

*Example (5).*—Y, a foreign corporation, maintains a branch in the United States. The branch holds on its books stock of domestic corporation D, a wholly owned subsidiary of Y corporation. There is no relationship between the business of D corporation and of Y corporation's branch in the United States, and the offices of D report to the home office of Y and not to the U.S. branch. Dividends paid on the stock of D corporation are paid to Y corporation's branch in the United States and are mingled with its general funds. However, such branch has no need in its business for the cash so received. The stock of D corporation is not used, or held for use in, the business of Y corporation's branch, and dividends paid on such stock are not effectively connected with such business.

*Example (6).*—Z, a foreign corporation, has a branch in the United States which acts as an importer and distributor of merchandise. As a result, Z corporation is engaged in business in the United States. Corporation Z also licenses patents to U.S. persons for use in the United States. The businesses in which such patents are used have no direct relationship to the business carried on in Z corporation's branch in the United States, although the merchandise marketed by the branch is similar in type to that manufactured under the patents. The negotiations and other activities leading up to the consummation of these licenses are conducted by employees of Z corporation who are not connected with the U.S. branch of Z corporation. Royalties received by Z corporation as a result of these licenses are not effectively connected with the conduct of its business in the United States because the activities of the business conducted within the United States were not a material factor in the production of such income.

For purposes of applying the provisions of paragraphs (2) and (4) of new subsection (c) in determining whether interest described in amended section 861(a)(1)(A) is effectively connected with the conduct of a trade or business within the United States (thereby determining under sec. 861(a)(1)(A) whether such interest is from sources within or without the United States), such interest shall be assumed to be income from sources within the United States to which the rules of such paragraph (2) apply and shall not be subject to the rule provided in such paragraph (4). However, if interest described in section 861(a)(1)(A) is determined to be income from sources without the United States (because not effectively connected with the conduct of a trade or business within the United States by reason of the rules of par. (2) of new subsec. (c)), such interest will not be considered to be effectively connected with the conduct of a trade or business within the United States pursuant to the rules provided in paragraph (4) of new subsection (c).

*Other income from sources within United States*

Paragraph (3) of new subsection (c) provides that all income, gain, or loss derived from sources within the United States (other than any income, gain, or loss to which par. (2) applies) by a non-resident alien individual, or by a foreign corporation, engaged in trade or business within the United States during the taxable year shall be treated as effectively connected with the conduct of a trade or business within the United States. Thus, the bill does not change the taxation of income from U.S. sources derived by a nonresident