

Bill section 2(b)(1): IRC section 861(a)(2)(B)—Dividends

This section states that dividends received from a foreign corporation will be deemed to be income from U.S. sources unless "less than 80 percent of the gross income of such foreign corporation for the 3-year period ending with the close of its taxable year * * * was effectively connected with the conduct of a trade or business within the United States * * *." If 80 percent or more of such gross income was effectively connected with the conduct of a trade or business within the United States, income is deemed to be from U.S. sources in the ratio that the gross income which is effectively connected with the conduct of a U.S. trade or business bears to total "gross income from all sources."

It is not clear whether the "gross income" of the foreign corporation for purposes of applying the 80-percent test is intended to be its gross income from U.S. sources only or its gross income from all sources. In this regard, reference should be made to proposed section 872(a) and section 82(b), both of which define gross income as income from U.S. sources or income which is effectively connected with the conduct of a trade or business within the United States whatever the source. Reference should also be made to the formula portion of section 861(a)(2)(B) which expressly specifies "gross income *from all sources*" [italics supplied] when foreign as well as domestic income is to be considered. To avoid ambiguity, the point should be clarified. It is submitted that the term "gross income" as used in the opening phrase of this section should be followed by the phrase "from all sources."

The policy considerations behind the proposed change are unclear. The summary of the new bill furnished by the Committee on Ways and Means refers to this provision as pertaining to the "second dividend" tax. Although such a characterization might be correct under present law (where the foreign corporation receiving dividends from sources within the United States may be subject to withholding tax upon the distribution thereof as a second such dividend), it seems inapposite in the new bill where the withholding tax on the foreign corporation applies only when 80 percent or more of the gross income of such foreign corporation is effectively connected with the conduct of a trade or business in the United States. Manifestly, such type of income would include little or no dividend income—and it is unlikely that any withholding tax would ever be a "second dividend" tax. Since the policy of the new bill is to very sharply narrow the number of cases in which the withholding tax in the case of a foreign corporation is to apply, it is submitted that the concept should be excised from the statute completely (as is done, in effect, by several treaties) and dividends from foreign corporations should never be considered as being income from sources within the United States.¹

Bill section 2(d)(1): IRC section 864(b)(1)—Personal Services

This section excludes from the definition of trade or business within the United States the performance of personal services by a nonresident alien under certain circumstances. The section, however, leaves open the question of whether a nonresident alien working for a foreign entity in the United States, although himself not deemed to be en-

¹ David Tillinghast, Esq., a member of the subcommittee, expresses no views on this point.