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OVERALL LIMITATION ON FOREIGN TAX CREDIT

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Mr. B RD of Virginia, from the Committee on Finance, submitted the following

REPORT

together with

MINORITY VIEWS

[To accompany H.R. 10087]

The Committee on Finance, to whom was referred the bill (H.R. 10087) to amend the Internal Revenue Code of 1954 to permit taxpayers to elect an overall limitation on the foreign tax credit, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

I. SUMMARY OF THE BILL

A. IN GENERAL

Under present law income taxes paid to a foreign country may be taken as a credit against income taxes otherwise due the United States. However, the taxes of each foreign country which may be taken as a credit are limited to the same proportion of the U.S. tax (before this credit) which the income from that foreign country is of the taxpayer's total taxable income. This is known as the "per country" limitation. This bill provides an alternative limitation known as the "overall" limitation which a taxpayer may elect. This limitation applies to taxes of all foreign countries taken together and allows as a credit the same proportion of the U.S. tax (before this credit) which the income from *all* foreign countries is of total taxable income. This has the effect of permitting taxpayers to treat the taxes of the various foreign countries collectively, rather than separately for each country.

B. Committee Amendments

Under the House bill taxpayers could make their initial shift from the per country limitation to the overall limitation at any time. Once under the overall limitation they could of their own volition shift back to the per country limitation after an interval of 5 years (or after a shorter period if they had the permission of the Treasury Department). After having shifted back to the per country limitation they could of their own volition again return to the overall limitation after a 5-year interval (or lesser time with the consent of the Treasury Department). Your committee's amendments provide that taxpayers may not of their own volition shift back and forth between these limitations after 5-year intervals. Under the bill as amended by your committee taxpayers may at their own election make an initial shift from the per country to the overall limitation but thereafter they can change from the overall limitation to the per country limitation, or vice versa, only with the consent of the Treasury Department. It is expected that this consent will be given where there are basic changes in a taxpayer's business as, for example, where he engages in substantial operations in a new foreign country or where existing investments are lost due to nationalization, expropriation, or war.

Under the House bill foreign income taxes, which may not be credited against U.S. taxes in the current year, may be carried back or forward from a year in which the per country limitation is used to either a year in which the per country or overall limitation is used. However, under the House bill foreign taxes may not be carried from an overall-limitation year to a per-country-limitation year. Under your committee's amendments taxes may not be carried either from a per-country-limitation year to an overall-limitation year or from an overall-limitation year to a per-country-limitation year. They may, however, be carried from a year in which the per country limitation applies to another year in which the per-country limitation applies, or from a year in which the overall limitation applies to another year in which the same limitation applies.

Your committee has also amended the bill to provide that to the extent foreign taxes are above those imposed by the United States because of the special 14 point tax differential provided by the United States for Western Hemisphere trade corporations, they cannot be used to offset U.S. taxes at a 52 percent rate on income earned in countries where the foreign taxes involved are less than those imposed by the United States. This amendment has application only where consolidated returns are filed.

Under both the House and your committee's version of the bill, the overall limitation is to be available for the calendar year 1961 and subsequent years.

Your committee has also added to the bill an amendment relating to another problem. It has provided that where individuals have received reimbursements from certain types of nonprofit corporations for moving expenses, these amounts are not to be included in gross income of the individuals. This rule is to apply only to the extent the amounts received did not exceed the actual moving expenses and only if the individuals were not advised by an agent of the employer that the amount was properly includible in gross income. The amendment is further limited to expenses paid by nonprofit corpora-

tions formed exclusively to operate scientific laboratories for the Atomic Energy Commission and operating on funds provided by the Commission.

C. Revenue Effect

It is estimated that this bill will result in an annual revenue loss of between $15 and $20 million.

D. Treasury Views

The Treasury Department has indicated that it has no objections to the bill as amended by your committee.

II. REASONS FOR THE OVERALL LIMITATION ON THE FOREIGN TAX CREDIT

A. In General

Present law, in general, provides that foreign income, war profits, or excess profits taxes paid to any foreign country or to a possession of the United States may be credited against the U.S. tax otherwise due (or alternatively may be treated as a deduction in arriving at the income subject to the U.S. tax). However, present law provides a limitation on the extent to which these foreign, etc., taxes may be credited against U.S. tax in order to prevent the foreign tax from offsetting U.S. tax on domestic income. Thus the limitation restricts the extent to which the foreign taxes may be credited to what the U.S. tax otherwise would be on the foreign source income. For example, if $200 of taxable income is derived from domestic sources and $100 from foreign sources, the extent to which the foreign taxes may offset U.S. taxes is limited to what the U.S. tax would be on the $100 of foreign source income. Thus, the maximum amount of foreign taxes which may be credited against the U.S. tax of $156 (assuming a flat 52-percent rate) on the $300 of taxable income is $52; namely, the amount of tax the United States would impose on the $100 of foreign source income.

The limitation in present law has been called a "per country" limitation because the limitation is applied separately with respect to the tax of each foreign country (and each possession of the United States). Thus, present law provides that the amount of tax paid (or accrued) to each foreign country which can be claimed as a credit is to be the same proportion of the total tentative U.S. tax which the taxpayer's taxable income from sources within the foreign country in question is of his total taxable income.

Prior to the adoption of the 1954 Code, two limitations were imposed on the extent to which foreign taxes could be taken as a credit against U.S. taxes. One limitation was the "per country" limitation referred to above and the other was a so-called overall limitation. The "overall" limitation was computed in the same manner as the per country limitation, except that this limitation applied to the aggregate taxes paid all foreign countries and possessions of the United States. Thus, this limitation (expressed in terms of current definitions of income) restricted the amount of the foreign taxes which could be claimed as credits against U.S. taxes to the same proportion

of the taxpayer's tentative U.S. tax which his taxable income from all foreign countries [1] was of this total taxable income.

Congress in 1954 concluded that it was inappropriate for both of these limitations to be applied in determining the foreign taxes allowable as a credit and at that time repealed the so-called overall limitation. The report of your committee at that time stated as the reason for this action:

> The effect of the (overall) limitation is unfortunate because it discourages a company operating profitably in one foreign country from going into another country where it may expect to operate at a loss for a few years. Consequently, your committee has removed the overall limitation. (Parenthesis added.)

While the per country limitation may be preferable to taxpayers where they are operating at a profit in one foreign country and at a loss in another, more frequently taxpayers find themselves in situations where averaging out the high and low taxes of different foreign countries in which they operate would be more advantageous. Thus, if $100 of a taxpayer's income is taxed at a 42 percent rate in foreign country A and another $100 of his income is taxed at a rate of 62 percent in foreign country B, such a taxpayer under the per country limitation will not be able to claim credits for all of his foreign taxes unless he is able to carry the noncredited taxes back or forward and use them in other years. This occurs under the per country limitation because while the full $42 paid in country A may be claimed as a credit, only $52 of the $62 paid in country B may be so claimed. Thus in this case in the current year the total foreign taxes claimed as a credit against U.S. tax may not exceed $94.

On the other hand, under the overall limitation the income and taxes with respect to countries A and B are added together before applying the limitation and since on $200 of foreign income the U.S. tax (again assuming a flat 52 percent rate) would be $104, the full $42 paid country A and the full $62 paid country B may be credited.

These two limitations represent basically different concepts of the relationship between domestic and foreign income. The overall limitation in effect treats the taxpayer's income as being divisible into two parts, domestic and foreign. Thus, under this limitation a foreign tax credit is allowed for any foreign income taxes so long as these taxes do not represent more than the U.S. tax rate applied to the taxpayer's total foreign income. The per country limitation, on the other hand, treats the taxpayer's income as being divisible into many parts, his domestic income and his income from each foreign country, and applies the limitation separately to each.

