., Chicago, Ill.
65. Troster, Singer & Co., New York, New York
66. Vance, Sanders & Co., Inc., Boston, Mass.
67. Waddell & Reed, Inc., Kansas City, Mo.
68. Weedon & Co., San Francisco, Calif.
69. Wellington Management Co., Philadelphia, Pa.
70. Wheeler, Munger & Co., Los Angeles, Calif.
71. White Weld & Co., New York, New York
72. William C. McDonnell, New York, New York
73. William E. Pollack & Co., Inc., New York, New York
74. Wood Struthers & Co., Inc., New York, New York

Changes in List of Participating Firms

Any other member or member organization of a national securities exchange or a national securities association registered with the Securities and Exchange Commission may become a Participating Firm if it files with the Commissioner of Internal Revenue, Washington, D.C., 20224 (Attention: CP) a letter signed by the member, a partner or an officer (i) requesting designation as a Participating Firm, (ii) agreeing to comply with the documentation, record-keeping and reporting requirements established by the Internal Revenue Service (whether established prior or subsequent to the date of the letter), (i'') agreeing that its books and records no matter where located may be examined by any employee of the Internal Revenue Service, and (iv) if the letter is filed with the Commis-

sioner of Internal Revenue on or after August 15, 1967 stating that such documentation, record-keeping and reporting requirement procedures are operational. The Internal Revenue Service will from time to time publish the names of those members or member organizations which have become Participating Firms subsequent to July 15, 1967.

Any member or member organization which became a Participating Firm prior to August 15, 1967 shall cease to be a Participating Firm unless on or before August 15, 1967 it files with the Commissioner of Internal Revenue a letter signed by the member, a partner, or an officer setting forth each of the items (i) to (iv), inclusive, of the preceding paragraph. A Participating Firm may terminate its status as such by filing a request with tne Commissioner of Internal Revenue. In addition, if the Commissioner of Internal Revenue has reasonable cause to believe that a Participating Firm is not complying with such statutory provisions, or with the documentation, record-keeping and reporting requirements, or any part thereof, he may cause the removal of such firm from the list of Participating Firms.

The effective date on which a member or member organization shall become or cease to be a Participating Firm shall be the date specified in a notice issued by the Internal Revenue Service, which date shall not be prior to the date following the date on which the notice was made available to financial publications and wire services.

Establishment of Exemption for Prior American Ownership and Complianc

The Treasury recommended that the amendments to H.R. 6098 authorize the following procedures, effective July 15, 1967, for the establishment of the exemption for prior American ownership and compliance:

1. If a United States person acquiring stock of a foreign issuer or a debt obligation of a foreign obligator directly from or through a Participating Firm receives in good faith from the Participating Firm an "IET Clean Confirmation" (meeting the requirements described below) applicable to the particular stock or debt obligation acquired, the exemption for prior American ownership and compliance shall be deemed to have been established.

2. If a United States person acquiring stock of a foreign issuer or a debt obligation of a foreign obligor receives in good faith copies 1 and 2 of a Validation Certificate issued by the Internal Revenue Service to the seller or to himself applicable to the particular stock or debt obligation acquired and, in the case where the Validation Certificate was issued to the seller, completes and files copy 2 of the certificate with the Internal Revenue Service, the exemption for prior American ownership and compliance shall be deemed to have been established.

3. If a United States person acquiring stock of a foreign issuer or a debt obligation of a foreign obligor establishes that there is reasonable cause for an inability to establish prior American ownershp and compliance in accordance with one of the foregoing, prior American ownership and compliance may be established by other evidence which satisfies the Internal Revenue Service that the person from whom such acquisition was made was a complying United States person not ineligible to sell as a United States person.

Sales Effected by Participating Firms

The Treasury further recommended that the amendments to H. R. 6098 provide that Partcipating Firms are required to sell stock of a foreign issuer or a debt obligation of a foreign obligor as stock or a debt obligation not exempt from the interest equalization tax by reason of the exemption for prior American ownership and compliance except in the following cases:

1. The Participating Firm (i) held in its custody at the close of business on July 14, 1967 for the account of the seller the stock or debt obligation being sold, (ii) has in its possession and relies in good faith on a certificate of American ownership with respect to the stock or debt obligation being sold, or a blanket certificate of American ownership with respect to such account, and (iii) included the stock or debt obligation in the Transition Inventory of the Participating Firm duly filed with the Internal Revenue Service as hereinafter provided.

2. The Participating Firm purchased on or after July 15, 1967 for, or sold to, the seller the stock or debt obligation being sold if the exemption for prior American ownership and compliance applied to the seller's acquisition and if the Participating Firm continuously held in its custody such stock or debt obligation or received from the seller the identical stock certificates or evidence of indebtedness which it had previously delivered to the seller in respect of the purchase.

3. The Participating Firm received the stock or debt obligation being sold from another Participating Firm or from a Participating Custodian with a Transfer of Custody Certificate meeting the requirements described below.

4. The Participating Firm has received from the seller copies 1 and 2 of a Validation Certificate issued by the Internal Revenue Service applicable to the stock or debt obligation being sold and on the date of the sale or the next business day completes and files copy 2 of the certificate with the Internal Revenue Service.

5. The Participating Firm withholds the amount of Interest Equalization Tax which would be imposed had the seller purchased in a taxable acquisition the stock or debt obligation being sold on the day of the sale. Information on withholding procedures will be published shortly.

IET Clean Confirmation

A Participating Firm is authorized to issue an "IET Clean Confirmation" to a customer with respect to stock or a debt obligation of a foreign issuer or obligor in the following circumstances:

1. In a case where the Participating Firm purchased the stock or debt obligation as broker for the customer from or through another Participating Firm in the regular market (in the case of a purchase on a national securities exchange referred to in Section 4918(c) of the Internal Revenue Code) or received a clean comparison from another Participating Firm under the procedures referred to in Section 4918(d) of the Internal Revenue Code.

2. It sold the stock or debt obligation as dealer to the customer and it was a complying United States person not ineligible to sell as a United States person.

Each IET Clean Confirmation shall state the date of acquisition, the number of shares or the face amount of obligations purchased, the description of the stock or debt obligations, the price paid and the name of the broker representing the seller and the market on or through which the purchase was effected. Only an original document may constitute an IET Clean Confirmation and each copy or duplicate shall be marked as such. All other confirmations issued by Participating Firms with respect to stock or debt obligations of foreign issuers or obligors shall be clearly and indelibly marked so as to be distinguishable from IET Clean Confirmations.

Issuance of Validation Certificates

Validation Certificates will be issued by all District Directors of Internal Revenue commencing Monday, July 17, 1967, upon proof that the United States person on whose behalf the Validation Certificate is requested has complied with his interest equalization tax obligations with respect to the securities to be covered by the Validation Certificate. The Internal Revenue Service will shortly announce the procedures for obtaining Validation Certificates. Each District Director will reissue Validation Certificates in different demoninations upon request.

Transition Inventory

The Transition Inventory shall be filed with the Commissioner of Internal Revenue no later than August 15, 1967. Each Participating Firm and each Participating Custodian filing a Transition Inventory (Participating Custodians are described below) shall list those stocks and debt obligations of foreign issuers and obligors held at the close of business July 14, 1967, and shall indicate those held for the accounts of United States persons and those held for the accounts of other persons.

Participating Custodians

During the period beginning July 15, 1967 and until a notice or notices to the contrary are published by the Internal Revenue Service, the Participating Custodians are the Federal Reserve Member Banks which are classified as reserve city banks.

A bank or trust company insured by the Federal Deposit Insurance Corporation may become a Participating Custodian if it files with the Commissioner of Internal Revenue, Washington, D.C. 20224 (Attention: CP) a letter signed by an officer (i) requesting designation as a Participating Custodian, (ii) agreeing to comply with the documentation, record-keeping and reporting requirements established by the Internal Revenue Service (whether established prior or subsequent to the date of the letter), (iii) agreeing that its books and records no

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matter where located may be examined by any employee of the Internal Revenue Service, and (iv) if the letter is filed with the Commissioner of Internal Revenue on or after August 15, 1967 stating that such documentation, record-keeping and recording requirement procudures are operational. The Internal Revenue Service will from time to time publish the names of those members or member organizations which have become Participating Custodians subsequent to July 15, 1967.

Any bank or trust company which became a Participating Custodian prior to August 15, 1967 shall cease to be a Participating Custodian unless on or before August 15, 1967 it files with the Commissoner of Internal Revenue a letter signed by an officer setting forth each of the items (i) to (iv), inclusive, of the preceding paragraph. A Participating Custodian may terminate its status as such by filing a request with the Commissioner of Internal Revenue. In addition, if the Commissioner of Internal Revenue has reasonable cause to believe that a Participating Custodian is not complying with the statutory provisions related to the interest equalization tax applicable to it, or with the documentation, record-keeping and reporting requirements, or any part thereof, he may cause the removal of such firm from the list of Participating Custodians.

The effective date on which a bank or trust company shall become or cease to be a Participating Custodian shall be the date specified in a notice issued by the Internal Revenue Service, which date shall not be prior to the date following the date on which the notice was made available to financial publications and wire services.

Transfer of Custody Certificates

Transfer of Custody Certificates shall be issued only by Participating Firms and Particpating Custodians and only in connection with a transfer from the account of a customer of a Participating Firm or Participating Custodian to the account of the same customer with a different Participating Firm or Participating Custodian in the following circumstances:

1. The Participating Firm or Participating Custodian held in its custody on July 14, 1967 for the account of the customer the stock or debt obligation referred to in the Transfer of Custody Certificate and acquired and holds in good faith a certificate of American ownership with respect to such stock or debt obligation or a blanket certificate of American ownership with respect to such account, if it included such stock or debt obligaton in the Transition Inventory duly filed by it with the Commissioner of Internal Revenue.

2. The Participating Firm or Participating Custodian received the stock or debt obligation referred to in a Transfer of Custody Certificate from another Participating Firm or Participating Custodian accompanied by a Transfer of Custody Certificate.

3. The Participating Firm purchased for the customer the stock or debt obligation referred to in the Transfer of Custody Certificate and in connection with the purchase either received (i) a Validation Certificate issued by the Internal Revenue Service, or (ii) was authorized to issue an IET Clean Confirmation and in either case continuously held in its custody the stock or debt obligation so purchased or received back from the purchaser the identical securities or evidence or indebtedness previously delivered to the purchaser.

Record Keeping Requirements

The record-keeping requirements for Participating Firms are, until further notice, identical to the record-keeping requirements for broker-dealers issued pursuant to the Securities Exchange Act of 1934 with the following required modifications:

1. Records of original entry (in most cases the purchase and sale blotter) shall be prepared and maintained separately for all purchases and sales of stock and debt obligations of foreign issuers and obligors. All entries shall clearly designate those transactions which involved foreign-owned securities. All entries reflecting a purchase of securities, the acquisition of which is exempt from the tax under the exemption for prior American ownership and compliance, shall clearly designate the documentation received establishing such exemption. All entries reflecting a sale of securities regular way on a national securities exchange referred to in Section 4918(c) of the Internal Revenue Code or under the clean comparison procedure established by Section 4918(d) of the Code shall clearly designate the documentation authorizing such sale.

2. The securities record or ledger reflecting separately for each stock or debt obligation of a foreign issuer or obligor all "long" or "short" positions

(including such securities in safekeeping) carried by such firm or custodian for its account or for the account of customers (commonly known as stock record sheets) shall be prepared and maintained apart from those prepared and maintained for all other securities. All entries in such record or ledger, and in each customer's account, shall clearly designate those of such securities with respect to which the firm or custodian can issue a Transfer of Custody Certificate without obtaining further documentation.

3. The ledger account itemizing separately the accounts of such firm or custodian reflecting all purchases, sales, receipts, and deliveries of stock or debt obligations of a foreign issuer or obligor for the firm's own investment and trading accounts shall be prepared and maintained apart from those prepared and maintained for all other securities. All entries shall clearly designate those transactions which involve securities on which the firm or custodian can issue a Transfer of Custody Certificate.

Appropriate files for each of said dealer-owned foreign securities shall be maintained, in readily accessible form, to hold all relevant information and evidence to substantiate tax free nature of the acquisitions pursuant to which such securities were acquired or, if acquired in a taxable transaction, the retained copies of the tax returns filed with respect to such acquisitions.

4. Separate files shall be maintained for all interest equalization tax reports filed with the Internal Revenue Service (both for information and tax paying purposes) including copies of all documents filed with the Internal Revenue Service and summaries and supporting schedules. In addition, such files shall contain substantiation of the Transition Inventory filed with the Commissioner of Internal Revenue.

Certain Debt Obligations

The foregoing procedures would not apply to those debt obligations of foreign obligors which are neither convertible nor listed or traded in domestic or foreign markets. In such cases, the exemption for prior American ownership and compliance will, until other procedures are announced, be established if the United States person acquiring the obligation receives in good faith a letter from the seller certifying to the exemption together with a copy thereof and files the copy with the Internal Revenue Service.

The CHAIRMAN. You are aware, are you not, Mr. Secretary, that we do have the power to tax retroactively if we want to do so. I am not saying we should nor am I saying we should not. But with regard to corrupt or illegal transactions, we have a right to go back and tax them if we want to.

Mr. DEMING. Correct. These are not, Senator, a question of applying a tax retroactively where it wasn't supposed to be paid anyway. These are fraudulent transactions where the evader was subject to tax, he just evaded the tax.

Senator WILLIAMS. What you need is a little more vigorous enforcement of the existing law.

Mr. DEMING. It is a procedure and enforcement problem rather than a tax matter itself.

As I said, attachment A, which is quite detailed, runs 21 pages and extends my general statement into specifics. I don't know whether you want me to run through all this or not. But the detail is contained in the attached.

The CHAIRMAN. I do not think we will ask you to go into that right now, Mr. Secretary. The members of the committee can read it and it will be made available to all persons who are here and it will be in the record and we can study this and those who want to testify, interested witnesses can study it. I suggest we do that. We will study this over the weekend.

Does that conclude your statement, Mr. Secretary?

Mr. DEMING. Yes, sir; it concludes my statement.

The CHAIRMAN. Let me ask you first about these evasion matters. What is the penalty for evading the tax?

Mr. DEMING. May I ask Mr. Surrey to answer that?

Mr. SURREY. There are a number of various penalties that apply. There isn't any single penalty. For example, there is a penalty for willful attempt in any manner to evade or to defeat any tax. That is $10,000 fine or 5 years in prison. This is a criminal penalty and turns on all the facts.

The CHAIRMAN. With regard to some of these people in connection with this, do you have any difficulty reaching them—these irresponsible persons outside of the United States?

Mr. SURREY. That is correct. Irresponsible people who have been signing false certificates who are outside the jurisdiction of the United States could not be reached by the United States. You can be a person residing in Bermuda, signing false certificates and the United States could not directly reach you unless you returned to the United States.

The CHAIRMAN. Do we not have some procedures to reach those people?

Mr. SURREY. There is no extradition for these violations. They constitute violations of tax laws and our various extradition treaties do not permit extradition in these cases.

The CHAIRMAN. I am surprised to find that to be the case.

Senator WILLIAMS. Can you cancel their passports?

Mr. SURREY. You might—I am not sure about that.

The CHAIRMAN. One thing we can do if we cannot get cooperation from the Bahamas—we can take away their sugar quota.

Mr. SURREY. These people can be in any country of the world. They can be in any place.

Senator WILLIAMS. You say you are not sure about whether we can cancel the passport. Will you have that checked and put the answer in the record for us?

Mr. SURREY. Yes.

(The Department of the Treasury subsequently supplied the following information:)

TREASURY DEPARTMENT,
Washington, D.C., July 17, 1967.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: At the Senate Finance Committee hearing on July 14, Senator Williams inquired about the possibility of revoking passports as a ready solution to the problem of Americans abroad signing false certificates of prior ownership of foreign stocks.

After looking into this problem we find that the regulations pertaining to the revocation or restriction of passports are in the Code of Federal Regulations (22 CFR 51.70 and 51.71). Section 51.71(c) covering violations abroad of the laws of the United States by Americans is the only provision which appears applicable as a basis to revoke the passport of an American for signing false certificates of prior ownership. Under the provisions of sections 51.80 through 51.105 of Title 22, CFR, however, a passport holder is provided a formal hearing and review of proposed adverse actions under Sections 51.70 and 51.71 before any decision can be made denying, restricting, revoking or invalidating a passport. These regulations preclude summary restriction or revocation of a passport.

We are checking further with the State Department about actual procedures to revoke the passports of Americans abroad who are involved in signing false certificates. However, as I suggested last Friday, the American abroad who signs such a certificate is not the key person in the scheme and therefore, the revoking

of his or her passport would not be an effective immediate solution to the problem. While there are exceptions, I note that while outside the United States in most countries in North, South, and Central America, American citizens are not required to bear valid United States passports.

Sincerely yours,

STANLEY S. SURREY.

Mr. SURREY. These people can be in any country in the world.

The CHAIRMAN. They can be in Tangier, for example, or Monaco, or Switzerland?

Mr. SURREY. Anywhere in the world.

Senator WILLIAMS. But they do need an American passport and it has to be validated here in Washington. We do not have to do that if we do not want to.

Mr. SURREY. He could be a foreigner claiming to be an American and we would have no hold in that particular case.

Senator WILLIAMS. Have there been examples of that?

Mr. SURREY. We don't know, Senator, who all these people are.

Senator WILLIAMS. I am speaking of the cases that you have discovered.

Mr. SURREY. Yes; I am informed there are some.

Senator WILLIAMS. How many foreigners were involved and how many of our citizens were involved that you know of?

Mr. SURREY. I cannot give you a definitive answer to how many are involved. To know how many are involved would require a check of all the certificates that have been filed.

Senator WILLIAMS. I did not ask that—of those that you have discovered.

Mr. SURREY. I think the majority are Americans.

Senator WILLIAMS. The ones that you have discovered—you must know how many there are discovered. You can give us that exact.

Mr. SURREY. Of a certain group of transactions examined, there was one dual, one foreign, and 28 United States. But that ratio doesn't have to hold at any given time. If, for example, it was announced that the United States was going to enforce this measure by withdrawing passports, I am pretty sure that the ratio would change.

Senator WILLIAMS. I am not asking about the prospective. What I was wondering was the experience over the 2 or 3 years in which this has been in effect of those that you have found to have violated, what were their nationalities?

Mr. SURREY. One foreign, one dual, 28 United States.

Senator WILLIAMS. Those are the only ones that you determined were violators? Those are the only ones?

Mr. SURREY. These are the only ones that showed up in the investigation of 15 or 16 brokerage houses in the New York area.

Senator WILLIAMS. I heard a rumor that there was a young lady in one of the islands that signed about $2 million worth of these certificates. What was her nationality? Was there anything to that rumor?

Mr. SURREY. Yes.

Senator WILLIAMS. It is correct?

Mr. SURREY. Yes.

Senator WILLIAMS. How long has the Department known about that?

Mr. SURREY. As Secretary Deming said, the Securities and Exchange Commission notified the Service that it believed that its investigations indicated there could be substantial violations. This was in April this year.

Senator WILLIAMS. Could you furnish the committee a copy of that notification?

Mr. SURREY. It may have been oral. I will check. As soon as that notification was given, the Internal Revenue Service commenced arrangements, using the knowledge of the SEC and at that time assigned an added group of Internal Revenue agents in New York to investigate a number of brokerage houses. The investigation was designed to do two things. It was designed to see whether the violations were substantial. In other words, was there an amount of violation such that remedies need be taken by statute? Secondly, what was the nature of the violations? How did they occur? Was their nature such that they could be handled under existing law? Both things were necessary to put us in the position to make recommendations to this committee. As Secretary Deming said, the violations were substantial, would readily grow if unchecked, and could not be deterred under existing procedures.

Senator WILLIAMS. When was this reported to you, in April of this year?

Mr. SURREY. No; this investigation has been going on continuously since the latter part of April through May and June.

Senator WILLIAMS. When did the report come back to you that you did not have authority under existing law?

Mr. SURREY. I will try to pinpoint the date. My instructions from the very beginning were to find out about the violations and, while working on this, also to prepare a plan of action for this committee. We have had this done in tandem. I don't think there has been a day, Senator, when this has not been moving along. We have been working day and night and in the last week or two with people from the industry. We have examined several methods of enforcement, we have had them checked through. Some methods looked productive but turned out to be not productive. Remember, you have a double game here; you have to see if the suggested procedure will work, can feasibly be handled. You then have to turn around to see if there are holes in it and if there are you have to start over again. We have been doing that.

Senator WILLIAMS. Your investigation was rather thorough and far reaching, as I understand it; is that correct?

Mr. SURREY. In New York I think the investigation was certainly adequate in the time available to establish two things. One, that the violations were substantial and would increase if unchecked, and secondly, that they could not be checked under existing procedures. I would say they were thoroughgoing for those two purposes.

Senator WILLIAMS. Do you think your investigation developed as much information of abuse of this law as was disclosed in the Wall Street Journal, or do you think their investigation was a little more productive than yours?

Mr. SURREY. The Wall Street Journal called this matter to our attention a considerable time after our investigation had been started. I think that—and this is a judgment, Senator—as Secretary Deming

said—that the violations are not in the magnitude set forth in the Wall Street Journal. Our best judgment is that the balance of payments loss would run on an annual basis from $100 million to $150 million. That is our best judgment based on our investigations that have been held in the New York area to date. We have not checked other areas of the country.

Senator WILLIAMS. What concerns me and some others is the fact that we did not get the picture of any concern on the part of the Treasury Department until after these articles were published and it is only since then—you mentioned yourself that you have been working day and night in the last couple of weeks—and now we are coming up with a series of new amendments. As I understand it, when you testified over in the House you were perfectly agreeable to simple extension of this program and we now find that you knew about this and had been notified about it prior to the House action.

Mr. SURREY. No, Senator. We testified in the House in February of this year.

Senator WILLIAMS. At that time you did not do anything about this?

Mr. SURREY. That is right, Senator.

Senator WILLIAMS. Am I correct at that time you did not do—you did not know about any abuses under this law?

Mr. SURREY. Don't say any abuses, Senator.

Senator WILLIAMS. Any significant abuses that would need correction?

Mr. SURREY. We did not at that time know that the violations were of the proportion indicated by our investigation. If we had, obviously we would have made recommendations then.

The CHAIRMAN. I have one question Senator, and then I will let Senator Williams and others ask some further questions.

Senator Williams has suggested that this Government has the right to revoke these people's passports where they go outside this country and commit this fraud. Even if the violations are only of the magnitude you suggest, rather than between $250 million and a billion dollars as suggested by the Wall Street Journal, that is still a lot of tax evasion.

Now, why should we not move to revoke these people's passports and anything else we know, and also call upon those countries to better cooperate with us in reaching those citizens?

Mr. SURREY. Let me indicate one thing, Mr. Chairman. These people that are signing the false certificates are not the principals in the transactions. They are pawns in a much more elaborate scheme. They are the people who, if you give them $10, will sit down and sign certificates. They are merely the pawns in an elaborate scheme or schemes that go far beyond them and therefore they are not really the keys in this. The people who are operating these schemes might be found anywhere in the world. These people who are signing the false certificates are not getting the profits from this and are not the principal movers.

The CHAIRMAN. You also have recourse against the American dealers, do you not?

Mr. SURREY. That question can perhaps be answered this way: The American dealers are not, we believe, the principals in this, either. The principals in this——

Senator WILLIAMS. Did you answer that question yes or no?

Mr. SURREY. The answer is if an American dealer has actual knowledge of a criminal violation he can be prosecuted. The willfulness and the criminality of these transactions turn on actual knowledge. But, when you look at these schemes, the operations do not, as far as we know, originate with American dealers.

Senator WILLIAMS. In a good game of chess one of the first actions is to eliminate the pawns of the opponent and you usually get to the king.

Mr. SURREY. And that is what we are doing in the recommendations before you. We are making it impossible for pawns of this nature to be available and for the scheme to operate in the fashion in which it does. We cannot correct it without these recommendations.

The CHAIRMAN. Senator Smathers?

Senator SMATHERS. Thank you, Mr. Chairman.

I just wanted to ask one or two questions.

First, I would like to state, however, that there are unfortunately people in the United States and throughout the world who in time devise ways and means to get around every law. That is why we continually have to change the law. I do not know at any time we have ever written a law that has been perfect. And this is another illustration, that those who do want in effect to cheat the Government finally devise some way to do it. I congratulate the Treasury and the Wall Street Journal on uncovering this, and the Treasury on the recommendations they have made. In seeking to find a solution to the problem I think you have done very well.

May I ask you this question? In your investigation what proportion of the people who are involved were either Canadian, located in Canada, or had some connection with the Canadian Government?

Mr. SURREY. Could I give you an example of how one of these transactions could work and answer your question in that way, Senator Smathers?

Senator SMATHERS. Surely.

Mr. SURREY. Suppose I want to make some money out of these transactions. I can be anybody in the world. Suppose I set up a Bermuda or Bahamas trust or some organization of that nature. It looks like a reputable organization. I can have an office in Canada. I can have a line of credit in a bank—a Canadian bank or any bank. I look like a responsible businessman. I can open up an account with a foreign broker and I will look like a responsible man.

Senator SMATHERS. You are talking about yourself as an American citizen?

Mr. SURREY. No; I may be an American, I may be a foreigner.

I have an account opened in the name of a Bermuda or Bahamas trust with a foreign broker. That looks like a reputable account because I have a line of credit with a reputable bank. I ask the foreign broker to sell some securities for me, which are foreign securities—to sell those securities on the American market and I present to this foreign broker a certificate of American ownership that has been signed by somebody, for whom I claim to be acting as an agent, who states that he is an American whose signature has been guaranteed by an American bank somewhere. The Canadian broker or any other

foreign broker will transmit those securities to a U.S. broker. The securities will come into the United States, a clerk will look at them, the clerk will see the securities are accompanied by a certificate of American ownership. The clerk will sell those securities on the American market, because any firm can sell securities on the American market, on the exchange, or over the counter, as American-owned if it has in its file a certificate of American ownership, unless it has actual knowledge that that certificate is false.

Now, this is the nature of the transaction. It can have a variety of forms. It can be engaged in by Americans or by foreigners. It can be engaged in by the Canadian brokers or brokers of other countries.

Senator SMATHERS. What I am driving at is this, Mr. Secretary. Apparently under our present law the Canadian new issues are not taxed.

Mr. SURREY. They are not taxable, sir.

Senator SMATHERS. The Canadian Government is a big Government as distinguished from the Bahamian Government or Bermuda Government. I assume they have in Canada what is equivalent to our SEC, although I do not know. But it seems to me that if a substantial portion of these violations came through the Canadian brokerage house or the operation had some Canadian color about it, that the threat of depriving Canadian new issues from that exemption which they now have in the United States would be sufficient to get the Canadian Government to cooperate with you in the elimination of this practice.

Now, if you look at the Bahamian Government, which as we know is small and I am sure they do not have anything equivalent to the Securities and Exchange Commission down there, they do not have the machinery—I do not want to cast any reflection on them—but I doubt if they even at this point have the sophisticated manpower to know exactly what is happening with respect to this type of transaction there, and I suspect that that is very much true in Bermuda. I do not know how you would get at them, but it seems to me it would be very easy to get the total cooperation of the Canadian Government, and it was my—I gathered from reading the Wall Street Journal articles that much of this actually had Canadian coloration.

Mr. SURREY. We assume that the Canadian Government would cooperate. But let me indicate the position of the Canadian broker. All the Canadian broker may know is that an organization or a person who forms an organization wants to open an account with it and asks it to sell some securities.

Now, they in many cases may just be in the position of our brokers. The difficulty has been that the exemption system based on a certificate of American ownership has broken down and you consequently need something more substantial than that. While I mentioned a Bermuda firm, the firm can be set up in any country. In other words, all you have to be is somebody who says, "I would like to sell foreign-owned securities and I have a certificate of American ownership signed by the owner for which I am acting."

Senator SMATHERS. Is there at any time any responsibility on the

brokerage firm to find out something about those people who want to sell through them?

Mr. SURREY. If they have actual knowledge that this certificate is false they are responsible, but you have to remember that many of these transactions are dealt with by clerks. It may be that some of these firms have such knowledge, and only time will tell this for sure. The certificate comes in, signed by a person indicating that the securities are American owned. The certificates have been guaranteed by a bank in some part of this country or by an overseas branch. Someone takes those people into a bank who is known to the bank and says, "I want to introduce to you Mr. So and So who is an American citizen." The bank just validates the certificate, or a quantity of certificates without further questions. This may operate all over the world. The fault lies, as Mr. Deming said, in the fact that the certificate of American ownership is not enough and that the present recordkeeping is not enough so that we have to add to this. Under the Treasury proposal you have to state how you acquired the stock which you are selling and prove that you paid the tax or acquired this stock in a transaction which was exempt. We have to restrict the number of people who can certify to this fact.

Senator SMATHERS. One other question. If we should adopt this law as recommended by you, at that point would you notify all the countries of the world, Tangier, Bermuda, Canada, Bahamas, Panama, wherever they are, to this effect and then at that point is it possible that you could get the cooperation from their governments where their governments could be helpful to us in the stoppage of this particular practice?

Mr. SURREY. If it became necessary. But I think under the recommendations we are making to you this kind of activity could not exist.

For example, it wouldn't do any good any more under our recommendations for a foreign broker to submit to an American broker the foreign stock with the certificate of American ownership. The American broker would have to say, "I am sorry, this is no longer adequate, I need proof that your seller got this in a transaction on which he paid the tax, or was exempt."

The only way that proof can be given is through one of the participating firms on our list which is keeping special records or through the Internal Revenue Service. That is the tightening up that we think is necessary.

Senator SMATHERS. I have no further questions.

The CHAIRMAN. Mr. Talmadge?

Senator TALMADGE. Mr. Secretary, I refer to page 8 of your second statement dealing with violations of the existing law. On page 8, the second paragraph, you state, "Eligible broker-dealers and banks may validate foreign securities held in their custody for American owners as of July 14, 1967." That is today. I presume most stocks are in brokers' offices, but how would he validate a certificate in a deposit box or trunk?

Mr. SURREY. If I had a stock certificate in my deposit box or in my trunk at home—that was your question; is that right?

Senator TALMADGE. Yes, sir.

Mr. SURREY. I can take the documents I have with respect to the acquisition of the stock, if I want to sell the stock as American owned, to an Internal Revenue office on Monday of next week. I will show to the Internal Revenue Service the necessary proof to establish that I am entitled to sell that stock as American-owned and that I received it validly in the sense that I either paid the tax or acquired it in a transaction not subject to the tax (for example, I have held it continuously since July 18, 1963). That is one alternative that I can use.

The other alternative that I can use, if I bought that stock from a participating broker is to go down to that broker and say, "I want to sell that stock." The participating broker can then sell for me if his records will show that he bought it for me before July 19, 1963, or as American owned. Therefore, I have two ways in which I can validly sell.

Now, most Americans—and this is just a statement of how most people handle it—most people will have the securities which they own today, July 14, 1967, either in the custody of their brokers or in the custody of their banks. The banks and brokers if they file the transition inventory we are requesting, can, upon instructions of the owner, sell the securities as American owned without further validation. This will cover the great range of American-held—foreign securities held today. But for those who do not hold them in that fashion, the two routes that I have indicated to you would be available on Monday morning.

Senator TALMADGE. Suppose he does not act on Monday morning?

Mr. SURREY. He dosen't have to act on Monday morning, only when he desires to sell. If I don't desire to sell my stock, nothing changes. I keep it right in my trunk.

Senator TALMADGE. In the first part of the second testimony, table 3. I understand Canada is exempt administratively under the terms of the act on new issues; is that correct?

Mr. DEMING. That is correct; on new issues.

Senator TALMADGE. I notice that the new issues have been going up substantially. In 1962 it was $457 million and in the first half of 1963 it was $608 million and the second half of 1963 it was $85 million and in 1964, $700 million, in 1965 $709 million and in 1966, $922 million and in the first quarter of 1967, $256 million.

Why should they enjoy the privilege that other nations do not enjoy?

Mr. DEMING. Senator, let me say Mr. Knowlton has been dealing with the Canadians on this matter and can speak more specifically to it.

We have an arrangement with the Canadians which I think effectively protects us against abuse of this exemption. If you will notice the footnote on the 1966 figure of $922 million you will see that that figure is before deducting $162 million of Canadian Government purchases from U.S. residents of outstanding foreign securities held in this country.

Senator TALMADGE. I saw that. But that still leaves almost $800 million there whereas the whole of Western Europe for 1966 is only $15 million.

Mr. DEMING. That is right, a little over $700 million—about the

same level in the previous year. Our arrangement with the Canadian Government runs in terms of their reserves and the Canadian Government arranges its transactions so that the total amount of their reserves do not change as the result of Canadian borrowings on our markets.

In other words, the arrangement we have assures us that we don't have a net balance-of-payments drain as the result of these transactions and borrowing in our market.

Broadly speaking, the Canadians run a current account deficit. In other words, we sell them more goods than we buy from them. They run a surplus with most of the rest of the world on current account and the difference between that is made up pretty much by borrowing in our markets. If the Canadians permitted their reserves to increase as a result of borrowing in our markets this would be a net balance-of-payments drain on us. But we have worked out various arrangements with the Canadians, the most significant one of which they have agreed not to have their reserves increase as a result of these borrowings. In a sense what this means is that no matter what the figure is of Canadian borrowings in the United States, the net impact on our balance of payments is zero simply because of the way they manage their reserves.

Mr. Knowlton may want to speak on that.

Senator TALMADGE. On the other developed countries they also have a surplus.

Mr. DEMING. Senator, I think the Canadian situation is a very special situation. The outflow of funds to the developed countries, particularly those in Western Europe is different—these are countries which had surpluses in general. Those surpluses should have been returned in the form of opening up their capital markets to the export of capital. Basically, the countries of Western Europe have been in surplus with the whole world, the world as a whole outside of themselves. Good international adjustment policy would call for that surplus to be reduced, partly by the export of capital. We have tried to arrange it so that they wouldn't increase their surplus by borrowing in our markets.

Senator TALMADGE. Thank you.

The CHAIRMAN. Well, let me ask you about this matter generally.

In view of this rapid increase in interest rates, does that not give you cause for a second thought about the desirability of what we did when we restored the investment credit this year?

Mr. DEMING. I don't think it raises that question particularly. The rapid run up in interest rates that has taken place, particularly in the last 3 months I think is a reflection of several factors, but the increase in investments in plant and equipment I would say has been a relatively small part of that borrowing increase.

Corporations in general have remembered what happened to them in 1966 when they got pinched in the very severe credit squeeze at that time. To meet their financial requirements they ran down some of their liquidity and have been attempting to restore their liquidity by borrowing primarily in the capital markets and have been borrowing to

repay some of the bank loans that they did make in 1966 and I think that there is a fairly substantial amount of what you might call anticipatory borrowing as a result of a feeling that things could get tighter as the economy expands. They are in a sense inventorying money, if you want to put it that way. All of these factors have been more important, I think, than the increase in plant investment expenditures which as you know from the surveys and forecasts that have been made, don't show anything like the big change in 1967 as took place in 1966. Consequently I would doubt that the restoration of the investment credit is having a major impact on the demand for either bank or capital credit.

The CHAIRMAN. It seems to me that we would do well to take a look at it and see to what extent that may be the case. It certainly suggests that we might have made a mistake in restoring this investment tax credit so soon. It may have been a strong factor, if not the major factor in pushing these interest rates on up.

With regard to this idea of this interest equalization tax generally, is this not pretty much a recognition of the fact that each nation can and in many respects must assume the responsibility for both the purchasing power of the currency and the rent that people have to pay on money in the country—a recognition that we cannot very well rely on some international board to determine what level of interest rates this Nation's economy requires in order to stay prosperous and sound? Is that not about the size of it?

Mr. DEMING. Yes, Senator. The interest equalization tax is a device which, while providing for a market determination as to whether borrowers come in or don't, tends to insulate the domestic interest rate structure from heavy demands from abroad. Now, it could have gone three ways beginning with the outflow of capital which was acting adversely on our balance-of-payments account. You could have established, as my statement indicates, capital issues controls in which everybody that wanted to sell a security could come in and get permission. Many countries use this sort of technique. It seemed to us that it was inadvisable. It was more interference than was warranted. You could have let interest rates run up to a level that would be equivalent to levels elsewhere and in that case there would have been no incentive. Given the state of the American economy where we wanted to foster growth, this seemed not a good economic description and it would have led to much higher interest rates in this country.

The third way of doing this was to attempt to drive a wedge in between the domestic rate structure and foreign rates, and this is the approach taken by the equalization tax.

On the record, as Senator Talmadge was noting there, it had a pronounced effect. Obviously no one knows how much borrowing would have taken place without the interest equalization tax, but if you just look and see what happened to the countries that were not subject to the tax—the less developed countries and, Canada—their borrowings did increase in this country, and if you applied that same percentage increase to what the developed world was borrowing in 1963, before the imposition of the tax, you could get an estimate for the borrow-

ing in our capital markets which might be as much as $500 million, $600 million, $700 million.

In 1966 new security issues of developed countries were $19 million of which half was subject to the tax. So that I think it has had a pronounced effect.

The CHAIRMAN. It seems to me what we have had to do here is to recognize that we have a responsibility to our own people and to our own economy, our own economy domestically which in the last analysis must come first.

Now, we have been told for a number of years that we had to have high interest rates because if we did not have high interest rates our gold would flow out.

The answer to that is fairly clear. When the gold flow becomes a real problem there are a number of things you can do about it, and one of them is, that insofar as there is an interest rate differential you can tax that differential until it no longer exists. That is the answer we are pursuing here, is it not?

Mr. DEMING. That is correct.

The CHAIRMAN. We seek to keep these equal. With regard to this flexible authority you are asking for here, just how do you propose to handle it? Do you propose to change it by one-eighth of a point or one-tenth of a point, or do you plan to change it by going from a half point or a quarter of a point or by smaller fractions?

Mr. DEMING. Mr. Chairman, I don't think I can answer that explicitly because I don't know what is going to happen.

The CHAIRMAN. If you do not know what you are asking for, it is sort of hard to expect to get it.

Mr. DEMING. Let me elaborate what I am saying here. The interest rate differential at the present time is effectively 1½ percent. That seems to be an interest rate differential that protects us because you can see there has been absolutely no borrowing subject to the tax in 1967 in the first quarter.

Now, presently, the spread, given the information that we have, is something over 1 percent but less than 1½ percent between us and the foreign markets.

Given this sort of situation I expect we wouldn't be likely to move the 1½-percent rate. We wouldn't try to move it down to 1.37 or 1.26 or some such thing like that. It is much more likely we would be moving this in quarter points than eighth points, because I think eighths are trying to tune this too finely. Quarters would be quite logical and if the spread widened fairly suddenly or narrowed fairly suddenly we might move as much as a half point down. All I was trying to say in my answer to you at first is that I couldn't say explicitly that you do all of them in halves. You would do probably halves or quarters and it is highly unlikely that one would do eighths.

The CHAIRMAN. Let me see if I understand how you would seek to administer this.

Do I understand that you would do this on a country-by-country basis?

Mr. DEMING. No.

The CHAIRMAN. So generally you are looking at Western Europe, then?

Mr. DEMING. Western Europe and the list of developed countries we have.

The CHAIRMAN. Japan?

Mr. DEMING. That is right.

The CHAIRMAN. So let us assume that you are looking at what appears to be an inadequate rate of 1 percent. I take it that you would rather not move in eighths. You think maybe one and a quarter may do it so you would go to one and a quarter. Would you just watch to see what happened?

Mr. DEMING. You would watch two things, Mr. Chairman. One thing that you would keep current on is the spread between rates abroad and the rates here.

The second thing that you would watch, and it would be a perfectly sensitive indicator, whether there were many securities being brought in. If you thought that a 1-percent rate was holding and you got some evidence that borrowers were coming in to borrow at any significant volume, you would move it. You would move it in the way any financial institution would move it to attempt to choke this off. My judgment would be that a quarter in most instances would be adequate to do this, but you might move it a half and if you had a change between zero and 2 percent you might move it even more than a half. But the twin indicator would be the rate spread which has given you a sort of feel of what would be happening, and the concrete evidence as people began to come in.

The CHAIRMAN. My understanding was that for a while a 1-percent interest equalization tax was holding the situation in hand, even though the differential was 2 percent.

Mr. DEMING. There was a 2-percent differential between some countries and the United States. But that differential didn't apply to all countries, and in some countries you could borrow in other markets. This is what has been happening in Western Europe. So that it isn't necessary, I think, to try to tune this precisely between the United States and each of the other countries, because the markets are much more flexible than that. You try to tune it to the average borrowing differential which is what we have tried to illustrate in these tables.

The CHAIRMAN. My impression was that there is something of a principle here—someone taught me in physics that starting friction is greater than sliding friction so once a thing starts moving it moves more easily and does not require as much effort to move it faster. Once the inertia has been overcome people start using it and then they will take advantage of the American market much more readily than they would than when they felt they were all thumbs and did not know how to do it. Once they got accustomed to it they would advise their clients to use it, it would seem to me.

Mr. DEMING. That is correct.

The CHAIRMAN. So I should think that this is no longer the impedi-

ment it once was, that people would go ahead and seek the money in this market if they thought they were justified in doing so.

You would then, I assume, try to keep the top pretty much within the differential and you think it should not exceed 2 percent. You do not think you will need more than 2 percent?

Mr. DEMING. I don't think we will need more than 2 percent, sir.

The CHAIRMAN. Do I understand from your statement here, then, that your understanding is that the differential is now less than 2 percent between the interest rates in Western Europe and the interest rates that we are paying here?

Mr. DEMING. On the average, Mr. Chairman, the differential, which I think is shown perhaps best in table 1, where you get a comparison of yields between the United States and other countries. The differential for Western Europe, as of May, which is the last time we can do this particular statistic is about 1.1 percent.

Senator WILLIAMS. It is less than that right now.

Mr. DEMING. It is still over 1, we think, Senator. These tables here are arranged in composites as you know and require some statistical work. Given the information that we have currently on rates in Europe and rates here, that differential might be a shade less than 1.1 percent, but I think it is still over 1. It has been wider as you can see. As of February it was 1½ percent.

The CHAIRMAN. I notice now that you had differentials as high as 2.33 in the United Kingdom and as high as 3.32 in Germany and 3.77 in Denmark. In some of those countries it has been well above the 2 percent.

Mr. DEMING That is right, Mr. Chairman. With respect to individual countries, it has been about that—their going rates on Government securities and our rate on Government securities here indicates that differential. But even though the rates in those countries at that point in time were high, we haven't had them borrowing in this country for I think two basic reasons. It was not necessarily the Government's policies to be borrowing in that point of time so they may not have had any need to borrow.

Secondly, there were other places, including the international markets here, where they could get a better rate than in their own country, and with an interest equalization tax, not a more favorable rate than they could get in the United States.

The CHAIRMAN. What is your present Treasury bond yield for long-term and short-term bonds?

Mr. DEMING. Our present yields on Treasury bonds, Senator—I have a table here which I just developed.

The CHAIRMAN. Just give me something on long term.

Mr. DEMING. On long-term bonds, approximately 4¾ percent and on short-term issues at the present time, the 3-month Treasury bills are in the neighborhood of 4¼ percent.

Senator WILLIAMS. Long-term bonds are up as high as 5 percent, too, are they not?

Mr. DEMING. Some of them are. But I was talking about these things

in general. The closing yield on these rates and on yields of the longest area we have is 4.53. They have ranged, for some issues of 1974, a yield of 5.13, but the average I think is roughly 4¾ for the long term.

The CHAIRMAN. If we get these rates back down, and it seems to me we have a duty to certainly try to do it, might we not need then a higher rate of tax for interest equalization purposes than you describe here?

Mr. DEMING. Senator, it is possible, I think, for the differential to be greater than 2 percent. I do not think it is very likely. So far we have been able to hold this with a rate that is 1½ percent and we have held this for a period of time from 1963 up until the spring of this year with a 1-percent differential and you can see the results from the table. So I doubt that we would need to go beyond the 2 percent rate. We picked the range from zero to 2. We think this would be an effective rate.

The CHAIRMAN. Would you mind implementing just for the record what your trade surplus figures include and what it does not include? For example, costs, insurance, and freight and various adjustments. These are items we have considered regarding statistical differences between the f.o.b. and the c.i.f. basis.

Also, just to make it clear, show just how much this disposal of agricultural commodities and things of that sort affect our trade balance so we can know just exactly what we are talking about.

Mr. DEMING. All right. I can give you those figures.

(The information follows:)

U.S. trade data are presented on what is called a "Census" basis and a "balance-of-payments" basis, reflecting somewhat different concepts of exports and imports and some differences in the way various components are reported. Generally, both sets of data refer to shipments. These two bases are clearly spelled out in the footnotes to Table 4 from the article on the first quarter balance of payments in the June, 1967 Survey of Current Business. A copy of Table 4 is attached.

Exports on the "balance-of-payments" basis, excluding military grant shipments, are broken down between (a) those financed and (b) those not financed by government grants and capital outflows. The estimate for (a) is based on financing data which may, of course, differ from actual shipments in a particular period.

The estimated amount of exports financed by U.S. Government grants and capital outflows in 1966 was $3,012, million. One component of this amount represents P. L. 480 commodities. This amounted to $1,170 million in 1966, excluding $130 million for which the government used the equivalent in local currencies to meet U.S. Government expenditures abroad. Another component of the $3,012 million is an estimated $1,335 million of AID-financed commodities. The balance consists almost entirely of Export-Import Bank financed items. These latter involve sales for the most part arranged by the private community and on terms competitive with the other hard loan, export financing agencies in the world.

F.O.B. VERSUS C.I.F. VALUATION OF IMPORTS

The regularly published import statistics for the most part reflect values at principal markets in the foreign country of origin (i.e., an f.o.b. basis) as provided in the Tariff Act.

Because of the interest expressed in c.i.f. data, the Bureau of the Census now is publishing estimates on this basis. See "Special Announcement" (attached) from the May, 1967 FT 990. These calculations are based on a six months' sample, which indicated that the difference between c.i.f. and f.o.b.

81-495 O—67——5

import values, as a preliminary estimate, is 8.0 percent. Census is continuing to work on c.i.f. valuation of imports.

On the "Census" basis, U.S. imports in 1966 are estimated at $27.82 billion c.i.f. as compared with $25.55 billion f.o.b.

Since 1832, U.S. trade data have been published on an f.o.b. basis, as required by law, for Customs purposes. Considerations favoring the f.o.b. as against the c.i.f. valuation method are:

The U.S. use of f.o.b. values—that is, values exclusive of any international shipping or insurance charges—is recognized as the preferred method both by the experts of the IMF and by the U.S. Review Committee for Balance of Payments Statistics. The IMF states that: " * * * f.o.b. * * * is preferable. It is essential for a classification of transactions by countries. In many cases the transportation and insurance of imports involve separate transactions, and the parties concerned are often not residents of the country from which goods are purchased. A further advantage in recording imports on an f.o.b. basis is that it permits a check on the accuracy of trade figures by a bilateral comparison of countries' trade data." The Review Committee states that: "The preferred balance-of-payments practice is to distinguish the value of the goods from the transportation and related costs of international shipment. Accordingly, procedure is to value goods at the border of the exporting country and to include transportation and related shipping costs incurred up to that point."

Showing our imports on a c.i.f. basis involves distortion of our international trade account, even if exports were also shown on the same basis. (The distortion of our trade picture would be even worse if imports only (and not exports) were shown on a c.i.f. basis.) Part of U.S. imports is carried in American bottoms so that addition of the total cost of insurance and freight to the value of imports overstates the foreign exchange cost of insurance and freight which is the relevant figure for balance-of-payments purposes. (Likewise, some of our exports are carried on foreign bottoms and do not involve U.S. receipts.)

Even if only the part of freight and insurance involving foreign exchange costs were included in the c.i.f. values, those values would still not reflect all foreign exchange receipts and payments associated with imports and exports. For example, foreign ships have sizeable port expenditures in the U.S. in connection with bringing in imports or carrying out exports. The same is true for U.S. ships in foreign ports.

To measure changes in our price competitiveness in world commodity trade, we need to appraise changes in other factors affecting our trade, such as the changing commodity composition of world demand for particular lines of U.S. imports or exports. Such appraisal is obscured if the import and export data are also affected by changes in freight and insurance costs, which is the case with c.i.f. data.

Valuing imports on a c.i.f. basis raises certain technical problems. For example, a number of commodity items often are shown on one import document. To determine c.i.f. values of each item would require a pro-rating of the freight and insurance cost.

It should be noted that freight payments to foreigners and receipts of freight earnings from foreigners in connection with our imports and exports are shown in our balance of payments under the "transportation" items. Therefore, receipts and expenditures associated with our merchandise trade are fully reflected in our balance of payments. This reporting procedure has clear advantages. As noted above, the economic forces which affect the U.S. competitive positon on commodity account may well differ from the forces which affect our competitive position in international shipping. The same is true for international insurance services which are reported in our balance of payments under "other private services."

ESTIMATED C.I.F. VALUES FOR U.S. IMPORTS

Estimated values for U.S. imports on a c.i.f. (cost, insurance, and freight) basis for current periods are shown in the table below.

The regularly published import statistics reflect values as reported on import entries for tariff purposes. The valuation provisions of the Tariff Act of 1930, as amended, (Section 402 and 402a) are somewhat complex, but for most imports the value at the principal markets in the foreign country is required to be reported on import entries.

Users of U.S. data have expressed an interest in additional information which would supply U.S. import values on a c.i.f. basis. In an attempt to meet this need, the Bureau of the Census, in cooperation with the Tariff Commission and the Bureau of Customs, initiated a study of a representative sample of individual U.S. import shipments. The study relates c.i.f. values determined (or, in some cases, estimated) for these sample transactions to the value reported in Census statistics for the same transactions. Results of the first segment of this study based on the first half of 1966 and released at the end of that year, indicate that the c.i.f. port of entry values for the sample shipments averaged 8.9 percent higher than their values as reported in U.S. foreign trade statistics.

For purposes of the study, c.i.f. value was defined as the cost of the commodities at the port of exportation plus insurance and freight to the U.S. Customs port of entry. (This is not always the first U.S. port of arrival.) Though the values reported in the import statistics are sometimes referred to as "f.o.b. port of export values," the Tariff Act valuation provisions are such that other value bases are also used.

The study is continuing, and later findings may modify the results in some respects, particularly where the relationship between c.i.f. and the statistical values for different types of commodities is concerned. It is believed, however, that the average relationship established in the completed part of the study can be used without further delay as an adjustment factor to derive useful estimates of the total c.i.f. value of current U.S. imports and comparative values for the recent past. Therefore, beginning with this issue, information will appear periodically in this space showing estimated c.i.f. totals for U.S. general imports, derived by applying the 8.9 percent adjustment factor to the regularly compiled import totals.

Estimated c.i.f. values compared with published values for U.S. general imports—Quarterly 1966 and 1967 and monthly 1968

[In millions of dollars]

Period	Estimated cost, insurance, and freight	Value as published in U.S. import statistics
1966:		
1st quarter	6,418.1	5,893.6
2d quarter	6,897.9	6,334.2
3d quarter	7,129.0	6,546.4
4th quarter	7,379.3	6,776.2
1967:		
1st quarter	7,210.5	6,612.2
January	2,463.1	2,261.8
February	2,181.8	2,003.5
March	2,565.6	2,355.9
April	2,277.2	2,091.1
May	2,420.2	2,222.4

TABLE 4.—*U.S. merchandise trade*

[In millions of dollars]

Line		1960	1961	1962	1963	1964	1965	1966
1	Merchandise exports, adjusted (table 1, line 3)	19,489	19,954	20,604	22,071	25,297	26,244	29,168
2	Plus merchandise exports, other than military grant shipments excluded from line 1 but included in census data [1]	268	387	531	512	472	662	440
3	Less merchandise exports included in line 1 but excluded from census data [2]	127	149	111	145	218	122	182
4	Less miscellaneous and special adjustments to census data incorporated in line 1, net [3]	4	2	51	11	−139	84	30
5	Equals: Merchandise exports, census basis, including reexports, excluding military grant shipments	19,626	20,190	20,973	22,427	25,690	26,700	29,396
6	Plus military grant shipments recorded in census data	949	810	727	920	818	778	940
7	Equals: Merchandise exports, census basis, including reexports and military grant shipments	20,575	21,000	21,700	23,347	26,508	27,478	30,336
8	Agricultural goods	4,832	5,024	5,034	5,584	6,347	6,343	7,028
9	Nonagricultural goods	15,743	15,976	16,666	17,763	20,161	21,135	23,308
10	Excluding military grant shipments	14,794	15,166	15,939	16,843	19,343	20,357	22,368
11	Merchandise imports, adjusted (table 1, line 15)	14,732	14,510	16,187	16,992	18,621	21,472	25,510
12	Plus merchandise imports excluded from line 11 but included in census data [4]	482	394	384	341	248	188	220
13	Less merchandise imports included in line 11 but excluded from census data [5]	126	125	150	157	176	202	245
14	Less miscellaneous and special adjustments to census data incorporated in line 11, net [3]	70	65	31	38	9	92	−65
15	Equals: Merchandise imports, census basis (general imports)	15,018	14,714	16,330	17,138	18,684	[6] 21,366	25,550
16	Foods, feeds, and beverages	3,286	3,331	3,573	3,753	3,914	3,946	4,499
17	Coffee, cocoa, and sugar	1,657	1,581	1,621	1,701	1,786	1,625	1,691
18	Other	1,629	1,750	1,952	2,052	2,128	2,321	2,808
19	Industrial supplies and materials	7,834	7,670	8,501	8,808	9,500	10,963	12,092
20	Fuel and lubricants	1,580	1,727	1,906	1,931	2,015	2,212	2,247
21	Building materials (except metals)	541	538	616	661	707	725	789
22	Iron and steel products	507	421	537	692	825	1,272	1,312
23	Other metals and metal ores (except uranium)	1,667	1,564	1,754	1,773	2,001	2,424	2,910
24	Other	3,539	3,420	3,688	3,751	3,952	4,330	4,834

Line	Item							
25	Capital goods (except automotive)	566	696	763	828	1,048	1,474	2,151
26	Machinery and miscellaneous transport equipment	540	576	685	803	1,028	1,372	1,939
27	Civilian aircraft, complete	2	74	40	1	2	67	153
28	Automotive vehicles and parts (including engines)	628	378	515	580	757	921	1,896
29	Passenger cars, new and used	544	317	433	467	593	670	1,244
30	Trucks, buses, and special vehicles	29	13	17	23	23	44	174
31	Automotive parts and accessories (including engines)	55	48	65	90	141	207	478
32	Consumer goods (nonfood), except autos and parts	1,901	1,889	2,276	2,389	2,694	3,305	3,912
33	Consumer durables, manufactured	971	1,000	1,216	1,266	1,379	1,732	2,108
34	Consumer nondurables, manufactured	714	644	811	843	991	1,192	1,349
35	Gem stones, nursery stock, etc., unmanufactured	216	245	249	280	324	381	455
36	All other, not elsewhere classified (uranium, military aircraft, low value shipments, U.S. goods returned, etc.)	803	750	762	780	771	849	1,000
37	Balance on merchandise trade, adjusted (line 1 less line 11)	4,757	5,444	4,417	5,079	6,676	4,772	3,658
	Memorandum items:							
38	Merchandise exports, adjusted, excluding those financed by U.S. Government grants and capital outflows (line 1 less A.28 of table 5)[7]	17,591	17,745	18,271	19,350	22,496	23,486	26,156
39	Balance on merchandise trade, adjusted, excluding exports financed by U.S. Government grants and capital outflows (line 37 less line A.28 of table 5)[7]	2,859	3,235	2,084	2,358	3,875	2,014	646

[1] Consists mainly of exports of military equipment under Defense Department sales contracts with foreign governments to the extent that such exports are included in the census data. Also includes exports of domestically owned goods into storage abroad (e.g., U.S. grain stored in Canada); exports to the Panama Canal Zone; and exports of exposed motion picture film for rental rather than sale.

[2] Includes exports of domestically owned goods out of storage abroad (e.g., U.S. grain sold from storage in Canada); exports of electrical energy; exports of nonmonetary gold, and silver and net sales of gold by U.S. private residents to the U.S. monetary gold stock; personal remittance in kind (gift parcels sent through the mail); and transfers, financed under nonmilitary aid programs, of goods to recipient countries from Defense Department stocks located abroad.

[3] Includes valuation adjustments for goods considered to be underpriced or overpriced in census data; timing adjustments for goods recorded in the census data in one period but known to have been shipped in another period; and coverage adjustments for special situations in which shipments are omitted from the census data.

[4] Consists mainly of Defense Department and other imports which duplicate in whole or in part purchases (e.g., of nuclear materials) included in table 1, line 16 (Military expenditures). Also includes imports of domestically owned goods returned from storage abroad (e.g., grain from storage in Canada); imports from the Panama Canal Zone; and foreign charges for repair of U.S. vessels.

[5] Includes imports of electrical energy; and imports of nonmonetary gold and silver, and net purchases of gold by U.S. private residents from the U.S. monetary gold stock.

[6] Reflects revisions made by the Bureau of the Census to correct for distortions in the monthly import totals originally reported for July to December 1965. These distortions were caused by large irregularities in the monthly flow of documents transmitted by Customs to the Census Bureau after the close-out date for processing a given month's statistics. The accompanying commodity detail, lines 16–36, incorporate the Census Bureau's revisions and, in addition, the special adjustments represented in line 4.

[7] The entries in this line reflect only an approximate measure of merchandise exports not financed by Government grants and capital outflows since Government financing of exports may not coincide with actual shipments.

Source: U.S. Department of Commerce, Office of Business Economics.

The CHAIRMAN. I have heard so many different arguments about the trade surplus that while we discuss it I would like to know what we are including and what we are not including, what adjustments were made and what adjustments were not made.

I do not believe I have any further questions at this time.

Senator Williams?

Senator WILLIAMS. Mr. Secretary, you have just indicated that you could not picture a situation developing in the future where the 2 percent would not be adequate to take care of the differentials. Is that based upon a feeling that the interest rates worldwide may decline or that we in this country can keep up with them as you are doing at this time?

Mr. DEMING. Based partly on experience and examination of the record, based on, as I say in the statement, on the hope that we can see a decline in interest rates in this country that would be accompanied by a decline in interest rates abroad.

Senator WILLIAMS. We hope that—and perhaps this question is a little facetious—you do not picture a situation where our interest rates here keep rising to the point where other countries would need an interest equalization to keep us from raiding?

Mr. DEMING. No, sir; I do not think we do.

Senator WILLIAMS. Mr. Surrey, I was very much interested in this case, this hypothetical case that you outlined to Senator Smathers as to how the present law could be avoided.

My question is, using that case, is it or is it not a violation of the law for any individual to have exactly followed the steps that you have outlined? Is there anything under existing law which would make that a violation if the Treasury Department found that to be the case?

Mr. SURREY. It would be a violation of existing law on the part of the person who signed the false certificate of American ownership.

There would be a violation of law on the part of the person who, knowing the certificate was false, worked and maneuvered the whole plan. Both of those people may well be outside the jurisdiction of the United States. There would be a violation of law on the part of any American brokerage firm who knowingly participated in the arrangement.

Senator WILLIAMS. And have there been any examples called to your attention other than the hypothetical case where this practice was actually being done?

Mr. SURREY. The pattern that I mave described to you is a pattern that has been disclosed in our investigations in New York.

Senator WILLIAMS. I gathered as much.

Were there any indictments under those cases that you outlined or any effort to get any indictments?

Mr. SURREY. There were indictments in New York in 1966 in cruder types of cases.

There is a grand jury currently sitting in New York that is investigating the interest equalization tax.

Senator WILLIAMS. I am aware of that.

Mr. SURREY. The material that we have has been obtained only in the last 2 months. The disposition of that material to the Department of Justice and to the grand jury will be in the course of ordinary procedures, and I cannot say what the grand jury will do.

Senator WILLIAMS. I understand that. I am not talking about the cases which may have been cruder. I am speaking of the cases outlined by you. I understand that there have been as yet no indictments under those cases.

Mr. SURREY. Not under these cases yet, because the facts only developed in the last couple of months.

Senator WILLIAMS. As the bill was passed by the House, did it change the existing law in any manner that would correct or tighten up upon the situation which you have outlined to Senator Smathers?

Mr. SURREY. No, sir.

Senator WILLIAMS. Do the amendments which you recommend to this committee tighten up the existing law?

Mr. SURREY. Yes, sir; the amendments which Secretary Deming outlined would tighten up existing law.

Senator WILLIAMS. Since those amendments tightened it up we assume it is your opinion that existing law does not adequately provide the penalties and methods to deal with it; is that correct?

Mr. SURREY. Correct.

Senator WILLIAMS. So if the existing law does not provide it and does not have it, how can you seek an indictment on something that is not a violation of the law?

