

II. SUMMARY OF PRINCIPAL PROVISIONS

The bill modifies the income, estate, and gift tax treatment of nonresident aliens and the income tax treatment of foreign corporations.

The purposes of the bill are to modernize the present U.S. tax treatment of foreigners and to encourage foreign investment in the United States—thereby beneficially affecting the U.S. balance of payments—by removing tax barriers to such investment.

The bill restructures the income tax treatment of foreigners to make them taxable at the regular U.S. graduated rates on their income which is “effectively connected” with the conduct by them of a trade or business in the United States. The U.S. source income of foreigners that is not so connected is to be taxable at a flat rate of 30 percent (or a lesser applicable treaty rate) regardless of whether the foreigner is engaged in trade or business in the United States.

The bill also provides a new lower schedule of estate tax rates applicable to the estates of nonresident aliens and increases the exemption for such estates from \$2,000 to \$30,000. Under the bill, nonresident aliens engaged in business in the United States will no longer be subject to the gift tax on transfers of intangible property.

The following is a listing of the principal changes made by the bill in the order in which they appear in the bill:

1. *Source rule for interest on bank deposits.*—Present law makes interest on U.S. bank deposits foreign source income when paid to persons not engaged in business in the United States. The bill amends this source rule, effective January 1, 1971, to conform it to the source rule generally applicable to other forms of interest. Thus, from that time on this interest will constitute U.S. source income.

2. *Source rule for interest on deposits with savings and loan associations or insurance companies.*—The bill extends the above exception (for the next 5 years) to interest on deposits or withdrawable accounts with savings and loan associations and to interest on amounts left on deposit with insurance companies.

3. *Source rule for interest on deposits with foreign banking branches of U.S. corporations.*—The bill provides that the interest on foreign currency deposits with foreign banking branches of U.S. corporations is to be classified as income from sources without the United States regardless of whether the depositor is engaged in business in the United States.

4. *Exemption for interest on bank deposits of foreign central banks of issue or of the Bank for International Settlements.*—The bill provides that the interest on bank deposits of a foreign central bank of issue or of the Bank for International Settlements is to be exempt from U.S. tax unless the deposits are held for use in connection with the conduct of commercial banking functions or other commercial activities.

5. *Source rule for dividends paid by foreign corporations (“second dividend” tax).*—The bill provides that a portion of the dividends paid by a foreign corporation are to be treated as U.S. source income