The taxpayer got into financial difficulties and negotiated a settlement under which he paid off the mortgage at 50 cents on the dollar. The income arising from this transaction, although having no business connection, is deemed to be effectively connected with the business so as to be subject to tax at graduated rates.

Since it is arbitrary and contrary to fact to treat income arising in transactions such as these as being effectively connected with the business carried on by the taxpayer, it is assumed that Congress would not desire to so classify it. It is recommended that section 864(c) (3), as added by section 2(d) of H.R. 13103, be amended by striking out the period at the end and adding a comma and the following: "unless the taxpayer affirmatively establishes to the contrary by the preponderance of the evidence."

Section 864(c)(4) as added by section 2(d) of H.R. 13103 relates to the taxation of income from sources without the United States if it is effectively connected with the conduct of a business in the United States. We believe the limitation placed upon the effectively connected concept by this provision will be helpful in avoiding some of the problems which otherwise would arise.

Section 864(c)(4)(C) provides that no income or loss from sources without the United States shall be treated as effectively connected with the conduct of a business in the United States if it consists either—

(i) Of dividends, interest, or royalties paid by a foreign corporation in which the taxpayer owns or is deemed to own under section 958(a) or 958(b), more than 50 percent of the total voting power; or

(ii) Is subpart F income.

The provisions of section 864(c)(4)(C)(i) appear to have been taken from section 957(a) of the Code for the purpose of incorporating the operating rules of sections 958(a) and 958(b). However, section 958(a) is applicable only for the purpose of subpart F and section 958(b) is applicable only for the purpose of certain specified sections of subpart F, all of which relate to the taxation of U.S. shareholders.

In order to secure the desired result, it seems necessary to amend section 864(c)(4)(C)(i) to insert immediately after the word "taxpayer" (line 15, p. 16), the following: "(considered for this purpose as a U.S. shareholder)".

THE PROPRIETARY ASSOCIATION,
Washington, D.C., March 2, 1966.

Re H.R. 11297.

Hon. WILBUR D. MILLS,
Chairman, House Ways and Means Committee,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: On February 21, 1966, this association submitted a letter requesting that public hearings be held on H.R. 11297. In recognition of the protests of this association and similar groups, revisions to the bill were published on March 1, 1966, and hearings on these revisions are scheduled for March 7, 1966.

While the association considers the amending of this bill and the holding of public hearings to be a favorable step toward the elimination of the problems which we envisioned, we are nevertheless concerned with some of the novel concepts still retained in the bill as revised. Unfortunately, we are unable to submit a detailed statement or make proper testimony in this regard because of the limited time available to canvass our association members and develop specific comments on these revised sections.

The tax committee of our association advises that the major concerns of the members of our Association will be relieved if section 882(c)(4)(C) is amended to read as follows:

"No income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States if it is derived by a foreign corporation which is more than 50-percent owned, directly or indirectly, by U.S. persons."

Very truly yours,

ARTHUR J. KIRIACON,
Chairman, Tax Committee.