Mr. SURREY. Let me answer in this way.

Senator WILLIAMS. If you have a law what is the meaning?

Mr. SURREY. Present law is inadequate in that the only indictments possible are cases in which we can prove actual knowledge on the part of persons within our jurisdiction. You prove actual knowledge by circumstantial evidence or by other evidence. It may be conceivably that in some of these cases it can be proved. But that is not an adequate method of policing these transactions.

Senator WILLIAMS. The reason I ask that question is: I think we should be well aware of the fact as to what extent the existing law can deal with them and if it needs to be changed, we should consider such changes. But I thought we should also make it clear as we consider the changes or tightening up that we also recognize the extent to which existing law can deal with it, otherwise you would in effect be giving exemption retroactively on all those heretofore if we proceeded as the Treasury Department and Congress, on the premise that we have no law. That is what I wanted to get clear.

Mr. SURREY. We do not desire to condone or give amnesty to any violations of existing law that can be proven.

Senator WILLIAMS. Then those investigations under existing law will be conducted even though nothing may be done in this bill now before us, is that correct? You would proceed under existing law to the extent that you can even though nothing may be done further?

Mr. SURREY. We would proceed under existing law with respect to the cases that could be developed under existing law. But in our judgment proceeding through the criminal law is not adequate to enforce the interest equalization tax in the light of what has been uncovered in the last few months.

Senator WILLIAMS. When did the Treasury Department get concerned that the law was not adequate and when did you first approach either the committee in the House or the Senate Finance Committee,

alerting us to your concern and the inadequacy of the law and ask for changes?

Mr. SURREY. From the very start the Treasury and Internal Revenue Service have been concerned with respect to violations of this law. When there came to our attention the cruder methods of violation, early in the history of the interest equalization tax, the Internal Revenue Service and Department of Justice cooperated to investigate the matters and the U.S. attorney acted and indictments were secured. The Internal Revenue Service has been briefing the entire securities industry as to their obligations. It has held a number of briefing seminars in that respect. It has audited the brokerage houses to see that they were filing their returns.

In April of this year, personnel of the Securities and Exchange Commission informally advised us that there may be substantial violations. It appeared that these substantial violations may have started late in 1966 and began to accelerate in the early spring, when the Securities and Exchange Commission began to suspect something. I think a good deal of credit is due to the SEC and to their investigators for this. They advised us in April that there certainly seemed to be something amiss in this whole area and that the methods of violation were rather sophisticated. That was in April 1967. Immediately the Internal Revenue Service people commenced discussions with the SEC and among themselves as to how best to investigate this matter and get on top of it. Continuously since then processes have been operating, and a number of revenue agents were detailed to this activity and have been investigating brokerage firms in New York. When it became apparent in the course of May and early June that there were substantial violations, that the criminal laws of the United States would be an inadequate method of enforcement, that the securities firms under their procedures and present recordkeeping would not be able to contain this, it was necessary to devise recommendations for this committee. The question was how to formulate the recommendations and we have recently been spending our time formulating the recommendations for this committee.

Senator WILLIAMS. And it was in April that the Securities and Exchange Commission called this to your attention?

Mr. SURREY. Middle or late April.

Senator WILLIAMS. And at that time it was the opinion of the Treasury Department that you had adequate law to deal with that situation which they called to your attention?

Mr. SURREY. Oh, no.

Senator WILLIAMS. You thought then——

Mr. SURREY. No, no. When the Securities and Exchange Commission came to us with this information we said, "Let us find out what is happening."

Senator WILLIAMS. You did not know what the law was?

Mr. SURREY. We knew what the law was then. You have to distinguish between what the law is——

Senator WILLIAMS. What I am trying to get at, Mr. Surrey, it was called to your attention in April. At what point did you determine that you did not have the law to deal with this situation?

Mr. SURREY. I would say sometime in the month of May and early June when the Internal Revenue Service reported to us the degree of

violations. If this had been infrequent, here and there, on a casual basis, it is one thing. But when the Internal Revenue Service reported to us the degree of violation and secondly the mechanics of the violation it became apparent that the criminal law (under which penalties apply, if one willfully evaded the U.S. laws) would not be adequate to handle this.

Senator WILLIAMS. And it was your intention to present this to the committee and we called the hearings off and postponed them until you could get your recommendations ready I am wondering—what I am trying to determine is, and perhaps this question is embarrasing both to the Congress and to the Treasury Department—how much of this excitement was generated after it was exposed in the press, this widescale avoidance and how much before? That is the point that disturbs me.

Mr. SURREY. It is an understable question. As I understand it, the Wall Street Journal article was on June 30.

Senator WILLIAMS. Yes.

Mr. SURREY. By that time it was already fully clear that something had to be done. I do think, I might say, that the result of our investigations had some salutary effect and there was a dropping off of activity.

If nothing is done, that activity will start to commence again and for that reason our recommendations were made to this committee to be effective tomorrow.

Senator WILLIAMS. On page 6 of the supplementary statement you state:

> The Treasury recommends the establishment, effective Saturday, July 15, 1967, of a new system with respect to transactions between American buyers and sellers of foreign securities. The new system is designed to prevent evasion of the interest equalization tax.

Now, these are steps being taken under the existing law.

Mr. SURREY. No, sir.

Senator WILLIAMS. Under which law?

Mr. SURREY. The steps being taken—the only way we think we can protect the interest of the United States—these steps are being taken pursuant to recommendations to your committee that the amendments to the law be enacted by the Congress effective July 15, and we are hopeful——

Senator WILLIAMS. This is a recommendation for a new law to take effect July 15?

Mr. SURREY. Amendments.

Senator WILLIAMS. To be part of this bill before us?

Mr. SURREY. Yes; to take effect July 15.

Senator WILLIAMS. Then you are correcting a loophole in the law proceeding on the premise that under existing law you do not have a method to deal with that particular situation.

Mr. SURREY. Correct.

Senator WILLIAMS. Do you have a copy of the amendments prepared which will carry that out?

Mr. SURREY. We have available, attached to Secretary Deming's statement as attachment A, a 20-page description of the procedures to be followed.

Senator WILLIAMS. I see that.

Mr. SURREY. You asked me earlier——

Senator WILLIAMS. If the description of the amendment to correct this is 20 pages, that is why I want to look at the amendment——

Mr. SURREY. Essentially the amendment, Senator, will put in statutory language the descriptive material in attachment A.

Senator WILLIAMS. It will not be as long as the description of it?

Mr. SURREY. No, it won't be because several pages of this are taken up with a list of the names of firms and the like.

Senator WILLIAMS. As I understand it you will submit the amendments?

Mr. SURREY. A good deal of it under our recommendation would be in regulatory material regarding the nature of record keeping and details which I don't think would be appropriate for the statute, but details which have to be made available to the industry tomorrow.

Senator WILLIAMS. But I understand that the Department will submit these memorandums to the committee Monday?

Mr. SURREY. Let me put it this way. Our staff is working today, tonight, Saturday, Saturday night, Sunday and Sunday night and we hope to have this done for you on Monday morning.

Senator WILLIAMS. I hate to see you work for so long, but after 2 years it may be a good idea.

Mr. SURREY. We do want to move it ahead as rapidly as possible.

Senator WILLIAMS. If necessary we could have another day of hearings. You would not mind coming back to have another day of hearings after we get your proposals?

Mr. SURREY. Yes, that would be satisfactory. But may I just suggest, Senator, based on my knowledge of what is helpful for witnesses and the like, the attached material which we have here really fully delineates the scope of the amendments. I realize people do want to look at the statutory language.

Senator WILLIAMS. I appreciate that. My concern was to help the witnesses and partly it was my interest in having this available so that our own staff can relate it to the existing law and give us their analysis as well as the Department's analysis as to what effect it would have on the changes that would be made. That was the reason I suggested that.

Mr. SURREY. We will be glad to answer any questions with respect to this matter.

Senator WILLIAMS. We mentioned earlier the young lady in one of the islands who was acting as one of these pawns, shall we say. Maybe she was the queen—maybe she proceeded beyond the pawn stage.

Mr. SURREY. Only the pawn stage, Senator.

Senator WILLIAMS. Would you outline that case—just outline to us that specific case, the extent of her transactions that were done, how much, how she operated, as well as the amount, dollar amounts involved and when this was going on?

Just give us a complete report because I understand that you have it there.

Mr. SURREY. Yes, sir. I think I would simply repeat what I said to Senator Smathers. What I described to Senator Smathers is a description of cases disclosed in our investigation, that a group of people——

Senator WILLIAMS. Excuse me. I understood that from Senator Smathers. It was very clear. I happen to be maybe a little more thick-headed than some. I can understand a specific case and I would like to follow that case through with transactions on such and such a time, so many millions of dollars here and there.

Mr. SURREY. I don't have the particular dates of the transactions, but the nature of the transactions.

Senator WILLIAMS. All right.

Mr. SURREY. The nature of the transactions would be—say Mr. Jones is desirous of making some money by violation of the interest equalization tax.

Senator WILLIAMS. Use Miss Jones because she did do it. This is the case I would like to follow.

Mr. SURREY. Mr. Smith is interested in making some money by violating the interest equalization tax. Mr. Smith is a foreigner. Mr. Smith establishes a Bahamas trust. He also establishes a Bermuda trust. The Bermuda and the Bahamas trusts have offices in Canada. The Bermuda trust and the Bahamas trust open an account with a Canadian broker.

Senator WILLIAMS. May I interrupt at this moment? In this particular case the young lady was involved. Did she establish these trusts?

Mr. SURREY. No.

Senator WILLIAMS. You are referring to this case?

Mr. SURREY. I don't know about this young lady——

Senator WILLIAMS. I am interested in this young lady. I do not want to get it confused with other cases.

The CHAIRMAN. Can we have the lady's name while we are at it?

Mr. SURREY. I don't want to give the names at this particular time.

Senator WILLIAMS. Mr. Surrey, in order to understand——

Mr. SURREY. Let me go on.

Senator WILLIAMS. Do not go beyond this case. We are just interested in this case. I want this case alone.

The CHAIRMAN. If this happens to be one of the cruder cases which you put before the grand jury I do not know why you cannot go ahead and tell us about that.

Mr. SURREY. I would not like to give actual names, Senator.

Mr. Smith in my example is operating the Bahamas trust and he desires to sell securities, foreign securities. He can buy these foreign securities through a New York broker or a Canadian broker acting through a New York broker.

Senator WILLIAMS. And he did buy them.

Mr. SURREY. Yes. Now he has foreign securities. To sell these foreign securities as American owned, he needs a certificate of American ownership. He can pick up his certificate of American ownership from your Miss Jones who is somebody in the Bahamas who is willing to sign the certificates for $10 or whatever fee he gives her. He then has the certificate of American ownership. Mr. Smith, thru the Bahamas trust, sells the stocks, with the certificate, through a New York broker, perhaps doing so through a Canadian broker. The industry, and the New York broker, believes under industry practices it is entitled to rely on the foreign broker. The New York broker accepts the certificate of American ownership, sells the stock on the New York Stock

Exchange, and it is bought as an American-owned foreign industry. At no time has it actually been owned by an American.

Now, this person signing the certificates down there as you can see, is, as I said to you, a pawn. The principal in the transaction is the person who set up the Bermuda trusts. The Bermuda trust is camouflage, essentially. It looks like a reputable front. It has a line of credit in a bank.

Senator WILLIAMS. Is this case being presented to the grand jury?

Mr. SURREY. Let me say information along those lines is in the possession of the Internal Revenue Service.

Senator WILLIAMS. Is this not one of the cases that you figured you did not have adequate law to handle?

Mr. SURREY. This hasn't been presented to the grand jury. This was obtained only in the last 2 months. Maybe less than that, maybe a month.

Senator WILLIAMS. How much money was involved in this young lady's case?

Mr. SURREY. The money involved—let me indicate that I have given you one transaction. There are many of this nature, and they have some variations. The money involved would run about—one particular person with respect to her certificates—$10 million in value of securities in 6 months.

Senator WILLIAMS. That is one particular transaction?

Mr. SURREY. A series of transactions utilizing that certificate of American ownership, using certificates of American ownership signed by that person. About $10 million in securities in 6 months.

Senator WILLIAMS. What other cases did she handle? Is that the only one in which she was the go-between on?

Mr. SURREY. These are a series of transactions.

Let me indicate that these may not all go to the same brokerage house in the United States.

Senator WILLIAMS. I understand that.

Mr. SURREY. This is a pattern that exists.

Senator WILLIAMS. I am just trying to pin down your description of Miss Jones' transactions.

Mr. SURREY. Please don't call them Miss Jones' transactions. The real thing—we don't know who the principal is behind this.

Senator WILLIAMS. I know you do not. Maybe we will find him. I will tell you, I do no want to press this—I have a tremendous respect for you and I just believe you can give us a better explanation of that transaction.

Mr. SURREY. I am trying to give you the best explanation I can, but I want to indicate, and I want to make sure that there is no misunderstanding that this person in Bermuda is not the principal.

Senator WILLIAMS. I do not think anybody will get much understanding from reading this record. I would like to have one transaction followed through for our committee files here.

Mr. SURREY. This is the one I just gave you.

Senator WILLIAMS. If a case like you just described was served on a grand jury they would almost indict you for incompetence—I have served on a grand jury. Maybe you want to furnish it in the executive

session. But I would like to have that transaction in detail. I have reason to think that I am very much interested in that transaction beyond this bill.

Mr. SURREY. You mean you want particular dates? You want details and so forth?

Senator WILLIAMS. It would help us and maybe we can help you.

Mr. SURREY. We can give you that in executive session.

Senator WILLIAMS. You will furnish us with the names, dates, and amounts?

Mr. SURREY. We can give it to you in executive session. I am not sure we can give to you the person who is behind this.

Senator WILLIAMS. You can leave the name of the person off and give it to us.

Mr. SURREY. We are not sure we know it.

The CHAIRMAN. Just to interrupt, to get it straight, if I understand what the witness is testifying here, you are saying that this is a transaction that occurred outside the United States where you are not privileged to send the FBI or Internal Revenue Service and call upon those people and subpena them and demand that they give information about their tax business. By the time you get to the Bahamas you are pretty much limited as to what you can do.

You might obtain voluntary information, but you certainly cannot call them and subpena people to come and testify. The person, that Miss Jones, let us say, who signed this certificate, is an American citizen, but she did not own those stocks.

Mr. SURREY. Owned no stocks at all, probably.

The CHAIRMAN. So far as you are concerned, that person violated the law, but that is not the person making the big money. That person is making a small fee for helping somebody else violate the law.

Mr. SURREY. That is right.

The CHAIRMAN. While that person is the violator, that is not the person making the real money out of it.

Senator WILLIAMS. That is very clear, and I will understand it thoroughly when you furnish the details of it so that I can examine it. I understand that you will because I feel you recognize you cannot go to Bermuda and maybe subpena a witness, and all that. But I think you will agree that you do not have to. You have that information in your files now.

You may not know all the principals back of it, but you do have a lot of the information, their associations with those in this country, and you have much of that information, and that is what I want, the names—to the extent that you have them.

Mr. SURREY. We have sufficient information that this can go on continuously, and we do not have the resources to stop it.

Senator WILLIAMS. I think perhaps you are correct, and that is the reason I am asking for it before we act on this bill, because I do not think—perhaps the rest of the committee can—but I know I cannot cooperate on plugging the loophole unless you see in plain language how it is operating, and that is what I want to see.

I have the understanding that you have that information, so there should be no objection to furnishing it.

As you say, if you do not have the existing laws to handle it, then you are not violating anybody's trust if you give us all that information in a public session, for that matter, so we can all see it.

Mr. SURREY. What I have described to you is the essence of the transaction. I am simply not giving you the particular securities, and particular dates. I haven't given you, also, the particular firms through which the securities were sold.

Senator WILLIAMS. I will be frank with you, I am a little bit surprised that all of this could go on, a transaction such as that, without being a violation of some of the existing laws. Maybe it is not. That is what I want to know.

Mr. SURREY. Let me put it this way. If the New York brokerage house which is dealing in this has actual knowledge of this scheme, there could be a violation of the laws of the United States.

Senator WILLIAMS. Do you think anyone would handle, as the principal for a transaction in this country some deal like that without having some suspicion that there may be something wrong? Do you think that you or I, as a broker, would do that without having suspicion aroused concerning the matter in which this particular case was handled?

And if not, how did the Securities and Exchange Commission ever get suspicious of it?

Mr. SURREY. There are two different things. One is, is this going on, and I think the Securities and Exchange Commission acted on a hunch—and I give them credit, full credit—on the good hunch that there seemed to be an unusual volume, of transactions, or that there may be something wrong.

Now, remember, American firms are getting in, daily, stock to which are attached certificates of American ownership. They can get in today a certificate of American ownership signed by John Williams—and right next to it, coming in, can be a certificate of American ownership signed by Mary Jones. Next to it, comes in a certificate of American ownership signed by Stanley Surrey. These can come in and the clerks look to see if this is a certificate of American ownership forwarded by a broker.

Senator WILLIAMS. That same thing is true in the transfer of securities as they are sold or purchased daily. But as those certificates come in with these various signatures on them—speaking of securities—there is also a certification on the part of a bank or broker guaranteeing that signature, and in this instance I understand there is no guarantee; is that correct?

Mr. SURREY. There does not have to be a signature guaranteeing the certificates.

Senator WILLIAMS. Under the existing law, there just has to be a signature.

Mr. SURREY. That is right. It says, "I am an American and I own this stock."

Senator WILLIAMS. That is a reflection on both the Congress and the Department for ever having such a lousy bill to start with.

Mr. SURREY. I think the banks——

Senator WILLIAMS. You can go over to the East Side of the city and get somebody to sign with the signature, and nobody goes behind it. I am amazed that it took 2 years to find that out.

Mr. SURREY. I was unclear on that. The bank is required to guarantee the signature, but not guarantee the fact of ownership.

Senator WILLIAMS. But they guarantee the signature and the responsibility of the signature.

Mr. SURREY. Just the signature. That is very easily accomplished.

Senator WILLIAMS. Could you have this particular case available for us Monday?

Mr. SURREY. In executive session?

Senator WILLIAMS. If it has to be in executive session. Frankly, I do not see too much of an executive privilege of something where there is no violation of a law.

Mr. SURREY. Senator, I don't want to say today to what extent there is a violation of the law. That depends on the knowledge of the people involved. I don't want to be in any position to prejudge any particular case.

Senator WILLIAMS. You will furnish it to us, then? When can you furnish it to us?

Mr. SURREY. You want an executive session or a public session?

Senator WILLIAMS. I personally do not see why it cannot be public. It must be executive session, I will not quarrel. The point that I do make is, I want time to examine it before we go into executive session to act on this bill. I just do not want it thrown on me 5 minutes before we move in, and say, "Let us plug it." If it took 2 years to discover it and it has taken all this time to find a remedy for it, it is going to take me more than 15 minutes to examine it. I am not trying to delay action. I want at least a day before we act on this bill in executive session.

Mr. SURREY. I think we can certainly give you, Monday morning, a detailed description of the transaction. Now, I will have to check and see—I am not sure you want the name of the particular firms in the United States.

Senator WILLIAMS. Yes, I do. We want that.

Mr. SURREY. Let me check and see if we have authority to furnish it in public.

Senator WILLIAMS. I can follow these transactions a lot clearer without getting lost if I know where I am going and where I have been. I always get lost in these hypothetical deals.

Mr. SURREY. My only point, Senator, is that these are matters that arise in the course of Internal Revenue investigations. There are rules of disclosure involved.

Senator WILLIAMS. That is true. We are going to wiretap anything.

Mr. SURREY. There are rules of disclosure that are involved.

Senator WILLIAMS. I think you are allowed to give it to us in executive session.

Mr. SURREY. If the chairman of the committee asks for it, we can give it to you in executive session.

Senator WILLIAMS. All I am speaking of is, I want time to see it.

Mr. SURREY. I would like to give you, Monday morning, a description of the mechanics of this along the lines that I have given you. I would like to omit the particular names and give that to you in executive session.

Senator Williams. That will be fine. Just leave "Mr. X" and so forth.

The CHAIRMAN. Let me ask you this: I do not want to hold this

hearing up forever talking about some particular case. My impression is that we are going to have to do something about the evasion here anyway. Why cannot you give us a memorandum setting forth under any assumed names you want, to what persons this has happened, and then if you want, you can give us in executive session in the hypothetical case you have given her, that Miss Smith is Miss Dolores Glunk, and Miss Jones here is Miss So-and-So, and the New York brokerage firm is so-and-so, and the Bermuda trust is so-and-so. So a person can look at the hypothetical case and you can provide us the key to it, so anyone who wants to know the name of the person, we can get the name of the person, and maybe even a picture of them. It is still not going to make any difference. If you want to close this loophole, we still have to close it.

Mr. SURREY. We will make that available.

Senator WILLIAMS. That is all I am trying to get from you. If you can just say, Miss A in Bermuda dealt with trust Y and trust X, and so forth. and broker B and identify them and then be ready in executive session to identify A, B, C, D. We may not need it.

At least follow the transaction through in specific details as to the form. You can certainly say so many shares of this, and the amount of money and tax avoidance, and the transaction amounted to x dollars, and item by item, and break it down with the names of the participants, and call it A, B, C, D. But hold it to exact dollars and cents in factual cases.

Mr. SURREY. I will do that. I will say it is what I described today.

Senator WILLIAMS Maybe others do not need that, but I do.

Mr. SURREY. I will be glad to do it. We will fill in the dollar amounts and the names of the stocks.

Senator WILLIAMS. That will be fine. The hour is getting late.

The CHAIRMAN. If I might just interject. I would suggest Mr. Surrey, that for the benefit of the committee, for those of us not present as well as those present, that you just give us a memorandum outlining this, which as far as you are concerned can be supplied for the record, and another confidential memorandum. This committee is competent, more competent than most committees, to evaluate it. Point out precisely who the people are and all the details that you think Senator Williams would like. You know his flair for detail. When you have all the blanks filled in, I think all of us can look at it and we will see what you are talking about and Senator Williams will perhaps be satisfied with that.

Otherwise, he can ask you some more questions in executive session.

Mr. SURREY. Please understand there is no disposition on our part to hold any information back.

(The following was subsequently supplied for the record:)

INTEREST EQUALIZATION TAX: DESCRIPTION OF THE MECHANICS OF AN ACTUAL TAX AVOIDANCE SCHEME

PRELIMINARY ACTIVITIES

The principals, on the basis of our present information, form a Bahamian corporation with a Bahamian "mail drop" and with its main offices located in Canada. They recruit an American citizen residing in Bermuda to sign, for a fee, certificates of American ownership, form 3625. In order to obtain the requisite

bank confirmation for the signature, a nominal account is set up in the American citizen's name at a convenient location (e.g., at an international airport in the United States). The bank guarantees the authenticity of the American citizen's signature on form 3625 which is signed in blank. The blank signed certificates are then forwarded to the Canadian office of the Bahamian company.

The Bahamian company, representing itself as a financial consulting firm buying and selling stock for its customers, open accounts with J., a Canadian brokerage house, and with C., an American over-the-counter brokerage firm which is a member of the National Association of Securities Dealers, Inc.

One of the customers for whom the Bahamian corporation is allegedly acting is the American citizen whose signature has been obtained on the forms 3625.

AN ACTUAL TRANSACTION

On the basis of our present information, an actual transaction, which is typical of many, appears to be as follows: On February 1, 1967, the Bahamian corporation placed an order to buy for its account 3,500 shares, foreign-owned, of a foreign corporation, W.D.L., with the Canadian brokerage firm J. The purchase was made, at an average price of $10.40 a share with a total cost of $36,400, from B., a United States brokerage firm. At the same time the Bahamian corporation placed an order to sell for its account 3,500 shares of W.D.L., American-owned, with the United States brokerage firm C. The sale was made on the same day at a net price of $10.76 per share with a total sale price of $37,645.30. The profit realized on this trade was $1,245.30 after commissions. (In other transactions the "arbitrage" profit was substantially higher.) The interest equalization tax due on this transaction was $8,470.19. On the day of the sale the Bahamian corporation completed the signed certificate of American ownership with the required information and then mailed this certificate to C. together with a letter confirming the sale. C. sold the 3,500 shares, American-owned, to D, a New York brokerage firm (or other U.S. brokerage firms) and issued a clean confirmation under the NASD rules, based on the certificate of American ownership provided by the Bahamian corporation.

The actual route of the stock certificate (and the related American Depository Receipt) is circuitous, partially as a matter of convenience and partially in order to clothe the transaction with a certain degree of substance. The essential transaction is not, however, affected by the manner in which the foreign securities are obtained by B., transferred to J., and sold into the American market by C.

AMOUNTS INVOLVED

The scheme described above resulted in sales on the basis of certificates of American ownership signed by the same American citizen through C. of $7,617,-925 during the period from January 1, 1967 through June 29, 1967. Similar transactions were entered into during this period by the same principals relying on certificates of American ownership signed by the same American citizen utilizing a Bermudian corporation and introducing these securities into this country through different brokers. Such schemes resulted in total sales of at least $1,654,325 during the first three months of 1967.

Senator WILLIAMS. One other question. Under H.R. 6098 as it was passed in the House, and I understand endorsed by the Department, it relaxes the penalty for failure to file timely notices of acquisition of new Canadian issues during the period of July 18, 1963, through October 9, 1965. It continues and says that these securities are tax free under Executive order, but failure to file a timely notice in effect cancels the exemption and therefore imposes a 100-percent penalty.

Since October 9, 1965, the penalty for failure to timely file the required notice is 5 percent of the exemption for each 3 days' delay up to a maximum of 25 percent.

Just what changes are you making in those penalties in that situation in order for it to be made retroactive?

Mr. SURREY. Are we recommending that?

Senator WILLIAMS. H.R. 6098.

Mr. SURREY. There is one provision to relieve State and local governments, to relieve them from the requirements of filing that notice. One of the States did overlook that notice and the House committee decided to relieve them from the obligation.

The House provision made it possible for people to avail themselves of the lower penalties on a retroactive basis. Those two provisions are in the House bill.

Senator WILLIAMS. This may be fully justified. I have no basis to say otherwise. But it has been my experience that a retroactive reduction of penalties is always for a specific purpose or purposes.

Would you furnish to the committee, the exact cases that would be affected by any retroactive relaxation of the penalties of the existing law, with the names and the amounts involved and the circumstances surrounding it? They may be fully justified. I do not question it. But I want to know exactly who, amounts, and what is involved in that particular provision.

Mr. SURREY. Yes, sir; I will. Some of the witnesses involved testified before the Ways and Means Committee.

Senator WILLIAMS. You will furnish that.

(The Department of the Treasury subsequently supplied the following information:)

TREASURY DEPARTMENT,
Washington, D.C., July 19, 1967.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: At the hearing on H.R. 6098 on Friday, July 14, 1967, Senator Williams requested information with respect to the cases which would be affected by the provisions of the bill amending Section 4917(d) of the Internal Revenue Code.

Section 4917(d) provides for a reduction in the exemption that would otherwise be applicable under Section 4917 in cases in which the acquiring person did not file the required notice of acquisition on time.

The interest equalization tax as originally enacted provided for a 100 percent reduction in exemption for late filing and pursuant thereto approximately 109 taxpayers were required to and did pay approximately $36,000. Information available as of February, 1967 indicates that some 605 additional taxpayers filed late notices and that some of the tax liability with respect thereto has not been paid and the cases are still pending..

The largest cases which are still pending involve primarily institutional investors who acquired Canadian securities after February 10, 1965 at which time the maximum reduction in exemption was 25 percent. These cases involve such investors as banks, insurance companies, and educational institutions and involve liability under present law ranging from $176,000 to $30,000. The House bill, if enacted, would reduce the liability in the above range approximately to $44,000 and $3,000 respectively.

While the reasons for the late filing vary, it appears from available information that in most of the cases and particularly those involving the institutional investors, the failure to file was the result of clerical error and oversight.

Sincerely yours,

STANLEY S. SURREY.

The CHAIRMAN. Mr. Secretary and Mr. Surrey, the longer I serve on this committee the more sympathy I acquire for the tax collector and those who have similar responsibilities. I am convinced that yours is one of the most thankless jobs that I know of in Government and

yet one of the most necessary. On occasion, I have been at business meetings where the collector of Internal Revenue was introduced and roundly booed by all present, and I resented it bitterly until I discovered that was standard procedure before the more sophisticated business clubs in America, and it was taken by both Democrats and Republicans without regard to party label and affiliation, and it has just seemed to be part of the job, and the people take it in good spirit.

It seemed very unfair to me that a respected person could do that job and do it well and without any more sympathy and encouragement than one gets in that job. You do, if I do say, a magnificent job. Your predecessors have always done a very fine job under Republican as well as under Democratic administration.

I believe I do understand some of your problems, because you try to draft a tax law to meet a problem. This law was not designed as a revenue law. It was designed to prevent the outflow of American capital. You did not want it to be necessary to provide any unnecessary redtape, all of which is subject to criticism. Like every other tax law we draft, it is subject to study by the best minds in the business, people who go to work to try to find out and get a way around it, or to do business so it does not affect them. And you have corrupt people working to try to find ways to violate the laws in ways you cannot have recourse to them.

I can understand how you have a real problem in this area with people outside this Nation beyond the reach of law enforcement officials who may have the sympathy of the governments where they are operating because there is no real sympathy in Bermuda or Canada, or any of these foreign countries, in this interest equalization tax, is there?

Mr. DEMING. No, sir.

The CHAIRMAN. They do not like it. They are opposed to it. You have a real difficult job in approaching this law and I compliment you as you have succeeded in this task.

Thank you very much.

Senator WILLIAMS. I would like to join the chairman, that when we passed this interest equalization tax, both the Treasury and the committee were moving into a new field and were bound to make mistakes. It did not take too long to discover them. Once having discovered them, I think we have the responsibility, both the Treasury and the committee, to sit down and try to understand just what the problem is and then make sure this time that we do not make that mistake again.

That is the reason I say, we have to have a clear picture of exactly what can and has been done under the existing law to the extent that the existing law can deal with it. To the extent that it does not deal with it, we cannot intelligently approach a solution to plug a loophole unless we both understand what that loophole is.

That is the reason that I am asking these questions, and that is the reason that I am asking that the Treasury amendments, whatever recommendations you have, be submitted to us in written form far enough in advance so that we can examine them, not just examples, examine your recommended changes and examine, and consult with our staffs, so that when we move in executive session to write up this bill, at least we will think we have a fair understanding of what we are doing.

I appreciate, and thank you in advance for the cooperation I am sure you are going to give us.

Thank you.

(The Department of the Treasury subsequently supplied the following:)

AMENDMENTS TO H.R. 6098 (INTEREST EQUALIZATION ACT OF 1967) TO EFFECT RECOMMENDATIONS OF THE TREASURY DEPARTMENT WITH RESPECT TO COMPLIANCE PROCEDURES

SEC. 5. COMPLIANCE PROCEDURES.

(a) Section 4918 is amended to read as follows:

"(a) GENERAL RULE.—The tax imposed by section 4911 shall not apply to an acquisition of stock of a foreign issuer or a debt obligation of a foreign obligor if it is established in the manner provided in this section that—

"(1) the person from whom such stock or debt obligation was acquired was a United States person throughout the period of his ownership or continuously since July 18, 1963, and was not ineligible, under the provisions of this chapter, to dispose of such stock or debt obligation as a United States person; and

"(2) such person—

"(A) had paid the tax imposed by section 4911 with respect to the acquisition of such stock or debt obligation by such person; or

"(B) acquired such stock or debt obligation without liability for payment of such tax by reason of an exemption or exclusion from tax provided in this chapter.

"(b) ESTABLISHING EXEMPTION FOR PRIOR AMERICAN OWNERSHIP AND COMPLIANCE.—

"(1) CONCLUSIVE PROOF.—For purposes of the exemption for prior American ownership and compliance provided in subsection (a)—

"(A) a validation certificate issued by, and filed in accordance with the requirements prescribed by, the Secretary or his delegate evidencing that the person from whom stock of a foreign issuer or debt obligation of a foreign obligor was acquired was a person described in subsection (a); or

"(B) a written confirmation (referred to as an IET clean confirmation) received by the person acquiring such stock or a debt obligation from a participating firm acting as a broker in effecting the acquisition (or acting as a dealer) which contains no reference to liability for the tax imposed by section 4911

shall be conclusive proof that such exemption applies with respect to the acquisition of the stock or debt obligation described in such certificate or confirmation, if the person making the acquisition relies in good faith on the validity of such certificate or confirmation.

"(2) OTHER PROOF.—If the person making an acquisition of stock or a debt obligation shows reasonable cause for his inability to establish such exemption under paragraph (1) he may furnish other evidence to establish to the satisfaction of the Secretary or his delegate that such exemption is applicable to such acquisition.

"(c) PARTICIPATING FIRM.—

"(1) DEFINITION.—A participating firm is a member or member organization of a national securities exchange or association registered with the Securities and Exchange Commission which satisfies the eligiblity requirements set forth in paragraph (2).

"(2) ELIGIBILITY REQUIREMENTS.—

"(A) IN GENERAL.—Subject to the provisions of subparagraph (B), a member or member organization of a national securities exchange or association registered with the Securities and Exchange Commission shall qualify as a participating firm if such member or member organization notifies the Secretary or his delegate after August 14, 1967, that he (or it)—

"(i) agrees to comply with the provisions of this chapter and with the documentation, recordkeeping, reporting, and auditing requirements prescribed by the Secretary or his delegate to implement such provisions; and

"(ii) is complying with such provisions and requirements on the date of such notification.

"(B) PARTICIPATING FIRMS DURING INTERIM PERIOD.—During the period commencing July 15, 1967, and ending on August 14, 1967, the following are deemed to be participating firms which satisfy the eligibility requirements of subparagraph (A):

"(i) all members and member organizations of the New York stock exchange;

"(ii) all members and member organizations of the American stock exchange; and

"(iii) members or member organizations of the National Association of Securities Dealers, Incorporated, which reported net capital (as defined in rule 15c 3-1 under the Securities Exchange Act of 1934) of $750,000 in the latest financial statement filed with the Securities and Exchange Commission on Form X-17A-5 prior to July 13, 1967, or which effected at least 300 transactions with respect to the sale or acquisition of stock of foreign issuers or debt obligations of foreign obligors during the week commencing on July July 2, 1967, or on July 9, 1967.

"(C) TERMINATION OF STATUS.—The status of a member or member organization of a national securities exchange or association registered with the Securities and Exchange Commission qualifying as a participating firm shall be terminated, if—

"(i) such member or member organization qualifies as a participating firm during the interim period described in subparagraph (B) and does not submit to the Secretary or his delegate, on or before August 15, 1967, the formal notification described in subparagraph (A);

"(ii) such member or member organization files a written request with the Secretary, or his delegate to terminate such status; or

"(iii) the Secretary or his delegate has reasonable cause to believe a participating firm is failing to abide by all the terms of the agreement which it has made (or is deemed to have made) with respect to compliance with the statutory provisions and procedural requirements described in subparagraph (A), and notifies the participating firm of such noncompliance.

Any termination of the status of a participating firm in accordance with this subparagraph shall be effective as of the date specified in a notice to such participating firm issued by the Secretary or his delegate subsequent to the date on which information regarding the termination of such status was made available to appropriate news media.

For purposes of this paragraph, an associate member of the New York Stock Exchange, American Stock Exchange, or a national securities association registered with the Securities and Exchange Commission shall be deemed a member of such exchange or association.

"(d) ISSUANCE OF IET CLEAN CONFIRMATION BY PARTICIPATING FIRM.—A participating firm may issue an IET clean confirmation (described in subsection (b)(2)) in connection with an acquisition of stock of a foreign issuer or a debt obligation of a foreign obligor by a United States person, if the participating firm—

"(1) acted as a broker in effecting such acquisition and received from a participating firm acting as broker for the seller (or acting as a dealer) a written comparison or broker-dealer confirmation which contained no reference to liability for the tax imposed by section 4911;

"(2) acted as a broker in effecting both the sale and acquisition of such stock or debt obligation and would have been entitled to issue a written comparison or broker-dealer confirmation under paragraph (e) if the acquisition had been effected by another broker; or

"(3) sold such stock or debt obligation as a dealer and was entitled to the exemption for prior American ownership and compliance provided in subsection (a) with respect to its acquisition of such stock or debt obligation as a United States person.

Any IET clean confirmation issued under this subsection shall be clearly distinguishable from any other confirmation issued with respect to an acquisition of stock of a foreign issuer or a debt obligation of a foreign obligor by a participating firm.

"(e) SALES EFFECTED BY PARTICIPATING FIRMS IN CONNECTION WITH EXEMPT ACQUISITIONS.—A participating firm effecting the sale of stock of a foreign issuer or a debt obligation of a foreign obligor may issue a written comparison or broker-dealer confirmation to the participating firm effecting the acquisition of such stock or debt obligation by a United States person, which indicates the exemption for prior American ownership and compliance provided in subsection (a) applies to such acquisition, only if the participating firm effecting the sale has in its possession a statement executed by the person making the sale (under penalty of perjury) that such person is a United States person within the meaning of section 4920(a)(4), upon which such participating firm relies in good faith—

"(1)(A) carried in its records (on a trade date basis) for the account of the seller at the close of business on July 14, 1967, such stock or debt obligation;

"(B) has in its possession a properly executed certificate of American ownership with respect to such stock or debt obligation or a properly executed blanket certificate of American ownership with respect to such account (and relies in good faith on the validity of such certificate or blanket certificate); and

"(C) included such stock or debt obligation in the transition inventory referred to in subsection (g) filed by such participating firm with the Secretary or his delegate in accordance with the provisions of such subsection;

"(2) after July 14, 1967—

"(A) as a dealer sold such stock or debt obligation to the seller, or acting as broker effected the acquisition of such stock or debt obligation by the seller, if the exemption for prior American ownership and compliance provided in subsection (a) applied to such acquisition; and

"(B) continuously carried in its records on a trade date basis for the account of the seller such stock or debt obligation;

"(3)(A) sold such stock or debt obligation to the seller, as a dealer or acting as a broker effected the acquisition of such stock or debt obligation by the seller, if the participating firm has in its possession a properly executed certificate of American ownership with respect to such stock or debt obligation or a properly executed blanket certificate of American ownership with respect to such account (and relies in good faith on the validity of such certificate or blanket certificate) or the exemption for prior American ownership and compliance provided in subsection (a) applied to such acquisition; and

"(B) after July 14, 1967, received from the seller the identical stock certificates or evidences of indebtedness which it had previously delivered to the seller with respect to such acquisition by the seller;

"(4) receives possession of such stock or debt obligation from another participating firm or from a participating custodian, together with a Transfer of Custody Certificate, as provided in subsection (h);

"(5) receives from the seller stock which was registered with a participating custodian which acted as transfer agent in registering such stock prior to July 18, 1963;

"(6) receives from the seller a validation certificate issued by the Secretary or his delegate certifying that the seller is a person described in subsection (a) and files such certificate with the Secretary or his delegate in accordance with the requirements imposed by the Secretary or his delegate; or

"(7) withholds from the proceeds of such sale (with the consent of the seller) an amount equal to the tax which would have been imposed under section 4911 on the acquisition of such stock or debt obligation by the purchaser if such acquisition were not exempted from such tax under this section.

The money withheld under paragraph (7) is to be treated as the collection of tax imposed under section 4911 on the acquisition of such stock or debt obligation by the seller and is to be paid over to the Secretary or his delegate or released to the seller at such time and in such manner as provided in regulations prescribed by the Secretary or his delegate.

"(f) PARTICIPATING CUSTODIAN.—

"(1) DEFINITION.—A participating custodian is a bank or trust company insured by the Federal Deposit Insurance Corporation which satisfies the eligibility requirements set forth in paragraph (2).

"(2) ELIGIBILITY REQUIREMENTS.—

"(A) IN GENERAL.—Subject to the provisions of subparagraph (B), a bank or trust company insured by the Federal Deposit Insurance Corporation may become a participating custodian if such bank or trust company notifies the Secretary or his delegate after August 14, 1967, that it—

"(i) agrees to comply with the provisions of this chapter and the documentation, recordkeeping, reporting, and auditing requirement prescribed by the Secretary or his delegate to implement such provisions, and

"(ii) is complying with such provisions and requirements on the date of such notification.

"(B) PARTICIPATING CUSTODIANS DURING INTERIM PERIOD.—During the period commencing July 15, 1967, and ending on August 14, 1967, Federal Reserve member banks which are classified as reserve city banks are deemed to be participating custodians which safety the eligibility requirements of subparagraph (A).

"(C) TERMINATION OF STATUS.—The status of a bank or trust company insured by the Federal Deposit Insurance Corporation as a participating custodian shall be terminated, if—

"(i) such bank or trust company qualifies as a participating firm during the interim period described in subparagraph (B) and does not submit to the Secretary or his delegate, on or before August 15, 1967, the formal notification described in subparagraph (A);

"(ii) such bank or trust company files a written request with the Secretary or his delegate to terminate such status; or

"(iii) the Secretary or his delegate has reasonable cause to believe a participating custodian is failing to abide by all the terms of the agreement which it has made (or is deemed to have made) with respect to compliance with the statutory provisions and procedural requirements described in subparagraph (A), and notifies the participating custodian of such noncompliance.

Any termination of the status of a participating custodian in accordance with this subparagraph shall be effective as of the date specified in a notice to such participating custodian issued by the Secretary or his delegate subsequent to the date on which information regarding the termination of such status was made available to news media.

"(g) FILING OF TRANSITION INVENTORY.—A participating firm and participating custodian shall, on or before August 15, 1967, file an inventory (designated as a transition inventory) with the Secretary or his delegate which shall include all stock of foreign issuers and debt obligations of foreign obligors carried in its records (on a trade date basis) by such participating firm or participating custodian as of the close of business on July 14, 1967, together with such information as may be required by the Secretary or his delegate.

"(h) TRANSFER OF CUSTODY CERTIFICATE.—

"(1) NATURE OF CERTIFICATE.—A certificate designated as a Transfer of Custody Certificate) may be issued in accordance with paragraph (2) by a participating firm or participating custodian in connection with a physical transfer of stock of foreign issuers or debt obligations of foreign obligors which are carried in its records for the account of a United States person to another participating firm or participating custodian for the account of the same United States person.

"(2) AUTHORIZED TRANSFERS OF CUSTODY.—A participating firm or participating custodian shall issue a Transfer of Custody Certificate only if—

"(A) such participating firm or participating custodian—

"(i) carried in its records (on a trade date basis) at the close of business on July 14, 1967, for the account of a United States person the stock or debt obligation described in the Transfer of Custody Certificate;

"(ii) has in its possession a properly executed certificate of American ownership with respect to such stock or debt obligation

or a properly executed blanket certificate of American ownership with respect to such account (and relies in good faith on the validity of such certificate or blanket certificate) ; and

"(iii) includes such stock or debt obligation in the transition inventory referred to in subsection (g) filed by such participating firm with the Secretary or his delegate in accordance with the provisions of such subsection;

"(B) such participating firm or participating custodian received the stock or debt obligation described in the Transfer of Custody Certificate from another participating firm or participating custodian accompanied by a Transfer of Custody Certificate with respect to such stock or debt obligation; or

"(C) such participating firm—

"(i) effected as broken (or dealer) the acquisition of the stock or debt obligation described in the Transfer of Custody Certificate, and the exemption for prior American ownership and compliance provided in subsection (a) applied to such acquisition; and

"(ii) continuously carried in its records for the account of the person who acquired such stock or debt obligation, or received from such person, the identical stock certificates or evidences of indebtedness which it had previously delivered to such person in connection with such acquisition.

"(i) CERTAIN DEBT OBLIGATIONS ARISING OUT OF LOANS TO ASSURE RAW MATERIALS SOURCES.—Under regulations prescribed by the Secretary or his delegate. subsection (a) shall not apply to the acquisition by a United States person of any debt obligation to which section 4914(d) applied where the acquisition of the debt obligation by such person is made with an intent to sell, or to offer to sell, any part of such debt obligation to United States persons The preceding sentence shall not apply if the tax imposed by section 4911 has applied to any prior acquisition of such debt obligation."

(b) INTERIM PROCEDURES.—The Secretary or his delegate may establish such procedures and require the filing of such information and the maintenance of such records as may be necessary or desirable in order to permit an orderly transition in respect to market procedures for a period not in excess of 15 days following the effective date of this section pursuant to which participating firms and participating custodians may issue IET clean confirmations, clean comparisons, broker-dealer clean confirmation, and Transfer of Custody Certificates without satisfying the specific procedural requirements for establishing the exemption for prior American ownership and compliance as provided in section (a) hereof.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to acquisitions of stock of foreign issuers or debt obligations of foreign obligors made after July 14, 1967.

SEC. 6. RETURN TO REQUIREMENTS.

(a) Section 6011(d)(1) (relating to interest equalization tax returns, etc.) is amended to read as follows:

"(1) IN GENERAL.—

"(A) Every person shall make a return for each calendar quarter during which he incurs liability for the tax imposed by section 4911, or would so incur liability but for the provisions of section 4918. The return shall, in addition to such other information as the Secretary or his delegate may by regulations require, include a list of all acquisitions made by such person during the calendar quarter for which exemption is claimed under section 4918 accompanied by a copy of any transactions tax returns filed during such quarter as provided in subparagraph (B). No return or accompanying evidence shall be required under this paragraph, in connection with any acquisition with respect to which—

"(i) an IET clean confirmation is obtained in accordance with the provisions of section 4918(b),

"(ii) a validation certificate described in section 4918(b) is obtained, and such certificate was filed in accordance with the requirements prescribed by the Secretary or his delegate, or

"(iii) a validation certificate was obtained by the acquiring person after such acquisition, providing such acquisition was exempt from tax imposed by section 4911;

nor shall any such acquisition be required to be listed in any return made under this paragraph.

"(B) Every person who incurs liability for the tax imposed by section 4911 shall, if he disposes of the stock or debt obligation with respect to which such liability was incurred prior to the filing of the return required by subparagraph (A), make a return of such tax."

(b) Section 6076 is amended to read as follows:

"SECTION 6076. TIME FOR FILING RETURNS WITH RESPECT TO THE INTEREST EQUALIZATION TAX.

"(a) Each return made under section 6011(d),(1)(A) shall be filed on or before the last day of the first month following the period for which it is made.

"(b) Each return made under section 6011(d)(1)(B) shall be filed before the date of disposition of the stock or debt obligation with respect to which such return is made."

(c) Section 6315 (relating to payment of estimated tax) is amended to read as follows:

"SECTION 6315. PAYMENTS OF ESTIMATED INCOME TAX AND INTEREST EQUALIZATION TAX.

"(a) Payment of the estimated income tax, or any installment thereof, shall be considered payment on account of the income taxes imposed by subtitle A for the taxable year.

"(b) Payment by a participating firm (as defined in section 4918 (c)) which withheld such tax pursuant to section 4918 (e)(6) shall be considered payment on account of the tax liability imposed by section 4911."

(d) Section 6681 is amended by adding at the end thereof the following subsection:

"(f) False Application for Validation Certificate.—Any person who knowingly supplies information which contains a misstatement of a material fact in connection with application for a validation certificate, described in section 4918, and obtains and transfers or uses a validation certificate pursuant to such application for the purpose of establishing exemption for prior American ownership and compliance under section 4918 (a), shall be liable to a penalty equal to 125 percent of an amount equal to the tax which would have been imposed by section 4911 if such stock or debt obligation described in such certificate had been acquired by a person required to pay such tax."

(e) Effective Date.—The amendments made by this section shall be effective as of July 15, 1967.

The Chairman. Thank you, gentlemen.

The next witness will be Mr. Ralph E. Purvis, of Bremerton, Wash.

You may proceed, Mr. Purvis.

STATEMENT OF RALPH E. PURVIS, BREMERTON, WASH.

Mr. Purvis. Mr. Chairman, members of the committee, my name is Ralph E. Purvis. I reside at Star Route 1, Box 221, Bremerton, Wash. I don't plan to read my statement. I thought I could explain it much better and make a few oral statements which will describe my problem.

I am glad, Mr. Chairman, that both you and the Secretary, Assistant Secretary, recognize that this bill was a regulatory bill and not a tax-raising measure because my proposal is to get some taxes back which I pay under the retroactive feature and that is important, that it was not an income-source bill, a regulatory bill.

Therefore, there should be no hesitancy in making it possible for me and others similarly situated to get back taxes paid, if it is considered fair.

Now, then, this bill was first proposed by President Kennedy on July 18, 1963. It languished in Congress for many reasons until Sep-

tember 2, 1964, when it was finally enacted. It contained a retroactive clause making the tax retroactive back to July 18, 1963. Nowhere in the act is there any distinction between purchases made prior to the time the law was enacted with capital which was exploited after July 18, 1963, or capital which was outside the country prior to July 18, 1963.

My proposal has to do, and is limited in scope, only to those of us who had capital out of the country prior to July 18, 1963, with which we made purchases prior to September 2, 1964.

In other words, my proposal has nothing to do with any transactions after the bill was enacted in September 1964.

On page 4 of my statement I have given you a list of nine persons in my area of Washington State whom I know who are faced with similar problems to mine, and it gives the amounts of retroactive taxes paid, and totals $39,000 for the nine people—about $39,000.

In each of those—they are all in the same category—and I can best explain it by giving you examples.

In my case, for many years prior to July 18, 1963, I had an investment and trading account in Canada on stocks. What was I to do after this law was first announced as being desired in July of 1963? I did not know whether it would ever be passed. I didn't know what the rate of tax would be; I didn't know which countries would be exempt. So what was I to do as a prudent man, with my account? Was I just to step aside and do nothing until such time as the law was actually passed? Or was I free to manage my account as a prudent man? I chose to do that.

But the important thing is I did not export any capital. I used the capital and credit available on my securities that were outside the country before July 1963, and made these purchases prior to September 2, 1964.

The CHAIRMAN. Let me ask you this: Did you have any knowledge of the Treasury-proposed draft at that time, or what the Treasury was proposing during that period?

Mr. PURVIS. I knew what I had read in the newspapers. I knew it was to be retroactive. Nowhere that I could read was there any statement that a distinction would be made where capital was already outside the country where it was used to make purchases before the law was enacted.

Senator SMATHERS. How long had you been trading in this account outside the country prior to July 18, 1963?

Mr. PURVIS. At least 10 years.

Senator SMATHERS. And you can establish that from your records, that you had been operating, in fact, this trading business outside of the country prior to the time that it was announced that the tax would be put on?

Mr. PURVIS. That is right.

Now, I can give you a couple examples that really clarify this that are on my list.

Dr. Marshall on the list is a Seattle pathologist. He came to this country several years ago from Australia. He had some securities in Australia which he let his broker handle—gave him discretion. During this retroactive period—and these were held by him many, many

years before July 18, 1963—during this retroactive period of 14 months and before there was a law on the books, his broker switched to stock B in Australia, and he paid this tax of eight-hundred-and-some-odd dollars. He didn't export any capital after July 18, 1963; yet he was taxed.

Mr. Vallat—Eugene Vallat—is a man who for many years, probably 15 at least, before 1963 owned and operated a small sawmill in a remote section of British Columbia and Canada. He reached the point where he wanted to retire and come back to the State of Washington, a U.S. citizen. So he sold his little mill in this period, before there was a law enacted, within the 14-month period. With the proceeds of some of the money from that sale he acquired some Canadian stocks and he paid a tax of $1,800 on that portion of the proceeds that he used to make those purchases.

Now, he had them in a remote area of Canada, where he didn't even read American newspapers and this occurred to him. The other travesty of the situation is, as a U.S. citizen, he made a gain on the sale of his mill and he had to pay a capital gains tax rate on that and that portion which he used of the proceeds to buy these stocks, and on this he had to pay another 51 percent. Yet he had never exported any capital. The mill was in Canada for many years before July 18, 1963.

Those are examples that make it clear.

I was too late on the Extension Act of 1965 to propose this amendment. But I came back here and saw my friend, Senator Magnuson, and to see what he could do. When I first told him what had happened to me, told him how this impact affected me and these others, his remarks to me were, "Why, Congress wouldn't do a thing like that."

And then I showed him that they did. I paid the tax and we all voluntarily paid the tax. They didn't have to come after us. Senator Magnuson said, "That is not right; I will do everything I can to help you."

The extension bill had already come out of this committee, so Senator Magnuson proposed an amendment in 1965 and on receiving assurances from Senator Smathers and Senator Williams—that this committee would give serious consideration to it, he withdrew his amendment.

This is the first opportunity since then that this committee has had the opportunity to give the consideration which it assured Senator Magnuson 2 years ago.

The Treasury has opposed this on several grounds, and I have effectively refuted every one of their arguments in my written statement which I won't render here unless you gentlemen are interested in hearing it, in addition to what I have stated.

Senator SMATHERS. Did you take this up before the Ways and Means Committee?

Mr. PURVIS. Yes, I took it up in February with the Ways and Means Committee.

Senator SMATHERS. What happened?

Mr. PURVIS. They didn't see fit to adopt my amendment; no, sir.

Senator SMATHERS. What seemed to be their principal objection to your amendment?

Mr. PURVIS. I don't know. In talking to many of the individual members before the meeting, I was practically assured that everybody I

talked to said, "You are absolutely right," and I thought sure they would pass it.

Senator SMATHERS. Do you have any knowledge how many people are involved outside of these that you have named here?

Mr. PURVIS. No, sir.

Now, on January 10, 1967, President Johnson made a speech on the state of the Union. I listened to him on television and he said this, and I quote: "Where there have been mistakes we will try very hard to correct them."

When I listened to him, I believed him, and I made a resolution on my part then that I would come back here and appear before both committees, if necessary, and do whatever was necessary to bring it to the attention of the Government, not only the legislative branch, but the executive branch, that there had been a mistake. And this is a mistake which has very seriously harmed the people on my list and probably many others whom I don't even know about.

Unfortunately, the Treasury Department to this date does not recognize this; at least, they did not before the House Ways and Means Committee—did recognize this as a mistake.

I am a small town, country lawyer; I practice law in my State, and I have been practicing law for over 30 years. I have been a member of the Washington State House of Representatives and Washington State Senate. I feel that as a lawyer, as a legislator, that I am right and that this is a mistake which President Johnson had in mind.

I do hope that as a result of this hearing, the Treasury will recognize it, and if they do not I am hopeful this committee will recognize it and adopt my amendment.

The CHAIRMAN. I suggest our staff should study this and see if we can work out an amendment that will try to do equity to you, and to people who are similarly situated.

As you point out in your statement, Mr. Purvis, I think it is clear that you were not exporting capital.

Mr. PURVIS. I am sure in my own mind that no committee of Congress intended this result.

The CHAIRMAN. We will have to have the advice of our staff. As a former legislator yourself, you understand the problem when we try to do equity to one group, it raises a problem with other people who might have parallel problems where they would like to be considered, also. We will try to do the best we can for you on this matter.

Mr. PURVIS. Thank you.

(The prepared statement of Mr. Purvis follows:)

STATEMENT OF RALPH E. PURVIS ON H.R. 6098

My name is Ralph E. Purvis. I reside at Star Route 1, Box 221, Bremerton, Washington. I am a member of the bar of Washington State and represent myself as an individual investor.

I propose that a new subsection be added which would exempt from taxation purchases made during the initial retroactive period from July 18, 1963, to September 2, 1964, but only in those instances where no capital was exported.

My proposal can be summarized under four main headings:

(1) Legislative history.
(2) Tax impact on acquisitions made within retroactive period.
(3) Suggested new subsection.
(4) Argument.

(1) LEGISLATIVE HISTORY

The existing law was first proposed by President Kennedy on July 18, 1963, but did not become law until September 2, 1964. The tax on the purchase of foreign securities was made retroactive to July 18, 1963, and applies to all purchases subsequent to that date. With regard to purchases within the retroactive period of thirteen months the act makes no distinction between purchases financed with capital already located outside the U.S. prior to July 18, 1963, and purchases made with capital exported from the U.S. between July 18, 1963, and September 2, 1964. The ostensible purpose of the act, as expressed by the President when first suggested, and the act itself, was to prevent any further outflow of dollars after July 18, 1963.

The impact of the retroactive feature with impact to instances of purchases made within that period, and with funds located outside the U.S. prior to the effective date, was never discussed or considered by any committee of Congress until presented by me to the House Ways & Means Committe in early 1967.

My proposed amendment was not adopted by that Committee, largely because of opposition from the Treasury Department. However, that Committee did grant relief for persons in a very similar factual situation, which is incorporated in Section 4914(b)(14)(B) on page 29 of the Committee Report. This subsection, which was added on the initiative of the Committee itself, exempts from the tax certain acquisitions made with funds derived from the sale of real property owned and located outside the U.S. on or before July 18, 1963.

Senator Warren G. Magnuson introduced a floor amendment in the 89th Congress which would have provided the relief which I now propose. Senator Magnuson was persuaded to withdraw the amendment upon receiving assurances that the Senate Committee on Finance would give serious considerations to this matter if and when it was presented to the Committee.

(See Congressional Records for August 24 and Augst 30, 1965, pages 21538–21542 and 22193 for the 89th Congress)

This hearing is the first opportunity afforded the Committee on Finance for that serious consideration of Senator Magnuson's floor amendment providing for the same relief as the new subsection which I now propose.

(2) TAX IMPACT ON ACQUISITIONS MADE WITHIN RETROACTIVE PERIOD, NAMELY: JULY 18, 1963 TO SEPTEMBER, 1964

During the retroactive period many persons like myself, who had funds invested in foreign securities prior to July 18, 1963, continued to manage those investments by making sales and purchases, not knowing whether the act would ever actually be enacted, what countries would be exempted, and what rates of tax would apply if it ultimately did become law. Since there was no actual prohibition of trading in foreign securities, and no tax actually enacted, as I say, many persons consummated purchase transactions prior to enactment and with funds located outside the U.S. prior to July 18, 1963.

Some persons in this category, like myself, no doubt assumed the act would not apply in those instances where no capital was exported after July 18, 1963. Not until shortly after the act became law did they realize these transactions were taxable not only in those instances where capital was exported, but also in those instances where capital was *not* exported. I fit the latter category.

For many years prior to July 18, 1963, I had funds in Canada and funds invested in Canadian securities, and had actively traded in listed stocks on Canadian exchanges. I was, of course, aware of President Kennedy's request that Congress enact this tax retroactively, but assumed it would not apply to my funds located outside the U.S. prior to July 18, 1963, which I might use to make purchases at any time before there was actually a tax law enacted. As a consequence, I continued to manage my investment portfolio in Canadian securities during the retroactive period, and made some purchases during that period, but with funds located outside the U.S. prior to July 18, 1963. In other words, I did not export any capital, yet incurred tax liability.

The following is a list of persons in Washington State who have paid retroactive taxes in the amounts indicated opposite the name of each. In all of these instances the purchases of foreign securities were made between July 18, 1963, and September 2, 1964, and the purchase price was paid with funds or credits

located outside the U.S. prior to July 18, 1963. No capital was exported within the period in order for these persons to consummate the purchases:

Ralph E. Purvis, Star Rt. 1, Box 221, Bremerton	$14,737.12
Arthur Ward, 6535 18th Ave., N.E., Seattle	11,461.00
Dr. C. E. Marshall, 1221 Minor, Seattle	833.97
Eugene Vallat, Box 1010, Port Angeles	1,825.06
John Harkoff, Box 709, Lynden	7,135.01
Marianne Harkoff, Box 709, Lynden	299.94
Helen Sue Harkoff, Box 709, Lynden	299.94
Martin H. Jensen, Lynden	1,454.04
Erling Crabtree, Lynden	876.00

Adoption of my proposed new subsection would enable myself and other persons in the same very limited category to obtain refunds of such taxes paid.

The following is the text and language of the new subsection which I propose:

"That (a) section 4914 of the Internal Revenue Code of 1954 (relating to exclusion for certain acquisitions) is amended by adding at the end thereof the following new subsection:

"'(k) CERTAIN ACQUISITIONS BEFORE SEPTEMBER 2, 1964.—The tax imposed by section 4911 shall not apply to an acquisition made before September 2, 1964, by a United States person of stock or a debt obligation if such acquisition was made—

"'(1) with foreign currency held by such person on July 18, 1963,

"'(2) from funds held by such person on July 18, 1963, which were on deposit outside the United States with persons carrying on the banking business,

"'(3) from the proceeds of the disposition of stock of foreign issuers, or debt obligations of foreign obligors, held by such person on July 18, 1963.

"'(4) from the proceeds of the disposition of stock of foreign issuers, or debt obligations of foreign obligors, acquired by such person after July 18, 1963, in an acquisition to which paragraph (3) applied, or

"'(5) from credit obtained in a foreign country.'"

(4) ARGUMENT

Enactment of the new subsection would correct a most unfair tax impact not anticipated when the act was first enacted, and not seriously considered since enactment. It is my opinion that the tax is probably unconstitutional, as a violation of the fifth amendment, with respect to the retroactive feature as applied to the factual situations to which the new subsection is limited in its scope. However, neither myself, nor other persons in my same category, should have to spend time and money in the courts to correct this obvious mistake in the law.