In most cases American firms operating abroad think of their foreign business as a single operation and in fact it is understood that many of them set up their organizations on this basis. It appears appropriate in such cases to permit the taxpayer to treat his domestic business as one operation and all of his foreign business as another and to average together the high and low taxes of the various countries in which he may be operating by using the overall limitation.

In addition, making the overall limitation generally available for foreign operations only provides treatment which is already available

[1] Technically this is income from sources without the United States.

in the case of the so-called foreign base corporation, or foreign subsidiary serving as a holding company for its subsidiaries carrying on active business enterprises. In the case of a foreign base corporation the Treasury regulations provide that the taxes paid by its subsidiaries are to be treated as if they were paid to the foreign country where the foreign base company is incorporated, and thus aggregated for purposes of applying the limitation.

On the other hand it is recognized that in some cases taxpayers may think of their businesses in various foreign countries as separate ventures. This, of course, is especially likely when a company begins in a different foreign country a business which is risky and which is likely to result in losses at least for an initial period of years. In such cases the company is more likely to think of such a business as being separate and apart from its other more stable operations in other foreign countries. It seems appropriate in such cases to permit taxpayers to use the per country limitation, thus for tax purposes treating each as a separate operation.

B. Committee Amendments

1. No automatic elections every 5 years

Your committee agrees with the basic concept expressed in the House committee report, namely, that taxpayers should either adopt a unitary concept of foreign operations or one which treats the business in each foreign country separately. However, it sees no reason to permit taxpayers of their own volition to shift back and forth between the two types of limitations over 5-year intervals as the House bill would do. Where the basic nature of the business changes, or where conditions in the foreign country change, under the bill as amended by your committee it will still be possible to change from one type of limitation to the other by obtaining the consent of the Treasury Department. Your committee has been assured that the Secretary of the Treasury will be reasonable in exercising this authority and will permit, for example, taxpayers to shift back to the per country limitation where they are about to enter substantial operations in a new foreign country and anticipate that the operations in that country will prove quite risky with the possibility of their resulting in a loss for a number of years. Also, it is understood that he will permit taxpayers to shift back to the per country limitation where substantial losses are realized with respect to existing investments because of nationalization, expropriation, or war. Similarly, it is expected that the Secretary or his delegate will develop appropriate rules allowing a taxpayer, upon a proper showing, to shift back to the overall limitation where he previously had the consent of the Secretary to use the per country limitation.

2. No carrybacks or carryforwards from per-country to overall-limitation years

Like the House bill, the bill as amended by your committee does not permit foreign taxes to be carried from an overall-limitation year to a per-country-limitation year. In addition, however, your committee's bill does not permit foreign taxes to be carried from a per-country-limitation year to an overall-limitation year. This restriction was added because otherwise there would be a windfall gain to those taxpayers who have accumulated unused carryovers, which

they could not use when the per-country-limitation was applicable, and which they might now be able to use if they shift over to the overall limitation. In many cases the greater averaging obtainable under the overall limitation would enable taxpayers to use these accumulated unused foreign taxes as credits when they otherwise could not do so. The Treasury Department has estimated that this aspect of the bill alone would have resulted in an immediate revenue loss for the first year after enactment of approximately $30 million. Your committee's amendments foreclose this windfall and possible revenue loss by permitting unused foreign taxes to be carried only from a year in which the per-country-limitation applies to another year in which this same limitation applies or from a year in which the overall limitation applies to another year in which this same limitation applies.

3. Application of overall limitation to Western Hemisphere trade corporations

Your committee has also amended the House bill in its application of the overall limitation to Western Hemisphere trade corporations filing a consolidated return with other domestic corporations. Under present law these corporations are given a 14-percentage-point tax differential or, in general, are taxed at 38 percent rather than 52 percent.

Under the House bill where a consolidated return is filed, foreign taxes which cannot be credited against U.S. tax, because this lower rate is in effect, can be used to offset U.S. taxes at 52 percent on other foreign-source income where the foreign tax rates involved are not this high. For example, assume that the income of a Western Hemisphere trade corporation is $100 before the imposition of foreign taxes of $45. Assume another domestic corporation also earns $100 in another foreign country and is subject to the same $45 foreign tax, but that this company is not a Western Hemisphere trade corporation. The Western Hemisphere trade corporation in this case would generally be subject to a U.S. tax (before foreign tax credit) of about $38 (ignoring the surtax exemption). Therefore, in this case only $38 of the $45 of foreign taxes could be credited against U.S. tax, leaving $7 of foreign taxes which cannot be credited. In the case of the other corporation, the U.S. tax before foreign tax credit would be $52 (again ignoring the surtax exemption). Against this could be credited the full $45 tax paid the foreign country, leaving a net U.S. tax of $7. If the income of the two corporations in this example were included in a consolidated return, it would be possible in effect to credit the $7 of foreign tax not be credited in the case of the Western Hemisphere trade corporation against the $7 of U.S. tax otherwise due in the case of the corporation subject to the 52 percent tax. To prevent this result, the amendments made by your committee provide that foreign taxes which cannot be credited against U.S. taxes in the case of Western Hemisphere trade corporations as a result of the special 14-point-tax differential provided for these corporations may not be used to offset U.S. tax on other foreign-source income either in the current year or in years to which the unused credits may be carried. This is applied only where a consolidated return is filed and only where the overall limitation is used.

The foreign taxes which may not be taken into account for this purpose are only those which cannot be credited because of the 14-

point-tax differential which Western Hemisphere trade corporations have. Thus, if the foreign taxes on $100 of income of a Western Hemisphere trade corporation were $62, the amount in excess of $52 (ignoring the surtax exemption), or $10, would be allowed as a credit against any U.S. tax on other foreign-source income.

If more than one Western Hemisphere trade corporation is involved, the taxes of this group of corporations are averaged before determining any foreign taxes which may not be taken into account. This can be illustrated by an example of a Western Hemisphere trade corporation having $100 of income on which the foreign taxes are $20, and another Western Hemisphere trade corporation, included in the same consolidated group, also with income of $100 but foreign taxes of $45. In this case the U.S. tax on this $200 of income before credit would be at an effective rate of about 38 percent, or amount to about $76. The combined foreign taxes on this income would be $65 ($20+$45). All of these taxes could be credited even though in the case of one of the companies the taxes were in excess of a 38 percent tax. This is because the *average* tax on the combined income of the two Western Hemisphere trade corporations is not in excess of a 38 percent effective rate.

III. GENERAL EXPLANATION OF THE OVERALL LIMITATION ON THE FOREIGN TAX CREDIT

A. In General

The bill amends section 904 of the Internal Revenue Code to provide two alternative limitations on the foreign tax credit, the "per country" limitation (already applicable under present law) and an "overall" limitation. The per-country limitation restricts the portion of foreign income, war profits, and excess profits taxes which may be credited against U.S. tax to the same portion of the total tentative U.S. tax (i.e., the tax computed without this credit) which the taxable income from the foreign country (or U.S. possession) is of the taxpayer's total taxable income. The overall limitation is computed in the same manner except that instead of computing this limitation separately with respect to the tax paid each country it is computed on an aggregate basis. Thus, under this limitation the aggregate amount of foreign taxes which may be claimed as a credit against U.S. tax is limited to the same proportion of the taxpayer's total tentative U.S. tax which his taxable income from *all* foreign countries [2] is of his total taxable income.

