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BRIEF SUMMARY OF THE PROVISIONS OF H.R. 8000, THE "INTEREST EQUALIZATION TAX ACT OF 1963"

AS REPORTED BY

THE COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

EIGHTY-EIGHTH CONGRESS

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Internal Revenue Taxation

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BRIEF SUMMARY OF THE INTEREST EQUALIZATION TAX ACT OF 1963 AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS (H.R. 8000)

ANTICIPATED FAVORABLE EFFECT ON THE BALANCE OF PAYMENTS

The administration estimates that enactment of this bill may reduce the balance-of-payments deficit by from $1.25 to $1.5 billion a year relative to the rate of deficit in the first 6 months of 1963. Of this amount, the bulk is attributable to the tax on new issues, but substantial savings are also attributable to the tax on outstanding securities.[1]

LIABILITY FOR TAX

U.S. citizens, residents, domestic partnerships, domestic corporations, and domestic estates and trusts are liable for the interest equalization tax if they acquire foreign securities (stock, bonds, mortgages, etc.) from foreigners. The tax applies to both new and outstanding issues. The tax does not apply when a U.S. person acquires foreign securities from another U.S. person.

AMOUNT OF TAX

In the case of the purchase of foreign stock, the tax is 15 percent of the price paid. In the case of debt obligations, the tax ranges from 2.75 percent of the purchase price for obligations having 3 to 3½ years remaining to maturity (measured from the time acquired) up to a top rate of 15 percent for obligations having 28½ or more years remaining to maturity.

Imposition of the tax at these rates has the effect of increasing the interest costs of foreigners borrowing in the U.S. market by approximately 1 percent a year. There is no tax on obligations having less than 3 years remaining to maturity.

PRINCIPAL NONTAXABLE ACQUISITIONS

1. *Investments in less developed countries.*—Purchases of securities of less developed countries (including their political subdivisions) and of less developed country corporations are exempt from tax. All countries other than the developed countries of Western Europe, Australia, Canada, Japan, New Zealand, and South Africa may be designated by the President as "less developed." Less developed country corporations are those which conduct most of their activities in less developed countries and have most of their assets in these countries.

2. *Investments of 10-percent-owned subsidiaries.*—Purchases of stock or debt obligations of a foreign corporation are exempt from tax if the

[1] Based upon a comparison of capital movements in the third quarter of 1963, relative to the first half of 1963, $1.1 billion would be attributable to the tax on new issues, while $400 million would be attributable to the tax on outstanding securities.

U.S. person acquiring the security owns 10 percent or more of the voting stock of the foreign corporation. This exemption will apply principally to acquisition of stock in foreign subsidiaries by their domestic parent corporations.

3. *Export transactions.*—These are a series of export exemptions which generally have the effect of exempting debt obligations from tax if they are obtained by U.S. persons in connection with the extension of credit to foreign purchasers of U.S.-produced goods.

4. *International monetary stability.*—The President is authorized to exempt new issues of foreign securities originating in a particular foreign country if he finds that such an exemption is required to maintain international exchange stability. Under present circumstances, the administration has indicated that new Canadian issues are the only issues that will be exempt under this authority, but has stated that the exemption is contingent on a moderation in Canadian borrowings to amounts necessary for Canada to attain an equilibrium in its reserve position. The exemption can be limited or revoked by the President.

5. *Commercial banks.*—Debt obligations obtained by commercial banks in making loans in the ordinary course of a commercial banking business are exempt from tax. Most of these debt obligations are in the less-than-3-years category, and as a result would in any event be exempt from this tax. Commercial banks must furnish information to the Secretary of the Treasury as to their foreign lending so that it will be possible to forestall any abuse of this exemption.

6. *Insurance companies.*—Insurance companies are permitted to invest premiums collected abroad in foreign securities tax free in an amount equal to 110 percent of their allowable reserves against foreign risks.

7. *Labor unions, etc.*—Labor unions and other membership-type exempt organizations are permitted to invest dues collected abroad from foreign members in foreign securities without payment of tax.

8. *Underwriters.*—U.S. underwriters of foreign securities are, in effect, exempt from tax on securities which they acquire and resell to foreigners as part of an underwriting.

9. *Stock of certain U.S.-controlled foreign corporations.*—Purchases of stock of a foreign corporation are exempt from tax if the stock of the corporation is more than 50 percent owned by U.S. persons and U.S. registered national securities exchange constituted the principal market for the stock for 1962.

METHOD OF PAYMENT

The purchaser of a foreign security must pay the tax due upon his purchase. He is required to pay the tax on a quarterly basis at the time he files a return with the Internal Revenue Service reporting his transactions.

In general, foreign securities are acquired either through a broker on a national securities exchange or in an over-the-counter transaction, or by a direct purchase from the seller. In the case of acquisitions through a broker executing an order on a registered stock exchange or in an over-the-counter transaction, the confirmation of purchase the buyer receives from his broker will indicate whether the purchase has been made from an American seller (and therefore exempt from tax) or from a foreign seller. This information is available to the purchaser's broker since rules adopted by the registered securities exchanges, and by over-the-counter dealers, require that transactions in foreign securities be made either in a "regular" market, which indicates that the seller is a U.S. person, or in a "special" market, which indicates that the purchaser is subject to tax unless an exemption applies. The seller may inform his broker as to his status as a U.S. person by notifying him each time a transaction occurs or by filing a blanket certificate covering all transactions through his account. Securities purchased directly from the seller will generally be subject to tax unless the purchaser obtains a certificate of American ownership from the seller.

PENALTIES FOR FAILURE TO FILE

If a person fails to file the required interest equalization tax return and fails to pay the tax, he is subject to a civil penalty of up to 25 percent of the tax due. In addition he may also be subject to a criminal penalty of $10,000 or 1 year in jail, or both.

EFFECTIVE DATE

The bill is effective with respect to acquisitions of foreign securities after July 18, 1963; except that in the case of acquisitions made on a national stock exchange, the tax applies to purchases made after August 16, 1963. No tax applies to subsequent acquisitions if they are made pursuant to a commitment existing before July 19, 1963. The tax is scheduled to apply only to purchases before January 1, 1966.

ESTIMATED REVENUE EFFECT

It is estimated that this bill will increase revenues by up to $30 million a year.

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