

harmed by segregating his investment from his business income, separate treatment is proper and equitable. Investment decisions may be made on the same basis whether or not the alien is engaged in business here, since income arising from investments here will not be subject to taxation at graduated rates in either event.

Moreover, a nonresident alien individual engaged in trade or business here should not be taxed on capital gains realized in the United States which are unrelated to the business activity carried on by him in this country, except where he would be subject to tax on those gains under the rules pertaining to nonresident aliens generally.

*Tax treatment of income from U.S. stock investments by foreign corporations*

Under present law all the activities of a corporation are treated as part of its trade or business. Thus, for example, all its expenses are treated as deductible as business expenses. Accordingly, it would be inappropriate to segregate a foreign corporation's U.S. "investment" income from its U.S. "business" income. However, there is one abuse in this area which should be eliminated. Frequently, a foreign corporation with stock investments in the United States engages in trade or business here in some minor way (such as by owning a few parcels of real estate) and then claims the 85-percent dividends-received deduction on its stock investments in the United States. Such a corporation thereby may pay far less than the 30-percent statutory or treaty withholding rate on its U.S. dividend income, although its position is essentially the same as that of a foreign corporation doing business elsewhere which has U.S. investment income.

To eliminate this abuse and treat all foreign corporations with investments in U.S. stocks alike, the 85-percent dividends-received deduction should be denied to foreign corporations doing business here. Their income from stock investments would be made subject to the 30-percent statutory withholding rate, or any lesser treaty rate applicable to such income, rather than regular U.S. corporate rates. For the purpose of determining whether the treaty rates on dividend income apply, a foreign corporation will be deemed not to have a permanent establishment in this country. To fully equate the tax treatment of stock investments of foreign corporations doing business in the United States with that of foreign corporations not doing business here, such corporations are exempted from the U.S. tax on capital gains realized on their U.S. stock investments.

*Definition of "Engaged in trade or business"*

Present law provides that the term "engaged in trade or business" does not include the effecting, through a resident broker, commission agent, or custodian, of transactions in the United States in stocks, securities, or commodities. There is some confusion as to whether the amount of activity in an investment account, or the granting of a discretionary power to a U.S. banker, broker, or adviser, will place a nonresident alien outside of this exception for security transactions so that he is engaged in trade or business in the United States. This uncertainty may deter investment in the United States and is undersirable as a matter of tax policy.

The fact that a discretionary power of investment has been given to a U.S. broker or banker does not really bear a relation to the foreigner's ability to carry out transactions in the United States—the discretionary power is merely a more efficient method of operating rather than having the investor consulted on every investment decision and frequently is merely a safeguard to protect him in case of world turmoil. Nor, where the alien is an investor, is the volume of transactions material in determining whether he is engaged in trade or business.

Accordingly, the proposed legislation makes clear that individuals or corporations are not engaged in trade or business because of investment activity in the United States or because they have granted a discretionary investment power to a U.S. banker, broker, or adviser. No legislative change is necessary to provide that the volume of transactions is not material in determining whether an investor is engaged in trade or business in the United States as this is the rule under present law.

*Real estate income and mineral royalties*

Under present law it is not clear whether a nonresident alien (or foreign corporation) is engaged in trade or business in the United States by reason of the mere ownership of unimproved real property or real property subject to a strict net lease, or by reason of an agent's activities in connection with the selection of real estate investments in the United States.

If because of such activity a nonresident alien is considered as not engaged in trade or business he becomes subject to withholding tax on his gross rents. Since