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DIGEST OF TESTIMONY PRESENTED AND STATEMENTS SUBMITTED TO THE COMMITTEE ON FINANCE WITH RESPECT TO H.R. 8000

("INTEREST EQUALIZATION TAX ACT OF 1963")

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

BY THE STAFF OF

THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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INTRODUCTION

On June 29 and 30 and July 1 and 2, 1964, the Committee on Finance held public hearings on H.R. 8000, the "Interest Equalization Tax Act of 1963."

This digest summarizes the arguments advanced for and against the bill. In general, the arguments advanced for the bill are summarized in section I, and those advanced against the bill are summarized in section II. Recommendations for basic modification of the bill are summarized in section III, while more specific recommendations are set forth in a section-by-section analysis in section IV. Finally, specific alternative recommendations made by witnesses are summarized in section V.

An attempt has been made to summarize generally all arguments and recommendations; however, if some testimony has been omitted, it was unintentional. For detailed statements presented by witnesses and by those whose statements were submitted for the record, it is necessary to refer to the printed hearings.

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I. SUMMARY OF TESTIMONY RECOMMENDING ENACTMENT OF H.R. 8000

Comments	Name of witness
A. Reasons for imposition of an interest equalization tax: (1) Imposition of the tax will reduce the immediate strains placed on the U.S. balance-of-payments position caused by accelerating capital outflows. (*a*) The deficit in the U.S. international accounts jumped from the 1962 level of $3.6 billion to an annual rate of $5.3 billion in the second quarter of 1963. If allowed to continue, that deficit would have undermined the international stability of the dollar. (*b*) Based on a comparison of the 9 months' before the interest equalization tax was proposed with the 9 months since that time, the outflow into foreign securities dropped from $1,985 million to $290 million at seasonally adjusted annual rates, a reduction of $1.7 billion in the annual rate of outflow.	Treasury Department.

II. SUMMARY OF TESTIMONY AGAINST ENACTMENT OF H.R. 8000

Comments	Name of witness or association
H.R. 8000 should not be enacted in any form for the following reasons:	
(1) There does not exist such a clear and present danger to the U.S. balance-of-payments position as to justify a reversal in the historic American policy of freedom of capital movements.	Investment Bankers Association of America. Senator Jacob K. Javits. Joint Committee on Japan-United States Trade. Morgan Stanley & Co. National Association of Securities Dealers, Inc. National Life Insurance Co. New York Chamber of Commerce. Smith, Barney & Co.
(2) Private foreign investment improves the overall asset position of the United States. Income from foreign investments annually exceeds new capital outflows.	American Stock Exchange. Association of Stock Exchange Firms. Chamber of Commerce of the United States. N. R. Danielian. Investment Bankers Association of America. Senator Jacob K. Javits. Morgan Stanley & Co. New York Stock Exchange. Henry Scharf. Wertheim & Co.
(3) The fundamental cause of the U.S. balance-of-payments deficit position is the expenditure of U.S. military and foreign aid abroad.	N. R. Danielian.
(4) The tax is inequitable. Due to exemptions, it applies to less than 10 percent of total private capital exported.	Association of Stock Exchange Firms. Burnham & Co. Senator Jacob K. Javits.
(5) H.R. 8000 will not make a significant contribution toward reduction of the U.S. balance-of-payments deficit.	American Stock Exchange. First National City Bank. Morgan Stanley & Co.

