such uninterrupted period, but such amount shall not exceed an amount which bears the same ratio to such percent of such dividends received out of such accumulated earnings and profits as the gross income of such foreign corporation [from sources within the United States], *which is effectively connected with the conduct of a trade or business within the United States*, for the portion of such uninterrupted period ending at the beginning of such taxable year bears to its gross income from all sources for such portion of such uninterrupted period.

For purposes of this subsection, the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States.

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Subchapter F—Exempt Organizations

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PART II—TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

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SEC. 512. UNRELATED BUSINESS TAXABLE INCOME.

(a) DEFINITION.—The term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the exceptions, additions, and limitations provided in subsection (b). In the case of an organization described in section 511 which is a foreign organization, the unrelated business taxable income shall be its unrelated business taxable income [derived from sources within the United States determined under subchapter N (sec. 861 and following, relating to tax based on income from sources within or without the United States)] *which is effectively connected with the conduct of a trade or business within the United States.*

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Subchapter G—Corporations Used To Avoid Income Tax on Shareholders

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PART II—PERSONAL HOLDING COMPANIES

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SEC. 542. DEFINITION OF PERSONAL HOLDING COMPANY.

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(c) EXCEPTIONS.—The term "personal holding company" as defined in subsection (a) does not include—

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[(7) a foreign corporation if—

[(A) its gross income from sources within the United States for the period specified in section 861(a)(2)(B) is less than 50 percent of its total gross income from all sources, and

[(B) all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through other foreign corporations;]

(7) a foreign corporation, if all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations;

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Subchapter L—Insurance Companies

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PART I—LIFE INSURANCE COMPANIES

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Subpart E—Miscellaneous provisions

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SEC. 819. FOREIGN LIFE INSURANCE COMPANIES.

[(a) CARRYING ON UNITED STATES INSURANCE BUSINESS.—A foreign life insurance company carrying on a life insurance business within the United States, if with respect to its United States business it would qualify as a life insurance company under section 801, shall be taxable on the United States business of such company in the same manner as a domestic life insurance company.]

[(b)] *(a)* ADJUSTMENT WHERE SURPLUS HELD IN UNITED STATES IS LESS THAN SPECIFIED MINIMUM.—

(1) IN GENERAL.—In the case of any [company described in subsection (a)] *foreign corporation taxable under this part*, if the minimum figure determined under paragraph (2) exceeds the surplus held in the United States, then—

(A) the amount of the policy and other contract liability requirements (determined under section 805 without regard to this subsection), and

(B) the amount of the required interest (determined under section 809(a)(2) without regard to this subsection),

shall each be reduced by an amount determined by multiplying such excess by the current earnings rate (as defined in section 805(b)(2).

(2) DEFINITIONS.—For purposes of paragraph (1)—

(A) The minimum figure is the amount determined by multiplying the taxpayer's total insurance liabilities on United States business by—

(i) in the case of a taxable year beginning before January 1, 1959, 9 percent, and

(ii) in the case of a taxable year beginning after December 31, 1958, a percentage for such year to be determined and proclaimed by the Secretary or his delegate.

The percentage determined and proclaimed by the Secretary or his delegate under clause (ii) shall be based on such data with respect to domestic life insurance companies for the preceding taxable year as the Secretary or his delegate considers representative. Such percentage shall be computed on the basis of a ratio the numerator of which is the excess of the assets over the total insurance liabilities, and the denominator of which is the total insurance liabilities,

(B) The surplus held in the Uinted States is the excess of the assets held in the United States over the total insurance liabilities on United States business.

For purposes of this paragraph and subsection [(c)] *(b)*, the term "total insurance liabilities" means the sum of the total reserves (as defined in section 801(c)) plus (to the extent not included in total reserves) the items referred to in paragraphs (3), (4), and (5) of section 810(c).

(3) REDUCTION OF SECTION 881 TAX.—In the case of any foreign corporation taxable under this part, there shall be determined—

(A) the amount which would be subject to tax under section 881 if the amount taxable under such section were determined without regard to sections 103 and 894, and

(B) the amount of the reduction provided by paragraph (1).

The tax under section 881 (determined without regard to this paragraph) shall be reduced (but not below zero) by an amount which is the same proportion of such tax as the amount referred to in subparagraph (B) is of the amount referred to in subparagraph (A); but such reduction in tax shall not exceed the increase in tax under this part by reason of the reduction provided by paragraph (1).

[(c)] *(b)* DISTRIBUTIONS TO SHAREHOLDERS.—

(1) IN GENERAL.—In applying sections 802(b)(3) and 815 [for purposes of subsection (a)] *with respect to a foreign corporation* the amount of the distributions to shareholders shall be determined by multiplying the total amount of the distributions to shareholders (within the meaning of section 815) of the foreign [life insurance company] *corporation* by whichever of the following percentages is selected by the taxpayer for the taxable year:

(A) the percentage which the minimum figure for the taxable year (determined under subsection [(b)] *(a)*(2)-(A)) is of the excess of the assets of the company over the total insurance liabilities; or

(B) the percentage which the total insurance liabilities on United States business for the taxable year is of the company's total insurance liabilities.

(2) DISTRIBUTIONS PURSUANT TO CERTAIN MUTUALIZATIONS.—In applying section 815(e) [for purpose of subsection (a)] *with respect to a foreign corporation*—

(A) the paid-in capital and paid-in surplus referred to in section 815(e)(1)(A) of a foreign [life insurance company] *corporation* is the portion of such capital and surplus determined by multiplying such capital and surplus by the per-

centage selected for the taxable year under paragraph (1); and

(B) the excess referred to in section 815(e)(2)(A)(i) (without the adjustment provided by section 815(e)(2)(B)) is whichever of the following is the greater:

(i) the minimum figure for 1958 determined under subsection [(b)] (*a*)(2)(A), or

(ii) the surplus described in subsection [(b)] (*a*)(2)(B) (determined as of December 31, 1958).

[(d) NO UNITED STATES INSURANCE BUSINESS.—Foreign life insurance companies not carrying on an insurance business within the United States shall not be taxable under this part but shall be taxable as other foreign corporations.]

(*c*) *CROSS REFERENCE.*—

For taxation of foreign corporations carrying on life insurance business within the United States, see section 842.

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PART II—MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE AND CERTAIN MARINE INSURANCE COMPANIES AND OTHER THAN FIRE OR FLOOD INSURANCE COMPANIES WHICH OPERATE ON BASIS OF PERPETUAL POLICIES OR PREMIUM DEPOSITS)

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SEC. 821. TAX ON MUTUAL INSURANCE COMPANIES TO WHICH PART II APPLIES.

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[(e) NO UNITED STATES INSURANCE BUSINESS.—Foreign mutual insurance companies (other than a life insurance company and other than a fire, flood, or marine insurance company subject to the tax imposed by section 831) not carrying on an insurance business within the United States shall not be subject to this part but shall be taxable as other foreign corporations.]

[(f)] (*e*) SPECIAL TRANSITIONAL UNDERWRITING LOSS.—

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[(g)] (*f*) CROSS REFERENCES.—

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(1) For exemption from tax of certain mutual insurance companies, see section 501(c)(15).

(2) For alternative tax in case of capital gains, see section 1201(a).

(3) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842.

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SEC. 822. DETERMINATION OF TAXABLE INVESTMENT INCOME.

