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DIGEST OF TESTIMONY PRESENTED AND STATEMENTS SUBMITTED TO THE COMMITTEE ON WAYS AND MEANS WITH RESPECT TO H.R. 3813

("Interest Equalization Tax Extension Act of 1967")

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

BY THE STAFF OF

THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

FEBRUARY 20, 1967

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I. GENERAL BALANCE OF PAYMENTS DISCUSSION

The following witnesses commented generally on the present status and causes of the deficit in the balance of payments. Varying suggestions for alleviation of the problem were made, such as providing an export tax credit provision, reduction of U.S. Government foreign aid and foreign defense expenditures, and trade and tariff modifications designed to stimulate exports.

Investment Bankers Association of America, Robert F. Seebeck, chairman, Foreign Investment Committee.

Dr. N. R. Danielian.

Investors League, Inc., Robert A. Gilbert, vice president and director.

Burnham & Co., Mr. Andries D. Woudhuysen.

Chamber of Commerce of the United States, Don A. Goodall.

American Bankers Association, Charls E. Walker, executive vice president.

II. OPPOSITION TO ANY EXTENSION

The following witnesses suggested that the interest equalization tax should be allowed to expire on July 31, 1967:

Bankers Association for Foreign Trade, William F. Ray, president.

Chamber of Commerce of the United States, Don A. Goodall.

American Chamber of Commerce in Japan, Albert H. Zinkard, president.

National Association of Manufacturers, Donald H. Gleason, chairman, Subcommittee on International Taxation of the Taxation Committee.

III. LIMITATION OF EXTENSION TO 1 YEAR

A number of witnesses expressed the opinion that sufficient changes may occur within the next year so that it may be in the national interest to review a question of this magnitude at that time. In this regard it was suggested that: the military phase of the Vietnam conflict may terminate; the trade surplus could increase; the administration's attempt to induce Americans to "see America" may result in less American spending for traveling to other countries; foreign aid outlays not restricted to exports may be further reduced; foreign investment in the United States may increase; and finally, the support of their military establishments at home by foreign creditor countries should increase in the years ahead.

Additionally, it was pointed out that a 1-year extension would demonstrate that the interest equalization tax is as objectionable to the United States as it is to many foreign nations and nationals, and also allow us to demonstrate that the United States has confidence in its ability to adjust the trend in its unfavorable balance of international payments. It was stated that "a period of 2 years, without necessity to review our balance of payments to see if more progress has been made and perhaps to raise the conclusion that other measures than those in existence now are called for, is too long."

Investment Bankers Association of America, Robert F. Seebeck, chairman, Foreign Investment Committee.

New York Stock Exchange, G. Keith Funston, president.

Burnham & Co., Andries D. Woudhuysen.

American Bankers Association, Charls E. Walker, executive vice president.

IV. CONTINUATION OF PRESENT RATE ON FOREIGN EQUITY SECURITIES

The proposed increase of the interest equalization tax on foreign equity securities from 15 to 30 percent should not be appproved. The effectiveness of the present rate is evidenced by the Treasury Department figures which indicate that Americans for the fourth year in a row were net sellers of foreign equities in 1966. This indicates a dollar inflow on foreign equity portfolio accounts. There is no reason to believe that doubling the tax will increase this "disinvestment" in foreign securities by U.S. persons. Additionally, the fact that the Treasury Department has collected only approximately $50 million (from both taxed security and debt transactions) indicates that the tax at the present rate already is relatively effective and does not need to be raised further. It was also pointed out that "at least one prominent publication reporting on discussions with public officials said there has not been any major increase in portfolio investment proportion of the increasing balance-of-payments deficit that would warrant doubling the tax but that it is decidedly a 'precautionary' tax to be prudent."

Comments were also received suggesting that the tax should not be doubled on foreign debt obligations. It was pointed out that the interest differential is not presently 2 percent or close to 2 percent nor is it likely to be 2 percent in the near future. One witness expressed the view that the domestic demand for capital will be sufficient to keep foreigners out of the U.S. capital market in the foreseeable future.

National Association of Securities Dealers, Inc., Henri L. Froy, chairman of Foreign Committee.

