

the U.S. rules. In such a case, where the U.S. taxes income which is derived from a third country, the country of domicile would not permit a foreign tax credit for the U.S. taxes paid on income derived from the third country.

Consideration should be given to defining more precisely the criteria given for the term "effectively connected" in section 864(c) (p. 12, lines 10-23). Otherwise, it is likely to discourage U.S. portfolio investment by foreign persons engaged in trade or business here, because in many cases they could not be sure of obtaining the generally lower rates of tax on investment income.

For the foregoing reasons we believe that it would be preferable to provide that a foreign corporation or a nonresident alien individual engaged in trade or business in the United States be taxed only on its *U.S.-source* income effectively connected with the U.S. trade or business.

We strongly urge that, if the Congress feels impelled to abandon the long-existing source of income rules in favor of this new and untried "effectively connected" concept, the committee reports should indicate clearly that the exercise by a U.S. corporation of management functions for a foreign subsidiary will not be considered to be the engagement in a trade or business within the United States by such foreign subsidiary. We also urge that code section 245 be amended to substitute the term "10 percent" wherever the term "50 percent" presently is used. This would permit a fractionalized dividends received credit in the majority of cases and would ameliorate, although not eliminate, the double taxation problems which we have described heretofore.

*Bill section 4: Proposed code section 882(c) (2)*

(7) *Softening of provision disallowing all deductions for failure to file a return (p. 33, line 21 through p. 34, line 8).*—The disallowance of all deductions and most credits for failure to file a return under proposed section 882(c) (2), is an unusually harsh provision. Even though this provision is a part of the present law, the purposes of the bill would seem to indicate that the provision should be softened.

*Bill section 6: Proposed code sections 901(c) and 2014(h)*

(8) *Consistency in provisions requiring 30-day notice prior to Presidential proclamation (p. 53, line 17, and p. 54, line 19; cf. p. 48, line 3 and p. 63, line 25).*—To be consistent with proposed sections 896 and 2108, proposed sections 901(c) and 2014(h) should require a 30-day notice to Congress before a proclamation is made by the President.

*Bill section 8: Proposed code section 2101(a)*

(9) *Rate of estate tax on nonresident alien decedents (p. 56, lines 21-23 and p. 57, lines 1-2).*—The Fowler Task Force Report contained a recommendation to "eliminate U.S. estate taxes on all intangible personal property of nonresident alien decedents." We believe this recommendation should be followed. As pointed out in the report:

"Under existing U.S. tax law, a foreigner willing to go through the expense and trouble of establishing a personal holding company, incorporated abroad, and assuring himself that this personal holding company does not run afoul of the U.S. penalty taxes or undistributed personal holding company income, can already legally avoid estate taxes."