

by doing so an expatriate would avoid the graduated tax rates on his U.S. investment income (and in certain cases, avoid some estate taxes).

(c) *Explanation of provision.*—For the reasons stated above, the bill adds a new section to the code which, in general, taxes both effectively connected income and any other U.S. source income of an expatriate at regular income tax rates, if he lost his citizenship within five years of the taxable year in question (and after March 8, 1965) and if one of the principal purposes of the expatriation was the avoidance of U.S. income, estate, or gift taxes. This treatment is not to apply if it results in a smaller U.S. income tax than would otherwise be imposed.

In addition to imposing this tax on both the expatriate's U.S. source income not effectively connected with the conduct of a U.S. trade or business and his income that is "effectively connected" regardless of its source, the new section contains special source rules to be used in determining his U.S. source income. These rules provide that gains from the sale or exchange of property (other than stock or debt obligations) located in the United States, and gains on the sale or exchange of stock of a domestic corporation or debt obligations of U.S. persons or of the United States, a State or political subdivision, or the District of Columbia are to be treated as income from sources within the United States regardless of where the sale or exchange occurs or title is transferred. Deductions are to be allowed only to the extent they are properly allocable to the gross income of the expatriate, determined under the above described provisions (except that the capital loss carryover provision is not to apply).

The new section contains a special rule with respect to the burden of proving the existence or nonexistence of U.S. tax avoidance as one of the principal purposes of the expatriation. Under this provision, the Secretary of the Treasury or his delegate must establish that it is reasonable to believe that the expatriate's loss of U.S. citizenship would (but for the application of these special provisions) result in a substantial reduction in the taxes based on the expatriate's probable income for the taxable year.

If this is established, then the expatriate must carry the burden of proving that the loss of citizenship did not have, for one of its principal purposes, the avoidance of U.S. income, estate, or gift taxes. However, the new section excepts persons whose loss of citizenship occurs under circumstances where it is unlikely that tax avoidance was a principal purpose. For example, this provision does not apply where the person acquired dual citizenship at birth and loses his U.S. citizenship by residing, for a certain period, in the foreign country of which he is also a citizen by birth.

(d) *Effective date.*—This amendment applies for taxable years beginning after December 31, 1966.

4. *Partial exclusion of dividends from gross income (sec. 3(f) of the bill and sec. 116(d) of the code)*

Present law allows nonresident aliens the \$100 dividends received exclusion only if the individual is taxable on U.S. source dividends at the regular graduated rates applicable to individuals. Your committee's bill amends this provision, effective for taxable years beginning after December 31, 1966, to conform to the effectively connected in-