Why an Interest Equalization Tax?

Owen Alan Knopping
SECTION ON TAXATION

Editor's Note: The opportunity for intensive study of various phases of taxation provided by the broad scope of tax course offerings has been productive of many tax articles of real interest. Those selected for publication are included in this section of the Review.

The course offerings in taxation at the Marshall-Wythe School of Law include Survey of Tax Literature, Basic Federal Taxation, State and Local Taxation, Tax Administration and Procedure, Adjective Tax Law, Preparation of Tax Forms, Estate and Gift Taxation, Advanced Income Taxation, and Tax Research. Most of these course offerings are open to second- and third-year law students on an elective basis. All are required for the Degree of Master of Law and Taxation.

The Master of Law and Taxation Degree was instituted at the Marshall-Wythe School of Law for the purpose of providing an opportunity for added scope and depth in the study of, and inquiry into, tax policy, theory and practice. Prerequisites for this degree, in addition to academic baccalaureate and law degrees and the courses in Taxation listed above, include the following undergraduate courses in the fields of Business Administration and Economics: Advanced Accounting, Cost Accounting, Auditing, Municipal and Governmental Accounting, Money and Banking, Statistics, Corporate Finance, Investments, Public Finance and National Financial Policy, and Government Regulation of Business.

A contributing factor to the interest in the study of taxation has been the papers presented at a Conference on the History and Philosophy of Taxation held at the College of William and Mary in 1955. These papers include "History of Taxation in the United States" by Randolph Paul; "Basic Tax Issues" by Roy Blough; "The Tax Court of the United States, Its Origin and Functions" by Bolon B. Turner; "Enforcement" by E. Barrett Prettyman; "Influence of the Courts on Tax Policy" by Joel Barlow; "Accounting Theory and Taxation" by Mark E. Richardson; and "The Role of Taxation in a Free Enterprise System" by C. Lowell Harriss.
The study of taxation has been given further encourage-
ment by papers presented each year at the Annual Tidewater Tax Conference sponsored by the Marshall-Wythe School of Law. Some of these papers have been published in earlier volumes of this Review.

The subject matter covered by tax articles contributed by students and others interested in the field of taxation and published in the Law Review for the years 1957 through 1962 is indicated by the following titles:


WHY AN INTEREST EQUALIZATION TAX?

OWEN ALAN KNOPPING

CHAPTER I. BACKGROUND

On July 18, 1963, the late President Kennedy presented, as part of his “Balance of Payments” message to Congress, a tax proposal which imposed a new excise tax on the acquisition of foreign stock, securities, or obligations. Why, at a time when the President and the Congress are debating future tax deductions, should a tax of the sort suggested be introduced?

Since 1950, the United States has experienced a deficit in its balance of payments in each year except one. In order to understand the nature of the problem, “balance of payments” will be defined as the flow of United States dollars resulting from transactions entered into between Americans and other peoples of the world. The accountant would probably define “balance of payments” in terms of a double entry—that for every export the United States receives a corresponding payment, and accompanying every import are corresponding payments to other countries.

One likes to think of the United States as the wealthiest of nations. Although this is, of course, true, it seems incredible that a wealthy nation such as ours should be experiencing a balance of payments problem at this time. Generally, it can be said that that is the price to be paid for being the leader of the free world.

Specifically, there are various reasons why we are involved in this problem. First, it can be said, that there is needed among the various nations of the world, not only the mutual exchange of products, but also reciprocal travel and investment. No one nation is so self-sufficient that it can exist alone without trading with other nations. This constitutes the very basis of the idea

4 Id. at 56.
5 Ibid.
of balance of payments. If trading was the only factor that had to be considered, the US would not be faced with any payments problem. Insofar as US exports and imports are concerned, which historically presents the usual balance of payments problem, the United States balance of payments has been favorable.⁶

The problem goes much deeper. Since World War II, the United States as a by-product of the Marshall Plan and subsequent military and economic assistance programs, has engaged in continued aid programs, unprecedented in nature, involving grants and loans totaling some $80 billion.⁷ Since our export surpluses were not enough to cover the amounts spent, this unprecedented expenditure of US dollars has resulted in large dollar claims against us.⁸ Although much has been done to rebuild the war-devasted nations, our role, as defender of freedom has remained constant. The United States, unilaterally, and as a principal partner in a strategic joint enterprise has undertaken the major share of the costs of defense which have been necessary to deter future communist aggression. Thus military and economic aid to the other nations of the world is the principle source of our deficits problem.

Along with this problem of military and economic aid, has been the problem of short-term outflows to Canada and the Eurodollar market, which has been accumulating at an annual rate of $3.5 billion.⁹ In addition, there has been a rising volume of long-term foreign borrowing in the United States, which is estimated at an annual rate of $2 billion. These two factors contribute greatly to an already aggravated deficits problem.

Insofar as foreign borrowing in the United States is concerned, there appears to be two primary reasons why the US market is so appealing.¹⁰ First, the United States offers lower long-term interest rates than do the other financial centers; and second, there exists a ready availability of capital in the United

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⁷ Ibid.
⁸ Ibid.
¹⁰ 1963 Hearings, p. 61.
States. As a result, demand for US dollars has increased greatly over the last few years, particularly the last few months. If this increased demand is allowed to continue unchecked, the stability of the dollar could be seriously undermined.\textsuperscript{11} To make matters worse, there is nothing to indicate that this wave on new issues appearing on the US market, will of its own accord reduce in volume.\textsuperscript{12}

Besides this interest that exists among foreigners in acquiring US dollars, there exists in the United States, a keen interest in these foreign issues.\textsuperscript{13} The following are reasons for the recent interest exhibited by Americans in foreign investments:

1) Higher interest rates in most foreign countries, amounting to one-third more than interest rates obtainable here;

2) Belief that foreign shares offer better profit growth and dividend opportunity;

3) Certain foreign governments paying from 25-50 per cent higher interest rates than the US government pays;

4) Huge flow of savings in this country resulting from the relative shortage of profitable investment outlets at home.\textsuperscript{14}

Portfolio investment, in terms of long term loans and securities' purchases have been rising rapidly. Figures show that long-term capital outflows, including both direct investment in productive plant abroad and portfolio investment, have increased from $850 million in 1960 to $1.2 billion in 1962 and for the year 1963, appears to be running at an annual rate of well over $1.5 billion with no sign of abatement in sight.\textsuperscript{15}

Secretary of Commerce Hodges admits that it is our duty, as a leading world power, to continue to supply urgently needed capital through private market facilities.\textsuperscript{16} However, he feels that, "it serves the interest of no free nation to have this flow run at a pace that sharply aggravates existing imbalance in inter-

\textsuperscript{11}Ibid.
\textsuperscript{12}Ibid.
\textsuperscript{13}1963 Hearings, p. 291.
\textsuperscript{14}1963 Hearings, p. 61.
\textsuperscript{15}1963 Hearings, p. 5.
\textsuperscript{16}1963 Hearings, p. 62.
national payments." He emphasized that it is incumbent upon the other highly industrialized countries to develop their own capital facilities and thereby support their own rapid growth. It is admitted that there is progress being made along these lines; however, this progress has been agonizingly slow, and unless temporary steps are taken, continued deficits will produce intolerable strains on the monetary system as a whole as well as imperiling future prospects of growing trade among nations.

Consequently, it can be said that since 1950, the United States by investment abroad and by its massive military and economic aid programs, has expended many more dollars than it has been able to accumulate. The following graph will illustrate the extent of the problem, by indicating that up until the year 1950 the United States found itself in a favorable payments position. However, since that date, as previously mentioned, a deficit has been evident each year except 1957.

UNITED STATES BALANCE OF PAYMENTS
(ANNUAL RATE, BILLIONS OF DOLLARS)

*Revised figures

Revision removes non-recurring items such as for debt pre-payments from an earlier method of calculating Balance of Payments, indicated by solid line below. Revisions not made prior to 1960.

What has this deficit problem meant in terms of our gold supply? Due to the aid and investment that had gone abroad in the late 1950's, foreign countries had accumulated large surplusage of dollars, and requested that they be able to exchange the dollars for gold. Since the United States possessed almost 60 per cent of the free world's supply of gold, this request was graciously met at first. However, this request for gold has continued until the point has now been reached where our gold supply has dwindled down to $15.7 billion as compared to the $24.6 billion reserve which the United States had in 1949. Since

17 Ibid.
18 Ibid.
19 Id. at 63.
$12 billion is needed to back the US currency, this leaves only $4 billion in what is termed "free gold" which is needed to meet foreign claims. At this time, potential claims amount to some $25 billion, which makes for a very unhealthy situation.  

Since gold is the very backbone of our monetary system, it is vital to our economic security that the price of gold be maintained at the present $35 per ounce. This price is necessary in order to insure confidence in the US dollar. However, this price becomes increasingly more difficult to maintain as the foreign dollar balance increases.  

Therefore, there is no doubt that a very serious problem exists. If for some unexpected reason all the foreign nations holding US dollars decided to exchange their dollar holdings for gold, one can imagine the catastrophic effects this would have, not only insofar as our monetary system is concerned, but also

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24 Ibid.
with respect to the whole international monetary system. Consequently, due to the immediate nature and seriousness of the problem, it has become necessary for the President to take the steps necessary to counteract the deficits problem.

