

to demonstrate that a particular tax would not have been assessed but for the fact of the taxpayer's citizenship, residence or incorporation in the foreign jurisdiction.

Non-resident aliens

Section 3 would establish new rules for the application of the income tax to non-resident aliens.

1. The Committee believes that the following substantive changes are sound and are appropriately carried out by the proposed bill.

(a) Non-resident aliens would be taxed separately on income effectively connected with a United States trade or business and income not so connected. Under the proposed bill, income not effectively connected with United States trade or business will be taxed at a 30 percent rate (or at a lower treaty rate, if applicable), and income which is effectively connected with a United States trade or business will be taxed at the regular graduated rate applicable to individuals. Under present law, the graduated rates apply only if non-resident aliens are engaged in trade or business in the United States or if their income exceeds \$21,200.

(b) A non-resident alien is not to be subject to United States tax on capital gains unless he is here for more than 183 days during the year or unless such gains are effectively connected with a United States business.

(c) Every non-resident alien, irrespective of whether he is engaged in business here, may elect to treat certain real property and mineral income as connected with a business in order to obtain deductions (such as depreciation and depletion) attributable to such income.

2. A major change proposed by the bill is that, in determining the taxation of a non-resident alien engaged in business here, an alien is to be taxed on his taxable income which is effectively connected with the trade or business conducted in the United States. While precise rules are not spelled out, it appears that the concept is intended to be broader than the present concept of gross income from United States sources. For the reasons stated in the discussion of Section 2 of the bill, it is believed that this change is inadvisable.

3. The withholding rules are amended to eliminate withholding on any item of income (other than compensation for personal services) which is effectively connected with conduct of a trade or business in the United States. It is believed that withholding should continue to be governed by the source of income rules, as these provide a much more objective and practicable standard for a withholding agent. At least, withholding should continue to be required with respect to dividends and interest. Under the proposed changes, there would be too great an incentive for persons to file false information with the withholding agent.

4. The definition of periodic income from United States sources (income subject to 30% tax) would be expanded to include income from the sale or liquidation of a collapsible corporation (Section 341) and from original issue discount (Section 1232). The Committee believes that this extension of the definition of "periodic income" is inadvisable. The change would not result in any appreciable increase in tax collections, since the tax could easily be avoided by selling outside of the United States. Since it is sometimes difficult to know whether or not Section 341 or Section 1232 is applicable in the first instance, this expansion would tend to increase the uncertainty of taxation of non-resident aliens, which the proposed bill is supposedly designed to reduce.

5. As noted above, a non-resident alien may elect to treat income from certain real property as connected with a business in order to obtain the benefit of deductions attributable to such income. This election is equally applicable to a foreign corporation and the following comments are pertinent both to the election available to a non-resident alien individual and the election available to a foreign corporation.

The Committee recommends that the election be extended to include personal property "associated" with the real property involved. For example, if a non-resident makes the election with regard to a hotel subject to a net lease, such election would also relate to all personal property in the hotel subject to the lease, so that the non-resident would not have one rule applying to the hotel lease and another rule applying to the lease of the personality associated with the hotel. Also, it is not clear whether the election would extend to interest from mortgages on real property. Under the various tax conventions mortgage interest, more often than not, is specifically excluded from the concept of "income from real property." It is therefore recommended that proposed Section 871 (d)(A) be amended to make it clear that interest from mortgages on real