come concept by limiting the availability of the exclusion to dividends which are effectively connected with the conduct of a trade or business in the United States. The exclusion is also allowed in the case of an expatriate subject to tax (under new section 877).

5. *Withholding of tax on nonresident alien individuals* (*secs. 3*(*g*) *and* (*k*) *of the bill and secs. 1441 and 3401 of the code*)

(*a*) *Present law.*—Present law generally requires the withholding of tax in the case of a nonresident alien on U.S. source fixed or determinable income (of the types previously described). The withholding is at a 30-percent rate (except in the case of certain treaty rates) and applies whether or not the flat 30-percent tax applies to the individual.[3] Thus it applies not only in the case of a nonresident alien with a gross income of $21,200 or less who is not engaged in a trade or business in the United States but also in the case of a nonresident alien with a larger gross income and also to one who is engaged in a trade or business in the United States.

(*b*) *Reason for provision.*—Your committee believes that withholding at the 30-percent rate should only be required in the case of income which is taxed at that rate. Therefore, income which is effectively connected to the conduct of a U.S. trade or business should not be subject to this withholding tax at a 30-percent rate. This is particularly important in the case of compensation paid a nonresident alien. Unlike domestic wage withholding, this 30-percent withholding does not, in most cases, take into account the personal exemptions to which the worker would be entitled if he were a U.S. citizen. Also, since the regular graduated rates on small incomes are less than 30 percent, this rate may result in substantial overwithholding in many cases where regular income tax rates apply. Although an alien may obtain a refund of the excess withholding when he files his return at the end of the year, overwithholding in these circumstances can create a substantial hardship for the alien.

(*c*) *Explanation of provisions.*—To meet the problem outlined above, the bill adds a new provision to the existing nonresident alien withholding provisions. Under the new provision, withholding is not required on payments to nonresident alien individuals with respect to any item of income (other than compensation for services) which is effectively connected with the conduct of a trade or business within the United States. Additionally, no withholding is required in the case of amounts received on retirement or exchange of bonds issued after December 28, 1965, which are treated as gains from the sale of property which is not a capital asset or to gains with respect to the sale of stock of a collapsible corporation.

In the case of salary and wage income, the bill also correlates the 30-percent-withholding rate applicable to nonresident aliens with the domestic graduated withholding rates. Thus, the bill amends present law to provide that the Secretary of the Treasury or his delegate may, by regulations, exempt compensation for services performed by nonresident aliens from the 30-percent withholding. Also, to permit withholding at the domestic graduated withholding rates where an

[3] For a limited category of scholarship and fellowship income and related income the withholding rate is 14 percent.