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[(e) FOREIGN MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE.—In the case of a foreign mutual insurance company (other than a life or marine insurance company or a fire insurance

company subject to the tax imposed by section 831), the taxable investment income shall be taxable income from sources within the United States (computed without regard to the deductions allowed by subsection (c)(7)), and the gross amount of income from the items described in subsection (b) (other than paragraph (1)(D) thereof) and net premiums shall be the amount of such income from sources within the United States. In the case of a company to which the preceding sentence applies, the deductions allowed in this section shall be allowed to the extent provided in subpart B of part II of subchapter N (sec. 881 and following) in the case of a foreign corporation engaged in trade or business within the United States.]

[(f)] (e) DEFINITIONS.—For purposes of this part—

(1) NET PREMIUMS.—The term "net premiums" means gross premiums (including deposits and assessments) written or received on insurance contracts during the taxable year less return premiums and premiums paid or incurred for reinsurance. Amounts returned where the amount is not fixed in the insurance contract but depends on the experience of the company or the discription of the management shall not be included in return premiums but shall be treated as dividends to policyholders under paragraph (2).

(2) DIVIDENDS TO POLICYHOLDERS.—The term "dividends to policyholders" means dividends and similar distributions paid or declared to policyholders. For purposes of the preceding sentence, the term "paid or declared" shall be construed according to the method regularly employed in keeping the books of the insurance company.

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PART III—OTHER INSURANCE COMPANIES

Sec. 831. Tax on insurance companies (other than life or mutual), mutual marine insurance companies, and certain mutual fire or flood insurance companies.
Sec. 832. Insurance company taxable income.

SEC. 831, TAX ON INSURANCE COMPANIES (OTHER THAN LIFE OR MUTUAL), MUTUAL MARINE INSURANCE COMPANIES, AND CERTAIN MUTUAL FIRE OR FLOOD INSURANCE COMPANIES

(a) IMPOSITION OF TAX.—Taxes are computed as provided in section 11 shall be imposed for each taxable year on the taxable income of—

(1) every insurance company (other than a life or mutual insurance company),

(2) every mutual marine insurance company, and

(3) every mutual fire or flood insurance company—

(A) exclusively issuing perpetual policies, or

(B) whose principal business is the issuance of policies for which the premium deposits are the same, regardless of the length of the term for which the policies are written, if the unabsorbed portion of such premium deposits not

required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy.

[(b) No United States Insurance Business.—Foreign insurance companies (other than a life or mutual insurance company), foreign mutual marine insurance companies, and foreign mutual fire insurance companies described in subsection (a), not carrying on an insurance business within the United States, shall not be subject to this part but shall be taxable as other foreign corporations.]

[(c)] (*b*) Election for Multiple Line Company To Be Taxed on Total Income.—

(1) In general.—Any mutual insurance company engaged in writing marine, fire, and casualty insurance which for any 5-year period beginning after December 31, 1941, and ending before January 1, 1962, was subject to the tax imposed by section 831 (or the tax imposed by corresponding provisions of prior law) may elect, in such manner and at such time as the Secretary or his delegate may by regulations prescribe, to be subject to the tax imposed by section 831, whether or not marine insurance is its predominant source of premium income.

(2) Effect of election.—If an election is made under paragraph (1), the electing company shall (in lieu of being subject to the tax imposed by section 821) be subject to the tax imposed by this section for taxable years beginning after December 31, 1961. Such election shall not be revoked except with the consent of the Secretary or his delegate.

[(d) Alternative Tax on Capital Gains.—

[For alternative tax in case of capital gains, see section 1201(a).]

(*c*) *Cross References.*—

(1) For alternative tax in case of capital gains, see section 1201(a).
(2) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842.

SEC. 832. INSURANCE COMPANY TAXABLE INCOME.

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[(d) Taxable Income of Foreign Insurance Companies Other Than Life or Mutual and Foreign Mutual Marine.—In the case of a foreign insurance company (other than a life or mutual insurance company), a foreign mutual marine insurance company, and a foreign mutual fire insurance company described in section 831(a), the taxable income shall be the taxable income from sources within the United States. In the case of a company to which the preceding sentence applies, the deductions allowed in this section shall be allowed to the extent provided in subpart B of part II of subchapter N (sec. 881 and following) in the case of a foreign corporation engaged in trade or business within the United States.]

[(e)] (*d*) Double Deductions.—Nothing in this section shall permit the same item to be deducted more than once.

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PART IV—PROVISIONS OF GENERAL APPLICATION

Sec. 841. Credit for foreign taxes.
[Sec. 842. Computation of gross income.]
Sec. 842. Foreign corporations carrying on insurance business.
Sec. 843. Annual accounting period.

SEC. 841. CREDIT FOR FOREIGN TAXES.

The taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of a domestic insurance company subject to the tax imposed by section 802, 821, or 831, to the extent provided in the case of a domestic corporation in section 901 (relating to foreign tax credit). For purposes of the preceding sentence (*and for purposes of applying section 906 with respect to a foreign corporation subject to tax under this subchapter*), the term "taxable income" as used in section 904 means—

(1) in the case of the tax imposed by section 802, the life insurance company taxable income (as defined in section 802(b)),

(2) in the case of the tax imposed by section 821(a), the mutual insurance company taxable income (as defined in section 821(b)); and in the case of the tax imposed by section 821(c), the taxable investment income (as defined in section 822(a)), and

(3) in the case of the tax imposed by section 831, the taxable income (as defined in section 832(a)).

[SEC. 842. COMPUTATION OF GROSS INCOME.

[The gross income of insurance companies subject to the tax imposed by section 802 or 831 shall not be determined in the manner provided in part I of subchapter N (relating to determination of sources of income).]

SEC. 842. FOREIGN CORPORATIONS CARRYING ON INSURANCE BUSINESS.

If a foreign corporation carrying on an insurance business within the United States would qualify under part I, II, or III of this subchapter for the taxable year if (without regard to income not effectively connected with the conduct of any trade or business within the United States) it were a domestic corporation, such corporation shall be taxable under such part on its income effectively connected with its conduct of any trade or business within the United States. With respect to the remainder of its income, which is from sources within the United States, such a foreign corporation shall be taxable as provided in section 881.

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Subchapter N—Tax Based on Income From Sources Within or Without the United States

Part I. Determination of sources of income.
Part II. Nonresident aliens and foreign corporations.
Part III. Income from sources without the United States.

PART I—DETERMINATION OF SOURCES OF INCOME

Sec. 861. Income from sources within the United States.
Sec. 862. Income from sources without the United States.
Sec. 863. Items not specified in section 861 or 862.
Sec. 864. Definitions.

SEC. 861. INCOME FROM SOURCES WITHIN THE UNITED STATES.

(a) GROSS INCOME FROM SOURCES WITHIN UNITED STATES.—The following items of gross income shall be treated as income from sources within the United States:

(1) INTEREST.—Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including—

[(A) interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States,]

(A) interest on amounts described in subsection (c) received by a nonresident alien individual or a foreign corporation, if such interest is not effectively connected with the conduct of a trade or business within the United States,

(B) interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Secretary or his delegate that less than 20 percent of the gross income of such resident payor or domestic corporation has been derived from sources within the United States, as determined under the privisions of this part, for the 3-year period ending with the close of the taxable year of such payor preceding the payment of such interest, or for such part of such period as may be applicable, [and]

(C) income derived by a foreign central bank of issue from bankers' acceptances[.], *and*

(D) interest on deposits with a foreign branch of a domestic corporation, if such branch is engaged in the commercial banking business.

