

are affected by this provision. The provisions of section 894(b) do not apply in the case of a nonresident alien individual subject to the tax imposed pursuant to section 877(b) (relating to expatriation to avoid tax), as added by section 3(e) of the bill.

Without the amendment provided by section 894(b) a nonresident alien individual, or a foreign corporation, having a permanent establishment in the United States would be taxable at the flat 30-percent rate under amended section 871(a) or 881 on the gross income from sources within the United States which is not effectively connected with the conduct of a trade or business within the United States. Under existing law such a nonresident alien individual or foreign corporation is taxable at graduated rates under section 1 (or section 11) or 1201 on such income and the flat 30-percent tax on gross income does not apply. Section 894(b) extends to such a nonresident alien individual or foreign corporation the benefit of any exemption, or reduced rate of tax, under a treaty in the case of income from sources within the United States which is not effectively connected with the conduct of a trade or business within the United States.

The provisions of section 894(b) may be illustrated by the following example:

*Example*

M, a corporation organized in foreign country Z, is engaged in business in the United States through a permanent establishment located therein. The United States and country Z are parties to an income tax convention. The convention provides that the United States will tax at a 15-percent rate dividends received from sources within the United States by a corporation of country Z not having a permanent establishment in the United States. Corporation M receives dividends from a domestic corporation all of whose income is from U.S. sources. The dividends are not effectively connected with the conduct of M corporation's business in the United States. The gross dividends are taxable under amended section 881, but the tax may not exceed the treaty rate of 15 percent. If the dividends were effectively connected with the conduct of M corporation's business in the United States, they would be taxable under section 882(a) after allowance of the dividends-received deduction under section 243 of the code.

SECTION 5 OF BILL—CONTINUED

(b) *Application of pre-1967 income tax provisions.*—Subsection (b) of section 5 of the bill adds new section 896 to subpart C of part II of subchapter N of chapter 1 of the code (relating to miscellaneous provisions applicable to nonresident aliens and foreign corporations). The amendment is effective for taxable years beginning after December 31, 1966.

CODE SECTION 896. APPLICATION OF PRE-1967 INCOME TAX PROVISIONS

(a) *Imposition of more burdensome taxes by foreign country.*—Subsection (a) of section 896 contains procedures whereby the President can proclaim that the tax of certain nonresident alien individuals and foreign corporations will be determined under the provisions of subchapter N of chapter 1, and of chapter 3, of the code which were in effect immediately before the date of enactment of this bill. Before