

viduals not engaged in a trade or business in the United States. They are interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income (including certain timber, coal, and iron ore royalties).

The U.S. source income of a foreign corporation engaged in business in the United States is taxed, under present law, at the regular corporate rates. In computing the tax, deductions generally are allowed to the extent that they are properly allocable to the U.S. source income if a true and accurate return is filed by the corporation.

(b) *Reasons for provision.*—Your committee's bill, both in the case of nonresident aliens and in the case of foreign corporations, provides a consistent pattern of taxation. Nonresident aliens and foreign corporations will be taxed at the regular income tax rates in the case of income which is effectively connected with a U.S. trade or business. In the case of nonresident alien individuals and foreign corporations, with U.S. source fixed or determined income which is not effectively connected with a U.S. trade or business, a flat 30-percent rate is applied. The reasons for differentiating the tax treatment on this basis have already been explained to a substantial extent in connection with the definition of effectively connected (No. B-2, above) and in connection with the explanation of the taxation of nonresident aliens (No. C-1, above).

In the case of foreign corporations, this new classification of income—that effectively connected—probably represents less of a departure from the present tax treatment than in the case of nonresident alien individuals. One of the principal changes resulting from this new classification in the case of foreign corporations is that investment income which is not related to a trade or business carried on in the United States will be taxed at the flat 30-percent rate (or lower treaty rate) rather than at the regular corporate rate. This does away with the arbitrary distinction which exists under present law which makes the type of tax, a flat 30 percent or regular rate, turn on the presence or absence of a trade or business in the United States which may be wholly unrelated to the investment income.

Under the bill all U.S. source investment income (fixed or determinable) of foreign corporations not effectively connected with a trade or business in the United States will be taxed at a flat rate. However, all investment income effectively connected with a U.S. trade or business will be taxed in the same manner as other income of that trade or business, and in the same manner as similar income of a domestic corporation.

As indicated in connection with the definition of effectively connected the new rule for the taxation for foreign corporations will also prevent the use of the United States as a "tax haven" in the case of limited categories of foreign source income. However, these limited types of income do not, in any event, include "subpart F income" or, generally, income received from a foreign subsidiary.

This new rule for the taxation for foreign corporations should also tend to encourage foreign investment in the United States and thus is likely to have a favorable effect on the U.S. balance of payments.