(2) DIVIDENDS.—The amount received as dividends—

(A) from a domestic corporation other than a corporation entitled to the benefits of section 931, and other than a corporation less than 20 percent of whose gross income is shown to the satisfaction of the Secretary or his delegate to have been derived from sources within the United States, as determined under the provisions of this part, for the 3-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence, or

(B) from a foreign corporation unless less than [50] *80* percent of the gross income *from all sources* of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was [derived from sources] *effectively connected with the conduct of a trade or business* within the United States [as determined under the provisions of this part]; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period [derived from sources] *which is effectively connected*

with the conduct of a trade or business within the United States bears to its gross income from all sources; but dividends from a foreign corporation shall, for purposes of subpart A of part III (relating to foreign tax credit), be treated as income from sources without the United States to the extent (*and only to the extent*) exceeding the amount which is 100/85ths of the amount of the deduction allowable under section 245 in respect of such dividends, or

(C) from a foreign corporation to the extent that such amount is required by section 243(d) (relating to certain dividends from foreign corporations) to be treated as dividends from a domestic corporation which is subject to taxation under this chapter, and to such extent subparagraph (B) shall not apply to such amount.

For purposes of subparagraph (B), the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States.

(3) PERSONAL SERVICES.—Compensation for labor or personal services performed in the United States; except that compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if—

(A) the labor or services are performed by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year,

(B) such compensation does not exceed $3,000 in the aggregate, and

(C) the compensation is for labor or services performed as an employee of or under a contract with—

(i) a nonresident alien, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

(ii) *an individual who is a citizen or resident of the United States, a domestic partnership, or* a domestic corporation, if such labor or services are performed for an office or place of business maintained in a foreign country or in a possession of the United States by such *individual, partnership, or* corporation.

(4) RENTALS AND ROYALTIES.—Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property.

(5) SALE OF REAL PROPERTY.—Gains, profits, and income from the sale of real property located in the United States.

(6) SALE OF PERSONAL PROPERTY.—Gains, profits, and income derived from the purchase of personal property without the United States (other than within a possession of the United States) and its sale within the United States.

(b) TAXABLE INCOME FROM SOURCES WITHIN UNITED STATES.—From the items of gross income specified in subsection (a) as being income from sources within the United States there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as taxable income from sources within the United States.

(c) INTEREST ON DEPOSITS, ETC.—For purposes of subsection (a) (1) (A), the amounts described in this subsection are—

(1) deposits with persons carrying on the banking business,

(2) deposits or withdrawable accounts with savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, but only to the extent that amounts paid or credited on such deposits or accounts are deductible under section 591 in computing the taxable income of such institutions, and

(3) amounts held by an insurance company under an agreement to pay interest thereon.

Effective with respect to amounts paid or credited after December 31, 1971, subsection (a) (1) (A) and this subsection shall cease to apply.

SEC. 862. INCOME FROM SOURCES WITHOUT THE UNITED STATES.

(a) GROSS INCOME FROM SOURCES WITHOUT UNITED STATES.—The following items of gross income shall be treated as income from sources without the United States:

(1) interest other than that derived from sources within the United States as provided in section 861 (a) (1);

(2) dividends other than those derived from sources within the United States as provided in section 861 (a) (2);

(3) compensation for labor or personal services performed without the United States;

(4) rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like properties;

(5) gains, profits, and income from the sale of real property located without the United States; and

(6) gains, profits, and income derived from the purchase of personal property within the United States and its sale without the United States.

(b) TAXABLE INCOME FROM SOURCES WITHOUT UNITED STATES.—From the items of gross income specified in subsection (a) there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be treated in full as taxable income from sources without the United States.

SEC. 863. ITEMS NOT SPECIFIED IN SECTION 861 OR 862.

(a) ALLOCATION UNDER REGULATIONS.—Items of gross income, expenses, losses, and deductions, other than those specified in sections 861(a) and 862(a), shall be allocated or apportioned to sources within or without the United States, under regulations prescribed by the Secretary or his delegate. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the taxable income therefrom) the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as taxable income from sources within the United States.

(b) INCOME PARTLY FROM WITHIN AND PARTLY FROM WITHOUT THE UNITED STATES.—In the case of gross income derived from sources partly within and partly without the United States, the taxable income may first be computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income; and the portion of such taxable income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Secretary or his delegate. Gains, profits, and income—

(1) from transportation or other services rendered partly within and partly without the United States,

(2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, or produced (in whole or in part) by the taxpayer without and sold within the United States, or

(3) derived from the purchase of personal property within a possession of the United States and its sale within the United States,

shall be treated as derived partly from sources within and partly from sources without the United States.

SEC. 864. DEFINITIONS.

(a) *SALE, ETC.*—For purposes of this part, the word "sale" includes "exchange"; the word "sold" includes "exchanged"; and the word "produced" includes "created", "fabricated", "manufactured", "extracted", "processed", "cured", or "aged".

(b) TRADE OR BUSINESS WITHIN THE UNITED STATES.—For purposes of this part, part II, and chapter 3, the term "trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include—

(1) PERFORMANCE OF PERSONAL SERVICES FOR FOREIGN EMPLOYER.—The performance of personal services—

(A) for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

(B) for an office or place of business maintained in a foreign country or in a possession of the United States by an

individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation,
by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000.

(2) TRADING IN SECURITIES OF COMMODITIES.—

(A) STOCKS AND SECURITIES.—

(i) Except in the case of a dealer in stocks or securities, trading in stocks or securities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a corporation (other than a corporation which is, or but for section 542(c)(7) would be, a personal holding company) the principal business of which is trading in stocks or securities for its own account, if its principal office is in the United States.

(ii) In the case of a person who is a dealer in stocks or securities, trading in stocks or securities for his own account through a resident broker, commission agent, custodian, or other independent agent.

(B) COMMODITIES.—

(i) Except in the case of a dealer in commodities, trading in commodities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such agent has discretionary authority to make decisions in effecting the transactions.

(ii) In the case of a person who is a dealer in commodities, trading in commodities for his own account through a resident broker, commission agent, custodian, or other independent agent.

(iii) Clauses (i) and (ii) apply only if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place.

(C) LIMITATION.—Subparagraphs (A)(ii) and (B)(ii) shall apply only if, at no time during the taxable year, the taxpayer has an office or place of business in the United States through which or by the direction of which the transactions in stocks or securities, or in commodities, as the case may be are effected.

(c) EFFECTIVELY CONNECTED INCOME, ETC.—

(1) GENERAL RULE.—For purposes of this title—

(A) In the case of a nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year, the rules set forth in paragraphs (2), (3), and (4) shall apply in determining the

income, gain, or loss which shall be treated as effectively connected with the conduct of a trade or business within the United States.

(B) Except as provided in section 871(d) or section 882(d), in the case of a nonresident alien individual or a foreign corporation not engaged in trade or business within the United States during the taxable year, no income, gain, or loss shall be treated as effectively connected with the conduct of a trade or business within the United States.

(2) PERIODICAL, ETC., INCOME FROM SOURCES WITHIN UNITED STATES—FACTORS.—In determining whether income from sources within the United States of the types described in section 871(a)(1) or section 881(a), or whether gain or loss from sources within the United States from the sale or exchange of capital assets, is effectively connected with the conduct of a trade or business within the United States, the factors taken into account shall include whether—

(A) the income, gain, or loss is derived from assets used in or held for use in the conduct of such trade or business, or

(B) the activities of such trade or business were a material factor in the realization of the income, gain, or loss.