Investment Bankers Association of America, Robert F. Seebeck, chairman, Foreign Investment Committee.

New York Stock Exchange, G. Keith Funston, president.

Burnham & Co., Andries D. Woudhuysen.

American Bankers Association, Charls E. Walker, executive vice president.

V. DISCRETIONARY PRESIDENTIAL AUTHORITY PROVISION

Two of the witnesses suggested that the current rate of tax should be retained but, as a precaution, the President be given authority to vary the rate as provided in the bill upwards to 30 percent and downward to zero depending upon the needs of the circumstances.

But that such a provision should be linked to the present rate rather than begun at the suggested increased rate which is presently unnecessary.

Investment Bankers Association of America, Robert F. Seebeck, chairman, Foreign Investment Committee.

Burnham & Co., Andries D. Woudhuysen.

It was also suggested that whether the rates are increased or left as they presently are, the President should be given the discretion to raise or lower the rates of tax separately with respect to debt obligations or securities or both, depending upon the circumstances, and that a top effective rate of 30 percent, such as that provided in the bill, should not be established since there will be a great reluctance to reduce that rate once established. In effect this amendment would treat the interest equalization tax as two separate taxes—one for debt obligations and one for equity securities.

National Association of Securities Dealers, Inc., Henri L. Froy, chairman of foreign committee.

Two witnesses expressed opposition to the granting of discretionary presidential authority such as that provided for in the bill.

New York Stock Exchange, G. Keith Funston, president.

National Association of Manufacturers, Donald H. Gleason, chairman, subcommittee on international taxation of the taxation committee.

VI. PROPOSED EXCEPTIONS

A. De minimis exemption for foreign subscribed issues

The President should be given authority to exempt original issues of securities from the tax if not more than 25 percent (or such other lower percentage as he may fix from time to time) is sold to U.S. persons. This amendment is in the nature of a de minimus exception for foreign issues with substantially foreign subscribers. This was considered desirable to encourage U.S. security dealers to handle foreign security issues.

Investment Bankers Association of America, Robert F. Seebeck, chairman, Foreign Investment Committee.

B. Extension of export trade exemption

It was suggested that the exemption for foreign debt obligations acquired in connection with the financing of U.S. exports should be liberalized and, in addition, extended to equity securities. Specifically, it was proposed that the proceeds of a bond issue for a foreign borrower could be escrowed with a U.S. commercial bank and released against documents evidencing shipment of U.S. goods abroad to the borrower. Alternatively, it was recommended that the present language of the export trade exemption be liberalized so as to require only that the foreign obligation must be, in the first instance, acquired by the exporter in connection with a bona fide export sale. The present language generally requires the exporter to hold the debt obligation unless the transfer is reasonably necessary to the effectuation of the sale and the terms of the debt obligation are not unreasonable in light of the credit practices of the business in which the seller is engaged.

It was also recommended that all the export and export-related exemptions be made applicable to equity securities received by an exporter in connection with goods or services sold to foreign persons as well as debt obligations so acquired.

Investment Bankers Association of America, Robert F. Seebeck, chairman, Foreign Investment Committee.

A statement suggested that the present export trade provision regarding debt obligations guaranteed by U.S. agencies or instrumentalities is unduly restrictive. While it exempts from tax, debt obligations guaranteed in whole or in part, by an agency or wholly owned instrumentality of the United States, it does so only if such obligations are acquired directly from a foreign obligor. In the interests of stimulating exports, it was suggested that commercial banks play an important role in financing such transactions. Presently the fact that the Export-Import Bank has guaranteed an obligation results in nontaxability only if the obligation has been acquired by a commercial bank directly from the foreign obligor, and while it is possible to obtain exemption if the bank receives a prior American ownership certificate from the seller, this imposes an administrative burden. The association believes that the statute should be amended so that a debt obligation guaranteed in whole or in part by an agency or a wholly owned instrumentality of the United States should be exempt from the interest equalization tax regardless of from whom acquired.

National Association of Manufacturers, Donald H. Gleason, chairman, subcommittee on international taxation of the taxation committee.