In President Johnson's recent State of the Union Message to Congress on January 10, 1967, he said:

"Where there have been mistakes, we will try very hard to correct them."

I submit that I have demonstrated a very serious mistake as a result of which many persons like myself have been trapped into a tax liability which neither Congress nor the Executive Department ever intended. Having demonstrated the mistake, I have suggested the appropriate correction, and I urge that this Committee include my proposed new subsection in H.R. 6098.

The Ways & Means Committee in the amendment as set forth in Section 4914 (b)(14)(B) has granted the exact relief which I seek, but limits the exemption to persons who owned real property in foreign countries on or before July 18, 1963, and thereafter used the proceeds of sale of such real property for the acquisition of foreign securities. This relief should be expanded to meet the situation of myself, where I owned foreign personal property, such as cash and securities, on or before July 18, 1963, and used those assets to make purchases of foreign securities prior to passage of the act on September 2, 1964. There is no reason why the owner of foreign real property should be exempted unless persons like myself are also exempted—we are all in the same factual category, and all are entitled to have this relief by way of exemption from the tax.

The Treasury Department has opposed my proposal, and the following is in answer to Treasury objections.

The argument is made that President Kennedy's request in his Message of July 18, 1963, was given wide publicity as to the scope and retroactive feature of the bill. I submit that our democratic process has reached a sorry state of affairs if the entire public is thereby presumed to know the law during a period of thirteen months by reading newspaper accounts of the progress of a bill such as this through Congress. Perhaps one can argue that people in the financial community should be cognizant of all the provisions, but surely one cannot say the same with respect to small and unsophisticated investors.

Also, I do not ever recall any publicity which stated specifically that the act would apply to purchases made before enactment with funds located outside the U.S. prior to July 19, 1963.

Treasury also advances the argument that failure to apply the tax to acquisitions described in the new subsection would have resulted in the creation of a "security dollar" which would have impaired world confidence in the dollar. This result might have occurred if the exemption I propose applied to all purchases made with funds previously located outside the U.S. irrespective of the date of purchase. But my proposal limits the exemption to purchases made prior to September 2, 1964, and therefore could not have had any such effect. Also in this connection, there is not presently any danger—that danger, if it existed, is not now present. Treasury's mission was accomplished when the act was enacted on September 2, 1964. Adoption of my proposed new subsection at this time would have no monetary impact, but would remedy a wrong to persons like myself who were trampled in the legislative process to protect the dollar. Treasury argues that the adoption of my proposal would have the effect of rewarding speculators who made purchases within the retroactive period, and penalizing those who refrained from so doing, based partially upon the premise that any such foreign security purchases would have a greater value if sold to other Americans after passage of the act. This argument is fallacious. In the first place, it does not recognize that my proposal is limited to purchases made with funds located outside the U.S. before July 18, 1963—any such persons did not speculate to the extent of exporting capital.

A careful examination of the daily market on Canadian securities indicates that generally there is no premium in price when one American buys Canadian stocks from another American as contrasted with purchases from non-Americans. In theory, an American would be expected to pay another American fifteen percent more for a Canadian stock than he would pay in buying from a non-American. Experience has demonstrated that this special market is very thin, and the theoretical premium is nonexistent. Even now, since the proposal has been made to increase the tax to thirty percent, American ownership sales of Canadian stocks are approximately the same price as shares traded without the American ownership certificate.

Treasury suggests that the purpose of the act was not only to prevent the further outflow of dollars, but also to cause a repatriation of funds already located in foreign lands. I submit that there certainly was no publicity with respect to any such intent, and I doubt if Congress had any such intention in passing the act. In any event, persons like myself should not be penalized, regardless of the intent of Congress or the Treasury.

In conclusion, by adopting my proposal, Congress would recognize that a mistake was made, thereby correcting the unjust tax impact in the special and very limited situations to which my proposal is applicable.

The CHAIRMAN. Mr. Paul C. Cohen.

STATEMENT OF PAUL C. COHEN, STEIN ROE & FARNHAM

Mr. COHEN. I am Paul C. Cohen, partner of Stein Roe & Farnham, an investment counsel firm of Chicago and New York. As specialists in handling investment portfolios, we have clients that include individuals, pension funds, profit-sharing plans, and charitable orga-

nizations. We also manage three no-load mutual funds with a total of about 17,500 shareholders. I am president of the Stein Roe & Farnham International Fund, which is invested in international securities.

I appreciate the opportunity to submit this statement to the committee.

At the outset, let me say that I share a concern over our balance-of-payments problem, and I recognize the potential risk which has prompted the request for additional regulatory authority in the period of uncertainty immediately ahead.

On the other hand, there is equally a risk that our eagerness to resolve the problem might cause us to adopt control devices that are too extensive and unnecessarily rigid.

My testimony proposes a modest amendment that would not in any way reduce the effectiveness of H.R. 6098. On the contrary, it would permit the rate of tax to be tailored more closely to specific needs. In doing so, it should help avoid making the tax too inflexible and sweeping a policy instrument.

As passed by the House, H.R. 6098 requires the President, if he increases or decreases the tax on any one type of security, to apply the same proportionate increase or decrease to all types—new bonds, outstanding bonds, new stocks, and outstanding stocks. This is required by subsection (2) (C), beginning on line 21 on page 4.

It seems clear to me that such rigidity is neither necessary nor desirable. The regulatory action that is needed or appropriate for one type of security may not be at all needed or desirable for another, since their nature and their balance of payments experience are really quite different. It would seem to be much more logical and appropriate to allow separate regulatory tax changes tailored to meet the different situations.

Accordingly, I suggest amending the bill to permit the President to adjust the tax separately for stocks and bonds, and within each group, separately between new issues and outstanding securities. Such an amendment would still permit the flexible range of rates presently authorized by the House bill—that is 15 percent to 22.5 percent for stocks—or whatever range of rates is finally established by the Congress. However, it would not inflexibly require a change of rates for all types of securities because of the need to change the rate for one type.

Let me digress from my prepared statement to say that, in essence, what we are proposing is for the Treasury, acting for the President, to have all of the authority for which they are now asking, but not to be obligated to use that authority where the data, the situation, et cetera, does not require that they do so.

In short, if interest rate differential rates widen——

Senator SMATHERS. Did you make this presentation to the House Ways and Means Committee?

Mr. COHEN. I was not able to at that time.

Senator SMATHERS. Did somebody else make that argument?

Mr. COHEN. Not to my knowledge.

In returning to my prepared statement let me urge that there is a

particular need for distinguishing between bonds and outstanding stocks.

As you know, there is a concern at present that the interest rate differential between United States and foreign capital markets may widen. This is the principal reason for the proposed authority in H.R. 6098 to increase the interest equalization tax. In his presentation today Mr. Deming dwelled on this at some length.

It is true, of course, that interest rate differences can and do affect the flow of funds in transactions involving bonds and other interest-bearing securities. Therefore, if given flexible authority, the President may wish to increase the tax on bonds, to offset a possible widening difference in interest rates.

But this by no means would indicate a need to increase the tax on outstanding stocks. The flow of funds in transactions involving outstanding stocks is governed by different considerations—in particular, comparative capital gain potential, which in turn is related to the outlook for corporate earnings and dividend growth, profit stability, financial strength, et cetera—and bears no direct relationship to changes in interest rates.

Moreover, as the attached table shows (the final page in the statement), the flow of funds on outstanding stocks has been strikingly different from the trend with respect to bonds. While there has been a pronounced net capital outflow on bonds, transactions involving outstanding stocks have provided a net inflow averaging $165 million a year for the past 5 years and ranging between $250 million and $350 million in 1965–1966. The inflow began more than a year before the interest equalization tax was even proposed in 1963. Outstanding stocks have not caused a problem since then, and there is no evidence that they will be a problem in the future.

Hence, all the evidence suggests that the present 15 percent tax on purchases of outstanding foreign stocks has been more than adequate, and that an increase in that rate would be unnecessary and inequitable. The President should not be required by law needlessly to increase the tax on outstanding stocks, just because it may become necessary to increase the tax on bonds, or to increase the tax on bonds if it should become necessary to increase them on stocks.

Stocks should not be entrapped in actions designed for bonds, or vice versa. The legislation should permit changes in the rate on either stocks or bonds in accordance with real needs, without arbitrarily binding different securities in the same rigid mold.

It seems very likely that any Executive order pertaining to bonds would make the same proportionate change for outstanding bonds as for new bond issues. This would have the same effective impact on annual interest costs for all bonds whatever their maturity. If conditions required, the amendment would also permit an increase in the tax on new stock issues to avoid any possibility of diversion of new financing from bonds to new stock issues. The possibility of such a diversion, of course, does not apply to outstanding stocks.

While the amendment I propose would provide flexibility to increase the tax on outstanding stocks, no such increase is likely to be needed under foreseeable conditions. In this connection, I want to

point out that the institutional investor in foreign stocks is also subject to another very rigorous restraint—namely, the Federal Reserve Board's balance-of-payments guidelines for nonbank financial institutions. Under those guidelines, financial institutions are limited to an increase of under 4 percent a year in their total foreign portfolio investments, and may not increase their investments in Western Europe at all.

That same combination of tax and guideline limits needlessly harms the U.S. institutional investor who holds foreign stocks. When, consistent with the Federal Reserve guidelines, he wishes simply to switch one holding into another as investment conditions warrant, he must pay the interest equalization tax regardless of the fact that no net outflow of funds from the United States is involved. In its present form, H.R. 6098 would very likely increase this tax burden in the course of meeting a problem which really involves only bonds. The amendment I suggest would avoid imposing this needless added burden.

In conclusion, I would like to emphasize that our proposed amendment would be in keeping with a basic U.S. policy, often affirmed by both the administration and the Congress. This policy supports a flow of goods, capital, and services that is as free from arbitrary restraint as is practicable.

When restrictions become necessary upon occasion, in the national interest, they should be limited to the necessary object and confined to the appropriate degree.

I am confident the amendment would permit a more effective application of this fundamental principle without in any way limiting our ability to safeguard the balance of payments.

Thank you for the privilege of making this statement to the committee.

(The table referred to follows:)

U.S. transactions in foreign stocks and bonds—Balance of U.S. net purchases (−) or net sales (+)

[In millions of dollars]

	1962	1963	1964	1965	1966
Stocks:					
New issues	−74	−53	−4	−4	[1] −46
Outstanding issues (net)	−26	+113	+210	+297	+253
Total stocks (net)	−100	+60	+206	+293	+207
Bonds:					
New issues	−1,002	−1,197	−1,059	−1,202	−1,164
Outstanding issues (net)	−70	−163	−16	−71	+70
Total	−1,072	−1,360	−1,075	−1,273	−1,094
Less redemptions	+203	+195	+193	+222	[2] +405
Total bonds (net) [3]	−869	−1,165	−882	−1,051	−689

[1] Consists largely of issues exempt from the IET including $34,000,000 Canadian, and approximately $8,000,000 underdeveloped countries. No European securities were involved.

[2] Foreign bond redemptions for 1966 include about $150,000,000 of a special character, in the form of advance amortizations of Canadian Government issues.

[3] Total net purchases of foreign bonds correspond to Commerce Department data. Treasury Department data are generally higher, the difference usually being $60,000,000 to $70,000,000 but amounting to several hundred million in 1965 and 1966. The difference arises because some bonds issued in this country by foreign subsidiaries (mostly Canadian) of U.S. corporations are treated as direct investment by Commerce but as bond or portfolio investment by the Treasury.

Senator SMATHERS. All right, sir; thank you very much, Mr. Cohen. I understand that you have a table with respect to the tax evasion described by the Secretary.

Mr. COHEN. Let me say first, that when the New York Times and the Wall Street Journal articles were published last week I was on my way back from the Middle East and had had no opportunity, really, to get very much involved or to improve my understanding of the tax evasion situation. It is one in which we have had no traffic in our operations. I decry these efforts at evasion, and I am most interested in what needs to be done to modify, correct, and eliminate them.

In thinking about the problem, however, sir, I—we at the firm—asked ourselves, "What must be involved here?" We don't have the benefit of statistics. What I have is something much simpler, which I think provides some perspective. We thought perhaps we might add some light to it. I think the people who are scheduled to testify Monday are better qualified with this than I, since my business is making investment judgments rather than being involved in brokerage transactions.

It seems to us there is unlikely to be evasion or efforts at evasion of the tax on any foreign securities were the foreign securities being bought and sold in the United States at prices not significantly different than overseas. If you can buy them in the United States at approximately the same price from other Americans without paying a tax, what interest would there be on the part of anyone to evade the law, and involve themselves in an illegality when they are unable to sell the security in the United States at a higher price? With that in mind, before coming to Washington this week I compared the prices of a group of foreign securities in their own local market with the prices of the same securities in the U.S. market. Here is a list of them.

The stocks in this list aren't selected for any other purpose than to get some feeling for the situation of stocks that represent, by and large, the bulk of American holdings of foreign securities.

I have listed them here by country and company [indicating].

Column 2 reports the foreign price in U.S. dollars in their local markets—the local markets of each of the securities as of the close of business last Friday, July 7.

The third column, which I have called the U.S. price, is the midpoint of the bid-ask range in the United States reported in the Wall Street Journal, and in the New York Times, at the close of the same day.

The fourth column measures the premium that you would have to pay in the U.S. market without an interest equalization tax, of course. What one sees as one goes down the page, is that—in comparatively few—in no more than one or two cases on the page would there have been any incentive on the part of the culprit to do the kind of thing we have heard about this morning. Indeed, there is only one stock here where the premium is of sufficient size that would perhaps prompt some encouragement to any attempted evasion.

I should suggest, sir, that these statistics in the table are subject to some qualification since foreign securities frequently do not trade on a given day in the United States; and so the prices reported do not necessarily reflect a transaction, but the bid-ask range established by the broker who maintains the principal market for the security in the United States.

(The table referred to follows:)

Foreign stock prices in their local markets and in the United States, as of the close July 7 1967

Country and issue	Foreign price (in U.S. dollars)	U.S. price (midpoint of bid-ask range)	Premium in the U.S. market (percent)
Australia: Broken Hill	11.10	11.13	
Canada:			
Massey Ferguson	20.80	20.87	
Falconbridge Nickel	79.68	83.50	4.8
France: Pechiney	37.31	39.00	4.5
Germany:			
AEG	42.00	42.25	
BASF	45.93	46.00	
Deutsche Lufthansa	27.00	26.75	
Farb. Bayer	31.13	31.25	
Siemens	47.00	47.00	
Italy:			
Fiat	4.50	4.38	
Olivetti, Pfd	5.13	5.13	
Japan:			
Kansas Electric	20.00	19.87	
Hitachi	20.13	20.50	1.8
Netherlands:			
Hoogovens	22.25	23.00	3.4
KLM	103.00	104.25	1.2
N. V. Philips	25.00	25.30	
Royal Dutch	34.85	35.50	1.9
Unilever, N. V.	25.05	25.00	
United Kingdom:			
Beecham	5.50	5.62	
Rank Organisation	6.13	7.87	28.4
Unilever, Ltd	19.04	18.87	

Mr. COHEN I also have not included in the table some other stocks which I discovered since coming to Washington have apparently figured in the evasion.

Senator SMATHERS. Could you supply for the committee as soon as you can the information with respect to Sony and Roan Selection and African Gold stock?

Mr. COHEN. Certainly, Sony and Roan Selection and African Gold stocks.

Senator SMATHERS. We would be interested in seeing what the premium was in the United States.

Mr. COHEN. I did not think in terms of gold stocks until I got to Washington and heard from the Treasury people that gold stocks were apparently involved. I will be happy to supply similar statistics.

The approach is really simple as taking last Saturday's New York Times and last Saturday's London Financial Times to compare the prices.

Senator SMATHERS. All right.

(Mr. Cohen subsequently supplied the following information:)

Company	As of close July 7, 1967		Premium in the U.S. market (percent)
	Foreign price (in U.S. dollars)	U.S. price (Midpoint of bid-ask range)	
Roan Selection Trust	10.08	9.75	
Sony	23.77	29.25	23.0
African gold stocks:			
De Beers Consolidated Mines	40.32	45.50	12.8
Pres. Brand Gold Mining	13.80	14.07	1.9
Pres. Steyn Gold Mines	3.15	3.63	15.2
Western Deep Levels	10.29	12.50	21.5
Western Holdings	19.60	22.25	13.5

Mr. COHEN. These data suggest to us that the problem of evasion is probably not a broad one, and that it involves essentially the "hot stock," the fast buck stock kind of thing.

With regard to methods of meeting or treating that problem, we are remote, really, from the day-to-day operation of the market. We manage funds, we advise clients, and we use the regular brokers to buy and sell stocks on behalf of these clients.

I would urge something, however, in this regard: establishment of the interest equalization tax, and the voluntary controls which followed under the Federal Reserve Board's aegis have had the effect of creating some psychological blocks to the purchase of foreign securities already long held by Americans. They have been an inhibition to the underlying value of securities held by Americans of foreign stocks. I would hope that in seeking to counter evasion, we do not "over kill" and introduce rigidities so severe as to depress unnecessarily the value of foreign securities presently held by U.S. citizens.

Since I have only this morning heard Secretary Deming's remarks on the subject, and seen a preliminary Treasury statement on recommended enforcement procedures, I do not feel qualified at the moment to comment on the evasion recommendations in detail. I would be pleased to do so after reviewing them, should the committee desire.

Senator SMATHERS. All right, sir.

Thank you very much, Mr. Cohen. We appreciate your testimony, and the meeting will stand in recess until 10 o'clock Monday morning.

(Whereupon, at 1:15 p.m., the committee recessed, to reconvene on Monday, July 17, 1967, at 10 a.m.)

INTEREST EQUALIZATION TAX EXTENSION ACT OF 1967

MONDAY, JULY 17, 1967

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

The committee met, pursuant to notice, at 10 a.m., in room 2221, New Senate Office Building, Senator Russell B. Long (chairman), presiding.

Present: Senators Long, McCarthy, Hartke, Harris, Williams, Carlson, Bennett, and Morton.

The CHAIRMAN. This morning we will conclude the hearings on the bill to extend the interest equalization tax. On Friday of last week the Under Secretary of the Treasury renewed the recommendations he made to the Ways and Means Committee of the House that the tax rate should be doubled from 15 to 30 percent, and that the President should be authorized to vary these rates between zero and 30 percent.

He also described for the committee a situation involving the evasion of the interest equalization tax through the use of false certificates of prior American ownership, and he recommended that Congress impose more stringent recordkeeping rules on securities brokers and dealers to enable the Treasury Department to combat the tax evasion.

The committee hopes that witnesses from the securities industry who are appearing this morning will address themselves to these recommendations so that we might have them in perspective when we take them up in executive session.

Our first witness is scheduled to be Mr. Henri L. Froy, chairman of the foreign committee of the National Association of Securities Dealers.

Mr. Froy, we are pleased to have you, and you may proceed with your statement.

STATEMENT OF HENRI L. FROY, CHAIRMAN, FOREIGN COMMITTEE, NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ACCOMPANIED BY FRANK J. WILSON, ASSOCIATE GENERAL COUNSEL, NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Mr. FROY. Thank you. Good morning, Senator.

Mr. Chairman, I am Henri L. Froy, chairman of the foreign committee of the National Association of Securities Dealers, Inc., and a general partner in Abraham & Co., a member of the New York Stock

Exchange and broker in domestic and foreign securities. I am accompanied today by Frank J. Wilson, associate general counsel of the association.

I have testified before this committee several times in the past on this association's behalf and I feel certain the respective members of the committee are aware of the background, nature, purpose, and function of the association. Suffice it to say, therefore, that the association is nationwide in scope and is composed of approximately 3,659 member broker-dealers actively engaged in the investment banking and securities business and has registered with it approximately 90,575 securities salesmen. The association is organized and registered with the Securities and Exchange Commission as a national securities association pursuant to the provisions of section 15A of the Securities Exchange Act of 1934, and has the responsibility under that act of enforcing upon its members just and equitable principles of trade for the protection of the public. It is the means by which the principle of self-regulation has been effectuated in the over-the-counter securities market. Virtually all foreign securities transactions are executed by its members.

In February, I testified before the Committee on Ways and Means of the House of Representatives and at that time noted that ever since an interest equalization tax was first proposed by the late President John F. Kennedy, the association has expressed its opposition thereto. That opposition has been expressed to the respective committees of the House and the Senate every time the matter has been before them and, while the members of the association and the foreign committee are in complete agreement with the Government's efforts to curb the continuing balance-of-payments deficit, we must again reiterate our opposition to the tax because we do not believe it is a proper way to attack the problem.

We have previously pointed to the problems inherent in the job of enforcing this so-called tax which, as this committee knows, was proposed as a deterrent and not as a revenue producing agent. Recent articles in the press dramatized and, in my opinion, have given credence to that concern. Those articles reported that simple schemes, almost worldwide in scope have been invented to circumvent this levy. These schemes are apparently perpetrated by paying U.S. persons abroad, and at home, for their signature which is then affixed to a Certificate of American Ownership for delivery in the U.S. market. The securities are thereafter sold at a premium, but below the total price had the tax been paid. In view of the provisions of the existing law, the broker-dealer who received the security with an American ownership certificate attached can rely upon the certificate as being conclusive proof of prior American ownership of the security unless he has actual knowledge to the contrary. The buyer does not, therefore, pay the tax and the purpose of its imposition is defeated by increasing rather than decreasing the outflow of funds.

The association became gradually aware several months ago of possible wrongdoing of the type I have just described. It is not the type of thing which one immediately discovers, because of the nature of the evasion. The awareness of its existence arises over a period of

time as a result of occurrences which one suspects while conducting his business. It becomes manifestly clear, though, when one learns that a small dealer or dealers, who had previously done little if any business in foreign securities, suddenly have unlimited amounts of a given foreign security or of several different foreign securities, American owned. The association is not, of course, in a position to police a scheme as grandiose as this one appears to be and the action it can take is rather limited because of the nature of the law and the language of our rules. As a result of action of the Foreign Committee, however, this association in March sent, over the signature of its president, Mr. Robert W. Haack, a notice to all of its 3,659 members warning them of the possible criminal consequences of such actions. This notice is attached hereto as appendix A and I should be appreciative if it is made part of the record herein. Also, information which had come to us during the course of our investigations was referred to the Internal Revenue Service pursuant to a previous informal agreement between the Service and the association. I cannot say that all broker-dealers have lived up to their responsibility by not consummating transactions which had all sorts of "red flags" flying to warn them of possible wrongdoing, but I can assure you that the National Association of Securities Dealers has and will continue to live up to its responsibilities and will take whatever action it can under the law and its rules.

The association is on record as opposing the concept of an interest equalization tax. We also oppose the increase in the maximum tax to 22½ percent as provided for in H.R. 6098, now before this committee, and the extension of the tax for 2 more years. We, therefore, urge the bill's rejection.

Recognizing the strong possibility of passage, however, the association expressed its desire to the Treasury Department and the Internal Revenue Service to cooperate in every way possible with them in attempting to stop this evasion of tax and if possible to close the loopholes in the law which give rise to it. I reiterate that offer at this time and I also hope that if a situation arises whereby the expertise of the members of my committee (all of whom are experts in the field of foreign securities) can be utilized, they will be called upon for assistance. They are willing to give it. We did in fact participate in meetings last week, but regret that none of our advice was taken.

At this point, I think I should state that my committee had agreed, notwithstanding our strong opposition to the tax itself, to go on record that we will support any reasonable proposals outlined by the Under Secretary of the Treasury on Friday, July 14, 1967, in trying to plug these loopholes. I have, however, the gravest doubts that the additional bookkeeping, controls, and reporting procedures suggested by him would achieve the desired result. The whole tax concept looks to the world as a type of uncontrollable foreign exchange control.

Since studying the contents of Mr. Deming's statement, we feel, however, we would fail in our duties to the United States, to the American investor and to the members of this association, if we did not take issue with the statement by the Under Secretary of the Treasury and I quote:

The United States trade position is improving * * *

but in view of the cost of the Vietnam war—

> we have no recourse but to continue to moderate the flow of our capital exports. The I.E.T. helps us to do this.

The Under Secretary tries to make a strong case for the need for the I.E.T. on account of discrepancies of interest rates. I will leave the answer to this statement to the chairman of the I.B.A. Foreign Committee. He is more qualified to answer this. It is not quite clear to us what the Under Secretary means in his statement that the effect of the I.E.T. on the outflow of U.S. capital in the form of bank loans is impressive. If all these favorable factors apply, what need is there for continuation of I.E.T.?

We further learn:

> The Interest Equalization Tax and the Voluntary Cooperation Program have worked in tandem and have complimented each other as measures for correcting the balance-of-payments deficit. * * * Failure to extend the Interest Equalization Tax would have adverse balance of payments consequences and would place undue strain on other elements of the administration's economic program.

May we ask at this point, where the interest equalization tax on outstanding equities has assisted the United States in the balance-of-payments deficit? We agree with the views of the Under Secretary of the Treasury that the tax is not a revenue producing measure nor an absolute deterrent for the purchase of foreign securities. It is neither one nor the other as can be demonstrated. We are further told that the existing presidential discretionary provisions of the I.E.T. law have resulted in substantial gains for the balance-of-payments position. Is it in view of these gains that the I.E.T. rate needs an upward change?

There are other means of controlling the inflow of outstanding securities less troublesome and more effective than the hurriedly prepared recommendations of the Treasury.

In my presentation to the Ways and Means Committee, I pointed out that a differentiation between the treatment under the I.E.T. law of outstanding equities and debt securities would be justified. The name given the impost—interest equalization tax—itself implies such a differentiation since interest can never be attributed to equities.

We urge this committee to take cognizance of our request for a differentiation between equity and debt securities. At the very least, the Treasury Department should be requested to justify its failure to support a differentiation in spite of our urging. The bill calls for amendment of section 4911 of the Internal Revenue Code to provide the President with the authority to vary the amount of tax between 15 and 22½ percent, such authority commencing 30 days after the enactment of the act. Notwithstanding our comments before the House Ways and Means Committee giving limited support to the proposed Presidential discretion, the members of my committee clearly feel that such a flexibility would create, here as well as abroad, a new and dangerous indicator as to our monthly balance-of-payments fluctuation. Should, however, this committee feel that such flexibility would serve a useful purpose, I submit that the discretion to be given to the President should permit him to raise or lower the rates of tax individually by category and downwards to zero. As presently written, any change in rate must be proportionate as to each rate of tax; that is, it must apply to the rate imposed on the stock category as well as the sliding

scale rate on the debt obligations and commercial bank loan categories and the discretion is limited to between 15 and 22½ percent. House Report No. 68, accompanying H.R. 6098, on page 15 states the same percentage increase or decrease would have to apply to all categories. We in the securities business do not feel such is wise because we believe a valid case can be made now for the reduction or complete elimination of the tax on equity securities. We, therefore, urge this committee to amend the bill to give the President authority to vary the rate by category down to zero.

As securities dealers, we naturally are concerned with the effect of the proposed increase in the tax on our market-making ability as well as on our businesses. We are also concerned about the image of the United States in the marketplaces abroad and especially in the eyes of foreign investors and institutions.

The U.S. securities industry and American broker-dealers have done a fabulous selling job in placing American securities with foreign investors. Their research and know-how have been so successful that there are now no foreign stock exchanges which function on a par with those of this country. The result of this marketing effort has created a considerable commission income in the form of foreign currency which has become a permanent asset in our balance-of-payments picture. In fact, the U.S. securities markets have become a model, but more importantly, a haven for foreign capitalists. The Foreign Investors Tax Act signed by the President on November 13, 1966, in addition to the recommendations of the Fowler report issued April 27, 1964, have helped us in our task.

The inactivity of foreign stock exchanges and the many economic problems which foreign investors have, resulted in a completely negative approach by the U.S. persons to those markets.

Foreigners look up to the United States for their economic example and freedom of trade. They are extremely disturbed by this so-called tax and they believe it is basically a levy on foreign exchange or a levy on the import of securities rather than a tax. This is especially so in the case of outstanding equity securities since, in respect to them, there is, as I said before, no interest to equalize. Should this committee against our advice and taking fully into consideration our balance-of-payments problem still decide in its wisdom not to reject this levy, we shall urge the President—if he is given the authority by Congress—to reduce the tax on equity securities to zero. If he is given this discretion, he would also be in a position to order a change upward promptly if such was found necessary thus diluting the possibility that the elimination of the tax would adversely affect our balance of payments for any length of time. The securities industry would certainly be in a considerably improved position in placing American securities abroad if this threatening levy on foreign equity securities were eliminated.

In conclusion, I would like to reemphasize the opposition of the Foreign Committee of the National Association of Securities Dealers to the interest equalization tax and especially to increasing the tax since the need for that action has in no way been demonstrated and we do not believe it can be demonstrated. Indeed, we feel the tax should be allowed to expire on July 31, 1967, which will occur if this committee takes no action.

In any event, whether the rates are increased or left the same the President should be given discretion, clearly spelled out in the bill, to vary rates of tax as to one or the other of the categories, individually.

Also, in the event the Congress desires to continue to tax, the association pledges its cooperation with the Treasury Department and the Internal Revenue Service to stop the evasion scheme which we understand has been running rampant. Again, I offer the services of the association and the Foreign Committee toward accomplishing that goal.

In addition, Mr. Chairman, the association would also like to request that the committee hold the record open so that it can submit a supplemental statement specifically directed toward that section of the Treasury's proposal designed to prevent a continuance of the tax evasion problem. Thank you.

(An attachment referred to, plus the supplemental statement, follows:)

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

IMPORTANT NOTICE TO NASD FOREIGN SECURITIES DEALERS

Re improprieties in foreign securities transactions.

The Association's Foreign Committee strongly urges members of the Association to use special caution when transacting business involving foreign securities with banks, brokers or private clients located or residing outside of the United States. To fully protect yourselves, it may sometimes be advisable to attempt to trace the history of the security in question prior to trading and prior to introducing the security into the United States. By doing so, all suspicion of wrongdoing on your part can be relieved if subsequent events reveal wrongdoing by others. It should be remembered that violations can be criminal in nature and if the situation is such that you knew or should have known of improper activity on the part of others, or that a "Certificate of American Ownership" was fraudulently executed, and you continued to participate with the wrongdoer, you possibly could be charged criminally. An example of a situation where you might want to investigate further would be a case in which a United States person seems to have an unlimited amount of many foreign securities.

Members should also be aware that a "signature guarantee" guarantees the signature of the signer only and in no way guarantees the validity of a "Certificate of American Ownership." In this connection, members should be aware of their responsibilities under the Interest Equalization Tax Act and regulations promulgated pursuant thereto. Rule 147.5–1 of the referred to regulations requires members to "maintain records sufficient to identify the United States owner for whom the stock or debt obligations were held and to establish the status of such owner as a United States person eligible to execute a certificate of American ownership for purposes of section 4918(a)." Thus, you are required to have as part of your records proof of the status of a signer of a "certificate" as a United States person.

The Administration has proposed to extend the Interest Equalization Tax Act, due to expire July 31, 1967, to July 31, 1969. It now appears that the maximum rate of tax will be increased from 15% to 22½%, and that the President of the United States will be given discretion to make certain changes in that rate within specified limitations if he determines such changes will be consistent with the balance of payments objectives of the United States. In view of the expected continuation of the Interest Equalization Tax Act, it is appropriate to again emphasize that members use the prudent businessman's approach in transactions involving foreign securities.

The Foreign Committee wishes, therefore, to take this opportunity to advise you to familiarize yourself fully with the requirements of the above-mentioned Act. Previous notices have drawn members' attention to this measure and its implications and the Committee reiterates them at this time

Very truly yours,

ROBERT W. HAACK, *President.*

SUPPLEMENTAL STATEMENT OF HENRI L. FROY

The Senate Finance Committee at its hearing on H.R. 6098 on Monday, July 17, 1967, granted permission to the Association to submit a supplemental statement concerning the proposals made by The Honorable Frederick L. Deming, Under Secretary of the Treasury, on Friday, July 14, 1967, to curtail the tax evasion problem which has recently been encountered in connection with the interest equalization tax.

The Treasury Department's proposals prescribe, generally, that existing procedures requiring proof of American ownership be changed to a system requiring proof of American owenrship and compliance. To implement this plan provisions are made for the validation of American owned foreign securities. Validations can be made by an eligible broker-dealer, an eligible bank and the Internal Revenue Service. To assist in compliance at the broker/dealer and bank levels, new documentation, record keeping and reporting requirements are provided for. These require, in addition to the issuance of validation documents, the segregation of transactions in foreign securities from those in domestic securities on the books of original entry and the maintenance of files containing substantiation of American ownership of affected securities and of the Transition Investory to be filed with the Service, among other things.

The underlying purpose of the new procedure is, of course, to insure, to the extent possible, that the interest equalization tax will be paid in the case of every transaction to which it applies.

Notwithstanding that the members of the Association and its Foreign Committee are opposed to the concept of an interest equalization tax, as well as the extension of the tax for another two years, we firmly believe that since it is law it should be strictly adhered to by all who are affected by it. We also believe that all broker/dealer members of the Association have a duty, both as Americans and members of the securities industry, to insure payment of the tax in appropriate cases and that they should not consummate transactions where they suspect wrongdoing.

We just as firmly believe, however, that the procedures which have been established by the Treasury Department, and which are now in fact operational to some extent (amid much confusion), will not prevent the evasion. And if the rate of tax is increased, the difficulty of enforcement will be increased in direct proportion to the amount of the increase because the margin of profit to the tax evader is greater.

In addition to what we consider to be the difficulty of enforcement, there is the additional, and yet undeterminable, burden and expense imposed upon our members by the new bookkeeping, record keeping and reporting requirements. These new regulations will impose a difficult task upon the affected members of the industry. When this is coupled with the fact that, in my opinion, evasion will be only a little more difficult than it was before, I think good reasons are shown why serious consideration should be given—assuming extension of the tax—to a new and more effective method of policing.

Illustrative, though not exclusive of the problems which many firms face, is the requirement to segregate domestic and foreign transactions. Many firms have never done this before. Many of those same firms are automated. Considerable computer programming will be required at considerable expense to the firm.

The factor which gave rise to evasion of the interest equalization tax in the past has been fraudulent certificates. Though it will be a little more difficult now, the possibility for the continued existence of fraudulent certificates will still be present. The only difference is that the mechanics of the scheme will have to be changed a little.

It seems to me that the evasion can better be met, and virtually eliminated, by the establishment of a "pool" of the existing outstanding foreign securities. Additions to the "pool" could be made only by a receipt from the Internal Revenue Service for the tax paid on those securities. Initial qualification for the "pool" would have to be made on the basis of proof of American ownership, of course.

The so-called "pool" could be established, for example, by depositing or registering all outstanding American owned foreign securities with an independent corporate entity established for that purpose, in a cooperative effort by the securities industry, with appropriate receipts issued and safekeeping

provided for. Any security properly registered or deposited could be sold without payment of the tax or additional documentation. If not deposited or registered, the tax would have to be paid. If a central depository or recording agent as suggested was used, policing for tax compliance as well as trading in foreign securities would be uncomplicated with little chance of evasion. The corporate entity could even be retained in normal times as an aid to the industry. The "pool" could also take other forms, anyone of which, once established, would be far more effective than the Treasury Department's new system. Also, establishing such a system would be no more difficult or complex than establishing the Treasury's system. Moreover, the confusion which is in existence in the marketplace this week as a result of the new proposals would have been eliminated.

This proposal relating to a "pool" has been suggested to and rejected by the Treasury Department. I offered my help in establishing it and I also offer it to this Committee if it believes the suggestion has merit.

Thank you very much for permitting the filing of this supplemental statement.

Senator McCARTHY (presiding). Thank you very much, Mr. Froy.

I am sorry I did not hear the major part of your testimony but it appears that you have been opposed to the extension of the interest equalization tax for other reasons in addition to the rather widespread evidence of evasion and of bootlegging of these securities exists.

Aside from the question of evasion of the tax and bootlegging that is now going on, would you consider the interest equalization tax effective for the determined purposes for which it was developed?

Mr. FROY. Not as far as equities are concerned, sir, because I feel that there has been a continued selling of foreign securities, and the only attraction to bring securities in was the wording of this tax which makes it more attractive for people to bootleg, as you called it, than to import securities on a legal—in a legal way, and the Treasury has suggested actually in their new bookkeeping procedure the identical scheme, as they have suggested before, which will again open many ways for bootlegging these securities, and there are much simpler ways of settling this problem than the one the Treasury is adopting via the tax measure.

Senator McCARTHY. Are you prepared today, Mr. Froy, to suggest what you think we ought to do in order to bring about a redress in the balance-of-payments situation?

Mr. FROY. Well, I feel direct investments are probably a much more costly way to our balance of payments than these indirect investments by equities which are producing income immediately they are made, whereas indirect investments may in some cases only bring profits in after many, many years; and, furthermore, they are always very, very difficult to liquidate, whereas ours can be liquidated within 24 hours and are practically under the control of the Government.

Senator McCARTHY. You mean investments such as some of the major automobile industries have made, for example?

Mr. FROY. Yes, and it may create more opposition in those countries to our activities than the buying of equity securities.

Senator McCARTHY. You have asked us to keep the record open so that you can testify with reference to the controls that the administration proposes, as well as other related matters.

Mr. FROY. Yes, we would like that, sir, if that is possible.

Senator McCARTHY. If there is no objection to that, we will keep the record open.

Mr. FROY. Thank you very much.

Senator McCARTHY. The staff advises me that we probably will have an executive session on this by Wednesday, so it might be well for you to get your comments in by them.

Mr. FROY. Very good, sir.

Senator McCARTHY. There are other members who wish to ask questions, Senator Carlson?

Senator CARLSON. Mr. Froy, I notice, of course, that you are opposed to this, and have continually opposed the interest equalization tax; is that correct?

Mr. FROY. That is right.

Senator CARLSON. As I follow your statement here—and I read it with great interest—you point out that there are many ways to circumvent this levy.

Mr. FROY. Yes, sir.

Senator CARLSON. How general do you think that is being done? You are in this field.

Mr. FROY. At present or in the future?

Senator CARLSON. Well, the present.

Mr. FROY. I think that the figures mentioned by the Under Secretary of the Treasury are very low.

Senator CARLSON. Well, that is the reason I raise this question. You state they were low. I think they are very low, too, based on information I have here, and I am going to put it in the record, Mr. Chairman. This is an article from Business Week issue of July 15, 1967, entitled "Foreign Stocks Yield a Fast Buck." That is the headline of the subject matter. It is an article that I shall not read into the record, but there are some interesting comments and statements in this. It mentions that there have been indictments, is that correct, in some of these cases?

Mr. FROY. Yes.

Senator CARLSON. Well, for the record I just want to read somewhat the extensiveness of these circumventions that you mention, and I think you are pointing a finger at something we really ought to look at:

> But government officials presented enough information to a New York grand jury last year to win two indictments for evasion of the tax, and the grand jury is still sitting.

I shall read the cases:

> The first indictment—against Stone, Ackerman & Co., an over-the-counter brokerage house in New York, and two of its officials—charges $3.5-million in shares were traded, with $522,160 in taxes evaded, and profits of "more than $100,000" for the defendants.
>
> The second indictment last November charged four individuals—Henry Scharf of Weston, Conn.; William Binder of Detroit; Max Blauner of Yonkers, N.Y.; and Edward Samuels of Huntington, N.Y.—with establishing trading accounts in false names at various brokerage houses in the U.S. and Canada to trade in foreign securities. They allegedly traded more than $50-million worth for a profit of "more than $500,000," and evaded interest equalization taxes of $7-million. All principals have denied their guilt.

I realize these are indictments, but evidently there must be some fire there where there is this much smoke.

Are you familiar with some of these circumstances?

Mr. FROY. Well, our counsel is, and we naturally have heard some of this, and, as I said in our statement, we have an informal agree-

ment with the Service where if in any of our investigations we come across any of those situations we certainly draw their attention to it.

Senator CARLSON. I want to commend you for a statement that is part of the record in which you have advised the folks of the dangers of this.

Mr. FROY. Yes. But the way this law has been worded, I think our legal chances, I understand, are very difficult unless you can prove that they were aware of the situation, which, I think, is very difficult to prove, and will certainly not be improved by the presently new proposals before you from the Treasury.

Senator CARLSON. Is it not reasonable if we increase the tax that there will be more chance to circumvent it?

Mr. FROY. It doubles the profits.

Senator CARLSON. That is right. I agree with you fully. I wanted to call this to the attention of the committee and make it a matter of record. Thank you, Mr. Chairman.

(The article referred to follows:)

[From Business Week, July 15, 1967]

FOREIGN STOCKS YIELD A FAST BUCK

UNDER-THE-COUNTER TRADERS HAVE CONCOCTED A DEAL THAT ENABLES THEM TO DUCK THE 15 PERCENT TAX ON U.S. PURCHASES OF FOREIGN SECURITIES, NOW LEGISLATION IS BEING SOUGHT TO CRIMP THE CAPER

The Treasury has been taken for a ride by fast-buck artists who have discovered sure-fire profits in buying foreign stocks abroad and selling them in the U.S.

The profits are based on evading the 15% excise tax required by U.S law But the Administration is trying to get Congress to write legislation to put an end to the game.

The scheme is simplicity itself, and it has netted an unknown number of participants millions in profits. Up to now the tax collectors have found it hard to lay a glove on anyone who has profited from the ploy.

Spelling it out

This week, Treasury and IRS officials were to explain for the first time what's going on and who seems to be involved, and to ask new authority for halting the gravy train. The officials were to appear at a Senate Finance Committee hearing—along with officials of the National Assn. of Securities Dealers and the New York and American stock exchanges.

The committee is considering amendments that would extend the interest equalization law for two years beyond the present July 31 expiration date. The extension, already passed by the House, also would give the President authority to raise the equalization tax on stock from the present 15% to 22.5% if need be—which would have the effect of making shady dealings even more profitable than they have been.

The Mafia?

Treasury officials imply the whole problem has been vastly overstated, but a House subcommittee investigating organized crime is taking a look at the caper on the suspicion that the Mafia may be involved.

The law, which became effective in July, 1963, was designed to help the U.S. balance of payments by lowering the profitability of lending money or buying stocks abroad. To restrain stock purchases, the price is made higher (and the effective dividend rate lower) by imposing the 15% tax on the first U.S. citizen to buy a stock from a foreign owner. Since there is no payments outflow when a U.S. citizen buys a foreign stock from another American, such transfers are not subject to the 15% levy. Stocks already owned by Americans, then, tend to bring a higher price in the U.S.

The first U.S. purchaser—whether he lives in the U.S. or abroad—fills out and signs a Treasury form called a certificate of American ownership. For subsequent

U.S. buyers of the stock, such a certificate, properly filled out, is prima facie evidence that the tax need not be paid. They needn't check the certificate's authenticity; legally they're home free.

Attraction

The price differential between American-held and foreign-held securities has been the big lure for the sharpies. What they do, according to Washington sources, is pay perhaps $25 or $50 to a U.S. citizen—perhaps a student or workman down on his luck in Nassau or Montreal—for his signature on the certificate. The signer is liable for the tax, but Internal Revenue agents find it hard to collect. He lives abroad and if he can be found, he's usually penniless anyway.

Once the certificate has been signed, the shares can be sold at the higher U.S. prices. Eventually, they get mixed in with similar securities that came to the U.S. through legitimate channels and become hard to trace.

The deal

The links in the chain are described as working something like this: A New York brokerage house—one of the eight or 10 that specialize in foreign stocks—has a legitimate buyer for 10,000 shares of, say, theoretical El Dorado Enterprises, Ltd., which owns a South African gold mine. (The stock could be Britain's Rank, Inc., or Royal Dutch Shell of the Netherlands, or Volkswagen of Germany.)

The New York firm phones a London broker to find a seller; the customer has said the stock has to have a certificate of American ownership. The New York firm isn't interested in paying the tax. A clerk in the London firm sells this information to a contact.

The contact buys the shares at the European price—although not the exact number of shares he knows the New York house is seeking. He gets an American to sign the certificate for a small fee.

A couple of days later, the New York house gets a call from a small brokerage firm in, say, Chicago. The Chicago man says he would like to find a buyer for 9,600 shares of El Dorado Enterprises—does the New York man by any chance have a buyer? The stock has a certificate of American ownership, and it's available at a favorable price. The Chicago firm accepts at face value the certificate of ownership.

Suspicions

The New York broker may wonder for a moment how this Chicago outfit is all of a sudden offering a large block of a foreign stock. However, it's certificated. He shrugs his shoulders, and the deal is closed.

The Chicago broker, if he's investigated, shows he got the stock from a foreign source—perhaps in Canada or the Bahamas—who offered it with the certificate

"Actually, it looks like all these outfits are willing links in the chain," says one federal official. "Everyone can say they had no reason to believe the certificate wasn't a legitimate one."

Upsurge

Treasury officials suggest that the upsurge in such traffic is fairly recent but say they don't know the volume involved. They have obviously been jolted by recent publicity. During the tax extension hearings last February such violations and evasions weren't even discussed. Little was done until news stories publicized the illicit trade.

But government officials presented enough information to a New York grand jury last year to win two indictments for evasion of the tax, and the grand jury is still sitting.

The indictments reveal the easy pickings for those that want to declare themselves in.

Cases in point

The first indictment—against Stone, Ackerman & Co., an over-the-counter brokerage house in New York, and two of its officials—charges $3.5-million in shares were traded, with $522,160 in taxes evaded, and profits of "more than $100,000" for the defendants.

The second indictment last November charged four individuals—Henry Scharf of Weston, Conn.; William Binder of Detroit; Max Blauner of Yonkers, N.Y.; and Edward Samuels of Huntington, N.Y.—with establishing trading accounts

81-495 O—67——8

in false names at various brokerage houses in the U.S. and Canada to trade in foreign securities. They allegedly traded more than $50-million worth for a profit of "more than $500,000," and evaded interest equalization taxes of $7-million. All principals have denied their guilt.

Some sources—including Canadian brokers—suggest that the way out of the whole mess is to drop the tax entirely. As one Canadian said: "It's a U.S. problem. They put the damn tax on in the first place. If there's a loophole, it's their fault and they can fix it up. It's none of Canada's concern."

However, the word has gone out that the tax is not going to be dropped. The rules are going to be changed so that perhaps the loophole will be closed without opening any new ones.

Senator MCCARTHY. Mr. Froy, can I ask one more additional question? Do you propose an interest equalization tax be used on the direct investment or would you think it would be better if we simply were to forbid some of these and deny companies the right to transport capital in such large amounts or are you against that, too?

Mr. FROY. No; I would not be against that, too. But the question here is that certain firms with foreign interests feel that pricewise they may not be able to compete abroad any more because of wage structures or tax situations, that they would have to be there.

But I also believe that there are quite a few firms which have already prepared for investments they may need in 1, 2, 3, or 4 years from now, and this is certainly reflected somewhere in our balance of payments as an outflow even if the funds are still intact abroad.

Senator MCCARTHY. Senator Williams?

Senator WILLIAMS. Mr. Froy, are you familiar with the latest recommendations of the Treasury Department for a modification of the existing law?

Mr. FROY. Yes, sir.

Senator WILLIAMS. I mean the ones that they were making Friday?

Mr. FROY. Yes, sir.

Senator WILLIAMS. Do you think that that will correct the possibilities of abuse?

Mr. FROY. No, sir.

Senator WILLIAMS. Would you be willing to furnish us a hypothetical case of how there would still be loopholes and how this law could still be evaded, and if you did not want to do it now, if you would furnish it for the record, I think it would be helpful to us.

Mr. FROY. Well, to begin with, the Treasury has agreed that certification from the IRS is acceptable. Nobody in the industry has the names of people or the signature list of people who are authorized to sign on behalf of the IRS.

Second, a lot of rich Americans who live abroad and pay honestly their taxes here, no provisions have been made how they can prove ownership of their foreign securities while they are living abroad.

You have to make arrangements with the consular service, and you will suddenly have a very large amount of people who are allowed to certify or validate the certificates where none of us in the industry is in a position to control if these people exist, if their signatures exist, and the work involved for the country to collect this tax or for the industry to adhere to it is just an impossible task to face. There are other means, sir, than this which would be very much more effective.

Senator WILLIAMS. You are submitting your recommendations for other means?

Mr. FROY. Well, I have submitted them to the Treasury already, and I would glady repeat them for your benefit.

I think if we have to control foreign securities there is only one way, and that is to create a pool of foreign securities where every foreign security must be registered in a name, a uniform name, a corporation which could be created for that purpose, and the only additions to this pool must be a tax receipt from the IRS for the tax paid, if you want to continue this tax. Any other way of having securities floating around would always create loopholes like the ones you have just had, and then even security traders become bootleggers.

Senator WILLIAMS. Thank you.

Senator McCARTHY. It is kind of a sophisticated smuggling really, is it not?

Mr. FROY. Well, it is very sophisticated, and it is very easy.

Senator McCARTHY. Easy, too.

Mr. FORY. Yes; and if, as long as these loopholes exist, the honest firms are out of business and the others have taken over.

Senator McCARTHY. You indicated that one of the measures of the extent to which this practice is growing occurs when you see a small, relatively incompetent, firm suddenly begin to fill up with a volume of business in this general area.

Mr. FROY. Yes, except there are sometimes small firms that are terribly honest, too. Capital requirement is not necessarily a sign of honesty.

Senator McCARTHY. The size of the buildup may be an indication anyway. There is a disposition to corrupt a lot of other firms as this becomes known and accepted.

Mr. FROY. The question arises have these small firms invented this business or not. This is the question which is really difficult to decide. I have my doubts because if these small firms would have a large placing capacity they would not be small firms.

Senator McCARTHY. Any other questions?

Senator Morton?

Senator MORTON. You are commenting on the fact that the proposed increase in the tax would enlarge the temptation for these bootlegging or smuggling operations.

Mr. FROY. Yes, sir.

Senator MORTON. This is true, is it not, in almost anything? For instance, today we read that there is a great deal of bootlegging in cigarettes into New York from North Carolina where there is no State sales tax into New York where it has gone up substantially in the last few years. So this applies in commodities and it applies in securities.

Mr. FROY. It is identical.

Senator MORTON. One takes a risk when one violates a law of this kind, and if the opportunity for profit is enhanced more people might be tempted to assume that risk.

Mr. FROY. It sure does.

Senator MORTON. The same prevails, the same apprehension, disturbs you?

Mr. FROY. Very much so.

Senator MORTON. In increasing this tax?

Mr. FROY. Very much so.

Senator MORTON. That is all.

Senator HARRIS. Mr. Chairman?

Senator McCARTHY. Senator Harris.

Senator HARRIS. Mr. Froy, I am sorry I did not get to hear all of your testimony. I understand you are opposed to the tax altogether. Did you speak to the provision in the bill recommended which allows the President, at his discretion, to alter the rate? Did you speak to that?

Mr. FROY. I did, sir. I will repeat that we would only create another indicator who would reflect the well being or the sickness of our balance of payments on a monthly basis instead of now on a 2-year basis.

Senator HARRIS. So, in addition to opposition to extension and increase in the tax, you also are against the discretionary power which is provided in this bill?

Mr. FROY. For the reasons I just gave.

Senator HARRIS. Thank you.

Mr. FROY. But if the discretion is given we certainly would like it changed in such a way that the President has authority to put it down to zero by categories.

Senator HARRIS. And not limit it on the lower end as this bill does?

Mr. FROY. That is right.

Senator HARRIS. That is all I have, Mr. Chairman.

Senator McCARTHY. The chairman wants to announce that we have received from the Treasury the new language with reference to the enforcement provisions, and if the committee is agreeable we will have a new bill printed with this proposed language included in the text of the bill so that we can see it all together.

Senator WILLIAMS. I think it would be a good idea to print a new bill.

Mr. FROY. We received it this morning at 2:45. I managed to read it through and to incorporate a little bit of it.

Senator McCARTHY. They said they would have it for you.

Senator MORTON. Have it introduced as a clean bill.

Senator McCARTHY. Yes; we'll print a clean bill.

Senator WILLIAMS. I think that bill ought to be available to all of industry.

(The committee print of the clean bill referred to follows:)

[COMMITTEE PRINT]

JULY 18, 1967

NOTE: This committee print contains the amendments to H.R. 6098 recommended by the Treasury Department for consideration by the Committee. Matter proposed to be stricken is printed in linetype or enclosed in brackets and matter proposed to be inserted is printed in italic.

90TH CONGRESS
1ST SESSION

H. R. 6098

IN THE SENATE OF THE UNITED STATES

MARCH 16, 1967

Read twice and referred to the Committee on Finance

AN ACT

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

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. SHORT TITLE, ETC.**
4 (a) SHORT TITLE.—This Act may be cited as the "In-
5 terest Equalization Tax Extension Act of 1967".

1 (b) AMENDMENT OF 1954 CODE.—Except as other-
2 wise expressly provided, whenever in this Act an amend-
3 ment is expressed in terms of an amendment to a section or
4 other provision, the reference is to a section or other provi-
5 sion of the Internal Revenue Code of 1954.

6 **SEC. 2. EXTENSION OF INTEREST EQUALIZATION TAX.**

7 Section 4911 (d) is amended by striking out "July 31,
8 1967" and inserting in lieu thereof "July 31, 1969".

9 **SEC. 3. IMPOSITION OF TAX.**

10 (a) AMOUNT OF TAX.—Section 4911 (b) is amended
11 to read as follows:

12 "(b) AMOUNT OF TAX.—

13 "(1) RATES OF TAX.—Except as provided in para-
14 graphs (2) and (3)—

15 "(A) STOCK.—The tax imposed by subsection
16 (a) on the acquisition of stock shall be equal to 15
17 percent of the actual value of the stock.

18 "(B) DEBT OBLIGATIONS.—The tax imposed

3

1 by subsection (a) on the acquisition of a debt obli-
2 gation shall be equal to a percentage of the actual
3 value of the debt obligation measured by the period
4 remaining to its maturity and determined under
5 column II (A) of the following table:

"I	II	
"If the period remaining to maturity is—	The tax, as a percentage of actual value, is—	
	(A)	(B)
At least 1 year, but less than 1¼ years	1. 05	1. 58
At least 1¼ years, but less than 1½ years	1. 30	1. 95
At least 1½ years, but less than 1¾ years	1. 50	2. 25
At least 1¾ years, but less than 2¼ years	1. 85	2. 78
At least 2¼ years, but less than 2¾ years	2. 30	3. 45
At least 2¾ years, but less than 3½ years	2. 75	4. 13
At least 3½ years, but less than 4½ years	3. 55	5. 33
At least 4½ years, but less than 5½ years	4. 35	6. 53
At least 5½ years, but less than 6½ years	5. 10	7. 65
At least 6½ years, but less than 7½ years	5. 80	8. 70
At least 7½ years, but less than 8½ years	6. 50	9. 75
At least 8½ years, but less than 9½ years	7. 10	10. 65
At least 9½ years, but less than 10½ years	7. 70	11. 55
At least 10½ years, but less than 11½ years	8. 30	12. 45
At least 11½ years, but less than 13½ years	9. 10	13. 65
At least 13½ years, but less than 16½ years	10. 30	15. 45
At least 16½ years, but less than 18½ years	11. 35	17. 03
At least 18½ years, but less than 21½ years	12. 25	18. 38
At least 21½ years, but less than 23½ years	13. 05	19. 58
At least 23½ years, but less than 26½ years	13. 75	20. 63
At least 26½ years, but less than 28½ years	14. 35	21. 53
28½ years or more	15. 00	22. 50

4

"I *If the period remaining to maturity is—*	II *The tax, as a percentage of actual value, is—*		
	(A)	(B)	(C)
At least 1 year, but less than 1¼ years	1.05	1.58	2.10
At least 1¼ years, but less than 1½ years	1.30	1.95	2.60
At least 1½ years, but less than 1¾ years	1.50	2.25	3.00
At least 1¾ years, but less than 2¼ years	1.85	2.78	3.70
At least 2¼ years, but less than 2¾ years	2.30	3.45	4.60
At least 2¾ years, but less than 3½ years	2.75	4.13	5.50
At least 3½ years, but less than 4½ years	3.55	5.33	7.10
At least 4½ years, but less than 5½ years	4.35	6.53	8.70
At least 5½ years, but less than 6½ years	5.10	7.65	10.20
At least 6½ years, but less than 7½ years	5.80	8.70	11.60
At least 7½ years, but less than 8½ years	6.50	9.75	13.00
At least 8½ years, but less than 9½ years	7.10	10.65	14.20
At least 9½ years, but less than 10½ years	7.70	11.55	15.40
At least 10½ years, but less than 11½ years	8.30	12.45	16.60
At least 11½ years, but less than 13½ years	9.10	13.65	18.20
At least 13½ years, but less than 16½ years	10.30	15.45	20.60
At least 16½ years, but less than 18½ years	11.35	17.03	22.70
At least 18½ years, but less than 21½ years	12.25	18.38	24.50
At least 21½ years, but less than 23½ years	13.05	19.58	26.10
At least 23½ years, but less than 26½ years	13.75	20.63	27.50
At least 26½ years, but less than 28½ years	14.35	21.53	28.70
28½ years or more	15.00	22.50	30.00

1 "(2) MODIFICATION OF TAX RATES BY EXECU-
2 TIVE ORDER.—
3 "(A) IN GENERAL.—If the President of the
4 United States determines that the rates of tax im-
5 posed by paragraph (1), or provided in any prior
6 Executive order issued pursuant to this paragraph,
7 are lower or higher than the rates of tax necessary to
8 limit the total acquisitions by United States persons
9 of stock of foreign issuers and debt obligations of for-
10 eign obligors within a range consistent with the
11 balance-of-payments objectives of the United States,

5

1 he may by Executive order (effective as provided
2 in subparagraph (C) (ii)) increase or decrease
3 such rates of tax.

4 ~~"(B) MAXIMUM AND MINIMUM RATES.—No~~
5 ~~change in the rates of tax which is prescribed in an~~
6 ~~Executive order issued under subparagraph (A)~~
7 ~~shall (i) cause the rate applicable to the acquisi-~~
8 ~~tion of stock to be higher than 22.5 percent or lower~~
9 ~~than 15 percent, or (ii) cause the rates applicable~~
10 ~~to debt obligations to be higher than the rates set~~
11 ~~forth in column II(B) of the table in paragraph~~
12 ~~(1)(B) of this subsection or lower than the rates~~
13 ~~set forth in column II(A) of such table.~~

14 *"(B) MAXIMUM RATE.—No increase in the*
15 *rates of tax which is prescribed in an Executive*
16 *order issued under subparagraph (A) shall—*
17 *"(i) cause the rate applicable to the acqui-*
18 *sition of stock to be higher than 30 percent, or*
19 *"(ii) cause the rates applicable to the*
20 *acquisition of debt obligations to be higher than*
21 *the rates set forth in column II(c) of the table*
22 *in paragraph (1)(B) of this subsection.*

23 "(C) APPLICATION OF EXECUTIVE ORDERS.—
24 "(i) Each increase and each decrease in
25 the rates of tax which is prescribed in an Execu-

1 tive order issued under subparagraph (A) shall
2 provide for the same proportionate increase or
3 decrease in each rate of tax, except that any
4 such rate may be rounded to the nearest 0.01
5 percent.

6 "(ii) Any Executive order issued under
7 subparagraph (A) shall apply with respect to
8 acquisitions made after the date on which such
9 order is issued (or, if later, after the 29th day
10 following the date of the enactment of this para-
11 graph); except that in the case of any such
12 order which increases the rates of tax (as in
13 effect without regard to such order), to the
14 extent specified in such order, rules similar to
15 the rules prescribed by paragraphs (2), (3),
16 and (4) of section 3(c) of the Interest Equali-
17 zation Tax Extension Act of 1967 shall apply.

18 *"(iii) If, by reason of an Executive order*
19 *issued under subparagraph (A), the rates of*
20 *tax in effect on the date of an acquisition*
21 *described in paragraphs (2), (3), or (4) of*
22 *section 3(c) of the Interest Equalization Tax*
23 *Extension Act of 1967 are lower than the rates*
24 *of tax in effect on January 25, 1967, the*
25 *applicable rate of tax prescribed in such Execu-*
26 *tive order shall apply to such acquisition.*

"(3) RATES DURING INTERIM PERIOD.—In the case of acquisitions of stock and debt obligations made after January 25, 1967, and before the thirtieth day after the date of the enactment of this paragraph, the tax imposed by subsection (a) shall be 22.5 percent in the case of acquisition of stock, and shall be determined under column II (B) ~~(rather than column II (A))~~ of the table in paragraph (1) (B) in the case of acquisition of a debt obligation.

"(4) REGULATIONS.—The Secretary or his delegate may prescribe such regulations (not inconsistent with the provisions of this section or of any Executive order issued and in effect under this section) as may be necessary to carry out the provisions of this section."