In determining whether an asset is used in or held for use in the conduct of such trade or business or whether the activities of such trade or business were a material factor in realizing an item of income, gain, or loss, due regard shall be given to whether or not such asset or such income, gain, or loss was accounted for through such trade or business. In applying this paragraph and paragraph (4), interest referred to in section 861(a)(1)(A) shall be considered income from sources within the United States.

(3) OTHER INCOME FROM SOURCES WITHIN UNITED STATES.—All income, gain, or loss from sources within the United States (other than income, gain, or loss to which paragraph (2) applies) shall be treated as effectively connected with the conduct of a trade or business within the United States.

(4) INCOME FROM SOURCES WITHOUT UNITED STATES.—

(A) Except as provided in subparagraph (B) and (C), no income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States.

(B) Income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States by a nonresident alien individual or a foreign corporation if such person has an office or other fixed place of business within the United States to which such income, gain, or loss is attributable and such income, gain, or loss—

(i) consists of rents or royalities for the use of or for the privilege of using intangible property described in section 862(a)(4) (including any gain or loss realized on the sale of such property) derived in the active conduct of such trade or business;

(ii) consists of dividends or interest, or gain or loss from the sale of exchange of stock or notes, bonds,

or other evidences of indebtedness, and either is derived in the active conduct of a banking, financing, or similar business within the United States or is received by a corporation the principal business of which is trading in stock or securities for its own account; or

(iii) is derived from the sale (without the United States) through such office or fixed place of business of personal property described in section 1221(1), except that this clause shall not apply if the property is sold for use, consumption, or disposition outside the United States and an office or other fixed place of business of the taxpayer outside the United States participated materially in such sale.

In the case of a sale described in clause (iii), the income which shall be treated as attributable to the office or other fixed place of business within the United States shall not exceed the income which would be derived from sources within the United States if the sale were made in the United States.

(C) In the case of a foreign corporation taxable under part I of subchapter L, any income from sources without the United States which is attributable to its United States business shall be treated as effectively connected with the conduct of a trade or business within the United States.

(D) No income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States if it either—

(i) consists of dividends, interest, or royalties paid by a foreign corporation in which the taxpayer owns (within the meaning of section 958(a)), or is considered as owning (by applying the ownership rules of section 958(b)), more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or

(ii) is subpart F income within the meaning of section 952(a).

PART II—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

Subpart A. Nonresident alien individuals.
Subpart B. Foreign corporations.
Subpart C. Miscellaneous provisions.

SUBPART A—NONRESIDENT ALIEN INDIVIDUALS

Sec. 871. Tax on nonresident alien individuals.
Sec. 872. Gross income.
Sec. 873. Deductions.
Sec. 874. Allowance of deductions and credits.
Sec. 875. Partnerships.
Sec. 876. Alien residents of Puerto Rico.
Sec. 877. *Expatriation to avoid tax.*
Sec. [877] 878. Foreign educational, chartiable, and certain other exempt organizations.

SEC. 871. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

[(a) NO UNITED STATES BUSINESS—30 PERCENT TAX.—

[(1) IMPOSITION OF TAX.—Except as otherwise provided in subsection (b) there is hereby imposed for each taxable year, in lieu of the tax imposed by section 1, on the amount received, by every nonresident alien individual not engaged in trade or business within the United States, from sources within the United States, as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income (including amounts described in section 402(a)(2), section 403(a)(2), section 631 (b) and (c), and section 1235, which are considered to be gains from the sale or exchange of capital assets), a tax of 30 percent of such amount.

[(2) CAPITAL GAINS OF ALIENS TEMPORARILY PRESENT IN THE UNITED STATES.—In the case of a nonresident alien individual not engaged in trade or business in the United States, there is hereby imposed for each taxable year, in addition to the tax imposed by paragraph (1)—

[(A) if he is present in the United States for a period or periods aggregating less than 90 days during such taxable year—a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from sales or exchanges of capital assets effected during his presence in the United States exceed his losses, allocable to sources within the United States, from such sales or exchanges effected during such presence; or

[(B) if he is present in the United States for a period or periods aggregating 90 days or more during such taxable year—a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from sales or exchanges of capital assets effected at any time during such year exceed his losses, allocable to sources within the United States, from such sales or exchanges effected at any time during such year.

For purposes of this paragraph, gains and losses shall be taken into account only if, and to the extent that, they would be recognized and taken into account if such individual were engaged in trade or business in the United States, except that such gains and losses shall be computed without regard to section 1202 (relating to deduction for capital gains) and such losses shall be determined without the benefits of the capital loss carryover provided in section 1212.]

(a) INCOME NOT CONNECTED WITH UNITED STATES BUSINESS—30 PERCENT TAX.—

(1) INCCME OTHER THAN CAPITOL GAINS.—There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual as—

(A) interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and

other fixed or determinable annual or periodical gains, profits, and income,

(B) gains described in section 401(a)(2), 403(a)(2), or 631 (b) or (c), and gains on transfers described in section 1235, and

(C) amounts which under section 341, or under section 1232 (in the case of bonds or other evidences of indebtedness issued after September 28, 1965, are treated as gains from the sale or exchange of property which is not a capital asset.

but only to the extent the amounts so received is not effectively connected with the conduct of a trade or business within the United States.

(2) CAPITAL GAINS OF ALIENS PRESENT IN THE UNITED STATES 183 DAYS OR MORE.—In the case of a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year, there is hereby imposed for such year a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from the sale or exchange at any time during such year of capital assets exceed his losses, allocable to sources within the United States, from the sale or exchange at any time during such year of capital assets. For purposes of this paragraph, gains and losses shall be taken into account only if, and to the extent that, they would be recognized and taken into account if such gains and losses were effectively connected with the conduct of a trade or business within the United States, except that such gains and losses shall be determined without regard to section 1202 (relating to deduction for capital gains) and such losses shall be determined without the benefits of the capital loss carryover provided in section 1212. Any gain or loss which is taken into account in determining the tax under paragraph (1) or subsection (b) shall not be taken into account in determining the tax under this paragraph. For purposes of the 183-day requirement of this paragraph, a nonresident alien individual not engaged in trade or business within the United States who has not established a taxable year for any prior period shall be treated as having a taxable year which is the calendar year.

[(b) NO UNITED STATES BUSINESS—AEGULAR TAX.—A non-resident alien individual not engaged in trade or business within the United States shall be taxable without regard to subsection (a) if during the taxable year the sum of the aggregate amount received from the sources specified in subsection (a)(1), plus the amount by which gains from sales or exchanges of capital assets exceed losses from such sales or exchanges (determined in accordance with subsection (a)(2) is more than $19,000 in the case of a taxable year beginning in 1964 or more than $21,200 in the case of a taxable year beginning after 1964, except that—

[(1) the gross income shall include only income from the sources specified in subsection (a)(1) plus any gain (to the extent provided in subchapter P; sec. 1201 and following, relating to capital gains and losses) from a sale or exchange of a capital asset if such gain would be taken into account were the tax being determined under subsection (a)(2);

[(2) the deductions (other than the deduction for charitable contributions and gifts provided in section 873(c)) shall be allowed only if and to the extent that they are properly allocable to the gross income from the sources specified in subsection (a), except that any loss from the sale or exchange of a capital asset shall be allowed (to the extent provided in subchapter P without the benefit of the capital loss carryover provided in section 1212) if such loss would be taken into account were the tax being determined under subsection (a)(2).