It can be said that the United States has been keenly aware of the problem prior to now. However, prior to the present action, the United States maintained a policy of avoiding any "direct" action on the deficits problem.\textsuperscript{25} In fact, government policy centered upon (1) improving the competitive position of the United States by means of wage-price restraints, tax-cuts, and export promotion, and (2) a series of "palliatives" designed to keep the outflow of gold minimized.\textsuperscript{26}

Action to rectify the payments' problem as initiated in mid-1960, prior to the late JFK's administration. In a move by the Federal Reserve, a "floor" was placed under short-term interest rates. Later, the aim was to maintain short-term interest while long-term interest rates were being reduced.\textsuperscript{27} In early 1961, the Treasury Department joined the Federal Reserve in a determined effort to combat the gold outflow. At this time, the Treasury tried to make investment more attractive in the United States by adding steadily to the available supply of short-term securities, and at the same time maintain a floor under the interest rates, so as to minimize short-term capital outflow.\textsuperscript{28} In March 1961, after the late President Kennedy's term of office had begun, the Treasury entered the foreign exchange market. This was the result of action taken by West Germany and Holland, both of whom revalued their currency upward by five per cent. The Treasury's aim was to dampen the speculative drain on dollars before a point was reached where the United States would be forced to sell gold.\textsuperscript{29} The Treasury joined with the European Central banks in the fall of 1961 to keep the London gold market under control. Their objective was to ward off any possible major speculative rises in the gold market.\textsuperscript{30}

\textsuperscript{25} Business Week, July 27, 1963, p. 60.
\textsuperscript{26} Ibid.
\textsuperscript{27} Ibid.
\textsuperscript{28} Ibid.
\textsuperscript{29} Ibid.
\textsuperscript{30} Ibid.
The extent to which the preceding measures were successful in thwarting the continuing drain upon our gold supply appears to have been negligible in the light of present conditions. The late President Kennedy in his special "Balance of Payments" message to Congress last July, did state that the balance of payments deficit had been reduced from $3.9 billion in 1960, to $2.4 billion in 1961 and to $2.2 billion in 1962.\(^{31}\) Much of this success has been attributed to special arrangements which have been made with some of our allies. These arrangements have included early debt repayment as well as advanced payment for military equipment and US borrowings abroad.\(^{32}\) Prepayment of foreign debts alone, have reduced the payments deficit by nearly $700 million in 1961, and again in 1962.\(^{33}\) Also contributing to the limited success of curtailing the outflow has been (1) the availability of US Treasury bonds for sale to foreign governments denominated in foreign currencies; and (2) by means of non-negotiable, non-interest bearing securities as payment of the United States subscription to certain international organizations.\(^{34}\)

However, in not trying to underestimate the effects of the previous steps mentioned, the late President as well as his top economic advisors believed that more immediate efforts were necessary to curtail the present outflow of dollars.

First, the late President recognized the fact that the Nation's over-all economic performance must be improved. In order to accomplish this, a long-term domestic program must be initiated. This would include increased investment, improved productivity, and wage-price stability. These steps are designed to better the US competitive position at home and abroad.\(^{35}\)

Since it will take a while for these long-range plans to take effect, these are areas in which, if immediate efforts are put forth, much can be accomplished to reduce the deficit and at the same time protect our gold reserve.\(^{36}\)

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\(^{32}\) Id. at 2.


\(^{34}\) Ibid.

\(^{35}\) CCH, Vol. 50, No. 41, August 10, 1963, p. 3.

\(^{36}\) Ibid.
Included among the areas mentioned in the President’s speech in which immediate strides could be made were: export expansion; tourism; federal expenditures abroad; short-term capital flows; investment by foreign savers in the securities of US private companies; special government transactions; gold sales and increased dollar holdings; the International Monetary Fund; and finally, long-term capital flows. The President discussed each of these areas in great detail, advancing ideas on how immediate improvements could be made which would slow down the gold outflow and at the same time improve our deficits situation.

The President, in his detailed discussion of each area, suggested six immediate measures by which our export potential could be developed more fully; encouraged a “See America Now” program; presented means by which federal expenditures abroad could be reduced, etc.

However, as part of his program to curtail long-term capital outflows, the President suggested three possible solutions to this problem of long-term capital outflows. The first would increase the whole long-term interest rate, while the second called for direct capital controls. The former suggestion would, however, probably throw the whole economy in reverse by causing increased unemployment and by substantially reducing import requirements. Direct capital controls, used by many countries, is contrary to our basic concept of free markets.

The third solution suggestion by the President was in the form of a tax proposal which he has urged the Congress to enact. President Kennedy had called it an “Interest Equalization Tax.” Generally, the tax would increase the cost to foreigners of obtaining capital in this country by approximately one per cent. It is hoped that the tax will have the effect of curtailing the flood of foreign security offerings in the United States and at the same time remain consistent insofar as economic growth and free capital movements are concerned. The following chart will illustrate the extent of private capital flows for the last four years, illus-

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37 Id. at 4-13.
38 Id. at 4.
39 Id. at 7.
40 Ibid.
41 Ibid.
tivating the severity of the situation. For the last four years, there has been a constant outflow in dollars, as a result of investment abroad.

PRIVATE CAPITAL FLOWS IN THE US BALANCE OF PAYMENTS
1959 to First Quarter 1963
(In Millions of Dollars)

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1Not seasonally adjusted.
2Including receipts on Export-Import Bank findings of US private Short-Term Credit—1961, 111; 1962, 93; 1st quarter, 1963, 8; Survey of Current Business.

Unless something is suggested immediately, there exists the possibility that the dollar will lose its status as the prime media of international payment, as various types of restrictions are imposed upon foreign transactions in the United States. In fact, there has been a trend along these lines for some time. These restrictions include: reduction of tourists' duty free imports from $500 to $100; more and more US aid tied to purchases in this country;

Americans prohibited from buying and holding gold overseas, etc.\textsuperscript{43}

Therefore, the President, along with Secretary of Treasury Dillon, believe that this "Interest Equalization Tax" would be a step towards the predetermined goal of curtailing the payments deficit. Mr. Dillon believes that the tax will have a two-fold purpose.\textsuperscript{41} First the tax will provide the means by which external equilibrium may be restored by increasing the profitability of investment in the United States and causing more effective capital markets abroad; and second, the tax will be instrumental in reducing the gold outflow.

The tax will have a positive effect on the balance of payments, and yet will not impede access to American markets by those foreigners unable to obtain longer term funds on reasonable terms elsewhere. Market prices and decisions will continue to determine the allocation of funds for investment in foreign securities.\textsuperscript{45}

The tax will, if correctly applied, raise the costs of acquiring capital in the United States, so as to place them more in line with the costs prevailing elsewhere. The end result, it is hoped, will be to substantially eliminate any incentive to obtain capital in the United States, where the purpose is simply to achieve savings in cost. Therefore the Government feels that long-term funds will remain available to those in a position to pay the higher rate.\textsuperscript{46}

What impact, if any, does the United States expect the tax to have on curtailing future capital outflow? Trying to predict the impact on capital outflow will certainly be an impossible task, since you are dealing with market prices rather than administrative controls. Mr. Dillon believes future transactions of the sort involved will depend upon the urgency of the needs of other countries, the speed with which capital markets in other

\textsuperscript{43} Ibid.
\textsuperscript{44} 1963 Hearings 58.
\textsuperscript{46} 1963 Hearings 64.
countries are developed, and upon other supply and demand factors existing at home.\textsuperscript{47}

Mr. Dillon predicts that the tax will have the effect of reducing investment for new bond and stock issues to the $500 to $700 million range, a range prevailing from 1959-1961. Besides aiding our deficits problem, the tax proposal should generate anywhere from $20 to $30 million annually, in terms of revenue.\textsuperscript{48}

The late President Kennedy's tax proposal came out at the same time that the Federal Reserve was raising the discount rate from 3 to 3\frac{1}{2} per cent and the ceiling rate permitted to be paid by banks on time deposits. In conjunction with these moves, the United States requested, and has been approved, a $500 million standby credit from the International Monetary Fund.\textsuperscript{49} The late President Kennedy believed that the new tax proposal plus reduced government spending and including the above mentioned policy moves could have the effect of reducing the deficit by some $2 billion over the next 18 months.\textsuperscript{50}

\textbf{CHAPTER II. \textit{Nature of the Tax}}

The late President Kennedy, as part of his effort to reduce the balance of payments deficit, and at the same time defend our gold reserve, suggested the immediate passage of what has been termed an "Interest Equalization Tax." The proposed tax, designated H.R. 8000, was introduced by the Honorable Wilbur D. Mills, of Arkansas, chairman, Committee of Ways and Means, United States, House of Representatives, on behalf of the administration.\textsuperscript{1}

The purpose of this chapter is to acquaint the reader with the nature of the tax and how it will affect the US investor. Then, without trying to get involved with a detailed analysis of the tax itself, a general description of the proposed "Interest

\textsuperscript{47} \textit{Id.} at 71.
\textsuperscript{48} \textit{Ibid.}
\textsuperscript{49} \textit{Business Week}, July 20, 1963, p. 25.

\textsuperscript{1} Hearings before the Committee on Ways and Means of the House of Representatives, 88th Cong., 1st sess., on H.R. 8000, 57, 1963 (Hereinafter cited as 1963 Hearings).
Equalization Tax” will be given. Most of the source material used in this chapter has been derived from the official “Description of the Proposed Interest Equalization Tax,” as released by the Treasury Department.2

Recognizing the serious payments situation that the US has been experiencing the last few years, and seeing that part of the problem has been the direct result of the flood of foreign securities on the American market. The Administration believed the enactment of H.R. 8000 would reinforce the existing effort being made to correct the US balance of payments deficit. Just to re-emphasize the wave of foreign securities being sold here, the figures of foreign security sales to US investors will be repeated. Foreign security sales in the United States which averaged about $600 million in the years from 1959-1961, have increased to $1.1 billion in 1962, and for the first half of 1963, has reached an annual rate of some $1.7 billion.3

Therefore, the proposed tax will impose a special temporary tax on US persons, who purchase “stock, debt securities, or other obligations of foreign issuers or depository receipts or other evidence of interest in, or rights to acquire, such interests.” The tax is intended to remain in effect until the end of 1965.4 The late President had said that the imposition of the tax in conjunction with some other suggested policy measures will reduce the deficit by some $2 billion over the next 18 months.5

The tax proposal will apply to all United States citizens, residents, and corporations including organizations ordinarily exempt from federal income taxes.6 Those liable for the tax will be all United States persons making taxable acquisitions.7 Since purchases by United States citizens from other United States citizens do not affect the balance of payments, transactions of this sort will be excluded from the tax.8

3 Ibid. at 13.
4 Id. at 14.
6 CCH, supra note 2, at 13.
7 Id. at 14.
8 Ibid.
The proposed tax will apply to both new and outstanding issues, including "portfolio purchases of stock or debt securities issued by foreign corporations, governments, or other persons," although it can be said that more than four-fifths of the outflow from all portfolio transactions in foreign securities for the past year has resulted from new debt issues.\(^9\) However, if outstanding foreign debt issues were exempt from the tax, the US investor's interest would turn to these issues, and the effectiveness of the tax would be greatly reduced. In contrast, transactions involving outstanding foreign equities have far exceeded the flow of new stock issues.\(^10\) Insofar as the tax is concerned, it makes no difference whether the tax purchase is consummated at home or abroad.\(^11\)