(b) APPLICATION OF EXECUTIVE ORDER 11198, ETC.—

(1) The table in section 4931 (c) (relating to debt obligations with maturity from 1 to 3 years) is amended to read as follows:

"If the period remaining to maturity is:	The tax, as a percentage of actual value, is:
"At least 1 year, but less than 1¼ years	1.58 percent
At least 1¼ years, but less than 1½ years	1.95 percent
At least 1½ years, but less than 1¾ years	2.25 percent
At least 1¾ years, but less than 2¼ years	2.78 percent
At least 2¼ years, but less than 2¾ years	3.45 percent
At least 2¾ years, but less than 3 years	4.13 percent."

(2) Section 3 (e) (1) (A) of the Interest Equali-

1 zation Tax Extension Act of 1965 is amended to read
2 as follows:
3 "(A) by striking out subsection (c) (as
4 amended by the Interest Equalization Tax Exten-
5 sion Act of 1967) and redesignating subsections
6 (d) and (e) as subsections (c) and (d), respec-
7 tively;".
8 (c) EFFECTIVE DATE AND SPECIAL RULES.—
9 (1) GENERAL RULE.—The amendments made by
10 subsection (a) shall apply only with respect to acquisi-
11 tions of stock or debt obligations made after January 25,
12 1967. The amendment made by paragraph (1) of
13 subsection (b) shall apply only with respect to acquisi-
14 tions of debt obligations made after January 25, 1967,
15 and before February 21, 1967 (the date on which the
16 amendments made by section 3(e)(1) of the Interest
17 Equalization Tax Extension Act of 1965 became effec-
18 tive).
19 (2) PREEXISTING COMMITMENTS.—Such amend-
20 ments shall not apply to an acquisition—
21 (A) made pursuant to an obligation to acquire
22 which on January 25, 1967—
23 (i) was unconditional, or
24 (ii) was subject only to conditions con-

1 tained in a formal contract under which partial
2 performance had occurred; or
3 (B) as to which on or before January 25,
4 1967, the acquiring United States person (or, in a
5 case where 2 or more United States persons are
6 making acquisitions as part of a single transaction,
7 a majority in interest of such persons) had taken
8 every action to signify approval of the acquisition
9 under the procedures ordinarily employed by such
10 person (or persons) in similar transactions and had
11 sent or deposited for delivery to the foreign person
12 from whom the acquisition was made written evi-
13 dence of such approval in the form of a commitment
14 letter, memorandum of terms, draft purchase con-
15 tract, or other document setting forth, or referring
16 to a document sent by the foreign person from whom
17 the acquisition was made which set forth, the princi-
18 pal terms of such acquisition, subject only to the
19 execution of formal documents evidencing the ac-
20 quisition and to customary closing conditions.
21 (3) PUBLIC OFFERINGS.—Such amendments shall
22 not apply to an acquisition made on or before March 27,
23 1967, if—

1 (A) a registration statement (within the
2 meaning of the Securities Act of 1933) was in
3 effect with respect to the stock or debt obligation
4 acquired at the time of its acquisition;
5 (B) the registration statement was first filed
6 with the Securities and Exchange Commission on
7 January 25, 1967, or within 90 days before that
8 date; and
9 (C) no amendment was filed with the Securi-
10 ties and Exchange Commission after January 25,
11 1967, and before the acquisition which had the ef-
12 fect of increasing the number of shares of stock or
13 the aggregate face amount of the debt obligations
14 covered by the registration statement.
15 (4) OPTIONS, FORECLOSURES, AND CONVER-
16 SIONS.—Such amendments shall not apply to an acquisi-
17 tion—
18 (A) of stock pursuant to the exercise of an
19 option or similar right (or a right to convert a debt
20 obligation into stock), if such option or right was
21 held on January 25, 1967, by the person making
22 the acquisition or by a decedent from whom such
23 person acquired the right to exercise such option

1 or right by bequest or inheritance or by reason of
2 such decedent's death, or
3 (B) of stock or debt obligations as a result of a
4 foreclosure by a creditor pursuant to the terms of an
5 instrument held by such creditor on January 25,
6 1967.
7 (d) RETURNS.—If, by reason of the enactment of this
8 Act, a person incurs additional liability for interest equaliza-
9 tion tax with respect to acquisitions of stock or debt obliga-
10 tions made after January 25, 1967, for which a return has
11 been filed under section 6011 (d) (1) of the Internal Reve-
12 nue Code of 1954 before the date of the enactment of this
13 Act, such person shall make an amended return showing
14 such additional liability. If liability for interest equalization
15 tax with respect to such acquisitions is initially created by
16 reason of the enactment of this section, the person incurring
17 such liability shall make a return. The returns required to be
18 made by this paragraph shall be filed on or before the last
19 day of the month following the close of the calendar quarter
20 in which the date of the enactment of this Act occurs or at
21 such later time as the Secretary or his delegate may prescribe.
22 *SEC. 4. COMPLIANCE PROCEDURES.*
23 *(a) EXEMPTION FOR PRIOR AMERICAN OWNERSHIP*

1 *AND COMPLIANCE.—Section 4918 is amended to read as*
2 *follows:*
3 *"SEC. 4918. EXEMPTION FOR PRIOR AMERICAN OWNER-*
4 *SHIP AND COMPLIANCE.*
5 *"(a) GENERAL RULE.—The tax imposed by section*
6 *4911 shall not apply to an acquisition of stock of a foreign*
7 *issuer or a debt obligation of a foreign obligor if it is*
8 *established in the manner provided in this section that—*
9 *"(1) the person from whom such stock or debt*
10 *obligation was acquired was a United States person*
11 *throughout the period of his ownership or continuously*
12 *since July 18, 1963, and was not ineligible, under the*
13 *provisions of this chapter, to dispose of such stock or*
14 *debt obligation as a United States person; and*
15 *"(2) such person—*
16 *"(A) had paid the tax imposed by section 4911*
17 *with respect to the acquisition of such stock or debt*
18 *obligation by such person; or*
19 *"(B) acquired such stock or debt obligation*
20 *without liability for payment of such tax by reason*
21 *of an exemption or exclusion from tax provided*
22 *in this chapter.*
23 *"(b) ESTABLISHING EXEMPTION FOR PRIOR AMERI-*
24 *CAN OWNERSHIP AND COMPLIANCE.—*
25 *"(1) CONCLUSIVE PROOF.—For purposes of the*

1 *exemption for prior American ownership and compli-*
2 *ance provided in subsection (a)—*
3 *"(A) a validation certificate issued by, and*
4 *filed in accordance with the requirements prescribed*
5 *by the Secretary or his delegate evidencing that the*
6 *person from whom stock of a foreign issuer or debt*
7 *obligation of a foreign obligor was acquired was a*
8 *person described in subsection (a); or*
9 *"(B) a written confirmation (referred to as*
10 *an IET clean confirmation) received by the person*
11 *acquiring such stock or a debt obligation from a par-*
12 *ticipating firm acting as a broker in effecting the*
13 *acquisition (or acting as a dealer) which contains*
14 *no reference to liability for the tax imposed by sec-*
15 *tion 4911*
16 *shall be conclusive proof that such exemption applies*
17 *with respect to the acquisition of the stock or debt obliga-*
18 *tion described in such certificate or confirmation, if the*
19 *person making the acquisition relies in good faith on the*
20 *validity of such certificate or confirmation.*
21 *"(2) OTHER PROOF.—If the person making an*
22 *acquisition of stock or a debt obligation shows reasonable*
23 *cause for his inability to establish such exemption under*
24 *paragraph (1) he may furnish other evidence to establish*

81-495 O—67——9

1 *to the satisfaction of the Secretary or his delegate that*
2 *such exemption is applicable to such acquisition.*
3 *"(c) PARTICIPATING FIRM.—*
4 *"(1) DEFINITION.—A participating firm is a mem-*
5 *ber or member organization of a national securities*
6 *exchange or association registered with the Securities and*
7 *Exchange Commission which satisfies the eligibility re-*
8 *quirements set forth in paragraph (2).*
9 *"(2) ELIGIBILITY REQUIREMENTS.—*
10 *"(A) IN GENERAL.—Subject to the provisions*
11 *of subparagraphs (B) and (C)(i), a member or*
12 *member organization of a national securities ex-*
13 *change or association registered with the Securities*
14 *and Exchange Commission shall qualify as a par-*
15 *ticipating firm if such member or member organiza-*
16 *tion notifies the Secretary or his delegate that it—*
17 *"(i) agrees to comply with the provisions of*
18 *this chapter and with the documentation, record-*
19 *keeping, reporting, and auditing requirements*
20 *prescribed by the Secretary or his delegate to*
21 *implement such provisions; and*
22 *"(ii) if such notification is made after*
23 *August 14, 1967, is complying with such pro-*
24 *visions and requirements on the date of such*
25 *notification.*

1 *"(B) PARTICIPATING FIRMS DURING IN-*
2 *TERIM PERIOD.—During the period commencing*
3 *July 15, 1967, and ending on August 14, 1967,*
4 *the following are deemed to be participating firms*
5 *which satisfy the eligibility requirements of subpara-*
6 *graph (A):*
7 *"(i) all members and member organizations*
8 *of the New York Stock Exchange;*
9 *"(ii) all members and member organizations*
10 *of the American Stock Exchange; and*
11 *"(iii) members or member organizations of*
12 *the National Association of Securities Dealers,*
13 *Inc., which reported net capital (as defined in*
14 *rule 15c 3–1 under the Securities Exchange Act*
15 *of 1934) of $750,000 in the latest financial*
16 *statement filed with the Securities and Exchange*
17 *Commission on form X–17A–5 prior to July*
18 *13, 1967, or which effected at least 300 transac-*
19 *tions with respect to the sale or acquisition of*
20 *stock of foreign issuers or debt obligations of for-*
21 *eign obligors during the week commencing on*
22 *July 2, 1967, or on July 9, 1967.*
23 *"(C) TERMINATION OF STATUS.—The status*
24 *of a member or member organization of a national*

1 *securities exchange or association registered with the*
2 *Securities and Exchange Commission qualifying as*
3 *a participating firm shall be terminated if—*
4 *"(i) such member or member organization*
5 *qualifies as a participating firm during the in-*
6 *terim period described in subparagraph (B)*
7 *and does not submit to the Secretary or his dele-*
8 *gate, on or before August 15, 1967, the notifi-*
9 *cation described in subparagraph (A);*
10 *"(ii) such member or member organization*
11 *files a written request with the Secretary or his*
12 *delegate to terminate such status; or*
13 *"(iii) the Secretary or his delegate has rea-*
14 *sonable cause to believe a participating firm is*
15 *failing to abide by all the terms of the agree-*
16 *ment which it has made (or is deemed to have*
17 *made) with respect to compliance with the statu-*
18 *tory provisions and procedural requirements*
19 *described in subparagraph (A), and notifies*
20 *the participating firm of such noncompliance.*
21 *Any termination of the status of a participating firm*
22 *in accordance with this subparagraph shall be effec-*
23 *tive as of the date specified in a notice to such par-*
24 *ticipating firm issued by the Secretary or his dele-*
25 *gate subsequent to the date on which information*

1 *regarding the termination of such status was made*
2 *available to appropriate news media.*
3 *For purposes of this paragraph, an associate member*
4 *of the New York Stock Exchange, American Stock Ex-*
5 *change or a national securities association registered with*
6 *the Securities and Exchange Commission shall be deemed*
7 *a member of such exchange or association.*
8 *"(d) ISSUANCE OF IET CLEAN CONFIRMATION BY*
9 *PARTICIPATING FIRM.—A participating firm may issue an*
10 *IET clean confirmation (described in subsection (b)(2))*
11 *in connection with an acquisition of stock of a foreign issuer*
12 *or a debt obligation of a foreign obligor by a United States*
13 *person, if the participating firm—*
14 *"(1) acted as a broker in effecting such acquisition*
15 *and received from a participating firm acting as broker*
16 *for the seller (or acting as a dealer) a written com-*
17 *parison or broker-dealer confirmation which contained*
18 *no reference to liability for the tax imposed by section*
19 *4911;*
20 *"(2) acted as a broker in effecting both the sale and*
21 *acquisition of such stock or debt obligation and would*
22 *have been entitled to issue a written comparison or*
23 *broker-dealer confirmation under paragraph (e) if the*
24 *acquisition had been effected by another broker; or*

1 *"(3) sold such stock or debt obligation as a dealer*
2 *and was entitled to the exemption for prior American*
3 *ownership and compliance provided in subsection (a)*
4 *with respect to its acquisition of such stock or debt obliga-*
5 *tion as a United States person.*
6 *Any IET clean confirmation issued under this subsection*
7 *shall be clearly distinguishable from any other confirmation*
8 *issued with respect to an acquisition of stock of a foreign*
9 *issuer or a debt obligation of a foreign obligor by a partici-*
10 *pating firm.*
11 *"(e) SALES EFFECTED BY PARTICIPATING FIRMS IN*
12 *CONNECTION WITH EXEMPT ACQUISITIONS.—A participat-*
13 *ing firm effecting the sale of stock of a foreign issuer or a*
14 *debt obligation of a foreign obligor may issue a written com-*
15 *parison or broker-dealer confirmation to the participating*
16 *firm effecting the acquisition of such stock or debt obligation*
17 *by a United States person, which indicates the exemption for*
18 *prior American ownership and compliance provided in sub-*
19 *section (a) applies to such acquisition, only if the participat-*
20 *ing firm effecting the sale has in its possession a statement*
21 *executed by the person making the sale (under penalty of*
22 *perjury) that such person is a United States person within*
23 *the meaning of section 4920(a)(4), upon which such par-*
24 *ticipating firm relies in good faith; and*
25 *"(1)(A) carried in its records (on a trade-date*

1 *basis) for the account of the seller at the close of business*
2 *on July 14, 1967, such stock or debt obligation;*
3 *"(B) has in its possession a properly executed cer-*
4 *tificate of American ownership with respect to such stock*
5 *or debt obligation or a properly executed blanket cer-*
6 *tificate of American ownership with respect to such ac-*
7 *count (and relies in good faith on the validity of such*
8 *certificate or blanket certificate); and*
9 *"(C) included such stock or debt obligation in the*
10 *transition inventory referred to in subsection (g) filed*
11 *by such participating firm with the Secretary or his dele-*
12 *gate in accordance with the provisions of such sub-*
13 *section;*
14 *"(2) after July 14, 1967—*
15 *"(A) as a dealer sold such stock or debt obli-*
16 *gation to the seller, or acting as broker effected the*
17 *acquisition of such stock or debt obligation by the*
18 *seller, if the exemption for prior American owner-*
19 *ship and compliance provided in subsection (a) ap-*
20 *plied to such acquisition; and*
21 *"(B) continuously carried in its records on a*
22 *trade-date basis for the account of the seller such*
23 *stock or debt obligation;*
24 *"(3)(A) sold such stock or debt obligation to the*

1 *seller, as a dealer or acting as a broker effected the*
2 *acquisition of such stock or debt obligation by the seller,*
3 *if the participating firm has in its possession a properly*
4 *executed certificate of American ownership with respect*
5 *to such stock or debt obligation or a properly executed*
6 *blanket certificate of American ownership with respect to*
7 *such account (and relies in good faith on the validity of*
8 *such certificate or blanket certificate) or the exemption*
9 *for prior American ownership and compliance provided*
10 *in subsection (a) applied to such acquisition; and*
11 *"(B) after July 14, 1967, received from the seller*
12 *the identical stock certificates or evidences of indebtedness*
13 *which it had previously delivered to the seller with respect*
14 *to such acquisition by the seller;*
15 *"(4) receives possession of such stock or debt obli-*
16 *gation from another participating firm or from a par-*
17 *ticipating custodian, together with a Transfer of Custody*
18 *Certificaie, as provided in subsection (h);*
19 *"(5) receives from the seller stock which was regis-*
20 *tered with a participating custodian which acted as trans-*
21 *fer agent in registering such stock prior to July 18, 1963;*
22 *"(6) receives from the seller a validation certificate*
23 *issued by the Secretary or his delegate certifying that the*
24 *seller is a person described in subsection (a) and files*
25 *such certificate with the Secretary or his delegate in*

1 *ccordance with the requirements imposed by the Secre-*
2 *tary or his delegate; or*
3 *"(7) withholds from the proceeds of such sale (with*
4 *the consent of the seller) an amount equal to the tax which*
5 *would have been imposed under section 4911 on the*
6 *acquisition of such stock or debt obligation by the pur-*
7 *chaser if such acquisition were not exempted from such*
8 *tax under this section.*
9 *The money withheld under paragraph (7) is to be treated as*
10 *the collection of tax imposed under section 4911 on the acqui-*
11 *sition of such stock or debt obligation by the seller and is to*
12 *be paid over to the Secretary or his delegate or released to*
13 *the seller at such time and in such manner as provided in*
14 *regulations prescribed by the Secretary or his delegate.*
15 *"(f) PARTICIPATING CUSTODIAN.—*
16 *"(1) DEFINITION.—A participating custodian is a*
17 *bank or trust company insured by the Federal Deposit*
18 *Insurance Corporation which satisfies the eligibility re-*
19 *quirements set forth in paragraph (2).*
20 *"(2) ELIGIBILITY REQUIREMENTS.—*
21 *"(A) IN GENERAL.—Subject to the provisions*
22 *of subparagraphs (B) and (C)(i), a bank or trust*
23 *company insured by the Federal Deposit Insurance*
24 *Corporation may become a participating custodian if*

1 *such bank or trust company notifies the Secretary or*
2 *his delegate that it—*
3 *"(i) agrees to comply with the provisions of*
4 *this chapter and the documentation, record-*
5 *keeping, reporting, and auditing requirements*
6 *prescribed by the Secretary or his delegate to*
7 *implement such provisions, and*
8 *"(ii) if such notification is made after*
9 *August 14, 1967, is complying with such pro-*
10 *visions and requirements on the date of such*
11 *notification.*
12 *"(B) PARTICIPATING CUSTODIANS DURING*
13 *INTERIM PERIOD.—During the period commencing*
14 *July 15, 1967, and ending on August 14, 1967,*
15 *Federal Reserve member banks which are classified*
16 *as reserve city banks are deemed to be participating*
17 *custodians which satisfy the eligibility requirements*
18 *of subparagraph (A).*
19 *"(C) TERMINATION OF STATUS.—The status*
20 *of a bank or trust company insured by the Federal*
21 *Deposit Insurance Corporation as a participating*
22 *custodian shall be terminated, if—*
23 *"(i) such bank or trust company qualifies*
24 *as a participating firm during the interim period*
25 *described in subparagraph (B) and does not*

1 *submit to the Secretary or his delegate, on or*
2 *before August 15, 1967, the formal notification*
3 *described in subparagraph (A);*
4 *"(ii) such bank or trust company files a*
5 *written request with the Secretary or his dele-*
6 *gate to terminate such status; or*
7 *"(iii) the Secretary or his delegate has*
8 *reasonable cause to believe a participating cus-*
9 *todian is failing to abide by all the terms of the*
10 *agreement which it has made (or is deemed to*
11 *have made) with respect to compliance with the*
12 *statutory provisions and procedural require-*
13 *ments described in subparagraph (A), and noti-*
14 *fies the participating custodian of such noncom-*
15 *pliance.*
16 *Any termination of the status of a participating cus-*
17 *todian in accordance with this subparagraph shall*
18 *be effective as of the date specified in a notice to such*
19 *participating custodian issued by the Secretary or*
20 *his delegate subsequent to the date on which informa-*
21 *tion regarding the termination of such status was*
22 *made available to news media.*
23 *"(g) FILING OF TRANSITION INVENTORY.—A partic-*
24 *ipating firm and participating custodian shall, on or before*
25 *August 15, 1967, file an inventory (designated as a transi-*

1 *tion inventory) with the Secretary or his delegate which shall*
2 *include all stock of foreign issuers and debt obligations of*
3 *foreign obligors carried in its records (on a trade date basis)*
4 *by such participating firm or participating custodian as of*
5 *the close of business on July 14, 1967, together with such*
6 *information as may be required by the Secretary or his*
7 *delegate.*
8 *"(h) TRANSFER OF CUSTODY CERTIFICATE.—*
9 *"(1) NATURE OF CERTIFICATE.—A certificate*
10 *(designated as a transfer of custody certificate) may*
11 *be issued in accordance with paragraph (2) by a par-*
12 *ticipating firm or participating custodian in connection*
13 *with a physical transfer of stock of foreign issuers or*
14 *debt obligations of foreign obligors which are carried in*
15 *its records for the account of a United States person to*
16 *another participating firm or participating custodian for*
17 *the account of the same United States person.*
18 *"(2) AUTHORIZED TRANSFERS OF CUSTODY.—A*
19 *participating firm or participating custodian shall issue*
20 *a transfer of custody certificate only if—*
21 *"(A) such participating firm or participating*
22 *custodian—*
23 *"(i) carried in its records (on a trade date*
24 *basis) at the close of business on July 14, 1957,*
25 *for the account of a United States person the*

1 *stock or debt obligation described in the transfer*
2 *of custody certificate;*
3 *"(ii) has in its possession a properly exe-*
4 *cuted certificate of American ownership with*
5 *respect to such stock or debt obligation or a*
6 *properly executed blanket certificate of American*
7 *ownership with respect to such account (and*
8 *relies in good faith on the validity of such*
9 *certificate or blanket certificate); and*
10 *"(iii) includes such stock or debt obliga-*
11 *tion in the transition inventory referred to in*
12 *subsection (g) filed by such participating firm*
13 *with the Secretary or his delegate in accordance*
14 *with the provisions of such subsection;*
15 *"(B) such participating firm or participating*
16 *custodian received the stock or debt obligation de-*
17 *scribed in the transfer of custody certificate from*
18 *another participating firm or participating custodian*
19 *accompanied by a transfer of custody certificate*
20 *with respect to such stock or debt obligation; or*
21 *"(C) such participating firm—*
22 *"(i) effected as broker (or dealer) the*
23 *acquisition of the stock or debt obligation de-*
24 *scribed in the transfer of custody certificate,*

1 *and the exemption for prior American owner-*
2 *ship and compliance provided in subsection (a)*
3 *applied to such acquisition; and*
4 *"(ii) continuously carried in its records*
5 *for the account of the person who acquired such*
6 *stock or debt obligation, or received from such*
7 *person, the identical stock certificates or evi-*
8 *dences of indebtedness which it had previously*
9 *delivered to such person in connection with such*
10 *acquisition.*
11 *"(i) CERTAIN DEBT OBLIGATIONS ARISING OUT OF*
12 *LOANS TO ASSURE RAW MATERIAL SOURCES.—Under*
13 *regulations prescribed by the Secretary or his delegate, subsec-*
14 *tion (a) shall not apply to the acquisition by a United States*
15 *person of any debt obligation to which section 4914(d) ap-*
16 *plied where the acquisition of the debt obligation by such*
17 *person is made with an intent to sell, or to offer to sell, any*
18 *part of such debt obligation to United States persons. The*
19 *preceding sentence shall not apply if the tax imposed by sec-*
20 *tion 4911 has applied to any prior acquisition of such debt*
21 *obligation."*
22 *(b) RETURN REQUIREMENTS.—Section 6011(d)(1) is*
23 *amended to read as follows:*
24 *"(1) IN GENERAL.—*
25 *"(A) Every person shall make a return for*

1 *each calendar quarter during which he incurs lia-*
2 *bility for the tax imposed by section 4911, or would*
3 *so incur liability but for the provisions of section*
4 *4918. The return shall, in addition to such other*
5 *information as the Secretary or his delegate may by*
6 *regulations require, include a list of all acquisitions*
7 *made by such person during the calendar quarter for*
8 *which exemption is claimed under section 4918 ac-*
9 *companied by a copy of any transactions tax returns*
10 *filed during such quarter as provided in subpara-*
11 *graph (B). No return or accompanying evidence*
12 *shall be required under this paragraph, in connec-*
13 *tion with any acquisition with respect to which—*
14 *"(i) an IET clean confirmation is ob-*
15 *tained in accordance with the provisions of sec-*
16 *tion 4918(b),*
17 *"(ii) a validation certificate described in*
18 *section 4918(b) is obtained, and such certificate*
19 *was filed in accordance with the requirements*
20 *prescribed by the Secretary or his delegate, or*
21 *"(iii) a validation certificate was obtained*
22 *by the acquiring person after such acquisition,*
23 *providing such acquisition was exempt from tax*
24 *imposed by section 4911;*

1 *nor shall any such acquisition be required to be*
2 *listed in any return made under this paragraph.*
3 *"(B) Every person who incurs liability for the*
4 *tax imposed by section 4911 shall, if he disposes of*
5 *the stock or debt obligation with respect to which*
6 *such liability was incurred prior to the filing of the*
7 *return required by subparagraph (A), make a re-*
8 *turn of such tax."*
9 *(c) TIME FOR FILING RETURNS.—The text of section*
10 *6076 is amended to read as follows:*
11 *"(a) Each return made under section 6011(d)(1)(A)*
12 *shall be filed on or before the last day of the first month fol-*
13 *lowing the period for which it is made.*
14 *"(b) Each return made under section 6011(d)(1)(B)*
15 *shall be filed before the date of disposition of the stock or debt*
16 *obligation with respect to which such return is made."*
17 *(d) PAYMENT OF WITHHELD TAX.—Section 6315 is*
18 *amended to read as follows:*
19 ***"SEC. 6315. PAYMENTS OF ESTIMATED INCOME TAX AND***
20 ***INTEREST EQUALIZATION TAX.***
21 *"(a) Payment of the estimated income tax, or any install-*
22 *ment thereof, shall be considered payment on account of the*
23 *income taxes imposed by subtitle A for the taxable year.*
24 *"(b) Payment by a participating firm (as defined in*
25 *section 4918(c)) which withheld such tax pursuant to sec-*

1 *tion 4918(e)(6) shall be considered payment on account of*
2 *the tax liability imposed by section 4911."*
3 *(e) PENALTY FOR FALSE APPLICATIONS.—Section*
4 *6681 is amended by adding at the end thereof the following*
5 *subsection:*
6 *"(f) FALSE APPLICATION FOR VALIDATION CERTIFI-*
7 *CATE.—Any person who knowingly supplies information*
8 *which contains a misstatement of a material fact in connec-*
9 *tion with application for a validation certificate, described*
10 *in section 4918, and obtains and transfers or uses a valida-*
11 *tion certificate pursuant to such application for the purpose*
12 *of establishing exemption for prior American ownership and*
13 *compliance under section 4918(a), shall be liable to a pen-*
14 *alty equal to 125 percent of an amount equal to the tax which*
15 *would have been imposed by section 4911 if such stock or*
16 *debt obligation described in such certificate had been acquired*
17 *by a person required to pay such tax."*
18 *(f) CLERICAL AMENDMENT.—The table of sections for*
19 *subchapter A of chapter 41 is amended by striking out the*
20 *item relating to section 4918 and inserting in lieu thereof*
21 *the following:*

"Sec. 4918. Exemption for prior American ownership and compliance."

22 *(g) EFFECTIVE DATE.—The amendments made by this*
23 *section (other than by subsection (e)) shall apply with re-*

1 *spect to acquisitions of stock and debt obligations made after*
2 *July 14, 1967. The amendment made by subsection (e) shall*
3 *take effect on July 15, 1967.*
4 *(h) INTERIM PROCEDURES.—The Secretary of the*
5 *Treasury or his delegate may establish such procedures and*
6 *require the filing of such information and the maintenance*
7 *of such records as may be necessary in order to permit an*
8 *orderly transition in respect to market procedures for a*
9 *period not in excess of 15 days following the effective date of*
10 *this section pursuant to which participating firms and par-*
11 *ticipating custodians may issue IET clean confirmations,*
12 *clean comparisons, broker-dealer clean confirmation, and*
13 *Transfer of Custody Certificates without satisfying the*
14 *specific procedural requirements provided in section 4918 of*
15 *the Internal Revenue Code of 1954 as amended by subsec-*
16 *tion (a) of this section.*
17 **SEC. ~~4~~ *5*. OTHER AMENDMENTS.**
18 (a) EXCLUSION OF ACQUISITIONS ARISING OUT OF
19 SALES OF CERTAIN FOREIGN REAL PROPERTY.—
20 (1) Section 4914 (b) (14) is amended to read as
21 follows:
22 "(14) FOREIGN PROPERTY.—Of debt obligations
23 arising out of the sale of—
24 "(A) tangible property located outside the

1 United States which was held by the person acquir-
2 ing such obligation for his personal use, or
3 "(B) real property (other than property to
4 which subparagraph (A) applies) located outside
5 the United States and owned, on July 18, 1963, by
6 the person acquiring such obligation."
7 (2) The amendment made by paragraph (1) shall
8 apply only with respect to acquisitions made on or after
9 the date of the enactment of this Act.
10 (b) EXCLUSION OF CERTAIN ACQUISITIONS BY RESI-
11 DENTS NOT CITIZENS.—
12 (1) Section 4914(b) is amended by adding at the
13 end thereof the following new paragraph:
14 "(15) CERTAIN ACQUISITIONS BY RESIDENTS NOT
15 CITIZENS.—Of stock or debt obligations by an individual
16 who is a resident but not a citizen of the United States,
17 during the 90-day period beginning on the date such
18 individual first became a resident of the United States."
19 (2) Section 4914(j)(2) is amended by adding at
20 the end thereof the following new sentence: "For pur-
21 poses of this chapter, if, after February 27, 1967, a
22 United States person sells or otherwise disposes of stock
23 or a debt obligation to the acquisition of which subsec-
24 tion (b)(15) applied, such person shall not, with

1 respect to that stock or debt obligation, be considered
2 a United States person."
3 (3) The amendment made by paragraph (1) shall
4 apply with respect to acquisitions made after July 18,
5 1963.
6 *(c) EXPORT CREDIT, ETC., TRANSACTIONS.—Sec-*
7 *tion 4914(c)(1) is amended to read as follows:*
8 *"(1) IN GENERAL.—The tax imposed by section*
9 *4911 shall not apply to the acquisition from a foreign*
10 *obligor of a debt obligation arising out of the sale of*
11 *tangible personal property or services (or both) by any*
12 *United States person, if—*
13 *"(A) payment of such debt obligation (or of*
14 *any related debt obligation arising out of such sale)*
15 *is guaranteed or insured, in whole or in part, by*
16 *an agency or wholly owned instrumentality of the*
17 *United States; or*
18 *"(B) such sale is made to such foreign obligor*
19 *and the United States person acquiring such debt*
20 *obligation makes the sale in the ordinary course*
21 *of his trade or business and not less than 85 percent*
22 *of the purchase price is attributable to the sale*
23 *of property manufactured, produced, grown, or*
24 *extracted in the United States, or to the performance*
25 *of services by such United States person (or by*

1 *one or more includible corporations in an affiliated*
2 *group, as defined in section 1504, of which such*
3 *person is a member), or to both.*
4 *The term 'services', as used in this paragraph and para-*
5 *graph (2), shall not be construed to include functions*
6 *performed as an underwriter."*
7 ~~(c)~~ *(d)* CERTAIN SALES OF ORES OR MINERALS BY
8 UNITED STATES PERSONS.—
9 (1) Section 4914 (c) (5) is amended by adding at
10 the end thereof (after and below subparagraph (B))
11 the following new sentence:
12 "For purposes of clause (iii) of subparagraph (A)
13 (and for purposes of determining whether a debt obliga-
14 tion arises out of a loan described in subparagraph (B)
15 in a case where the ores, minerals, or derivatives in-
16 volved are obtained under a contract described in such
17 clause), a contract shall be deemed to have been entered
18 into on or before July 18, 1963, if it is entered into after
19 such date and before January 26, 1967, and is a substi-
20 tute for a contract, which has been canceled or termi-
21 nated, between the same parties which was entered into
22 on or before July 18, 1963; except that the total amount
23 of the acquisitions excluded by this paragraph on the
24 basis of a contract entered into after July 18, 1963,
25 which is deemed by this sentence to have been entered

34

1 into on or before such date shall not exceed the total
2 amount of the acquisitions which could have been ex-
3 cluded by this paragraph on the basis of the earlier con-
4 tract for which such contract was substituted."
5 (2) The amendment made by paragraph (1) shall
6 apply with respect to acquisitions made on or after the
7 date of the enactment of this Act.
8 *(e) LESS DEVELOPED COUNTRY SHIPPING COM-*
9 *PANIES.—Section 4916(c) is amended—*
10 *(1) by redesignating subparagraph (B) of para-*
11 *graph (1) as subparagraph (C);*
12 *(2) by striking out subparagraph (A) of para-*
13 *graph (1) and inserting in lieu thereof the following:*
14 *"(A) meets the requirements of section 955*
15 *(c)(1);*
16 *"(B)(i) meets the requirements of section 955*
17 *(c)(2), and*
18 *"(ii) on each day of such applicable periods, is*
19 *owned (as determined under section 958(a)), to*
20 *the extent of at least 80 percent of each class of its*
21 *stock, by United States persons or residents of one or*
22 *more less developed countries; or";*
23 *(3) by striking out the last sentence of paragraph*
24 *(1) and inserting in lieu thereof the following: "A for-*
25 *eign partnership, as defined in section 7701(a) (2) and*

1 *(5), the assets, gross income, and ownership of which,*
2 *for the applicable periods set forth in paragraph (3),*
3 *satisfy the requirements of subparagraph (A), (B),*
4 *or (C) of the first sentence of this paragraph, shall be*
5 *treated as a less developed country corporation for pur-*
6 *poses of this section.";*
7 *(4) by striking out "subparagraphs (A) and (B)"*
8 *in paragraph (2)(A) and inserting in lieu thereof "sub-*
9 *paragraphs (A), (B), and (C)"; and*
10 *(5) by striking out "subparagraph (B)" in para-*
11 *graph (2)(C) and inserting in lieu thereof "subpara-*
12 *graph (C)".*
13 ~~(d)~~ *(f)* INTERNATIONAL MONETARY STABILITY EX-
14 CLUSION.—
15 (1) Section 4917(d) is amended by striking out
16 "after the date of the enactment of the Interest Equal-
17 ization Tax Extension Act of 1965".
18 (2) The amendment made by paragraph (1) shall
19 apply with respect to acquisitions made after July 18,
20 1963.
21 (3) If, with respect to an acquisition after July 18,
22 1963, and before the date of enactment of this Act, by
23 a State or political subdivision, or by any agency or
24 instrumentality thereof, of stock or a debt obligation
25 which is all or part of an original or new issue to which

1 an Executive order issued under section 4917 (a) is
2 applicable (other than an Executive order which is
3 applicable to a limited aggregate amount of such issues),
4 the notice of acquisition required by section 4917 (a) is
5 filed on or before the 60th day after the date of enact-
6 ment of this Act, such notice shall be considered as filed
7 on or before the last day specified in the regulations
8 prescribed by the Secretary or his delegate under sec-
9 tion 4917 (a).
10 (4) No interest shall be paid with respect to any
11 credit or refund allowed or made by reason of the appli-
12 cation of this subsection.
13 ~~(e)~~ *(g)* RESALES OF DEBT OBLIGATIONS BY UNITED
14 STATES DEALERS.—
15 (1) Sections 4919 (a) (2) (A) (ii) and 4919
16 (a) (2) (B) (ii) are each amended by striking out "on
17 the same or the next business day" and inserting in lieu
18 thereof "within 30 days after the day of purchase".
19 (2) Section 4919 (b) (3) is amended—
20 (A) by striking out in subparagraph (A) (ii)
21 "on the day of purchase or the next business day"
22 and inserting in lieu thereof "within 30 days after
23 the day of purchase";
24 (B) by striking out in the sentence following
25 subparagraph (A) (ii) "on the day on which it

1 was purchased or the next business day" and insert-
2 ing in lieu thereof "within 30 days after the day of
3 purchase";
4 (C) by striking out "or" at the end of sub-
5 paragraph (B) (i);
6 (D) by striking out "or debt obligation" in
7 subparagraph (B) (ii) and by adding "or" at the
8 end of such subparagraph;
9 (E) by adding after subparagraph (B) (ii)
10 the following:
11 "(iii) purchased a debt obligation which
12 he resold within 30 days after the day of pur-
13 chase to a person other than a United States
14 person,"; and
15 (F) by striking out in the matter following
16 subparagraph (B) (iii) (as added by subparagraph
17 (E) of this paragraph) "on the day of purchase
18 or the next business day" and by inserting before
19 the period at the end of subparagraph (B) the fol-
20 lowing: "on the day of purchase or the next bus-
21 iness day in the case of stock, or within 30 days
22 after the day of purchase in the case of a debt ob-
23 ligation".
24 (3) The amendments made by this subsection shall
25 apply only with respect to an acquisition by a dealer of

1 a debt obligation which is resold by such dealer to an-
2 other dealer (whether such acquisition by the former
3 dealer occurs before or after such resale) after January
4 25, 1967.
5 ~~(f)~~ *(h)* FOREIGN LENDING AND FINANCE BUSI-
6 NESSES.—
7 (1) Section 4920(a)(3) is amended by striking
8 out the period at the end of subparagraph (B) and in-
9 serting in lieu thereof "; or", and by adding after sub-
10 paragraph (B) the following new subparagraph:
11 "(C) a domestic corporation which together
12 with its subsidiaries (if any)—
13 "(i) is primarily engaged in the lending
14 or finance business through offices located out-
15 side the United States, and
16 "(ii) holds itself out, in the course of such
17 business outside the United States, as lending
18 money to the public generally,
19 and which elects to be treated as a foreign issuer or
20 obligor for purposes of this chapter. The election
21 under the preceding sentence shall be made on or
22 before the 60th day after the date of the enactment
23 of this subparagraph or the 60th day after the or-
24 ganization of the corporation, whichever is later,
25 under regulations prescribed by the Secretary or his

1 delegate. Any such election shall be effective as of
2 January 26, 1967, or the date of the organization
3 of the corporation, whichever is later, and shall re-
4 main in effect until revoked. If, at the close of any
5 succeeding calendar quarter, the corporation ceases
6 to meet the requirement of clause (i) or clause (ii),
7 the election shall thereupon (with respect to quar-
8 ters after such calendar quarter) be deemed revoked.
9 When an election is revoked no further election may
10 be made."
11 (2) Section 4920(a) is further amended by insert-
12 ing after paragraph (3) the following new paragraph:
13 "(3A) For purposes of paragraph (3)(C)—
14 "(A) the term 'lending or finance business'
15 has the meaning given it by section 542(d)(1);
16 except that for such purposes the term '60 months'
17 appearing in subparagraph (B)(i) of such section
18 shall be deemed to read '48 months', and the sub-
19 sequent portion of such subparagraph (B)(i) shall
20 be disregarded;
21 "(B) a corporation shall be considered a 'sub-
22 sidiary' of another corporation only if stock pos-
23 sessing at least 50 percent of the voting power of
24 all classes of its stock is directly or indirectly owned

40

1 by such other corporation and the two corporations
2 are affiliated with each other; and
3 "(C) a corporation primarily engaged in lend-
4 ing money to one or more other corporations each
5 of which is affiliated with it and satisfies the require-
6 ments of clauses (i) and (ii) of paragraph (3) (C)
7 shall itself be deemed to satisfy such requirements.
8 For purposes of this paragraph, two corporations are
9 'affiliated' with each other if they are members (or
10 would be members if they were both domestic corpora-
11 tions) of the same affiliated group (within the meaning
12 of section 1504)."
13 (3) Section 4920(a) (4) (C) is amended by
14 striking out "paragraph (3) (B)" and inserting in lieu
15 thereof "subparagraph (B) or (C) of paragraph (3)".
16 ~~(g)~~ *(i)* CERTAIN EXPORT-RELATED TRANSACTIONS.—
17 (1) Section 4920(a) (3) is amended by striking
18 out "or" at the end of subparagraph (B) and the period
19 at the end of subparagraph (C) (as added by subsec-
20 tion ~~(f)~~ *(h)* (1) of this section), by inserting in lieu of
21 such period "; or", and by adding after subparagraph
22 (C) the following new subparagraph:
23 "(D) a domestic corporation if—
24 "(i) substantially all of the business of
25 such corporation consists of the acquisition from

41

1 foreign obligors of debt obligations, arising out
2 of loans made to such obligors, all of the pro-
3 ceeds of which are to be used by such obligors
4 to pay part or all of the purchase price in sales
5 to such obligors of tangible property or property
6 described in section 4914 (e) (3) (A) or serv-
7 ices (or any combination thereof) by one or
8 more includible corporations in an affiliated
9 group, as defined in section 1504, of which such
10 corporation is a member,
11 "(ii) at least 15 percent of the purchase
12 price of each such sale is attributable to the sale
13 of property manufactured, produced, grown, or
14 extracted in the United States by one or more
15 such includible corporations, or to the perform-
16 ance of services by one or more such includible
17 corporations, or to both,
18 "(iii) such corporation establishes that such
19 debt obligations are acquired solely out of the
20 proceeds of the sale by such corporation (or
21 by a domestic corporation described in section
22 4912 (b) (3) which owns all of the stock of
23 such corporation) of debt obligations of such
24 corporation (or such other domestic corpora-
25 tion) to persons other than United States per-

1 sons (including such a sale in a transaction
2 described in section 4919(a)(1)),
3 "(iv) the actual value and period remain-
4 ing to maturity of the debt obligations acquired
5 by such corporation do not exceed at any time
6 the actual value and period remaining to matu-
7 rity of the debt obligations the proceeds of the
8 sale of which are established, in accordance with
9 clause (iii), to have been used to make such
10 acquisitions,
11 "(v) such corporation does not acquire
12 any stock or debt obligations of foreign issuers
13 or obligors (other than debt obligations de-
14 scribed in clause (i)) which would have been
15 subject to the tax imposed by section 4911 had
16 such corporation not elected to be treated as a
17 foreign issuer or obligor under clause (vii),
18 "(vi) such corporation maintains, in a
19 manner satisfactory to the Secretary or his dele-
20 gate, such records and accounts as may be
21 necessary to establish that the requirements of
22 the foregoing clauses have been met, and
23 "(vii) such corporation elects to be treated
24 as a foreign issuer or obligor for purposes of
25 this chapter.

1 The election under clause (vii) shall be made on
2 or before the 60th day after the date of the enact-
3 ment of this subparagraph or the 60th day after the
4 organization of the corporation, whichever is later,
5 under regulations prescribed by the Secretary or his
6 delegate. Any such election shall be effective as of
7 the date thereof and shall remain in effect until
8 revoked. If, at any time, the corporation ceases to
9 meet any requirement of clause (i), (ii), (iii),
10 (iv), (v), or (vi), the election shall thereupon be
11 deemed revoked. When an election is revoked, no
12 further election may be made. If an election is re-
13 voked, the corporation shall incur liability at the
14 time of such revocation for the tax imposed by
15 section 4911 with respect to all debt obligations
16 described in clause (i) (and all stock and debt
17 obligations described in clause (v)) which were
18 acquired by it during the period for which the elec-
19 tion was in effect and which are held by it at the
20 time of such revocation; and the amount of such tax
21 shall be equal to the amount of tax for which the
22 corporation would be liable under such section if it
23 had acquired such stock or debt obligations im-
24 mediately after such revocation. For purposes of
25 sections 4912 and 4915, a corporation which has

44

1 made an election under clause (vii) shall, during
2 the period for which such election is in effect, be
3 treated, with respect to acquisitions from such cor-
4 poration, as a foreign corporation which is not
5 formed or availed of for the principal purpose
6 described in section 4915 (c) (1)."
7 (2) Section 4920 (a) (4) (C) (as amended by sub-
8 section ~~(f)~~ *(h)* (3) of this section) is amended by striking
9 out "subparagraph (B) or (C) of paragraph (3)" and by
10 inserting in lieu thereof "subparagraph (B), (C), or (D)
11 of paragraph (3)".

Passed the House of Representatives March 15, 1967.

Attest: W. PAT JENNINGS,

Clerk.

Mr. FROY. It went to the American Stock Exchange and the New York Stock Exchange at 9 o'clock this morning. But I have the greatest doubt if anybody can read it and act upon it by the opening of the stock exchange.

(The letter of July 17, 1967, from Mr. Surrey to the chairman, together with the attachments follow:)

JULY 17, 1967.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Attached hereto is a draft of the statutory language designed as an Amendment to the Internal Revenue Code for the purpose of effectuating the interest equalization tax recommendations submitted to the Senate Finance Committee by Under Secretary Frederick L. Deming on Friday, July 14, 1967, with respect to proof of prior American ownership and compliance.

(Clerk's note. The document referred to appears at pp. 80.)

Since announcement of these procedures on July 14, 1967, and as a result of discussions with representatives of the securities industry and others, we have made certain minor clarifying amendments to our recommendations which are reflected in the attached letter to the New York Stock Exchange.

Since we recommend that the new compliance procedures be effective as of July 15, 1967, in order to facilitate orderly market procedures during the transition, we have also agreed with representatives of the securities industry with respect to certain procedures for handling transactions during the week of July 17. In substance these procedures will permit members of the New York and American Stock Exchanges and participating members of the National Association of Securities Dealers, Inc., to verify the availability of the exemption for prior American ownership and compliance with respect to transactions not exceeding $50,000 per customer during such week and only with respect to persons who have been customers and with certain other safeguards, including reporting requirements. These procedures are set forth in another letter to the New York Stock Exchange which I also enclose.

As was requested by Senator Williams, we are enclosing copies of a description of an actual interest equalization tax avoidance transaction effectuated under present law.

(Clerk's note. The document referred to appears at pp. 76.)

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

TREASURY DEPARTMENT,
Washington, D.C., July 16, 1967.

Mr. ROBERT M. BISHOP,
New York Stock Exchange,
New York, N.Y.

DEAR MR. BISHOP: In confirmation of the telephone conversation between Mr. Robert T. Cole of the Treasury staff and you concerning Attachment A to the Supplementary Statement of Under Secretary Frederick L. Deming on H.R. 6098 before the Senate Finance Committee on July 14, 1967, this will confirm that the Treasury Department will recommend to Congress that, to the extent reflected in H.R. 6098, the changes in the operation of the interest equalization tax set forth in Attachment A incorporate the modifications marked in the attached pages 10, 11, 12, 13, 14, 16 and 17 thereof.

This will authorize you to distribute copies of Attachment A so modified to your member organizations and others.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

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(Page 10)

SALES EFFECTED BY PARTICIPATING FIRMS

The Treasury further recommended that the amendments to H.R. 6098 provide that Participating Firms are required to sell stock of a foreign issuer or a debt obligation of a foreign obligor as stock or a debt obligation not exempt from the interest equalization tax by reason of the exemption for prior American ownership and compliance except in the following cases:

1. The Participating Firm (i) at the close of business on July 14, 1967 (trade date) carried in its records for the account of the seller the stock or debt obligation being sold, (ii) has in its possession and relies in good faith on a certificate of American ownership with respect to the stock or debt obligation being sold, or a blanket certificate of American ownership with respect to such account, and (iii) included the stock or debt obligation in the Transition Inventory of the Participating Firm duly filed on or before the due date (whether it occurs prior to or subsequent to the sale) with the Internal Revenue Service as hereinafter provided.

(Page 11)

2. The Participating Firm purchased on or after July 15, 1967 for, or sold to, the seller the stock or debt obligation being sold if the exemption for prior American ownership and compliance applied to the seller's acquisition and if the Participating Firm continuously carried in its records for the account of the seller such stock or debt obligation.

3. The Participating Firm purchased for, or sold to, the seller the stock or debt obligation being sold if the exemption for prior American ownership or the exemption for prior American ownership and compliance applied to the acquisition and if the Participating Firm on or after July 15, 1967, received from the seller the identical stock certificates or evidence of indebtedness which it had previously delivered to the seller in respect of the purchase.

4. The Participating Firm received the stock or debt obligation being sold from another Participating Firm or from a Participating Custodian with a Transfer of Custody Certificate meeting the requirements described below.

5. The Participating Firm has received from the seller copies 1 and 2 of a Validation Certificate issued by the Internal Revenue Service applicable to the stock or debt obligation being sold and on or before the business day following the delivery of the security by the seller or the day of the sale, whichever is later, completes and files[1] copy 2 of the certificate with the Internal Revenue Service.

(Page 12)

6. If the sale involves stock, the Participating Firm received from the seller proof that the seller is a United States person (until otherwise announced a Certificate of American ownership with respect to the stock being sold is acceptable proof) and the stock certificate is registered in the name of the seller by a United States transfer agent which is a bank or trust company and dated prior to July 19, 1963.

7. The Participating Firm withholds the amount of Interest Equalization Tax which would be imposed had the seller purchased in a taxable acquisition the stock or debt obligation being sold on the day of the sale. Information on withholding procedures will be published shortly.

IET CLEAN CONFIRMATION

A Participating Firm is authorised to issue an "IET Clean Confirmation" to a customer with respect to stock or a debt obligation of a foreign issuer or obligor in the following circumstances:

1. In a case where the Participating Firm purchased the stock or debt obligation as broker for the customer from or through another Participating Firm in the regular market (in the case of a purchase on a national securities exchange referred to in Section 4918(c) of the Internal Revenue Code) or received a clean comparison or confirmation from another Participating Firm under the procedures referred to in Section 4918(d) of the Internal Revenue Code.

[1] Timely mailing is treated as timely filing if in accordance with section 7502 of the Internal Revenue Code.

2. It sold the stock or debt obligation as dealer to the customer and it was a complying United States person not ineligible to sell as a United States person.

(Page 13)

Each IET Clean Confirmation shall state the date of acquisition, the number of shares or the face amount of obligations purchased, the description of the stock or debt obligations, the price paid and the market on or through which the purchase was effected. Only an original document may constitute an IET Clean Confirmation and each copy or duplicate shall be marked as such. All other confirmations issued by Participating Firms with respect to stock or debt obligations of foreign issuers or obligors shall be clearly and marked in ink, by typewriter or by business machine so as to be distinguishable from IET Clean Confirmations.

ISSUANCE OF VALIDATION CERTIFICATES

Validation Certificates will be issued by all District Directors of Internal Revenue commencing Monday, July 17, 1967, upon proof that the United States person on whose behalf the Validation Certificate is requested has complied with his interest equalization tax obligations with respect to the securities to be covered by the Validation Certificate. The Internal Revenue Service will shortly announce the procedures for obtaining Validation Certificates. Each District Director will reissue Validation Certificates in different denominations upon request.

(Page 14)

TRANSITION INVENTORY

The Transition Inventory shall be filed with the Commissioner of Internal Revenue no later than August 15, 1967. Each Participating Firm and each Participating Custodian filing a Transition Inventory (Participating Custodians are described below) shall list those stocks and debt obligations of foreign issuers and obligors carried on its records at the close of business July 14, 1967 (trade date) and shall show (i) the aggregate amount of each such security carried for the accounts of United States persons, (ii) the aggregate amount of each such security carried for the accounts of other persons, and (iii) the aggregate amount of each such security not in the physical custody of the Participating Firm or Participating Custodian.

PARTICIPATING CUSTODIANS

During the period beginning July 15, 1967 and until a notice or notices to the contrary are published by the Internal Revenue Service, the Participating Custodians are the Federal Reserve Member Banks which are classified as reserve city banks.

A bank or trust company insured by the Federal Deposit Insurance Corporation may become a Participating Custodian if it files with the Commissioner of Internal Revenue, Washington, D.C. 20224 (Attention: CP) a letter signed by an officer (i) requesting designation as a Participating

(Page 16)

equalization tax applicable to it, or with the documentation, record-keeping and reporting requirements, or any part thereof, he may cause the removal of such firm from the list of Participating Custodians.

The effective date on which a bank or trust company shall become or cease to be a Participating Custodian shall be the date specified in a notice issued by the Internal Revenue Service, which date shall not be prior to the date following the date on which the notice was made available to financial publications and wire services.

TRANSFER OF CUSTODY CERTIFICATES

Transfer of Custody Certificates shall be issued only by Participating Firms and Participating Custodians and only in connection with a transfer from the account of a customer of a Participating Firm or Participating Custodian to the account of the same customer with a different Participating Firm or Participating Custodian in the following circumstances:

1. The Participating Firms or Participating Custodian on July 14, 1967 (trade date) carried in its records for the account of the customer the stock or debt obligation referred to in the Transfer of Custody Certificate and acquired and holds in good faith a certificate of American ownership with respect to

(Page 17)

such stock or debt obligation or blanket certificate of American ownership with respect to such account, if it included such stock or debt obligation in the Transition Inventory duly filed on or before the due date (whether it occurs prior to or subsequent to the sale) by it with the Commissioner of Internal Revenue.

2. The Participating Firm or Participating Custodian received a like amount of the stock or debt obligation referred to in a Transfer of Custody Certificate from another Participating Firm or Participating Custodian accompanied by a Transfer of Custody Certificate.

3. The Participating Firm purchased for the transferor the stock or debt obligation referred to in the Transfer of Custody Certificate and in connection with the purchase either received (i) a Validation Certificate issued by the Internal Revenue Service, or (ii) was authorized to issue an IET Clean Confirmation and in either case continuously carried for the account of the Transferor the stock or debt obligation so purchased or received back from the purchaser the identical securities or evidence of indebtedness previously delivered to the purchaser.

NEW YORK STOCK EXCHANGE,
New York, N.Y., July 17, 1967.

U.S. TREASURY DEPARTMENT,
Washington, D.C.

GENTLEMEN: Since the announcement by the Treasury Department last Friday of its proposals to replace the exemption for prior American ownership which is part of the Interest Equalization Tax with an exemption for prior American ownership and compliance effective July 15, 1967, the New York Stock Exchange Staff has been studying the procedures proposed in Attachment A of the supplementary statement to the announcement.

We believe that the changes which have been made by the Trasury Department in Attachment A over the weekend upon our recommendation will assist materially in making the proposals concerning exemptions more practicable of operation. We will proceed immediately with representatives of our member organizations to examine the record keeping proposals and to work out with Teasury officials modifications intended to assure effective compliance within the framework of practicality. We will also consider carefully whether it may be necessary to recommend addition of a specific provision that a Participating Firm may accept an order from or deal with another Participating Firm without special documentation except to indicate transfers subject to the Interest Equalization Tax.

In order to permit orderly and lawful markets to continue while Participating Firms become familiar with the new procedures, we deem it essential that a special procedure be established for omnibus validation of trades through the current calendar week as has been tentatively agreed upon by members of our and your staff in a draft of a letter of reply by the Treasury Department to this request. This procedure must be effective by the opening of trading this morning.

In the event that the Treasury Department agrees to the tentative plan, the staff of the Exchange will recommend to the Board of Governors of the Exchange at a special meeting at 9:00 a.m. this morning that the Board adopt resolutions requiring member organizations to comply with the proposed procedures with respect to any sale of relevant securities in the regular market on this Exchange and to open trading in such issues this morning in the normal course.

It is our present opinion that continued cooperation between the Exchange and the Treasury Department will permit the new procedures to be reasonably operating by the time the special procedure terminates, and we will continue to devote our effort toward that end.

Our sincere efforts to cooperate with the Treasury Department, of course, do not diminish the equally sincere basic belief which will be expressed to a committee of Congress by our representatives today in opposition to the continuance of the Interest Equalization Tax.

Sincerely yours,

ROBERT M. BISHOP.

JULY 17, 1967.

NEW YORK STOCK EXCHANGE,
New York, N.Y.

DEAR SIRS: This will acknowledge receipt of your letter of today concerning the proposal of the Treasury Department to replace the exemption for prior American ownership under the interest equalization tax with an exemption for prior American ownership and compliance, effective July 15, 1967. The proposal was published in the Federal Register of that date.

Based on your letter and discussions we have had with others, this will advise you that the Treasury will recommend to Congress that the legislation embodying these proposals permit the validation procedure, described below, for sales effected prior to the close of business July 21, 1967.

Under this procedure, on sales of stock of a foreign issuer or a debt obligation of a foreign obligor made by a Participating Firm (as defined in the proposal) prior to the close of business on July 21, 1967 there will be deemed to have been issued a Validation Certificate with respect to such securities if in a letter, filed in duplicate, with the District Director on or before August 2, 1967 the Participating Firm certifies that: (i) to the best of its knowledge and belief the seller for whom it sold such foreign securities was a resident of the United States at the time of the sale and the Participating Firm had reason to believe that the seller had been a resident of the United States for the preceding 18 months, (ii) to the best of its knowledge and belief the seller is the beneficial owner of such securities, (iii) that during the calendar week ending July 21, 1967 the Participating Firm had not sold (or by selling such securities did not sell) securities in an amount in excess of $50,000 for the seller which were subject to the interest equalization tax and which could not be sold regular way on a national securities exchange or under the clean confirmation procedures over-the-counter pursuant to sections 4918(c) and (d) of the Internal Revenue Code without a Validation Certificate, and (iv) the seller had had previous brokerage relations as a customer with the Participating Firm.

With respect to each stock of a foreign issuer or debt obligation of a foreign obligor sold pursuant to the foregoing paragraph, the letter shall indicate the name and address of the seller, the Social Security number of the seller, the number of shares or face amount of the security of the debt obligation, the name of the issuer or obligor, the class of stock or description of the debt obligation, the total amount for which the stock or debt obligation was sold and the settlement date. The letter must be signed by a partner or officer of the Participating Firm.

During the calendar week ended July 21, 1967 a Participating Firm may accept an order from or deal with another Participating Firm or a United States bank or trust company (excluding a United States branch or agency of a foreign bank) in any amount without special documentation, except to indicate transfers subject to the interest equalization tax.

Sincerely yours,

STANLEY S. SURREY,
Assistant Secretary.

Senator MCCARTHY. Mr. Robert F. Seebeck, former chairman of the Foreign Investment Committee of the Investment Bankers Association of America.

Do you have counsel with you?

STATEMENT OF ROBERT F. SEEBECK, FORMER CHAIRMAN, FOREIGN INVESTMENT COMMITTEE, INVESTMENT BANKERS ASSOCIATION OF AMERICA

Mr. SEEBECK. No, sir.

I am Robert F. Seebeck, a vice president and director of Smith, Barney & Co., Inc. Until approximately 1 month ago, I was chairman of the Foreign Investment Committee of the Investment Bankers Association of America, when a change of my responsibilities within

my firm caused me to pass this position to Stephen Kellen, president of the firm of Arnhold & S. Bleichroeder, Inc. of New York. Mr. Kellen planned to be present but a rescheduling of hearings prevented him from being here. Also Mr. Stevenson, our special counsel, had prior commitments to be in Europe.

I have adapted this statement somewhat from the one before you, and I request that it be included in the record. I can give the reporter this copy. It varies only somewhat.

Senator McCARTHY. Thank you.

Mr. SPEBECK. At the outset, I should like to reiterate our association's previously expressed opposition in principle to the interest equalization tax which we view as a form of control that impairs the position of the dollar and the longstanding U.S. espousal of the principle of freedom of capital movements. Representatives of the IBA testified at the initial hearings in 1963 when the tax was first proposed and again in 1964 when it was first enacted. I would like to repeat for the record our belief that much better answers can and must be found which deal more directly with the fundamentals of the balance-of-payments deficit.

The investment banking industry is not unaware of the basic causes of this deficit which have resulted in such strains on the dollar. We are not unaware, for example, of the difficulties inherent in seeking to decrease the deficit through reduced military expenditures abroad, through a larger trade surplus, through reduced allocations of foreign aid with increased amounts of such aid tied to exports, and through attempts to reduce the net exchange loss, now nearing $2 billion annually, resulting from greater expenditures by American tourists abroad than by foreign tourists in the United States. Finally, we are not unaware of the economic and political considerations involved in monetary and budgetary policy which bear on the important subject of the competitive international position of the United States.

With these longer term considerations in mind, our first recommendation is that the proposed extension of the interest equalization tax be limited to 1 additional year or until July 1, 1968. We are of the opinion that sufficient changes may occur within the next year that it will be in the national interest to review a question of this magnitude at that time. Though it seems unlikely right now, the military phase of the Vietnam conflict could be reduced or could terminate; our trade surplus could increase; the administration's attempt to induce Americans to "see America first" may result in less American spending for travel to other countries; foreign aid outlays not restricted to exports may be further reduced; support of their own foreign military establishments at home by foreign creditor countries should increase in the years ahead. Not the least important reason for seeking only a 1-year extension is that this measure was adopted as a temporary expedient. A 2-year renewal would mean that the tax had existed for 6 years, hardly a temporary period. For these many reasons, we therefore believe that a review of the interest equalization tax is not only warranted, but imperative sooner than 2 years from now.

Our second recommendation relates to the proposed increase in the tax on foreign equity securities from 15 to 22½ or 30 percent as recently mentioned on Friday. The Treasury Department figures, which

we have seen and which were referred to by Under Secretary Deming in his remarks to you last Friday, indicate that Americans for the fourth year in a row were net sellers of foreign equities in 1966; that is, they were not purchasers of foreign equities on balance, but rather the reverse.

This obviously means there was a dollar inflow on foreign equity portfolio account. We do not believe that increasing the levy on the purchase of foreign equities will significantly increase this "disinvestment."

