

*Section 2(b). Dividends from foreign corporations*

This section modifies present Code section 861(a)(2)(B) to provide that dividends from a foreign corporation are to be considered income from U.S. sources only if 80 percent of the corporation's gross income for the preceding 3-year period consisted of income effectively connected with the conduct of a trade or business within the United States. This change represents a marked liberalization of the present requirements for exclusion of dividends of foreign corporations from U.S. source income and the Committee questions the necessity therefor. Presumably the change is designed to eliminate the so-called "second dividend tax", particularly with respect to investment income. However, where a foreign corporation is carrying on activities here which are effectively connected with a U.S. trade or business, there would seem to be no reason why the withholding tax should not apply. Accordingly, it is suggested that the present requirement be retained, or more appropriately, reduced below 50 percent.

In any event, in the interest of clarity, the word "total" should be added before the words "gross income" where they first appear in the subparagraph and the words "from all sources" should be added after the words "gross income". Since under the bill provisions (Sec. 4(b)) amending section 882(b), the "gross income" of a foreign corporation would be limited to income from sources within the United States plus "effectively connected" income, Section 861(a)(2)(B), as proposed, would produce an unintended result.

*Section 2(c). Personal services*

This provision desirably broadens the present exclusion from U.S. source income of the earnings of employees of (i) foreign corporations or (ii) foreign branches of U.S. corporations who earn less than 3 thousand dollars and are present here for less than 90 days, the exclusion being extended to employees of foreign offices of U.S. partnerships or individuals. No change has been made in the basic 3 thousand dollar exclusionary test. Since this figure has been part of the Code at least since 1939 (and apparently has its genesis in § 201(c) of the Revenue Act of 1917), and since wage levels have increased materially in that period, consideration might be given to increasing this amount.

The exclusion presently applies to employees of foreign corporations, etc. where the employer is not engaged in trade or business in the United States if the employee is employed by a foreign office of the foreign employer. There would seem to be no basis for putting employees of a foreign branch of a foreign employer engaged in trade or business here in a worse position than that of employees of a foreign branch of a U.S. corporation. Section 861(a)(3)(C)(i) of the Code and proposed section 864(b)(1)(A) should be amended to extend this exclusion to employees of a foreign branch of a foreign employer engaged in business in the United States.

*Section 2(d). Definition of "trade or business within the United States"*

Proposed Code section 864(b)(2)(A) would provide that trading in stocks or securities through a resident broker custodian or other agent having discretionary authority would not constitute the carrying on of a trade or business within the United States. This is a desirable amendment which should aid in effectuating the purposes of the bill. The Treasury Department release of March 8, 1965, accompanying H.R. 5916, stated that no legislative change is necessary to provide that the volume of transactions is not material in determining whether an investor is engaged in trade or business in the United States since this is the rule under existing law. It is not believed that existing law in this regard is as clear as the Treasury release would indicate and it is therefore suggested that a specific clause be inserted in the proposed section 864(b)(2) affirmatively stating that the volume of securities or commodities transactions is not material in the determination of whether an investor is engaged in trade or business within the United States.

*Income "effectively connected" with a U.S. trade or business*

The bill actually utilizes the "effectively connected" concept for two purposes. First, the concept is used to determine whether dividends, interest, royalties and other ordinarily "passive" types of income which are admittedly subject to United States tax are part of the income of a U.S. trade or business and properly subject to full rates of U.S. income tax or subject only to normally lower withholding tax rates. This use of the "effectively connected" concept parallels its use in the recent protocol to the U.S.-German Income Tax Convention and in the O.E.C.D. Draft Double Taxation Convention. To this extent the use of the concept is