(*a*) Foreign borrowers have switched from long-term debt and equity financing to short-term or bank loan financing as a means of avoiding the tax.	Association of Stock Exchange Firms. Burnham & Co. Investment Bankers Association of America. Senator Jacob K. Javits. Morgan Stanley & Co. National Association of Securities Dealers, Inc. Smith, Barney & Co. Wertheim & Co.
(*b*) Due to the fact that interest differentials between countries are not uniform, some foreign borrowers will find it cheaper to borrow in the United States and pay the interest equalization tax than pay the interest rates applicable to loans made in foreign countries.	American Life Convention & Life Insurance Association of America. Burnham & Co. Chamber of Commerce of the United States. Senator Jacob K. Javits. Machinery & Allied Products Institute. New York Stock Exchange. Dan Throop Smith.
(*c*) Foreign countries may, in retaliation, adopt economic policies which will negate the effects of H.R. 8000.	American Life Convention & Life Insurance Association of America Chamber of Commerce of the United States. Investment Bankers Association of America. U.S. Council of the International Chamber of Commerce, Inc. Wertheim & Co.
(6) U.S. exports which are tied to funds borrowed in the United States will decline.	Carl Marks & Co. Central Soya. Chamber of Commerce of the United States. Investment Bankers Association of America. Senator Jacob K. Javits. Morgan Stanley & Co.
(7) Enactment of H.R. 8000 will lessen confidence in the dollar.	Model, Roland & Co.
(8) The tax is administratively complex	Investment Bankers Association of America.

III. SUMMARY OF TESTIMONY RECOMMENDING BASIC MODIFICATIONS OF H.R. 8000

Comments	Name of witness or association
(1) H.R. 8000 should not apply to acquisitions of—	
(*a*) Outstanding securities:	American Stock Exchange. Association of Stock Exchange Firms. Burnham & Co. Carl Marks & Co. Investment Bankers Association of America. Model, Roland & Co. New York Stock Exchange. Henry Scharf. Wertheim & Co. J. Peter Williamson.
(i) Issues which were outstanding as of July 18, 1963.	U.S. Council of the International Chamber of Commerce, Inc.
(*b*) New and outstanding issues of stock: (i) New issues;	Dan Throop Smith. Model, Roland & Co. Wertheim & Co.
(ii) Outstanding issues;	Stein, Roe & Farnham.
(iii) Outstanding Canadian issues.	Husky Oil Co.

(2) U.S. persons who own foreign securities should be permitted to switch from one foreign security to another foreign security without imposition of a tax.	Burnham & Co. Carl Marks & Co. International Investors, Inc. Pomerene, Burns, Milligan & Frase. Ralph E. Purvis. Walter V. Steiner. J. Peter Williamson.
(3) Securities the proceeds of which are used to purchase U.S. goods and services should be exempt from tax.	Investment Bankers Association of America. Morgan Stanley & Co.

IV. SECTION-BY-SECTION ARRANGEMENTS OF COMMENTS

Witness	Brief résumé of testimony
SEC. 4911—IMPOSITION OF TAX	
Dan Throop Smith	In the case of new issues of debt obligations, the tax should be imposed upon the foreign obligor, rather than the U.S. purchaser.
SEC. 4912—ACQUISITIONS	
Baker & Daniels	Under the present bill, an acquisition of foreign stock is exempt from tax if it is acquired in a stock for stock exchange (a "B" reorganization). The witness recommends that an acquisition be exempt even though the transfer does not qualify as a "B" reorganization due to the fact the American may receive cash as well as foreign stock.
Davis, Polk, Wardwell, Sunderland & Kiendl	Under the present bill, a contribution to a foreign trust by a U.S. person is treated as an acquisition of foreign stock to the extent the foreign trust acquires foreign securities which would be taxable to the U.S. person if acquired directly by him. However, this provision is made inapplicable in the case of contributions to trusted pension or profit-sharing plans established by an employer by U.S. employees who perform personal services for the employer on a full-time basis in a foreign country. The witness recommends that the exclusion also apply to contributions by a U.S. employer if the trust is established by the employer for the exclusive benefit of employees who perform personal services for him on a full-time basis in a foreign country.
SEC. 4913—LIMITATION ON TAX ON CERTAIN ACQUISITIONS	
No comments.	