These two alternative limitations can be illustrated by the same example used in the prior section, namely, the case of a taxpayer operating abroad through branches who has $200 of foreign income, $100 of which is subject to a $42 tax in country A and $100 of which is subject to a $62 tax in country B. In addition, assume he has $100 of domestic income. The tentative U.S. tax on the $300 of income would be $156 (assuming a flat 52 percent rate). The formula for the per country limitation is as follows:

$$\text{Tentative U.S. tax} \times \frac{\text{Taxable income from country in question}}{\text{Total taxable income}}$$

[2] Technically this is income from sources without the United States.

Applying this formula in the case of the tax paid to country A gives the following result:

$$\$156 \times \frac{\$100}{\$300} = \$52.$$

In this case the actual tax paid is less than the $52 which may be credited under the limitation, with the result that the full $42 of tax paid may be credited. However, in country B, although the formula will provide the same $52 limitation, in this case the limitation is applicable and reduces from $62 to $52 the amount of taxes which may be credited. Thus, the total taxes in this case which may be taken currently as a credit under the per-country limitation are $42 plus $52 or $94.

Under the overall limitation, on the other hand, the formula is as follows:

$$\text{Tentative U.S. tax} \times \frac{\text{Taxable income from all foreign countries}}{\text{Total taxable income}}$$

Applying this formula in the illustration used here gives the following result:

$$\$156 \times \frac{\$200}{\$300} = \$104.$$

Thus, in this case, since the foreign taxes paid ($42 plus $62) do not exceed the $104 limitation, the entire amount may be claimed as a credit.

Under the bill the per-country limitation is to be applied unless the taxpayer elects the overall limitation. This in effect means that the present limitation is to apply unless the taxpayer desires to change to the overall limitation. This overall limitation may be elected for the first time for taxable years beginning on or after January 1, 1961. Once this overall limitation is elected, under the House bill it would continue to apply for a 5-year period unless the taxpayer received the consent of the Secretary of the Treasury or his delegate to change back to the per-country limitation at an earlier date. Under the amendments made by your committee, however, once this overall limitation is elected, the taxpayer may change back to the per-country limitation only with the consent of the Secretary or his delegate. Once a taxpayer has changed back from the overall limitation to the per-country limitation under the House bill he can, after waiting 5 years, of his own volition again elect the overall limitation (or at a shorter interval if he receives the consent of the Secretary or his delegate to make such a change). Under your committee's amendments, however, once having been permitted to go back to the per-country limitation by the Secretary or his delegate, he must again receive this consent in order to shift back to the overall limitation.

Under present law foreign taxes which, because of the per-country limitation, cannot be credited against U.S. tax in the current year, may be carried back 2 years and then any foreign taxes still remaining may be carried forward to the 5 immediately succeeding years. The House bill would provide that foreign taxes may not be carried from a year in which the overall limitation applies to another year in which the per-country limitation applies.

The amendments made by your committee similarly do not permit unused foreign taxes to be carried from a year in which the overall limitation applies to a year in which the per-country limitation applies. However, in addition, the amendments made by your committee do not permit unused foreign taxes to be carried from a year in which the per country limitation applies to a year in which the overall limitation applies.

The House bill provides no special restriction as to the application of the overall limitation in the case of Western Hemisphere trade corporations. Your committee's bill provides that where one or more Western Hemisphere trade corporations files a consolidated return with other corporations and the overall limitation applies, the amount of foreign taxes paid by the Western Hemisphere trade corporation in excess of the amount of U.S. tax on the consolidated return attributable to them is not to be taken into account for purposes of the foreign tax credit. Thus, assume that a Western Hemisphere trade corporation has paid foreign taxes of $45 on $100 of income (the income being that on the consolidated return attributable to the Western Hemisphere trade corporation) and that the U.S. tax on the consolidated income attributable to the corporation is $38 (this ignores the effect of the surtax exemption and possibly other items). In this case the excess of the $45 foreign tax over the $38 U.S. tax, or $7, is not to be taken into account for purposes of the foreign tax credit. If two or more Western Hemisphere trade corporations are involved in a consolidated return, the income and taxes of the two are averaged together in applying this restriction.

The bill also provides that the foreign taxes not to be taken into account in general are only those imposed at rates between 38 percent and 52 percent. This result is accomplished by providing that the restriction referred to above is not to apply to the extent that the foreign taxes paid by the Western Hemisphere trade corporation (or corporations) is in excess of the tax it would have to pay the United States (before any foreign tax credit and without regard to the 2-percent penalty tax on consolidated returns) if the corporation were not a Western Hemisphere trade corporation.

B. Statute of Limitations

Both the House and your committee's version of the bill provide that the statute of limitations for a year to which foreign taxes are carried back as a result of the unused credit is not to close for purposes of the foreign taxes credited in that year until 1 year after the statute runs for the year from which the taxes are carried (or that is, generally, the year in which the taxes were paid or accrued). The purpose of this is to prevent taxpayers from claiming a double benefit with respect to an amount where the statute has run with respect to 1 year and not the other. Thus, for example, if the per country limitation were applicable in 1961, taxes which could not be credited in that year could be carried back and credited in 1959 if in both cases the per country limitation applied. However, if after the statute of limitations has run for the year 1959 the taxpayer changes his election with respect to 1961 and elects the overall limitation, then no carryback to a per country limitation year would be available and taxes not credited would be available in full as a carryforward to years in which the over-

all limitation applied. This would be true despite the fact that this same amount which is being carried forward has been claimed as a credit in the prior year with respect to which the statute of limitations has run. The extending of the statute of limitations with respect to the credits in the earlier year until 1 year after the statute of limitations has run for the year in which the taxes arose will prevent this double benefit and give the Internal Revenue Service time to review the application of the foreign tax carryback in the earlier year. This double benefit is prevented not only in the case of changes from the per country to the overall limitation but also in cases of the change from a credit to a deduction.

Both versions of the bill also provide that the choice to take the foreign tax credit in lieu of the deduction, and the choice to take the overall limitation in lieu of the per country limitation, must in general be made or changed within the 3-year statute of limitations (or the statute which applies to the tax itself) and not within the special 10-year statute provided by section 6511(d)(3). The bill provides that for the periods to which the 1954 Code is applicable (generally the calendar year 1954 and subsequent years) this 10-year statute is to be available only for purposes of determining the size of the credit, and not for purposes of making a choice between per country or overall limitations or a choice between a deduction or credit.

C. Effective Dates

Although generally, under both the House and your committee's versions, the bill is to be available only with respect to taxable years beginning on or after January 1, 1961, the provision described above, preventing a double benefit as a result of the running of the statute of limitations, is made applicable to taxable years beginning on or after January 1, 1958. The calendar year 1958 is the earliest taxable year to which unused foreign taxes may be carried. In any case this year will be open at least until 1962. Also as indicated above, the bill provides that generally the 3-year statute, but in no case the 10-year statute, is to be available for choices between the selection of the deduction or credit, or overall or per country limitation for taxable years beginning after December 31, 1953, and ending after August 16, 1954.

IV. REIMBURSEMENT FOR MOVING EXPENSES RECEIVED BY EMPLOYEES OF CERTAIN CORPORATIONS FORMED EXCLUSIVELY TO OPERATE LABORATORIES FOR THE ATOMIC ENERGY COMMISSION

A situation has been called to the attention of your committee involving moving expenses received by employees of a corporation formed to perform research, development and production tasks for the Atomic Energy Commission on the ordnance aspect of atomic weapons. The corporation concerned engages only in activities assigned to it by the Atomic Energy Commission, and it operates under a contract which specifically provides that all costs and expenses of operation will be reimbursed by the Atomic Energy Commission

from appropriations by Congress. Also, under the contract the services of the corporation involved are to be rendered without profit of any kind.

