

of a trade or business within the United States for the deduction to be available. Also, the deduction is limited to 85 percent of the same proportion of the dividend as its gross income, which is effectively connected with a U.S. trade or business, is of the corporation's total gross income from all sources.

The bill also contains a transitional rule which makes it unnecessary to apply the effectively connected income concept when any of the years which are taken into account for the 50-percent test is a pre-1967 year. This rule provides that, for purposes of computing this deduction, all of a foreign corporation's U.S. source income, for any period, before the first taxable year beginning after December 31, 1966, is to be considered to be effectively connected income.

(c) *Effective date.*—These amendments apply for taxable years beginning after December 31, 1966.

4. *Unrelated business taxable income of certain foreign charitable organizations (sec. 4(e) of the bill and sec. 512(a) of the code)*

Under present law the unrelated business taxable income of foreign charities is subject to tax if it is derived from sources within the United States.

The bill conforms this provision to the effectively connected concept by providing that the unrelated business taxable income of a foreign charity is to be subject to tax only if it is effectively connected with the conduct of a trade or business in the United States.

This amendment applies for taxable years beginning after December 31, 1966.

5. *Corporations subject to personal holding company tax (sec. 4(f) of the bill and sec. 542(c) of the code)*

(a) *Present law.*—Under present law any foreign corporation with U.S. investment income, whether or not doing business here, may be taxed as a personal holding company unless all its outstanding stock is owned (directly or indirectly) by nonresident alien individuals and its U.S. source gross income is less than 50 percent of its total gross income for that year. If taxable as a personal holding company the foreign corporation is subject to a special 70 percent tax on its undistributed U.S. source personal holding company income in addition to the flat rate 30 percent tax (or possibly the regular corporate tax).

(b) *Reason for provision.*—The primary reason for applying the U.S. personal holding company tax to foreign corporations owned by nonresident aliens has been to prevent the avoidance of the graduated rates of U.S. tax applicable to certain nonresident alien individuals by utilizing foreign holding companies as the recipients of their U.S. source investment income. Generally the graduated rates presently apply when a nonresident alien's U.S. gross income exceeds \$21,200 or when he is engaged in a trade or business here. However, under your committee's bill nonresident aliens are not to be subject to the graduated rates of tax unless their income is effectively connected with a trade or business here. In view of this the retention of the personal holding company tax would appear to serve no purpose in those cases where all of the shareholders are nonresident aliens.

(c) *Explanation of provision.*—The bill deletes the provision in present law excluding from the personal holding company definition