

tax policy and has the effect of limiting foreign investment in the United States. Many foreigners do not desire to invest in U.S. stocks if they cannot give a U.S. bank or broker discretionary authority to act for them.

The bill also changes present law by giving foreign individuals and foreign corporations an election to compute their income from real property on a net income basis at regular U.S. rates rather than at the 30 percent withholding rate or lower treaty rate on gross income. This type of treatment is common in the tax treaties to which the United States is a party and is designed to deal with the problem which arises from the fact that the expenses of operating real property (e.g., taxes, interest, depreciation) may be high and cannot be taken as deductions if the recipient of the income from such real property is not engaged in trade or business in the United States. It is sometimes difficult for a foreigner to determine whether his U.S. real estate activities constitute engaging in trade or business in the United States. Thus, taxation at higher graduated rates on a net basis, i.e., after allowable deductions, frequently results in a lower tax liability than taxation at a 30-percent rate (or lower treaty rate) on gross income without any allowance for deductions.

*Segregation of investment and business income.*—Under present law, if a foreign individual is doing business in the United States he is subject to tax on all his U.S. income, whether or not connected with his business operations, at regular graduated rates. H.R. 13103 would separate the business income of a foreign individual engaged in business here from his investment income (e.g., dividends, interests, royalties), and would tax the investment income at the 30-percent statutory withholding rate or at the lower appropriate treaty rate. All business income would remain subject to tax at graduated rates.

With respect to foreign corporations doing business in the United States (so-called resident foreign corporations), which also have investments here, H.R. 13103 would likewise separate the investment income from the business income of the foreign corporation. Under the legislation, a resident foreign corporation deriving such investment income from the United States would thus be taxable on such income at the statutory 30-percent rate or at the lower applicable treaty rate.

The bill conforms our treatment of investment income to the general approach followed by many other nations. It also is in accord with the Organization for Economic Cooperation and Development Model Income Tax Convention and the approach followed in our more recent treaties with the United Kingdom, Germany, and the Netherlands, and thus has the advantage of conformity to international practice.

The bill offers guidelines, which are supplemented by the legislative history, to the application of the "effectively connected" concept. A foreigner who is receiving investment income from the United States, under the approach of the bill would no longer have to be concerned that some other activity in the United States will suddenly be considered as attributing to him a trade or business status in the United States, thus subjecting the investment income to business taxation. Instead, as long as the investment income is not effectively connected with the other activity, any uncertainty as to the status of the latter would not color or affect the investment income. The removal of such uncertainty should encourage investments by foreigners in the United States.