In hiring the professional and skilled employees required for the type of work in which the corporation is involved, the corporation paid the traveling and moving expenses incurred by the new employees in moving to accept employment. Until Revenue Ruling 55-140 (C.B. 1955-1, 317) was issued in March of 1955, the officials of the corporation had assumed that such expense reimbursement was not taxable income. This was based on the fact that an Internal Revenue Service ruling issued in 1949 to a laboratory, which was an Atomic Energy Commission installation, and which initially had held that reimbursed travel expense to a new employee from a person under contract to the Atomic Energy Commission was taxable income, was modified by the Commissioner in 1951. In the 1951 ruling it was held that reimbursement for travel expense on transfers between different nonprofit contractors in the Atomic Energy Commission complex was not considered to be taxable income.

In view of all of the circumstances involved in this case, your committee believes that it would be unfortunate to impose income tax with respect to the reimbursement of moving expenses for the employees of this corporation. It has, therefore, added a new section to the bill relating to amounts received by an individual, after December 31, 1949, and before the date of enactment of this bill from a corporation meeting certain qualifications, as reimbursement for moving himself and his immediate family, household goods, and personal effects to a new place of residence in order to accept employment with the qualifying corporation. This section provides that moving expenses of the type referred to above are to be excluded from the gross income of the individual to the extent that the reimbursement did not exceed the actual expenses paid or incurred for these purposes.

This provision is not, however, to apply in any case where the individual involved was advised at the time of his employment by an authorized official of the corporation that the amount of the reimbursement would be includible in gross income. In the case in question it is understood that new employees on or about September 1, 1955, were advised specifically that the amounts reimbursed to them for moving and travel expenses were taxable income and thus many, if not all, of the new employees hired after that date will not receive the treatment accorded by this provision.

The conditions which must be met by a corporation to qualify under this provision are (1) it must be formed exclusively for the purpose of, and be exclusively engaged in, operating without profit a scientific laboratory for the Atomic Energy Commission, and (2) it must be operated solely on funds appropriated to the Atomic Energy Commission by Congress.

This amendment was added by your committee as a section in the Technical Amendments Act of 1958 but was deleted in the conference on that bill on the understanding that the Treasury Department objected to this provision. The Treasury Department has now indicated that it does not object to the enactment of this provision.

V. TECHNICAL EXPLANATION OF THE BILL

First Section of the Bill

The first section of the bill makes amendments to section 904 of the Internal Revenue Code of 1954 (relating to limitation on foreign tax credit). Subsection (a) strikes out subsection (a) of section 904 and inserts in lieu thereof new subsections (a) and (b).

Alternative limitations.—The new section 904(a)(1) contains the existing provisions of section 904(a) but prefaced with a clause to the effect that such provisions (referred to in the heading as the per-country limitation) shall apply in the case of a taxpayer who does not elect the overall limitation provided by a new paragraph (2) of section 904(a). Under the per-country limitation, the amount of the credit in respect of the tax paid or accrued to any foreign country or possession of the United States may not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country or possession (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

In the case of a taxpayer who elects the overall limitation provided by the new paragraph (2), the total amount of the credit with respect to taxes paid or accrued to all foreign countries and U.S. possessions may not exceed the same proportion of the tax against which such credit is taken as the taxpayer's taxable income from sources without the United States (but not to exceed total taxable income) bears to the taxpayer's entire taxable income for the same taxable year.

In computing the per-country limitation, only income from sources within the country in question is taken into account in the numerator of the ratio. In computing the overall limitation, on the other hand, all income from sources without the United States is to be taken into account. Thus income which is from sources without the United States but not from sources within any foreign country or possession of the United States (for example, high seas income) is not taken into account under the per-country limitation but is taken into account under the overall limitation.

Election of overall limitation.—Section 904(b)(1) provides that a taxpayer may elect the overall limitation for any taxable year beginning after December 31, 1960, and that the election remains in effect for all subsequent years up to (but not including) a taxable year for which the election is revoked. It may be revoked with the consent of the Secretary of the Treasury or his delegate for any taxable year.

Section 904(b)(2) provides that if a taxpayer has made an election of the overall limitation which, with the consent of the Secretary or his delegate, has been revoked, he may not make a new election of the overall limitation unless the Secretary or his delegate consents to such new election.

Section 904(b)(3) provides that either the election of the overall limitation or the revocation of such an election may be made only in such manner as the Secretary or his delegate by regulations prescribes. Such election or revocation for any taxable year may be made or changed at any time before the expiration of the period prescribed by section 6511(a) (generally, 3 years from the time the return was filed) for making a claim for credit or refund of U.S. income tax imposed for such taxable year. Since the initial election of the

overall limitation does not require consent of the Secretary or his delegate, the initial election made for a taxable year (whether or not the first taxable year beginning after December 31, 1960) may be revoked without the consent of the Secretary or his delegate before the expiration of the period prescribed for making a claim for credit or refund of U.S. income tax imposed for the taxable year in which the initial election was made. After such a timely revocation the taxpayer could make his initial election of the overall limitation for a later taxable year without the consent of the Secretary or his delegate. If, however, a taxpayer has made his initial election of the overall limitation, and the period prescribed for making a claim for credit or refund of U.S. income tax imposed for the taxable year to which the initial election first applied has expired, the taxpayer may not revoke such election for any taxable year without the consent of the Secretary or his delegate. Moreover, if the taxpayer revokes such election for any taxable year with the consent of the Secretary or his delegate, he may not make a new election without the consent of the Secretary or his delegate even though the period prescribed for making a claim for credit or refund of U.S. income tax imposed for such taxable year has not expired. In such case the taxpayer may make an election of the overall limitation for any subsequent taxable year only with the consent of the Secretary or his delegate.

Conforming amendments.—Subsections (b) and (c) of the first section of the bill redesignate subsections (b) and (c) of existing section 904 as subsections (c) and (d), respectively, and insert "the applicable limitation under subsection (a)" in lieu of "the limitation under subsection (a)" in such subsections.

Carrybacks and carryovers where overall limitation is elected.—Subsection (d) of the first section of the bill amends section 904 by adding a new subsection (e), relating to the carryback and carryover of taxes where the overall limitation is elected, and a new subsection (f), a cross-reference.

The new section 904(e) provides special rules for carrybacks and carryovers of foreign taxes where the overall limitation is elected. Section 904(e)(1) provides that, for the purpose of determining the carryover or carryback under the first sentence of section 904(d), the foreign taxes for a taxable year to which the overall limitation applies shall be aggregated on an overall basis rather than taken into account on a per-country basis.

Section 904(e)(2) provides that no amount of foreign taxes paid or accrued for a taxable year to which the per-country limitation applies shall be deemed paid or accrued under subsection (d) in any taxable year to which the overall limitation applies, and that no foreign tax paid or accrued for a taxable year to which the overall limitation applies shall be deemed paid or accrued under subsection (d) in any taxable year to which the per-country limitation applies. The taxable years in which such taxes are not deemed paid or accrued under the preceding sentence shall, however, be taken into account to determine the number of preceding or succeeding taxable years that have elapsed for purposes of subsection (d).