[If (without regard to this sentence the amount of the taxes imposed in the case of such an individual under section 1 or under section 1201(b), minus the credit under section 35, is an amount which is less than 30 percent of the sum of—

[(A) the aggregate amount received from the sources specified in subsection (a)(1) plus

[(B) the amount, determined under subsection (a)(2), by which gains from sales or exchanges of capital assets exceed losses from such sales or exchanges,

then this subsection shall not apply and subsection (a) shall apply. For purposes of this subsection, the term "aggregate amount received from the sources specified in subsection (a)(1)" shall be applied without any exclusion under section 116.

[(c) UNITED STATES BUSINESS.—A nonresident alien individual engaged in trade or business within the United States shall be taxable without regard to subsection (a). For purposes of part I, this section, sections 881 and 882, and chapter 3, the term "engaged in trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include the performance of personal services—

[(1) for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

[(2) for an office or place of business maintained by a domestic corporation in a foreign country or in a possession of the United States,

by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000. Such term does not include the effecting, through a resident broker, commission agent, or custodian, of transactions in the United States in stocks or securities, or in commodities (if of a kind customarily dealt in on an organized commodity exchange, if the transaction is of the kind customarily consummated at such place, and if the alien, partnership, or corporation has no office or place of business in the United States at any time during the taxable year through which or by the direction of which such transactions in commodities are effected).]

(b) INCOME CONNECTED WITH UNITED STATES BUSINESS—GRADUATED RATE OF TAX.—

(1) IMPOSITION OF TAX.—A nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 1 or 1201(b)

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on his taxable income which is effectively connected with the conduct of a trade or business within the United States.

(2) DETERMINATION OF TAXABLE INCOME.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

[(d)] *(c)* PARTICIPANTS IN CERTAIN EXCHANGE OR TRAINING PROGRAMS.—For purposes of this section, a nonresident alien individual who (without regard to this subsection) is not engaged in trade or business within the United States and who is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101 (a) (15) of the Immigration and Nationality Act, as amended *(8 U.S.C. 1101 (a) (15) (F) or (J))*, shall be treated as a nonresident alien individual engaged in trade or business within the United States, *and any income described in section 1441(b) (1) or (2) which is received by such individual shall, to the extent derived from sources within the United States, be treated as effectively connected with the conduct of a trade or business within the United States.*

(d) ELECTION TO TREAT REAL PROPERTY INCOME AS INCOME CONNECTED WITH UNITED STATES BUSINESS.—

(1) IN GENERAL.—A nonresident alien individual who during the taxable year derives any income—

(A) from real property held for the production of income and located in the United States, or from any interest in such real property, including (i) gains from the sale or exchange of such real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631 (b) or (c), and

(B) which, but for this subsection, would not be treated as income which is effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (b) (1) whether or not such individual is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

(2) ELECTION AFTER REVOCATION.—If an election has been made under paragraph (1) and such election has been revoked, a new election may not be made under such paragraph for any taxable year before the 5th taxable year which begins after the first taxable year for which such revocation is effective, unless the Secretary or his delegate consents to such new election.

(3) FORM AND TIME OF ELECTION AND REVOCATION.—An election under paragraph (1), and any revocation of such an election, may be made only in such manner and at such time as the Secretary or his delegate may by regulations prescribe.

(e) CROSS REFERENCES.—

[(2)] *(1)* For tax treatment of certain amounts distributed by the United States to nonresident alien individuals, see section 402(a)(4).

(2) For taxation of nonresident alien individuals who are expatriate United States citizens, see section 877.

[(1)] (3) For doubling of tax on citizens of certain foreign countries, see section 891.

(4) For reinstatement of pre-1967 income tax provisions in the case of residents of certain foreign countries, see section 896.

(5) For withholding of tax at source on nonresident alien individuals, see section 1441.

(6) For the requirement of making a declaration of estimated tax by certain nonresident alien individuals, see section 6015(i).

(7) For taxation of gains realized upon certain transfers to domestic corporations, see section 1250(d)(3).

SEC. 872. GROSS INCOME.

(a) GENERAL RULE.—In the case of a nonresident alien individual, gross income includes only—

(1) [the] gross income *which is derived* from sources within the United States *and which is not effectively connected with the conduct of a trade or business within the United States, and*

(2) gross income which is effectively connected with the conduct of a trade or business within the United States.

(b) EXCLUSIONS.—The following items shall not be included in gross income of a nonresident alien individual, and shall be exempt from taxation under this subtitle:

(1) SHIPS UNDER FOREIGN FLAG.—Earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(2) AIRCRAFT OF FOREIGN REGISTRY.—Earnings derived from the operation of aircraft registered under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(3) COMPENSATION OF PARTICIPANTS IN CERTAIN EXCHANGE OR TRAINING PROGRAMS.—Compensation paid by a foreign employer to a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended. For purposes of this paragraph, the term "foreign employer" means—

(A) a nonresident alien individual, foreign partnership, or foreign corporation, or

(B) an office or place of business maintained in a foreign country or in a possession of the United States by a domestic [corporation] *corporation, a domestic partnership, or an individual who is a citizen or resident of the United States.*

(4) BOND INTEREST OF RESIDENTS OF THE RYUKYU ISLANDS OR THE TRUST TERRITORY OF THE PACIFIC ISLANDS.—Income derived by a nonresident alien individual from a series E or series H United States savings bond, if such individual acquired such bond while a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands.

SEC. 873. DEDUCTIONS.

[(a) GENERAL RULE.—In the case of a nonresident alien individual the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in part I, under regulations prescribed by the Secretary or his delegate.

[(b) LOSSES.—

[(1) The deduction, for losses not connected with the trade or business if incurred in transactions entered into for profit allowed by section 165(c)(2) (relating to losses) shall be allowed whether or not connected with income from sources within the United States, but only if the profit, if such transaction had resulted in a profit, would be taxable under this subtitle.

[(2) The deduction for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), shall be allowed whether or not connected with income from sources within the United States, but only if the loss is of property within the United States.

[(c) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts provided by section 170 shall be allowed whether or not connected with income from sources within the United States, but only as to contributions or gifts made to domestic corporations, or to community chests, funds, or foundations, created in the United States.

[(d) PERSONAL EXEMPTION.—In the case of a nonresident alien individual who is not a resident of a contiguous country, only one exemption under section 151 shall be allowed as a deduction.

[(e) STANDARD DEDUCTION.—

[For disallowance of standard deduction, see section 142(b)(1).]

(a) GENERAL RULE.—In the case of a nonresident alien individual, the deductions shall be allowed only for purposes of section 871(b) and (except as provided by subsection (b)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary or his delegate.

(b) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income which is effectively connected with the conduct of a trade or business within the United States:

(1) LOSSES.—The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property located within the United States.

(2) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts allowed by section 170.

(3) PERSONAL EXEMPTION.—The deduction for personal exemptions allowed by section 151, except that in the case of a non-

resident alien individual who is not a resident of a contiguous country only one exemption shall be allowed under section 151.

(c) *CROSS REFERENCES.—*

(1) For disallowance of standard deduction, see section 142(b)(1).

(2) For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1).

