

There would seem to be only two alternative solutions in each of the foregoing cases. Either the entire income from the entire industrial and commercial income producing activity here and abroad is subject to U.S. tax or only part is so subject. If it is intended to subject all of such income to tax, this certainly represents a drastic and questionable change in our tax system. If only part of the income from the entire profitmaking activity is subject to U.S. tax then "source" rules will have to be provided and the bill simply becomes a vehicle for the rewriting of the source of income rules; and if this is what is intended, the rules should be set forth specifically in the bill and should not be left to committee reports or "guidelines."

The committee believes that this second and novel use of the "effectively connected" concept should not be adopted. Well-defined principles provided by the present source rules should be retained for purposes of determining what part of the industrial or commercial profits of a foreign person engaged in trade or business in the United States are to be taxed by the United States. This can be done by adding the words "from sources within the United States" after the words "gross income" in proposed section 882(b)(2) and after the words "gross income" the second time that they appear in proposed section 872(a)(2). Similar changes would be required in other provisions of the bill where the "effectively connected" phrasing appears.

Adoption of the "effectively connected" concept will mean the imposition of U.S. taxes on income of foreign corporations not presently subject thereto; and as this occurs, the risk of double taxation of the same income will increase notwithstanding the foreign tax credit and extension thereof proposed in section 6 of the bill. This provision would allow to foreign taxpayers engaged in trade or business in the United States a credit not presently allowed for foreign taxes imposed upon income "effectively connected" with the U.S. trade or business. The credit would not be allowed with respect to taxes which would not be imposed by the foreign jurisdiction but for the fact that the taxpayer was a citizen or resident of such country or was incorporated in that country. The committee believes that it will be extremely difficult in many cases for taxpayers to demonstrate that a particular tax would not have been assessed but for the fact of the taxpayer's citizenship, residence, or incorporation in the foreign jurisdiction.

Nonresident aliens

Section 3 would establish new rules for the application of the income tax to nonresident aliens.

1. The committee believes that the following substantive changes are sound and are appropriately carried out by the proposed bill.

(a) Nonresident aliens would be taxed separately on income effectively connected with a U.S. trade or business and income not so connected. Under the proposed bill, income not effectively connected with U.S. trade or business will be taxed at a 30-percent rate (or at a lower treaty rate, if applicable), and income which is effectively connected with a U.S. trade or business will be taxed at the regular graduated rate applicable to individuals. Under present law, the graduated rates apply only if nonresident aliens are engaged in trade or business in the United States or if their income exceeds \$21,200.