To illustrate paragraphs (1) and (2) of section 904(e), assume that A elects the overall limitation for taxable years 1961, 1962, 1963, 1964, and 1965, revokes the election for taxable year 1966, and reelects the overall limitation for taxable year 1969. The excess of the aggregate

of taxes paid or accrued to foreign countries in 1961 over the overall limitation (as provided in sec. 904(a)(2)) for such year may not be carried back to 1959 or 1960 since 1959 and 1960 are per-country limitation years. Such excess, however, may be carried over to 1962, 1963, 1964, and 1965, since such years are overall limitation years, but may not be carried over to 1966 since 1966 is a per-country limitation year. If there were an excess of the aggregate taxes over the overall limitation for 1965, such excess could be carried back to 1963 and 1964; such excess could not be carried over to 1966 through 1968 but could be carried over to 1969 and 1970, overall limitation years; it could not be carried to 1971 and later years because 5 succeeding taxable years would have elapsed with respect to the carryover from 1965. If there were an excess of any foreign or U.S. possession taxes over the per-country limitation for 1967 such excess could not be carried back to 1965 nor over to 1969, 1970, 1971, or 1972. Such excess could be carried, however, back to 1966 and over to 1968 since such years are per-country limitation years.

Cross reference.—Section 904(f) is a cross reference to section 1503(d) added by section 2 of the bill relating to a special rule for application of the foreign tax credit in the case of an affiliated group which includes Western Hemisphere trade corporations for years in which the overall limitation applies.

SECTION 2 OF THE BILL

Special rule for application of overall limitation on foreign tax credit.—Section 2 of the bill amends section 1503 of the Internal Revenue Code of 1954 (relating to computation and payment of tax in case of consolidated returns) by adding a new subsection (d). The new subsection (d) provides that, if an affiliated group includes any Western Hemisphere trade corporations for a taxable year to which the overall limitation on the foreign tax credit applies, the amount of taxes paid or accrued to foreign countries and possessions of the United States by such Western Hemisphere trade corporations which is in excess of a specified amount shall not be taken into account for the purpose of section 901 (relating to the allowance of the foreign tax credit). Such specified amount is the tax which would be computed under section 1503(a) (without regard to the foreign tax credit) on the aggregate consolidated taxable income attributable to the Western Hemisphere trade corporations. The rule stated in the second sentence of this paragraph does not apply, however, to the extent that the amount of taxes paid or accrued to foreign countries and U.S. possessions by the Western Hemisphere trade corporations exceeds the amount of tax which would be computed under section 1503(a) (but without the 2-percent surtax) on the aggregate consolidated taxable income which would be attributable to such corporations if they were not Western Hemisphere trade corporations.

Example.—Assume that an affiliated group of corporations makes a consolidated return for taxable year 1962, chooses the foreign tax credit under section 901, and elects the limitation under section 904(a)(2). Assume also that, of the four corporations in the group, two are Western Hemisphere trade corporations. To simplify this illustration, the surtax exemption is disregarded. With that qualification the foreign tax credit is computed as follows:

Consolidated taxable income attributable to the Western Hemisphere trade corporations before the section 922 deduction	\$100
Section 922 deduction $\left(\frac{14}{52}\times \$100\right)$	27
Consolidated taxable income attributable to Western Hemisphere trade corporations after the section 922 deduction (\$100 minus \$27)	73
U.S. tax computed on consolidated taxable income attributable to Western Hemisphere trade corporations (\$73×0.52)	38
U.S. tax which would be computed on the consolidated taxable income attributable to such corporations if they were not Western Hemisphere trade corporations but without the 2 percent surtax under section 1503(a) (\$100×0.52)	52
Income, war-profits, and excess profits taxes paid or accrued by such corporations to foreign countries or U.S. possessions	60
The amount of such foreign taxes taken into account under sec. 901 (\$38+(\$60−\$52))	46
Consolidated taxable income not attributable to Western Hemisphere trade corporations (½ of which is assumed to be from sources outside the United States)	100
Consolidated taxable income (\$100+\$73)	173
U.S. income tax before the foreign tax credit (0.52×\$173) plus (\$100×0.02)	92
Income, war-profits, excess profits taxes paid or accrued to foreign countries or U.S. possessions by other than the Western Hemisphere trade corporations	20
Foreign taxes taken into account and allowed as a credit subject to the overall limitation (\$46+\$20)	66
Consolidated taxable income from sources outside U.S. (\$73+\$50)	123
The foreign tax credit for 1962 as limited by the overall limitation $\left(\frac{123}{173}\times \$92\right)$	65
The excess foreign taxes over such limitation available to be carried to another taxable year (\$66−\$65)	1

SECTION 3 OF THE BILL

References in section 901 to limitation of section 904.—Subsection (a) of section 3 of the bill amends subsections (a) and (b) of section 901 to make it clear that the reference in each such subsection to the "limitation of section 904" is to be read as a reference either to the per-country limitation of section 904(a)(1) or to the overall limitation of section 904(a)(2), whichever is applicable.

Time for choosing between credit and deduction.—Subsection (b) of section 3 of the bill amends the second sentence of section 901(a) of the 1954 Code to make it clear that the choice as to whether to take a foreign tax credit for any taxable year, or to take the foreign taxes as a deduction for such year, must be made or changed before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed for such taxable year by chapter 1 of the 1954 Code. This period will usually expire at the time prescribed by section 6511(a) (generally, 3 years from the time the return was filed). If, however, the time for filing such a claim for credit or refund is extended by agreement (as provided under sec. 6511(c)), then the time for making the choice as to claiming a credit or a deduction for foreign taxes will extend to the expiration of the time agreed upon.

It is to be noted that the period prescribed by the second sentence of section 901(a) is not extended by section 6511(d)(3). Section 6511(d)(3) provides, in effect, a 10-year period of limitation for claims for credit or refund of overpayments attributable to foreign taxes. However, for this 10-year period to be applicable, the choice to take

the foreign tax credit (in lieu of the deduction) must have been timely made (that is, made within the time prescribed by the second sentence of sec. 901(a)).

In applying the second sentence of section 901(a) in a case where a carryback or carryover of taxes under section 904 is involved, the taxable year which is determinative of the period for making the choice between a credit and a deduction is the taxable year from which the excess taxes may be carried (and not the taxable years to which they may be carried). In addition, the excess taxes for such taxable year may not be used as a credit in another taxable year to which carried unless the taxpayer chose to take a credit (rather than a deduction) for such other taxable year within the period prescribed by the second sentence of section 901(a) for making the choice for such other taxable year.

For example, assume that foreign taxes in excess of the per-country limitation of section 904(a)(1) are paid or accrued for 1961. Even though, under section 904(d), such excess may be carried back to 1959 and 1960, and may be carried over to 1962, 1963, 1964, 1965, and 1966, the determinative year for the period for making the choice of taking a credit or deduction with respect to these taxes is 1961 (in the normal case this period will expire March 15, 1965, in the case of a corporation, and April 15, 1965, in the case of any other taxpayer). Assuming a timely choice for taking a credit for 1961, no amount may be used as a credit for any taxable year to which the 1961 taxes may be carried unless, for that other year also, the choice of the foreign tax credit route (in lieu of the deduction route) was also made within the time prescribed for such other taxable year.

Deficiencies attributable to foreign tax carrybacks.—Subsection (c) of section 3 of the bill adds a new subsection (i) to section 6501 of the code. This new subsection, which is similar to the existing section 6501(h), relating to net operating loss carrybacks, provides in effect that in the case of a deficiency attributable to the application to the taxpayer of a carryback of taxes paid or accrued to foreign countries or possessions of the United States in excess of the applicable limitation under section 904(a) of the code (the per-country or the overall limitation, as the case may be), such deficiency may be assessed at any time before the expiration of 1 year after the expiration of the period within which a deficiency may be assessed for the taxable year from which such excess may be carried.

For example, assume that the taxpayer T chooses to have the benefits of the foreign tax credit for taxable years 1959, 1960, and 1961. Assume further that by reason of the application of the per-country limitation for 1961 there is a carryback to 1959 of $60 taxes paid to country X and $50 taxes paid to country Y. Assume also that all of the taxes so carried back may be used for 1959. On the basis of these carrybacks, T obtains a refund of his 1959 U.S. tax in the amount of $110.

