

2. Deductions (sec. 3(c) of the bill and sec. 873 of the code)

(a) *Present law.*—In the case of a nonresident alien individual, present law generally allows deductions to the extent they are properly allocable to income from sources within the United States but only if the alien's U.S. income is subject to the regular income tax. However, where the regular income tax applies, the deduction of losses is allowed even though they are not connected with a U.S. trade or business if they are incurred in transactions entered into for profit provided that the transaction, had it resulted in a profit, would have been subject to U.S. tax. Also allowed are property losses not connected with a trade or business arising from certain casualties or thefts if the loss is of property located within the United States.

(b) *Explanation of provision.*—Your committee's bill amends present law generally to limit the allowance of deductions in case of a nonresident alien individual to deductions allocable to income which is effectively connected with the conduct of a trade or business in the United States. The allowance of deductions is limited in this manner, since it is only effectively connected income which under the bill is subject to the regular income tax.

In addition, the bill deletes the provision relating to the deduction of losses not connected with a trade or business but incurred in transactions entered into for profit since the criteria for the allowance of deductions under your committee's bill is whether or not they are effectively connected with the conduct of a trade or business in the United States. However, the casualty loss deduction is to be available even if the property which gives rise to the loss is not effectively connected with the conduct of a trade or business in the United States if the property is located in this country. Also, the charitable contribution deduction is available even though not related to the trade or business.

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

3. Expatriation to avoid tax (sec. 3(e) of the bill and new sec. 877 of the code)

(a) *Present law.*—The U.S. individual income tax applies to U.S. citizens, U.S. residents, and to nonresident aliens, but in this latter case, generally only with respect to income derived from sources within the United States. Under present law, if an individual who has been a U.S. citizen gives up this citizenship and becomes a nonresident, no tax is then imposed with respect to income he derives from sources without the United States. Moreover, under present law the regular graduated rates applicable to a citizen apply in the case of an expatriate, only if he is engaged in a trade or business in the United States or his income exceeds \$21,200.

(b) *Reasons for the provision.*—Your committee's bill by the elimination of progressive taxation with respect to the income of nonresident aliens which is not effectively connected with the conduct of a trade or business within the United States (as well as the reduction of the estate tax rates—described subsequently—applicable to the estates of nonresident aliens) may encourage some individuals to surrender their U.S. citizenship and move abroad. As indicated above,