The administration is presently attempting, and properly so we think, to induce more Europeans to become interested in the American equity market. To the extent that this drive is successful, it will stimulate an inflow of dollars—a positive approach to the deficit problem—and one which we therefore enthusiastically applaud and are supporting by our own efforts. A substantial increase in the tax is certainly not likely to attract more foreign buying. European reaction to the current proposal is understandably anguished, particularly in light of the recommendations, for example, of a meeting earlier this year sponsored by the Atlantic Institute and the Business and Industry Advisory Committee to the OECD attended by representatives of 10 Western European nations, Japan, Canada, and the United States. Among the recommendations made by this group after their deliberation were the following:

> (IX.) To assure the most effective use of available resources, measures should be taken aiming at the complete liberalization of international capital flow . . .
>
> (X.) The use of restrictions on international capital movements to correct economic disturbances originating in areas other than capital markets should be avoided as such practices result in fragmented national capital markets.[1]

We believe it is neither wise nor desirable to turn a deaf ear to the adverse points of view that are being expressed from abroad about this legislation. The implications of H.R. 6098 are giving concern to many of these people—they wonder whether, in terms of finance, the dollar is truly a fully convertible currency. The question was raised in an editorial earlier this year in the London Times, a copy which is appended to this report. We believe adequate evidence exists to support the contention that a 15-percent rate has been sufficient to implement the IET as it was passed. We do not feel that doubling or increasing the rate by 50 percent will be an additional deterrent, and question the purpose that would be served by so doing.

In light of the testimony on last Friday by Under Secretary of the Treasury Deming, I would like to depart very briefly from the text of my statement which was mailed to each member of this committee. These remarks are obviously for inclusion in the record.

In brief, your committee is being asked to consider an increase in, and extension of, the interest equalization tax. By its very designation, interest equalization, it should simply not have anything to do with equity securities. As I will point out later, we in the industry believe the administration's concern about the dollar outflow was prompted originally by the aggregate amount of foreign borrowings through the sale of debt securities. The Under Secretary has satisfactorily shown

[1] Atlantic Institute, B.I.A.C., "Recommendations, Capital Markets Conference, Cannes," Jan. 22, 1967.

that these figures were in fact large when the tax was first proposed and have in fact declined substantially during the time the tax has been in existence. His later remarks concerning the growth of the international capital market refer solely to the increased ability of the European market to handle a large volume of debt securities, international bond issues. But we have been told that Americans have been net sellers of foreign equity securities for the past 4 years. If the "tax" has contributed to this state of affairs, what reason is there to believe that a larger tax would be more effective?

The point I am trying to make is that wholly different considerations govern whether an investment manager or an individual invester will place his funds in a debt or equity security. He will generally invest the funds going into debt obligations of similar quality and safety in the one paying the higher return. When considering equity investments, he almost invariably will seek capital appreciation or growth. If the growth potential of an equity security were sufficintly attractive, there is no real reason why the investor would not accept a 30-percent handicap, for example, if he felt the security in question offered the possibility of doubling over a given period. This has been proved in the past by British investors who, despite a premium of 20 percent or more on "investment dollars," have still been important purchasers of U.S. equity securities.

Looking at the question from the point of view, of the issuer, on the other hand, there are several reasons why debt capital would be more desirable than equity capital, and this has been the case as the figures you have heard point out. In the first place, the treatment of interest charges in many countries has a tax advantage to the borrower much as is true here in the United States. Thus the real cost of money is less than the apparent rate which is indicated by the coupon on the issue. Perhaps more importantly, the issuer who chooses to sell a new equity security must consider the effects of dilution on the company's earnings, as these earnings are spread over a larger number of outstanding shares. Both considerations would tend to favor his selling a debt obligation. Thus, as we have said, we are more sympathetic to the Treasury's concern about the prospective dollar outflow through debt issues than we are by way of new equity offerings or the trading in outstanding equities.

Our original recommendation was that the least disruptive approach would be to extend the present 15-percent tax on foreign equities purchased from foreigners for only 1 year, at which time we would have asked a review with this committee of the then current picture. However, as Mr. Froy just told you, we are aware that members of the NASD Foreign Committee have been working closely with the Treasury in order to evolve an effective way of dealing with outstanding equity securities. We believe the NASD to be competent to deal satisfactorily with this problem and support in principle their recommendations.

I would like to turn now to what we believe is a wholly different question, and that is the tax as it affects debt financing, which may have been the original, and was certainly the principal, intent of the interest equalization tax.

At the time the administration requested the tax be doubled retroactive to January 25, 1967, it was apparently concerned that anticipa-

tory borrowing would occur in this market prior to the passage of legislation extending the IET which had been due to expire in July of this year. For a variety of reasons, not the least important of which is the fact that interest rates in the United States have returned to a very high level historically after a substantial decline early in the year, such borrowing has, in fact, not taken place nor would it have done so even without the request publicly for an increase in the IET.

As a matter of fact, relative stability in the foreign dollar market has permitted a substantial amount of financing to take place in Europe, at quite attractive rates until a very recent reversal in the long-term market.

As we mentioned in our appearance before the House Ways and Means Committee in testimony about this bill on February 16, 1967, the decline in rates for high-grade domestic borrowers from mid-January until about March was not transmitted to the same extent either to companies with lower credit standings or the securities of foreign issuers. We said in that statement:

> * * * sufficient improvement in rates here in the U.S. for foreign bonds over rates abroad has not manifested itself, nor, for a variety of reasons, is it likely to do so in the foreseeable future; second, the Guidelines for institutional investors, combined with both a sympathetic psychological, or if you will, "patriotic" reluctance to lend to foreigners and appealing rates on domestic financing, have tended to limit interest in such foreign loans here.

This statement is still true today. On the other hand, strength in the market abroad permitted the foreign subsidiaries of some American companies to borrow at long term with interest rates of 6 percent or less, the lowest such coupons since February of 1966. A continuing strong demand for long-term capital both here and abroad to date has caused interest rates in both markets to rise once again, essentially preserving the relative spread in rates that have existed. The U.S. market has, therefore, not become any more appealing in the recent past to prospective foreign borrowers. The availability of funds is what governs the investment decisions of investors, both individual and institutional. The continuing heavy demand for funds over the next several months on the part of domestic corporate and municipal borrowers is likely to preclude foreign obligors from obtaining significant amounts of capital in the U.S. market.

While we understand the administration's rationale in seeking to extend this tax, we suggest that the tax on debt obligations be continued at existing rates until July 31, 1968. We do, however, subscribe to the Treasury's proposal that a desirable element of flexibility be added by giving the President the right to vary the rate applicable to debt securities in such a way that the differential could be as little as zero or as much as 1½ or even 2 percent, if conditions warranted. It is our hope, of course, that the administration will react as promptly in reducing the tax when appropriate as it will in raising the levy when such a deterrent seems advisable.

In order to further increase the Secretary of the Treasury's ability to permit the U.S. capital market to function in as normal a manner as possible within the limits determined by him to be compatible with the U.S. balance-of-payments position, we advance again a suggestion made before the Ways and Means Committee of the House of Repre-

sentatives in July of 1964 by the then Chairman of the Foreign Investment Committee of the IBA regarding the enactment of the interest equalization tax. It was stated that, for many years, there had been a history of interest on the part of Europeans in buying dollar bonds of foreign obligors even when these issues were registered under the Securities Act of 1933 and originally offered only in the United States (pre-IET days). Such interest still exists, of course. The IBA Committee's proposal is that any debt or equity issue of a foreign issuer or obligor acquired by a U.S. underwriter would be exempt from the interest equalization tax if it can be shown that not more than 25 percent of the principal amount of debt obligations or of the shares of stock of the aggregate issue had been sold to U.S. persons. The Secretary of the Treasury would have the authority, in his discretion, to increase or decrease the specified percentage applicable to all issues from time to time, in accordance with the Treasury's view of the U.S. balance-of-payments position. If an amount in excess of this specified percentage were sold to U.S. persons, this provision could be implemented by requiring that an interest equalization tax equal to 150 percent of that normally due be paid on the excess amount. In order to avoid a possible "flowback" to the United States of securities sold to foreigners, the exemption would apply only to the initial distribution or placement and not to the security itself; that is, a subsequent resale to a U.S. person by a foreign purchaser would be subject to the tax. If the number of issues contemplated on this basis became too large, the percentage which must be sold abroad could be increased up to 100 percent. Such an arrangement has the essential elements of flexibility and ease of supervision, and would give the U.S. investment banking industry a chance to participate more actively in international dollar financing.

In 1964 we also proposed the exemption from the tax of new issues of securities the proceeds of which are used to pay U.S. persons for goods or services. The financing of the purchase of U.S. goods or services does not adversely affect our balance of payments. On the contrary, it is an effective means of carrying out the administration's objective of stimulating exports and reversing the 3-year downward trend in our merchandise trade surplus. We then proposed, in order to give assurances to the Treasury that the proceeds of a particular foreign issue for which exemption was claimed would, in fact, be used for purchases from U.S. persons, that the proceeds be escrowed with a bank subject to withdrawal only in order to make payment to U.S. persons for goods and services. We believe that the proceeds of a foreign bond purchase should be escrowed with a bank subject to withdrawal only in order to make payment to U.S. persons for goods and services. We believe that the proceeds of a bond issue for a foreign borrower could readily be escrowed with a U.S. commercial bank and released against documents evidencing shipment of U.S. goods abroad, and thereby qualify for exemption from the IET on the grounds of financing U.S. exports. We again recommend that such an exemption be considered and would be pleased to work with the Treasury and the staff of the committee in developing effective administrative procedures in this area.

In the interest of saving the valuable time of this committee as requested of me by Mr. Tom Vail, I will not read certain technical

recommendations we have made for liberalizing this legislation. This does not mean that we feel any less strongly about these proposals, and I respectfully request that this committee study these suggestions which are contained in my written statement.

In summary, we urge again that your committee think of this legislation not as a substitute for the admittedly more difficult yet decidedly basic policy questions which adversely affect the balance of payments and to give careful consideration as to reactions the proposed legislation is engendering abroad. Europeans are assuming that the situation in the United States is more critical than it may really be. It is a serious matter when the judgment is made by responsible Europeans that the dollar is no longer a fully convertible currency. U.S. prestige declines when defensive measures of this type are unduly prolonged or made more drastic than our conditions warrant. It is our committee's view that the Congress should think more in positive terms of stimulating a dollar inflow through such measures as the Foreign Investors Tax Act (which we believe could have gone even further in eliminating taxes on foreign holders of U.S. securities) rather than in perpetuating existing controls or creating new ones. We in the industry are desirous of restoring to the U.S. capital market its proper role as the financial capital of the free world. The worldwide demand for funds for projects which are truly sound and forward looking is enormous; it is impossible to conceive of these projects proceeding without drawing on the huge pool of American capital We must strive to free our market, and other markets, of controls—not extend them. Thank you, gentlemen.

Senator McCarthy. Thank you very much, Mr. Seebeck., Am I right in concluding you are not opposed to the extension of the act if these modifications you suggest are adopted?

Mr. Seebeck. We believe that the tax has some effectiveness in the area of debt security, as I pointed out. We feel it is a wholly different question to put a levy on equity securities.

Senator McCarthy. You would like to have it eliminated on all equity securities?

Mr. Seebeck. Yes, sir.

Senator McCarthy. I thought your testimony was that it did not have any bearing really on debt securities. In one case you say you are against it because it should not be levied. In the other case you say there is no need for it.

Mr. Seebeck. We are against the tax in principle as a control.

Senator McCarthy. On all things.

Mr. Seebeck. On all securities. But we accept the problems of the administration and the present balance-of-payments problems which we think warrant our support of the tax as a short-term measure to help control this area in debt issues.

Senator McCarthy. I thought you said that it did not really have any bearing on debt securities or was that only on short term? On long term you said you felt it had no effect?

Mr. Seebeck. In long-term debt we think the situation has been improved by the tax.

Senator McCarthy. It has been effective?

Mr. Seebeck. Yes.

Senator McCARTHY. I see. I thought you said it had not.

Senator Williams.

Senator WILLIAMS. Do you think there has been much abuse under existing law?

Mr. SEEBECK. Sir, it is difficult for me to say. I have been aware of the abuse referred to most recently, only since I read it in the press, so it is very difficult for me to comment. I have not been aware of it prior to reading about it in the press.

Senator WILLIAMS. You had not heard of the abuse prior to reading it in the press or you did not know anything about it, is that correct?

Mr. SEEBECK. Pardon me?

Senator WILLIAMS. Did I understand you to say you did not know about the abuse or had not heard anything about this until reading about it in the press?

Mr. SEEBECK. Correct.

Senator WILLIAMS. Apparently the Treasury did not know too much about it either.

Mr. SEEBECK. I cannot speak for them, but apparently not, sir.

Senator WILLIAMS. Did you have any indication from the Treasury Department in your daily discussions with them in connection with this bill or revisions that they knew about it before it was revealed in the press?

Mr. SEEBECK. No, sir; we did not.

Senator WILLIAMS. Thank you.

Senator McCARTHY. Senator Bennett.

Senator BENNETT. No questions.

Senator McCARTHY. Senator Hartke.

Senator HARTKE. I have no questions.

Senator McCARTHY. You include in your text, which you asked us to put in the record, a photostatic copy of an editorial from the London Times.

Mr. SEEBECK. Yes, sir.

Senator McCARTHY. Do you think there is serious danger that the Europeans would retaliate especially if the interest equalization tax would increase?

Mr. SEEBECK. I think there is a chance there that this may happen, sir. It is very difficult to say whether this is in the heat of what people's reactions are at any given time or whether this will actually be the case. I do not know.

Senator McCARTHY. You think the position of the dollar in the European money market and the questions raised in that editorial are close enough to being in position of balance where this increase might move it or do you think this is a kind of standard threat of retaliation that one might expect from the London Times?

Mr. SEEBECK. We think this is quite obviously control which indicates weakness of the dollar because essentially a premium has to be paid to use the dollar to buy these securities.

Senator McCARTHY. You do not think the dollar is that weak?

Mr. SEEBECK. I hope not.

Senator McCARTHY. I have no more questions. Thank you very much. We will include all that you have requested in your statement in the record.

(Attachments to Mr. Seebeck's statement follow:)

SUPPLEMENTARY STATEMENT OF ROBERT F. SEEBECK, FORMER CHAIRMAN, FOREIGN INVESTMENT COMMITTEE, INVESTMENT BANKERS ASSOCIATION OF AMERICA

The Foreign Investment Committee of the Investment Bankers Association suggests the following amendments and additions to H.R. 6098 introduced in the Senate on March 16, 1967.

A. *Proposed Amendments to H.R. 6098.*

1. *Page 2, line 6,* Substitute "July 31, 1968" for "July 31, 1969."
2. *Page 4, line 1.* Insert "sub-paragraph (B) of" before "paragraph (1)."
3. *Page 4, line 5.* Delete "stock of foreign issuers and".
4. *Page 5, line 17.* Delete "stock and".
5. *Page 5, lines 20 and 21.* Delete "shall be 22.5% in the case of acquisition of stock, and".

B. *Suggested amendments in Interest Equalization Tax Act as presently in effect:*

1. *Exemption for issues 75% or more of which are sold abroad.*

(a) Add as a new paragraph (4) to Section 4919(a) the following:

"(4) Certain Other Transactions—

are acquired by an underwriter in connection with a public offering or private placement by a foreign issuer or obligor provided that not more than 25% of the total number of shares of stock or total principal amount of debt obligations sold are sold (including sales by other underwriters) to United States persons. The Secretary or his delegate may from time to time by regulaton increase or decrease such percentage that may be sold to United States persons, provided that any decrease in the percentage theretofore in effect shall not be effective until 60 days after notice of such decrease is published in the Federal Register. If more than the prescribed percentage then in effect is sold to United States persons the provisions of this paragraph (4) shall nevertheless be satisfied if a tax equal to 150% of the tax imposed by section 4911 is paid on the amount of sales to United States persons in excess of such prescribed percentage. Any tax so paid shall be deemed to be a tax paid under section 4911."

(b) At the end of the first sentence of Section 4919(b)(1) following the words "United States person." add:

"or the provisions of subsection (a)(4) have been satisfied."

(c) In line 2 of Section 4919(b)(2) following the words "under subsection (a)(1)" add the following:

"or subsection (a)(4)"

(d) In line 5 of Section 4919(b)(2) following the words "foreign person" add:

"or as to the satisfaction of the provisions of subsection (a)(4)"

(e) In line 9 of Section 4919(b)(2) following the word "person" add:

"or the provisions of subsection (a)(4) were satisfied."

2. *Exemption for Export Transactions.*

(a) Amend Sections 4914(c)(1), 4914(c)(4) and 4914(c)(6) to make them applicable to stock of foreign issuers as well as debt obligations of foreign obligors.

(b) Amend Section 4914(j) to delete references to paragraph (1)(B), (2), (4) and (6) of subsection 4914(c).

3. *Exemption for trading foreign debt securities.*

(a) *Page 15.* Delete lines 16–21 and substitute the following:

"The amendments made by this subsection shall apply with respect to acquisitions made after July 18, 1963."

[From the London Times, June 27, 1967]

A SERIOUS ERROR OF POLICY

The decision of the United States Government to double the interest equalization tax is a serious error of policy; it does not create a critical situation in the short term but in the longer term it can only do harm. The increase in the tax

on American purchases of foreign stocks is from 15 to 30 per cent; this puts the American investor in British stocks at an even greated disadvantage than the British investor in American stocks, who at present has to pay only a 22 per cent premium. In effect a 30 per cent tax is an absolute prohibition on the American purchase of foreign securities.

The simplest reflections show what a disadvantage to the world economy this is. In the first place it cuts off the rest of the world from the world's largest capital market, based on the world's most productive economy. It robs Wall Street of half its constructive international function. It forces finance out of the dollar market, which can be regulated and assisted, and into the Euro-dollar market, which is open to uncontrolled fluctuation.

The decision also reduces the convertibility of the dollar, reversing still further the progress towards, general convertibility made under the International Monetary Fund in the 1950s. In terms of finance the dollar is no longer a fully convertible currency. This is serious enough for any major currency, but for the dollar is quite unjustifiable. The dollar is the great reserve currency of the world; whatever the advantages of the dollar-exchange system, world reserves cannot continue to depend indefinitely on a currency of limited and progressively reduced convertibility.

Almost inevitably, if Congress approves this misconceived tax increase, the European powers will be forced to retaliate. If European companies are not to be allowed to borrow in America (except by and for their American subsidiaries), why should American companies be allow to borrow in Europe? Indeed the form of this tax increase shows positively callous disregard of the known views and interests of the European powers. Under the old tax European companies issuing stock in order to raise dollars suffered a capital surcharge of 15 per cent, but direct investment by American companies abroad went free, though subject to voluntary restraint. Under the new tax European companies pay 30 per cent; American companies still go free.

Discrimination might even be acceptable if the United States were investing a surplus, but in fact the United States is suffering from a deficit which will be larger this year than last. On these terms Europe really is being asked to finance the American takeover of European industry, while being deprived of normal access to the American capital market.

Yet retaliation would carry a stage farther the division of the world economy into compartments, a process in which the British Government and the European Economic Community have both played their part. In the 1920s and 1930s tariffs were the weapon used to cut up world trade, and the result was a great trade slump. Now it is the flow of money—the flow of investment—which is being dammed; the consequences are bound to be serious.

This is not to say that the immediate situation is alarming; it is not. There is no immediate shortage of money in Europe, and with the cut in the United States prime rate and the British Bank rate there is no reason to fear that money will become dearer. The 30 percent tax decision is a major move in the wrong direction, and will in the end reduce confidence and therefore reduce world liquidity, but it is not a move which poses an immediate threat to stability.

It does, however, force one to look again carefully at the dollar exchange standard itself. If present trends were allowed to continue then there might be no workable alternative but to accept M. Rueff's ideas and re-create world liquidity on the basis of a higher gold price. That would in the end be the natural consequence of a failure of the dollar, or the management of the dollar, to support the present load. President Johnson's Council of Economic Advisers itself produced a scheme for a new international currency last night.

The whole future of the dollar is, however, directly dependent on the future of the war in Vietnam. Last December President Johnson stated that the cost of the Vietnam war to the United States balance of payments was running at more than $1,000m. a year. The figure is certainly still rising. If the war is ended this year, then the outlook for the American balance of payments would become very favourable; next year and all might still be well; but the United States cannot indefinitely maintain this vast war expenditure and the dollar exchange system at the same time. The cost of Vietnam enforces defensive financial measures which are themselves precisely calculated to make international opinion turn against the dollar standard.

Senator McCarthy. Mr. Calvin.

STATEMENT OF DONALD L. CALVIN, VICE PRESIDENT, NEW YORK STOCK EXCHANGE, ACCOMPANIED BY STAN WEST, DIRECTOR OF RESEARCH, AND SAM B. LYONS, WASHINGTON CONSULTANT

Mr. CALVIN. My name is Donald L. Calvin. I am a vice president of the New York Stock Exchange, 11 Wall Street, New York, N.Y.

I have with me Mr. Stan West, director of research of the New York Stock Exchange, and I am expecting another gentleman to accompany me, with your permission, Mr. Sam Lyons, Washington consultant to the exchange, who is coming up to the table now.

With your permission, Mr. Chairman, what I would propose doing in the interest of time, and so that we could answer any questions that the members of the committee might have, is to summarize Mr. Funston's statement which we submitted to the committee last Friday, and then offer that statement for the record. As I summarize it, I will point out the portions that are being deleted, if that is satisfactory.

Senator MCCARTHY. No objection. You may proceed.

Mr. CALVIN. The New York Stock Exchange and its member organizations have diligently cooperated with the Federal Government in its efforts to alleviate our Nation's balance-of-payments problem. The exchange recognizes that, despite the efforts of both the business community and Government, our balance-of-payments situation remains serious. It pledges continued cooperation in the effort to achieve a solution to this pressing national problem. We believe, however, that ajustmants can be made in the proposed Interest Equalization Tax Extension Act without diluting its impact on our balance of payments. Therefore, the New York Stock Exchange urges the following—I might say at this point I will summarize our points, and not go into detail in each of them:

(1) All outstanding stocks of foreign companies should be exempt from the interest equalization tax: Europeans have been liquidating their holdings of stocks of U.S. companies since the imposition of the IET. This has occurred despite the far better stock market performance here than in Europe. The tax on outstanding stocks of foreign companies has not achieved the objective of improving our balance of payments. The opposite result has occurred. Moreover, elimination of this tax would solve the existing enforcement problems involved in trying to collect the tax on the purchase of outstanding foreign stocks from foreigners.

(2) The tax on new issues of foreign stocks should not be increased. The existing tax rate has been an effective barrier to sales of new issues of foreign stocks here. It will continue to be so. A rate increase would have no practical value, but could further undermine foreign interest in American securities.

(3) If extended, the tax extension should be limited to no more than 1 year. An extension of 1 year would be more in keeping with the original congressional intent that the tax be a temporary one, subject to frequent review. A 1-year extension would permit an early review and assessment of the exemption for outstanding foreign stocks. A longer extension would reduce the pressures for, and postpone the achievement of, long-term solutions to the balance-of-payments problem.

(4) Discretionary authority to make rate changes in the IET should be questioned. Such authority introduces a new element of uncertainty in world capital markets. Its enactment at this time is particularly inopportune, because it may inhibit the growing spirit of cooperation in international financial matters. More fundamentally, the issue of congressional delegation of the authority to change tax rates is so basic, it deserves separate study.

I would like to comment on each of these four points in detail.

Senator McCARTHY. All right.

Mr. CALVIN. No. 1, exemption of outstanding equities. The exchange proposes the exemption of outstanding equities—previously issued stocks of foreign companies—for four reasons.

First, the exchange's basic belief is that the most satisfactory way to close the gap between U.S. capital outflows and foreign capital inflows is not to restrict investment abroad, but to stimulate foreign investment in the United States. This was the situation in international securities markets prior to the interest equalization tax.

Second, capital investment abroad generates the return of even more funds to the United States over the long run. That this is fact, not theory, is demonstrated by the data for 1966. The approximately $3.9 billion outflow of private investments in 1966 was more than offset by private investment income of some $5.6 billion returned to the United States.

Third, the tax on U.S. residents purchasing outstanding foreign stocks from foreigners is difficult to enforce. The proposed increase in the IET would increase the already difficult enforcement problem. On the other hand, the rescission of the tax on outstanding foreign stocks would all but eliminate the enforcement problem.

Fourth, based on the available data, an exemption for outstanding foreign equity securities would not adversely affect our balance of payments and, indeed, may result in an improvement. The exemption is necessary if the securities industry is to mount a successful effort to sell American securities abroad. This stems from the the fact that the very foundation of our international securities market is reciprocity between American and foreign brokers. If one side of this two-way market is blocked, it inevitably has repercussions on the other side. The exchange believes that the Government can take an important step toward free capital markets by exemption outstanding equities from the interest equalization tax, and that this step can play a positive role in the overall balance-of-payments picture.

The International Federation of Stock Exchanges, which is the spokesman for a major segment of the world financial community, issued a resolution last week—this resolution is included in full in exhibit 1, and is summarized in our statement at the top of page 4, so I shall not read it now. It says, in effect, that the Federation regards the United States as the outstanding financial center of the world, and if the U.S. authorities, you gentlemen, think it necessary to prolong this tax, that proposals of exemption be made for all outstanding stocks of foreign companies. Again, that resolution is in full in exhibit 1.

I am now skipping down to after the quote on page 4.

The record of the recent past justifies this view. Between 1950 and 1963, in each year except one (1958), foreigners held more U.S. stocks than they did the year before. Americans also increased their holdings of foreign stocks in 12 of these 14 years. A two-way equities market existed. The net effect of these transactions, exclusive of 1958, which was a special case, as explained in the footnote at the bottom of page 4, was favorable to our balance of payments and, overall, represented a plus of $544 million for the United States.

In each of the 3 full years since the passage of the interest equalization tax—1964–66—foreigners have liquidated holdings of U.S. stocks and Americans have liquidated holdings of foreign stocks. The result of these transactions has been adverse to our balance of payments, to the extent of $376 million. The chart which appears at the top of page 5 shows our favorable balance of payments in all years when it was favorable up until the time of the tax, and it shows our balance of payments in equity transactions as being unfavorable since the imposition of the interest equalization tax.

The U.S. Department of Commerce reached a similar conclusion in an article entitled "Foreign Investments in the United States," an excerpt of which is attached (see exhibit III). Thus, the evidence would indicate that as far as outstanding equities are concerned, the attempt to control American purchase of foreign stocks and yet encourage foreign purchase of U.S. stocks has not been successful.

The variations in the experience of nations covered by the tax, primarily Europe, and those which are exempt, further supports the case for exemption of outstanding equities. Paradoxically, since 1963, countries exempt from the tax have produced a favorable effect on the balance of payments, while stock transactions from those which are fully subject to the tax now contribute to our deficits—rather than surpluses as formerly.

Then there is the chart on page 6 which demonstrates this statement.

Since the IET's impact is aimed primarily at Europe, an examination of transactions in American stocks by Europeans is particularly germane. Overall, Europeans, including the British, took back over $1.5 billion by selling their American stocks in the past 3 years. The reason for that outflow is clear when one understands the reciprocal business arrangements existing in the international securities market. In many situations, the foreign broker receives no direct compensation for transactions in American securities. As an accommodation to his customer, he acts as an intermediary between the customer and an American broker, at times even absorbing administrative costs. In return, he expects his American contact to give him orders for foreign securities. Without such orders, the foreign broker has little incentive to recommend American securities.

Although the unfavorable balance of payments on equities since 1963 has been due in large part to British Treasury liquidations of American stocks by the United Kingdom, this has not accounted for the entire adverse balance. There is in the appendix, exhibit V, a discussion of the impact of these liquidations.

Europeans, excluding the British, have also been liquidating Ameri-

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can holdings, despite stock market conditions which favor investment in American equities. Over the 3-year period 1964-66, American equities have generally outperformed European equities. (Our price decline last year was in line with the trend in most European markets.) While American stock prices were experiencing strong gains, European markets generally were down, as chart 3, at the bottom of page 7, shows.

Despite the relatively favorable American stock price situation, Europe, excluding the United Kingdom, liquidated $432 million worth of U.S. stock holdings from 1964 to 1966. In the 3 full years prior to the IET, 1960 to 1962, these same countries increased their U.S. stock holdings by $632 million. This is demonstrated in exhibit VI in the appendix.

By contrast with Europe, the major target of the interest equalization tax, holdings of U.S. stocks in foreign nations outside of Europe rose $435 million over the 1964-66 period. Canada accounted for about 70 percent of that gain.

One major objection to an exemption for outstanding equities has been that it might be used to circumvent the interest equalization tax by selling new equity issues abroad and then reselling them here. This can be guarded against by designating a period after which outstanding equities would be exempt from the tax.

These, in our opinion, are compelling reasons why this committee should exempt all outstanding stocks from the IET. A special situation in which the reasons for exemption are especially compelling—not only for outstanding stocks, but for all foreign securities—arises when Americans currently holding taxable foreign securities wish to switch to other taxable foreign securities. Those investors already have funds out of the country, they cannot reinvest abroad without subjecting themselves to the IET. In truth, their trading does not figure into the balance of payments at all.

I skip now from the bottom of page 8 to the first paragraph at the top of page 9.

An exemption for outstanding foreign equities would only partially rectify the situation just described. Therefore, the exchange suggests that investment in foreign securities be exempt from the IET if the funds invested are the proceeds from sales of American-owned foreign stocks and bonds. This would help stimulate the two-way market in securities without impairing the balance of payments. It would help encourage foreign securities dealers to sell American securities and foster the Treasury Department's objective of stimulating sales of American securities abroad.

(2) Retention of present rate on new equities: The exchange sees little justification for further increasing the interest equalization tax on new stock issues. At the present 15-percent rate, the tax has been an effective barrier against the sale of new stock issues.

I would then skip from that paragraph through to point 3.

One-year extension of the interest equalization tax: The IET was introduced as a temporary measure to help alleviate pressing balance-of-payments problems. In keeping with that approach, the law should be frequently reviewed. This would be in keeping with the law's

transitory nature and would permit its expiration as soon as practicable. Frequent review would provide continuing incentive to achieve permanent solutions to our balance-of-payments problem.

I would then skip down to page 12 and point 4, discretionary authority. The exchange questions the advisability of the delegation of broad discretionary authority to the administration to change IET rates. Under such an option, rate increases could be instantaneous. A sudden shift in the interest equalization tax rate would have an immediate impact on capital costs. The possibility of such a quick move by the United States would create uncertainty in world capital markets. It could discourage further moves to achieve international coordination and deescalation of interest rates.

In addition to international considerations, the exchange has doubts about the advisability of granting discretionary authority on more traditional grounds. Be it interest equalization or any other tax directly affecting investments, investors need to know the rules under which they operate. Uncertainty about tax rates greatly complicates investment decisions. A flexible tax rate could introduce a new element of speculation in foreign securities dealings and, thus, be an unsettling influence in both international and domestic securities markets.

I skip the next paragraph in the formal text, and resume:

Should a situation serious enough to warrant tax adjustment in the IET develop over the coming months, Congress has demonstrated the ability to act swiftly when required.

In conclusion, the exchange's position on the interest equalization tax is rooted in its longstanding adherence to the principles of free trade and free capital markets. It also reflects the belief that expedients such as the interest equalization tax could do permanent damage to this country's standing as the financial capital of the world.

That belief underlies the exchange's position that the tax be reviewed frequently and eliminated as soon as practicable. Accordingly, the exchange is opposed to a lengthy, 2-year extension. It strongly recommends the exemption of all outstanding stocks. This action would, in our opinion, improve the Nation's balance-of-payments position. It also would provide the basis for a viable two-way market in securities transactions, would stimulate sales of U.S. securities abroad, and would keep open securities trade channels for the day when our capital market is once again completely free. The exchange also points out that the 15-percent tax on stocks has been fully adequate to its task. An increase would have little practical effect but could run the risk of stimulating protectionist attitudes abroad.

The exchange fears that shortsighted actions at this time may reverse the growing international interest in lowering barriers to trade and capital flows. It would be ironic if the United States itself were to take another step that could injure free world markets, which this country has worked so long to nurture.

I then offer, Mr. Chairman, this entire statement of Mr. Funston, president of the New York Stock Exchange, for the record.

Senator McCarthy. Without objection it will be included in the record.

(The statement of Mr. Funston referred to follows:)

STATEMENT OF G. KEITH FUNSTON, PRESIDENT, NEW YORK STOCK EXCHANGE

SUMMARY

The New York Stock Exchange and its member organizations have diligently cooperated with the Federal Government in its efforts to alleviate our nation's balance-of-payments problem. The Exchange recognizes that, despite the efforts of both the business community and Government, our balance-of-payments situation remains serious. It pledges continued cooperation in the effort to achieve a solution to this pressing national problem. We believe, however, that adjustments can be made in the proposed Interest Equalization Tax Extension Act without diluting its impact on our balance of payments. Therefore, the New York Stock Exchange urges the following:

(1) *All outstanding stocks of foreign companies should be exempt from the interest equalization tax.*—Europeans have been liquidating their holdings of stocks of U.S. companies since the imposition of the IET. This has occurred despite the far better stock market performance here than in Europe. The tax on outstanding stocks of foreign companies has not achieved the objective of improving our balance of payments. The opposite result has occurred. Moreover, elimination of this tax would solve the existing enforcement problems involved in trying to collect the tax on the purchase of outstanding foreign stocks from foreigners.

(2) *The tax on new issues of foreign stocks should not be increased.*—The existing tax rate has been an effective barrier to sales of new issues of foreign stocks here. It will continue to be so. A rate increase would have no practical value, but could further undermine foreign interest in American securities.

(3) *If extended, the tax extension should be limited to no more than one year.*—An extension of one year would be more in keeping with the original congressional intent that the Tax be a temporary one, subject to frequent review. A one-year extension would permit an early review and assessment of the exemption for outstanding foreign stocks. A longer extension would reduce the pressures for, and postpone the achievement of, long-term solutions to the balance-of-payments problem.

(4) *Discretionary authority to make rate changes in the IET should be questioned.*—Such authority introduces a new element of uncertainty in world capital markets. Its enactment at this time is particularly inopportune, because it may inhibit the growing spirit of cooperation in international financial matters. More fundamentally, the issue of Congressional delegation of the authority to change tax rates is so basic, it deserves separate study.

NYSE PROPOSALS RE H.R. 6098

(1) *Exemption of outstanding equities.*—The Exchange proposes the exemption of outstanding equities—previously issued stocks of foreign companies—for four reasons.

First, the Exchange's basic belief is that the most satisfactory way to close the gap between U.S. capital outflows and foreign capital inflows is not to restrict investment abroad, but to stimulate foreign investment in the U.S. This was the situation in international securities markets prior to the Interest Equalization Tax.

Second, capital investment abroad generates the return of even more funds to the U.S. over the long run. That this is fact, not theory, is demonstrated by the data for 1966. The approximately $3.9 billion outflow of private investments in 1966 was more than offset by private investment income of some $5.6 billion returned to the U.S.

Third, the tax on U.S. residents purchasing outstanding foreign stocks from foreigners is difficult to enforce. The proposed rise in the IET would increase the already difficult enforcement problem. On the other hand, the rescission of the tax on outstanding foreign stocks would all but eliminate the enforcement problem.

Fourth, based on the available data, an exemption for outstanding foreign equity securities would not adversely affect our balance of payments and, indeed, may result in an improvement. The exemption is necessary if the securities industry is to mount a successful effort to sell American securities abroad. This stems from the fact that the very foundation of our international securities market is reciprocity between American and foreign brokers. If one side of this two-

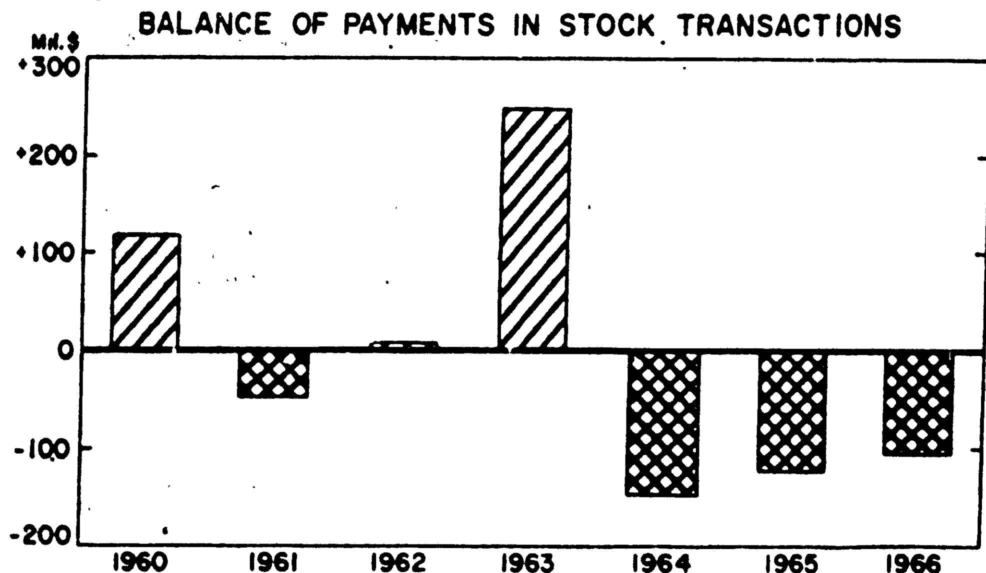
way market is blocked, it inevitably has repercussions on the other side. The Exchange believes that the Government can take an important step toward free capital markets by exempting outstanding equities from the Interest Equalization Tax, and that this step can play a positive role in the over-all balance-of-payments picture.

The International Federation of Stock Exchanges, which is the spokesman for a major segment of the world financial community, issued a resolution last week (see Appendix, Exhibit I) stating, in part, that: "this Interest Equalisation Tax is injuring the efforts made by the free world financial community to further free international capital and securities movement, because it impedes acquiring of foreign equity securities by U.S. citizens and provokes sales of stocks of foreign companies from the U.S.A. to foreigners, as has been clearly shown by the available figures;" and "if U.S. authorities think it necessary to prolong the Tax, exemption be made for all outstanding stocks of foreign companies;" [The Federation] "is hoping that U.S. authorities will decide in accordance to this suggestion which would be in conformity with the U.S. traditions of furthering free international capital flows and with the position of the U.S.A. as the outstanding financial centre of the world."

The record of the recent past justifies this view. Between 1950 and 1963, in each year except one (1958) foreigners held more U.S. stocks than they did the year before. Americans also increased their holdings of foreign stocks in 12 of these 14 years. A two-way equities market existed. The net effect of these transactions, exclusive of 1958, which was a special case,* was favorable to our balance of payments and over-all represented a plus of $544 million for the United States.

In each of the three full years since the passage of the Interest Equalization Tax—1964–66—foreigners have liquidated holdings of U.S. stocks and Americans have liquidated foreign stocks. The result of these transactions has been adverse to our balance of payments to the extent of $376 million (see Chart 1 which follows, and Appendix, Exhibit II).

Chart 1



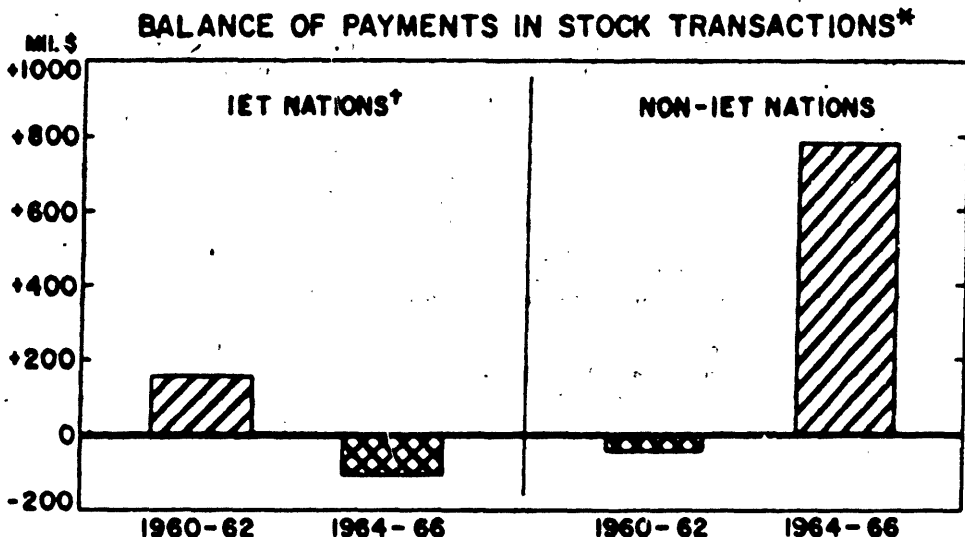
The U.S. Department of Commerce reached a similar conclusion in an article entitled "Foreign Investments in the United States," an excerpt of which is attached (see Appendix, Exhibit III). Thus, the evidence would indicate that as far as outstanding equities are concerned, the attempt to control American

*Temporary capital restrictions were in effect in all West Europe countries except Switzerland in 1958.

purchase of foreign stocks and yet encourage foreign purchase of U.S. stocks has not been successful.

The variations in the experience of nations covered by the Tax, primarily Europe, and those which are exempt, further supports the case for exemption of outstanding equities. Paradoxically, since 1963, countries exempt from the Tax have produced a favorable effect on the balance of payments, while stock transactions from those which are fully subject to the Tax now contribute to our deficits—rather than surpluses formerly (see Chart 2 which follows and Appendix, Exhibit IV).

Chart 2



* Three full years before & after IET. † Data for IET nations exclude United Kingdom.
Source: Treasury Bulletin

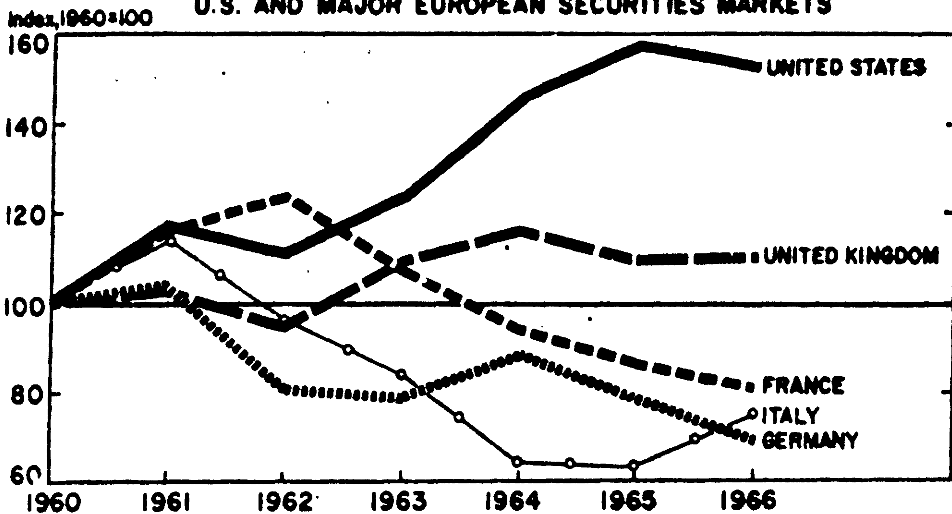
Since the IET's impact is aimed primarily at Europe, an examination of transactions in American stocks by Europeans is particularly germane. Over-all, Europeans, including the British, took back over $1.5 billion by selling their American stocks in the past three years. The reason for that outflow is clear when one understands the reciprocal business arrangements existing in the international securities market. In many situations, the foreign broker receives no direct compensation for transactions in American securities. As an accommodation to his customer, he acts an intermediary between the customer and an American broker, at times even absorbing administrative costs. In return, he expects his American contact to give him orders for foreign securities. Without such orders, the foreign broker has little incentive to recommend American securities.

Although the unfavorable balance of payments on equities since 1963 has been due in large part to British Treasury liquidations of American stocks by the United Kingdom, this has not accounted for the entire adverse balance. (See Appendix, Exhibit V, for a discussion of the impact of these liquidations.)

Europeans, excluding the British, have also been liquidating American holdings, despite stock market conditions which favor investment in American equities. Over the three-year period 1964–1966, American equities have generally outperformed European equities. (Our price decline last year was in line with the trend in most European markets.) While American stock prices were experiencing strong gains, European markets generally were down, as Chart 3 shows.

Despite the relatively favorable American stock price situation, Europe, excluding the United Kingdom, *liquidated* $432 million worth of United States stock holdings from 1964 to 1966. In the three full years prior to the IET, 1960 to 1962, these same countries *increased* their United States stock holdings by $632 million (see Appendix, Exhibit VI).

By contrast with Europe, the major target of the Interest Equalization Tax, holdings of United States stocks in foreign nations outside of Europe rose $435



million over the 1964–1966 period. Canada accounted for about 70% of that gain.

One major objection to an exemption for outstanding equities has been that it might be used to circumvent the Interest Equalization Tax by selling new equity issues abroad and then reselling them here. This can be guarded against by designating a period after which outstanding equities would be exempt from the tax.

These, in our opinion, are compelling reasons why this Committee should exempt all outstanding stocks from the IET. A special situation in which the reasons for exemption are especially compelling, not only for outstanding stocks, but for all foreign securities arises when Americans currently holding taxable foreign securities wish to switch to other taxable foreign securities. Though these investors already have funds out of the country, they cannot reinvest abroad without subjecting themselves to the IET. In truth, their trading does not figure into the balance of payments at all. As a result, many Americans who wish to maintain holdings abroad are locked-in to their existing foreign holdings. This places a special hardship on investment companies and other institutions which, as a matter of investment policy, hold a certain proportion of their assets in foreign securities. Elimination of the lock-in would also work to the benefit of our balance of payments. That is because many investors now locked-in may, after liquidation, decide to switch only part of their holdings and repatriate the rest.

An exemption for outstanding foreign equities would only partially rectify the situation just described. Therefore, the Exchange suggests that investment in foreign securities be exempt from the IET if the funds invested are the proceeds from sales of American-owned foreign stocks and bonds. This would help stimulate the two-way market in securities without impairing the balance of payments. It would help encourage foreign securities dealers to sell American securities and foster the Treasury Department's objective of stimulating sales of American securities abroad.

(2) *Retention of present rate on new equities.*—The Exchange sees little justification for further increasing the Interest Equalization Tax on new stock issues. At the present 15% rate, the tax has been an effective barrier against the sale of new stock issues. The impact of the IET on stock is relatively unaffected by the shifts in money market conditions to which prices of debt issues are tied.

In terms of its effects, the Interest Equalization Tax on bonds and on stocks is really two different taxes. Unlike debt issues, equities are not primarily interest-sensitive. The stock purchaser typically looks for prospective capital

appreciation. Thus, in relation to equities, the Tax is not an "interest-equaliser," but is more like a protective tariff.

The 15% tax on equities has successfully blocked legal foreign equity sales to date, and there is no reason to believe a basic shift in the equity investment situation is in the offing. Therefore, a tax increase, regardless of size, would have no practical value in reducing equity sales. On the contrary, a higher tax would stimulate additional evasion. It may also serve to restrain further moves to free foreign capital markets.

Even more serious, a tax increase could be misread abroad, further undermining confidence in the dollar and, thus, be self-defeating. One very recent example of the extremely strong feeling against the IET in governmental and financial circles abroad is the action taken by the International Federation of Stock Exchanges, which is the spokesman for a major segment of the world financial community. The Federation last week adopted a resolution expressing disappointment in the proposal to prolong the IET for two years and urging an exemption for outstanding stocks of foreign companies, if extension of the Tax is necessary.

(3) *One-year extension of the interest equalization tax.*—The IET was introduced as a temporary measure to help alleviate pressing balance-of-payments problems. In keeping with that approach, the law should be frequently reviewed. This would be in keeping with the law's transitory nature and would permit its expiration as soon as practicable. Frequent review would provide continuing incentive to achieve permanent solutions to our balance-of-payments problem.

An extension limited to one year is particularly appropriate at this time because of possible developments over the next year which conceivably could obviate the need for the Interest Equalization Tax, or at least permit adjustments. Potentially favorable developments are a continuation of the tremendous expansion in international bond issues in Europe; the success of efforts to achieve international coordination of interest rate policies; recovery of the merchandise trade surplus to pre-1966 levels; and the early results of the Kennedy Round tariff cuts. Thus, the Exchange feels it would be appropriate to review the Tax again in 1968, rather than waiting two years.

It is the Exchange's understanding that the voluntary program on the balance of payments and the IET are supposed to complement each other. This impression is confirmed by the reasons for the IET as expressed by the House Ways and Means Committee in its report of March 6, 1967. Among these reasons is that "the tax assures participants in the voluntary program that they are not being asked to assume a disproportionately large share of the burden of eliminating payments deficit by reaching investors who are not under the voluntary program."

This statement would imply that if conditions should warrant the voluntary program "to be moderated or eliminated prior to July 31, 1969," they should also permit moderation or elimination of the IET. Yet, the rationale for a two-year extension is based on a completely contrary view. As expressed by Under Secretary of the Treasury Deming in his statement before the House Ways and Means Committee, the rationale is as follows: "If conditions permit the voluntary cooperation program to be moderated or eliminated prior to July 31, 1969, the interest equalization tax may again have to assume the full burden of restraining excessive capital outflows. It must be adequate for that task." A two-year extension on this basis would be a rejection of the principle that all types of investors should share the burden of reducing the capital outflow.

(4) *Discretionary authority.*—The Exchange questions the advisability of the delegation of broad discretionary authority to the administration to change IET tax rates. Under such an option, rate increases could be instantaneous. A sudden shift in the Interest Equalization Tax rate would have an immediate impact on capital costs. The possibility of such a quick move by the United States would create uncertainty in world capital markets. It could discourage further moves to achieve international coordination and de-escalation of interest rates.

In addition to international consideration, the Exchange has doubts about the advisability of granting discretionary authority on more traditional grounds. Be it Interest Equalization or any other tax directly affecting investments, investors need to know the rules under which they operate. Uncertainty about tax rates greatly complicates investment decisions. A flexible tax rate could introduce a new element of speculation in foreign securities dealings and, thus, be an unsettling influence in both international and domestic securities markets.

The Exchange would also point out that the pending proposal represents a departure from historic Executive-Legislative prerogatives. The issue of discretionary authority is so important that it warrants a separate, intensive study by Congress. This issue should not be disposed of solely on the basis of a possible need for rapid tax adjustment.

Should a situation serious enough to warrant tax adjustment in the IET develop over the coming months, Congress has demonstrated the ability to act swiftly when required.

CONCLUSION

The Exchange's position on the Interest Equalization Tax is rooted in its long-standing adherence to the principles of free trade and free capital markets. It also reflects the belief that expedients such as the Interest Equalization Tax could do permanent damage to this country's standing as the financial capital of the world.

That belief underlies the Exchange's position that the tax be reviewed frequently and eliminated as soon as practicable. Accordingly, the Exchange is opposed to a lengthy, two-year extension. It strongly recommends the exemption of all outstanding stocks. This action would, in our opinion, improve the nation's balance-of-payments position. It also would provide the basis for a viable two-way market in securities transactions, would stimulate sales of United States securities abroad, and would keep open securities trade channels for the day when our capital market is once again completely free. The Exchange also points out that the 15% tax on stocks has been fully adequate to its task. An increase would have little practical effect but could run the risk of stimulating protectionist attitudes abroad.

The Exchange fears that short-sighted actions at this time may reverse the growing international interest in lowering barriers to trade and capital flows. It would be ironic if the United States itself were to take another step that could injure free world markets, which this country has worked so long to nurture.

EXHIBIT I

RESOLUTION OF THE INTERNATIONAL FEDERATION OF STOCK EXCHANGES CONCERNING THE AMERICAN "INTEREST EQUALIZATION TAX"

The International Federation of Stock Exchanges, speaking on behalf of the Stock Exchanges of Austria, Belgium, Denmark, France, Germany, Italy, Luxembourg, the Netherlands, South Africa, Spain, Switzerland and the United States of America:

1. is disappointed by the U.S. Government proposal to prolong the "Interest Equalization Tax" for another two years and to increase its tariffs;

2. does not want to enter upon the question whether a taxation of this kind be necessary with a view to American balance of payments policy because this question cannot be judged by the Federation;

3. nevertheless, would like to state that this Interest Equalization Tax is injuring the efforts made by the free world financial community to further free international capital and securities movement, because it impedes acquiring of foreign equity securities by U.S. citizens and provokes sales of stocks of foreign companies from the U.S.A. to foreigners, as has been clearly shown by the available figures;

4. points out that, on the other hand, the practical experiences and the figures demonstrate that since the Tax has come into force substantial sales of U.S. securities by foreigners to the U.S.A. have taken place equally;

5. thinks it most likely that these latter sales for an important part found their grounds in the decreasing confidence of foreign investors caused by the Interest Equalization Tax;

6. reminds that, so far as such sales outweigh those of stocks of foreign companies from the U.S.A. to foreigners, in this respect the ultimate influence of the Tax on the U.S. balance of payments should be considered as unfavourable;

7. **suggests that, if U.S. authorities think it necessary to prolong the Tax, exemption be made for all outstanding stocks of foreign companies;**

8. **is hoping that U.S. authorities will decide in accordance to this suggestion which would be in conformity with the U.S. traditions of furthering free international capital flows and with the position of the U.S.A. as the outstanding financial centre of the world.**

EXHIBIT II.—*Balance of payments in stock transactions*

[In millions of dollars]

Year	Change in holdings of—		Balance of payments ((−) indicates capital outflow)
	U.S. stock by foreigners	Foreign stock in the United States[1]	
1950	3	24	−21
1951	120	76	44
1952	1	36	−35
1953	55	−7	62
1954	135	252	−117
1955	128	214	−86
1956	256	126	130
1957	143	29	114
1958	−56	336	−392
1959	363	238	125
1960	202	83	119
1961	323	370	−47
1962	111	104	7
1963	198	−51	249
1964	−349	−200	−149
1965	−413	−290	−123
1966	−333	−290	−104

[1] Increases in holdings of foreign stock result in capital outflows, decreases result in capital inflows.

Source: Treasury Bulletin.

EXHIBIT III

[From Survey of Current Business, September 196[illegible] p. 28]

FOREIGN INVESTMENTS IN THE UNITED STATES

The principal feature of foreign investments in the United States since 1964 (other than changes in liquid dollar holdings) *has been a continued net liquidation of U.S. corporate stocks,* more than offset in the first half of 1966 by large additions to foreign holdings of deposits in U.S. banks with maturities of over 1 year and by purchases of various types of corporate and U.S. Government agency bonds. Flows of capital connected with foreign direct investments in the United States have been erratic and relatively small.

Net sales of corporate stocks rose to nearly $0.5 billion in 1965 and were over $0.1 billion in the first half of 1966. *These represent mainly the reduction of holdings of the United Kingdom Government, but sales have also been recorded for other European countries.* In contrast, Canadians have been net purchasers of U.S. equity securities, and in the second quarter of this year raised their net acquisitions to nearly $100 million.

For most of the period from 1962 to the early months of 1966, the U.S. market for corporate stocks was stronger than most foreign markets, but it failed to attract foreign investors. This contrasts with a persistent inflow for investment in these securities averaging $150 million per year in the 1951–62 period. It seems likely that the intensive demand in Europe for investment funds has diverted this flow into European debt instruments or the Euro-dollar market.

In 1965 and the first half of 1966, purchase of U.S. bonds by foreigners were substantial, but this reflected rather special circumstances. In 1965, net purchases of U.S. corporate bonds by European countries (other than the United

Kingdom, which was liquidating bonds acquired in 1964) amounted to about $150 million. However, that total includes purchases by foreigners of nearly $200 million of debentures and bonds issued by the newly organized U.S. financing affiliates of direct-investment companies, so that foreigners were apparently selling other U.S. corporate bonds. Some of the sales of U.S. equity securities by Europeans in 1965 mentioned above may also have been for the purpose of investing in these new issues. In the first half of 1966, European countries (other than the United Kingdom) purchased a net amount of $405 million of U.S. bonds. Since these purchases included about $475 million of securities issued by the special financing affiliates, there was evidently a continuing liquidation of other U.S. corporate bonds. Purchases of $187 million of U.S. bonds by international institutions in the first half were largely U.S. agency issues.

Another new development in 1965, which continued into 1966, was the acquisition by foreigners of long-term (over 1 year) certificates of deposit or other obligations of U.S. banks. These acquisitions amounted to a net of $230 million in 1965 and about $400 million in the first half of 1966 (excluding any United Kingdom transactions).

EXHIBIT IV.—*Effect of stock transactions on the U.S. balance of payments by geographic area, 1960–66*

[In millions of dollars]

	1960-62	1963	1964-66
World	79	249	−377
Europe	72	161	−1,193
United Kingdom	−111	212	−1,114
Europe, excluding United Kingdom	183	−51	−80
Canada	19	135	673
Latin America	−16	9	50
Rest of world	4	−56	84
Countries exempt from IET	37	93	790
IET countries [1]	42	156	−1,148

[1] Nonexempt countries are Europe, Japan, South Africa, and Australia.

Source: U.S. Treasury Bulletin.

EXHIBIT V

IMPACT OF BRITISH TREASURY SALES OF AMERICAN SECURITIES ON TOTAL BRITISH LIQUIDATIONS

The impact of liquidations of American securities by the British Treasury on total British liquidations of U.S. stock is indeterminable from the data available to us. However, these data do not support the position that the British Government liquidation of American stocks has obscured an accumulation of American stocks by private British residents.

All told, from the time the British Treasury started liquidating its portfolio in the early 1960's (a precise date is not available) through 1965, it sold $884 million of securities, including bonds as well as stocks.

In the two years 1964 and 1965 combined, liquidations of American stocks held in Great Britain totaled $575 million. From the size of this liquidation, it would have to be assumed that most of the British Treasury sales of stock during the 1960's took place in the two years 1964 and 1965 if one is to conclude that British residents were accumulating stock.

Furthermore, the downward trend in British gross purchases of American stocks since 1963 does not seem to support the thesis that British nationals have been accumulating American stocks. Since 1963, British gross purchases of American stock have been almost halved. The totals for recent years were as follows: 1963—$741 million; 1964—$638 million; 1965—$547 million; 1966—$385 million.

EXHIBIT VI.—*Net European transactions in U.S. equity securities 1960–62, 1963, 1964–66*

[Acquisitions (liquidations) in millions of dollars]

	1960–62	1963	1964–66
Great Britain	$93	$197	$1,099
Rest of Europe	632	31	432
Total Europe	539	166	1,531

Source: U.S. Treasury Bulletin.

Senator McCARTHY. Senator Williams.

Senator WILLIAMS. Mr. Calvin, to what extent have we been handicapped in this law either through loopholes or the abuse of the law, the exasion? Do you think it has been rather widespread?

Mr. CALVIN. No, I do not think it has been that widespread, Senator Williams.

Senator WILLIAMS. I noticed that you say the exchange points out that the 15 percent tax has been fully adequate. Do you think the existing law, as it is written, is adequate to do the job, if it is going to be extended?

Mr. CALVIN. Well, if you are talking about the——

Senator WILLIAMS. The potential loopholes in it.

Mr. CALVIN. The loopholes at the present time—I think the situation that has developed, as Mr. Surrey testified on Friday, indicate that the law has not been adequate to the task of having people comply with the interest equalization tax.

Senator WILLIAMS. Did this abuse or possibility of abuse become—was it called to the attention of the exchange or were you people aware of it prior to it being exposed——

Mr. CALVIN. Yes, we were.

Senator WILLIAMS. When did the exchange first become aware that the existing law was not adequate to deal or cope with this problem?

Mr. CALVIN. Well——

Senator WILLIAMS. I mean approximately when?

Mr. CALVIN (continuing). My problem in answering is that we did not view it from the standpoint as to whether the law was adequate or not.

Senator WILLIAMS. I understand.

Mr. CALVIN. We became aware that there may have been problems under existing law a number of months ago. From what I have been told, this would have been back some time in probably May of this year. It may have been also earlier than that, but this is the date that I have heard.

Senator WILLIAMS. To your knowledge was the Treasury Department aware of it at that time or doing anything about it?

Mr. CALVIN. Well, what we have done is—I would assume, and I would have to assume this, that they were aware of it. I go back beyond that, and I would say I remember participating in a meeting going back a number of years ago, which involved at that time a possible evasion problem under the tax. This was, I think, the case that led to the indictments that have been discussed here from time to time.

We, the exchange, I think, have been not only diligent in this area, but we have tried to be as cooperative as possible with the Treasury and the Internal Revenue Service, and we have offered to them, as we always do in these matters, our full cooperation.

Senator WILLIAMS. I was not suggesting criticism of the exchange. After all, it is not your duty to enforce the law.

Mr. CALVIN. No, I realize that.

