

resident aliens and foreign corporations engaged in trade or business within the United States would be subject to regular rates of tax on *worldwide* income "effectively connected" with such trade or business. This is the most surprising change in the bill, as compared with H.R. 5916, because it represents a real innovation in U.S. taxation of foreign persons. Heretofore foreign corporations and nonresident alien individuals engaged in trade or business here have been subject to U.S. income tax only on U.S.-source income.

It has been said that the adoption of the "effectively connected" concept is in accord with the OECD model income tax convention and with our new treaty approach as evidenced by the recent protocol with Germany. Our study of these documents and of the reports of the Department of State and of the staff of the Joint Committee on Internal Revenue Taxation on the German protocol has disclosed no indication that foreign source income would be taxed. Article III of the convention with Germany as amended, dealing with the taxation of the industrial or commercial profits of an enterprise, does not even use the term "effectively connected" and article XV, dealing with the avoidance of double taxation, limits the allowable tax credits and/or exclusions from taxable income to income having its *source* in the other country.

We believe that enactment of H.R. 11297 could lead to serious problems of double taxation, particularly with regard to foreign subsidiaries of U.S. corporations. If such a foreign subsidiary were subjected to U.S. taxes under this principle, double taxation would result when the U.S. parent corporation receives dividends from the subsidiary since no credit is permitted for U.S. income taxes paid by a foreign corporation.

It is recognized that a motivating factor in this proposal to tax foreign persons engaged in trade or business in the United States on their worldwide income is concern that otherwise tax avoidance may be permitted. We do not believe that major tax avoidance does result under the existing provisions for taxation of such foreign persons. The Treasury has various ways of dealing with efforts to avoid U.S. income taxes, such as section 482, arrangements under various income tax treaties, and its ability to challenge such devices as the mere arrangement of title passage outside the United States for tax avoidance purposes.

The majority of our existing tax treaties contain provisions which limit the imposition of tax to income from sources within the taxing country. These include Australia, Austria, Denmark, Finland, Greece, Honduras, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Switzerland, and the United Kingdom. Since H.R. 11297 provides that the changes which it would make in U.S. tax law would not contravene any existing treaties, the treaties with the above-named countries would require amendment before the foreign source income of their corporations could be taxed by the United States.

The foreign tax credit proposed under new section 906 would not be allowed for taxes paid to a country solely by reason of the foreign person being domiciled there for tax purposes. This could result in double taxation where the country of domicile imposes limitations on allowable credits for foreign taxes which are similar to