

income at the 30-percent statutory withholding rate or at the lower appropriate treaty rate. All business income would remain subject to tax at graduated rates.

With respect to foreign corporations doing business in the United States (so-called resident foreign corporations), which also have stock investments here, H.R. 5916 would likewise separate dividend income from the other income of the foreign corporation. Under the legislation, a resident foreign corporation deriving such dividend income from the United States would thus be taxable on its dividend income at the statutory 30-percent rate or at the lower applicable treaty rate. As a result, the foreign corporation would no longer receive the deduction now afforded under the Internal Revenue Code to dividends received by one corporation from another corporation.

The elimination of the dividends received deduction as respects resident foreign corporations is in part designed to end an abuse which has developed. Frequently, a foreign corporation with stock investments in the United States engages in trade or business here in some minor way and then claims the dividends received deduction on its stock investments. Such a corporation ends up paying far less than the 30-percent statutory or applicable treaty rate on its U.S. dividends, even though its position is basically the same as a corporation which is not doing business here which derives investment income from the United States. In those cases where the applicable treaty rate is 5 percent (the rate set by certain treaties where subsidiary dividends are involved), the resident foreign corporation will benefit from this proposed change.

As to definition of the term "engaged in trade or business"—H.R. 5916 makes clear that individuals or corporations are not engaged in trade or business in the United States—and thus subject to tax at regular graduated rates rather than the 30-percent withholding rate or lower treaty rate—because of investment activities here or because they have granted a discretionary investment power to a U.S. banker, broker, or adviser. This provision should have the effect of removing much of the uncertainty which now surrounds the question of what amounts to engaging in trade or business in the United States. Uncertainty of this type is undesirable as a matter of tax policy and has the effect of limiting foreign investment in the United States. Many foreigners are afraid of investing in U.S. stocks if they cannot give a U.S. bank or broker authority to act for them. This change will have relatively limited impact, however, since under the legislation, business income does not include dividends or gains from the sale of stock.

The bill also changes present law by giving foreign individuals and corporations an election to compute their income from real property on a net income basis at regular U.S. rates rather than at the 30-percent withholding rate or lower treaty rate on gross income. This type of treatment is common in the treaties to which the United States is a party and is designed to deal with the problem which arises from the fact that the expenses of operating real property may be high and cannot be taken into consideration if the income from real property is subject to withholding tax.

As to personal holding companies and the "second dividend tax,"—H.R. 5916 changes the personal holding company provisions of the Internal Revenue Code as applied to the U.S. investment income of