The tax proposal will not apply to direct investments made by United States persons in overseas subsidiaries or affiliates.\(^12\) In order to constitute a direct investment, it must include "the acquisition of debt or equity interest in a foreign corporation by a United States person owning at least 10 per cent control after the transaction is completed." This definition of "direct investment" is based on the statutory test utilized by the 1962 Revenue Act.\(^13\) It is not necessary to apply the tax to this area because questions of market position and long-range profitability which are closely connected to decisions to undertake direct investment, completely outweigh concern over interest rate differentials.\(^14\) However, it should be noted, that if foreign corporations are formed purely for purposes of avoiding the tax, United States citizens making direct investments under these conditions, will be subject to the tax.\(^15\)

Acquisitions of indebtedness payable on demand and those having a maturity of less than three years will not be subject to the tax.\(^16\) Since these transactions involve enormous volume and at the same time constitute a vital "lubricant" for world commerce, any disadvantage which may result from not applying

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\(^9\) 1963 Hearings 66.
\(^10\) \textit{Ibid.}
\(^11\) CCH, \textit{supra} note 2, at 14.
\(^12\) \textit{Ibid.}
\(^13\) 1963 Hearings 68.
\(^14\) \textit{Ibid.}
\(^15\) CCH, \textit{supra} note 2, at 16.
\(^16\) \textit{Id.} at 14.
the tax to this source, and some do exist, is greatly subordinated to those reasons given for excluding these short-term obligations from the tax.\textsuperscript{17} Trade financing transactions will not, therefore, be affected by the tax, to any measurable degree, because transactions of this sort will ordinarily fall within the three year category previously mentioned.\textsuperscript{18}

Export-Import Bank financing and commercial bank loans executed in the ordinary course of their banking business will not be subject to the tax.\textsuperscript{19} It is felt that the majority of these loans will not be subject to the tax, anyway, due to the three year exemption. Furthermore, foreign loans from the above sources, which are of a longer variety, are relatively small, volume-wise, and in the majority of cases can be tied to specific United States exports.\textsuperscript{20}

United States producers extending credit as part of their export sales will not be subject to the tax proposal.\textsuperscript{21} Therefore, if one considers this specific tax exclusion along with that provided for Export-Import financing and for commercial bank loans, it becomes apparent that the tax will have no effect whatsoever on the present ability of the United States to offer to their foreign customers, the finest credit facilities existing today.\textsuperscript{22}

Acquisitions of security offerings, issued by international organizations of which the United States belongs, will not be taxable. In addition, corporation issues and government issues of certain countries who are considered to be less-developed will also be excluded from the tax. In order to fall within this category, corporations must have their principal activities located in these less-developed countries, as regulated by section 955 (c) of the IRC.\textsuperscript{23}

Countries considered to be less-developed will be those defined by Executive order of the President. At the present time,

\textsuperscript{17} 1963 Hearings 67.  
\textsuperscript{18} CCH, supra note 2, at 15.  
\textsuperscript{19} Id. at 14.  
\textsuperscript{20} 1963 Hearings 67.  
\textsuperscript{21} CCH, supra, note 2, at 14.  
\textsuperscript{22} 1963 Hearings 68.  
\textsuperscript{23} CCH, supra note 2, at 14.
the list of less-developed countries includes, "all Latin American countries, African countries with the exception of South Africa, Asian countries except for Japan and the Crown Colony of Hong Kong, and to a few other nations outside the Sino-Soviet Bloc." The purpose of this exclusion is to aid "those nations with chronic capital shortages, urgent development needs, and limited capability for foreign borrowing on normal commercial terms." 24

If the tax, as applied to a particular country, will threaten the stability of the international monetary system, the President has within his discretion, the power to exclude from the tax, new issues of that particular country.25 Presidential authority may be exercised only when a highly unusual set of circumstances exist. An example of this sort of situation would be a particular foreign country, who as a result of the tax, would be forced to take measures which, if enacted, would imperil not only the stability of its own currency, but the international monetary system as a whole.26 (It is interesting to note that this Presidential authority has already been exercised with respect to Canada. This will be discussed in Chapter III.)

The discussion above, represents the particular areas which will and will not be subject to the tax. The tax proposal presents the area to which the tax will apply, followed by the areas within which an exclusion will apply.

The proposed tax will be collected by means of the filing of returns. Returns must be filed on the last day of the calendar month following each calendar quarter in which a United States person consummates a purchase.27

The Treasury Department has already designed forms which will indicate that the security involved has been purchased from another United States person and therefore will be exempt from the tax.28 Temporary form 3625 and form 2626 for nominees have been devised for this purpose. Instructions on the above mentioned forms state that the forms can only be executed by a

24 1963 Hearings 68.
25 CCH, supra note 2 at 14.
26 1963 Hearings 69.
27 CCH, supra note 2, at 15.
person who is either a United States citizen or resident during the time of ownership or continuously since July 18, 1963, and that it is imperative for the purchaser to secure this form or an approved substitute from the seller in order to claim an exemption from the tax.\textsuperscript{29} Temporary form 3650 and form 3651 for nominees are to be used only for those "sales of foreign securities which are effected on a national securities exchange registered with the Securities and Exchange Commission by a member or member organization of such exchange." The same rules, insofar as who may execute such a certificate and who must secure the certificate which applied to forms 3625 and 3626, apply to forms 3650 and 3651 also. It appears that forms 3650 and 3651 need only be used if a member of a national securities exchange registered with the SEC desires to make a regular sale of a foreign security on such exchange, but hasn't secured from the seller forms 3625 or 3626.\textsuperscript{30} "Substitute" forms, in order to be used, must conform to the requirements of Revenue Procedure 61-31.\textsuperscript{31}

In conjunction with the creation of the temporary forms by the Treasury Department, the New York Stock Exchange has issued the following rules for transactions involving the purchase of foreign securities.\textsuperscript{32} Primarily the selling broker is held responsible to determine the status of the seller. To accomplish this, the broker can follow one of two alternatives. The broker can either obtain a blanket certificate of American ownership for the account, or else supply a certificate of American ownership for each individual transaction. If it is determined that the seller is a United States person, no problem exists, and the sale is handled in the same manner as any other transaction. If, on the other hand, the seller is a foreigner and the sale is subject to the tax, the transaction is marked, "Buyer Subject to Equalization Tax." In addition to the regular ticker symbol of the security involved, the letter "F" is also noted on the ticker tape as part of the notice of sale.\textsuperscript{33}

Insofar, as the sale of the foreign security is stock, the tax is based on the value of the security acquired, and is imposed at

\textsuperscript{29} US Treasury Department, IRS, Form 3625, 3626, August 1963.
\textsuperscript{30} US Treasury Department, IRS, Form 3650, August 1963.
\textsuperscript{32} 1963 Hearings 440.
\textsuperscript{33} Ibid.
the rate of 15 per cent. The rate of tax of debt securities ranges from 2.75 per cent to 15 per cent and is figured from a period beginning with the date of acquisition and ending at maturity.\textsuperscript{34} The following,\textsuperscript{35} illustrates the rate of the tax for debt securities of a period including from 3 to 28 years:

<table>
<thead>
<tr>
<th>Maturity</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>At least 3 years, but less than 3(\frac{1}{2}) years</td>
<td>2.75%</td>
</tr>
<tr>
<td>At least 3(\frac{1}{2}) years, but less than 4(\frac{1}{2}) years</td>
<td>3.55</td>
</tr>
<tr>
<td>At least 4(\frac{1}{2}) years, but less than 5(\frac{1}{2}) years</td>
<td>4.35</td>
</tr>
<tr>
<td>At least 5(\frac{1}{2}) years, but less than 6(\frac{1}{2}) years</td>
<td>5.10</td>
</tr>
<tr>
<td>At least 6(\frac{1}{2}) years, but less than 7(\frac{1}{2}) years</td>
<td>5.80</td>
</tr>
<tr>
<td>At least 7(\frac{1}{2}) years, but less than 8(\frac{1}{2}) years</td>
<td>6.50</td>
</tr>
<tr>
<td>At least 8(\frac{1}{2}) years, but less than 9(\frac{1}{2}) years</td>
<td>7.10</td>
</tr>
<tr>
<td>At least 9(\frac{1}{2}) years, but less than 10(\frac{1}{2}) years</td>
<td>7.70</td>
</tr>
<tr>
<td>At least 10(\frac{1}{2}) years, but less than 11(\frac{1}{2}) years</td>
<td>8.30</td>
</tr>
<tr>
<td>At least 11(\frac{1}{2}) years, but less than 13(\frac{1}{2}) years</td>
<td>9.10</td>
</tr>
<tr>
<td>At least 13(\frac{1}{2}) years, but less than 16(\frac{1}{2}) years</td>
<td>10.30</td>
</tr>
<tr>
<td>At least 16(\frac{1}{2}) years, but less than 18(\frac{1}{2}) years</td>
<td>11.35</td>
</tr>
<tr>
<td>At least 18(\frac{1}{2}) years, but less than 21(\frac{1}{2}) years</td>
<td>12.12</td>
</tr>
<tr>
<td>At least 21(\frac{1}{2}) years, but less than 23(\frac{1}{2}) years</td>
<td>13.05</td>
</tr>
<tr>
<td>At least 23(\frac{1}{2}) years, but less than 26(\frac{1}{2}) years</td>
<td>13.75</td>
</tr>
<tr>
<td>At least 26(\frac{1}{2}) years, but less than 28(\frac{1}{2}) years</td>
<td>14.35</td>
</tr>
<tr>
<td>At least 28(\frac{1}{2}) years or more</td>
<td>15.00</td>
</tr>
</tbody>
</table>

Generally, it can be said that the tax, if enacted, will apply to acquisitions occurring after July 18, 1963, the date of the late President's message.\textsuperscript{36} If the tax was not applied retroactively, serious problems could result if the administration permitted time to elapse before the tax became effective. Any appreciable time allowed before the tax became effective would allow sufficient time for a large volume of transactions, which would only result in worsening the deficits problem.\textsuperscript{37}

At the request of the New York Stock Exchange, acquisitions effected on a national securities exchange on or before August 16, 1963, will not be subject to the tax. The reason for

\textsuperscript{34} CCH, \textit{supra} note 2, at 14.
\textsuperscript{35} \textit{Id.} at 19.
\textsuperscript{36} \textit{Id.} at 14.
\textsuperscript{37} 1963 Hearings 70.
this request was so that the Exchange could have a sufficient amount of time to formulate procedures, etc., in order to expedite the means by which acquisitions subject to the tax will be handled.\textsuperscript{38}

In addition, transactions consummated within 60 days after July 18, 1963, the date of the late President's message, and if the security acquired was covered by a registration statement filed with the Securities and Exchange Commission within 90 days prior to the July 18th date, will be exempt from the tax.\textsuperscript{39}

\textbf{Chapter III. Foreign Reaction to the Tax}

The "Interest Equalization Tax," as has been previously mentioned, is a tax proposal suggested by the late President Kennedy, as part of his special balance of payments message, presented to Congress on July 18, 1963. Generally speaking, its purpose and effect with which we are quite familiar by now—its purpose being to reduce capital outflow and its effect being to raise the costs of borrowing by foreigners in the United States market.

