

In addition, the "general supervision and control" rule needs to be broadened so that it would clearly not affect the performance by parent company personnel of services for the subsidiary that might be deemed to be nonmanagement in nature (e.g., clerical services). We think that when (as is normally the case) the performance of such "nonmanagement" services is clearly only a minor or incidental part of the parent company's overall activity with respect to the subsidiary, the subsidiary should not be deemed to have a business location in the United States.

RENTS OR ROYALTIES (CODE SECTION 864(C) (4) (B) (i))

This provision, as amplified in the report, would permit rents and royalties to be "effectively connected" with the United States if a business location of the foreign subsidiary in this country "either actively participates in soliciting, negotiating, or performing other activities required to arrange, the lease or license * * * or performs significant services incident to such lease or license."²

It is clear then that U.S. tax can be imposed even though the lease or license arrangements are negotiated from a foreign business location of the foreign subsidiary so long as the U.S. business location is deemed to have performed "significant" services incident to the lease or license. It seems to us that this provision is unsound because it would permit U.S. taxation in cases where the activities of the U.S. business location, even though admittedly "substantial," are obviously subordinate to or minor in comparison with the activities performed by the foreign business location with respect to the lease or license. This provision should be amended to provide that U.S. tax will not be imposed so long as a foreign business location of the subsidiary or of a related company "participates materially" in the activities relating to the lease or license.

SALES INCOME (CODE SECTION 864(C) (4) (B) (iii))

As noted earlier, sales income of a foreign subsidiary which is deemed to have a U.S. business location may be considered "effectively connected" unless the goods in question are sold for use, consumption, or disposition outside this country, *and* a foreign business location of the subsidiary has "participated materially" in the transaction.

This provision seems to us more logical than the related provision respecting rental and royalty income because it would exempt the sales income from U.S. taxation providing there is material participation by a foreign business location of the subsidiary in the transaction. However, there is a problem which we think should be corrected; this relates to multiple foreign subsidiaries. In many cases, a capital goods manufacturer in this country will have one foreign subsidiary take care of the sales transaction itself while another subsidiary is charged with the responsibility of providing necessary services in connection with that sale. There is no question that, as a practical matter, a foreign business location of the foreign sales operation (considered as a whole) has materially participated in the sales transaction. Yet the bill, as currently worded, would exempt sales income only if the material participation abroad is by a foreign business location of the foreign subsidiary which is deemed to be doing business in the United States. We suggest that this might be corrected by providing for exemption when there is material participation in the sales transaction by a foreign business location of the subsidiary *or* a related corporation.

EXCLUSION FOR SUBPART F INCOME (CODE SECTION 864(C) (4) (D) (II))

The bill would exempt from the reach of the "effectively connected" concept any income of the foreign subsidiary which is deemed to be Subpart F income within the meaning of Code Section 952(a). A question arises as to whether this exclusion would also apply to foreign subsidiary income which would be considered Subpart F income but for the operation of one or more of the exclusions to Subpart F itself, such as, for example:

1. A minimum distribution under Code Section 963;
2. Export trade income under Code Section 970;
3. Foreign base company income which constitutes less than 30 percent of the total gross income of the foreign subsidiary; and

² *Ibid.*, p. 64.