Senator WILLIAMS. I am just trying to establish when the potential loopholes were discovered by the Treasury and whether or not they were loopholes or just a weakness in the law.

I think we would both agree any law which is put on the books which cannot be enforced or which is not enforced is worse than no law at all.

Mr. CALVIN. Well, we would add something further to that, Senator. We think, and this is the whole point of our statement, that the objective here is to improve our balance of payments.

The interest equalization tax on outstanding foreign securities has not done that, and it has created an enforcement problem, as was discussed on Friday. And, as I am sure you well know, this is not a tax measure, but a regulatory measure. And it has not succeeded in that area, in our opinion.

Senator WILLIAMS. Have you reviewed the recommendations of the Treasury as they were submitted here this morning, their amendments—are you familiar with those?

Mr. CALVIN. With the amendments, or their attachment A?

Senator WILLIAMS. The amendments. They have sent down a recommendation for, I think it was, about 16 pages of amendments to the House bill which supposedly will close potential loopholes. Are you familiar with those recommendations?

Mr. CALVIN. Yes, we are familiar with those recommendations.

May I tell you what has been happening since Friday on this, for your interest?

Senator WILLIAMS. Yes.

Mr. CALVIN. Friday, we had a messenger present in this room to receive a copy of Mr. Deming's statement, so that he immediately could hand-carry it back to New York, so that our people could review this, knowing it would become effective soon. And, as you know, it was proposed to become effective this morning.

This messenger arrived in New York at 12:30 on Friday, and since that time our top staff people and our counsel have been at the New York Stock Exchange almost continually—that is, Friday, Saturday, and all day yesterday, until late last night and early this morning.

We have discussed with the Treasury staff those changes in procedures which they have mutually worked out, changes in those procedures to make the system workable—or more workable, at the least. So we are well aware of what has been going on.

In addition to that, our board, the Board of Governors of New York Stock Exchange, had a special meeting this morning at 9 o'clock, to consider whether it was at all possible to commence trading in the foreign issues on the New York Stock Exchange. They have decided by telephone, I am told, as a result of changes that were made and as a result of the changes that the Treasury will be suggesting, I under-

stand, making certain suggestions for the balance of this week, so we could open trading in those issues this morning, and that has been done by our office.

Senator WILLIAMS. Do I understand you to say that there have been changes in the recommendations which we have received this morning as compared with the recommendations that they made in the room here last Friday?

Mr. CALVIN. I have not seen the recommendations that you are talking about this morning. What I am saying is that there have been changes that have been made, to my knowledge, in the recommendations that were made on Friday.

Senator WILLIAMS. That is what I mean. The Treasury has changed its mind or changed its recommendations somewhat since Friday, since they testified Friday, is that correct?

Mr. CALVIN. On the procedures, on attachment A.

Senator WILLIAMS. Would their changes be of substance to affect the tax liability in certain circumstances?

Mr. CALVIN. They are not that type of change. They are changes so that these new procedures can be more effective.

Senator WILLIAMS. They are procedures only?

Mr. CALVIN. It is procedures only.

Senator WILLIAMS. Now, if these recommendations of the Treasury are accepted, do you think that they would effectively close any potential loopholes in this law or can you still use potential evasion or avoidance—I won't call it evasion. Do you think there is a way that they could still get around this law?

Mr. CALVIN. That is difficult for me to answer for a number of reasons. First of all, I would think that if the incentive is great enough, from a dollars and cents standpoint, people can exercise great ingenuity. This would still be a difficult law to enforce.

I cannot say that these procedures will stop all possible evasion. What we do say—and what we feel strongly, and we have told this to the Treasury recently, and again in this statement this morning—is that we think the thing to be done is to exempt outstanding equities. This will eliminate the enforcement problem and, at the same time, will accomplish the result that is intended, and that is to improve our balance-of-payments position.

Senator WILLIAMS. Well, if we passed the law and then exempted equities, all you would have left is the debt, is that not correct?

Mr. CALVIN. We would have the debt obligations and the new issues.

Senator WILLIAMS. And the new issues.

Mr. CALVIN. And there has not been, to our knowledge any evasion problem in these areas.

Senator WILLIAMS. In the absence of the Senate approving that exemption which you are recommending, assuming that they decided to proceed along the lines that the Treasury is recommending, do you think that the law would be enforceable in its present form as it is presently before us in the last revision or do you think there would still be this potential or large-scale avoidance on the part of those who seek such loopholes in the law?

Mr. CALVIN. I would have to say that in my opinion the potential would still exist, particularly if you are going to double the tax rate.

Senator WILLIAMS. I was going to ask that again. The increase in the rate would make that more attractive.

Mr. CALVIN. The incentive would be greater, from a dollars and cents standpoint.

Senator WILLIAMS. And it would be your thought that even the latter recommendations of the Treasury Department would still leave this possibility where this avoidance could continue; is that correct?

Mr. CALVIN. I would have to say so, in my opinion, sir.

Senator WILLIAMS. Would you or could you furnish us a hypothetical case of how it could be avoided even though under these new regulations or would you care to do that?

Mr. CALVIN. I do not think I can do that, because I am giving you this opinion, that it can be avoided, just based upon the facts of the situation.

Here is a tax that is not intended to be a revenue-producing measure. It is intended to help our balance of payments. You are dealing with foreigners who are outside the jurisdiction of the United States. You are dealing with a possibility of a substantial increase in the dollar incentive if there is an increase in the rates. And I am talking about these general factors, not any specific scheme that I or anyone else can see, but just the fact that the general climate or situation is such that evasion would be possible, and enforcement would still be difficult.

We at the New York Stock Exchange, however, have told the Treasury and IRS we are willing to do whatever we can, everything that we can, to help deal with this problem and to turn over all information we have—what has happened in the past, and anything that develops in the future.

Senator WILLIAMS. Yes. No further questions.

Senator MCCARTHY. Senator Bennett.

Senator BENNETT. No questions.

Senator MCCARTHY. Mr. Calvin, these five or six grand jury indictments that have been issued, do any of them involve firms that are in the stock exchange or are they all over the counter? Have the indictments reached the stock exchange at all?

Mr. CALVIN. In those cases involving the indictments, as I recall, they do not involve members of the New York Stock Exchange.

I would also like to say, in responding to your question, that in the current cases being discussed, and information that we have concerning these matters, that they do not involve member organizations of the New York Stock Exchange, and they do not involve New York Stock Exchange-listed issues, or issues listed on any other stock exchange. These are over-the-counter securities, and the only way that members of the New York Stock Exchange have become involved is just through their regular commerce in securities.

In the case of over-the-counter securities, our members in most cases are the primary market makers in those over-the-counter securities.

Because of that, most transactions will ultimately flow through our member firms. And from the inquiries and investigations that we have made, and from the information we have received from the Treasury, there is no indication at all that member firms of the New York Stock Exchange have been involved or have participated in these schemes, and definitely not knowingly.

Senator McCARTHY. Regarding these transactions that you had no knowledge of, at what point would the stock exchange be involved? You are not involved in the conspiracy but involved in the marketing or resale process, whatever might take place. At what point might these securities reach the stock exchange?

Mr. CALVIN. Well, first, the only securities that are traded on the New York Stock Exchange are those that are listed there.

Now, from the information we have, and we have told this to Treasury, to our knowledge there is no involvement at all in NYSE-listed issues. The stocks that have been involved here have been over-the-counter securities that are not listed on any stock exchange. There may have been some isolated transactions in our issues, but we are not aware that this was the involvement, the thing involved here.

Senator McCARTHY. The Wall Street Journal story on the 30th of June describes the process of how the foreign stock is purchased abroad and then sold to a small securities firm which must be a member of the National Association of Securities Dealers; that is right, is it not?

Mr. CALVIN. That is true.

Senator McCARTHY. Then this stock is sold in the open market. What is that open market? Is that just the regular over-the-counter?

Mr. CALVIN. You see, here you are talking about an over-the-counter security.

Senator McCARTHY. Would it have to be an over the counter? Why could it not be a security that might be traded on the exchange? Why is it that none of these securities happen to be involved here?

Mr. CALVIN. Well, first of all, there are only 18 foreign stocks that are listed on the New York Stock Exchange.

Senator McCARTHY. It was just an accident that they are not?

Mr. CALVIN. No. But these are high-quality securities. You are talking about KLM, Royal Dutch. These are, I think you could say, the top foreign securities in the world.

Senator McCARTHY. Yes.

Mr. CALVIN. Now, these people, of course—and it is just like anything else—the controls that they exercise, the procedures that they follow, go beyond what is the ordinary case in a security that does not have that type of market, and a company that does not have that stature.

Senator McCARTHY. Yes. But what I mean is, is it incident to the nature of the security itself?

Mr. CALVIN. In addition to that, it is also incident to the nature of the market.

Senator McCARTHY. Yes, but not formal in any way. It is a condition of the market or a condition of the security that keeps it from being involved in this bootlegging or smuggling process?

Mr. CALVIN. Yes.

Senator McCARTHY. It might be theoretically possible that stocks could go through this process and also be handled on the exchange?

Mr. CALVIN. Yes, it is possible.

Senator McCARTHY. There is no formal obstacle for this.

You suggest an exemption for old securities. Would it not be possible for new issues to become old after one transaction? They do after one transaction, don't they?

Mr. CALVIN. Well, they become outstanding, you mean?

Senator MCCARTHY. Yes. They are then outstanding and they would be old.

Mr. CALVIN. This is something that we think could be solved by definition of "outstanding."

Senator MCCARTHY. You think so?

Mr. CALVIN. Yes, sir.

Senator MCCARTHY. The first issue might be sold and the new issue might be sold overseas and then it would become an old issue. You think that could be handled by regulation?

Mr. CALVIN. There are a number of ways we feel this could be handled, so that you could have an exemption for an outstanding foreign equity security which would not open up new issue being made abroad, and then sold in the United States to the detriment of our balance of payments.

Senator MCCARTHY. What is your overall view of the interest equalization tax; do you think it has done more harm or good or done so little good that it would be better to get rid of it?

Mr. CALVIN. No; in our statement here—the statement of the New York Stock Exchange, Mr. Funston's statement—we are not opposing the extension of the interest equalization tax. There is no doubt that the tax has aided our balance of payments.

What we are suggesting, by this proposed exemption for outstanding foreign equity securities, is that we feel that this is a way that the tax can be—the impact of the tax can be—improved. That is to say, that we can improve our balance of payments. So we are not advocating repeal of the tax at this time. We are not opposing the tax at this time. We are making these four comments that I have read to you this morning.

Senator MCCARTHY. Is that in the spirit of going along with the administration, the public image of the exchange, or does it reflect your basic economic judgment?

Mr. CALVIN. I would say a combination of both.

Senator MCCARTHY. I thought I read some propaganda in your statement about how much confidence you had in the Congress' ability to react quickly when called upon to do so. Do you really have that confidence, especially in view of the time it took us to work on the investment tax credit this year?

Mr. CALVIN. But there have been other examples, where the initial stages of that——

Senator MCCARTHY. Give me a couple of good examples.

Mr. CALVIN. They have stood out.

Senator MCCARTHY. I was further impressed—do you think Congress ought to ask for changes in the rediscount rate also instead of leaving that up to the discretion of the Federal Reserve Board?

Mr. CALVIN. That is something I am not competent to comment on.

Senator MCCARTHY. That has an effect on capital. Your confidence in the Congress does not go that far?

Mr. CALVIN. I have confidence in the Congress——

Senator MCCARTHY. To act quickly on all issues?

Senator BENNETT. Like the current railroad strike.

Senator McCARTHY. Like the present railroad strike.

At this point I want to include in the record the Treasury Department's letter with reference to the modifications of it, Attachment A which you have already described.

Senator WILLIAMS. Mr. Chairman, I do not believe the Wall Street Journal articles and the Journal of Commerce article have been put yet in the record, and if not, I ask that they be put in the record.

Senator McCARTHY. Without objection.

(The articles referred to follow:)

[From the Wall Street Journal, June 30, 1967]

"STOCK-TAX DODGE"—U.S. FEARS MANY SKIRT 15% LEVY ON PURCHASES OF FOREIGN SECURITIES—SHARES INVOLVED MAY TOTAL $1 BILLION A YEAR; CRIMINALS SEEN PROFITING BY PRACTICE—COLLEGE BOYS, SKID-ROW BUMS

(By Lee Silberman and Norman C. Miller, staff reporters of the Wall Street Journal)

An intensive Government investigation is turning up strong evidence that a tax on purchases of foreign evidence by Americans is being evaded on a gigantic—and still growing—scale.

The scheme is complex. It involves dummy accounts in Canada and England, skid-row derelicts, college boys and probably the Mafia. Government officials now suspect the evasion has been going on ever since the 15% tax was enacted in September 1964 to slow the flow of dollars out of the U.S., and they say that it now involves annual stock purchases totaling $250 million to $1 billion.

Thus, the Government is being gypped out of about $40 million to $150 million in taxes a year, assuming the purchasers would have bought the stock legally had the illegal opportunities not existed. In addition, international rings of crooks are taking as their cut some $15 million to $60 million a year.

Top officials of the Treasury Department and the Internal Revenue Service have known that the tax was being evaded to some extent from the very start. But for reasons that can best be described as bureaucratic bumbling, Washington officialdom has until recently been ignorant of the size of the fraud.

IS WALL STREET INVOLVED?

Officials still don't know for sure who is masterminding the operation, though Canada appears to be the main center for the illegal activity. One investigator says the scheme is so complex it rivals "a medieval cathedral in magnificence of size and design." And it is said that some Wall Street securities concerns aren't necessarily innocent dupes. It's believed that some traders for big-name firms are at least condoning—if not fostering—the practice, though they remain within the letter of the law themselves.

The tax itself is simple. The law merely provides that if an American buys a foreign security from a foreigner, he must pay a 15% levy to the Government to deter the outflow of dollars caused by his transaction. If he buys the same foreign-company shares from an American, though, he needn't pay the tax—because the dollars involved in the transaction theoretically don't leave the country.

The question, though, is how can the Government tell if a seller of the foreign shares is an American or a foreigner. The Treasury, after conferring with the securities industries, decided that foreign stocks sold by an American had to be accompanied by a "certificate of American ownership," signed and attested to by the seller.

HOW THE SCHEME WORKS

And that's where the crooks come in. They obtain the blank affidavit forms (which are readily available at most of the 60 IRS offices) and then solicit signatures from drunks, derelicts and anyone else needing the $10 to $35 that the crooks are willing to pay.

Then they buy the foreign stock abroad—where it sells cheaper than it does in the U.S. because of the tax—and attach the affidavits. The crooks then sell these shares, at, say, an 8% to 10% markup, to small securities firms in the United States. These firms, which must be members of the National Association of Securities Dealers in order for the scheme to work, then sell the stock in the open

market in the U.S. at a price equivalent to the going price in the U.S. Their profit is the difference between the slightly cut rate they paid the crooks for the stock and the U.S. market price.

The securities firms apparently have no trouble reselling the shares to other brokers specializing in foreign stocks. The law provides that only the first American securities firm buying American-owned foreign securities must receive the affidavit. A subsequent purchaser, if a securities firm, doesn't need the affidavit so long as the selling firm is a member of the NASD, which regulates over-the-counter trading.

ENTER THE BIG NAMES

Here is where the big-name securities houses enter the picture. Many traders know which little houses have hot supplies of what stocks, so they can—and, apparently, often do—just phone these little houses and place their orders at the market price or, perhaps, just a shade below it.

Why would a big trader order from a small, unethical house? The answer: Because he is assured of a supply for which he and his firm don't have to bother with the documentation. He receives the stock on a "clean confirmation" basis.

The affidavits are kept on file by the little securities firms that buy the stock from the crooks. When and if the Government audits these firms, it checks the names on the slips to see if these people paid the tax, which is known formally as the interest equalization tax. The person signing the slip—not the brokerage—is responsible for paying the tax. The U.S., however, has a slim chance of collecting millions of dollars from derelicts. Or from the college boys who signed phony papers while on vacation in Nassau not so long ago. Or from the $4,800-a-year American milkman in Canada who regularly sells his signature.

It would seem that even the little securities firms are within the letter of the law. But that isn't necessarily so. Some of these firms are knowingly buying the stock with the phony affidavits, and they thus are as vulnerable as the suppliers of the affidavits.

They may be more vulnerable, in fact. Even if investigators finally penetrate the maze of screens protecting the masterminds, it is doubtful they will be able to prosecute them. Members of the ring aren't violating the laws of Canada or other countries where they find Americans willing to sign.

Moreover, foreign authorities have little reason to sympathize with the U.S. The interest equalization tax is widely despised by other governments because it has almost choked off their access to new capital in the big New York money market.

"We find ourselves in a very difficult position," says John B. Doran, a commissioner of the Quebec Securities Commission. "There are known undesirables in this scheme, and we don't like that. But we might be criticized (by fellow Canadian politicians) if we showed concern for the enforcement of another country's law." Nonetheless, Canadian authorities and stock exchange officials say they have brought informal pressure on their brokers to turn down suspicious business.

A KEY MAN VANISHES

The whole thing leaves U.S. authorities in a muddle. About all they can do is periodically audit the files of small securities firms suspected of cheating. If they find an inordinate number of "affidavits," they can investigate further. That's what is happening increasingly, and they are turning their findings over to a Federal grand jury in New York.

But so far there have been only two indictments. Last December four men were indicted for evading more than $7 million of taxes in foreign stock—but the key figure in that indictment has vanished. In February 1966, an indictment was handed up against Stone, Ackerman & Co., a New York over-the-counter firm, charging the invasion of $522,160 of taxes. The firm and two cited officials deny the charges.

There are maneuverings on the selling side that are just as complex as those on the buying side. The Canadians or others who sell the stock to the small U.S. securities firms get their own supplies through dummy accounts in various nations. These dummy accounts, which are used to conceal the identity of the real buyer, purchase the shares on various markets throughout the world.

Vast sums of money are required to finance these purchases. Since the criminals behind these dummy accounts understandably prefer not to deal with banks, they frequently turn to loan sharks. Although the identity of the loan sharks isn't known, it is assumed they have Mafia ties.

LOST IN THE BUREAUCRACY

Ironically, top officials of the Treasury and Internal Revenue Service believed for some time that the interest equilization tax was working smoothly precisely because they were not collecting much revenue. In more than three years, only $54 million in taxes was paid by Americans buying foreign securities from foreigners, and officials tended to regard this low total as evidence that they had succeeded in discouraging purchases.

The warnings sent repeatedly to Washington by investigators in the field apparently were lost in bureaucratic pigeonholes. For one thing, IRS officials, many of whom don't understand the intricacies of the stock market, simply didn't grasp the potential for profiteering by evasion.

At the Treasury, officials were concerned with the balance of payments, and the tax seemed to be working for their purposes. So they ignored warnings signs. Workers at the Securities and Exchange Commission possessed the stock market savvy—but they lacked direct jurisdiction over tax problems.

Now that the dimensions of the evasion scheme finally have caught the attention of top-level officials, their underlings are struggling into action in all-but-desperate attempts to avoid taking the rap.

THE OPPOSITE EFFECT

Ironically, the tax law so far has had just the opposite effect on stocks of what was intended. It has actually worsened the U.S. deficit in the balance of payments. When the tax was first enacted, the price of many foreign-owned stocks fell 15% below the price of the same stocks held by Americans, reflecting the new tax.

But as the crooks began to flood the U.S. market with foreign stocks bought at the discounted foreign price but intended for sale at the higher U.S. price, the U.S. price of these stocks began to fall, too. In effect, the price differential became whatever the crooked suppliers thought the traffic would bear. At the moment, it generally is 8% to 10%.

This lower price, coupled with a general decline in stock prices abroad, has made some foreign stocks look like bargains to U.S. investors, so they have been turning increasingly to them—sending their money outside the U.S. and hurting the balance of payments. Federal officials who keep track of the balance of payments—which is the difference between the amount of money the U.S. spends, lends and gives away abroad and the amount it takes in from foreigners—have been bewildered by the international securities figures.

After three quarters in which Americans had been net sellers of foreign securities, in this year's first quarter they become net buyers. Of course, it is impossible to say to what extent this change has been prompted by the tax-evading scheme.

ADDING TO THE PROBLEM

Government officials have unwittingly prompted an increase in the evasion in recent months. The House has passed an Administration-sponsored bill that would increase the tax to 22½% from 15% and the Senate has been expected to approve the increase routinely. Under the House bill, the rise would be retroactive to Jan. 25.

The differential between the U.S. and the foreign prices of some stocks has widened in recent months on the assumption the bill will be passed. This has allowed the illegal suppliers to increase their markup—and take more money out of the U.S.

[From the Wall Street Journal, July 3, 1967]

CONGRESS SEEMS LIKELY TO CHANGE TAX LAW ON FOREIGN STOCK PURCHASES BY AMERICANS

(By a Wall Street Journal Staff Reporter)

WASHINGTON.—Congress seems almost certain to change the law imposing a tax on foreign stock purchases by Americans as part of the Government's attempt to halt massive and increasing evasion of the 15% levy.

The evasion scheme, disclosed last Friday, is believed by Government investigators to involve annual stock purchases totaling $250 million to $1 billion.

International rings of criminals that control the scheme are pocketing $15 million to $60 million a year, authorities believe, and the tax loss to the Government is even higher.

Treasury officials refuse to confirm that the fraud has reached the dimensions described by other Government sources. But they concede that evasion of the so-called interest-equalization tax is substantial, and say its very likely that the Administration will ask Congress to change the law in an effort to reduce tax-evasion opportunities.

The Administration's recommendations probably will be announced at Senate Finance Committee hearings tentatively slated to start next week. Meantime, an intensive backstage debate about the nature of the recommendations is in progress.

DIFFERENT OPINIONS

Treasury officials appear determined to continue the tax on all purchases of foreign securities by Americans from foreigners because they consider it an important element of the Administration's overall program to slow a flow of dollars from the U.S. However, officials of the Internal Revenue Service hint they think it would be best to drop the tax altogether as it applies to outstanding shares of foreign companies, retaining it only for new issues of foreign stock and debt obligations. IRS officials indicate it may be almost impossible to enforce the tax on outstanding foreign-company stock regardless of what changes are made in the law.

Basically, the opportunity for illegal profiteering by tax evasion arises because shares of many foreign stocks have cost less in markets in other countries than they have in the U.S. since the enactment of the 15% interest-equalization levy in September 1964. In complex transactions, criminals operating through dummy accounts in the U.S. and other countries buy cheaper shares on foreign markets and then sell them in the U.S., accompanied by false "certificates of American ownership," at higher prices than the stocks command here without such certificates.

Selling the stocks with such certificates exempts the legitimate purchaser here from payment of the 15% tax. The presumption of the law is that the person selling a foreign stock with such a certificate has paid the tax when he acquired the stock. But the crooks have found it easy to manufacture false certificates of American ownership and evade the tax. Their profit in such a deal is the difference between the lower price the stock sells for in foreign markets and the price they get in the U.S.

HARD SCHEME TO STOP

U.S. authorities say that under current law they are almost helpless to stop the evasion scheme. The criminals are operating from other countries where they aren't breaking the law. Their operations in this country apparently haven't been curtailed by an intensive U.S. Government investigation of the scheme during the past few weeks.

"The stakes are high and the offenders haven't been scared off by any means," states Donald Bacon, an assistant IRS commissioner. Government officials say that tighter controls must be placed over certificates of American ownership of foreign stocks in order to curb evasion. As it stands now, there isn't any effective way to tell whether the Americans signing these certificates actually have owned the stock and paid the tax on it. There had been some talk within the Government of changing the law so that banks and brokers would be required to countersign the certificates as a guarantee that individuals actually have owned the stock.

But it's questionable whether these proposals will be recommended to Congress. Such changes, one official remarks, would be sure to provoke strong protest from the banking and securities industry.

A Treasury official says the Administration will work closely with the securities industry in developing legislative recommendations.

SECURITIES INDUSTRY VIEW

Judging by their past positions, representatives of the securities industry are likely to urge that the tax be dropped completely for outstanding shares of foreign companies. This view is supported, for different reasons, by some Gov-

ernment officials. They fear that even with changes in the law, crooks would find new ways to evade the tax.

Congress approved the tax in the first place only after a great deal of complaining and it's possible that it might go along with proposals to exempt outstanding foreign-company stock. The initial reaction of one member of the tax-writing House Ways and Means Committee to news of the fraud, was that the entire levy might have to be dropped.

The 15% interest-equalization tax is due to expire on July 31 but the House already has approved an Administration bill that would extend the tax and increase it to 22½% retroactive to Jan. 25. It's that legislation that the Senate Finance Committee will have before it when it opens hearings next week.

The tax also applies to foreign debt obligations sold to Americans; there has been little or no known evasion of the levy on those securities.

[From the Journal of Commerce, July 5, 1967]

TAX CREDIT LOOPHOLE PLUG SOUGHT

(Washington Bureau)

WASHINGTON, JULY 4.—A grim Treasury Department will ask Congress on Thursday of next week to close a major loophole in the interest equalization tax and unless all signs are misleading, will push hard also to get a Justice Department crackdown on IET avoidance that has already occurred.

When it does it will face a battle with the securities industry which is arguing that the part of securities trading where a new upsurgence of avoidance has occurred, in outstanding securities as distinguished from new issues, should be exempted from the tax on the ground that the levy is unworkable in this sector.

TREASURY DISAGREES

The Treasury disagrees—very firmly. "This isn't going to be like prohibition," says one department aide.

On the other hand, the avoiders of the tax, enacted to prevent a balance of payments drain by reducing lending to foreigners by making the purchase of foreign securities more expensive, have been very successful at it. This gives rise to industry claims that the tax has been avoided so widely as to have broken down. New York reports have put avoidance at $250 million to $1 billion.

Treasury sources snort that these figures are "grossly exaggerated." But in fact neither it nor its tax-gathering arm, the Internal Revenue Service, are well enough versed in the market to be sure. They have just started a crash self-education program with the help of the Securities and Exchange Commission.

As of now, the department hopes to have ready by July 13 its proposed amendments to close the loophole and Treasury Undersecretary Frederick Deming will present them at that time to the Senate Finance Committee.

On the following day the industry will get its chance to testify. The Finance Committee is considering a bill to amend the existing legislation to extend its IET for two years and to empower President Johnson to vary its effective rate from the existing 1 per cent to 1½ per cent.

DOUBLED INCENTIVE

Though it isn't clear for certain, it appears that when on Jan. 25 the President asked for power to vary the rate between zero and 2 per cent effective that date and put investors on notice the rate would be levied at 2 per cent from Jan. 25 until enactment the problem of avoidance began to worsen. By raising the tax cost from the previous 1 per cent to 2 per cent, the administration doubled the incentive to avoid or criminally evade payment.

There had been sporadic reports of avoidance schemes from New York ever since the IET was first enacted back in 1964, resulting in a couple of indictments. But by February of this year the situation was such that IRS agents started an intensive investigation. That probe has been rushed to completion so that the fruits of it could be embodied in new amendments . . . it is believed to have been the digging of IRS agents which led to recent publication of the matter.

The avoidance or evasion scheme usually requires some kind of connivance by a securities dealer. Consequntly, Capitol Hill observers were speculating over the holiday that the Treasury's proposals for closing the IET loophole would hinge in some way on obtaining the assistance of brokerage houses in policing the working of the securities tax law.

Mr. CALVIN. May I clarify one statement I made? I said earlier that member organizations of the New York Stock Exchange were not involved in the tax evasion schemes. They have been involved to the extent that some of those transactions have flowed through these firms. By that I mean, as I am sure you understand, that they have not been knowingly involved, but they have not been a knowing party or a principal in these transactions.

Senator MCCARTHY. Thank you very much. We will keep the record open until Wednesday of this week. This is the end of the formal hearing.

(Whereupon, at 11:40 a.m., the committee adjourned.)

(By direction of the Chairman the following are made a part of the record:)

BANKERS' ASSOCIATION FOR FOREIGN TRADE,
New York, N.Y., May 23, 1967.

Hon. RUSSELL B. LONG,
U.S. Senate,
Washington, D.C.

DEAR SIR: Enclosed is a copy of the policy statement adopted by this Association at its annual meeting on April 26, 1967. Also enclosed is a copy of a letter of the First National Bank of Minneapolis which describes in some detail the concern of many banks throughout the United States about the effect that the governmental restrictions have on their ability to finance foreign operations, including exports of American goods and services.

The Association recommends this policy statement to your attention and I am at your entire disposal if you would like to discuss any of the points raised in greater detail.

Respectfully yours,

ALFRED H. VON KLEMPERER, *President.*

STATEMENT OF THE BANKERS' ASSOCIATION FOR FOREIGN TRADE

STATEMENT OF PRINCIPLES AND RECOMMENDATIONS ADOPTED AT THE ANNUAL MEETING, PALM SPRINGS, CALIFORNIA, APRIL 26, 1967

The members of the Bankers' Association for Foreign Trade at their annual meeting on April 26, 1967 hereby resolve to express themselves in favor of the following principles and policies and recommend them to the Directors and Officers of the Association for careful consideration and implementations during the coming year.

GOVERNMENTAL RESTRICTIONS

We express our grave concern about the continuing trend towards restrictions on International Capital Movements, in particular as they relate to the foreign lending operations of commercial banks in the United States. These restrictions are now beginning to impair the growth of international banking in the United States and the role of the United States as the leading financial center of the world. They are reducing the benefits of these operations to the U.S. balance of payments and the national interest. We believe that this problem must be faced by the United States Treasury and the Federal Reserve Board in the immediate future if we want to prevent the United States from gradually sliding into an increasingly complex network of restrictions. *Once these restrictions have been permitted to take root they will stifle the creative forces of international banking that have historically created important and lasting sources of foreign income to the economics of countries with large financial centers.*

We stress in this connection that bank loans to foreigners create a dependable and early reflow of funds to the United States because they are made typically to

borrowers of the highest credit worthiness and are subject to rapid and regular amortization. Nevertheless, foreign bank loans have been burdened with a disproportionately heavy share of the U.S. balance of payments effort. The point has now arrived where continued and increased restrictions on bank loans—going beyond measures insuring merely against an uncontrolled growth in their volume—result in a net loss to the U.S. balance of payments. We urge careful consideration of these factors and we request our Officers and Directors to seek cooperation with the U.S. Treasury and the Federal Reserve Board in working out solutions that make possible maximum continued growth of international banking without detriment to the national interest.

There are, in particular, two types of restrictions on foreign lending on which we would like to comment, as follows:

Voluntary Restraint Program

We shall continue our full co-operation with the Federal Reserve Board's Voluntary Restraint Program on foreign loans and investments. We regret—for psychological as much as for practical reasons—the tightening of this program last December which had an uneven and arbitrary effect on the position of individual banks and which occurred at a time when actual conditions did not clearly require such tightening. We urge that the administration of these regulations be flexible and subject to continuous review—in co-operation with the banking industry—in the spirit that this is an emergency program justified only when it is clearly required by the U.S. balance of payments position.

The usefulness to our balance of payments of EXPORT FINANCING, involving both the developed and developing countries, has been emphasized by the National Export Expansion Council and by all sectors of the government and has justified an unprecedented volume of loans to DEVELOPED countries by the Export-Import Bank during the past year.

Recommendation

From the above paragraph, it is clearly logical and equitable to give the commercial banks full opportunity to participate in this effort by permitting them to exclude their export loans from the restrictions of the Voluntary Credit Restraint Program. The present inclusion of these loans within the Guidelines is impairing the expansion of export financing and promotion, in particular by the smaller banks throughout the country. We are encouraged to make this strong recommendation by the conviction that this step would be an important part of an effective balance of payments effort of the United States. In the area of export promotion, the services of the commercial banks are essential and they are co-operating extensively. If the Guidelines continue to discourage them from participation the entire national effort will be impaired.

Interest Equalization Tax

We reiterate the Resolution passed at our meeting last year in which we recognize the utility of the Interest Equalization Tax as a temporary expedient for balance of payments reasons. This tax imposes serious restrictions, which are sometimes artificial and arbitrary, on the normal business of commercial banks. We again urge that the tax should be retained no longer than is absolutely necessary to assist the balance of payments objectives of the United States. If the President receives the power under H.R. 3813 to reduce the rate of the tax by Executive Order, we urge that this be done to the maximum possible and as soon as the balance of payments situation warrants such reduction.

BALANCE OF PAYMENTS AND INTERNATIONAL LIQUIDITY

We reiterate the Resolution at our Convention last year that we advocate financial policies in the United States which assure confidence in the value of our money and which will restore exchange equilibrium so as to avoid the disruption of international trade and finance caused by exchange restrictions or devaluations. *With respect to International Liquidity, we strongly support the effort of the U.S. Government to study, evaluate, and put into effect measures looking towards the sound enlargement of international means of payment.*

FOREIGN INVESTORS TAX ACT

We welcome the action of the Congress and the Administration, through the Foreign Investors Tax Act, which makes the foreign branches of American banks more competitive with foreign banks by classifying interest paid by such

branches as foreign source income and by exempting from Interest Equalization Tax certain loans made by them. At the same time we believe that the imposition by this Act of federal inheritance and income taxes on foreign-owned deposits in the United States is untimely and undesirable and should be reversed. The imposition of these taxes will drive foreign deposits out of the United States to the disadvantage of the U.S. balance of payments and will damage the competitive position of American banks, particularly the many which have no foreign branches. At the same time these taxes should have little if any success in achieving the purposes for which they were created, i.e., to attract foreign investment to the United States and to create equity in taxation of residents and nonresidents. The reports by congressional committees on the delayed effective date of these new taxes express a desire for further review. We urge that this review be commenced promptly and be carried out with full consideration of the balance of payments effect of these taxes. We request the Officers and Directors of our Association to participate actively in this review.

REGULATION "M"

We believe that the amended provisions of Regulation "M" of the Federal Reserve Board will be helpful to American banks in broadening their operations abroad. The development of new and flexible methods and channels of operations is one of the important aspects of international banking at this time where there are continuous changes in the traditional ways of doing business and where the opportunities for developing new forms of international business are particularly bright.

EXPORT-IMPORT BANK OF WASHINGTON

We welcome the various improvements in the Export-Import Bank's program of guaranteees for export financing that were announced at our Meeting last year and have since been put into effect. We request our Officers and Directors to continue and deepen their contacts with Eximbank's Directors and Staff and, in particular, urge that they emphasize the importance of policies that permit the maximum participation of commercial banks in export financing, in recognition of the important role of the banks in developing U.S. exports. Despite the fact that the return of greater monetary ease restores the capacity of commercial banks for export lending, additional refinements in the Export-Import Bank's program as to procedures, interest rate ceilings, and the rediscount facility will be required. We request our Officers and Directors to co-operate with the Export-Import Bank and other Washington agencies in studies aiming at a privately financed exports finance corporation to tap the resources of the private capital market for jet aircraft and other capital goods exports.

ACCEPTANCE FINANCING

We ask our Officers to continue our study of Bankers' acceptances and their role in the financing of domestic and international trade, in co-operation with the Federal Reserve Bank of New York which has been asked by the Federal Reserve Board to undertake a study similar to our own.

REGULATION OF FOREIGN BANKING IN THE UNITED STATES

A number of Bills are pending in Congress, including one sponsored by Senator Javits in 1966, that address themselves to the Regulation of Foreign Banking in the United States. These Bills could affect individual members of our Association in different ways and we do not take any position on this legislation at present. Foreign banking activities in the United States have had for many years a strong and beneficial effect on the development of international financial skills in the United States and are a welcome addition to the activities of the American banks. We hope that this situation will continue and that it will be paralleled by maximum opportunities for the operation of U.S. banks in the countries whose banks operate in the United States. In devising new legislation, the greatest care should be taken to assure that traditional systems of banking supervision in the United States should not be violated for the mere purpose of systematizing the regulation of foreign bank activities. We hope that any new legislation that may be passed will be administered in a spirit of liberality and with the forebearance expected of a nation with our role of leadership in the international financial community.

DOCUMENTATION IN INTERNATIONAL TRADE

We welcome the proposed establishment of the National Committee on International Trade Documentation or other similar national group which will concern itself with the serious problem of the volume and complexity of the various forms of documentation required by all organizations and entities involved in the domestic and international movement of trade.

INTERNATIONAL TRADE

We welcome the recent agreement between the Departments of State and Commerce aiming at an upgrading of the services available to U.S. business at our embassies abroad.

EAST-WEST TRADE

We support any action that would facilitate EAST-WEST TRADE within the framework of our national security and economic self-interest, favoring those nations which by their course of conduct evidence a desire to improve their relations with us. We continue to support the principles of the Export Control Act which embargoes shipments of goods or technology to unfriendly countries if these items make a significant contribution to their military or economic potential and are detrimental to our national security and welfare. We feel that the actions taken by the Export-Import Bank last year in providing short and medium term guarantees for export loans to Eastern European countries will be useful in developing trade with these areas. We oppose any restrictions on such guarantees, provided they cover trade based on the above principles.

FOREIGN AID

We recognize that one of the most pressing problems of our times is the relationship between economically advanced and prosperous nations and those which are in the process of development. Nations that enjoy abundance cannot ignore the plight of many unfortunate people living in poverty and hunger and we acknowledge the grave need of those people for assistance. We commend the generous spirit which has motivated our government in extending aid to the developing countries in the past and applaud its encouragement of the private sector to make mutually beneficial investments and loans in these areas to increase production. However, we have grave doubts about the effectiveness of many aspects of our aid program and we question whether our assistance has always reached the people who were in the greatest need of it. We urge that it should be a condition of our aid programs that recipient nations make every possible effort to help themselves and create the basic economic and social conditions without which our aid will not result in lasting benefits. By combining in our aid-giving effort moral principles with a reasonable amount of self-interest, the effect of our assistance and its benefits to the recipients and to ourselves, can be many times the amount contributed by us. We recognize and applaud the spiritual values which exist in many less affluent countries and urge that, in our aid effort, we take special care that these values be preserved and honored.

WILLIAM F. RAY, *President,*
Bankers Association for Foreign Trade.

FIRST NATIONAL BANK OF MINNEAPOLIS,
Minneapolis, Minn., April 19, 1967.

Mr. ALFRED VON KLEMPERER,
Chairman, Resolutions Committee, Bankers' Association for Foreign Trade, Palm Springs, Calif.

DEAR FRED: We would like to add our whole-hearted support to the resolutions being proposed for the BAFT meeting April 26, 1967. We are particularly pleased to see a strong resolution showing concern about the restrictions on foreign lending under the Voluntary Restraint Program. Perhaps if I outlined to you our situation here in Minneapolis, our feelings will be more easily understood.

First, as I am sure you know, international trade, and the financing that accompanies it, has historically moved through East Coast facilities, principally New York. Recently, however, many interior banks such as ourselves have grown large enough to handle international business on a direct basis and are anxious to do so. Not only does it strengthen their position with their domestic

customers, but it can be a source of profits. Also, the banks provide badly needed local service and advice for manufacturers who want to export but are not large enough to switch their export activities to a coastal city. The exporting helps local companies expand their markets and in turn foreign deposits and investments are often attracted to the region. Together it helps build stronger and more active business communities in the interior of our country.

Although we have had an active international department for many years, it was in 1964 that our general management undertook in earnest to expand credit facilities for international transactions. Shortly, in fact almost immediately after this, the President's Voluntary Program was announced and, in effect, almost stopped us before we began.

Our base under the guide lines now amounts to approximately $4,000,000. This represents less than 1% of our bank's total loan portfolio during the last year, and a substantial part of it is tied up in operating balances in accounts we maintain overseas. When you consider the size of most overseas loans, this leaves us very little room to do any so-called foreign lending. Compared to a conservative estimate of the annual volume of regional goods and services moving into foreign trade (approximately $900,000,000) our allotment together with the other banks in the Ninth Reserve District is hardly significant.

Although the guide lines have been a strong limiting factor, we have expanded our international activities. However, outside of the Export-Import Bank and FCIA, our loans have had to be almost entirely limited to advances made to domestic customers to help them carry foreign export paper themselves. Naturally, this curtails their own borrowing ability with us for other purposes. The larger companies don't like this and in most instances prefer to leave their lines with us unencumbered for more volatile domestic needs. In these cases they either refuse to sell on extended terms or send the international financing to one of the New York or West Coast banks where they have unused lines.

I am sure that you understand this since we have talked about it at length and better still you and others in New York have helped us place financing or arrange loans through your main office or overseas branches.

Of course, we do arrange financing through Exim or FCIA. Although both institutions have been very helpful to us, recourse to their programs is not always easy or successful. Also, the guarantee fees and premiums do raise the effective rate. As for direct lending to our foreign banking correspondents (to support their trade activity in this area), it has been practically impossible.

Despite the restrictions, we have and, I am sure, will continue to provide excellent local service for handling collections, letters of credit, and foreign exchange. However, this is just the gravy of international trade and we cannot set a full table without the necessary loan and deposit relationships which are after all the meat and potatoes of this business. A loan portfolio and resulting deposit activity are the real source of bank income and profits. Without the ability to expand in this area, no inland bank can attract or pay adequate staff to provide good international services.

If the Voluntary Program must remain, we would like to see modifications that would give the interior banks a chance to substantially increase our participation in foreign financing. This allowance might be based on a percentage of foreign trade in a region or it might be based on the bank's total assets. It is true that the present allowance based on past activity is a just and fair one and rewards best those who have struggled longest. However, it is one that frustrates the growth and development of good banking facilities in the areas where exports and international trade are just beginning to become important.

Our senior management firmly believes that this is a vital growth area for both ourselves and our customers, and we are willing to devote a substantial part of our time and capital to its development. In this respct I am sure there are many other banks throughout the interior who feel the same.

Fred, I am sorry to have written so much but you did say you wanted to know my feelings and there they are.

With kind regards,

WILLIAM F. OGDEN, Jr.

MONTREAL, P.Q., CANADA,
July 5, 1967.

DEAR SENATOR: I am an American citizen and teach at McGill University. In accordance with New York State law, I vote from my mother's address at 907 5th Ave., New York City.

I am writing about the Interest Equalization Tax and would like to make the following points:

1) An increase to 22½% would be ruinous. I bought Unilever N.V. and Philips N.V. in 1963, and I am sure that one reason they have gone down is the 15% tax.

2) Both Canada and Quebec have a surtax on American dividend income (and a dividend credit on Canadian income.) Thus, it seems that I have to pay extra taxes either way, and it is hard to build up savings.

3) Since I am investing Canadian and not American dollars, I feel that one should be permitted to invest 20% of his income (foreign earned) in stocks of the country where he works. Important

With many thanks for your kind attention.

MICHAEL WOLOCH.

LAW OFFICES, LEE, TOOMEY & KENT,
Washington, D.C., July 12, 1967.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The following statement is submitted for the consideration of the Committee on Finance in connection with the hearings on H.R. 6098, the Interest Equalization Tax Extension Act of 1967.

We suggest that § 4915(a)(1) of the Internal Revenue Code be amended so as to permit the tax-free acquisition by a domestic or foreign financing subsidiary of wholesale and retail paper arising out of the sales of products manufactured or assembled by an affiliated domestic or foreign company.

1. BACKGROUND

American businesses operating abroad increasingly encounter the need to provide sales financing to the wholesale and retail customers of their foreign manufacturing, assembly and sales subsidiaries. Absent the availability of favorable financing terms, the foreign operating subsidiaries cannot compete effectively in foreign markets. Although American investments in foreign manufacturing, assembly, and sales subsidiaries are exempt from the Interest Equalization Tax ("IET"), investments in foreign financing subsidiaries which finance the sales of products manufactured or assembled by affiliated foreign companies run a substantial risk of incurring IET at a prohibitive 15 percent rate. This is an unreasonable and illogical result which the enactment of the suggested amendment would alleviate.

2. EXISTING STATUTORY FRAMEWORK

The basic problem is presented by the undue restrictiveness of § 4915(a)(1) of the Internal Revenue Code, the so-called "direct investment" provision, which provides an exclusion from IET for acquisitions "of stock or a debt obligation of a [10% or more owned] foreign corporation, or of a debt obligation from [such] foreign corportion which received such obligation in the ordinary course of its trade or business as a result of the sale or rental of products *manufactured or assembled by it*." [Emphasis added.] Under this provision, a domestic corporation can acquire wholesale and retail paper from a foreign subsidiary free of tax only if such subsidiary itself manufactures or assembles the product sold. Likewise, if a foreign financing subsidiary acquires commercial paper arising from sales of products of affiliated companies IET applies as the result of the "formed or availed of" tax avoidance exception of § 4915(c)(1) of the Code.

3. ILLUSTRATIVE EXAMPLE

Unfortunately, modern day business activities abroad cannot be easily compartmentalized. Not every foreign affiliate manufactures or assembles a complete line of products. The following facts represent a typical pattern of integrated foreign operations: Let us assume that A is the U.S. parent, which has foreign subsidiaries B, C, and D, located in England, France and Germany respectively. B manufactures or assembles light tractors and agricultural implements and accessories; C manufactures or assembles heavy tractors and other types of implements. In addition to selling its own products, B also sells those manu-

factured by C. C sells its own products and those manufactured by B. D does not manufacture or assemble, but sells only products manufactured by B and C. Under existing law, A, the U.S. parent can acquire debt obligations from B arising from sales of B's products, but acquisitions of debt obligations from B arising from sales of C's products are subject to tax. If C sells its own products, no IET results if A finances such sales; on the other hand, A's financing of C's sales of B's products results in IET. Of course, under present law, A cannot finance any sales of D without tax.

Since A does not come within the direct investment exclusion with respect to paper arising from sales of products manufactured by related entities, A cannot organize a foreign financing subsidiary to accomplish the same purpose without incurring tax since the "formed or availed of" tax avoidance exception of § 4915(c)(1) of the Code would apply. This is an illogical result which we believe was not considered when the IET was first enacted.

4. REASONS FOR EXPLANATION OF PROPOSED AMENDMENT

It is clear that in the illustration just given A could invest in stock or debt obligations of subsidiaries, B, C, and D without incurring tax, even though such funds were utilized by these foreign manufacturing, assembly, and sales subsidiaries to "self-finance" their sales and as leverage for additional borrowings from foreign banks for sales financing purposes. This result is clearly supported by legislature history which states that if the foreign subsidiary "actively engages in the conduct of a business other than a securities business and acquires debt obligations as an incident of such business, it is not considered to be availed of for the proscribed purpose." H. Rep. No. 1046, 88th Cong., 1st Sess. 52–53 (1963).

If, then, A can invest tax free in B, C, and D in order to finance their sales, logically A should be permitted to invest in X, a foreign financing subsidiary, the principal purpose of which is to finance the sales of B, C and D. There is no justificaton for disparate treatment and the purely business motivated formation of a centralized financing subsidiary would make a positive contribution to the balance of payments position because of the increased borrowing power and greater profiability resulting from the concentration of management expertise and decreased borrowing costs.

The effect of the proposed amendment is to permit acquisitions by a domestic corporaton of wholesale and retail obligations arising out of the sale by an 80% or more owned foreign subsidiary of products manufactured or assembled by the same foreign subsidiary or by other 80% or more owned foreign subsidiaries to come within the direct investment exclusion of § 4915(a)(1) of the Code. By permitting such acquisitions by a domestic corporation, it will automatically follow that similar acquisitions by a foreign sales financing subsidiary will not give rise to IET consequences.

5. PROPOSED AMENDMENT

We accordingly propose that § 4915(a)(1) of the Internal Revenue Code be amended to read as follows (new matter in italics):

(a) *In General.*—(1) *Excluded Acquisitions.*: Except as provided in subsections (c) and (d) of this section, the tax imposed by section 4911 shall not apply to the acquisition by a United States person (A) of stock or a debt obligation of a foreign corporation, or of a debt obligation from a foreign corporation which received such obligation in the ordinary course of its trade of business as a result of the sale or rental products manufactured or assembled by it *(or by one or more includible corporations in an affiliated group—as determined under section 48 (o) (3) (C) except that clause (i) of such section shall not apply—of which such acquiring corporation is a member)* or of the performance of services by it, if immediately after the acquisition such person (or one or more includible corporations in an affiliated group, as defined in section 1504, of which such person is a member) owns (directly or indirectly) 10 percent or more of the total combined voting power of all classes of stock of such foreign corporation, or (B) of stock or a debt obligation of a foreign partnership if immediately after the acquisition such person owns (direcly or indirectly) 10 percent or more of the profits interest in such foreign partnership. For purposes of the pre-

ceding sentence, stock owned (directly or indirectly) by or for a foreign corporation shall be considered as being owned proportionately by its shareholders, and stock owned (directly or indirectly) by or for a foreign partnership shall be considered as being owned proportionately by its partners.

4. CONCLUSION

We submit that foreign subsidiaries which finance the sales of affiliated companies abroad are essential to continuing competitiveness of American industry in the international market. Investments in such financing subsidiaries comply with the substantial ownership, management participation and long-range profit motivation factors on which the direct investment provision is founded. To distinguish between sales financing activities on the one hand, and manufacturing, assembly and sales operations on the other, is unreasonable and illogical. Sales financing of affiliated companies' products should certainly be entitled to the same benefits of the direct investment provision.

For these reasons we respectfully urge the amendment of § 4915(a)(1) of the Internal Revenue Code in the manner indicated above.

Respectfully submitted.

LEE, TOOMEY, & KENT,
By THOMAS E. JENKS.

JULY 8, 1967.

Subject: Hearings on proposed extension of interest equalization tax law.

COMMITTEE ON FINANCE,
U.S. Senate,
Washington, D.C.
(Attention: Mr. Tom Vail, Chief Counsel).

DEAR MR. VAIL: Thank you for sending me your Press Release of July 3rd.

As I am unable to come to Washington at the time of these hearings, I am sending you enclosed my written statement for consideration by your Committee and your record.

I hope that the situation described will find fair consideration at long last.

I would be grateful if you would have a copy of the printed record of the hearings mailed to me.

Sincerely yours,

GEORGE REINHARDT.

STATEMENT OF GEORGE REINHARDT, NEW YORK, N.Y.

UNJUST APPLICATION OF INTEREST EQUALIZATION TAX LAW

Summary:

(1) The loose wording of the law makes it applicable to funds which never were U.S. funds.

(2) Definition: my own case.

(3) Refusal by the Ways and Means Committee of the House of Representatives to consider remedial action. Reference to cases that have no bearing on the matter.

(4) A simple and practical method to administer the necessary exemption.

(5) Protection of long-term nonspeculative foreign investments has always and everywhere been regarded as of prime interest for a country.

EXPLANATION OF SUMMARY

(1) The stated purpose of this law is the restraint of the outflow of U.S. funds. According to a communication from the Ways & Means Committee, House of Representatives, the law has, furthermore, the implied purpose to cause the return of these funds to the U.S.

The law is so loosely and vaguely worded that its full force applies also to funds of U.S. persons which were never U.S. funds. This causes intolerable hardship to the owners of such funds and, over the long term, damage to the U.S. balance of payments.

(2) While stationed with the U.S. Army in England during World War II, I married. My wife, British-born and of British nationality, owned some British securities and, since the war, has come into possession of some further securities

by inheritance. All dividends and capital gains derived from these British investments since our return to the U.S. in 1946 have been duly reported in our Income Tax returns. Far from sending dollars to England for investment, most of the dividend income and some capital has been brought from England to this country in these years.

The enactment of the above law has meant severe hardship: it has resulted in a virtual embargo on any securities sales and re-investments as required from time to time by prudent foresight; and in tax payments at the rate of 15 percent on those few re-investments that had to be made.

(3) I have drawn the attention of the Ways and Means Committee of the House of Representatives to this ludicrous consequence of the loose wording of the law, but have found no willingness to understand or to redress this situation.

I was referred to "hardship" cases submitted to and denied by the Committee which were clearly connected with funds taken out of the U.S. at one time or another. And, when first submitting the matter in 1965 through my Congressman, I was referred to "the difficulty of administering such an exemption."

(4) There is no difficulty in administering cases of this kind. If the wording of the law cannot be rewritten to exclude entirely funds of this kind from its application, then there is the following simple and practical way for effective administration of the necessary exemption:

All acquisitions of foreign stock by a U.S. person remain subject to reporting on the Interest Equalization Tax Returns.

Acquisitions made with proceeds of foreign stock or with foreign funds in the possession of the tax payer before first enactment of this law, or inherited by him since that date from a foreign person, are to be reported under a separate heading for non-taxable acquisitions.

Reporting on signed tax return forms will preclude evasions and loopholes and will enable Internal Revenue to request the taxpayer at any time to prove these criteria.

(5) Long-term, non-speculative foreign investments of private citizens have always been regarded as the most reproductive and valuable assets of a country. It is utterly incomprehensible why this law takes a position diametrically opposed to this old-established principle and, in addition, leads to injustice.

NEW YORK, N.Y., *April 3, 1967.*

Subject: Extension of the Interest Equalization Tax Law.

Hon. RUSSELL B. LONG,
Chairman, Finance Committee, U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: I am sending you enclosed certain correspondence with the Committee on Ways and Means of the House of Representatives.

The issue involved is stated in my letter of February 13th, 1967, to Chairman Mills.

The Law, as it is now worded, encompasses cases such as mine which have nothing whatever to do with the stated purpose of the Law: restraint of the outflow of U.S. funds and the return of such funds to the U.S.

The application of this Law to cases such as mine, caused by its all too broad and general wording, represents hardship and injustice. The Ways and Means Committee has, so far, evaded the very clear issue (see their letter of March 13th and my reply of March 31st).

I hereby lodge respectfully a strong appeal to your Committee for the required action before enacting the pending extension of this Law.

Sincerely yours,

GEORGE REINHARDT.

NEW YORK, N.Y., *March 31, 1967.*

Subject: Interest Equalization Tax Law.

COMMITTEE ON WAYS AND MEANS,
House of Representatives,
Washington, D.C.
(Attention: Mr. Leo H. Irwin, Chief Counsel).

DEAR SIR: This is to acknowledge receipt of your letter of March 13th in reply to the letters of February 13th and March 3rd addressed by me to the Chairman of your Committee.

Your letter implies refusal of my request that this Law be now properly worded so as not to extend to matters entirely unrelated to its stated purpose. You refer me in this connection to cases that are irrelevant to the issue submitted to you, to wit:

> Objections raised by taxpayers in connection with certain investments of U.S. funds in Canadian securities; or that
>
> The tax might cause funds located outside the U.S. to be returned, which would be favorable to the balance of payments problem and, therefore, in accordance with the underlying purpose of this law.

Your above references evade the clear issue of funds that were not derived from U.S. funds nor ever located in the U.S. It is preposterous to speak of a "return" of funds which have never been here, not to speak of the forcible compulsion referred to above but never stated by the legislature.

I must therefore repeat my request that this Law before its extension be so amended that it does not extend to foreign re-investment of the proceeds of foreign securities owned by taxpayers before the original enactment of this Law.

I am sending copies of this correspondence to the Senate's Finance Committee for its own deliberations and for consideration with your Committee before enactment of the pending extension of this Law.

Sincerely yours,

GEORGE REINHARDT.

NEW YORK, N.Y., *February 13, 1967.*

Subject: Interest Equalization Tax.

Hon. WILBUR MILLS,
Chairman, Ways and Means Committee,
U.S. House of Representatives, Washington, D.C.

DEAR CONGRESSMAN MILLS: Once more I go on record with a strong objection to a certain consequence of this Law, which has nothing whatever to do with its purpose. I respectfully request that, before its imminent extension by the Congress, provision be made to remedy the injustice and hardship resulting from the present wording of the Law.

The clear purpose of the Law is to restrain the outflow of U.S. funds.

My case concerns the application of the full force of this Law to securities for the acquisition of which no U.S. funds were ever required or used. In plain English, these securities are not "U.S. funds".

While stationed with the U.S. Army in England during World War II, I married. My wife, British-born and of British nationality, owned some British securities and, since the war, has come into possession of some further securities by inheritance. All dividends and capital gains derived from these British investments since our return to the U.S. in 1946 have been duly reported in our Income Tax returns. Far from sending dollars to England for investment, most of the dividend income and some capital has been brought from England to this country in these years.

The enactment of the above Law has meant severe hardship: It has resulted in a virtual embargo on any securities sales and re-investments as required from time to time by prudent foresight; and in tax payments at the rate of 15% on those few re-investments that had to be made.

When the Law was enacted I referred the Treasury Department and Mr. J. V. Lindsay, then Congressman of this District, to this unjust extension of the purpose of the Law, due only to its wording. Both replied in a sympathetic but negative vein (see copies enclosed).

The problem is purely administrative. I am convinced that the required exemption could be administered in a very simple and foolproof way as far as the purpose and full enforcement of the Law are concerned. As I see it, nothing could be simpler than to make these foreign-securities purchases subject to quarterly reports on signed and sworn Internal Revenue forms. It would be the duty of the taxpayer to prove to the authorities, any time they might demand it, that he possessed the foreign funds used for these purchases prior to a certain key date or that he inherited them since.

Several major exemptions of the Law have been made for large-scale dollar investments abroad by various economic and financial interests. Why, then, refuse the above exemption which, but for the present wording of the Law, would be unnecessary? It is a gross injustice to apply it to matters entirely unconnected with its purpose, thereby causing hardship to taxpayers never associated with dollar investments abroad.

Respectfully yours,

GEORGE REINHARDT.

COMMITTEE ON WAYS AND MEANS,
HOUSE OF REPRESENTATIVES,
Washington, D.C., March 13, 1967.

Mr. GEORGE REINHARDT,
New York, N.Y.

DEAR MR. REINHARDT: Chairman Mills has requested me to respond to your letter dated March 3, 1967, in which you have expressed the opinion that the interest equalization tax should not be applicable under the facts related in your earlier letter of February 13, 1967.

Your letter of February 13, 1967, was referred to the Committee on Ways and Means for consideration during the hearings held on February 15 and 16, 1967. I am enclosing a copy of those hearings and call your attention to pages 197 to 203. These pages contain a presentation to the Committee of the problem of purchasing foreign security investments with funds already outside the United States on September 2, 1964.

The suggested amendments in this area were not adopted by the Committee. In the hearings before the Ways and Means Committee on the Interest Equalization Tax Extension Act of 1965 on June 22, 1965, your problem came up very briefly during Secretary of the Treasury Fowler's testimony. Assistant Secretary of the Treasury Surrey stated that the Treasury Depatment meant the tax to apply under circumstances similar to yours, and Secretary Fowler stated that the applicability of the tax to such a situation might cause the funds located outside the United States to be returned. Such return, of course, would be favorable to the balance of payments problem and, therefore, in accordance with the underlying purpose of the interest equalization tax.

Sincerely yours,

LEO H. IRWIN,
Chief Counsel.

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., February 9, 1965.

Mr. GEORGE REINHARDT,
175 East Seventy Ninth Street,
New York, New York 10021

DEAR MR. REINHARDT: I was distressed to read your letter describing the effect of the Interest Equalization Tax. I strongly opposed many sections of the Revenue Act of 1962—including the equalization tax—as ill-conceived and poorly executed. I hope you will take the time to read the enclosed statement made when the bill was under consideration.

But now that the bill has passed you are, as far as I know, without a remedy. An amendment to the act to exempt people in your situation has little chance of passage; such a proposal was made when the bill was first under consideration, and was rejected—partly because of the difficulty of administering such an exemption, but largely because it would imbue United States funds abroad with two different effective values: some subject to tax, and some not.

Because of this dual-value argument, I can offer you little hope—only sympathy. I'm sorry not to be able to be of more assistance, but hope you will understand.

Best wishes.

Sincerely,

JOHN V. LINDSAY.

U.S. TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
Washington, D.C., November 16, 1964.

Mrs. ROSAMOND REINHARDT,
New York, N.Y.

DEAR MRS. REINHARDT: This is in reply to your letter of November 2, 1964, requesting information with respect to the application of the interest equalization tax to investments made with foreign funds.

Section 4911 of the Internal Revenue Code of 1954 imposes the interest equalization tax on acquisitions of stock or debt obligations of foreign issuers or obligors. The Interest Equalization Tax Act provides several exemptions and exclusions, none of which would seem to be applicable to the acquisitions which you

describe. The source of the funds used in making the acquisitions is not the basis for any exemption or exclusion. Also, the fact that the acquisition will not add to our balance of payments deficit is not the basis for any exemption or exclusion.

In acting upon the Interest Equalization Tax Act, Congress did not provide any mechanism for differentiating between foreign funds, which never have been within the United States, and United States' funds. While not unmindful of your problem, we must stay within the meaning of the language enacted by Congress in handling each acquisition.

We hope this information will be helpful to you.

Very truly yours,

L. H. SCHWEICHHARDT.
Chief, Corporation Tax Branch.

STATEMENT OF ROBERT H. BROME, SENIOR VICE PRESIDENT AND GENERAL COUNSEL OF BANKERS TRUST CO., NEW YORK, N.Y.