C. Liberalization of the 1-day U.S. dealer resale rule

The trading exemption for U.S. dealers reselling foreign debt obligations to a foreign person within 90 days should be broadened to eliminate the requirement that when the resale is affected through another U.S. dealer, such dealer must resell to a foreign person within the following business day. It is proposed that the second U.S. dealer be provided with 1 full business day or the balance of the 90-day period not utilized by the first U.S. dealer, whichever is the greater.

Investment Bankers Association of America, Robert F. Seebeck, chairman, Foreign Investment Committee.

D. Exemption of all outstanding foreign issues

All outstanding stocks of foreign companies should be exempted from the interest equalization tax. The following reasons were offered: it is consistent with the exchange's basic belief that the most satisfactory way to close the gap between capital flow abroad and foreign capital flow here is not to limit the former but to stimulate the latter; capital investment generates considerable returns over the long run; for example, the approximately $3.6 billion outflow of private investment in 1966 was more than offset by investment income of some $5.5 billion, the fruit of capital outflow of past years. Based on the available data, it was suggested that an exception for outstanding foreign equity securities should not adversely affect our balance of payments and may be necessary if the securities industry is to sell appreciable amounts of American securities abroad. This was suggested that in order to have an effective international market of securities there must be free flow of capital in both directions.

New York Stock Exchange, G. Keith Funston, president.

E. Acquisitions with foreign earned income

An amendment was suggested which would exempt from the tax acquisitions of foreign obligations or foreign securities purchased with income earned abroad by bona fide foreign residents. It was asserted that in many instances it is impossible to remit savings for investment to the United States and, therefore, the tax negates any possibility of investing moneys earned abroad by U.S. citizens who are bona fide foreign residents.

Mr. Bruce D. Crawford, Johannesburg, South Africa.

American Chamber of Commerce in Japan, Albert H. Zinkard, president.

F. Acquisitions resulting from foreign real estate sales

It was suggested that an exemption be provided from the interest equalization tax to exclude from its application debt obligations acquired from the sale of foreign real estate by a U.S. person, trust, or estate. Such an amendment would be similar to that presently provided with respect to sales of foreign personal property.

Hon. Olin E. Teague.

G. Switching or rollover amendments

Two amendments were suggested which would permit U.S. investors to switch foreign security investments without application of the interest equalization tax. The first would provide an exception for acquisitions made before September 2, 1964 (the enactment date of the tax) with funds, including investments held outside the United States on July 18, 1963 (the date the tax was requested by the President) or for acquisitions before September 2, 1964, with foreign credit obtained before that date. (See H.R. 3924, introduced by Mr. Hicks.)

Mr. Pervis, Bremerton, Wash.

The second amendment would provide that the tax is not to apply with respect to acquisitions of securities (during any period including the future) made with funds held outside the United States at the time of the announcement of the interest equalization tax. The argument made is that since these funds were already outside the United States the switching from one foreign security to another would not adversely affect the U.S. balance of payments.

Mr. George Reinhardt, New York City.

Mr. Vernon F. Taylor, San Antonio, Tex.

VII. EFFECTIVE DATE PROVISIONS

It was suggested the President should not be given the authority to increase the tax rates with respect to financings in which commitments have been made or a registration statement filed with the Securities and Exchange Commission. It was thought that financings that have advanced to such positions should always be excepted.

Investment Bankers Association of America, Robert F. Seebeck, chairman, Foreign Investment Committee.

VIII. NONINTEREST EQUALIZATION TAX AMENDMENTS

Bond situs rule for estate tax of nonresident aliens

A statement was received which requested an amendment revoking section 108(c) of the Foreign Investors Tax Act of 1966. That amendment provided that for purposes of the tax imposed on the estates of nonresidents not citizens, all debt obligations (including bonds) of a U.S. person, the United States, a State or political subdivision of a State, or the District of Columbia owned or held by a nonresident not a citizen of the United States are to be considered property situated within the United States and therefore subject to the U.S. estate tax. The suggestion was to return to prior law which treated these U.S. bonds as having a foreign situs (where held abroad) and therefore not subject to U.S. estate tax.

Dean Witter & Co., Richard de La Chapelle.

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