

Income from sources within the United States which is not effectively connected with the conduct of a trade or business within the United States is taxable under section 881 of the code, as amended by section 4 (a) of the bill, if such income is described in section 881 (a). Any such income which is not described in section 881 (a), such as almost all capital gains, is not subject to U.S. income tax.

(c) *Allowance of deductions and credits.*—Subsection (c) of section 882 contains the rules applicable to the allowance of deductions and credits to a foreign corporation.

*Allocation of deductions*

Paragraph (1) (A) of section 882 (c) provides that generally the deductions allowed under subtitle A (relating to income taxes) of the code are allowed to a foreign corporation only if and to the extent that such deductions are connected with income which is effectively connected with the conduct of a trade or business within the United States; moreover, such deductions are allowed only for purposes of determining under section 882 (a) the tax on taxable income which is effectively connected with the conduct of a trade or business within the United States. The Secretary of the Treasury or his delegate is authorized to prescribe by regulations the proper apportionment and allocation of the deductions for such purposes. The deductions allowed by section 882(c) may in no case be used to reduce amounts subject to the 30-percent tax imposed by section 881.

Paragraph (1) (B) of section 882(c) provides that, in determining the tax imposed pursuant to section 882(a), a foreign corporation may take the deduction for charitable contributions and gifts allowed by section 170 of the code whether or not such deduction is connected with income which is effectively connected with the conduct of a trade or business within the United States. In determining the limitations on the amount of the deduction pursuant to section 170(b), only the gross income which is effectively connected with the conduct of a trade or business within the United States is to be taken into account.

For a more detailed discussion of the allowance of deductions, see the comments on section 873, as amended by section 3(c) of the bill.

The provisions of amended section 882 may be illustrated by the following example:

*Example*

During the taxable year, foreign corporation M maintains a branch sales office in the United States and by reason of its activities therein is engaged in business within the United States. The income which is effectively connected with the business carried on through such sales office is derived from sources within the United States. Corporation M also owns stock in a domestic corporation, and, by reason of the application of new section 864(c), the dividends on such stock, and a capital gain derived from the sale of a part of the stock, are not effectively connected with the conduct of the trade or business within the United States. The tax under section 11 of the code is imposed on the taxable income which is effectively connected with the business carried on through such sales office, determined after allowance of all deductions connected with income which is effectively connected with the conduct of the trade or business within the United