

individuals, dividing their income, for tax purposes, into two basic groups according to whether or not the income is effectively connected with a U.S. trade or business.

(1) *Income not effectively connected with the conduct of a U.S. business.*—Income of a nonresident alien individual which is fixed or determinable (substantially the same categories referred to under present law) and which is not effectively connected with the conduct of a trade or business in the United States is to be taxed at a flat 30-percent rate (or lower applicable treaty rate).

Generally, the fixed or determinable income referred to here, as under present law, includes such income as interest, dividends, rents, salaries, annuities, and certain income accorded capital gain treatment. In addition, however, your committee has added two items not included in the list contained in present law and has slightly modified the language of present law so as to clarify this provision as it relates to certain amounts received from pensions or annuity plans, certain timber, iron ore, and coal royalties, and gains on certain transfers of patent rights. The two new items added to the list are (1) gains with respect to the sale of stock of a collapsible corporation and (2) amounts received on retirement or exchange of bonds and other evidences of indebtedness issued after September 28, 1965, which are treated as gains from the sale of property which is not a capital asset. Under present law income of nonresident aliens of these two types may entirely avoid U.S. tax. Your committee believes that it is appropriate that this income be taxed in the case of nonresident alien individuals where it is derived from U.S. sources. In the case of original issue discount received on the retirement or sale or exchange of bonds the income is to be considered as having the same source as interest paid by the corporation issuing the bonds. As a result, if the corporation with respect to whose bonds the original issue discount arises is a domestic corporation which in the prior 3 years derives 80 percent or more of its income from foreign sources, then the original issue discount (interest) at the time of the retirement or sale or exchange of the bonds also will be considered as foreign source income.

In the case of a nonresident alien's net U.S. source capital gains (other than those specifically included in the list as taxable at the 30-percent rate) which are not effectively connected with the conduct of a trade or business within the United States, your committee's bill provides that no U.S. tax is to be imposed unless the nonresident alien has been present in the United States for at least 183 days during the taxable year. Present law provides a 90-day test. For purposes of applying the 183-day test an alien will be treated as being on a calendar year basis unless he has previously established a different taxable year. The requirement of present law which taxes capital gains when the alien is physically present in the United States at the time of realization is dropped entirely.

(2) *Income effectively connected with the conduct of U.S. business.*—Income of a nonresident alien individual that is effectively connected with the conduct of a trade or business in the United States, under your committee's bill is taxable at the regular U.S. graduated rates applicable to individuals. Thus, this income will be taxed the same as under existing law although the category itself is more limited