The announcement of the tax proposal had repercussions all over the free world. Some of the countries reacted violently, to the proposed tax, fearing the worse, while others more or less accepted it for what it stood for, and at the same time hoped that it would never pass.

Canada and Japan appeared to be the most concerned of all the countries that would be affected by the tax. This stands to reason, as the following chart will illustrate, new Canadian and Japanese securities had the greatest appeal of all foreign issues floated in the United States.\textsuperscript{1}

\textsuperscript{38} \textit{Id.} at 439.

\textsuperscript{39} CCH, \textit{supra} note 2, at 14.

\textsuperscript{1} Hearings before the Committee on Ways and Means of the House of Representatives, 88th Cong., 1st sess. on H.R. 8000, 74, 1963, (Hereinafter cited as 1963 Hearings).
### Table 3

**NEW ISSUES OF FOREIGN SECURITIES PURCHASED BY US RESIDENTS, BY QUARTERS, 1962-1963**

(first half)

(In Millions of Dollars)

<table>
<thead>
<tr>
<th></th>
<th>1962</th>
<th>1963</th>
<th>1963 1st Half</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>I</td>
<td>II</td>
<td>III</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>227</td>
<td>10</td>
<td>112</td>
</tr>
<tr>
<td>Canada</td>
<td>237</td>
<td>10</td>
<td>112</td>
</tr>
<tr>
<td>Western Europe</td>
<td>57</td>
<td>35</td>
<td>138</td>
</tr>
<tr>
<td>Japan</td>
<td>61</td>
<td>11</td>
<td>17</td>
</tr>
<tr>
<td>Latin Amer. Repub.</td>
<td>18</td>
<td>5</td>
<td>19</td>
</tr>
<tr>
<td>Other Developed</td>
<td>43</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Countries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Less Developed</td>
<td>95</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Countries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>International Institutions</td>
<td>12</td>
<td>80</td>
<td>312</td>
</tr>
</tbody>
</table>

1 Preliminary.
2 Not seasonally adjusted.
3 Less than $500,000.
4 Includes $75,000,000 issued by Inter-American Development Bank.
5 Not available.

**Source:** Survey of Current Business—Department of Commerce.

From the chart, it is quite apparent that our neighbor to the north would lose most of all, if the tax proposal were enacted.

The tax proposal, when announced, had an almost immediate effect in Canada. The following day when the Montreal Stock Exchange opened, it was greeted by a huge wave of selling. The President of the Montreal and Canadian Stock Exchange announced that if passed, the tax would have a most serious effect on the entire Canadian economy, including a sharp drop in prices.²

The tax would result in further devaluation of the Canadian dollar. The Minister of Finance in a statement said that "while France, Italy and Germany have accumulated dollar surpluses in recent years, Canada has a deficit and does not raise any more..."

capital in the United States than is necessary to pay debts to the United States."

The Minister intimated that the tax was more directly aimed at these Western European countries, and because of the payment deficit problem existing within Canada at the present time, he hoped that some concessions could be granted to Canada.

It was announced that the Canadian annual deficit is running at an annual rate of about $1,000,000. Another Canadian government spokesman's reaction was that the application of the tax was ironical because it would fall heaviest on Canada, although as stated by Canada's Minister of Finance, it was designed to correct the unfavorable balance of trade existing with various Western European countries.

Foreign Minister Gordon of Canada stated that the tax would act as a brake on Canadian expansion. This would be so because it would make it much more costly and difficult for Canadian provinces and municipalities to borrow money in the United States. Mr. Gordon went on further to say that the tax would act to worsen Canada's already existing deficits' problem as well as seriously affecting the Canadian economy as a whole.

The Canadian Government had announced, about one month prior to the President's message, measures to control United States investment and lessen control of Canadian companies by United States companies. The United States, in announcing the proposed "Interest Equalization Tax" reassured Canada that the tax was not intended as a reprisal against the earlier announced Canadian policy.

Less than two days after the tax was announced, "high-level" US-Canadian talks were called for by Canadian government officials. The primary purpose of these "high-level" talks by Canadian officials was, of course, to seek relief from the tax.

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5 Ibid.
Canadian officials stated that this heavy borrowing in the United States was necessary to finance the heavy purchases in the United States. American government officials estimated that 40 per cent of dollar outflow went to Canada last year.\(^7\)

The "high-level" talks brought some results insofar as the present Canadian situation was concerned. If in retrospect, one examines H.R. 8000 as written, it will be remembered that the President has within his authority, discretion to exclude from the tax new issues of securities from foreign countries, if in his opinion, application of the tax would imperil or threaten to imperil the stability of the international monetary system.\(^8\)

Consequently, the late President announced that the tax would not apply to new Canadian issues floated in the United States.\(^9\) This exclusion came about four days after the tax proposal was presented to Congress. The action resulted, not only because of the serious fiscal problem existing in Canada, but also, because two-thirds of the new issues floated on the New York Stock Exchange were of Canadian origin, and both countries are each other's best customers.\(^10\)

The relief granted to Canada was to act as a two-way sword. In return for the US concession to Canada, the latter promised to aid the United States in its deficit fight. Canada promised to reduce the long-term interest rates, which in turn would bring the cost of borrowing in the US and Canada more in line with one another, and thereby achieve the objective sought by the tax.\(^11\)

This added relief granted to Canada resulted in further repercussions from other free world countries insofar as application of the tax was concerned. Although this will be developed more fully in the next chapter, it can be generally stated that reaction to this concession included opinion that the US was retreating in its efforts to reduce the balance of payments and

\(^7\) Ibid.
\(^10\) Ibid.
that this further relief granted to Canada would defeat the very purpose of the tax.

It appears, that next to Canada, Japan has more to lose than any other nation who will be affected by the tax. "In the 4½ years ended July 1963, the Japanese government has had two issues of long-term bonds aggregating approximately $43 million, and Japanese corporations have had over 30 issues of securities (stock and/or long-term debt) aggregating approximately $390 million (including 6 issues aggregating $111 million for two government guaranteed corporations)." 12 By mid-1963, over 20 Japanese corporations have been able to obtain long-term funds in the United States by means of either private or public sale of equity or debt securities. It is no wonder then that the passage of such a tax could have nothing but far-reaching consequences on the future financial planning and attitudes of all Japanese corporations interested in obtaining money in our market.13

Although activity on various foreign markets was somewhat moderate, declines ranging in the area of from 2 to 3 per cent, heavy selling was reported in Tokyo.14 The Tokyo stock market, in the two days following the late President's message, declined 123 points. This drop, without parallel in Japan's financial history, resulted in a loss in the aggregate of $1.8 billions in security values.15

Tokyo's violent reaction to the tax seems to stem from the fact that the tax will have the effect of "restricting Japan's ability to get long-term capital from the New York capital market which is important in supporting Japan's balance of payments' position."16 The Japanese Foreign Minister said that the tax measure will have the effect of reducing the "flow of long-term funds from the United States to Japan in the form of stocks, bonds, and debentures issued by the Japanese Government and business organizations." He also feared that reductions in United States

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12 1963 Hearings 467.
13 Id. at 468.
15 1963 Hearings 473.
overseas spendings would have serious effects on the Japanese defense program.  

(Although I had planned to devote the entire next chapter to public reaction at home, it appears that for purpose of continuity, it would be proper to insert reactions of both the State of Hawaii and firms whose work is devoted to Japanese securities.)

Although the State of Hawaii is the newest addition to the United States, its distance from the US mainland makes it a “foreign” country for many purposes, one of which is its relationship to Japan.

First, the Honorable John A. Burns, Governor of the State of Hawaii, believes that the tax, if enacted, would invite retaliatory measures by the Japanese, which would in the long run frustrate Hawaiian efforts to expand efforts and promote travel to its shores.  

Because of its location and ideal climate, the Far East and Japan represent a “goldmine” bolstering Hawaii's efforts to induce tourism to its shores. If the provisions of the proposed tax were imposed upon Japan, as is intended, it could very easily retard the growth of Hawaii’s tourist trade. In addition, the effect of the tax may go so far as to hamper efforts to promote more Hawaiian pineapple products in Japan.  

It is estimated that Hawaiian investors own somewhere in the neighborhood of $25 million worth of Japanese securities. However, at the same time, it should be made clear that United States investment in Japan, including Hawaii’s share, is only one part of the story. In 1962 alone, foreign capital investment in the United States totaled some $1 billion. On the other side, US investors received, in the form of interest and dividends, some $800 million, on their foreign security holdings. In addition to these impressive figures, it should be noted that although US

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17 Ibid.
18 1963 Hearings 416.
19 Id. at 371.
20 Id. at 416.
21 Ibid.
investors acquired some $124 million worth of Japanese securities, Japanese businessmen purchased in the United States machinery worth in the neighborhood of $516 million.\textsuperscript{22}

Governor Burns, in presenting these facts and figures, intimated that the proposed tax could very well result in conditions which could increase rather than negate the present deficits position.

