

This rule is limited in the case of certain tax-free transfers so the amount taxed (recaptured) as ordinary income does not exceed the gain recognized on the transfer (generally the amount of the "boot"). Among the transfers to which this limitation applies are certain transfers to a corporation in exchange for its stock or securities.

(b) *Reason for provision.*—Under present law a foreigner may defeat the recapture provision by forming a domestic corporation and transferring the real estate with "excess depreciation" to the corporation solely in exchange for its stock. Thereafter, a nonresident alien can sell the stock outside the United States and thereby escape all U.S. tax liability on the sale. No U.S. tax applies in this case since the income from the sale of the stocks (outside the United States) is considered to be from sources outside the United States. Also, since all that was received in the earlier exchange of the real estate was stock, no tax applies on that transaction.

(c) *Explanation of provision.*—To prevent the tax avoidance referred to above the bill amends present law to provide that the recapture provision is to apply to a transfer of depreciated real estate by a foreigner to a domestic corporation in a tax free exchange for stock or securities in the domestic corporation.

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

8. *Definition of foreign estate or trust (sec. 3(l) of the bill and sec. 7701(a) (31) of the code)*

Present law defines the terms "foreign trust" and "foreign estate" to mean a trust or estate, whose income from sources without the United States is not included in gross income for U.S. income tax purposes. The bill amends this definition to conform it to the effectively connected concept. As amended, the terms mean an estate or trust whose income from sources without the United States, which is not effectively connected with the conduct of a trade or business within the United States, is not included in gross income for U.S. income tax purposes. This amendment applies for taxable years beginning after December 31, 1966.

9. *Citizens of possessions of the United States (sec. 3(m) of the bill and sec. 932(a) of the code)*

Under present law, individuals who are citizens of possessions but not otherwise citizens of the U.S. are taxed as nonresident aliens on their U.S. source income. This provision is amended, effective for taxable years beginning after December 31, 1966, to conform to the changes made to the taxation of nonresident aliens generally.

D. TAXATION OF FOREIGN CORPORATIONS

1. *Income tax on foreign corporations (secs. 4 (a) and (b) of the bill and secs. 881 and 882 of the code)*

(a) *Present law.*—Present law taxes foreign corporations not engaged in a trade or business in the United States at a flat rate of 30 percent on fixed or determinable income from sources within the United States. These items are (with a few exceptions) the same as those presently taxed at the 30-percent rate to nonresident alien indi-