As a result of the above-described changes, the foreign corporation engaged in business in the United States and also receiving dividend income would no longer automatically receive on those dividends the deduction now afforded under the Internal Revenue Code to dividends received by one corporation from another corporation. The elimination of the dividends received deduction in certain cases as respects resident foreign corporations is in part designed to end an abuse which has developed. Frequently, a foreign corporation with stock investments in the United States engages in trade or business here in some minor way and then claims the dividends received deduction on its stock investments—which results in the taxpayer paying tax at a rate of only 7.2 percent on the dividends (48 percent corporate tax on 15 percent of the dividends). Thus, such a corporation ends up paying far less than the 30 percent statutory or applicable treaty rate on its U.S. dividends, even though its position as respects its investment income is basically the same as a corporation which is not doing business here but which also derives investment income from the United States. In those cases where the applicable treaty rate is 5 percent (the rate set by certain treaties where subsidiary dividends are involved), the resident foreign corporation will benefit from this proposed change. Where the treaty rate is more than 7.2 percent and the dividend income is not effectively connected, the higher treaty rate will govern.

TAXATION OF FOREIGN SOURCE INCOME OF CERTAIN FOREIGNERS

The House noted that under present law certain foreigners can conduct business activities within the United States and not pay any tax to the United States (or frequently any other country) on the income derived from such activities. This is in contrast with the tax rules of other countries, which under comparable circumstances would tax active businesses with similar activities in their countries. To give the United States a parity of tax jurisdiction, and also to prevent the United States from being used in some cases as a kind of "tax haven" country because of the absence of that jurisdiction, the bill provides for the U.S. taxation of four limited kinds of income which are attributable to the conduct within the United States of a trade or business by a foreigner, even though the technical source of such income under our code rules is foreign. Under the circumstances covered, this provision is consistent with economic realities in attributing the profits to the U.S. business, and is in accordance with the practice of many member countries of the OECD.

The bill provides that such limited kinds of foreign source income of foreigners can be subject to U.S. tax only if the foreigner has an office or other fixed place of business within the United States to which such income is attributable. Thus, for example, under the bill a U.S. tax would be imposed where a U.S. branch of a foreign enterprise imports goods from abroad, solicits, negotiates, and performs other activities required in arranging the sale of such goods, and then resells the goods in the United States. Today the transaction may not be taxed by the United States if the sale is considered to take place outside the United States in view of the passage of title