

percent rate, is whether or not the income is effectively connected with the U.S. business.

In the case of investment and other fixed or determinable income and capital gains from U.S. sources the income is to be treated as effectively connected with the U.S. business if the income is derived from assets used, or held for use, in the conduct of U.S. business or if the activities of the U.S. business were a material factor in the realization of the income. All other types of U.S. source income are to be considered to be effectively connected if there is a U.S. business.

Income from sources without the United States will not be treated as effectively connected with a U.S. business unless the nonresident alien or foreign corporation has a fixed place of business in the United States and the income is attributable to that place of business.

Moreover, even in such cases the only types of foreign source income which may be subject to U.S. tax under the bill are rents or royalties from licensing operations, income from banking and similar type operations, or certain types of sales income. Moreover, neither "Subpart F" income nor dividends, interest or royalties derived from a foreign corporation more than 50 percent owned by the nonresident alien or foreign corporation, will be considered effectively connected under any circumstances.

2. INCOME TAX SOURCE RULES

The bill proposes an amendment with respect to the taxation of the interest paid to nonresident aliens and foreign corporations on their U.S. bank deposits. Presently this type of interest income is subject to U.S. tax only if the foreign recipient is engaged in trade or business in the United States.

Your committee believes that it is questionable whether interest income of this type, which is so clearly derived from U.S. sources, should be treated as though derived from sources without the United States and thereby escape U.S. taxation. At the same time, however, your committee realizes that immediate alteration of the present rule might have an adverse effect upon our balance of payments. To meet these two quite different objectives your committee's bill repeals this special foreign source rule, but postpones the repeal until after 1971. At that time your committee will have an opportunity to reconsider any balance of payments problem that then exists.

The bill also provides that as long as bank deposit interest is treated as foreign source income, similar types of interest income are to be given the same treatment.

On the other hand, the present rule with respect to interest paid to nonresident alien individuals or foreign corporations on deposits with foreign branches of U.S. banks would be changed. As

amended, this type of interest would be treated as from sources without the United States, and therefore not subject to U.S. tax. Your committee believes that it was appropriate to treat this type of interest as from sources without the United States, since in reality that is what it is. Also it is believed that this amendment was necessary to place these foreign branches of U.S. banks in a competitive position with the other banks in the foreign countries in which they are located.

3. ESTATE TAX PROVISIONS

Another major amendment would modify the United States estate taxation of nonresident aliens. Although the U.S. estates of nonresident aliens are presently subject to the same estate tax rates as citizens or residents, the deductions, exemptions, and credit available to them are substantially less than those allowed to citizens or residents of the United States. Therefore, the estate of a nonresident alien frequently pays a heavier tax on its U.S. assets—and, in some instances, a much heavier tax—than would [P. 12681]

be true in the case of a similar estate of a U.S. citizen or resident. In an effort to more closely equate the taxation of the U.S. estates of nonresident aliens with the estates of U.S. citizens or residents, the bill would establish a new scale of graduated estate-tax rates applicable to nonresident aliens, which would tax those estates in an amount which would be generally equivalent to the tax imposed upon an estate of similar value of a U.S. citizen entitled to a marital deduction. Also, the bill would raise the estate tax exemption of nonresident aliens from \$2,000 to \$30,000.

The present rule, which excludes deposits in U.S. banks from the gross U.S. estate of a nonresident alien, would be amended by this bill so as to include these assets in the gross estate of such persons since they are includible in the estates of American citizens and residents.

Additionally, as in the case of the income tax amendments in this bill, a new provision is added to the estate tax provisions which excludes the deposits by foreigners in foreign branches of U.S. banks from the U.S. taxable estates of nonresident aliens. This is done for the simple reason that those assets never enter the United States.

4. EXPATRIATION PROVISIONS

The bill also provides an amendment which establishes special tax treatment for U.S. citizens who expatriate in order to avoid U.S. taxes. Your committee considers such an amendment necessary since—although there are undoubtedly few Americans who would avail themselves of such a maneuver—but for this provision, the bill does make such a scheme more advantageous. Therefore,