The term "effectively connected" had its genesis in the OECD model treaty and has been used in the new United States-German Income Tax Convention. The concept involves a term which is novel and has no clear meaning in ordinary speech, nor does a resort to the dictionary produce a sensible meaning for the term. The statute does not attempt to define the term, but section 2(c) sets out three factors which are to be taken into account in determining whether gains, profits and income, or loss are to be treated as effectively connected with the conduct of a trade or business. However, only the factors set forth in subdivisions (1) and (3) are similar to the factors mentioned in the Memorandum of Understanding with Respect to the Protocol to the United States-German Income Tax Convention. The factor mentioned in subdivision (2) of the statute but not in the memorandum of understanding is whether the gains, profits or income, or loss are accounted for through such trade or business.

The new factor added by the statute is an extremely loose concept and seems likely to cause considerable adminstrative difficulty. If the rule is applied literally, it is apt to be a trap for the unwary and a facile means of evasion for the sophisticated. If the rule is to be applied on the basis of what the Service decides should have been accounted for through such trade or business, great uncertainty will be injected into the statute. Accounting is not an exact science and competent accountants can disagree violently as to what is good accounting practice in a particular situation.

Except where uniform accounting rules are imposed upon taxpayers by regulatory authorities, as for example in the case of insurance companies, accounting rules should be omitted as a factor.

The first factor—whether assets are used in the conduct of the trade or business—also may unduly favor taxpayers who are well advised and penalize those who are not. If the cash requirements of a U.S. branch of a foreign corporation fluctuate from time to time, it may become desirable to make a temporary investment of the excess cash.

If an investment in U.S. bonds appeared desirable, the cash would be remitted to the home office which would then invest it. Under those circumstances, the interest would not appear to be effectively connected with the U.S. business and thus would incur the withholding tax of 30 percent, or the rate might be reduced to 15 percent or entirely eliminated by a treaty.

If an investment in U.S. stocks appeared desirable, the cash would be left under the control of the branch, which would make and hold the investment. Under those circumstances, the dividends would seem to be effectively connected with the branch's business. The dividends received deduction allowable under those circumstances would reduce the effective rate of tax to 7.2 percent.

In view of the genesis of the term "effectively connected" there is another factor which deserves consideration. Austria, Belgium, Canada, Denmark, England, France, the Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and Turkey are members of OECD. Presumably one or more or all of those countries may utilize the term in treaties with other countries. If the concept is written into the statute, it would seem desirable for the committee reports to