Dr. James H. Shoemaker, Vice President of the Bank of Hawaii, and representing various interested organizations in Hawaii, stated that at the time a Japanese syndicate was very interested in purchasing the Sheraton Hotel in Hawaii. The price tag for this transaction was about $8 million, or one-third of the total volume of Hawaiian investment in Japanese securities.\textsuperscript{23} Dr. Shoemaker, as did Hawaii's Governor, believed that particularly in the case of Hawaii, the tax could do more harm than good. Dr. Shoemaker was quick to point out that the tax had already caused a general tightening up throughout Japan. This could very likely result in import restrictions, which again could tend to impede any significant improvement in our payments problem.\textsuperscript{24}

Of even greater significance to the United States are the consequences which could occur, if the Japanese element supporting trade with Red China were to win even more support, because of the adverse effects that the tax might have on the Japanese economy.\textsuperscript{25} This situation should be given careful consideration by Government officials.

A statement by Governor Burns summarizes Hawaii's position on the subject of the tax. He is convinced that the tax will, "simply drive away the better credit risk borrowers who can get their money elsewhere, leaving the market to the borrowers who will pay anything for their money just so long as they get it."

The Japanese Federation of Securities' Dealers Associations in a letter to the Chairman of the House Ways and Means Com-

\textsuperscript{22} Ibid.
\textsuperscript{23} Id. at 371.
\textsuperscript{24} Id. at 373.
\textsuperscript{25} Ibid.
mittee, stated its position on the tax.\textsuperscript{26} In his letter, he stated that besides the effect of slowing down Japan's industrial growth, the United States will find Japan reducing its imports in proportion to the reduction in money available to the Japanese by means of the US capital market. Here is evident a reprisal in the form of a veiled threat. Governor Burns of Hawai'i feared just such a threat.

In a statement by Mr. Albert H. Gordon, a senior partner of Kidder, Peabody & Co., Mr. Gordon stated that "when the outflow of long term capital is viewed in its proper perspective, as an asset creating and income earning expenditure, of American dollars, it appears shortsighted indeed to inhibit so drastically this segment of our payments outflow."\textsuperscript{27} Mr. Gordon thinks this is especially true in light of even larger outflows such as tourist expenditures. Due to Japanese reliance on the United States as a free capital market since the war, Mr. Gordon further believes that the "disintegration of a fabric of relationship and mutual confidence" built over the last 15 years or so would be a great loss to all concerned.\textsuperscript{28}

Because Japan felt it would be as much effected by the tax as Canada, Japanese officials immediately came to the United States, requesting concessions similar to those received by Canada. However, Japan's request for special treatment was denied. For some reason, the United States felt that this discretionary authority retained by the President would be exercised only if the tax caused serious economic difficulties in Japan; and perhaps at the present time, such economic difficulties as contemplated by the bill do not exist.\textsuperscript{29}

From Europe, came mixed and varied reaction to the late President's tax proposal.

There is evidence to indicate that the tax, although unenacted, has begun to have the effect intended. A British banker reports that quite a number of European borrowings, which ordinarily would go to New York, are being discussed in London.

\begin{itemize}
\item\textsuperscript{26} Id. at 473.
\item\textsuperscript{27} Id. at 469.
\item\textsuperscript{28} Id. at 468.
\item\textsuperscript{29} New York Times, August 3, 1963, p. 21, col. 1.
\end{itemize}
In fact, it has been reported that a number of planned New
York borrowings have been cancelled in London and on the
Continent. Good or bad, foreign markets are being utilized.
The late President Kennedy in his speech hoped that such re-
sults would occur as part of his program to improve our pay-
ments position.

Although it would seem that foreign markets would be
pleased by the present action, because it would mean more
business to them, reports indicate general discontentment with
the tax in its present form.

London financiers look upon the tax proposal with great
suspicion. Many of them feel that a decrease in the confidence
of US currency can be expected if the tax is enacted in its
present state. Private business interests in London believe present
US action indicates a weak dollar. London's financiers also
believe that the subsequent exemption to Canada and postpone-
ment of the effective date of the tax securities listed on the NY
Stock Exchange give evidence that the plan was hastily con-
ceived. As some London observers put it, the tax leaves "more
gaps than a bikini." It is their opinion that the United States
could have acted more decisively on its payments problem. In
the long run, these same London observers believe that the
United States will have to resort to still tighter money and
higher interest rates.

Trading in Amsterdam fell sharply as a result of the an-
nouncement of the tax. Sales of such issues as Royal Dutch Shell
and Uniever which have been American favorites, came to a
standstill. However, the main reason for the effect on the market
in Amsterdam appears to stem from the uncertainty of what the
tax means, how effective it will be, and whether it will be enacted
at all.

In Italy, private commercial and banking people were quite
critical of the tax plan. The tax proposal comes at a bad time

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33 Newsweek, August 17, 1963, p. 89.
because Italy, is also having its payments problems, and as a result had intended to borrow heavily from the United States. Many Italian observers feel that the tax will lessen existing confidence in the dollar. Besides that, they feel the tax might very well lead to exchange controls, instead of achieving its primary goal—curtailing outflows of the dollar from the United States. 35

Sweden appeared to be quite uneasy over the tax proposal because the proposal runs contra to the current trend of liberalization in the international economy. It also believes that the tax runs contra to the US policy of free trade and capital movement. 36

In summary, the "Interest Equalization Tax" worries European financial experts. In general, European financiers believe that the tax is unworkable and that it will never pass in its present form. 37 Others believe the tax will downgrade New York as the financial capital of the world. 38

There are some who believe that the effects of the tax may be avoided. An example of this would be a foreign government bond to be sold in New York at a price of 100. The foreign government in order to compensate for the tax would reduce the price of the bond. Essentially, the tax would be paid by the seller and not the buyer. European experts feel that if a European borrower is willing to borrow in the United States at the rate of 5 1/2 per cent, he would still be willing to borrow at 6 1/2 per cent. 39 It also would be possible for a US investor to ship dollars abroad, purchase the stocks there and deposit them at some overseas address. 40

Some European bankers, as well as some others are happy, not because of the tax proposal, but because the United States is making a determined effort to strengthen its balance of payments position. 41

36 Ibid.
In short, reaction in the major financial centers ranged from great enthusiasm to concerned criticism. There are some who are bewildered and confused by what the tax will mean, while others hope that tax will never become law.

Chapter IV. Public Reaction at Home

Reaction to the news of the proposed “Interest Equalization Tax” was immediate, and as had occurred on foreign stock exchanges, the New York Stock Exchange witnessed a sharp decline on the price of foreign securities traded through the exchange.\(^1\) Although foreign security sales came to a halt, Americans continued to acquire outstanding foreign securities from other Americans, since these transactions would not be subject to the tax.\(^2\) Although a probable coincidence, it was announced that as of July 19th, gold reserves had reached their lowest point since April 19, 1939—\(\$15,663,000,000\).\(^3\)

The newspapers were quite critical of the tax proposal. The “Detroit Free Press” stated that the effect of the tax would be inconsequential. A man who is earning from 10-15 per cent on foreign securities was not going to be stopped by a two per cent excise tax.\(^4\)

The “New York Times” was quick to state that the tax was ill-advised and hastily proposed.\(^5\) Evidence of this was the special treatment that Canada received just after the tax was announced. In fact, this special consideration given to Canada, largest of all foreign borrowers, will lessen much of the plan’s potential effect on the payments problem. The “Times” stated that the tax would have the effect of creating a two price system for long-term capital markets,\(^6\) and it is their belief that the tax amounted to a form of “control.”\(^7\) As far as the “Times” is concerned, foreign borrowers are drawn to our shores, not because of the

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\(^{4}\) N.Y. Times, July 21, 1963, p. 9, col. 5.
\(^{6}\) Ibid.
\(^{7}\) N.Y. Times, September 1, 1963, Sec. IV, p. 8, col. 2.
low cost of capital, but primarily for the reason that there is always a ready availability of funds.\textsuperscript{8}

There is a small minority who view the tax proposal as regrettable, but feel that it is about time that the United States exert some effort in solving the payments problem, or at least, reduce the outflow of gold to a point where it is considered safe.\textsuperscript{9}

As soon as the tax was announced, leading foreign security dealers got together to draw up counterproposals. Although it was not clear as to what these proposals would involve, it was felt that the dealers would ask that only new issues of foreign securities be taxed. Their logic is that the balance of payments is not penalized when a US investor switches from one outstanding foreign security to another. The dealers also criticized the 15 per cent tax on outstanding foreign securities. In their opinion, the outflow of dollars resulting from such purchases is insignificant when compared to the outflow resulting from the acquisition of bonds.\textsuperscript{10}

Many observers feel that it is impossible to measure the effects that the new tax proposal will have on the payments problem. Since the area involved is quite delicate and very complex, the risk that is being taken cannot be underestimated.\textsuperscript{11}

On Friday, August 16th, the New York Stock Exchange experienced the heaviest trading in foreign bonds, and which has been estimated to have been the largest ever. Of the $3,420,000,000 of foreign bonds traded on that day, at least $1,400,000,000 was of Japanese origin. The buyers, realized that if the tax was enacted, it would be applied retroactively, with August 16th as the cut-off date, and therefore tried to get in "under the wire."\textsuperscript{12}

One of the biggest fears confronting the New York Stock Exchange is that the tax, if enacted, could possibly weaken New York's position as the financial capital of the world.\textsuperscript{13}

\textsuperscript{8} Ibid.
\textsuperscript{11} N.Y. Times, July 22, 1963, p. 33, col. 7.
\textsuperscript{12} N.Y. Times, August 17, 1963, p. 25, col. 7.
\textsuperscript{13} N.Y. Times, August 24, 1963, p. 23, col. 5.
others expressed similar concern, with regard to New York and the United States losing its position as the financial center of the free world. In a statement by Mr. Mark E. Richardson, Executive Vice President of the New York Chamber of Commerce, he said that “any substantial transfer of financial transactions to foreign money centers, as would certainly occur from the imposition of the tax in question, would have an immediate and damaging effect on New York’s economy and employment.” He went on to say that the business and jobs which would be lost, could in no way be compensated for, and that these losses, would in the long run be detrimental to the United States.\textsuperscript{14}

The public received its opportunity to express opinion on H.R. 8000, at the scheduled public hearings of the House Ways and Means Committee. Much of the following material, which summarizes public reaction to the proposed tax, comes from the reported Hearings on H.R. 8000, before the Committee on Ways and Means of the House of Representatives, held August 20, 21, 22 and 23, 1963.\textsuperscript{15}

The Hearings Report totals 540 pages. Of all the persons who had the privilege of testifying before the Committee, only a handful actually favored the tax without any changes. In fact, it can be said that very few people favored the tax at all.