SEC. 4914—EXCLUSION FOR CERTAIN ACQUISITIONS

American Chamber of Commerce in Japan Price Waterhouse & Co. U.S. Council of the International Chamber of Commerce, Inc.	The tax should not apply to U.S. citizens resident abroad who purchase foreign securities with their foreign currency earnings.
J. Peter Williamson U.S. Council of the International Chamber of Commerce, Inc.	The tax should not apply to the acquisition of stock in a foreign corporation by an American who is an employee of that corporation.
Janin, Morgan, Brenner & Freeman	An exemption should be provided for acquisitions made pursuant to the exercise of a stock option granted after July 18, 1963, if the person exercising the option is a bona fide foreign resident. The present bill exempts acquisitions made pursuant to the exercise of a stock option granted prior to July 19, 1963.
The Fund of Funds, Ltd	An American resident or employed on a full-time basis outside the United States should be allowed to invest up to $5,000 a year tax free in the stock of a foreign corporation which at the close of the calendar quarter immediately preceding July 18, 1963, and at the close of every quarter thereafter, had substantially all its assets in U.S. securities.
National Foreign Trade Council, Inc U.S. Council of the International Chamber of Commerce, Inc.	All transactions which are related to the active conduct by a U.S. company of any type of foreign business should be exempt from tax.
Westinghouse Electric Corp	Under the present bill, a U.S. person who exercises a right to subscribe to additional stock is generally subject to tax based on the subscription price if he has less than a 10-percent equity interest in the issuing corporation. The witness recommends that the tax should not apply to acquisitions undertaken to maintain an existing equity position; however, the exemption would be limited to the amount of dividend, interest, rent, royalty, and sales income received by the shareholder from the foreign issuer during the preceding 12-month period.
First National City Bank	Under the present bill, tax does not apply to debt obligations of a foreign obligor which are received by a commercial bank in the ordinary course of its commercial banking business. The witness recommends an amendment which would exempt debt obligations received by foreign branches of American commercial banks from tax, regardless of the type or duration of the loan, if the debt obligation is payable in a foreign currency.
Chemical International Finance, Ltd	Under the present bill, tax does not apply to debt obligations of a foreign obligor which are received by a commercial bank in the ordinary course of its commercial banking business. The House committee report (at p. 35) states that an "Edge Act" corporation may qualify as a commercial bank if "it is regularly engaged in accepting deposits from customers." The witness recommends that an "Edge Act" corporation be treated as a commercial bank, whether or not it receives deposits, if the loans made by it are of a type and dollar volume commensurate with past practice.

IV. SECTION-BY-SECTION ARRANGEMENTS OF COMMENTS—Continued

Witness	Brief résumé of testimony
SEC. 4914—EXCLUSION FOR CERTAIN ACQUISITIONS—Continued	
Grolier Inc	The witness recommends that the part of an installment obligation with a period remaining to maturity of 36 months or more should be exempt from tax, regardless of where the article sold was produced, if the transaction involves a sale at retail of (1) books, printed matter, or educational devices and (2) the retail price did not exceed $1,000.
National Constructors Association	Under the present bill, the acquisition of foreign stock or debt obligations is exempt from tax if the securities arise out of the sale of tangible personal property or services (or both) if (1) at least 30 percent of the purchase price is attributable to property produced by the exporter in the United States or to services performed by him and (2) at least 50 percent of the purchase price is attributable to property produced or services performed by all U.S. persons. The witness recommends modification of this exception so as to exempt foreign securities to the extent of 333 percent of the value of the property produced in the United States by the person receiving the securities or to services performed by him or, if lesser, to the extent the value of the foreign securities received exceed 200 percent of the value of the property produced or services performed by all U.S. persons.
International Holdings Corp	The witness recommends that investment companies 66⅔ percent or more of whose stock is held by foreigners should be allowed to reinvest proceeds from the sale of foreign securities in other foreign securities without tax.
SEC. 4915—EXCLUSION FOR DIRECT INVESTMENTS	
Ralph E. Purvis	The 10-percent ownership requirement should be reduced to 5 percent.
American Research & Development Corp	The present bill prevents the application of the direct investment exclusion in cases where a foreign corporation is formed or availed of for the purpose of acquiring foreign securities which would be taxable to a 10-percent or greater shareholder if acquired directly by him. The witness recommends that the direct investment exclusion apply to the acquisition of stock in a foreign corporation notwithstanding the fact that the foreign corporation is availed of for the purpose of acquiring foreign securities if the foreign corpora-

	tion principally furnishes capital to foreign corporations engaged in the development or exploitation of inventions, etc., and investment in these corporations generally consist of at least a 10-percent equity interest.
Transamerica Corp	The present bill, in effect, provides that the 10-percent exclusion rule applies to an investment in a foreign commercial bank even though the commercial bank acquires foreign securities that would be taxable to the U.S. shareholder if acquired directly by him. The witness recommends that the 10-percent exclusion rule also apply in the case of investments in foreign corporations engaged in the business of receiving deposits and other borrowed funds in foreign currencies and making loans in such currencies.