SUMMARY

I would like to propose to the Committee a technical amendment of the Interest Equalization Tax by adding a new paragraph (4) to section 4915(c) of the Internal Revenue Code to make it clear that foreign investments made with foreign source assets by foreign subsidiaries will not impose Interest Equalization Tax liability upon the United States parents of such subsidiaries. In other words, when a foreign subsidiary of a United States corporation sells its bonds or other securities overseas and uses the proceeds to acquire investments abroad, the proposed amendment would make it clear that such acquisitions do not subject the United States parent to Interest Equalization Tax liability.

STATEMENT

The Interest Equalization Tax, as you know, is designed to aid our balance of payments position by restraining the demand on our capital market. The Committee on Ways and Means of the House of Representatives in its original report on this bill (House Report No. 1046, 88th Cong. 2nd Sess., at p. 8) stated:

> The tax * * * is a part of the broader attack on the balance-of-payments problem * * * it is anticipated that as the capital markets in other industrialized countries abroad become more efficient and are freed from controls, they will supply a larger share of the world's capital requirements.

In 1965, when the Congress last extended the Act, it provided for several exclusions to the otherwise broad scope of the tax on the grounds that the transactions involve use of foreign source assets and did not, therefore, adversely affect our balance of payments. These include: (1) the exemption for certain foreign branch acquisitions on the ground that such transactions are carried out with foreign currency deposits of the foreign depositor (see H. Report No. 602, 89th Cong., 1st Sess., at p. 17); (2) the exemption for certain loans made by foreign branches of United States financing companies on the grounds that they could be expected to be financed out of foreign funds (ibid, p. 28); and (3) the inclusion of deposits of foreign banks with foreign branches of United States banks in the permissible loan basis of such branches, because the committee could see "no reason for excluding deposits of foreign banks from such a branch's permissible loan basis since these also represent foreign currency deposits and are no more likely to have an adverse effect on our balance of payments than the branch's other foreign currency deposits" (ibid, at p. 22).

Similarly, the present bill (H.R. 6098) as passed by the House of Representatives provides that a United States financing subsidiary of a domestic manufacturing concern which borrows money overseas and uses that money to finance its parent's sales abroad may elect to be exempt from the tax, because "The funds used to make these loans will come from foreign sources . . . (and) will not have an adverse effect on our balance of payments." (Cong. Record, March 15, 1967, at p. H2741).

As pointed out, the Tax is part of a broader attack on the balance of payments problem. That broader attack includes the Voluntary Restraint Program administered in respect of banks by the Board of Governors of the Federal Reserve System and with respect of other business corporations by the Department of Commerce.

Since the extension of the Tax in 1965, several United States corporations, including at least two banks, have arranged for the sale of long-term debt issues of subsidiary corporations in the European capital markets to foreign investors.

These issues were sold with the understanding that the proceeds could be used for foreign investments and loans outside of the balance of payments guidelines because the transactions would not have an adverse effect on the United States balance of payments.

If these subsidiaries are foreign corporations, they may freely utilize the dollars obtained abroad without incurring any Interest Equalization Tax liability, since foreign corporations are not subject to the Tax. This is as it should be, since there is no adverse effect upon the United States balance of payments position. In fact, the United States position is benefited in that the obtaining of dollars abroad for use in the foreign operations of American corporations tends to reduce the drain of United States source dollars. Moreover, the borrowing of dollars by a foreign subsidiary of a United States corporation has the indirect benefit of placing such dollars under the control of the United States parent. The issuance of debt of a subsidiary of a prominent United States corporation appeals to European investors who might otherwise put their dollars to other uses.

The ultimate repayment of these dollar debts will not, under ordinary circumstances, have an adverse effect upon the United States balance of payments since repayments will be made from the foreign subsidiary's pool of Eurodollars which was obtained abroad and not from the United States. In addition, the issues are long-term and will be largely repaid out of foreign earnings generated with the borrowed funds. The earnings should, in fact, ultimately benefit our balance of payments position.

The only Interest Equalization Tax problem arises when the United States makes a capital investment in the foreign subsidiary. Such an investment (at the rate of one-fifth of the sum borrowed) has been required by the Internal Revenue Service in order for it to issue a ruling for income tax purposes that the foreign subsidiary will be recognized as a separate entity and that interest paid on its indebtedness will be foreign source income to the holders of the debt, and therefor not subject to United States withholding tax requirements.

In addition, an investment in a foreign subsidiary by a United States parent is ordinarily exempt from the Interest Equalization Tax under the direct investment exclusion in Section 4915(a). However, this exclusion is not available if the foreign subsidiary is formed or availed of for the *principal purpose* of acquiring stock or debt obligations which would be subject to Interest Equalization tax if acquired by the United States parent. It would seem that a relatively minor investment by the United States parent for the purpose of making feasible the borrowing of substantially larger sums abroad by the foreign subsidiary in order to avoid a drain on the United States balance of payments should not be considered to violate the principal purpose proscription. This is particularly so in view of the recent interpretation by the Supreme Court in *Malat* v. *Riddell*, 383 U.S. 569(1966) of the term "primarily" as meaning "of first importance" or "principally." In other words, these terms have all been equated and would appear to exclude any minor purpose which might exist. Technically, however, the principal purpose provision in Section 4915(c) is susceptible of construction by the Internal Revenue Service in a manner which would subject the United States parent's investment in the foreign subsidiary to Interest Equalization Tax if the foreign subsidiary, in turn, makes any investment which would be taxable if such investment were made by the United States parent. And this is so even though such investment is made with foreign source assets and not with assets obtained from the United States parent. Because it is not clear that the principal purpose provision will not be violated, the free use of such foreign source dollars is presently restrained without any benefit to the United States balance of payments position.

As I have indicated, we are proposing a solution to this problem in the form of a technical amendment to Section 4915(c) which would make clear that the use of funds obtained from foreign sources by a foreign subsidiary will not result in the imposition of the Interest Equalization Tax upon assets contributed to the capital of the foreign subsidiary by a United States parent. I am submitting to the committee a draft form of such an amendment, more to make clear to the committee precisely what is being proposed than to urge the adoption of the specific language of the draft.

This proposed amendment would not create any new exemption. All it does is say that when a foreign corporation (or partnership) acquires foreign securities with foreign source funds such as Eurodollars this shall not result in the imposition of Interest Equalization Tax upon the capital investment by the United States parent in the foreign corporation (or partnership). The language of this proposed amendment follows the form of existing Section 4915(c)(2).

In order to avoid any problems of identification of assets in applying the proposed amendment it requires that the foreign subsidiaries segregate on their books their foreign source assets. Such segregation is intended to include income and gains from the investment and reinvestment of the segregated funds. It is contemplated that although the amendment will be retroactive in application, the segregation requirement will be prospective only, commencing when regulations governing segregation are promulgated by the Treasury Department; that is, the regulations should contain provisions for the segregation of assets already owned when the regulations are issued. The proposed amendment is stated in negative terms and is not intended to make any affirmative change in the interpretation of the principal purpose provisions of Section 4915(c) in the cases of taxpayers who do not choose to comply with the segregation of funds requirement, but only to provide a "clear channel" for those who do. In other words, the proposed amendment is not intended, by negative inference, to impose Interest Equalization Tax in any case in which the tax would not be applicable under present law, which requires no segregation, but merely an absence of the proscribed principal purpose. Nor does the proposed amendment affect the Interest Equalization Tax liabilities of United States persons using Eurodollars or other foreign source assets, since it applies only to activities by foreign corporations in which a United States person makes or has made a direct investment.

I might say in closing that the effects of the proposed amendment will primarily be of assistance to financial type institutions since these are the ones most likely to utilize the assets of their foreign subsidiaries in acquiring foreign stock or debt. At present, I know of two such subsidiaries of American banks, including one of Bankers Trust Company, which I represent. However, other banks are interested and I think would be encouraged to use this method of implementing their international operations if the proposed amendment is enacted. As previously noted, this would be to the interest of the United States since it will facilitate the use, in such international operations, of Eurodollars rather than United States source dollars.

Because the principal application of the proposed amendment would be to financial institutions, it may be that the committee would wish to restrict its application to such institutions rather than to make it as broadly applicable as is suggested in the draft which I have submitted.

I wish to thank the committee for this opportunity to present our suggestion, and also to offer to the committee and its staff any further assistance which I may be able to furnish in connection with the amendment which I have proposed.

DRAFT BILL PROVIDING EXCLUSION OF FOREIGN INVESTMENTS BY FOREIGN SUBSIDIARY WITH FOREIGN SOURCE ASSETS FROM IMPOSING POSSIBLE INTEREST EQUALIZATION TAX LIABILITY UPON U.S. PARENT

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

That subsection (c) of section 4915 of the Internal Revenue Code of 1954 is amended by inserting after paragraph (3) the following new paragraph:

"(4) ACQUISITIONS WITH FOREIGN SOURCE ASSETS.—For purposes of this subsection, the acquisition by a United States person of stock or debt obligations of a foreign corporation or foreign partnership which acquires stock or debt obligations of foreign issuers or obligors with assets obtained after July 17, 1963 from persons not United States persons in exchange for stock or debt obligations of such foreign corporation or foreign partnership or with the proceeds of investment of such assets shall not, by reason of such acquisitions by the foreign corporation or foreign partnership, be considered an acquisition by the United States person of an interest in stock or debt obligations of foreign issuers or obligors. Such assets and the proceeds of investment thereof shall be segregated on the books of the foreign corporation or foreign partnership in accordance with such regulations as the Secretary or his delegate may prescribe."

STATEMENT BY THE ASSOCIATION OF STOCK EXCHANGE FIRMS ON THE INTEREST EQUALIZATION TAX EXTENSION ACT OF 1967 (H.R. 6098)

1. INTRODUCTION

The Association of Stock Exchange Firms was founded in 1913, and as of this date represents over 500 members and member firms of the New York Stock Exchange. This statement is made pursuant to an announcement by Senator Russell

B. Long, Chairman of the Committee on Finance, dated July 3, 1967, to the effect that the Committee will hold Hearings beginning July 13th on H.R. 6098, the Interest Equalization Tax Extension Act of 1967 and, in compliance with the Committee's request to file written statements for inclusion in the printed record of the Hearings in lieu of a personal appearance, to conserve the time of the Committee.

The statement embodies the views of the Association with respect to the Interest Equalization Tax Extension Act and the United States Balance of International Payments which it purports to strengthen.

At the outset, the Association wishes to state that it is deeply concerned about the continuous deficits in our Balance of International Payments, and that it welcomes equitable and effective measures which will contribute to the attainment of equilibrium at the earliest possible moment commensurate with our Nation's political and economic objectives. In reviewing our Balance of International Payments for the period during which the Interest Equalization Tax has been in effect and for several years preceding its enactment, the Association questions if at this state economic measures of the kind under consideration accomplish equilibrium in our monetary inflow and outflow without either a change in our political objectives or a quick and successful attainment thereof. The Association does not believe that the Interest Equalization Tax contributes materially to a solution of our Balance of Payments problems; nor that an extension of the Act for a period of two years and in increase in the tax rate will bring us any closer to the aim of equilibrium.

2. THE U.S. BALANCE OF INTERNATIONAL PAYMENTS

A. Appended to this statement, as Schedule I, is a table representing the U.S. Balance of International Payments for the years 1960 through 1966. As indicated by a footnote, the 1966 figures are not final, but are a revised estimate.

The following breakdown and analysis of the 1966 figures into categories in which we enjoyed a surplus and in which we suffered a deficit, evidences the over-riding influence which the Nation's political objectives have on our Balance of International Payments:

Breakdown into categories and analysis of surpluses and deficits in 1966 balance of payments

[Millions of dollars]

SURPLUSES	
Trade	+3,658
Other services and transfers (exclusive of direct investment income)	+1,188
Direct investment	+615
Bank claims (short and long)	+261
Foreign securities, outstanding issues and redemptions [1]	+679
Foreign capital	+2,207
Total surplus	+8,608
DEFICIT	
Travel	−1,794
Military	−2,700
Government grants and capital	−3,433
Nonbank claims (short and long)	−383
Foreign securities, new issues [1]	−1,105
Errors and omissions	−589
Total deficit	−10,004
Deficit categories	10,004
Surplus categories	8,608
Overall deficit	[2] 1,396

[1] As compared with schedule I attached to this statement, the category "Foreign Securities" has been split up in this table because such splitup is material and helpful for the purpose.

[2] The overall deficit of $1,396 is not exactly the same as in schedule I. See footnote on schedule I.

B. MILITARY EXPENDITURES AND GOVERNMENT GRANTS AND CAPITAL

Let us first isolate the two categories which in 1966 accounted for a deficit of over $6.1 billion out of a total of over $10 billion, and about which not much can be done short of major political decisions which are outside the scope of this written testimony. These are the Military Expenditures and the Government Grants and Capital. For the period 1960 through 1966, the net combined outflow of capital was as follows:

[In millions of dollars]

	1960	1961	1962	1963	1964	1965	1966
Military expenditures	2,750	2,574	1,957	1,932	1,859	1,723	2,700
Government grants and capital	2,727	2,700	2,619	3,542	3,325	3,492	3,433
Total	−5,477	−5,274	4,576	−5,474	−5,184	−5,215	−6,133

Clearly, in these two categories—but primarily due to the Military Expenditures—we suffered a deterioration in 1966 of $918 million as compared to 1965! The above table also demonstrates the burden which is placed upon those in the Executive Branch of our Government—notably the Treasury and the Department of Commerce—charged with the task of reversing the trend of our Payments Balance from a deficit to equilibrium! The principal areas of outflow are of a military and/or political nature over which they have no authority. In the final analysis these expenditures are the ultimate responsibility of the Congress in voting or denying the funds. The Treasury and the Department of Commerce become involved after the fact. Much has been done already in an attempt to become aware of an adverse trend at the earliest possible moment; perhaps the period of time elapsing can be shortened further, but the fact remains that these Departments can never be alerted before things happen.

C. TRADE SURPLUS

The next item we would like to subject to closer scrutiny is our Trade Surplus which did not only decline sharply in the last three years, but rendered in 1966 the smallest surplus since before 1960! The sharp improvement which our terms of trade exhibited between 1962, 1963, and 1964, can perhaps be explained by pointing to the relative cost stability which the U.S. enjoyed in those years when our principal industrial competitors in Western Europe and in the Far East experienced a series of wage increases. However, the severe decline which our trade surplus suffered in 1965 and in 1966 cannot be explained so easily. The severity of this deterioration is best demonstrated in the following table in which the surplus for each of the years 1960 through 1965 is compared with the surplus for the year 1966:

	1960	1961	1962	1963	1964	1965	1966
Trade surplus	4,757	5,444	4,417	5,079	6,676	4,772	3,658
In 1966	3,658	3,658	3,658	3,658	3,658	3,658	....
Total	1,099	1,786	759	1,421	3,018	1,114	....

As compared with the surplus in 1964, the deterioration in 1966 amounted to over $3 billion; as compared with 1965, it amounted to $1.1 billion.

D. TRAVEL

A category showing an increasing deficit is the Travel Sector. Admittedly, the increase from year to year has been relatively small, and amounted only to $51 million in 1966 over 1965. At the same time, one cannot ignore the fact

that the deficit in this sector has increased slowly but surely, from $1,256 million in 1960 to $1,794 million in 1966! Here the Administration has clearly indicated that it seeks improvement in a constructive rather than in a restrictive manner; by promoting foreign travel to and in the U.S. rather than by restricting residents of the U.S. in their travel abroad. How effective these promotional steps will be remains to be seen. The Balance of Payments figures in Schedule I attached to this statement indicate that over the years 1960 through 1966, in terms of international monetary effect:

	Percent
(i) foreign travel to and in the United States has increased by	64
(ii) U.S. travel abroad has increased by	52
(iii) The deficit in this sector has increased by	43

The question arises if we will ever catch up. The steps taken and to be taken will have some effect, but the best that can probably be expected is that the deficit in this sector will increase at a slower pace than would be the case without steps to promote foreign travel to and in the U.S.

E. SOME MID-WAY CONCLUSIONS

In the preceding paragraphs we have briefly:

(i) broken down the Balance of Payments in an effort to determine which are the principal areas of surplus and of deficit, and

(ii) reviewed some of the principal areas of surplus and of deficit, and we have reached the conclusion that in the most important areas;

(a) the deficit in 1966 as compared to 1964 increased by $918 million in the categories of Military Expenditures and Government Grants and Capital, and

(b) the surplus in 1966 as compared to 1965 decreased by $1,114 million in the Trade category.

If we just take these two items and for a moment disregard the smaller setbacks suffered in 1966, we see a deterioration of over 2 billion dollars. Notwithstanding these sad results, our over-all 1966 Balance of Payments deficit is practically unchanged from 1965—when it was around $1,350 million—and for all practical purposes at its lowest level since 1960! What then are the areas where our Payments Balance has improved so substantially that the increased inflow of capital at least prevented a further deterioration?

F. CURSORY REVIEW OF OTHER CATEGORIES

A glance at Schedule I attached to this statement, indicates that:

(a) *Other services and transfers* (exclusive of Direct Investment income) increased steadily from a surplus of $226 million in 1960 to a surplus of $1,188 million in 1966. The increase in 1966 over 1965 amounted to $194 million.

(b) *Direct Investment* has not rendered in recent years the surplus one would have expected. Although slightly up in 1966 over 1965, it nevertheless contributed a surplus of only about half as much as during the period 1961 through 1964. This is not due to reduced investment income (inflow) which—although in 1966 only $17 million more than in 1965—nevertheless shows a steady rise from $2,355 million in 1960 to $3,978 million in 1966. If the surplus in 1965 and 1966 was nevertheless disappointing, it is due to the even sharper rise in capital outflow, i.e. direct investment by U.S. companies overseas which increased from $1,674 million in 1960 to $3,363 million in 1966. Thus, it appears that while such U.S. corporate investments overseas increased by 200% between 1960 and 1966, the income from such investments during that same period increased only by 168%. Incidentally, *it should be noted that this category of Direct Investment is exempt from the Interest Equalization Tax*, but is subject to the voluntary guidelines promulgated by the Federal Reserve Board.

(c) *Bank Claims* (short and long) and *Non-Bank Claims* (short and long) show an erratic pattern during the 1960–1966 period with both categories showing considerable improvement from 1964 to 1965. In 1966, Bank Claims

show further improvement but Non-Bank Claims reversed themselves from an inflow of $345 million in 1965 to an outflow of $383 million in 1966. The Association does not feel competent to comment on these two categories.

(d) *Foreign Securities* are segregated into two subcategories:

(i) new issues, and

(ii) outstanding securities and redemptions—which must be dealt with separately:

(i) *New Issues* (by foreigners in the U.S.) created an outflow of capital of $555 and $523 million in 1960 and 1961 respectively. In 1962, this deficit increased to $1,076 million and became the focal point upon which the introduction in July 1963 and subsequent enactment of the Interest Equalization Tax was presumably based. Between 1962 and the end of 1966, the deficit moved rather narrowly between $1,076 million and $1,250 million with a deficit of $1,105 million in 1966 (approximately $100 million less than in 1965).

If the deficit on account of new issues held steady between 1962 and the end of 1966, it is due to two facts; i) it did not grow any larger because the Interest Equalization Tax in its application to debt securities probably prevented it from growing larger; ii) the deficit did not become smaller during this period because of the many exemptions in the I. E. T. such as exemptions for Canadian issues, for less developed countries, and for issues of international institutions of which the U.S. is a member.

(ii) *Outstanding Securities and Redemptions* created a deficit of $108 million in 1960 and $239 million in 1962. The trend actually turned around in the course of 1962 from a deficit into a surplus. However, it is doubtful that a complete breakdown by quarters was available when the I. E. T. was—apparently rather hurriedly—introduced in the middle of 1963. Because the Administration was probably not cognizant of a reversal or what later appeared to be a reversal of the trend from a deficit to a surplus, it would appear that the category *Outstanding Securities* was incorporated into the I.E.T. as an afterthought. We say "as an afterthought" because even the title "Interest Equalization Tax" indicates that it was meant to apply to debt securities and not equities. Equities do not pay interest and, in our country, foreign equities are not really purchased for income but for capital appreciation. Hence, there is nothing to "equalize". It is the general impression that at a time when a reversal from a deficit to a surplus was not yet foreseen, the fear that the deficit in this category might also sharply increase prompted the Administration to include it in the Interest Equalization Tax Act.

History now proves overwhelmingly that this fear was unfounded. As against an outflow of $108 million in 1960 and $239 million in 1961, this sub-category showed the following surpluses in subsequent years:

1962	+$107
1963	+146
1964	+386
1965	+448
1966	+679

This surplus—or inflow of foreign capital into the U.S.—resulted from U.S. holders of foreign outstanding securities selling their holdings abroad to foreigners who pay us for their purchases. It does not mean that Americans have not bought foreign securities in these years. Rather, it means that Americans have sold in the aggregate more foreign securities than they have bought, and increasingly so from year to year after 1961, resulting in a steadily increasing surplus which in 1966 amounted to an all-time high of $679 million.

(e) *Foreign Capital*

Although the preceding paragraph affords an ideal bridge over which to cross into the merits of the proposed Interest Equalization Tax Extension

Act, for the sake of completeness we would wish to subject one more category of the Balance of Payments to closer scrutiny, and that is the category of Foreign Capital. This category produced the outstanding gain of the year 1966, i.e. from a deficit of $8 million in 1965, it produced a surplus of $2,207 million in 1966! A breakdown into sub-categories proves that:

(i) foreign purchases of U.S. securities, other than Treasury securities, reversed themselves from a deficit of $443 million in 1965 to a surplus of $881 million in 1966—an improvement of $1,324 million! (Less favorable economic and corporate developments abroad, primarily in Western Europe, and sharply improved economic and corporate developments in the U.S. and stock prices which moved from a depressed level in May 1966 to an all-time or near all-time high in the U.S., created an atmosphere in which foreign investors sharply increased their ownership of U.S. stocks), and

(ii) long-term deposits and Certificates of Deposit sub-category increased its surplus from $204 million in 1965 to $979 million in 1966. (Higher interest rates in the U.S. offered by U.S. banks to attract foreign capital to the U.S., which had to cope with an unprecedented demand for long-term capital, created a sharply increased inflow of foreign long-term capital).

8. THE INTEREST EQUALIZATION TAX EXTENSION ACT

The purpose of briefly analyzing, in the preceding chapters, the principal categories of the Balance of Payments, is to demonstrate that its continuous deficit is largely due to non-economic considerations and that the economic components of our payments balance are largely positive and make an ever-increasing contribution towards equilibrium. Nevertheless, the Association feels that some of the 1966 contributions toward equilibrium in our Balance of Payments may not recur in subsequent years. The large inflow of Foreign Capital was to some extent coincidental, e.g., poor equity markets abroad and excellent equity markets in the U.S. Also, high interest rates in the U.S. which attracted long-term foreign capital was another contributory factor which may or may not present itself in 1967. It certainly is not a factor on which we can count indefinitely from year to year. Fortunately, however, it appears that our Terms of Trade have improved sharply during the first half of 1967. If this improvement continues during the second half, the surplus in 1967 in our Trade Balance may increase by more than $1 billion and reduce our over-all deficit to manageable proportions . . . if we don't suffer reverses in other categories.

It appears to the Association that the entire legislative effort to attain equilibrium in our Balance of Payments is restrictively directed toward the one area which has shown such substantial improvement, namely—the private capital sector of the Balance of Payments in a manner which is demonstrably inimical to the best interests of the U.S.

A. *Bank Loans.*—We shall leave it to representatives of the banking industry to express an opinion with respect to the effect of the tax on bank loans. While banks in recent years have gradually lengthened the maturity of some of their loans to industry, bank loans are basically short term, and it is our guess that most of them mature within one year and are, therefore, exempt from the I.E.T.

B. *Direct Investment.*—A category which is specifically exempt from the Interest Equalization Tax—and continues to be so exempt under the proposed legislation—is the so-called "direct invesment" category, i.e., investments of a size of 10% or more of the voting stock of a foreign corporation. An individual or a corporation resident in the U.S. may acquire from a non-U.S. person 10% or more of the voting stock of a foreign corporation and enjoy a statutory exemption from the tax. The 10% does not even have to be acquired during any one quarter in respect of which a return has to be filed; it can be acquired gradually over a 12-month period, and the exemption is still effective. On the other hand, the small investor has to pay a 15%—or perhaps a 22½% tax if this legislation is enacted—if he buys from a non-U.S. person 100 or 500 or 1000 shares of that same foreign corporation!

We question if this is equitable and if it is not a violation of the Constitution

that a purchase of 100 or 1000 shares by a small or medium-size investor is subject to a tax from which the purchaser of one or five million shares is exempt. While there may be some reasons to justify it, it appears to discriminate against the small and medium-size investor.

Another question which arises is whether or not this exemption promotes the acquisition—by large investors and corporations—of controlling interests in foreign companies to the detriment of our terms of trade. Could it not be that such acquisitions are at least one reason why our 1966 exports have increased by only approximately 10% as compared to 1965, whereas our imports have increased by approximately 18%? These acquisitions may well enable U.S. companies to manufacture abroad, at lower wage scales, what heretofore was made in and exported from the U.S. Conversely, these acquisitions may also enable U.S. companies to manufacture abroad, under the same advantageous conditions, products and parts therefor which they then import to the U.S. A typical example is the automobile industry in Europe in which our own U.S. automobile industry has taken a very substantial interest. Is our own export of the smaller automobile made in the U.S. not subject to severe competition from the European companies in which U.S. manufacturers have acquired a controlling interest? Don't we have that competition from imports in our own country? It is this not fostered by the exemption accorded "direct investment" under the I.E.T.? Admittedly, the guidelines promulgated by the Federal Reserve Board restrict that kind of investment except when the funds are raised abroad and where such investments are made from earnings generated and reinvested abroad instead of repatriated.

This leads us to the question as to whether a larger amount of income from direct foreign investments would be repatriated to the U.S. if some tax advantages were granted for repatriation of earnings generated aboard. There is reason to believe that only part of these foreign earnings are repatriated and that, consequently, our Balance of International Payments is not enjoying as much of the benefits as it should in this area.

Enough about the discriminatory and balance of payments aspects of this exemption. Most of the weight of the burden of the I.E.T. falls on two different sub-categories of the Private Capital Export Sector, e.g., New Issues and Outstanding Securities and Redemptions.

C. *New Issues.*—In that connection, we point out that the Treasury Department release of January 25, 1967, announcing the proposed legislation, is not clear when it states:

> "In order to avoid accelerated purchases by U.S. residents, of foreign debt obligations or foreign equities prior to legislative enactment, the bill sent to the Congress would make a 2 percent per annum rate effective tomorrow, January 26, 1967."

In this sentence, as in the entire release, the impression is created that the legislation increases the effective rate of foreign debt obligations or *foreign equities* from 1 to 2 percent. As a matter of fact, the effect of the tax rate on foreign *equities* was never 1%; it was a flat 15% and the legislation passed by the House increases the effective rate from 15% to 22½%. We would like to clarify the issues at stake. The proposed legislation has three primary objectives as we see them:

(i) to extend expiration date of the Act for a two-year period from July 31, 1967 to July 31, 1969;

(ii) to increase the rate at which the tax is levied.

- (a) for equity securities from 15% to 22½% and
- (b) for debt securities from 15% to 22½%—which has the effect of reducing the yield on foreign debt securities by 1½% (whereas at a 15% tax rate the yield was reduced only by 1%); and

(iii) to grant to the President authority to vary the rate.

We see some logic in a variable tax rate with respect to new issues. The request to grant that authority to the President demonstrates at once a weakness of the current law. The current tax rate is progressive from 1.05 percent on debt securities with a maturity of 1¼ years to a tax rate of 15% on debt securities with a maturity of 28½ years and longer, and *has the effect of reducing the yield on such debt obligations in each category by approximately 1%.* But what would

happen if foreign debt obligations are available to yield a rate of return *more* than 1% above the rate of return obtainable in the U.S.? The I.E.T. would have lost its effectiveness because under such circumstances residents of the U.S. would again be tempted to invest in foreign debt obligations. Not that it is a crime to seek the higher yield of comparable quality debt securities, but it would be detrimental to our Balance of Payments. It is conceivable that interest rates in the United States depreciate faster than interest rates in Western Europe. This could result in a spread between the two markets of more than 1%. However, we have not yet reached the point that an increase is needed, and there is no indication that we will need it in the foreseeable future. Rather than change the rate by statute, we propose that it be retained at its current level, but, that the President be given authority to vary the rate, upwards and downwards, depending on the needs and the circumstances. In this way we will not rock the boat unnecessarily, and can hope that an increase will never be required.

We do not believe that the I.E.T. is desirable. With its introduction, we have created a novel device which other nations can and have used since. When Germany suffered from an excessive inflow of foreign investment capital buying high-yielding internal German bonds, the German Government was quick to introduce legislation levying a 25% tax on interest accruing to non-resident holders of German internal bonds, thus reducing their attraction to foreigners. When the United Kingdom found the pressure on its balance of payments becoming nearly unbearable, it instituted a temporary 15% tax on non-essential imports, to which it added a small tax credit on exports. What we can do, others can do as well. Now, after a post-war period of 15 years during which barriers to international trade and finance were gradually reduced, we were the first to create new obstacles to international trade with the introduction of the I.E.T.

Does the creation of such barriers in the Private Capital Export Sector strengthen the monetary position of the U.S. Dollar? We fear that it does the opposite—particularly the proposal to increase the Interest Equalization Tax rate which is apt to be interpreted by the rest of the world as a signal that our monetary position has worsened!

D. *Outstanding Securities and Redemptions.*—The other area which bears the burden of the tax is the sub-category outstanding securities and redemptions, In this area we can see no logic in a proposal to increase the tax rate. Schedule I, appended hereto, demonstrates that there has been no outflow of capital from the United States on account of this sub-category after 1961. Beginning with 1962. there has been a steadily increasing inflow of capital. We have no breakdown between U.S. purchases and U.S. sales of outstanding foreign securities, but the Balance of International Payments demonstrates that U.S. sale of foreign securities to foreigners have exceeded U.S. purchases of foreign securities from foreigners by:

[In millions of dollars]

1962	107
1963	146
1964	386
1965	448
1966	679

A limited amount of redemptions of debt securities may be included, but those in the securities industry who are involved in the international end of it know that redemptions can only be a small part of the total. They know from their own experience that the U.S. has been a continuous seller of foreign securities. The fact that the U.S. has not been a buyer—but a seller—of foreign securities, is to be attributed to a variety of circumstances, e.g.:

(i) by and large, foreign economic growth slowed down after 1961 at a time when U.S. economic growth accelerated and investment in U.S. equities held out greater promise for capital appreciation and increased dividends. (Stock market developments here and abroad give generous evidence that in nearly every instance the sale of foreign holdings and re-investment of the proceeds in U.S. equities proved advantageous).

(ii) the 15% tax rate, increasing the cost of a purchase by 15% of the purchase price, has been prohibitive in most situations.

We fail to comprehend how, under these conditions, an increase in the tax rate can benefit our balance of payments. Since the tax is levied on purchases abroad only, and not on sales, and since the U.S. has been a seller on balance, we cannot see that increasing the tax rate would have the effect of either reducing the purchases or accelerating the sales. If U.S. sales of foreign outstanding securities have any tendency of abating, it is because there just are not that many foreign securities holdings left to be sold. From 1962 through 1966, sales of foreign portfolio securities have exceeded purchases by $1,774 million. Since this figure represents only the excess over purchases, and since there must have been some purchases, actual sales must have been substantially in excess of $1,774 million. What we have seen happening in these 5 years is not only a reduction in U.S. investment purchases of foreign securities, but a large liquidation.

To raise the tax rate under these circumstances serves no purpose other than to antagonize foreign nations and to rub salt in the wounds which are in the process of healing at a time when we want them to buy our U.S. securities in increasing volume. The U.S. Treasury Department, in consultation with members of the financial community, is presently stimulating methods which will promote increased investment by foreigners in the securities of U.S. issuers. We believe that this is a constructive approach with which this Association gladly associates itself. Indeed, we believe that the United States economy, through the medium of our stock markets, affords an ideal opportunity for participation by foreign investors. The Interest Equalization Tax, by imposing a tax on *the purchase of foreign securities by residents of the U.S.*, creates an atmosphere which deters the success of our efforts to *persuade foreigners to buy more U.S. securities*. The members of the Committee will understand how difficult it is and how it undermines our approach in trying to sell American securities abroad when U.S. legislation makes it prohibitive for Americans to buy foreign securities. This argument against the I.E.T. has been used when it was originally introduced in 1963 and 1964. While the statistics show that foreigners have increased their purchases of U.S. securities in 1966 very substantially over prior years' figures, that does not mean that our inability to reciprocate from time to time has not affected foreign purchases of U.S. securities. They might have been larger had we been able to reciprocate. The fact that foreign purchases of U.S. securities increased in 1966, is no guarantee that foreigners will continue to increase their purchases of U.S. securities in every following year.

Fundamentally we are opposed to any prohibitive tariff, but we also realize that the present trend, wherein the United States is a large seller on balance of foreign securities, may some day be reversed. If our stock markets continue to appreciate and foreign markets continue their current listless trend, it is conceivable that sophisticated U.S. investors would show a renewed interest in investing in certain selected foreign securities with price/earnings ratios substantially below those prevailing in our markets. If the Committee fears this possibility and is therefore disinclined to abolish the tax on outstanding equities at this time, as we recommend, we propose that it maintain the current tax rate of 15%.

E. *Extension of the Act.* This leaves the proposal to extend the effective period of the Act 2 years beyond the date of its present expiration. The International Balance of Payments is a peculiar animal; small changes in economic and political conditions here and abroad can create substantial changes. All of us from time to time are encouraged by certain symptoms which tend to create the impression that a settlement of the Viet Nam conflict is not inconceivable. It could certainly happen within a two-year period. Wages rates in other highly developed industrial countries may rise faster in the coming 12-month period than in the U.S. If we are forced to create obstacles to the free international flow of capital, let us demonstrate at the same time that these are indeed temporary measures, scheduled to expire at the earliest possible moment. Let us demonstrate that the Interest Equalization Tax is as objectionable to us as it is to many foreign nations and nationals, and let us demonstrate that we have confidence in our ability to adjust our unfavorable balance of international payments trend. A period of 2 years without the need to review our balance of payments to see if any progress has been made—and perhaps reach the conclusion that other measures than those in existence now are called for—is too long. We propose that the extension be limited to one year only.

SCHEDULE I.—*U.S. balance of payments, 1960–66*

[In millions of dollars]

	1960	1961	1962	1963	1964	1965	1966
Trade	4,757	5,444	4,417	5,079	6,676	[1] 4,772	[1] 3,658
Exports	19,489	19,954	20,604	22,071	25,297	[1] 26,244	[1] 29,168
Imports	−14,732	−14,510	−16,187	−16,992	−18,621	[1] −21,472	[1] −25,510
Travel (including fares)	−1,256	−1,247	−1,469	−1,653	−1,601	−1,743	−1,794
Receipts	981	995	991	1,052	1,245	1,377	1,605
Payments	−2,237	−2,242	−2,460	−2,705	−2,846	−3,120	−3,399
Other services and transfers (excluding direct investment income)	226	503	802	749	953	994	1,188
Military (excluding commercial transactions)	[1] −2,740	[1] −2,560	[1] −1,940	[1] −1,970	[1] −1,850	[1] −1,780	[1] −2,700
(Receipts, DOD basis)	(322)	(536)	(1,353)	(1,227)	(1,207)	(1,331)	(1,331)
(Payments, DOD basis)	(−3,089)	(−3,004)	(−3,106)	(−2,961)	(−2,872)	−(2,905)	(−3,709)
(Net, DOD basis)	(−2,767)	(−2,468)	(−1,753)	(−1,734)	(−1,665)	(−1,574)	(−2,378)
Government grants and capital	−2,735	[1] −2,704	[1] −2,633	[1] −3,501	[1] −3,333	[1] −3,437	[1] −3,433
Outflows	−3,405	−4,054	−4,293	−4,551	−4,263	−4,277	−4,623
(Dollar outflow)	(−1,126)	(−1,146)	(−1,044)	(−814)	(−685)	(−708)	(−749)
Debt repayments	[1] 610	[1] 1,250	[1] 1,250	[1] 960	[1] 690	[1] 830	[1] 1,190
U.S. Government nonliquid liabilities	[1] 60	[1] 100	[1] 410	[1] 90	[1] 240	[1] 10	....
Direct investment	681	1,169	1,396	1,158	1,254	590	615
Capital outflows	−1,674	−1,599	−1,654	−1,976	−2,416	−3,371	−3,363
Investment income	2,355	2,768	3,050	3,134	3,670	3,961	3,978
Bank claims (short and long)	−1,150	−1,261	−451	−1,535	−2,464	94	[1] 261
Nonbank claims (short and long)	−398	−558	−351	159	−966	345	−383
Foreign securities:							
New issues	−555	−523	−1,076	−1,250	−1,063	−1,206	−1,105
Outstanding issues and redemptions	−108	−239	107	146	386	448	679
Foreign capital	340	622	157	303	222	−3	2,207
Purchases of U.S. securities (other than Treasury securities)	282	324	134	282	−84	−443	881
Long-term deposits and CD's	6	−5	5	62	237	204	[1] 979
Other	52	303	18	−41	69	236	347
Errors and omissions	−941	−1,006	−1,159	−352	−1,011	−429	−589
Liquidity balance	−3,881	−2,370	−2,203	−2,670	−2,798	−1,337	[1] −1,367
Official settlements balance	−3,402	−1,347	−2,706	−2,044	−1,546	−1,305	[1] +244

[1] Revised estimates. Detail does not add to total.

Source: Department of Commerce, Survey of Current Business, June 1966 and March 1967. Department of Defense estimate, Jan. 14, 1967.

MCCLURE & TROTTER,
Washington, D.C., July 10, 1967.

In re Statement submitted for the Record of the Hearings in the Senate Finance Committee on the Interest Equalization Tax

Senator RUSSELL E. LONG,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: I represent the estate of Mrs. Leonora B. Hopkins and desire to call to your attention what I believe to be an unintentional omission in H.R. 6098, the Interest Equalization Tax Bill, which was recently passed by the House of Representatives.

Mrs. Hopkins died on March 4, 1964, owning certain real estate in the Bahamas. Her estate intends to sell this property to an alien, and under the terms of sale, to take a long-term first mortgage payable in United States dollars. I submit that such a transaction is not intended to be covered by the Interest Equalization Tax, as it would be modified by H.R. 6098, but due to a technical omission such sale would be subject to the tax. This is so since Section 4 of H.R. 6098, which deals with real estate, would not cover the sale because that

provision would apply in our case only to Mrs. Hopkins herself, who unfortunately, is dead, and not to her estate or to her heirs. In other words, it was Mrs. Hopkins rather than her estate of her heirs who owned the property on July 18, 1963, which is the effective date of the Interest Equalization Tax and the critical date under H.R. 6098. It would seem inconceivable that it would be the intention of the framers of H.R. 6098 to penalize a person for having died on or after July 18, 1963.

It is respectfully requested that H.R. 6098 be amended so as to provide that the real estate must be owned by the taxpayer on July 18, 1963, or in the event of death, by her heirs, beneficiaries, or estate.

Thank you very much for your consideration in this matter.

Sincerely yours,

WILLIAM P. MCCLURE.

THE FIRST BOSTON CORP.,
New York, N.Y., March 21, 1967.

Mr. WILL E. LEONARD, Jr.,
Senate Finance Committee,
New Senate Office Building,
Washington, D.C.

DEAR MR. LEONARD: Thank you very much for spending so much time with me on Friday, March 10, to discuss the amendments to the Interest Equalization Tax. As stated to you on that occasion, we wish to engage your support for a technical change in the Tax as it applies to certain dealers who trade the debt obligations of foreign issuers. The need for such an amendment becomes greater as the rate of the Interest Equalization Tax is increased.

As you know, Section 4919 of the present Act permits a United States dealer to purchase bonds from a non-United States person and to be entitled to a credit or refund of Interest Equalization Tax due upon their acquisition, if, within 90 days after the acquisition, the dealer resells the bonds to a non-United States person or to a United States dealer who, within one day thereafter, resells to a non-United States person. At the time of the original enactment of the Interest Equalization Tax, the purpose of these provisions was stated in the Reports of the House Committee on Ways and Means and the Senate Finance Committee as being to assist in maintaining effective international capital market facilities and to exempt from the Tax transactions which do not adversely effect the balance of payments position of the United States. By and large, the 90-day period has been found to be sufficient to permit a United States dealer to find a non-United States buyer for an originally foreign owned bond. However, it has been our experience and that of some of our competitors that where we have bought from other United States dealers and have thus been required either to resell the bond within one day or to assume the burden of the Interest Equalization Tax, we have not often been able to contact our foreign clients and to secure an agreement from them to purchase our bonds within the necessary one-day period. In this case, we have been required to assume the burden of the Interest Equalization Tax, even though we have been able to place the bonds in foreign hands before the expiration of the 90-day period for which the dealer from whom we purchased could have held the bond without being subject to the Interest Equalization Tax.

H.R. 6098, the bill introduced in the House of Representatives by Mr. Mills on February 27, 1967 to extend the Interest Equalization Tax, provides for amending Section 4919 of the Interest Equalization Tax Act so that a United States dealer purchasing originally foreign owned foreign bonds from another United States dealer and retaining them for a period not exceeding 30 days will be exempt from the Tax. We wish to enlist your support for the retention of such amendments in the version of the bill which will be introduced in the Senate.

If this amendment is adopted, our operations and those of our competitors in the major capital markets of the foreign developed countries will be made both simpler and more flexible and we will be in a better position to withstand competition of foreign financial institutions as well as to retain our place in the market through the period that the Interest Equalization Tax remains effective.

Since the reasons making the above amendment to the Tax Act desirable have existed since its original enactment and a number of firms, including our own, have been in our view unfairly penalized by the present one-day resale provision, we further suggest that the above mentioned amendments be made retroactive to February 10, 1965. I hope that you will agree that the proposed amendment and the request for retroactive treatment will be of substantial value to

United States securities dealers without being detrimental to the purposes of the Interest Equalization Tax and that they will receive the support of you and your colleagues.

Very truly yours,

ARTHUR R. TAYLOR, *Vice President.*

INTERNATIONAL FEDERATION OF STOCK EXCHANGES,
Paris, France, July 6, 1967.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: I have the honour to submit to your kind attention the resolution concerning the Interest Equalization Tax, the text of which is enclosed.

Very truly yours,

AUGUST RIBI,
President.
LOUIS DELANNEY,
Secretary General.

RESOLUTION OF THE INTERNATIONAL FEDERATION OF STOCK EXCHANGES CONCERNING THE AMERICAN "INTEREST EQUALIZATION TAX"

The International Federation of Stock Exchanges, speaking on behalf of the Stock Exchanges of Austria, Belgium, Denmark, France, Germany, Italy, Luxembourg, the Netherlands, South Africa, Spain, Switzerland and the United States of America:

1. Is disappointed by the U.S. Government proposal to prolong the "Interest Equalization Tax" for another two years and to increase its tariffs;
2. Does not want to enter upon the question whether a taxation of this kind be necessary with a view to American balance of payments policy because this question cannot be judged by the Federation;
3. Nevertheless, would like to state that this Interest Equalization Tax is injuring the efforts made by the free world financial community to further free international capital and securities movement, because it impedes acquiring of foreign equity securities by U.S. citizens and provokes sales of stocks of foreign companies from the U.S.A. to foreigners, as has been clearly shown by the available figures;
4. Points out that, on the other hand, the practical experiences and the figures demonstrate that the Tax has come into force substantial sales of U.S. securities by foreigners to the U.S.A. have taken place equally;
5. Thinks it most likely that these latter sales for an important part found their grounds in the decreasing confidence of foreign investors caused by the Interest Equalization Tax;
6. Reminds that, so far as such sales outweigh those of stocks of foreign companies from U.S.A. to foreigners, in this respect the ultimate influence of the Tax on the U.S. balance of payments should be considered as unfavourable;
7. Suggests that, if U.S. authorities think it neccesary to prolong the Tax, exemption be made for all outstanding stocks of foreign companies;
8. Is hoping that U.S. authorities will decide in accordance to this suggestion which would be in conformity with the U.S. traditions of furthering free international capital flows and with the position of the U.S.A. as the outstanding financial centre of the world.

FARMINGDALE, N.Y., *July 14, 1967.*

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

GENTLEMEN: In view of the fact that the outlook for the United States balance of payments is not good, to say the least, I most earnestly and strongly urge that the United States Interest Equalization Tax Law should be applied equally to all countries without exceptions and without exemptions.

Respectfully submitted.

HARRY B. FUCHS.

ON THE RECORD

I am the pioneer inventor of push button wireless tuning (p. 765, March 1918 *Electrical Experimenter*), inventor of the method for controlling multiple functions in space-time relationship by means of a single press-button or equivalent (Pat. No. 1,967,816), inventor of the pulse-time switching basic concept (Claim 4, Pat. No. 1,967,817). The automatic automobiles in the year 2007 operated by an eletromagnetic field through induction from an underground cable, predicted in the book "Russian Science in the 21st Century" published by McGraw-Hill, was invented by me in 1917 (p. 398, Oct. 1917 *Electrical Experimenter*), and the prediction in the same book of knifeless surgery is already described in my biography in Vol. 5, Who's Who in Commerce & Industry, published in 1946, which also documents my basic concept for protection from nuclear explosions that was successfully tested by the U.S. Army in 1955. Furthermore, the basic unifying law of the symmetry in nature, as well as the derivation of our alpha-numerical system from phases of a circle, and the bilateral symmetrical relationship between the sine waveform and the origin of algebra are proved in my essay "God's Circle" (Reg. No. A 93605 Library of Congress). There are many more of my masterpieces.

Another basic factor influencing our scientific and technological aspirations is the newly attained knowledge that casts doubt on the validity of established concepts. For example, the law of the conservation of mass and energy is not conclusive in view of momentum and entropy which are conserved only under certain conditions, and at persistence of waveforms wherein particles thereof are always changing and in which mass and energy disappear or come into existence. These phenomena are important in filtering out and storing anti-matter particles and in anti-gravitational devices.

HARRY BRICKER FUCHS.

As can be noted in my biography in Vol. 5, Who's Who In Commerce and Industry (1946), I am the inventor of the basic concept of "ionized particles in gaseouscolloidal suspension" (smoke) as protection against the effects of atomic explosions. Nine years later in 1955, the U.S. Army verified the successful application of my basic concept in the news releases "Smoke Insulation Tested In A-Blast" in the March 12, 1955 N.Y. World-Telegram and "Nevada Atom Blast Tests Smog As Shield Against Nuclear Heat" in the March 13, 1955 New York Times; also "Smoke Proposed As Atomic Shield" in the April 9, 1959 New York Times.

The basic unifying law of the symmetry in nature is explained very simply in my essay "God's Circle", Registration No. A93605 Library of Congress, wherein it is disclosed that all living forms in the Universe develop symmetrically from a nucleus on a zeroline of force in geometro-dynamic space-time progression and that our alphabetical and numerical symbols are interchangeable descriptive angular segments of a circle or zero in geometro-dynamic space-time progression as illustrated on p. 4 and 5 of my essay. My "Trendletter" on p. 12–14 of the June–July 1961 issue of Industrial Research magazine notes the relation to the development of energy at the backward flow of time.

HARRY B. FUCHS.

STROOCK & STROOCK & LAVAN,
New York, N.Y., July 14, 1976.

HON. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
New Senate Office Building,
Washington, D.C.

DEAR SIR: In connection with the hearings on H.R. 6098, the proposed Interest Equalization Tax Extension Act of 1967, we respectfully submit for consideration a suggested addition to the Act, drafted to resolve certain doubts about the intent of the Congress which have arisen in the administration of Section 4912(b)(2)(B) of the Internal Revenue Code. The suggested addition is set forth below. The need therefor, we believe, is demonstrated by the following facts and circumstances and the researchers of the Treasury Department, the Internal Revenue Service and ourselves in connection therewith:

Our client, Loeb, Rhoades & Co. (hereinafter referred to as "Loeb, Rhoades") is a limited partnership engaged in all phases of the securities business. Its principal office is located at 42 Wall Street, New York, N.Y. It is a member of the New York Stock Exchange, the American Stock Exchange and other leading

exchanges in the United States, and acts as a dealer, broker, underwriter, and investment banker in domestic and foreign securities all over the world.

For approximately 30 years, Loeb, Rhoades has had a branch office in London, now located at 11 Copthall Court, London, E.C. 2. The principal function of the London at all times has been to generate commission and like business for New York. Orders are taken from banks, brokers, institutional and individual investors in the United Kingdom and on the Continent and thereafter forwarded to New York. These orders are for the purchase and sale of United States securities in the United States markets, as well as for transactions involving commodities, mutual funds and underwritings. In this fashion the London office is in each year responsible for the investment in United States securities of millions of dollars of funds belonging to non-United States persons. These activities of the London office have produced very substantial commission business for the New York head office, which commissions are paid in dollars by the foreign customer.

In addition to the producing of commission business for New York, the London office has for some years dealt in foreign securities. Prior to July 1963 this aspect of the activities of the London office was highly profitable. The profits from such dealings in foreign securities not only were sufficient to pay all of the expenses of operating the London office but in addition enabled annually the remittance, in dollars, by London to New York of substantial amounts which had been earned in London.

In order that the London office could continue to operate as a dealer in foreign securities, which operations had theretofore proven so profitable and by the same token so productive of dollar income for the United States, Loeb, Rhoades following the enactment of the Interest Equalization Tax in September 1964, duly filed with the District Director, Manhattan, New York, its election pursuant to Section 4920(a)(5) with regard to the London office. By reason of this election and the applicable provisions of the statute, the London office is not, for the purposes of the Interest Eqaulization Tax, regarded as a domestic partnership but as a foreign partnership (Section 4920(a)(5)(E)). As a foreign entity, the London office could deal in foreign securities without any Interest Equalization Tax consequence.

However, contrary to expectations the operations in London following the making of the election have not been sufficiently profitable. There are several reasons for this development. When the Interest Equalization Tax was first proposed in 1963 there was no definitive knowledge of the provisions of the statute but it had been announced that the tax would be effective as regards transactions occurring even before the enactment date. Accordingly, since profit margins are small, the London office perforce stopped dealing in foreign securities. When the statute as ultimately enacted became known in the Fall of 1964 and the election hereinabove referred to was filed, the London office could resume. However, it is difficult fully to resume operations as a dealer in securities once the dealer has withdrawn from the market. In addition, prevailing market conditions and new regulations (introduced by a successor Government) in London resulted in further impediments to profitable operations. Thus, commencing with the year 1964 the London office has not been able to pay its expenses from income generated by its activities in London. The deficit has been met by borrowings from London banks. These borrowings have incurred unnecessary and material costs since interest rates payable by Loeb, Rhoades are generally substantially in excess of those payable upon borrowings by Loeb, Rhoades New York, a result surely not consistent with the purposes of the Interest Equalization Tax.

The expenses in London, including the staff there maintained, have not been necessitated by the activities as a dealer in foreign securities. In fact, these activities in foreign securities are and have been conducted entirely by the resident partner in charge of the London office. He has not needed or required assistance of any consequence. The expenses in London have existed because the London office solicits orders for securities transactions in the United States markets. Significantly, the principal employees in London are registered representatives, duly licensed by the New York Stock Exchange and the Securities & Exchange Commission of the United States to solicit and take orders for United States markets.

When the problem arose, consideration was given to whether Loeb, Rhoades could meet the London deficit by remittance from New York. Loeb, Rhoades was advised that unless the remittance was permitted by the statute, it would be subject to an Interest Equalization Tax of 15% pursuant to Section

4912(b)(2)(B). A study was thereupon undertaken to determine if circumstances were present which under the statute justified payments to London.

Upon analysis, it appeared that the relationship between Loeb, Rhoades New York and Loeb, Rhoades London was analogous to that existing between a domestic entity and an affiliated foreing entity. Loeb, Rhoades New York is a United States person, and by reason of the provisions of the Interest Equalization Tax (Section 4920(a)(5)(E)) the London branch is deemed to distinct foreing entity affiliated with the United States entity. It was also apparent that pursuant to other relevant provisions of the Internal Revenue Code, the commission income from accounts for which the London office is responsible could be deemed earned in part in London. In fact, if the London office were an unaffiliated foreign entity, Loeb, Rhoades New York would find it necessary to remit such part to London. The amount of such commission income was readily identifiable from records which were and had been regularly maintained (long before the Interest Equalization Tax).

Where there is an item of income and two affiliated entities each contributed to the earning thereof, the Treasury in its regulations under Section 482 of the Internal Revenue Code provides bases for allocating the income between them. A most acceptable basis is where the allocation can be fixed according to the sharing in like circumstances which is customarily accepted at arms length by unaffiliated entities.

Loeb, Rhoades New York handles orders for the purchase and sale of securities taken by unrelated correspondent brokerage firms. The commission earnings are shared. The minimum paid correspondents has been 65% of the commissions, Loeb, Rhoades retaining 35%. It therefore seemed appropriate to credit and remit to the London office based on the Treasury's own regulations under Section 482, 65% of the dollar commission business generated through the London office.

In December, 1965, a request was submitted to the Internal Revenue Service for ruling that the transfer or applicable by Loeb, Rhoades New York to or for its London branch office of amounts not exceeding 65% of the United States commission income for which the London office was responsible, was not a transfer described in Section 4912(b)(2)(B) and therefore not subject to the Interest Equalization Tax. Discussions with the ruling section of the Internal Revenue Service then took place in which a full and sympathetic understanding of the problem and of the propriety of the requested ruling was evidenced by the Service. Following (we understand) unofficial concurrence by a representative of the Chief Counsel's office (Internal Revenue Service) in the contemplated favorable response, conferences were held to resolve possible policy questions with the representatives of the Treasury Department and the Federal Reserve Bank in New York (the latter at the suggestion of the Treasury representative).

In the course of the discussions with the Treasury, its representative did suggest that our proposal be limited so that regardless of the amount which might be represented by the 65%, the remittance or application by New York should be limited to the amount by which London income was exceeded by London expenses[1] as well as by a formula designed to attribute to the commission business generated by London a part of the London expenses. In January 1966, the ruling request was modified accordingly. Thereupon, we were advised that neither the Treasury nor the Federal Reserve Bank had any objection to favorable action on our ruling request as modified.

Approximately one month later we were informed that Chief Counsel was now of the opinion that under Section 4912(b)(2)(B) the ruling even as limited could not issue. It was apparently their opinion that no matter the justification, the statutory provision was completely rigid and did not permit application of the allocation methods and analysis approved under Section 482.

Further discussions then followed to determine if modifications in form if not in substance of the ruling request could overcome the objections of Chief Counsel. After initial encouragement, Chief Counsel reverted to its former position. We are now advised that under the circumstances, the ruling section, though favorably disposed according to prior conversations, will rule unfavorably.

It is our understanding that the Treasury is of the opinion that our position is not contrary to the national interest or the purposes of the Interest Equalization Tax. It has been recognized that the Loeb, Rhoades London office should by all means be encouraged to continue to produce orders for United States securities

[1] When the ruling request was first submitted, the total of the borrowings in London for the described purpose was not overly large. These borrowings now aggregate considerably more, and this limitation which was then practical, may no longer be such.

and dollar commission income. It has also been recognized that the profits earned in London even if not now sufficient to meet London expenses do help with the balance of payments to the extent that London expenses are paid therefrom rather than from New York, and that there could be no reason to eliminate such profits by forcing a revocation of the election.

Based upon the foregoing, we respectfully propose that the following provision be added to Section 4912(b) (2) (B) : "; provided however than any such transfer or application which is no greater than an amount properly deemed the net income received in the United States of a branch office described in section 4920(a) (5) (which net income shall be determined in accordance with rules to be prescribed by the Secretary or his Delegate) shall not be a transfer or application within the meaning of this subparagraph B of this Section 4912(B)."

If the suggestion is adopted, Section 4912(b) (2) (B) will henceforth read as follows:

> (B) Transfers to foreign branches.—If a domestic corporation or partnership transfers money or other property (including, in the case of a transfer to a branch office described in section 4920(a) (5A), a transfer made for consideration) to, or applies money or other property for the benefit of, a branch office of such corporation or partnership with respect to which there is in effect an election under paragraph (5) or (5A) of section 4920(a), or if funds are borrowed by such branch office from a bank (as defined in section 581), other than from a branch of such a bank located outside the United States lending such funds in the ordinary course of its business, such domestic corporation or partnership shall be deemed to have acquired stock of a foreign corporation or partnership in an amount equal to the actual value of the money or property transferred or applied, or the funds borrowed; provided however that any such transfer or application which is no greater than an amount properly deemed the net income received in the United States of a branch office described in Section 4920(a) (5) (which net income shall be determined in accordance with rules to be prescribed by the Secretary or his Delegate) shall not be a transfer or application within the meaning of this subparagraph B of this Section 4912(b).

The suggested amendment makes it clear beyond doubt that the Internal Revenue Service is authorized to apply the thinking and rules developed by it under Section 482 and should therefore permit favorable Internal Revenue Service ruling in appropriate circumstances. No attempt is made to fix a statutory formula; in like fashion, no attempt was made in Section 482. The Internal Revenue Service is authorized to prescribe appropriate rules so that evasion of the tax or remittances not in accordance with Congressional intent or the purposes of the Interest Equalization Tax, can be precluded. We further believe that the suggested amendment is in accordance with the intent of the Congress in enacting Section 4920(a) (5) and that the Congress did not intend by enacting Section 4912(b) (2) (B) that an appropriate part of income received in the United States, which part was earned abroad by the branch office, could not be remitted to that office.[3]

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[3] Pertinent legislative history may be found in the Senate Finance Committee Report (S. Rep. No. 1267, 88th Cong., 2d Sess., U.S. Code Cong. and Adm. News 3478–3542 (1964)) and in the Report of the Conference Committee (Conf. Rep. No. 1816, 88th Cong., 2d Sess., U.S. Code Cong. and Adm. News 3542–57 (1964)). It is made clear that if an election is filed, then for the purposes of the Interest Equalization Tax the foreign branch becomes a foreign entity. There are examples in the Senate Finance Committee Report concerned with situations where a payment is made by the United States office for the benefit of the foreign branch (S. Rep. No. 1267, *op. cit. supra* 3509). It seems apparent that if the amounts involved belonged to the foreign branch because they had been there earned, their transfer would not be subject to the Interest Equalization Tax. Such a transfer constitutes payment of an amount due an affiliated foreign entity and therefore not subject to the tax; nowhere in the statute are payments of obligations made taxable. Moreover, the interpretation taken by Chief Counsel can, as here, effectively frustrate the election specifically provided in Section 4920(a) (5) and could not therefore have been intended by Congress.

Further indicia of Congressional intent may be found in the amendment made in 1965 to Section 4912(b) (2) (B). Congress had at the same time added to Section 4920(a) (5) a new and comparable election applicable to certain finance corporations. The newly-added election is Section 4920(a) (5A). An amendment was therefore required to Section 4912(b) (2) (B) so that transfers to branch offices as to which the new election was filed would be subject to the tax. However, Congress went further and added to Section 4912(b) (2) (B) the parenthetical provision quoted above. By reason thereof, as regards entities as to which an election under Section 4920(a) (5A) is applicable, there is an additional transfer made expressly subject to the tax, namely, "a transfer made for consideration." No such statutory language specifically taxing transfers for consideration (such as services) was added at any time as regards elections under Section 4920(a) (5)—the election applicable to the Loeb, Rhoades London office.

We further respectfuly request that the within letter and the suggestion therein set forth be included in the printed hearings in connection with the Interest Equalization Tax Extension Act of 1967.

Respectfully submitted.

STROOCK & STROOCK & LAVAN.
By BERNARD E. BRANDES.

BRITISH ASSETS TRUST LTD.,
Edinburgh, July 12, 1967.

Senator RUSSELL B. LONG,
U.S. Senate,
Washington, D.C.

DEAR SENATOR: I have today submitted to Mr. Tom Vail, your Chief Counsel, a brief statement for the Committee on the effect of the Interest Equalisation Tax on portfolio investment. I am not familiar with the formal procedure but have produced a very short statement which I hope may be of some value to the Committee in their deliberations.

I am extremely grateful to you personally for the interest which you have taken in this matter and the help which you have given me and I hope very much to renew our acquaintance on some future occasion. If you ever come to Scotland, I hope very much you will come and see us.

With best regards.

Sincerely yours,

JAMES GAMMELL.

JULY 12, 1967.

Mr. TOM VAIL,
Chief Counsel, Committee on Finance,
U.S. Senate, New Senate Office Building,
Washington, D.C.

SIR: At the request of Senator Russell Long, I have the honour to submit to the Committee on Finance of the United States Senate a written statement regarding the operation of the Interest Equalisation Tax as it affects foreign investment trusts.

I have the honour to be, Sir, your obedient servant,

JAMES G. S. GAMMELL, *Manager.*

JULY 12, 1967.