SEC. 874. ALLOWANCE OF DEDUCTIONS AND CREDITS.

(a) RETURN PREQUISITE TO ALLOWANCE.—A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this subtitle only by filing or causing to be filed *with the Secretary or his delegate* a true and accurate return [of his total income received from all sources in the United States], in the manner prescribed in subtitle F (sec. 6001 and following, relating to procedure and administration), including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. This subsection shall not be construed to deny the credits provided by sections 31 and 32 for tax withheld at [the] source or the credit provided by section 39 for certain uses of gasoline and lubricating oil.

(b) TAX WITHHELD AT SOURCE.—The benefit of the deduction for exemptions under section 151 may, in the discretion of the Secretary or his delegate, and under regulations prescribed by the Secretary or his delegate, be received by a nonresident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

(c) FOREIGN TAX CREDIT NOT ALLOWED.—[A nonresident] *Except as provided in section 906, a nonresident* alien individual shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

SEC. 875. PARTNERSHIPS.

For purposes of this subtitle, a nonresident alien individual shall be considered as being engaged in a trade or business within the United States if the partnership of which he is a member is so engaged.

SEC. 876. ALIEN RESIDENTS OF PUERTO RICO.

(a) NO APPLICATION TO CERTAIN ALIEN RESIDENTS OF PUERTO RICO.—This subpart shall not apply to an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, and such alien shall be subject to the tax imposed by section 1.

(b) CROSS REFERENCE.—

For exclusion from gross income of income derived from sources within Puerto Rico, see section 933.

SEC. 877. EXPATRIATION TO AVOID TAX.

(a) IN GENERAL.—Every nonresident alien individual who at any time after March 8, 1965, and within the 5-year period immediately preceding the close of the taxable year lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B, shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection exceeds the tax which, without regard to this section, is imposed pursuant to section 871.

(b) ALTERNATIVE TAX.—A nonresident alien individual described in subsection (a) shall be taxable for the taxable year as provided in section 1 or section 1201(b), except that—

(1) the gross income shall include only the gross income described in section 872(a) (as modified by subsection (c) of this section), and

(2) the deductions shall be allowed if and to the extent that they are connected with the gross income included under this section, except that the capital loss carryover provided by section 1212(b) shall not be allowed; and the proper allocation and apportionment of the deductions for this purpose shall be determined as provided under regulations prescribed by the Secretary or his delegate.

For purposes of paragraph (2), the deductions allowed by section 873(b) shall be allowed; and the deduction (for losses not connected with the trade or business if incurred in transactions entered into for profit) allowed by section 165(c)(2) shall be allowed, but only if the profit, if such transaction had resulted in a profit, would be included in gross income under this section.

(c) SPECIAL RULES OF SOURCE.—For purposes of subsection (b), the following items of gross income shall be treated as income from sources within the United States:

(1) SALE OF PROPERTY.—Gains on the sale or exchange of property (other than stock or debt obligations) located in the United States.

(2) STOCK OR DEBT OBLIGATIONS.—Gains on the sale or exchange of stock issued by a domestic corporation or debt obligations of United States persons or of the United States, a State or political subdivision thereof, or the District of Columbia.

(d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to a nonresident alien individual whose loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487).

(e) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction for the taxable year in the taxes on his probable income for such year, the burden of proving for such taxable year that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B shall be on such individual.

SEC [877] *878.* FOREIGN EDUCATIONAL, CHARITABLE, AND CERTAIN OTHER EXEMPT ORGANIZATIONS.

For special provisions relating to unrelated business income of foreign educational, charitable, and other exempt trusts, see section 512(a).

Subpart B—Foreign Corporations

[Sec. 881. Tax on foreign corporations not engaged in business in United States.]
[Sec. 882. Tax on resident foreign corporations.]
Sec. 881. Income of foreign corporations not connected with United States business.
Sec. 882. Income of foreign corporations connected with United States business.
Sec. 883. Exclusions from gross income.
Sec. 884. Cross references.

[SEC. 881. TAX ON FOREIGN CORPORATIONS NOT ENGAGED IN BUSINESS IN UNITED STATES.

[(a) IMPOSITION OF TAX.—In the case of every foreign corporation not engaged in trade or business within the United States, there is hereby imposed for each taxable year, in lieu of the taxes imposed by section 11, a tax of 30 percent of the amount received from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income (including amounts described in section 631 (b) and (c) which are considered to be gains from the sale or exchange of capital assets).]

SEC. 881. INCOME OF FOREIGN CORPORATIONS NOT CONNECTED WITH UNITED STATES BUSINESS.

(a) IMPOSITION OF TAX.—There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as—

(1) interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

(2) gains described in section 631 (b) or (c), and

(3) amounts which under section 341, or under section 1232 (in the case of bonds or other evidences of indebtedness issued after September 28, 1965), are treated as gains from the sale or exchange of property which is not a capital asset,

but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

(b) DOUBLING OF TAX.—

For doubling of tax on corporations of certain foreign countries, see section 891.

SEC. 882. [TAX ON RESIDENT FOREIGN CORPORATIONS.] *INCOME OF FOREIGN CORPORATIONS CONNECTED WITH UNITED STATES BUSINESS.*

(a) *NORMAL TAX AND SURTAX.*—

(1) IMPOSITION OF TAX.—A foreign corporation engaged in trade or business within the United States *during the taxable year* shall be taxable as provided in section 11 *or 1201(a) on its taxable income which is effectively connected with the conduct of a trade or business within the United States.*

(2) DETERMINATION OF TAXABLE INCOME.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

(b) GROSS INCOME.—In the case of a foreign corporation, gross income includes only—

(*1*) [the] gross income *which is derived* from sources within the United States[.] *and which is not effectively connected with the conduct of a trade or business within the United States, and*

(*2*) *gross income which is effectively connected with the conduct of a trade or business within the United States.*

(c) ALLOWANCE OF DEDUCTIONS AND CREDITS.—

[(2)] (*1*) ALLOCATION OF DEDUCTIONS.—

(*A*) *GENERAL RULE.*—In the case of a foreign corporation the deductions shall be allowed *only for purposes of subsection* (*a*) *and* (*except as provided by subparagraph* (*B*)) only if and to the extent that they are *connected with income which is effectively* connected with [income from sources] *the conduct of a trade or business* within the United States; and the proper apportionment and allocation of the deductions [with respect to sources within and without the United States] *for this purpose* shall be determined as provided in [part I, under] regulations prescribed by the Secretary or his delegate.

[(3)] (*B*) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts [provided] *allowed* by section 170 shall be allowed whether or not *connected with income which is effectively* connected with [income from sources] *the conduct of a trade or business* within the United States.

[(1)] (*2*) DEDUCTIONS *AND CREDITS* ALLOWED ONLY IF RETURN FILED.—A foreign corporation shall receive the benefit of the deductions *and credits* allowed to it in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return [of its total income received from all sources in the United States], in the manner prescribed in subtitle F, including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions *and credits. This paragraph shall not be construed to deny the credit provided by section 32 for tax withheld at source or the credit provided by section 39 for certain uses of gasoline and lubricating oil.*

[(4)] (*3*) FOREIGN TAX CREDIT.—[Foreign] *Except as provided by section 906, foreign* corporations shall not be allowed the [credits] *credit* against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

(*4*) *CROSS REFERENCE.*—

For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1).

