

(relating to income not connected with a U.S. business) on such corporation will not be jeopardized by the exemption. The Secretary or his delegate is authorized to prescribe by regulations the terms and conditions pursuant to which a foreign corporation may be exempted from withholding under subsection (a). The terms and conditions so prescribed may be such as to insure that the tax imposed by section 881 on the income of the foreign corporation is returned and paid by the exempted foreign corporation, no later than the date such amounts would be returned and paid by the withholding agent if the exemption from withholding had not been granted.

SECTION 4 OF BILL—CONTINUED

(d) *Dividends received from certain foreign corporations.*—Subsection (d) of section 4 of the bill amends section 245 of the code (relating to the allowance of a deduction for dividends received from a foreign corporation). The amendment is effective for taxable years beginning after December 31, 1966. Under existing law a corporation, whether domestic or foreign, receiving dividends from a foreign corporation which, for the specified 36-month period, is engaged in trade or business in the United States and derives 50 percent or more of its gross income from sources within the United States is entitled, if the deduction is otherwise allowable, to take as a deduction a pro rata portion of 85 percent of the dividends received from the foreign corporation paying the dividends. The pro rata portion is based on the ratio which the paying corporation's gross income from sources within the United States bears to its gross income from all sources.

The amendments made by paragraphs (1), (2), and (3) of section 4(d) of the bill strike out of section 245(a) all references to income from sources within the United States and substitute references to income effectively connected with the conduct of a trade or business within the United States. These amendments are necessary to conform section 245 to the amended taxing provisions applicable to foreign corporations and operate to continue the principle of the existing provision. Thus, the deduction for dividends received from a foreign corporation, when otherwise allowable, is to be allowed if 50 percent or more of the total gross income of such foreign corporation from all sources for the applicable period is effectively connected with the conduct of a trade or business within the United States. The amount of the deduction is determined as under existing law, but the pro rata portion is based upon the ratio which the gross income which is effectively connected with the conduct of a trade or business within the United States bears to such corporation's total gross income from all sources.

Paragraph (4) of section 4(d) of the bill provides in effect that, to the extent gross income of the foreign corporation for any period before its first taxable year beginning after December 31, 1966, is required to be taken into account for purposes of applying amended section 245, the gross income of such corporation for such period from sources within the United States will be considered to be gross income effectively connected with the conduct of a trade or business within the United States.