On December 1, 1964, T elects for 1961 the overall limitation provided by the new section 904(a)(2). Since under the new section 904(e)(2) the excess (if any) for an overall limitation year may not be carried to 1959, a per-country limitation year, the election results in a deficiency for 1959 of $110. Disregarding the new section 6501(i), and assuming no special circumstances, the period for assessing the deficiency for 1959 would have expired. Under the new section 6501(i),

however, the deficiency attributable to the election to take the overall limitation in lieu of the per-country limitation could be assessed.

The new section 6501(i) applies, under section 4 of the bill, to taxable years beginning after 1957. Thus, for example, it would apply to a case where the taxpayer has received the benefit of a per-country limitation carryback from 1960 to 1958 and, after the expiration of the general period for assessing deficiencies for 1958, the taxpayer changes his choice as to claiming the foreign tax credit for 1960 and instead claims a deduction for foreign taxes for 1960.

Section 4 of the Bill

Section 4 of the bill provides the effective date for the amendments made by the first three sections of the bill.

The first sentence of section 4 provides that the amendments made by the first section and section 2 of the bill, and the amendments made by subsection (a) of section 3 of the bill, are to apply with respect to taxable years beginning after December 31, 1960.

The second sentence of section 4 provides that the amendment made by subsection (b) of section 3 of the bill (relating to time for choosing between the foreign tax credit and the deduction for foreign taxes) is to apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. (This is the same effective date as was provided, in general, for the 1954 Code.)

As explained above, section 3(c) of the bill inserts a new subsection (i) in section 6501 of the 1954 Code, relating to the period for assessing deficiencies attributable to the carryback of excess foreign taxes. Under the third sentence of section 4 of the bill, the new section 6501(i) will apply to the assessment of deficiencies for taxable years beginning after December 31, 1957.

Section 5 of the Bill

This section, for which there is no corresponding provision in the House bill, provides an exclusion from gross income of amounts received as reimbursement for moving expenses of new employees of certain corporations, to the extent that such amounts do not exceed the actual expenses paid or incurred by the employee for such purposes. Under existing law, payments or reimbursements to a new employee of moving or relocation expenses come within the statutory description of gross income, and the expenses incurred by a new employee in moving his family and household goods are not expenditures for which deductions may be taken in computing income taxes. *U.S.* v. *Sherrill O. and Doris M. Woodall*, *U.S.* v. *Glenn S. and Margaret H. Mills* (255 F. 2d 370 (C. A. 10th 1958)) (cert. denied 358 U.S. 824, Rev. Rul. 55–140, C. B. 1955–1, 317, amplified in Rev. Rul. 59–236, I.R.B. No. 1959–28).

Section 5 of the bill as added by your committee provides that, notwithstanding any other law or rule of law, a reimbursement of moving expenses under the circumstances described below shall be treated as an amount which was not includible in the gross income of the individual, to the extent that such reimbursement did not exceed the actual moving expenses paid or incurred by the individual.

The applicability of section 5 is limited to reimbursements received from a corporation which was (1) formed exclusively for the purpose of,

and was engaged exclusively in, operating without profit a scientific laboratory for the Atomic Energy Commission and (2) operated solely on funds appropriated to the Atomic Energy Commission.

This section further provides that the general rule, and not the exception provided in section 5, will apply where the individual was advised, at the time of his employment, by an authorized officer, employee, or agent of such corporation that the amount of such reimbursement would be includible in gross income.

VI. CHANGES IN EXISTING LAW

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

INTERNAL REVENUE CODE

SEC. 901. TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.

(a) ALLOWANCE OF CREDIT.—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the *applicable* limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under section 902. [Such choice may be made or changed at any time prior to the expiration of the period prescribed for making a claim for credit or refund of the tax against which the credit is allowable.] *Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year.* The credit shall not be allowed against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1333 (relating to war loss recoveries), or against the personal holding company tax imposed by section 541.

(b) AMOUNT ALLOWED.—Subject to the *applicable* limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) CITIZENS AND DOMESTIC CORPORATIONS.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(2) RESIDENT OF THE UNITED STATES OR PUERTO RICO.—In the case of a resident of the United States and in the case of an individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid or accrued during the taxable year to any possession of the United States; and

(3) ALIEN RESIDENT OF THE UNITED STATES OR PUERTO RICO.—In the case of an alien resident of the United States and in the case of an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid

or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and

(4) PARTNERSHIPS AND ESTATES.—In the case of any individual described in paragraph (1), (2), or (3), who is a member of a partnership or a beneficiary of an estate or trust, the amount of his proportionate share of the taxes (described in such paragraph) of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

* * * * * * *

SEC. 904. LIMITATION ON CREDIT.

[(a) LIMITATION.—The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.]

(a) ALTERNATIVE LIMITATIONS.—

(1) PER-COUNTRY LIMITATION.—In the case of any taxpayer who does not elect the limitation provided by paragraph (2), the amount of the credit in respect of the tax paid or accrued to any foreign country or possession of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources within such country or possession (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

(2) OVERALL LIMITATION.—In the case of any taxpayer who elects the limitation provided by this paragraph, the total amount of the credit in respect of taxes paid or accrued to all foreign countries and possessions of the United States shall not exceed the same proportion of the tax against which such credit is taken which the taxpayer's taxable income from sources without the United States (but not in excess of the taxpayer's entire taxable income) bears to his entire taxable income for the same taxable year.

(b) ELECTION OF OVERALL LIMITATION.—

(1) IN GENERAL.—A taxpayer may elect the limitation provided by subsection (a)(2) for any taxable year beginning after December 31, 1960. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

(2) ELECTION AFTER REVOCATION.—If a taxpayer has made an election under paragraph (1) and such election has been revoked, such taxpayer shall not be eligible to make a new election under paragraph (1) for any taxable year, unless the Secretary or his delegate consents to such new election.

(3) FORM AND TIME OF ELECTION AND REVOCATION.—An election under paragraph (1), and any revocation of such an election, may be made only in such manner as the Secretary or his delegate may by regulations prescribe. Such an election or revocation with respect to any taxable year may be made or changed at any time

before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year.

[(b)] *(c)* TAXABLE INCOME FOR PURPOSE OF COMPUTING LIMITATION.—For purposes of computing the *applicable* limitation under subsection (a), the taxable income in the case of an individual, estate, or trust shall be computed without any deduction for personal exemptions under section 151 or 642(b).

[(c)] *(d)* CARRYBACK AND CARRYOVER OF EXCESS TAX PAID.—Any amount by which any such tax paid or accrued to any foreign country or possession of the United States for any taxable year beginning after December 31, 1957, for which the taxpayer chooses to have the benefits of this subpart exceeds the *applicable* limitation under subsection (a) shall be deemed tax paid or accrued to such foreign country or possession of the United States in the second preceding taxable year, in the first preceding taxable year, and in the first, second, third, fourth, or fifth succeeding taxable years, in that order and to the extent not deemed tax paid or accrued in a prior taxable year, in the amount by which the *applicable* limitation under subsection (a) for such preceding or succeeding taxable year exceeds the sum of the tax paid or accrued to such foreign country or possession for such preceding or succeeding taxable year and the amount of the tax for any taxable year earlier than the current taxable year which shall be deemed to have been paid or accrued in such preceding or subsequent taxable year (whether or not the taxpayer chooses to have the benefits of this subpart with respect to such earlier taxable year). Such amount deemed paid or accrued in any year may be availed of only as a tax credit and not as a deduction and only if taxpayer for such year chooses to have the benefits of this subpart as to taxes paid or accrued for that year to foreign countries or possessions. For purposes of this subsection, the terms "second preceding taxable year" and "first preceding taxable year" do not include any taxable year beginning before January 1, 1958.

