

various factors affecting the level of foreign investment in the United States. It is anticipated that, when combined with an expanding U.S. economy, the proposed legislation will result over the years in a significant increase in such investment.

Most provisions of the draft bill are proposed to become effective to taxable years beginning after December 31, 1965. However, those provisions which provide a revised estate tax treatment for the estates of foreigners are made applicable to the estates of decedents dying after the date of the enactment of the proposed legislation. In addition, those special provisions applicable to U.S. citizens who have surrendered their U.S. citizenship are made applicable if the surrender occurred after March 8, 1965.

SPECIFIC RECOMMENDATIONS

The following paragraphs describe the specific changes in the Internal Revenue Code of 1954 which are proposed. For this purpose the technical language of the Internal Revenue Code has been used; e.g., foreigners are described by the technical term "alien."

1. *Graduated rates.*—Eliminate the taxation at graduated rates of U.S. source income of nonresident alien individuals not doing business in the United States.

Under present law, nonresident aliens deriving more than \$21,200 of income from U.S. sources are subject to regular U.S. graduated rates and are required to file returns. However, graduated rates on investment income already are eliminated by treaty in the case of almost all industrial countries, except where a taxpayer is doing business in the United States and has a permanent establishment here. Only a very small amount of revenue is collected from graduated rates at present. For example, for 1962 graduated rates resulted in the collection of \$746,743 above the taxes already withheld. Although graduated rates are rarely applicable they complicate our tax law and tend to frighten and confuse foreign investors.

Thus, graduated rates, whether applied to investment income or such types of income as pensions, annuities, alimony, and the like, serve no clearly defined purpose, deter foreign investment, and should be eliminated. The elimination of graduated rates will limit the liability of nonresident aliens not engaged in trade or business to taxes withheld, and where the alien is not engaged in trade or business here no return need be made. (However, graduated rates would be retained for the U.S. business income of nonresident aliens engaged in trade or business here.)

2. *Segregation of investment and business income and related matters.*—Provide that (a) nonresident alien individuals engaged in trade or business in the United States be taxed on investment (nonbusiness) income at the 30-percent statutory withholding rate, or applicable treaty rate, rather than at graduated rates; (b) foreign corporations engaged in business in the United States be denied the 85-percent dividends-received deduction and be exempt from tax on their capital gains from investments in U.S. stocks; (c) nonresident alien individuals and foreign corporations not be deemed engaged in trade or business in the United States because of investment activity in the United States or because they have granted a discretionary power to a U.S. banker, broker, or adviser; and (d) nonresident alien individuals and foreign corporations be given an election to compute income from real property and mineral royalties on a net income basis and be taxed at graduated rates on such income as if engaged in trade or business in the United States.

Segregation of business and investment income

Under present law, if a nonresident alien is engaged in trade or business within the United States, he is subject to tax on all his U.S. income (including capital gains), even though some of the income is not derived from the conduct of the trade or business, at the same rates as U.S. citizens.

A nonresident alien individual engaged in trade or business in the United States should be subject to taxation on his investment income on the same basis as a nonresident alien not so engaged. Thus his investment income would be taxed at the 30-percent statutory rate or applicable treaty rate, rather than at graduated rates. For the purpose of determining the applicability of treaty rates the alien will be deemed not to have a permanent establishment in this country. All business income should remain subject to tax at graduated rates, but the rates on business income would be computed without regard to the amount of investment income.

This change conforms to the trend in international treaty negotiations to separate investment income from business income. Whether a taxpayer is helped or