SUMMARY OF SUBMISSION BY BRITISH ASSETS TRUST LIMITED, 9 CHARLOTTE SQUARE, EDINBURGH

1. *General:* The purpose of the Act is to improve the United States balance of payments.

2. *Historical:* United Kingdom investment trusts hold American investments in excess of $2 billion, built up over a period of a hundred years, to the mutual benefit of both countries.

3. *Dollar Loans:* British Assets Trust Ltd. in 1963 borrowed $10,000,000 for 18 years at 5%. The proceeds of which were invested wholly within the United States and a further $10,000,000 is kept as additional security.

4. *Effects of the Loan on the balance of payments:*
   (a) On capital account—nil.
   (b) On income account—a small inflow.
   (c) The holding of additional security for the loan removes a potential threat to the balance of payments.

5. *Conclusion:* Dollar loans encourage portfolio investment in the United States by United Kingdom trusts to the benefit of both countries without damage to the balance of payments of either.

6. *Submission:* It is submitted that loans by United States banks and insurance companies to foreign investment trusts for the purpose of portfolio investment within the United States be exempted from the Interest Equalisation Tax.

JULY 12, 1967.

STATEMENT TO THE COMMITTEE ON FINANCE OF THE U.S. SENATE

INTEREST EQUALISATION TAX ACT

1. *General:* The purpose of the Act is to improve the United States balance of payments. This statement sets out to show that to the extent that the Act applies to loans made to foreign investment companies for the purpose of portfolio investment within the United States, the effect of the Act is the opposite to that intended.

2. *Historical:* For a hundred years investment trusts in the United Kingdom and particularly in Scotland have been investing money in the United States and over this period have built up a combined portfolio of American investments exceeding $2 billion in value. Many of the earliest trusts were formed as mortgage companies for the specific purpose of lending money for the opening up of new land in the United States and in this way contributed greatly to the development of the country during the latter part of the 19th century. The development and management of these large portfolios of investment has been mutually beneficial to the United States and the United Kingdom over a long period and it is only in recent years that new regulations in both countries have impeded the free flow of funds to the detriment of both.

3. *Dollar Loans:* In the summer of 1963, shortly before the proposal for an Interest Equalisation Tax Act, two Scottish investment trusts negotiated long term loans from the New York Life Insurance Company. The loan obtained by British Assets Trust Limited, 9 Charlotte Square, Edinburgh, was of $10 million for 18 years at 5% and the loan agreement provided that the whole of the proceeds of the loan should be invested in United States stocks and, further, that during the currency of the loan British Assets should keep with a bank in New York United States stocks and securities to a value equal to twice the nominal value of the loan.

4. *Effects of the loan on the balance of payments:*

(a) On capital account the effect has been nil as the money never left the United States and has been wholly invested in United States securities. It is possible that is not the way the figures show up in government statistics but it is in real terms what has happened.

(b) On income account the dividends received from the stocks purchased have not yet been sufficient to cover the interest payable on the loan. There has, therefore, been a small net *inflow* of foreign exchange to cover the interest payments.

(c) As the loan agreement provided for 200% cover for the loan $10 million worth of securities which could previously have been sold at any time and the proceeds withdrawn from the United States are now held in New York as additional cover for the loan and are, therefore, effectively sterilized as a threat to the balance of payments.

5. *Conclusions:*

(a) $2 billion worth of United States stocks are held by United Kingdom trusts.

(b) Because of the difficulties created by governments in recent years there has been some selling of these stocks during the last three years and repatriation of the proceeds to the United Kingdom.

(c) This process is likely to continue to the detriment of the United States balance of payments but could be mitigated to the extent that dollar loans for portfolio investment within the United States were exempted from the Interest Equilization Tax because every million dollars borrowed effectively sterilizes a further $1 million to provide the customary margin of security.

(b) Dollar loans would encourage portfolio investment in the United States by United Kingdom trusts to the benefit of both countries.

(e) The direct effect of such loans on the United States balance of payments is likely to be marginally favourable.

6. *Submission:* It is respectfully submitted that, with the introduction of suitable safeguards, loans by United States banks and insurance companies to

bona fide foreign investment trusts for the purpose of portfolio investment within the territorial United States be exempted from the Interest Equilization Tax.

STATEMENT OF THE NEW YORK CLEARING HOUSE ASSOCIATION, SUBMITTED BY PAUL R. FITCHEN, EXECUTIVE VICE PRESIDENT

The New York Clearing House Association is a non-profit association of ten of the major commercial banks located in New York City which, in addition to performing check clearing services and similar functions, acts in matters of mutual concern for its members.

1. One of the amendments proposed in H.R. 6098 would authorize the President, by Executive order to increase by as much as 50% the rates of the interest equilization tax, including the rates applicable to loans and other debt obligations acquired by banks. He would be authorized to vary the rates of tax between a high of 150% of the present rates down to a low equal to the present rates, all to be consistent with the balance of payments objectives of the United States.

Under proposed Section 4911(b)(2)(C)(ii), the President would be authorized, in any Executive order increasing the rates of tax, to specify whether and to what extent the increased rates would apply to an acquisition subsequently made where an unconditional obligation or similar commitment to make the acquisition existed on the date when the Executive order was issued. The implication that the President could fail, deliberately or inadvertently, to exclude from the increased rates acquisitions made pursuant to such commitments could have a substantial adverse effect on the business of banks and other financial institutions which frequently and in the normal course of business enter into commitments that legally obligate them to make loans at some time in the future.

It is believed that the uncertainties created by the risk of such action would be altogether out of proportion with any presently foreseeable abuses or unfavorable balance of payments effects that might be corrected by such action. If any real need arose to apply rate increases to commitments existing at the time, this could, of course, be accomplished by appropriate legislation.

Accordingly, it is recommended that lines 11 and 12 of page 5 of H.R. 6098 be amended by deleting the words: ", to the extent specified in such order,".

2. While The New York Clearing House Association and its member banks recognize that the continuance of the Interest Equalization Tax may reasonably be considered necessary in view of the current condition of the United States balance of payments, and make no comment with respect to the proposed increase in the rates of tax, the Congress and the President are urged to recognize that the tax imposes serious restrictions, which are sometimes artificial or arbitrary, on normal business transactions, especially foreign trade. The tax should not, therefore, be retained any longer than is absolutely necessary to assist the balance of payments objectives of the United States. In order to permit prompt action, at such time as the continuation of the tax is no longer necessary for balance of payments purposes, H.R. 6098 should provide that the President's authority to decrease the rates of tax includes the authority to reduce all rates to zero, and the President should be directed to exercise this authority immediately upon determining that the tax is no longer necessary for balance of payments purposes.

The Bank of New York; The Chase Manhattan Bank (N.A.); First National City Bank; Chemical Bank New York Trust Company; Morgan Guaranty Trust Company of N.Y.; Manufacturers Hanover Trust Company; Irving Trust Company; Bankers Trust Company; Marine Midland Grace Trust Company of N.Y.; United States Trust Company of New York.

WIGGIN & DANA,
New Haven, Conn., July 14, 1967.

Senator RUSSELL B. LONG,
Senate Finance Committee,
Washington, D.C.

DEAR SENATOR LONG: Your attention is invited to a problem arising under the provisions of the Interest Equalization Tax which may be solved in part by H.R. 6098 which was passed by the House of Representatives on March 15, 1967

and which is now before the Senate Finance Committee. We respectfully ask your Committee to consider an amendment to this Bill which would extend to certain exempt organizations the tax relief offered by the Bill to states and other political subdivisions.

Under Section 4917 of the Internal Revenue Code and Executive Order 11304, the Interest Equalization Tax does not apply to the acquisition by a United States person of original issuance Canadian stock provided a Notice of Acquisition (form 3779) is file on or before the last day of the month following the month in which such acquisition occurs. Regulation Section 14.4–1(c)(2). Under Section 4917(d), added by the Interest Equalization Tax Extension Act of 1965, the exclusion is reduced, if form 3779 is not filed within the time required, by 5 percent for each 30-day period or fraction thereof during which failure to file continues, except that in no event will the exclusion be reduced by more than 25 percent. This is a most severe penalty applied generally across the board to all United States persons, including exempt organizations unaccustomed to filing returns of income, regardless whether such failure was inadvertent or even due to reasonable cause. It is believed that no other provision of the Revenue Laws imposes so severe a sanction for inadvertent failure to file an information return. Even civil penalties imposed for failure to file returns of income, for taxes due, are generally imposed only where there is a wilful neglect or where reasonable cause cannot be shown.

Section 4(d)(3) of H.R. 6098 would (quite properly we believe) extend to states or political subdivisions or their agencies or instrumentalities (including pension funds) a 60-day grace period following enactment of the Bill within which they might file notices covering past Canadian acquisitions for which the required notice may not have been filed and thereby escape penalty. This opportunity has been afforded because the prior failures to file were "inadvertent" and such agencies "are not accustomed to have to concern themselves with Federal Tax matters". (Cong. Rec. H. 2740, March 15, 1967.) It would seem most appropriate to afford the same opportunity to educational institutions similarly situated.

As you are aware educational institutions that maintain a regular faculty and curriculum—that is schools and universities—are, like the instrumentalies of states and local political subdivisions, exempt from the requirement to file income tax or information returns. Section 6033(a)(2). One instance has come to our attention where such an institution has inadvertently failed to file the required form 3779 covering a past Canadian acquisition. On behalf of this institution, and any others similarly situated, we submit that there seems no reason to discriminate between public and private exempt organizations with respect to information requirements under the Interest Equalization Tax.

Accordingly, we hope very much that your Committee will amend Section 4(d)(3) of the Bill to provide that organizations described in Section 6033 (a)(2) may also have the opportunity to file a Notice of Acquisition with respect to past Canadian acquisitions on or before the sixtieth day after the date of the enactment of the Act.

Respectfully,

CHARLES N. SCHENCK III.

NATIONAL FOREIGN TRADE COUNCIL, INC.—SUGGESTED AMENDMENTS TO THE INTEREST EQUALIZATION TAX EXTENSION ACT OF 1967, SUBMITTED BY ROBERT T. SCOTT, DIRECTOR, TAX-LEGAL DIVISION

SUMMARY—NATIONAL FOREIGN TRADE COUNCIL PROPOSED AMENDMENTS TO THE INTEREST EQUALIZATION TAX EXTENSION ACT OF 1967 (H.R. 6098) RELATING TO FOREIGN FINANCING TRANSACTIONS

Under the Interest Equalization Tax Extension Act of 1967 as passed by the House of Representatives, a number of finance arrangements to facilitate the sale of goods by American or American owned companies would be subject to tax. This would be the case even though no U.S. source funds were involved in the transaction.

To prevent the Interest Equalization Tax from applying to such transactions, the National Foreign Trade Council is proposing several amendments to the House bill. These amendments would not be contrary to the intended purpose of the bill i.e. improvement of the U.S. balance of payments position. The amend-

ments, through facilitating the use of foreign funds to finance the sale of goods produced by American owned companies, would tend to reduce the need for U.S. financing. Therefore, these amendments would contribute favorably toward the U.S. balance of payments position.

Briefly, the proposed amendments together with their intended purposes may be summarized as follows:

AMENDMENT	INTENDED PURPOSE
1. Exempt foreign debt obligations acquired with foreign source funds by domestic corporations.	To facilitate the financing with foreign funds of goods sold abroad by U.S. owned companies.
2. Exempt acquisitions with foreign funds by a domestic corporation of stock or debt obligations of a foreign subsidiary or affiliate where the subsidiary or affiliate is primarily engaged in financing sales of products of U.S. owned companies through the use of foreign source funds.	To facilitate the financing with foreign funds of goods sold abroad by U.S. owned companies.
3. Exclude from bill (1) any requirement that borrowings by a domestic corporation be subject to restrictions such as a required matching of maturity dates of borrowings and loans and (2) imposition on borrowings of a minimum term to maturity of one year.	To permit use by domestic corporations of established financing methods which involve only foreign source funds.

I. PROPOSED AMENDMENTS TO H.R. 6098 RELATING TO FINANCING THROUGH A DOMESTIC CORPORATION

Problem and proposed solution

In certain instances it would be preferable for U.S. corporations to finance overseas sales of products manufactured or assembled either at home or abroad through a domestic corporation (operating either in the U.S. or abroad through a foreign branch) rather than through a foreign subsidiary. However, under present law, as well as under the proposed amendments, the interest equalization tax would apply to acquisitions of debt obligations of foreign obligors by a U.S. financing corporation, even though the transaction was financed entirely with funds obtained abroad.

To solve this problem the Council urges that the Interest Equalization Tax Extension Act of 1967 (H.R. 6098), be amended to provide specific exemption for the creation and/or operation of U.S. corporations located at home or abroad and operating with funds obtained abroad to acquire debt obligations arising from the sale of products produced or assembled at home and abroad. Such exemption should apply equally to products produced by affiliated or unaffiliated corporations.

Beneficial effect of proposed solution

The suggested amendment will not only provide equity and flexibility but will otherwise benefit both government and industry. Since the foreign sales are financed by way of foreign currency or "Euro-dollars" obtained and repaid abroad there can be no adverse effect on our balance of payments position. Moreover, operating abroad through a domestic corporation like operating through a foreign subsidiary would favorably affect the U.S. balance of payments first, by way of the remittance to the United States of the earnings from such lending activities and, second, by improving the sales revenues and earnings of the foreign manufacturing subsidiaries of U.S. corporations, which are, in turn, reflected in dividend remittances to the United States.

However, financing through a foreign subsidiary often requires an initial capitalization of such subsidiaries with U.S. sourced dollars to the detriment of our balance of payments. Moreover, it is not uncommon for foreign law to require compulsory capital increases as, for example, under Mexican law. Other countries, such as Germany, may require an increase in capitalization of a German corporation depending upon the ratio of borrowings to capital. The use of a foreign branch of a domestic corporation usually eliminates this possible additional

outward flow of dollars that would otherwise occur when operations are conducted through a foreign financing subsidiary.

Under present conditions the essential flexibility of choice between operating through a domestic corporation, as described above, or through a foreign subsidiary is lacking. Although the interest equalization tax as a practical matter requires the use of foreign subsidiaries for foreign fiancing, this is not always sound from a business point of view. Use of a local subsidiary frequently presents difficult organizational and operational problems not engendered by the use of a branch. A foreign subsidiary may result in a greater measure of local governmental control than that encountered in a branch operation. For example, under Italian law an Italian financing subsidiary is subject to a local board of auditors. Operation through a subsidiary rather than a branch often requires greater disclosures to the foreign country and preparation of more burdensome and detailed financial statements and reports. Subsidiary operation often requires compliance with formalities such as that of maintaining a resident director in the foreign country and requiring that board of directors and other operating committee meetings be held in the foreign country.

Present law and House passed amendments inadequate

The present interest equalization tax and the House passed amendments thereto will not provide equity and flexibility required by a number of taxpayers whose methods of financing their ordinary trade or business operations do not cause the slightest drain on our balance of payments.

In this regard, the overseas branch financing sanctioned by proposed section 4920(a)(3)(D), as added by section 4(g) of H.R. 6098, will not be available where the products, the purchase of which would be financed by a foreign branch of a domestic corporation, are wholly produced or manufactured abroad. Nor will proposed section 4920(a)(3)(D) permit a branch to finance the sale of products manufactured by a non-affiliated corporation.

The acquisitions of debt obligations of a foreign obligor repayable other than in U.S. currency made by a commercial bank in the ordinary course of its banking business through overseas branches are excluded from the interest equalization tax. A corresponding exemption for the acquisition of debt obligations of foreign obligors is proposed to be given to certain corporations operating lending and finance businesses abroad through foreign branches under proposed section 4920(a)(3)(C), added by section 4(f) of H.R. 6098. Finally, by virtue of Executive Order 11328, February 20, 1967, "Euro-dollar" loans may now be made by foreign branches of U.S. commercial banks.

Under section 4920(a)(5A) certain debt obligations acquired by a foreign branch office of a domestic corporation in connection with the financing of sales of goods manufactured by a foreign affiliate at home or abroad may not be subject to the interest equalization tax. However, under subparagraph (C) of section 4920(a)(5A) this relief is limited to those foreign branch offices which were in existence for a period of not less than 12 months before February 10, 1965.

The exemptions which are provided for business oriented transactions are certainly appropriate. Foreign currency and "Euro-dollar" loans by overseas branches of U.S. banks of finance companies have no adverse effect upon the balance of payments. Also, acquisitions by a U.S. corporation of debt obligations of foreign obligors with funds obtained abroad to finance the manufacturing and sales activities of foreign affiliates have no adverse effect on the balance of payments. However, under both present law and H.R. 6098 these obligations are and will continue to be taxable.

In our opinion, the business of financing the manufacturing and sales activities of foreign affiliates of U.S. corporations through a domestic corporation operating with funds derived from sources outside the U.S. should receive the same equitable treatment as do the other financing arrangements set forth above. All of such arrangements make a positive contribution to our balance of payments. All of such arrangements are commercially oriented and are not motivated by interest rate differentials existing between different capital markets.

Suggested amendments

Accordingly, the Council suggests that H.R. 6098 be amended to specifically provide an exemption for the acquisition of debt obligations by domestic corporations as described above operating with funds obtained abroad where the proceeds

81-495 O—67——16

of the loan are used to finance the sale of products produced or assembled at home or abroad. This exemption should exclude from the interest equalization tax those debt obligations received in the financing of products produced or assembled by corporations either related or unrelated to such financing corporations.

The desired effect could be achieved, at least for the financing by a domestic corporation, as described above, of sales of products manufactured by members of an affiliated group (as defined in section 48(c) (3) (C)) by amending proposed section 4920(a)(3)(D), as added by section 4(g) of H.R. 6098 as follows:

Clause (i)

Clause (i) of proposed section 4920(a)(3)(D) should be expanded so as to apply to a domestic corporation primarily engaged in the trade or business of acquiring:

(1) from foreign obligors debt obligations arising out of:

(a) sales by related or unrelated persons (such as franchised dealers) of personal property produced, manufactured, assembled or extracted at home or abroad by one or more includable corporations in an affiliated group as determined under section 48(c)(3)(C).

(b) sales of personal property received as part or all of the consideration in sales of personal property described in (a) above.

(c) sales of personal property received as part or all of the consideration in sales of personal property described in (b) above.

(d) capital loans made to dealers described in (a) above. For this purpose, capital loans made to dealers would include amounts borrowed by a dealer to finance plant, equipment and other capital items.

(e) sales described in clause (i) and (ii) of proposed section 4920(a)(3)(D) as added by section 4(g) of H.R. 6098.

(2) stock and debt obligations of a foreign subsidiary qualifying under section 4915(a). For this purpose, acquisitions of stock or debt obligations by a domestic finance corporation from a foreign finance subsidiary (of which 30 percent or more of the stock is directly or indirectly owned by the domestic finance corporation) should be deemed to qualify under section 4915(a) and correspondingly, section 4915(c) should be inapplicable thereto.

(3) debt obligations or stock in any combination of the activities in (1) and (2) above.

For this purpose, a domestic corporation shall be treated as primarily engaged in a trade or business described above if at least 90 percent of the face amount of the debt obligations and/or stock acquired by such corporation during a taxable year consists of debt obligations and/or stock described in (1) through (3) above.

Consideration should also be given to extending the relief suggested above to the acquisition of debt obligations of foreign obligors with funds obtained abroad by a foreign branch of a domestic corporation which engages not only in financing but also manufacturing and/or selling activity.

Clause (iii)

Clause (iii) of proposed section 4920(a)(3)(D) should be expanded to provide that the debt obligations acquired by the domestic finance corporation may be acquired out of the proceeds of loans from a corporation which is affiliated with such finance corporation within the meaning of section 48(c)(3)(C).

The above provision would be designed to provide additional borrowing leverage for the domestic financing corporation. Under this rule a foreign manufacturing affiliate with substantial investment in plant and equipment in a foreign country could borrow foreign funds from non U.S. persons upon the strength of such foreign based assets. These foreign borrowings could then be loaned to the financing corporation. This would eliminate the need of capital contributions to the financing corporation as would be required if the financing corporation borrowed funds directly from a non affiliated foreign lender. When such capital contributions are required they are frequently made with U.S. funds.

In any event, clause (iii) should be expanded to recognize and permit the domestic finance company to carry the ordinary trade accounts payable which result from day to day business operations. These trade accounts payable arise during the short term period from delivery of products by the manufacturer to the dealer to date of payment by the finance company to the manufacturer.

Clause (iv)

Clause (iv) of proposed section 4920(a)(3)(D) would require complex and difficult tracing of funds and matching of maturity dates which, as a practical matter, might be impossible to accomplish. Further, from a business standpoint it is often impractical to borrow funds with maturity dates which coincide with maturity dates of debt obligations acquired in the financing business. The Council therefore suggests that the language of clause (iv) be deleted and replaced with the words: "the debt obligations acquired during the period in which the interest equalization tax is in effect must continue to be financed solely with funds obtained abroad throughout the term remaining to maturity of such debt obligations".

Any decision regarding restrictions that might be imposed on borrowings by a domestic finance company should be viewed in the light of normal commercial borrowing practices abroad. For instance in connection with procedures employed in foreign financing operations it is common for a U.S. financing corporation operating abroad to obtain funds abroad through the so-called "overdraft system". Under this procedure a line of credit is established with a local foreign bank. Funds are simultaneously borrowed and loaned by such U.S. financing corporation by drawing a check against this line of credit. As loans are repaid to the finance company, the collections are deposited and credited to the line of credit. Thus borrowings under an overdraft system do not mature on a fixed date but are repaid to the bank as the collections are received by the finance company. Nonetheless, such overdrafts are contractually subject to "call" provisions and other conditions for repayment which vary from bank to bank and country to country. For example, under one particular arrangement, a Netherlands bank has the right to "call" the overdraft for collection at any time, and the amount called is repayable thereafter in six equal monthly installments. As another specific example, an overdraft contract with a bank in Germany covers a two year period but can be canceled and repaid by the borrower subject to thirty days notice to the bank. Generally similar arrangements are available with numerous other banks abroad.

As a practical matter, where an overdraft system is used bank "calls" are seldom made. The finance company borrows and lends simultaneously by issuance of a check. The borrowings are oustanding, in effect, for the period the loan is made by the finance company since collections are deposited to the account daily by the finance company.

It is thus evident that where an overdraft system is used it would be difficult to state with any precision the period of maturity of the borrowing. Accordingly, any requirement for matching of maturity dates of borrowings with maturity dates of financing loans such as presently contemplated in clause (iv) of proposed section 4920(a)(3)(D), or even if limited to matching or maturities of one year or less, should exempt funds borrowed under an overdraft system. Moreover, any rule requiring a period of at least one year to maturity for each borrowing would be unworkable. Assuming a constant level of operations, excess funds would develop in an overdraft system as profits are realized. These excess funds would be available for immediate remittance to the U.S.

II. PROPOSED AMENDMENT TO H.R. 6098 RELATING TO FINANCING THROUGH A FOREIGN SUBSIDIARY

As indicated above, when considering the form or organization to use in a new foreign financing operation it may at times be determined appropriate or required to utilize a foreign subsidiary in order to finance overseas sales of products manufactured or assembled either at home or abroad by related corporations. Here too, the financing operation has no adverse effect upon the balance of payments where the foreign subsidiary finances such foreign sales with foreign currency or "Euro-dollars" obtained abroad and repaid abroad. Rather, as set forth at page 2, *supra*, these activities also have a salutory effect upon the balance of payments.

Under these circumstances, if the foreign subsidiary is capitalized with foreign funds or "Euro-dollars" obtained abroad there are likewise no adverse balance of payments consequences. The same would be true of mandatory capital increases required by foreign law which are made with funds obtained abroad.

Suggested amendment

Accordingly, the Council suggests that H.R. 6098 be amended to specifically provide an exclusion for the acquisition of stock of a foreign subsidiary which is a member of an affiliated group, as defined in section 1504, without regard to section 1504(b) (3), which is capitalized with funds obtained abroad where it can be established that such subsidiary will be engaged in financing the sales of products produced or assembled at home or abroad through the use of funds borrowed and repaid abroad.

In such case the exclusion provided for in Section 4915(a) (1) should apply, and correspondingly, Section 4915(c) should not be applicable.

III. PROPOSED AMENDMENTS TO H.R. 6098 RELATING TO FINANCING OF U.S. EXPORTS

U.S. corporations have been urged by the Commerce and Treasury Departments to increase their exports in order to help the balance of payments and some of them have organized affiliated companies to finance export shipments. Under Section 4914(j) (1) (A) (ii), a domestic manufacturing company which sells to a customer abroad and receives a promissory note maturing in more than a year can discount the note with a commercial bank without giving rise to any liability for interest equalization tax. However, liability may be incurred if the note is transferred to an affiliated corporation in a transfer that might not qualify under section 4914(j) (1) (A) (iii).

In order to meet the requirements of subdivision (iii) if the obligation is transferred, it must be shown that the extension of credit by the domestic manufacturing company and the acquisition of the debt obligation related thereto were reasonably necessary to accomplish the sale or lease of property or services out of which the debt obligation arose. In addition, the acquiring company would have to show that the terms of the debt obligations are not unreasonable in the light of credit practices in the business in which the manufacturing company is engaged. These requirements impose severe administrative burdens when applied to U.S. manufacturers making sales and arranging financing on a high volume basis.

Accordingly, in order to facilitate the expansion of U.S. exports, the Council urges that a domestic manufacturing corporation not be subject to these requirements when it transfers an obligation to a member of the same affiliated group. This would place the financing affiliate in the same position as a commercial bank.

Suggested Amendment

It is recommended that the language is Section 4914(j) (1) (A) (ii) (which removes from the loss of exports-credit exclusion the transfer of an export-credit debt obligation to a commercial bank in the ordinary course of its commercial banking business) be broadened by adding to subdivision (ii) the following.

> "or to a corporation which would be includible in an affiliated group as defined in section 1504 (without regard to section 1504(b) (3)) of which the transferor with respect to such debt obligation is a member."

Members of the Council will be pleased to assist you in any way possible with regard to the foregoing.

STATEMENT OF THE CHAMBER OF COMMERCE OF THE UNITED STATES

The Chamber of Commerce of the United States wishes to express its continued opposition to an interest equalization tax and, more specifically, to H.R. 6098, the proposed Interest Equalization Act of 1967.

SUMMARY OF THE POSITION OF THE CHAMBER OF COMMERCE

The Chamber is deeply concerned with the proposal to extend the interest equalization tax, repeatedly said to be a temporary measure, for still another two-year period. The tax contravenes established national policies and does not advance our long-term balance of payment goals.

If, however, the Senate is committed to extension of the interest equalization tax, the amendment to H.R. 6098 introduced by Senator Ribicoff to assure equality of treatment for all taxpayers similarly situated should be adopted. Under this amendment all taxpayers would be permitted to file notices with respect

to Canadian securities acquired after July 18, 1963, and before the date of enactment of H.R. 6098 for sixty days following passage of the Act without losing any part of the exemption for original or new issues of Canadian stock or debt obligations. The bill, as passed by the House, provides this urgently-needed relief only for State or local governmental units or agencies.

OPPOSITION TO AN INTEREST EQUALIZATION TAX

Our national policy has been to promote an international community through the freer flow and exchange of goods and investment. This policy has perhaps been exemplified most recently by the significant tariff reductions growing out of the recently concluded Kennedy Round of the GATT. The imposition of an interest equalization tax, the effect of which is to control certain types of investment abroad, is inconsistent with these goals.

It has been repeatedly demonstrated that the tax is effective, if at all, only as an interim stopgap measure and in the long run will aggravate the balance of payments deficit. However, this "temporary" tax has already been in effect for four years.

Our long-range balance of payments goal is to increase United States earnings abroad. Impeding the movement of capital and goods works counter to this goal. Any remedial steps should be oriented to expansion rather than restriction of world trade and investment, since United States investment abroad has the long-range effect of bringing home more dollars than are invested initially and generating United States exports in a near equal proportion. The interest equalization tax, which restricts trade and investment, works directly against long-run balance of payments goals.

The Chamber does, however, recognized that the United States balance of payments position does need strengthening. The extension, now for a second time, of a temporary measure which has proved impossible to administer and enforce, is no solution to the problem. The Chamber has been studying the balance of payments and a copy of the report of the National Chamber's Special Advisory Panel on Balance of Payments, approved by the Board of Directors, is enclosed.

PROPOSED AMENDMENT TO H.R. 6098

If Congress is committed to extend the interest equalization tax for two more years, it should at the very least assure that all taxpayers similarly situated received equality of treatment.

Under present law the President is authorized to exempt original or new issues of stock or debt obligations of a foreign country from interest equalization tax where he determines that imposition of the tax would imperil or threaten to imperil international monetary stability. The President has exercised his authority to exempt from tax acquisitions of new or original issues of Canadian stock or debt obligations.

Under the original law, the exclusion from interest equalization tax was lost entirely for failure to file a timely notice for acquisitions after July 18, 1963. In 1965, when the tax was extended for two more years, Congress realized that many taxpayers had been trapped by this provision and had forfeited their exemptions merely because of failure to file a notice form. Thus, the law covering Canadian stock or debt obligations acquired after October 9, 1965, now provides for a loss of five percent of the exclusion for each 30-day period, or portion thereof, during which the notice is delinquent, with a maximum loss of twenty-five percent of the exclusion.

H.R. 6098, as reported by the House, would extend the limited 25 percent penalty to acquisitions made prior to enactment of the 1965 relief provisions, but after the date of enactment of the original act. In addition, an amendment to the bill added on the floor of the House provides further relief for state or local governmental units. An exemption from all penalties is provided in the case of "a State or political subdivision, or by any agency or instrumentality thereof," for acquisitions made between July 19, 1963 and the date of passage of H.R. 6098, provided notice is filed within sixty days after the enactment of H.R. 6098.

The Ribicoff amendment would extend the relief provision for state or local governmental units and agencies to any United States person making an acquisition between July 18, 1963, and the date of enactment of H.R. 6098, if notice is filed within sixty days after the enactment of the Act.

If Congress votes to extend the interest equalization tax, the Chamber urges immediate passage of these relief provisions. Congress itself recognized the severity of a 100 percent penalty when it passed the 1965 Act. The unfairness of a 100 percent penalty for some taxpayers and a 25 percent penalty for others, depending on when the acquisition was made, is obvious.

The Chamber also urges adoption of the amendment introduced by Senator Ribicoff. Much confusion has existed with respect to the obligations under the law of a taxpayer acquiring original or new issues of Canadian securities. While many taxpayers were aware that original or new issues of Canadian securities were exempt from interest equalization tax, fewer taxpayers realized that the exemption was conditioned upon the filing of a notice form.

It has come to the attention of the Chamber that its members, even those whose experience in making investments matches that of the States, overlooked the notice requirements and as a result lost all or part of the exemption Congress meant to accord to purchasers of Canadian securities. It is appropriate to accord these investors the same relief as provided in the bill for the States.

If the broader relief provision is adopted, it will encourage taxpayers who have invested in new or original issues of Canadian securities without reporting their acquisitions to come forward and file notices. By giving this incentive to investors to give notice of acquisitions which have not previously been reported, the Treasury will have more accurate information as to the amount being invested in original or new issues of Canadian securities.

Chamber of Commerce of the United States Report and Recommendations of Special Advisory Panel on Balance of Payments

I. INTRODUCTION

While the Balance of Payments situation of the United States is a matter for concern, it is no occasion for alarm. The international financial position of the United States is strong, and the proper posture for the United States is one of confidence and strength.

In appraising this problem and devising courses of action, particular effort must be made to avoid *ad hoc* measures which would result in undesirable restraints or controls, particularly on the free flow of trade and capital. Rather, the situation should be viewed, not in the perspective of the next year or two alone, but with a view to the longer term. It is recognized that in the short term the impact of our commitments in Southeast Asia upon the U.S. Balance of Payments will be adverse and that as a result the steady progress made toward reducing the deficit may be temporarily reversed. It is in the circumstances difficult to evaluate the size of the problem, and it accordingly appears important to avoid any types of restrictive measures that could become entrenched in the system and have undesirable longer-term implications. For the immediate period ahead, therefore, the United States should be prepared to accept and live with this larger deficit.

In its international and economic relations the United States should be committed to increasing the scope of international cooperation within the context of the International Monetary Fund, the World Bank and the General Agreement on Tariffs and Trade. Such increasing cooperation should extend also to the international monetary and economic arrangements which have developed in recent years, such as the system of currency swaps among the central banks of the industrial countries, consultation within the auspices of the Organization for Economic Cooperation and Development, and the like.

Finally, particular attention must be drawn to the range of responsibilities which have come to the United States in its role as international banker. This is a role which the United States neither can nor should seek to escape; it has great advantages to the country and the world. It entails, however, the responsibility of so conducting our affairs as to command trust and respect in the international monetary sphere without compromising other U.S. national objectives. As long as the United States serves as world banker there will be a tendency for the United States payments balance to show a deficit to the extent that official and non-official foreigners wish to add to their dollar holdings.

It is a matter for concern that in their efforts to restrain excesses arising from high levels of business activity, authorities in the United States and Europe have placed undue reliance upon monetary policies and insufficient

reliance on fiscal policies; consequently, in some parts of the world interest rates are rising to levels that may prejudice maximum capital formation and impair productive and efficient market behavior.

II. RECOMMENDATIONS

It is recommended:

1. That to avoid further deterioration in the United States Balance of Payments, and indeed to reduce existing imbalance, it is imperative that reliance be placed on fiscal rather than monetary measures to the extent that further action is required to offset overheating of the U.S. economy, which has markedly stimulated the growth of merchandise imports and has had adverse effects upon U.S. exports;
2. That government and business continue to promote the private export of United States commodities and services abroad;
3. That regulations on direct foreign investment should not be changed from voluntary to mandatory controls and that no tax should be imposed on American direct investment abroad, in clear recognition that the continued flow of United States investment abroad is among the most promising and important sources of current-account income in the American balance of payments;
4. That the existing cooperation with other national economic and monetary authorities be continued and furthered, both bilaterally and multilaterally.
5. That there be no increase in the present dollar price of gold.

STATEMENT RE PROPOSED AMENDMENT—SUBMITTED BY BRITISH-AMERICAN OIL CO.

Shareholders of Company X, a foreign corporation, other than Company Y, an American corporation, have requested that Company X seek an amendment to section 4920(b) of the Internal Revenue Code of 1954, so as to exempt all Company X's common stock from the interest equalization tax. Acquisitions of Company X stock by Company Y have been exempt from the interest equalization tax for all periods for which the tax was effective since Company Y owned more than 10% of Company X's stock. Therefore, Company Y, but not the other shareholders of Company X, qualified for an exemption from this tax.

In general, the section of the interest equalization tax which the Company X shareholders wish to have amended, section 4920(b), provides that a foreign corporation shall not be considered to be a foreign issuer (and therefore exempt) with respect to any class of stock if as of the corporation's latest record date before July 19, 1963, more than 65% of such class of stock was held of record by United States persons. This section limits the definition of a "class of stock" to "all shares of stock of a corporation issued and outstanding as of the corporation's latest record date before July 19, 1963, which are identical with respect to the rights and interests such shares represent in the control, profits, and assets of the corporation."

As of the latest record date prior to July 19, 1963, Company X had outstanding 300X common shares, which was the only class of stock outstanding on that date. Company Y owned 200X of the outstanding shares or approximately 70% of the total outstanding common shares. Also as of that date, 115X of the shares owned by Company Y were denominated "restricted common shares." The restricted shares were identical in all respects to the common shares except for restrictions as to the payment of dividends. However, the arrangement temporarily restricting payment of dividends was entered into in 1956, seven years prior to the interest equalization tax.

The restricted common shares were issued to Company Y on the purchase by Company X from Company Y of all the issued and outstanding shares of Company Z. The shares were issued with restrictions solely for the protection of existing shareholders. In fact, had it not been for the concern for existing shareholders, other than Company Y, no restriction whatsoever would have been imposed.

Pursuant to the agreement entered into in 1956 the restriction on the dividends ceased to apply on February 12, 1965, and the restricted common shares assumed the rights and interests of the other common shares on March 8, 1965. Thus, prior to the original expiration date of the interest equalization tax, the restricted aspects of the 115X common shares owned solely by Company Y ceased to exist and all the issued and outstanding shares of Company X became identical with respect to the rights and interests such shares represent in the control, profits, and assets of the corporation.

The Internal Revenue Service has indicated they would probably take the position that the restricted shares were not "identical" within the meaning of section 4920(b)(2) of the Code, and therefore the "restricted shares" constituted a separate class of stock. Consequently, the 65% requirement of section 4920(b) could not be satisfied with respect to the shareholders other than Company Y. The anomaly of this result is that Company Y, who was already exempt under section 4915, was entitled to an additional exemption under this provision (section 4920(b)) while the other common shareholders (who the restriction provisions sought to protect) were considered by the Internal Revenue Service not entitled to relief.

It may be that during the period some of the Company Y-owned stock was restricted there was some reason to deny an exemption, however, since pursuant to a pre-interest equalization tax arrangement the restrictions were automatically removed prior to the original expiration date of the Interest Equalization Tax Act and all of the issued and outstanding stock of Company X became identical in all respects, there appears to be no reason to deny the exemption at this time. Moreover, it should be noted that the original statutory test upon which section 4920(b) was originally based, a specific degree of American involvement, is now satisfied by the effectuation of a pre-interest equalization tax arrangement.

It should be emphasized that the arrangement implementing the differentiation between the common shares was entered into before the interest equalization tax; under that arrangement the differentiation aspects were scheduled to end during the period of the original Interest Equalization Tax Act; and the actual period during which the differentiation aspects were in effect ended prior to the original Interest Equalization Tax Act. Additionally, when the restriction was lifted from the Company Y-owned shares on March 8, 1965, the previously issued common shares plus those previously restricted became identical and indistinguishable.

It is our understanding that the Internal Revenue Service would at the present time treat the previously restricted shares as a separate class of stock for purposes of section 4920(b). Therefore, at this time, the issued and outstanding Company X common stock, which meets the definition of a single "class of stock" (as defined in section 4920(b)(2)), which is publicly traded, and which is identical with respect to the rights and interests such shares represent in the control, profits, and assets of a corporation, will not be treated as identical for purposes of the Interest Equalization Tax. Since these common shares of Company X stock are all now identical, the problem of separating the previously restricted shares from the previously non-restricted shares, or the exempt from the non-exempt, would seem to constitute a problem similar to and of parallel magnitude to that for which section 4920 was originally designed, namely, to eliminate the administrative burden which would be imposed on brokers if certificates of American ownership were required with respect to classes of stock which were substantially (65%) United States-owned.

It is our view that section 4920(b) should be amended to exempt all outstanding common stock of Company X primarily because the differentiation between the restricted and non-restricted shares was implemented by an arrangement entered into prior to the original interest equalization tax, the arrangement was scheduled to end during the original Interest Equalization Tax Act, and the actual period during which the differentiation aspects were in effect ended during the original Interest Equalization Tax. Secondly, the present situation of having outstanding one class of identical common stock which is considered to be two classes of stock (one exempt and one non-exempt) by the Internal Revenue Service could create a very confusing problem.

CHRYSLER CORP.,
Detroit, Mich., July 18, 1967.

Subject: H.R. 6098; a bill to provide an extension of the interest equalization tax, and for other purposes.

Hon. RUSSELL B. LONG,
Chairman of the Senate Committee on Finance,
Senate Office Building, Washington, D.C.

MY DEAR SENATOR LONG: Chrysler Corporation respectfully requests your support for an amendment to subject Bill. This requested amendment would not

have any adverse effect on the U.S. balance of payments, however, it would increase both the short-range and long-range inflow of funds to the United States and it has the support of the Treasury Department.

THE PROBLEM

Credit is becoming an increasingly important factor in the competition for sales of products outside the United States. In order for U.S. businesses to maintain or improve their competitive positions outside the U.S., it is necessary that all steps possible be taken which will maintain and/or increase the efficiency and effectiveness of U.S. businesses in overseas markets. Under present tax law, a U.S. business would incur the interest equalization tax on *U.S. funds* used outside the United States to conduct a finance business. Furthermore, such tax would also apply to foreign transactions of a captive domestic finance company which finances *with funds acquired abroad* the sale of products which are manufactured, assembled, produced or extracted by the U.S. parent corporation or a domestic or foreign affiliated corporation. Obviously, U.S. businesses should be permitted to use funds acquired outside the U.S. in the conduct of a foreign finance business without being subjected to the interest equalization tax.

THE PROPOSAL

Chrysler Corporation has discussed this problem with the Treasury Department and Senate Finance Committee Staff who have, pursuant to requests by Chrysler Corporation and other taxpayers, developed amendments to subsection (g) of section 4 of H.R. 6098 which would, provided certain conditions and restrictions are met, permit U.S. businesses to establish domestic and/or foreign captive finance subsidiaries to borrow funds *outside* the U.S. for use *outside* the U.S. in the conduct of a business to (directly or through related domestic or foreign finance companies) finance the sale of products manufactured, assembled, produced or extracted by the U.S. parent or an affiliated corporation, without incurring any interest equalization tax either on the capital investment in such finance subsidiaries (provided certain restrictions are met) or the acquisition of stock or debt obligations obtained in pursuance of its finance business.

Your consideration of the above requested amendment would be greatly appreciated. As we have stated, the Treasury Department supports this amendment and has worked with your Committee's staff in drafting appropriate language to solve this problem. If you wish us to elaborate with respect to any part of this request, we would be happy to comply with your request.

Very truly yours,

EDWARD A. SIGLER, *Tax Affairs.*

APPENDIX

PROPOSED AMENDMENTS TO SUBSECTION (g) OF SECTION 4 OF H.R. 6098

Subsection (g) of section 4 of H.R. 6098 should be amended to permit—

1. The use of either a domestic or foreign super captive finance subsidiary and domestic and foreign captive sub-sub or affiliated finance companies. We understand that the exclusion for foreign finance subsidiaries may require amendment to section 4915(c).

2. The acquisition of debt obligations arising out of (i) the sale of products which are produced, manufactured, assembled or extracted by members of a group of related corporations (determined under the 10% stock ownership requirement in section 4915(a)); (ii) the resale of trade-in products received as part payment of the sale of products referred to in (i) and trade-ins on trade-ins; (iii) the sale of intangible property described in section 4914(c)(3)(A) or services, if at least 15% of each sale represents U.S. content; (iv) capital loans to related or unrelated distributors and dealers; (v) loans to corporations qualifying under section 4915(a); and (vi) any combination of (i) through (v), provided at least 90% of the debt obligation in dollar volume arises from such acquisitions.

3. Domestic and foreign finance subsidiaries to borrow funds from foreign affiliated corporations which have obtained such funds through foreign

borrowings, where the U.S. parent, pursuant to regulations to be issued, advises the Commissioner in advance of such borrowing. (This is to enable businesses to borrow on manufacturing facilities owned by foreign affiliates which would reloan such funds to affiliated finance corporations.)

4. An equity investment in a captive finance subsidiary, provided that an amount equal to such equity investment is at all times invested by such finance subsidiary in certain excluded acquisitions (e.g., stock or debt obligations of a less developed country corporation, etc.) as determined by the Treasury Department and the Senate Finance Committee Staff in their draft legislation.

SUMMARY OF STATEMENT—CONNECTICUT GENERAL LIFE INSURANCE COMPANY

Extension of Time for Filing Notices of Acquisition of Original or New Issues of Canadian Securities

Section 4(d) of H.R. 6098 should be amended to permit any United States person acquiring an original or new issue of a Canadian stock or debt obligation after July 18, 1963, to the date of enactment of H.R. 6098, to file a notice of acquisition within 60 days following passage of the Act and have the notice deemed to be timely filed. Sen. Amendment 227, to H.R. 6098, proposed by Senator Ribicoff, provides this needed relief. It is therefore recommended and urged that the Ribicoff Amendment be adopted.

CONNECTICUT GENERAL LIFE INSURANCE CO.,
Hartford, Conn., July 18, 1967.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: We are writing you on behalf of our affiliate, Aetna Insurance Company of Hartford, to call your attention to a harsh and, we believe, unfair situation under the Interest Equalization Tax Act. While H.R. 6098, the pending bill to extend the Act for two more years, contains several relief provisions for taxpayers failing to file timely notices in connection with the acquisition of original or new issues of Canadian securities, these provisions do not go far enough. However, Senator Ribicoff has proposed an amendment (Sen. Amdt. No. 227) which would provide the further relief needed. We urge that you give this amendment your careful consideration and support.

Under Section 4917 of the Internal Revenue Code of 1954, the President is authorized to exempt from interest equalization tax original or new issues of stock or debt obligations of a foreign country if he determines that imposition of the tax would imperil or threaten to imperil international monetary stability. The President has exercised his authority to exempt from tax acquisitions of new or original issues of Canadian stock or debt obligations.

Under the original law, failure to file a timely notice of acquisition resulted in a complete loss of the exclusion, *i.e.*, a 100 percent penalty. The Interest Equalization Tax Extension Act of 1965 moderated this very harsh provision and provided for a charge of 5 percent of what the tax would otherwise be for each 30-day period, or portion thereof, during which the notice was delinquent, with a maximum charge of 25 percent of the tax. However, this amendment applies only to acquisitions made after October 9, 1965, and acquisitions prior to that date remain subject to the 100 percent penalty.

Section 4(d) of H.R. 6098, as originally proposed, would extend the 1965 relief provision to all acquisitions after July 18, 1963. The Ways and Means Committee, in its report on the bill,* gave two reasons for the relief provision: (1) the penalty of complete loss of exclusion was thought to be an unnecessarily severe provision; and (2) it was thought that the amount of the penalty for late filings should not depend on whether the acquisition was made before or after October 9, 1965.

Although the relief proposed in Section 4(d) of the bill is badly needed, it does not go far enough. It is now abundantly clear that the notice requirement of Section 4917, was, in practice, a hidden snare for taxpayers. Numerous cases exist where investors fell into the trap and lost either all or a portion of the

*H.R. Rep. No. 68, 90th Cong., 1st Sess. 19 (March 6, 1967).

exemption, depending on when the acquisition was made and the oversight discovered.

The uncertainty which has existed with respect to the taxpayer's obligations under the law arose because of the retroactive application of the tax, the numerous amendments made to the law, and the often-asserted "temporary" nature of the tax. The complex exclusion and exemption rules were not fully understood even by most people with special training in taxes.

In our case, as we would suppose to be the case of most institutional investors, matters relating to interest equalization tax could not be handled, as a practical matter, by accountants or lawyers with tax experience. The keeping of records and filing of notices of acquisition were necessarily handled by investment personnel, who normally handle only the details of purchase and sale of securities Failure to file a notice of acquisition was virtually always the result of an inadvertent clerical error.

Once the filing requirement has been overlooked, it is most unlikely that the error will ever come to light in the normal course of business. The error is usually not discovered until the Revenue Service conducts an audit.

The difficulty faced by taxpayers in trying to assure administratively that filing requirements were met is illustrated by the facts of the Connecticut General case. An affiliate of Connecticut General, Aetna Insurance Company, failed to file notices of acquisition covering three Canadian debt acquisitions between February 26, 1965, and June 17, 1965. One of these three issues and a portion of one of the other two involved maturities of less than three years and, thus, were not even covered by the interest equalization tax law until the Extension Act was passed in October, 1965, several months after the acquisitions. In all three cases the filing requirement was overlooked, and the failure to file was not discovered until a recent Revenue Service audit. The Company now appears to be subject to a substantial penalty.

The House of Representatives, in addition to reducing the maximum penalty from 100 percent to 25 percent, did take a second step toward providing the relief needed. A floor amendment to H.R. 6098 provides an exemption from all penalties for late filing of notice of acquisitions made after July 18, 1963, to the date of enactment of H.R. 6098 by "a State or political subdivision or by any agency or instrumentality thereof," if notice is filed within sixty days after the enactment of the Act.

The further amendment proposed by Senator Ribicoff would extend the relief provision for state or local governmental units, agencies or instrumentalities to any United States person making an acquisition after July 18, 1963, to the date of enactment of H.R. 6098, if notice is filed within sixty days following passage of the Act. Relief is urgently needed and since any investor could reasonably have the same problem as the states, it is appropriate to extend the relief provisions to all investors.

Under the Ribicoff amendment, however, if notice is not filed within sixty days following enactment of the Act, the person required to file will then lose 5 percent of the exclusion for failure to file on time. An additional 5 percent of the exclusion will be lost for each 30-day period in which notice is not filed, up to a maximum loss of 25 percent of the exclusion.

No interest will be paid with respect to any credit or refund allowed or made by reason of the application of this amendment.

We respectfully urge that the Committee endorse and support these relief provisions, including the Ribicoff amendment (Sen. Amdt. No. 227), in order to remedy a grossly inequitable situation. Where taxpayers attempt, in good faith, to comply with a complex tax law, they deserve reasonable treatment.

Respectfully submitted.

B. M. ANDERSON,
Vice President and Counsel.

STATEMENT SUBMITTED BY ROGER M. CARTER, ATTORNEY—APPLICATION OF INTEREST EQUALIZATION TAX TO SALE BY U.S. PERSON OF FOREIGN OWNED REAL ESTATE

A. BACKGROUND

The Interest Equalization Tax (IET) imposes a tax on acquisitions of foreign securities and debt obligations. IRC § 4911. The tax is an excise tax, and supposedly aids this country's balance-of-payments position by restraining the

demand on our capital market from other industrialized countries. The law is temporary and due to expire July 31, 1967. Indications are that it will be extended, with an added possibility that the rate of tax will be increased.

B. UNINTENDED CONSEQUENCES CAN RESULT UNDER FOLLOWING CIRCUMSTANCES

A U.S. trust owns real estate in a developed foreign country that it acquired in 1964 from a U.S. individual who had owned the real estate since 1961. A prospective purchaser who will be a "foreign obligor" under the factual situation described herein is interested in buying and wants to pay one-third down in U.S. dollars and the balance in U.S. dollars over a period of 30 years at 6½%, the obligation to be evidenced by a promissory note and secured by a mortgage. The prospective purchaser is not interested in financing locally because of the high rate of interest.

Query: If the sale is made, will the obligation of the foreign obligor as evidenced by the promissory note constitute a "debt obligation" within the meaning of IRC § 4920(a)(1)? The answer is apparently "yes" which is believed to be an unintended consequence. Under IRC § 4911(b), the present tax on such a debt obligation will be 15% which imposes too heavy a burden to make the sale advisable.

C. BRIEF ANALYSIS

The definition of "debt obligation" in IRC § 4920(a)(1) is so broad that the obligation considered herein is probably included. Also, Rev. Rul. 66–268 IRB 1966–36, 15 provides that unless a specific statutory exemption or exclusion is applicable, the tax applies. There appear to be no exemptions or exclusions.

It is clear the factual situation presented above that the sale will repatriate U.S. capital and, in addition, generate foreign-source income in the form of interest flowing in this direction. The net effect will be to assist in the U.S. balance-of-payments problem, and exclusion from the tax is therefore desirable. Comparable exclusions are provided in IRC § 4914(b)(10): Acquisitions of debt obligations on sale or liquidation of wholly owned foreign subsidiaries or sale of foreign branches and (1) Acquisition of debt obligation in sale of tangible property held for personal use.

D. RECOMMENDATION

If IET is extended, a provision be added to IRC § 4914 to exclude application to debt obligations acquired in the sale of foreign real estate. The following language is suggested:

"IRC § 4914(b) EXCLUDED ACQUISITIONS.—The tax imposed by section 4911 shall not apply to the acquisition—

* * * * * * *

(14) [TANGIBLE] FOREIGN PROPERTY [HELD FOR PERSONAL USE].—Of debt obligations arising out of the sale of.—

(A) * * * * * * *

(B) real property (other than property to which subparagraph (A) applies) located outside of the United States and owned on July 18, 1963, by the person acquiring such obligation *or acquired by such person from a person who was a United States person throughout the period of his ownership or continuously since July 18, 1963, or who had acquired it from such a person.*"

* * * * * * *

AMERICAN STOCK EXCHANGE,
New York, N.Y., July 17, 1967.

Re Interest Equalization Tax Extension Act of 1967 (H.R. 6098).

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: In order that the comments of the American Stock Exchange may be incorporated into the record of your Committee, we are submitting our views on the bill to extend and modify the Interest Equalization Tax.

In this connection the Exchange has not had an opportunity to consider fully the amendments to the bill proposed by the Treasury Department on Friday, July 14, 1967. The American Stock Exchange provides markets for more issues of foreign securities than any other stock exchange in the U.S. and, consequently, is seriously affected by the Interest Equalization Tax and by the new Treasury proposals. It is, therefore, unfortunate that we have been allowed so little time to analyze those proposals and prepare our comments.

We feel that the new procedures proposed by the Treasury Department are extremely complex and impose complicated record-keeping and validation requirements onerous to both investors and the securities industry. The problem of evasion alleged to give rise to the need for such procedures arises from the application of the tax to transactions in outstanding equity shares. The Interest Equalization Tax creates a price differential betweeen foreign markets for foreign securities and domestic markets for the same securities. As Under Secretary of the Treasury Deming stated in his Supplementary Statement before the Committee on July 14, 1967, "this spread of several points furnishes the profit resulting from these tax-evading transactions."

Elimination of the tax on transactions in outstanding equity shares would eliminate the price differential giving rise to the problem and thereby obviate the enforcement problem described by the Treasury Department. At the same time, limiting the tax to new or original offerings of securities in this country does not mean that foreign issuers would be able to disguise new offerings as trades in outstanding shares. Stocks not already in the U.S. are introduced into the U.S. markets in amounts significant for balance of payments purposes ordinarily under circumstances which would give rise to tax as new or original issues. Foreign issuers of securities listed on the national stock exchanges require exchange approval to issue additional shares so that as to such issues there is an adequate basis for assuring that original offerings are not camouflaged as outstanding shares. If an issue not subject to this control by the national stock exchanges were originally sold outside the U.S. with a view towards resale in the U.S. as outstanding shares, in most cases the resale would require registration under the Securities Act of 1933 as a public offering. The introduction of new foreign securities into either the exchange or over-the-counters markets in the U.S. is a one-time matter, and the tax would be collected with relative ease at the time of introduction.

Elimination of the tax on outstanding shares would also obviate a number of other administrative burdens for investors and the securities industry. Application of the tax to outstanding shares results in a need to maintain two markets for a single stock issue: one for shares selling subject to the tax and another for shares selling free of the tax. The maintenance of these distinct markets is confusing to investors and creates an administrative burden for exchanges and others in the securities industry. Elimination of the tax on outstanding shares would clear away this confusion and burden.

While the Treasury Department contends that the application of the Interest Equalization Tax to outstanding shares has had a favorable effect on the U.S. balance of payments during the period of its imposition, this result is far from clear. Data presented to the Committee indicate that during the period since the passage of the Interest Equalization Tax, foreigners have been net sellers of U.S. equity securities. It is reasonable to infer that the Interest Equalization Tax has discouraged foreign investment in U.S. securities as well as U.S. purchases of foreign securities, and removal of the tax could stimulate sufficient foreign investment in U.S. securities to offset any possible increase in U.S. purchases of foreign securities. Accordingly, it does not necessarily follow that repeal of the tax as applied to transactions in outstanding equity shares will result in an adverse effect on the U. S. balance of payments.

An especial anomaly arises under Section 4917, which provides an exemption for new or original issues of a corporation or government unit in countries where the President has found that such an exemption serves the interests of international monetary stability. Executive Order No. 11175 makes the exemption applicable to new or original issues of Canadian and certain Japanese securities. Yet, acquisitions of these same securities after the initial issuance are subject to tax. We submit that, at the least, securities which qualify for exempion under this section on initial sale should also be afforded an exemption as to subsequent transactions.

We recognize that the problems giving rise to the imposition of the Interest Equalization Tax still exist. Nonetheless, the tax should be regarded as a temporary measure and the problem of dollar outflow through investment in foreign securities a temporary problem. Accordingly, if the tax is to be extended we suggest it be extended for only one year to assure that the balance of payments situation is reviewed by the Congress on a timely basis and that any alternatives to the tax which might be proposed are given prompt consideration.

We oppose, however, the proposal to increase the present rates of tax applicable to acquisitions of equity securities. The increase is apparently intended to assure that financing by foreigners is discouraged even where United States interest rates are as much as two points below the rates in foreign capital and money markets. This rationale certainly does not justify increasing the tax on acquisitions of outstanding equity shares, for relative interest rates do not influence such transactions. Taxing acquisitions of equity securities from foreigners at as much as 30% rate constitutes a penalty on foreign holders who are forced to liquidate investments in many foreign equity securities having their principal markets in this country.

We appreciate the opportunity to present our views to the Committee.

Sincerely,

RALPH S. SAUL.

NEW YORK, N.Y., *July 18, 1967.*

TOM VAIL,
Senate Finance Committee, New Senate Office Building,
Washington, D.C.:

In order to facilitate participation by persons other than U.S. persons in financing of exports of goods manufactured or produced in the United States an amendment to the Interest Equalization Tax is respectfully requested. It is the current practice of U.S. exporters to sell certain debt obligations which have been acquired from foreign persons in the export of goods manufactured in the United States. Since it is often necessary for the U.S. manufacturer or producer to sell the debt obligation at a discount or to guarantee that the rate of interest paid on the debt obligation will be equal to or a stated percentage above the prime rate applicable to similar debt obligations the U.S. manufacturer often requires a right to repurchase the debt obligation if such undertakings should become too costly. Since such debt obligation cannot be repurchased from a foreign person without incurring the interest equalization tax a U.S. manufacturer will not presently sell this type of debt obligation to a foreign person if this restriction were removed. It is believed that foreign capital would be attracted to this type of financing. This type of financing would have a favorable effect on the U.S. balance of payments. It is therefore respectfully requested that section 4914(c) be amended as follows:

1. By redesignating paragraph (7) as paragraph (8).
2. By adding after paragraph (6) the following new paragraph: "(7) reacquisition of export debt obligation where an exclusion provided by paragraph (1), (2), or (6) of this subsection has applied with respect to the acquisition of a debt obligation by a United States person, and such debt obligation is subsequently transferred by such United States person to a person other than a United States person, the tax imposed by section 4911 shall not apply to the subsequent acquisition by such United States person of such debt obligation from such person other than a United States person."

HILL SAMUEL & CO., LTD.,
By PETER KIRWAN-TAYLOR, *Director.*

STATEMENT FILED BY JUSTIN M. MARTIN, SEATTLE, WASH., ON BEHALF OF JUSTIN MARTIN & CO., CERTIFIED PUBLIC ACCOUNTANTS OF SEATTLE, WASH.

I am Justin M. Martin, a Certified Public Accountant and a partner in the firm of Justin Martin & Co., Certified Public Accountants, with offices at 923 White-Henry-Stuart Building, Seattle, Washington. Justin Martin & Co. represents several medium sized corporate and individual clients who are engaged principally in the forest products industry in western United States and Canada. In connection with their activities in Canada, Justin Martin & Co. has been

engaged frequently to prepare interest equalization tax returns, notices of acquisition of original or new Canadian stock or debt obligations and certificates of American ownership, and to consult with and advise these clients on matters relating to the interest equalization tax. I am submitting this statement to urge that Section 4917(d) of the Internal Revenue Code (relating to the exclusion for original or new issues where required for international monetary stability) be amended to provide for the omission of penalties in the case of late filing of certain notices of acquisition where it is shown that such failure is due to reasonable cause and not to willful neglect.

In the enactment of the Interest Equalization Tax Extension Act of 1965, the Senate Finance Committee moderated what in effect had been a 100% penalty under prior law for failure to file a timely notice of acquisition where the acquisition was eligible for the international monetary stability exclusion. In lieu of, in effect, imposing the 100% penalty the 1965 act provided on acquisitions after the enactment date thereof a charge of 5% of what the tax would be for each 30 day period or any portion thereof during which the notice is delinquent, up to a maximum of 25% of the tax. H.R. 6098 amends Section 4917(d) further by providing that these reduced penalties shall apply with respect to acquisitions made after July 18, 1963, and not limited to those made "after the date of the enactment of the Interest Equalization Tax Extension Act of 1965".

In spite of the relief resulting from these reduced graduated penalties I believe, based upon my experience, that such penalties may be unreasonable, unjust and punitive in circumstances which because of death, illness or other reason, the failure to file such notices of acquisition on time has been beyond the control of the taxpayer.

Section 6651 of the Internal Revenue Code imposes graduated penalties corresponding to those under Section 4917(d) upon failure to file tax returns, including income tax, gift tax and estate tax returns unless it is shown that such failure is due to reasonable cause and not due to neglect. Since Section 4917(d) relates to the late filing of certain notices of acquisition with respect to transactions which are excluded or exempt from interest equalization tax, I can see no distinction nor justification for imposing penalties for late filing when under the same conditions the late filing of income tax, gift tax and estate tax returns may be excused from penalties.

In order to be equitable, I believe that H.R. 6098 should be amended to provide for the omission of penalties upon a showing that failure to file on time is due to reasonable cause, effective with respect to acquisitions made after July 18, 1963.

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