(e) CARRYBACKS AND CARRYOVERS WHERE OVERALL LIMITATION IS ELECTED.—

(1) FOREIGN TAXES TO BE AGGREGATED FOR PURPOSES OF SUBSECTION (d).—With respect to each taxable year of the taxpayer to which the limitation provided by subsection (a)(2) applies, the taxes referred to in the first sentence of subsection (d) shall, for purposes of applying such first sentence, be aggregated on an overall basis (rather than taken into account on a per-country basis).

(2) FOREIGN TAXES MAY NOT BE CARRIED FROM PER-COUNTRY YEAR TO OVERALL YEAR OR FROM OVERALL YEAR TO PER-COUNTRY YEAR.—No amount paid or accrued for any taxable year to which the limitation provided by subsection (a)(1) applies shall (except for purposes of determining the number of taxable years which have elapsed) be deemed paid or accrued under subsection (d) in any taxable year to which the limitation provided by subsection (a)(2) applies. No amount paid or accrued for any taxable year to which the limitation provided by subsection (a)(2) applies shall (except for purposes of determining the number of taxable years which have elapsed) be deemed paid or accrued under subsection (d) in any taxable year to which the limitation provided by subsection (a)(1) applies.

(f) *Cross Reference.*—

For special rule relating to the application of the credit provided by section 901 in the case of affiliated groups which include Western Hemisphere trade corporations for years in which the limitation provided by subsection (a)(2) applies, see section 1503(d).

* * * * * * *

SEC. 1503. COMPUTATION AND PAYMENT OF TAX.

(a) General Rule.—In any case in which a consolidated return is made or is required to be made, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under section 1502 prescribed prior to the last day prescribed by law for the filing of such return; except that the tax imposed under section 11(c) or section 831 shall be increased for any taxable year by 2 percent of the consolidated taxable income of the affiliated group of includible corporations. For purposes of this section, the term "consolidated taxable income" means the consolidated taxable income computed without regard to the deduction provided by section 242 for partially tax-exempt interest.

(b) Limitation.—If the affiliated group includes one or more Western Hemisphere trade corporations (as defined in section 921) or one or more regulated public utilities (as defined in subsection (c)), the increase of 2 percent provided in subsection (a) shall be applied only on the amount by which the consolidated taxable income of the affiliated group exceeds the portion (if any) of the consolidated taxable income attributable to the Western Hemisphere trade corporations and regulated public utilities included in such group.

* * * * * * *

(d) Special Rule for Application of Foreign Tax Credit When Overall Limitation Applies.—If the affiliated group includes one or more Western Hemisphere trade corporations (as defined in section 921) for a taxable year to which the limitation provided by section 904(a)(2) (relating to overall limitation on foreign tax credit) applies, the amount of taxes paid or accrued to foreign countries and possessions of the United States by the Western Hemisphere trade corporation or corporations which is in excess of the amount of the tax computed under subsection (a) with respect to the consolidated taxable income attributable to such corporation or corporations (determined without regard to the credit provided by section 901) shall not be taken into account for purposes of section 901. The preceding sentence shall not apply to the extent that the amount of taxes paid or accrued to foreign countries and possessions of the United States by such corporation or corporations exceeds the amount of the tax which would be computed under subsection (a) with respect to the consolidated taxable income attributable to such corporation or corporations (determined without regard to the credit provided by section 901 and without regard to the increase of 2 percent provided in subsection (a)) if such corporation or corporations were not Western Hemisphere trade corporations.

* * * * * * *

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * * * * * *

(h) NET OPERATING LOSS CARRYBACKS.—In the case of a deficiency attributable to the application to the taxpayer of a net operating loss carryback (including deficiencies which may be assessed pursuant to the provisions of section 6213(b)(2)), such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the net operating loss which results in such carryback may be assessed.

(i) FOREIGN TAX CARRYBACKS.—In the case of a deficiency attributable to the application to the taxpayer of a carryback under section 904(d) (relating to carryback and carryover of excess foreign taxes), such deficiency may be assessed at any time before the expiration of one year after the expiration of the period within which a deficiency may be assessed for the taxable year of the excess taxes described in section 904(d) which result in such carryback.

[(i)](*j*) JOINT INCOME RETURN AFTER SEPARATE RETURN.—For period of limitations for assessment and collection in the case of a joint income return filed after separate returns have been filed, see section 6013(b) (3) and (4).

MINORITY VIEWS ON H.R. 10087

As is so often the case, the subject bill, H.R. 10087, cannot be considered in isolation nor can it be taken at face value. Under the guise of assisting in the economic advancement of the underdeveloped countries, this bill would provide a privileged minority of American taxpayers with tax concessions not available to all. It is part and parcel of the larger problem of the proper method of taxing the income earned abroad by U.S. corporations. At the present time, certain foreign taxes are allowed as credits against the U.S. income tax, and, furthermore, the incidence of the U.S. tax varies, both as to rate and as to time levied, with the organization of the foreign operating arm of the U.S. corporation.

Specifically, this bill would allow a U.S. corporation, in taking credit for foreign income, war profits, and excess profit taxes against U.S. income taxes, to apply either the per-country limitation, now in effect, or the overall limitation at the option of the corporation. This bill was originally section 5 of the bill, H.R. 5, the so-called Boggs bill which is still pending in the House of Representatives. For some reason this part of H.R. 5 is now singled out for special treatment. The Treasury opposed the provisions of this bill when such provisions were embodied in section 5 of the Boggs bill, in hearings before the Ways and Means Committee.

The foreign tax credit, considered as a tax package, constitutes one of the glaring loopholes in our tax laws.

Allowing any item of expense or expenditure as a credit against taxes violates all principles of taxation. All such items, if considered at all, should be treated as deductions in arriving at the net income subject to applicable tax rates. The foreign tax credit should be abolished, it being basically unsound in principle and discriminatory in practice. Failing this, many changes should be made to tighten existing laws and procedures governing this method of handling the income tax on income earned abroad. The bill now under consideration does not do this. On the contrary, it nibbles away a bit more around the periphery of the foreign tax credit loophole for the benefit of a few taxpayers of whom not one has demonstrated an inequity under present law.

The Congress of the United States, since our present income tax laws first became effective in 1913, has always maintained the right to tax the income of U.S. citizens or corporations on a worldwide basis. The Congress has never surrendered the right to tax, or to legislate concerning the taxation of, income of U.S. corporations earned anywhere in the world.

This principle is seldom openly attacked. Instead, those who would profit from a broadening of the foreign tax credit loophole seek to do so on grounds varying from expediency to economic foreign policy. Most of the arguments, however, boil down to excuses for requesting tax benefits to which the corporations concerned are not entitled.

The proper handling of multijurisdictional taxation, foreign or domestic, has long presented a problem. Prior to 1918 all foreign

taxes, including income taxes, were treated as deductible expenses just as were taxes levied by States or local governments within the United States. As a matter of expediency or accommodation, and on the grounds that American corporations operating abroad were allegedly at a competitive disadvantage with foreign corporations, foreign income taxes in 1918 were placed in a separate category from taxes imposed by domestic jurisdictions and it was provided by law that foreign income taxes could be either credited against American income taxes or allowed as deductions from taxable income at the option of the taxpayer. Taxes levied by domestic jurisdictions, States and local governments, continued to be treated as deductions. This operates a discrimination against business within the United States in competition with business in foreign countries.

