

escape the graduated tax rates applicable to individuals. Elimination of progressive taxation on the nonbusiness income of nonresident alien individuals, therefore, would remove a basic reason for imposing penalty taxes on personal holding companies entirely owned by nonresident aliens. Such corporations are currently excluded from the definition of personal holding companies if less than 50 percent of their gross income is derived from U.S. sources. If the exclusion were broadened, as we have recommended, this would remove the substantial incentive existing under current law to limit the portion of such corporations' assets which is invested in the United States. This change would have no effect on the taxation of personal holding companies having U.S. shareholders.

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*Recommendation No. 34:*

Clarify the definitions of engaging in trade or business to make it clear: (i) that a nonresident alien individual or foreign corporation investing in the United States will not be deemed engaged in trade or business because of activity in an investment account or by granting a discretionary investment power to a U.S. banker, broker, or adviser; and (ii) that a nonresident alien individual or foreign corporation will not be deemed engaged in trade or business by reason of the mere ownership of real property, by reason of a strict net lease, or by reason of an agent's activity in connection with the selection of real estate investments in the United States.

There is a general feeling of confusion among foreign investors over the application to investment activities of the tests for engaging in trade or business. This confusion certainly fosters a fear among foreign investors that they may through inadvertence be deemed to have engaged in trade or business and thereby become subject to regular U.S. taxation on their income and gains. These fears, whether or not realistic, unquestionably are a deterrent to foreign investment in this country.

Clarification of three major points through the issuance of regulations or rulings would aid materially in eliminating the existing confusion and fears. One would be to make it clear that the degree of activity in a securities account is not a factor in determining