SEC. 4916—EXCLUSION FOR INVESTMENTS IN LESS-DEVELOPED COUNTRIES

Robert M. Kaufman	Under the present bill, a corporation is treated as a less-developed-country corporation if it derives 80 percent of its income from sources within, and has 80 percent of its assets within, less-developed countries. A Treasury Department recommendation for modification of the bill would, in effect, treat U.S. source income and assets in either of 3 ways: (1) less-developed-country income or assets; (2) non-less-developed-country income or assets; and (3) as an exclusion from income or assets. The witness recommends that U.S. source income and assets be treated as less-developed-country income or assets in all cases for purposes of the 80-percent tests. The witness also recommends that the test of qualification be made solely on the basis of the prior year's corporate experience rather than on the basis of the prior, current, and succeeding years' experience required under the present bill in the absence of an advance ruling from the Treasury Department.
Tropical Gas Co., Inc	The President should be given authority to designate Puerto Rico and other possessions of the United States as less-developed countries.

IV. SECTION-BY-SECTION ARRANGEMENTS OF COMMENTS—Continued

Witness	Brief résumé of testimony
SEC. 4917—EXCLUSION FOR ORIGINAL OR NEW ISSUES WHERE REQUIRED FOR INTERNATIONAL MONETARY STABILITY	
U.S. Council of International Chamber of Commerce.	The exemption should apply to outstanding securities as well as to new issues.
International Minerals & Chemical Corp	The witness recommends that the exemption for new issues originating in a foreign country should not apply unless the President finds (1) that failure to grant the exemption may imperil the stability of the international monetary system (as required under the present bill) and (2) that the foreign country involved does not discriminate against investments made by U.S. citizens in such foreign country.
American Chamber of Commerce in Japan	The proposed exemption for Canadian securities discriminates against Japan.
Smith, Barney & Co	Japan should be granted a full or limited exemption.
SEC. 4918—EXEMPTION FOR PRIOR AMERICAN OWNERSHIP	
No comment.	
SEC. 4919—SALES BY UNDERWRITERS AND DEALERS TO FOREIGN PERSONS	
Investment Bankers Association of America. Senator Jacob K. Javits. Dan Throop Smith. Morgan Stanley & Co.	Underwriters should be entirely exempt from tax with respect to an acquisition if 75 percent of the issue underwritten is resold to foreigners. Under the present bill, the underwriter is, in effect, liable for tax on the portion of the issue which is sold to Americans.
Burnham & Co Charles King & Co	Dealers should be permitted, in effect, to buy foreign *stock* tax free if the dealer sells the stock to a foreigner within 90 days arter acquisition. The Treasury Department has recommended that dealers be permitted to, in effect, buy foreign stock tax free if they resell it to a foreigner on the same day as they purchase it.

J.R. Timmons & Co	In the case of stock, a dealer should be permitted 5 days, in lieu of the same-day rule recommended by the Treasury Department, within which to sell stock to a foreigner in order to qualify for exemption.
	The bill should provide that a sale of stock in the "foreign market" raises a presumption that the sale was made to a foreigner.
	The exemption for dealers in stock should be limited to firms engaged in arbitrage transactions as principals.
Henry Scharf	Individuals who are not "dealers" should have the same benefits as dealers in the case of arbitrage transactions.