This approach to the handling of foreign income taxes has remained the basic law, although a great many changes have been made from time to time to broaden this favor. At the present time, then, our tax laws provide a haven for foreign income, war profits, and excess profits taxes which is not available to other kinds of taxes. Because of this, many U.S. corporations have established foreign branches or subsidiaries to compete in the U.S. market.

Allowing credit for these foreign taxes rather than treating them as deductions has given rise to many abuses. Companies such as the Arabian American Oil Co., for example, have been able to persuade the governments of the host countries in which their principal operations are conducted to classify royalties, subsidies and other charges as income taxes, thus denying the U.S. Government many millions of dollars in taxes. Some such large corporations pay very little, if any, taxes to the U.S. Government. Many abuses connected with subsidiaries, including the use of third country tax havens have been made possible.

Many arguments have been advanced for continuing and broadening the foreign tax credit loophole. Generally speaking, they can be grouped under three general headings:

(1) The foreign tax credit is necessary to prevent double taxation. This argument assumes that double taxation, that is, the taxation of the same income by more than one government, is wrong per se. Our tax laws recognize no such principle. There is essentially no difference, so far as a taxpayer is concerned, between a State income tax and an income tax levied by a foreign government. So-called double taxation is not avoided in the case of State taxes by allowing such taxes to be deducted as an item of business expense. What is accomplished is an accommodation which works satisfactorily. The foreign tax credit represents an accommodation, just as does the allowance of the State income tax as a deduction. Either is a compromise. The tax credit, however, is wrong in principle.

(2) It is said that a dollar earned anywhere should be subject to the same tax. This objective, if it is a proper objective, is not achieved by the foreign tax credit. A dollar earned through a subsidiary operating abroad does not bear the same tax burden as does a dollar earned in New York or New Orleans.

(3) It is said that the foreign tax credit encourages private investment abroad. This is the argument which is most often advanced today to justify tax preferences to companies operating abroad. It is true that a desirable ingredient of our foreign economic policy is an

increased private investment abroad. Achieving this increased investment by means of tax incentives is not, however, the most appropriate method. Such incentives do not necessarily direct investment into the most desirable channels or into the most desirable areas of the world. There is a great deal of difference, insofar as the furtherance of our national objectives is concerned, between encouraging a manufacturer to begin assembling automobiles in Germany and encouraging a food processor to open a plant in India. The foreign tax credit may, as I have shown, promote undesirable development. There are better, more direct and more manageable means of promoting desirable foreign investment and development.

Several arguments can be made against the foreign tax credit. I would like to call attention to three which I consider pertinent.

(1) The foreign tax credit allows the foreign government to determine the effective U.S. tax rate, operating frequently as a preemption. It has been alleged that many foreign governments have tended to adjust their tax rates to the U.S. rate. Be this as it may, we have given the foreign government, through the mechanism of the foreign tax credit, the power to decide whether the United States can collect taxes on income of U.S. corporations earned abroad at the rate of 52 percent, 20 percent, 10 percent, or 0 percent.

(2) The benefits of foreign tax credits accrue to a relatively few companies. According to a study of this problem made in 1955, it was then estimated that 40 percent of all foreign investment is accounted for by 10 U.S. corporations and 71 percent by 62 corporations. Any concessions made in the form of tax reductions would necessarily accrue very largely to these few corporations. It was estimated that 25 to 50 corporations would receive half the benefits from any tax reductions, and nearly all the benefits from such reductions would be received by 150 corporations.

(3) Benefits accruing to corporations as a result of the foreign tax credit do not necessarily further national objectives. It was formerly felt that most of the benefits derived from the foreign tax credit accrued to export operations and thus benefited the entire American economy. This does not now appear to be the case. On the contrary, the foreign tax credit now encourages the establishment of manufacturing concerns in foreign countries where goods are produced which are in direct competition with American exports or become competitive as imports into the United States. It would also appear that, except for those corporations engaged in the extractive industries, the foreign investment which is encouraged by the foreign tax credit takes place largely in Europe in countries which are already highly developed. The export of capital to such areas may not further national objectives at all, but instead may add to the competition which already exists for American exports and, furthermore, directly complicates our critical balance-of-payments problem. The foreign tax credit may equally promote the desirable or undesirable.

In amplification of the above reference to national objectives, it is pertinent to cite a few facts.

Many who wish to increase private American investment abroad in the underdeveloped areas feel that such private investment can replace foreign aid. This is not possible. Private investment, with or without tax incentives, goes where it can produce a good return. In most of the underdeveloped countries the public sector must first be built

up. Only then will there be a base on which private investment can build.

During recent years new U.S. direct investment in the underdeveloped countries of Asia, the Middle East, and Africa has amounted to only about $100 million per year, and a great deal of even this small amount has gone into petroleum in a few countries.

Tax forgiveness, which assists only those enterprises making substantial profits, will not accomplish our desired economic foreign policy objectives. Even if it did, the results may be contradictory. Tax forgiveness, applied across the board, will pull American investment into the already industrialized countries. It will not lend effective encouragement to reluctant investors to go into the underdeveloped countries where markets must be created.

Net return, regardless of the tax structure, is a governing factor in sending capital abroad. As an illustration of the inefficacy of the tax incentive, I might cite the fact that U.S. investment in Western Europe increased 135 percent from 1950 to 1959, while at the same time investment in Latin America increased only 92 percent, and the Western Hemisphere Trade Act gives Latin American investments a tremendous tax advantage.

As I have pointed out, there are serious objections to the foreign tax credit in principle. Aside from the principles involved, however, there are further serious defects in our laws relating to foreign tax credits. The most serious of these are:

(1) No tax is levied on the income of subsidiaries until such income is remitted in the form of dividends to the parent company in the United States.

(2) Because of the way in which foreign taxes paid by subsidiaries are credited, it is often possible, particularly if a third country tax haven is employed, to reduce the effective 52 percent U.S. tax rate to an effective rate of slightly more than 40 percent.

(3) The Western Hemisphere trade corporation is a historical accident and should be abolished.

To return to the subject bill, H.R. 10087, more specifically, the main reason which has been advanced for its adoption is that some companies regard their foreign operations as one operation and they, therefore, should be allowed to adopt the overall limitation. Other companies, it is said, regard operations in each foreign country as a separate operation and these companies should, therefore, if they so desire, be allowed to use the per-country limitation. It is certainly a strange concept of tax law which allows a company to choose any method of computing its tax which it desires merely because such a method comports with the concept which that company holds as to its own operations. This is about as logical as allowing an individual to regard himself as a corporation for tax purposes in any year his income puts him in a bracket higher than 52 percent, and pay his income tax accordingly.

In 1954 the per-country limitation was decided on. Insofar as we may wish, and are able, to use tax policy to further national economic policy, this limitation is more appropriate than is the overall limitation. When a corporation opens up a new plant or undertakes a new operation in a new country, it is quite likely to undergo a loss for a few years in that country. In such a case the company is generally better off under the per-country limitation than under the overall

limitation. Existing law, to that extent, does encourage U.S. corporations to begin new operations in new, and it may be hoped underdeveloped, countries.

The amendments adopted by the Senate Finance Committee are excellent and do much to make this bill more nearly acceptable. Despite these improvements in the bill, however, it still represents an effort to enlarge an existing loophole in the tax laws without justification. This bill will result in a loss of revenue to the U.S. Government of between $20 and $40 million. In effect, a gift of this amount will be made to corporations which have shown neither need nor deserts to such largess. This is another example of a special bill to give tax relief to "somebody" (usually a few) when the crying need is for more equitable tax laws for all.

ALBERT GORE.