(*d*) *ELECTION TO TREAT REAL PROPERTY INCOME AS INCOME CONNECTED WITH UNITED STATES BUSINESS.*—

(*1*) *IN GENERAL.*—*A foreign corporation which during the taxable year derives any income*—

(*A*) *from real property held for the production of income and located in the United States, or from any interest in such real property, including* (*i*) *gains from the sale or exchange*

of real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631 (b) or (c), and

(B) which, but for this subsection, would not be treated as income effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (a) (1) whether or not such corporation is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

(2) ELECTION AFTER REVOCATION, ETC.—Paragraphs (2) and (3) of section 871 (d) shall apply in respect of elections under this subsection in the same manner and to the same extent as they apply in respect of elections under section 871 (d).

[(d)](e) RETURNS OF TAX BY AGENT.—If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return required under section 6012 shall be made by the agent.

SEC. 883. EXCLUSIONS FROM GROSS INCOME.

The following items shall not be included in gross income of a foreign corporation, and shall be exempt from taxation under this subtitle:

(1) SHIPS UNDER FOREIGN FLAG.—Earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

(2) AIRCRAFT OF FOREIGN REGISTRY.—Earnings derived from the operation of aircraft registered under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

SEC. 884 CROSS REFERENCES.

[(4)] *(1)* For special provisions relating to unrelated business income of foreign educational, charitable, and certain other exempt organizations, see section 512(a).

[(3)] *(2)* For special provisions relating to foreign [insurance companies], *corporation carrying on an insurance business within the United States* see [subchapter L (sec. 801 and following)] *section 842.*

[(2)] *(3)* For rules applicable in determining whether any foreign corporation is engaged in trade or business within the United States, see section [871(c)] *864(b).*

(4) For reinstatement of pre-1967 income tax provisions in the case of corporations of certain foreign countries, see section 896.

(5) For allowance of credit against the tax in case of a foreign corporation having income effectively connected with the conduct of a trade or business within the United States, see section 906.

[(1)] *(6)* For withholding at source of tax on income of foreign corporations, see section 1442.

Subpart C—Miscellaneous Provisions

Sec. 891. Doubling of rates of tax on citizens and corporations of certain foreign countries.
Sec. 892. Income of foreign governments and of international organizations.
Sec. 893. Compensation of employees of foreign governments or international organizations.
[Sec. 894. Income exempt under treaty.]
Sec. 894. Income affected by treaty.
Sec. 895. Income derived by a foreign central bank of issue from obligations of the United States *or from bank deposits.*
Sec. 896. Application of pre-1967 income tax provisions.

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SEC. 894. *INCOME AFFECTED BY TREATY.*

(*a*) *INCOME EXEMPT UNDER TREATY.*—Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

(*b*) *PERMANENT ESTABLISHMENT IN UNITED STATES.*—*For purposes of applying any exemption from, or reduction of, any tax provided by any treaty to which the United States is a party with respect to income which is not effectively connected with the conduct of a trade or business within the United States, a nonresident alien individual or foreign corporation shall be deemed not to have a permanent establishment in the United States at any time during the taxable year. This subsection shall not apply in respect of the tax computed under section 877(b).*

SEC. 895. INCOME DERIVED BY A FOREIGN CENTRAL BANK OF ISSUE FROM OBLIGATIONS OF THE UNITED STATES *OR FROM BANK DEPOSITS.*

Income derived by a foreign central bank of issue from obligations of the United States owned by such foreign central bank of issue, *or from interest on deposits with persons carrying on the banking business*, shall not be included in gross income and shall be exempt from taxation under this subtitle unless such obligations *or deposits* are held for, or used in connection with, the conduct of commercial banking functions or other commercial activities. *For purposes of the preceding sentence, the Bank for International Settlements shall be treated as a foreign central bank of issue with respect to interest on deposits with persons carrying on the banking business.*

SEC. 896. APPLICATION OF PRE-1967 INCOME TAX PROVISIONS.

(*a*) *IMPOSITION OF MORE BURDENSOME TAXES BY FOREIGN COUNTRY.—Whenever the President finds that—*

(1) under the laws of any foreign country, considering the tax system of such foreign country, citizens of the United States not residents of such foreign country or domestic corporations are being subjected to more burdensome taxes, on any item of income received by such citizens or corporations from sources within such foreign country, than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country,

(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such taxes so that they are no more burdensome than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country, and

(3) it is in the public interest to apply pre-1967 tax provisions in accordance with the provisions of this section to residents or corporations of such foreign country,

the President shall proclaim that the tax on such similar income derived from sources within the United States by residents or corporations of such foreign country shall, for taxable years beginning after such proclamation, be determined under this subtitle without regard to amendments made to this subchapter and chapter 3 on or after the date of enactment of this section.

(b) ALLEVIATION OF MORE BURDENSOME TAXES.—Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that citizens of the United States not residents of such foreign country or domestic corporations are no longer subject to more burdensome taxes on such item of income derived by such citizens or corporations from sources within such foreign country, he shall proclaim that the tax on such similar income derived from sources within the United States by residents or corporations of such foreign country shall, for any taxable year beginning after such proclamation, be determined under this subtitle without regard to subsection (a).

(c) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

(d) IMPLEMENTATION BY REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as he deems necessary or appropriate to implement this section.

PART III—INCOME FROM SOURCES WITHOUT THE UNITED STATES

Subpart A. Foreign tax credit.
Subpart B. Earned income of citizens of United States.
Subpart C. Western Hemisphere trade corporations.
Subpart D. Possessions of the United States.
Subpart E. China Trade Act corporations.
Subpart F. Controlled Foreign Corporations.
Subpart G. Export Trade Corporations.
Subpart H. Income of certain nonresident United States citizens subject to foreign community property laws.

Subpart A—Foreign Tax Credit

Sec. 901. Taxes of foreign countries and of possessions of United States.
Sec. 902. Credit for corporate stockholder in foreign corporation.
Sec. 903. Credit for taxes in lieu of income, etc., taxes.
Sec. 904. Limitation on credit.
Sec. 905. Applicable rules.
Sec. 906. Nonresident alien individuals and foreign corporations.

SEC. 901. TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.

(a) ALLOWANCE OF CREDIT.—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the applicable limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1333 (relating to war loss recoveries), or against the personal holding company tax imposed by section 541.

(b) AMOUNT ALLOWED.—Subject to the applicable limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) CITIZENS AND DOMESTIC CORPORATIONS.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(2) RESIDENT OF THE UNITED STATES OR PUERTO RICO.—In the case of a resident of the United States and in the case of an individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid or accrued during the taxable year to any possession of the United States; and

(3) ALIEN RESIDENT OF THE UNITED STATES OR PUERTO RICO.—In the case of an alien resident of the United States and in the case of an alien individual who is a bona fide resident of Puerto Rico during the entire taxable year, the amount of any such taxes paid or accrued during the taxable year to any foreign country[, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country]; and

(4) NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.—In the case of any nonresident alien individual not described in section 876 and in the case of any foreign corporation, the amount determined pursuant to section 906; and

[(4)](5) PARTNERSHIPS AND ESTATES.—In the case of any individual described in pargraph (1), (2), [or (3),] *(3), or (4)*, who is a member of a partnership or a beneficiary of an estate or trust, the amount of his proportionate share of the taxes (described in such paragraph) of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(c) SIMILAR CREDIT REQUIRED FOR CERTAIN ALIEN RESIDENTS.—Whenever the President finds that—

(1) a foreign country, in imposing income, war profits, and excess profits taxes, does not allow to citizens of the United States

residing in such foreign country a credit for any such taxes paid or accrued to the United States or any foreign country, as the case may be, similar to the credit allowed under subsection (b) (3),

(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit to citizens of the United States residing in such foreign country, and

(3) it is in the public interest to allow the credit under subsection (b) (3) to citizens or subjects of such foreign country only if it allows such a similar credit to citizens of the United States residing in such foreign country,

the President shall proclaim that, for taxable years beginning while the proclamation remains in effect, the credit under subsection (b) (3) shall be allowed to citizens or subjects of such foreign country only if such foreign country, in imposing income, war profits, and excess profits taxes, allows to citizens of the United States residing in such foreign country such a similar credit.

