

tions, or at the flat 30-percent rate on the gross amount. Taxing income on real property at a flat 30-percent rate without the allowance of allocable deductions—which in the case of this type of income may be relatively large—may result in quite heavy tax burdens on this type of income. Your committee believes that the law in this area should be clarified and doubts whether the disallowance of deductions in such cases is appropriate. Moreover, the disallowance of deductions in such cases would tend to discourage foreign investment in U.S. realty.

The bill deals with the problem described above by providing that nonresident aliens deriving income from real property held for the production of income and located in this country, or from an interest in this type of real property located in this country, may elect to treat all the income as effectively connected to the conduct of a U.S. trade or business. This permits the nonresident alien to utilize the deductions attributable to this real estate income with the result that he is taxed on only his net income from these sources.

The election is applicable with respect to gains from the sale or exchange of real property held for the production of income (or an interest therein) and rents or royalties from mines, wells, or other natural deposits, as well as certain timber, iron ore, and coal royalties. The election is not applicable to income not specifically covered by these provisions, such as distributions by real estate investment trusts. If the election is made, it applies to all of the alien's income from this of U.S. real property for the taxable year which is not otherwise "effectively connected" with the conduct of a trade or business in this country. The election applies for all subsequent taxable years until revoked and can be revoked only with the consent of the Secretary of the Treasury or his delegate.

If the election is revoked, a new election may not be made for 4 years unless the Secretary of the Treasury or his delegate consents to an earlier reelection.

(iii) *Bond interest of residents of the Ryukyu Islands, etc.*—At the present time the Ryukyu Islands (including Okinawa) are governed by the United States and large numbers of the individuals of these islands are in the employ of the U.S. Military Establishment. As such, their savings have frequently been invested in series E or H U.S. savings bonds. Interest income on U.S. savings bonds is, of course, U.S. source income. As a result, under present law the residents of the Ryukyu Islands, as well as the Trust Territory of the Pacific Islands, are subject to a flat 30-percent tax on the income from these bonds. Since investment in U.S. savings bonds in their case is merely a convenient way for these individuals to save a portion of their income, it is difficult for them to see why a tax should be imposed any more than would be true if they were to invest their income, in the islands, in some other type of investment. Because of this, your committee's bill excludes from gross income subject to U.S. tax, income derived by nonresident aliens from U.S. savings bonds (series E or H) if the alien at the time of acquiring the bonds was a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands.

(d) *Effective date.*—These amendments apply with respect to taxable years beginning after December 31, 1966.