

*Bill section 3**2. Proposed code section 871(a)*

Subject of the tax on non-resident alien individuals (page 18, lines 3 and 17) : In proposed Section 871(a)(1), the words "gross" income should replace the words "amount received." In Regulations Section 1.871-7(b)(1) there is the following clarification: "For the purpose of Section 871(a)(1) 'amount received' means 'gross income'."

3. Proposed code section 871(a)

(Page 18, lines 5-7) : This proposed subsection describes the kinds of income *not* connected with a United States business which shall be subject to tax at the rate of 30 per cent. It repeats the enumeration of the types of income presently described in Section 871(a)(1), including the words "salaries," "wages," "compensations," "remunerations," and "emoluments." Under proposed Section 864(b) the performance of personal services within the United States will constitute engaging in a trade or business within the United States except under certain limited circumstances. Remunerations for such personal services, therefore, would be taxed at graduated rates under proposed Section 871(b) as income effectively connected with the conduct of a trade or business within the United States. Accordingly, proposed Section 871(a) should be revised to exclude the terms cited above which are descriptive of payments for personal services.

4. Proposed code section 871(a)(2)

Determination of capital gains of aliens present in the United States 183 days or more (page 18, lines 20-24; page 19, lines 1-24) : It is assumed that the intent of the Bill is to subject nonresident aliens who are present in the U.S. for 183 days or more during a year to a 30% rate of tax. This provision places such an alien in a disadvantageous position in comparison with a domestic investor, because under the provisions of lines 11-15, page 19 the capital gain deduction and capital loss carryover provisions are not to be allowed. While the 183 days is a liberalization of current law, there should be further relief. We recommend that the rate of tax be 25 per cent and that consideration be given to allowing the deduction of capital loss carryovers.

5. Proposed bill section 871(b) and 882

Income "effectively connected" with a U.S. trade or business (page 20, lines 3-8, and page 37, lines 8-13) : It is proposed that nonresident aliens and foreign corporations engaged in trade or business within the United States would be subject to regular rates of tax on certain foreign source as well as U.S. source income "effectively connected" with such trade or business. This is the most questionable provision in the bill because it represents a drastic extension of U.S. taxing jurisdiction and unduly complicates U.S. taxation of foreign persons. Heretofore foreign corporations and nonresident alien individuals engaged in trade or business here have been subject to U.S. income tax only on U.S. source income.

It has been said that the adoption of the "effectively connected" concept is in accord with the OECD Model Income Tax Convention and with our new treaty approach as evidenced by the recent protocol with Germany. Our study of these documents and of the reports of the Department of State and of the staff of the Joint Committee on Internal Revenue Taxation on the German protocol has disclosed no indication that foreign source income would be taxed.

Article III of the Convention with Germany as amended, dealing with the taxation of the industrial or commercial profits of an enterprise, does not even use the term "effectively connected" and Article XV, dealing with the avoidance of double taxation, limits the allowable tax credits and/or exclusions from taxable income to income having its *source* in the other country.

We believe that enactment of H.R. 13103 could lead to serious problems of double taxation, particularly with regard to foreign subsidiaries of U.S. corporations. If such foreign subsidiary were subjected to U.S. taxes under this principle, double taxation would result when the U.S. parent corporation receives dividends from the subsidiary since no credit is permitted for U.S. income taxes paid by a foreign corporation. (Relief under the proposed Section 245 would in most cases be wholly inadequate.) It is recognized that a motivating factor in this proposal to tax foreign persons engaged in trade or business in the United States on certain of their foreign source income is concern that otherwise tax avoidance may be permitted. We do not believe that major U.S. tax avoidance