Among those favoring the proposed tax were the Honorable Franklin D. Roosevelt, Jr., Acting Secretary of the Department of Commerce; the Honorable George W. Ball, Under-Secretary of the Department of State; and the Honorable C. Douglas Dillon, Secretary, Department of the Treasury. In addition to above mentioned government officials who favored the new tax, in their reports to the Ways and Means Committee, it appears that of all the public witnesses testifying, only Mr. Nathaniel Goldfinger, of the Department of Research of the AFL-CIO, favored the tax.

Mr. Roosevelt restricted his comments on the tax, to the subject of exports. He believes that since the tax does not apply

\textsuperscript{14} Hearings before the Committee on Ways and Means of the House of Representatives, 88th Cong., 1st sess. on H.R. 8000, 159, 1963 (Hereinafter cited as 1963 Hearings).

\textsuperscript{15} Id. at 134.
to credits of less than 3 years, and since certain other exclusions are allowed, if the transaction is directly related to exports, the tax will not have a substantial effect on US exports. Although recognizing that a small number of non-manufacturing exporters might be required to alter their present financing arrangements, he believes that in the long run, such alterations, if they become necessary, are inconsequential as compared to the savings expected to result from the tax.¹⁰

Many of the public witnesses who testified before the Committee, had opinions that were opposed to those expressed by Mr. Roosevelt. The United States Council of the International Chamber of Commerce, in a statement to the Committee, warned of the detrimental effects that the tax might encourage, with respect to our international trade, as well as to our relations with other nations. The tax could go so far as to “handicap United States business operations abroad, so that the long-run result would be to reduce the sale of US goods and services in foreign markets and reduce the flow of dividend and interest receipts on foreign investments—thus worsening our balance of payments position.”¹⁷ As a word of warning, the council emphasized the fact that we have been enjoying a surplus in the all-important balance of trade category, and therefore the government must be careful not to do anything which might “tip the scale” the other way, in the form of reduced sales of American goods and services abroad.¹⁸ Another observer stated that many of our exports are purchased with dollars obtained by means of security sales on the US market, and as such, exports will probably be reduced in direct proportion to the amount of reduction in our foreign investment.¹⁹

Under-Secretary Ball considered the tax proposal as an integral part of the President’s program to curtail the payment’s deficit. He emphasized the importance of that section of the bill which gives the President authority to exclude from the tax new security issues, in those cases where extreme hardship exists. This section of the bill is necessary, not only for purposes of preserving the stability of the international monetary system, but

¹⁶ Ibid.
¹⁷ Id. at 409.
¹⁸ Ibid.
¹⁹ Newsweek, October 28, 1963, p. 84.
is also necessary in order to protect and maintain foreign policy objectives of the United States.\textsuperscript{20}

Secretary Dillon also supported the bill with great enthusiasm, and much of what he said in support thereof can be found in Chapter I.\textsuperscript{21}

From the labor standpoint, the AFL-CIO came out in favor of the bill. As head of the Department of Research for the AFL-CIO, Mr. Nathaniel Goldfinger, stated that although he realized a balance of payments problem exists, it is greatly over-exaggerated. He attributes the payments' difficulty to the failure of the United States to sustain full-employment and maximum utilization of its productive capacity. Being, of course, pro labor, Mr. Goldfinger believes that the solution to the payments' problem rests with three factors: rapid, growing full employment at home; increased international confidence in the dollar; and increased opportunities for profitable investment at home. Although a long run solution is necessary, the "Interest Equalization Tax" represents a step in the right direction.\textsuperscript{22}

Before stating further reaction to the tax at home, it is of interest to note that although unenacted, the "Interest Equalization Tax" appears to be attaining much success. Reports indicate that since the late President Kennedy's message on July 19th, trading in existing securities have declined drastically, while no new foreign securities have been issued. For all intensive purposes, both of these conditions have halted the outflow of capital.\textsuperscript{23}

Another published report gives credit to both the rise in short-term interest rates and to the new tax proposal for maintaining US gold stocks at a steady figure for a period of five weeks, ending in mid-September.\textsuperscript{24}

Mr. Mark E. Richardson, a representative of the New York Chamber of Commerce, stated that the whole international

\textsuperscript{20} 1963 Hearings 156.
\textsuperscript{21} Id. at 58.
\textsuperscript{22} Id. at 421.
\textsuperscript{23} N.Y. Times, September 23, 1963, p. 43, col. 6.
\textsuperscript{24} N.Y. Times, September 20, 1963, p. 43, col. 2.
monetary operation today depends almost wholly on the United States dollar, and on the complete and high regard that the rest of the free world has in its integrity as a means of international exchange.26 Many others expressed similar opinions, and feared that the proposed tax would strike a strategic blow at the reputation of the strongest currency in the world.26 The enactment by Congress of such a tax might lead Americans and foreigners alike, into believing that the dollar is weak, and thereby undermining confidence in it.27

Statistics seem to bear out the fact that investment abroad has been averaging at an annual rate of approximately $1.9 billion. Of this amount, $1.3 billion consists of exempt moneys, while some $400 million is of Japanese origin, and which will still be placed on the US market, in spite of the tax. Therefore imposing a tax, which would effect a small portion of the total is hardly worth the risk, when one considers the consequences of having doubt thrown on the integrity of the dollar.28

The Chairman of the International Investment Division of the Investor's League, Inc., believes that the gold reserve is not quite in the condition that reports make it out to be. He feels that no matter how hard we try to control our gold reserves, a continuing pressure, resulting from continued leaps in standards of living and trade, will exert a continuing pull on our gold reserves. The problem lies in the fact that the United States lags in its rate of industrial production as compared to some of the more highly industrialized nations, thereby resulting in no flow of foreign funds seeking diversification here.29

To some, the proposed tax, if enacted, would contradict previous State Department policy encouraging private investment and trade with other nations.30 The United States, having for all substantial purposes, become world banker, has been instrumental in raising capital for other free countries. The tax, as such, appears to be inconsistent with our long standing policy

26 Id. at 177.
27 Id. at 288.
28 Id. at 158.
29 Id. at 176.
30 Id. at 182.
of free capital movements, and thus to many observers, involves grave consequences which far outweigh the little benefit which might be derived from it. The overall international assets position of the United States as well as its balance of payments position for future years is greatly enhanced when one considers the expected return of interest, dividends and capital.\textsuperscript{31}

Mr. I. W. Burnham, representing the Wall Street brokerage firm of Burnham & Co., believes that the proposed bill is inequitable and discriminatory. First, H.R. 8000 discriminates in favor of the large investor. While the small investor, who buys a few shares of stock and bonds is subject to the tax, the large company, by acquiring 10 per cent or more of the voting stock of the same foreign corporation that the small man has invested in, escapes tax free. In addition, the bill seems to tax equities at a higher rate than are debt securities. Mr. Burnham feels that this is inconsistent, since debt securities constitute the principal form of new issues. Since trading is a two-way affair, the tax could very well have the effect of curtailing purchases by foreigners of our securities.\textsuperscript{32}

Other testimony presented to the Committee indicated that, if enacted, the tax proposal would create two different markets, one among Americans and another for overseas transactions. Americans unable to purchase certain foreign securities at home from other Americans, will as a consequence, have to pay the 15 per cent tax, and acquire the security from an overseas source. Although such a situation was never intended, the tax is certain to have these results, if passed.\textsuperscript{33}

The International Economic Policy Association was represented by its President, Dr. N. R. Danielian. Dr. Danielian believes that the private flow of capital is a symptom rather than the cause of the deficits' problem. When one considers the enormous amount spent by the United States for foreign defense and aid, it is not possible for the surplus created by US commercial sales to offset these expenditures. As long as the United States is faced with this burden, which in the final analysis is

\textsuperscript{31} Id. at 219.
\textsuperscript{32} Id. at 254.
\textsuperscript{33} Id. at 294.
the ultimate cause of the problem, capital will continue to flow at this unprecedented pace. If this burden could be eliminated, then private capital outflows, which are self-sustaining, would be inconsequential.\footnote{Id. at 323.}

Timmons & Co., a brokerage firm engaged in buying and selling foreign securities, especially Canadian issues, objects to passage of the bill because, in addition to some of the criticism expressed by others, relating to the bill’s discriminatory features,\footnote{Id. at 254.} the legislation imposes a tax regardless of whether a dollar outflow is involved or not. Many observers feel that although new issues should be subject to the tax, outstanding issues should be excluded. In allowing a US person to sell the foreign security he presently owns, for another outstanding foreign security, no dollar outflow is involved, unless additional cash is necessary for the purchase.\footnote{Id. at 353, 425.}

Insurance companies believe that the tax will have a substantial bearing on their ability to carry on the life insurance business abroad. If one tries to understand the operation of insurance companies overseas, the impact of the tax on their business becomes apparent. These companies must take the premium collections and invest them in that particular country, because at death, the claims will eventually have to be paid in the currency of that country. Besides the exchange risk involved, if the premiums collected were sent to the US for investment and later returned to the country in order to satisfy insurance claims, it seems quite inconceivable that the people of the country would appreciate their life savings being taken from the country, when the savings are necessary to sustain economic growth there.\footnote{Id. at 355.}

In a position similar to that of the insurance companies, the construction business opposed the bill because a “tax would be imposed upon payment received from foreign countries whenever the client does not make an immediate full cash payment.” The construction business believes that the tax will place them in a very disadvantageous position. It is their opinion that con-
struction jobs overseas represents eventual payments to counteract the deficit, although full payment may not be immediate.\textsuperscript{38}