SEC. 4920—DEFINITIONS

Husky Oil Co	Under the present bill, a foreign corporation i s treated as a domestic corporation with respect to a class of stock if (1) such class of stock is more than 50 percent owned by U.S. persons, and (2) U.S. registered exchanges constituted the principal market for the stock during 1962. The witness recommends that a foreign corporation be treated as a domestic corporation if *either* of the above requirements are satisfied.
Tropical Gas Co., Inc	A foreign corporation should be treated as a domestic corporation if it can show that more than 50 percent of its stock is owned by Americans and the U.S. *over-the-counter* market constituted the principal market for its stock in 1962.
Carl M. Loeb, Rhoades & Co	A foreign branch office of a domestic corporation which is a dealer in securities should be treated as a foreign person if the operations of the branch consist of the purchase of foreign securities and their sale to foreigners.
Bache & Co	Under the present bill, a regulated investment company may elect to be treated as a foreign corporation for interest equalization tax purposes if at least 80 percent of the value of securities held by it on July 18, 1963, and every quarter thereafter, consist of foreign securities. In effect, the corporation is allowed to switch its investments in foreign securities tax free, but U.S. persons who buy stock in the regulated investment company from foreigners are subject to tax on their acquisitions. The witness recommends that the July 18, 1963, requirement be waived (as well as intervening quarterly periods) in the case of newly created companies.

IV. SECTION-BY-SECTION ARRANGEMENTS OF COMMENTS—Continued

Witness	Brief résumé of testimony
	EFFECTIVE DATE
Association of Stock Exchange Firms Henry Scharf. J. R. Timmons & Co.	The tax should be effective on the date of enactment rather than with respect to acquisitions made after July 18, 1963.
U.S. Council of International Chamber of Commerce, Inc.	The effective date should be changed to the date the Finance Committee reports the bill.
American Research & Development Corp	The witness recommends that the tax not apply to acquisitions made after July 18, 1963, if at least 75 percent of the U.S. shareholders acquiring stock in a foreign corporation after that date had signified to the person coordinating the organization of such foreign corporation their intention to invest a specified amount in the stock of the foreign corporation.
	RETURNS
Association of Stock Exchange Firms	The bill, as passed by the House of Representatives, requires selling dealers to maintain records with respect to sales made in the regular market of a registered exchange or an exempt sale made over the counter. The amendments recommended by the Treasury Department would require a purchasing dealer to maintain comparable records with respect to his acquisition of a security in a taxable transaction. The witness recommended that a requirement to maintain records of this type, and the filing of information returns with respect thereto, be made effective as of the enactment date rather than as of July 19, 1963.

V. ALTERNATIVE PROPOSALS

Public witnesses recommended consideration of the following alternatives to enactment of H.R. 8000.

(1) The formation of a voluntary Capital Issues Committee to limit the sale of new issues of foreign securities to Americans.	Association of Stock Exchange Firms. Burnham & Co. Senator Jacob K. Javits. New York Stock Exchange. Dan Throop Smith. Smith, Barney & Co. Stein, Roe & Farnham. Wertheim & Co.
(2) Solution of the deficit in the U.S. balance-of-payments account lies in measures which will increase the inflow of capital to the United States rather than restricting capital outflow, for example, the proposals of the President's Task Force on *Promoting Increased Foreign Investment.*	Chamber of Commerce of the United States. Investment Bankers Association of America. New York Chamber of Commerce. New York Stock Exchange.
(3) Domestic long-term interest rates should be allowed to increase.	American Life Convention & Life Insurance Association of America.
(4) If emergency measures are indicated, outflows of a nonproductive nature (such as tourist expenditures) would be more appropriate subjects for regulation.	Morgan Stanley & Co.
(5) The United States should seek to have the burden of its military and foreign aid expenditures shared by other developed countries.	N. R. Danielian.
(6) The Treasury Department should be granted standby authority to apply the proposed interest equalization tax to specific areas of capital outflow.	Stein, Roe & Farnham.
(7) The Internal Revenue Code should be amended to exclude from U.S. income tax dividends paid by mutual savings and loan associations to nonresident aliens and the principal of such accounts should be exempt from U.S. estate tax.	U.S. Savings & Loan League.

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