Mr. Peter D. Seghers, the President and Founder of the Institute of United States Taxation, stated that reliable statistics indicate that reduction in foreign investment, because of the tax and its application, will amount to only $250 million annually, as opposed to the $500 million figure estimated by the Government. Because of the various complexities of the tax, its exemptions and arbitrary power which is retained by the President, Mr. Seghers feels that corrective measures in the form of more competent disbursements for aid and defense might provide a better solution to the problem. In addition, the Government should not forget to give careful consideration to the effect that the bill might have on the "most favored nation" clause of our treaties of friendship and commerce which we have with other nations of the world.\textsuperscript{39}

The United States Chamber of Commerce opposes the tax on the grounds that it is "inconsistent with the objective of reducing, rather than increasing barriers to free international movement of goods and capital." Overlooking the fact that the tax probably will not have too much effect on improving our payments position, the Chamber of Commerce pointed out that over the past 30 years, the United States has relaxed its own trade barriers and at the same time has encouraged other nations to do likewise.\textsuperscript{40}

Since commercial banks are permitted to make loans of indeterminate maturity as long as the loans are in the "normal course of business," there are those who believe that this provides an easy means of escape for potential borrowers. All the foreign borrower has to do is shift to commercial bank loans, and thus, in essence, the bank exemption becomes self-defeating.\textsuperscript{41}

As brought out by one of the critics of the bill, after you take into account the exclusions which have been allowed to

\textsuperscript{38} Id. at 363.
\textsuperscript{39} Id. at 401.
\textsuperscript{40} Id. at 423.
\textsuperscript{41} Id. at 470.
“Canada, the World Bank, the Inter American Development Bank, the less-developed countries, bank loans, obligations of under three years maturity,” the tax can have only but so much effect on curtailing the dollar outflow. To make matters worse, of all the new securities floated on the American market, 62 per cent of the volume were of Canadian origin.\textsuperscript{42} Evidence of what is left after all of these exclusions are allowed can be set forth in terms of figures, for the year 1962. In that year, foreign security sales of new securities amounted to $1,076 millions. This figure is net of the $221 million of these issues written here, but sold abroad. If we exclude first, the exempt securities of international institutions which total $84 million plus the $102 million worth of securities from exempt Latin-American countries, we are left with a net balance of new securities, totaling $890 million, which would be subject to the proposed tax. Of this amount, there is left Canadian issues accounting for $457 million and Japanese securities totaling $101 million. Forgetting whether or not the whole $457 million of new Canadian issues will be exempted from the tax, it seems unlikely that there will be any significant reduction in Canadian and Japanese sales of new issues on the American market. The reasons for this include, an anticipated reduction in United States exports if the tax is enacted, and the fact that many will borrow here, tax or no tax. Therefore, after all these calculations, only the $195 million balance resulting from new issues of European securities, might possibly affect the deficit, assuming the tax is effective and deters Europeans from borrowing here.\textsuperscript{43}

Not to be forgotten in analyzing H.R. 8000 is the advantage that the Communists might receive from the proposed tax. Lest we forget that American enterprise abroad has done much to bolster our defense economically against Communist aggression. Included in the category of American enterprise abroad is the private investor. If we impede the private investor’s ambitions overseas, the end result could very well be increased outlays by the government in the form of more aid overseas. In the long run, this could have a more drastic effect on the payments situation, because it takes $2 of foreign aid to equal the effect of $1 business dollar. Of noted importance also, is the effect that the

\textsuperscript{42} Id. at 484.
\textsuperscript{43} Id. at 222.
tax has had on the Latin-American under-developed countries, whose securities are tax exempt from the bill. Reports indicate that trading has come to a halt on quite a few securities which originate from the above countries, because, with the powerful discretionary authority granted the President, these so-called tax exempt securities could become subject to the bill eventually.44

Criticism of the proposed bill appeared to be an “endless stream,” and it was possible to include a wealth of other material, representing the reaction of still other witnesses who testified before the Committee. However, much of what was said by these witnesses was repetitious in nature, and merely affirmed the position taken by the majority of those who reacted to the tax proposal. However, from what has been given, one can visualize and understand the various viewpoints expressed, with respect to H.R. 8000. Almost!!

CHAPTER V. Alternatives to the Tax

After discussing overseas reaction to H.R. 8000 and the reaction received at home, as reflected in newspapers and at the Hearings, it was quite apparent that the majority of those voicing an opinion of the bill, were opposed to it, in one way or another. However, the above mentioned critics did realize the nature of the payments problem as well as the serious ramifications related to it. Opinion was not given just for the sake of the record. Many of those who voiced opinion and at the same time recognized the unprecedented difficulties which the United States balance of payments has created, offered invaluable alternatives to the tax. These observers believe that if the suggested alternatives are followed the deficit could be reduced substantially, and thus, there would be no need for the imposition of an “Interest Equalization Tax”. This chapter deals with these alternatives.

First, as has been mentioned in Chapter I, current steps are being taken and are being enforced as part of the over-all program to cope with the payments problem. The late President in his Special Balance of Payments message to Congress, suggested various areas in which immediate efforts would be made to reduce the deficit and at the same time protect our gold re-

44 Id. at 181.
serves. Among the areas mentioned were export; tourism; federal expenditures abroad, etc.¹

Most observers agreed with the President, that of primary importance, would be intensive programs to expand exports, realizing, of course, that exports could not do the job alone.² “The long range and fundamental solution to our balance of payments problem will depend on our ability to increase earnings abroad through an expansion of exports of goods and services, and income on foreign investment, to such magnitude as will generate a favorable Balance of Payment in the private sector sufficient in size to cover our foreign expenditures under government programs.”³ This quote is taken from the Committee on Finance and Currency of the New York Chamber of Commerce, in a report examining the US deficit problem, and seems to express the over-all opinion with respect to using exports as an instrumentality to reduce the deficit.

In connection with the discussion of exports, the New York Chamber of Commerce in a different report, suggested that the US dollars created abroad by United States agencies be reduced where these expenditures are not connected directly to US exports. In addition, the Administration planned to save about $1 billion annually by reducing the number of military personnel overseas, especially the dependents of those stationed abroad. Also emphasized was the purchase of US goods and services, while acquisitions of foreign goods and services were being de-emphasized.⁴

In concluding its position on possible suggestions to compensate for the dollar outflow, the New York Chamber of Commerce advocated policies which would promote confidence in the US economy, both here and abroad. Included among these policies were reduced taxes for both individuals and corporations and rigorous control of government expenditures, both domestic and foreign. The former policy it is hoped will create vigorous

¹ Hearings before the Committee on Ways and Means of the House of Representatives, 88th Cong., 1st sess. on H.R. 8000, 4, 1963. (Herein after cited as 1963 Hearings.)
² Id. at 167.
³ Id. at 171.
⁴ Id. at 167.
incentives to invest at home, while the latter is intended to achieve a balanced budget and insure stability of the dollar.\textsuperscript{5}

The Honorable Thomas B. Curtis analyzed the United States Balance of Payments problem in a recent article on the subject. Besides believing that a complete review of our foreign economic and military programs was necessary, Mr. Curtis suggested that immediate efforts should be put forth to equalize existing competitive conditions between US exporters and those of other industrial nations. These efforts should include a better return on invested capital; federal fiscal policy efforts to maintain a stable price line; and policies to increase the productivity of American industry, including lower prices, especially for manufactured goods. In conjunction with these policies, Mr. Curtis also advocated removing the guaranteed price of gold at $35 per ounce or any other pre-determined price. This would add an element of risk to those desiring to hold gold.\textsuperscript{6}

An editorial by the “New York Times” suggested that the “best way to promote the free flow of capital is to enhance the attractiveness of American securities, and not by putting up barriers on foreign investment.” The “Times” believes that no immediate dollar crisis exists, and that none need exist, if the President would concentrate on his original tax reform and forget the present tax proposal, especially in view of its disruptive effect on the United States economy and by the psychological effects which it has created.\textsuperscript{7}

Another alternative to the tax can be found in the testimony presented by Dr. N.R. Danielian, President of the International Economic Policy Association. It is his belief that the United States should not carry as heavy a load as it has in defending the free world from Communist aggression. “The solution must be found in top level political agreement among the leaders of the free world, including a definition of mutual obligations of the parties, as to budgetary as well as foreign exchange costs, not only in defense of Europe, but also in the containment of Communist China in the Far East.” Dr. Danielian believes that if this

\textsuperscript{5} Id. at 163.
\textsuperscript{6} Tax Foundation’s Tax Review, July 1963, XXIV, No. 7, p. 28.
burden is eliminated from the international payments system, then dollar outflows created by US foreign investment would be insignificant when it is realized that it is practically self-sustaining. In addition the Dr. has advocated a "lend lease program" instead of the present foreign aid set-up, as a means of supplying credit to our foreign neighbors.

The President of the First National City Bank of New York, Mr. George S. Moore, suggested "non-inflationary financing of Treasury deficits" as an alternative to the tax proposal. Recognizing the theoretical appeal created by such a tax, he does not believe it will solve the payments difficulty, because of the practical problems presented and the necessary exemptions which curtail its effectiveness. As part of his suggestion, Mr. Moore has recommended another small increase in the Federal Reserve discount rate as well as by another cut in required bank reserves. In addition, a moratorium on existing and on proposed Federal spending programs should be imposed until a time when United States economic growth can bring our budgets into balance.

A number of those echoing criticism of H.R. 8000 suggested the creation of a "capital issues committee", a device well known and trusted by Europeans. This committee would consist of representatives from the Treasury Department, the Federal Reserve Board, and the investment banking community at large. It would be the committee's responsibility to investigate new foreign issues on the basis of their anticipated drain on payments, and thereby the committee would use its judgment in limiting the number and the amount of foreign issues, as long as the emergency exists.

One of the above critics was William C. Cates, Secretary of International Investments Analysts of New York, an organization consisting of individuals associated with various financial institutions and who are concerned with analyzing stocks of international companies. Therefore, in addition to the adoption of a "Capital Issues Committee", Mr. Cates, in testimony presented before the House Ways and Means Committee, suggested various

8 1963 Hearings 324.
9 Id. at 335.
other likely alternatives. One alternative which would be instrumental in bringing back dollars fast would be a two year tax moratorium on repatriated earnings of United States corporations. Also to be considered are tax incentives to foreign holders of US securities as well as a tax on United States citizens traveling abroad. The former suggestion could include the removal of withholding and inheritance tax liabilities on these US securities. As for the latter suggestion, Mr. Cates believes that travel is in a category similar to fur coats or night clubs, etc., and such a tax on travel could be administered quite easily. All that would be necessary is that those traveling abroad report the number of months that they have been out of the country, and then the tax could be applied monthly.\(^\text{12}\)

Another alternative to the tax which has been suggested is that the Administration try, by voluntary means, to curtail the dollar outflow, created to some degree by the American purchase of foreign securities. Under this alternative, it would be necessary for the Government to obtain by means of a pledge or gentleman's agreement from the various large institutional investors, a promise to refrain from acquiring foreign securities for such a period of time as the emergency may exist. It is estimated that if approximately 15 of the largest institutional investors agreed to such a plan, the deficit could be reduced from $500,000,000 to $300,000,000 annually.\(^\text{13}\) In conjunction with this suggestion, requesting voluntary assistance as a means of curtailing the deficit, one observer recommended that the United States attempt to persuade foreign governments to take it upon themselves voluntarily to regulate the volume of securities that they and their citizens would be allowed to sell here. Under this alternative, the Administration would place a ceiling on the volume of new foreign securities which would be allowed to be sold here during a stated period of time.\(^\text{14}\)

With all the criticism that has already been expressed with regard to the proposed "Interest Equalization Tax", there are some who believe that the bill might still have a chance of being passed into law. Although these critics maintain their position

\(^{12}\) 1963 Hearings, 295.
\(^{13}\) N.Y. Times, August 22, 1963, p. 37, col. 1.
\(^{14}\) N.Y. Times, August 23, 1963, p. 31, col. 4.
in believing that the tax proposal is not the solution to the problem, they have recommended various changes to the present bill, so that if enacted, it will be more equitable to all concerned.

Of primary concern to most of the critics of the bill is the fear that if enacted, the tax could result in reprisals by other foreign countries, in terms of reduced purchases of American goods and services. As previously noted, the proceeds of many of the foreign security sales made in this country, have been used to purchase American goods and services. In 1959, KLM, Royal Dutch Airlines offered and sold $18,500,000 of 4 ¼ per cent convertible subordinate debentures to United States persons, the proceeds of which were used to acquire jet aircraft from US manufacturers. Another transaction in 1959 was the sale of $10 million of sinking fund dollar debentures (together with warrants to purchase capital stock) by an Italian Chemical Firm, Montecitine. Here, the proceeds were needed to finance the construction of a chemical plant near Huntington, West Virginia.

Therefore, fearing that transactions similar to the above, might be halted, if such a tax was enacted, and it has been suggested that stock, debt obligations, or other securities acquired in connection with the conduct of international trade and commerce be given special treatment. Special treatment would include exemption for those securities, the proceeds of which are used to pay US persons for goods or services. It has also been recommended, that modifications be made to other provisions of the bill, so as to eliminate or minimize potential unintended hardships on US business.

Mr. I. W. Burnham of Burnham & Co., a well-known Wall Street brokerage firm, believes that the proceeds derived from the sale abroad of US owned securities, and re-invested in other foreign securities be permitted tax free treatment. Since no additional dollar outflow results from such a transaction, the Administration would not be deviating in any respect from its

15 1963 Hearings 417.
16 Id. at 227.
17 Id. at 259.
18 Id. at 420.
original purpose in enacting H.R. 8000.\textsuperscript{19} In fact, an amendment has been suggested which would allow any United States person to exchange a foreign security for another of like value, so long as no additional dollar outflow is created by the transaction.\textsuperscript{20}

In addition to the suggestions already mentioned, the firm of Smith, Barney & Co., an organization which has been active in the management of foreign dollar financing, and responsible for the public issuance of many foreign dollar issues in the United States, had various recommendations to make with reference to H.R. 8000. The firm's representative at the hearings, emphasized that the exemption granted bank loans, under the present bill, be limited to strictly commercial credit transactions or to the financing of specific export transactions. As a consequence, bank loans which involve maturities in excess of one year or renewals thereof, should not be exempt from the tax. Long term foreign issues exempted from application of the tax could be informally limited to specific maximum amounts. Finally, the firm believes that Japan, who is the US's second best customer, be given special treatment, similar to that given to Canada. Considering the consequences to both Japan and the United States, if such treatment is not granted, the firm believes that the US cannot afford to take the risks involved, and therefore special treatment should be given to Japan.\textsuperscript{21}

\textbf{Chapter VI. Conclusion}

What can be said in conclusion with respect to the "Interest Equalization Tax", and the effects that it might have in solving the balance of payments problem? As for the purpose of the tax proposal, no problem is presented. The "Interest Equalization Tax" represents an integral part of the late President Kennedy's efforts to improve the balance of payments situation, and at the same time defend our gold reserve. Needless to say, the President's aims were sincere, and no particular business or country was meant to be the object of any discriminatory policy. Out of due respect to Mr. Kennedy, his policy moves always had as their purpose, a better and stronger America.

\textsuperscript{19} \textit{id.} at 259.
\textsuperscript{20} \textit{id.} at 353.
\textsuperscript{21} \textit{id.} at 471.
However, as is true with many so-called "emergency measures", certain individuals or groups will be effected by the application of the tax more than others. Since the purpose of the tax was to raise the cost of borrowing in the United States, and thereby reduce the sale of foreign securities to American investors, the investment industry and certain countries, who have in the past relied on the US' capital market for borrowing purposes, will be effected substantially, if the tax is enacted. Therefore, much of the criticism raised in the newspapers and at the Hearings before the Committee on Ways and Means, came from these groups. Wall Street Brokerage houses, dealers in foreign securities, investment organizations, trade councils, bank presidents, etc., and countries like Canada and Japan were among the leading groups who would be adversely effected, if H.R. 8000 was passed into law.

Much of what was said by these groups was primarily aimed at saving their own position, for certainly much of the criticism was raised from a self-centered point of view. All of these groups recognized the seriousness of the payments' problem; however, if it were possible, they hoped that the tax would not be passed, or if passed, their particular group would be given special consideration. This would be true of any business or group who would be affected by special legislation which could seriously hurt their business, in one way or another.

Nevertheless, much of the criticism raised at home and overseas, appeared to have much merit in what was said. In reviewing the countless arguments against the tax, it seemed quite conceivable that the tax could result in serious complications, not anticipated by the Administration, or at least not mentioned by them. Among the serious complications which could occur are: the effect of the tax on New York City as the financial capital of the world and the unemployment problem that would result in N. Y.; the effect of the tax on our exports, and the fact that reprisals by other nations might result in a worsened payments' position; the effect of the tax on the United States dollar in the eyes of the free world; the effect of the tax on previously announced United States trade policy; and the effect of the tax on US trade customers, like Japan and Canada.
If application of the tax would result in these complications, the above critics would be perfectly right in opposing the tax proposal. However, it seems highly unlikely that the Administration failed to take these adverse effects into consideration in proposing the tax. Although the tax is still under consideration, with passage unlikely at the present moment, evidence indicates that the tax has already had positive effects on the deficit and on the gold supply. As was mentioned in various newspaper articles, the sale of new foreign securities has come to an almost complete halt. In addition, the gold reserves have remained steady since the announcement of the tax proposal on July 18th. As for the adverse effects emphasized by the various critics, there has been no indication that such effects have become a reality. Only time will tell, as to whether the critics were right, in anticipating the evils which they have found to exist in H.R. 8000. Certainly the criticism voiced by these people should not be taken lightly, and it should be incumbent upon the Administration to make sure that, if enacted, the tax will not turn out to be a failure, and thereby cause us unnecessary embarrassment and further problems.

On the other side, there is the plea by the Administration that the “Interest Equalization Tax” is just the thing that is needed, to reduce the payments deficit to a point where it is considered safe. The Administration admits the difficulty of predicting the effectiveness of the tax. However, it does feel that the tax will definitely reduce the overall deficit and thus, reduce the present threat to our gold reserves. The Government realizes that the primary contributor to the deficit problem has been the large expenditures for foreign aid and defense. However, because of our position as leader of the free world, the United States cannot afford to become too conservative in this area, and therefore, expenditures in this area must remain at a fairly constant figure.

As has been mentioned, predicting the eventual outcome of the tax on the payments’ problem is an impossible task. However, it is interesting to note that despite the staunch criticism which has been expressed since announcement of the tax on July 18th, the House Ways and Means Committee, on December 5, 1963, approved the tax proposal. Except for some minor technical
amendments, which in some cases were designed to avert individual hardships, and in others, to clarify the bill, H.R. 8000 was passed by the Committee intact. The Committee noted that the mere existence of the tax proposal has been enough to completely halt new foreign issues on the New York market; and at the same time, has substantially improved the United States balance of payments position. It appears that the impact of the tax proposal, which has already been shown, has impressed Congress, and indications point to eventual approval of the bill by Congress.¹

The stamp of approval given to the bill by the Committee resulted in very little reaction by the foreign stock market. Foreign security dealers concede that lack of reaction to the Committee's report, indicates the effectiveness of the tax. Some dealers attribute the effectiveness of the tax to its retroactive provisions, while others believe the tax is more effective as a proposal, than it would have as law.²

Therefore, it seems quite evident that pro or con, the "proof is in the pudding". Although unenacted, the tax as a proposal has proven quite effective. What more can one ask for? The problem is there, and something must be done to rectify the situation. The tax proposal, from all outward appearances, seems to be a step in the right direction. At this point, there is no other criteria to go by, except for the success which has already been evident by various reports. However, as has been mentioned, the criticism expressed by many, should be examined in light of present conditions. If it is found that the tax, as applied, is having the effects which were feared, corrective steps can be taken before the situation gets out of hand.

Action had to be taken; it was, and so far, its application has proved effective—although the tax remains unenacted. After reading the various opinions expressed about H.R. 8000, one cannot help but agree with the critics of the tax. The more you read, the more indoctrinated one gets, insofar as the adverse effects of the tax are concerned. However, when you consider the effectiveness of the tax, in the proposal stage, you cannot help but agree with the Administration's viewpoint, that the tax is a step in the right direction.

¹ N.Y. Times, December 6, 1963, p. 56, col. 3.