[(c)] *(d)* CORPORATIONS TREATED AS FOREIGN.—For purposes of this subpart, the following corporations shall be treated as foreign corporations:

(1) a corporation entitled to the benefits of section 931, by reason of receiving a large percentage of its gross income from sources within a possession of the United States; and

(2) a corporation organized under the China Trade Act, 1922 (15 U.S.C., chapter 4), and entitled to the deduction provided in section 941.

[(d)] *(e)* CROSS REFERENCE.—

(1) For deductions of income, war profits, and excess profits taxes paid to a foreign country or a possession of the United States, see sections 164 and 275.

(2) For right of each partner to make election under this section, see section 703(b).

(3) For right of estate or trust to the credit for taxes imposed by foreign countries and possessions of the United States under this section, see section 642(a)(2).

(4) For reduction of credit for failure of a United States person to furnish certain information with respect to a foreign corporation controlled by him, see section 6038.

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SEC. 904. LIMITATION ON CREDIT.

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(f) APPLICATION OF SECTION IN CASE OF CERTAIN INTEREST INCOME.—

(1) IN GENERAL.—The provisions of subsection (a), (c), (d), and (e) of this section shall be applied separately with respect to—

(A) the interest income described in paragraph (2), and

(B) income other than the interest income described in paragraph (2).

(2) INTEREST INCOME TO WHICH APPLICABLE.—For purposes of this subsection, the interest income described in this paragraph is interest other than interest—

(A) derived from any transaction which is directly related to the active conduct of a trade or business in foreign country or a possession of the United States,

(B) derived in the conduct of a banking, financing, or similar business,

(C) received from a corporation in which the taxpayer owns at least 10 percent of the voting stock, [or]

(D) received on obligations acquired as a result of the disposition of a trade or business actively conducted by the taxpayer in a foreign country or possession of the United States or as a result of the disposition of stock or obligations of a corporation in which the taxpayer owned at least 10 percent of the voting stock [.], *or*

(E) received by an overseas operations funding subsidiary on obligations of a related foreign corporation.

(3) OVERALL LIMITATION NOT TO APPLY.—The limitation provided by subsection (a)(2) shall not apply with respect to the interest income described in paragraph (2). The Secretary or his delegate shall by regulations prescribe the manner of application of subsection (e) with respect to cases in which the limitation provided by subsection (a)(2) applies with respect to income other than the interest income described in paragraph (2).

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(5) DEFINITIONS FOR PURPOSES OF PARAGRAPH (1)(E).—For purposes of paragraph (1)(E)—

(A) the term "overseas operations funding subsidiary" means a domestic corporation which (i) is a member of an affiliated group (within the meaning of section 1504) and is not the common parent corporation, and (ii) was formed and is availed of for the principal purpose of raising funds outside the United States through public offerings to foreign persons and of using such funds to finance the operations in foreign countries of one or more related foreign corporations, and

(B) a foreign corporation is, with respect to an overseas operations funding subsidiary, a related foreign corporation if the affiliated group of which such subsidiary is a member owns 50 percent or more of the voting stock of such foreign corporation either directly or through ownership of the voting stock of another foreign corporation.

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SEC. 906. NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.

(a) ALLOWANCE OF CREDIT.—A nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year shall be allowed a credit under section 901 for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year (or deemed, under section 902, paid or accrued during the taxable year) to any foreign country or possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States.

(b) SPECIAL RULES.—

(1) For purposes of subsection (a) and for purposes of determining the deductions allowable under sections 873(a) and 882(c), in determining the amount of any tax paid or accrued to any foreign country or possession there shall not be taken into account any amount of tax to the extent the tax so paid or accrued is imposed with respect to income which would not be taxed by such foreign country or possession but for the fact that—

(A) in the case of a nonresident alien individual, such individual is a citizen or resident of such foreign country or possession, or

(B) in the case of a foreign corporation, such corporation was created or organized under the law of such foreign country or possession or is domiciled for tax purposes in such country or possession.

(2) For purposes of subsection (a), in applying section 904 the taxpayer's taxable income shall be treated as consisting only of the taxable income effectively connected with the taxpayer's conduct of a trade or business within the United States.

(3) The credit allowed pursuant to subsection (a) shall not be allowed against any tax imposed by section 871(a) (relating to income of nonresident alien individual not connected with United States business) or 881 (relating to income of foreign corporations not connected with United States business).

(4) For purposes of sections 902(a) and 78, a foreign corporation choosing the benefits of this subpart which receives dividends shall, with respect to such dividends, be treated as a domestic corporation.

Subpart B—Earned Income of Citizens of United States

Sec. 911. Earned income from sources without the United States.
Sec. 912. Exemption for certain allowances.

SEC. 911. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES.

(a) GENERAL RULE.—The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) BONA FIDE RESIDENT OF FOREIGN COUNTRY.—In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such uninterrupted period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

(2) PRESENCE IN FOREIGN COUNTRY FOR 17 MONTHS.—In the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or

countries during at least 510 full days in such period, amounts receievd from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such 18-month period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

An individual shall not be allowed, as a deduction from his gross income, any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this subsection.

(b) DEFINITION OF EARNED INCOME.—For purposes of this section, the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary or his delegate, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

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(d) CROSS REFERENCE.—

(1) For administrative and penal provisions relating to the exclusion provided for in this section, see sections 6001, 6011, 6012(c), and the other provisions of subtitle F.

(2) For elections as to treatment of income subject to foreign community property laws, see section 981.

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Subpart D—Possessions of the United States

Sec. 931. Income from sources within possessions of the United States.
Sec. 932. Citizens of possessions of the United States.
Sec. 933. Income from sources within Puerto Rico.
Sec. 934. Limitation on reduction in income tax liability incurred to the Virgin Islands.

SEC. 931. INCOME FROM SOURCES WITHIN POSSESSIONS OF THE UNITED STATES.

(a) GENERAL RULE.—In the case of citizens of the United States or domestic corporations, gross income means only gross income from sources within the United States if the conditions of both paragraph (1) and paragraph (2) are satisfied:

(1) THREE-YEAR PERIOD.—If 80 percent or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section) for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be

applicable) was derived from sources within a possession of the United States; and

(2) TRADE OR BUSINESS.—If—

(A) in the case of such corporation, 50 percent or more of its gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

(B) in the case of such citizen, 50 percent or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

(b) AMOUNTS RECEIVED IN UNITED STATES.—Notwithstanding subsection (a), there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States.

(c) DEFINITION.—For purposes of this section, the term "possession of the United States" does not include the Virgin Islands of the United States, and such term when used with respect to citizens of the United States does not include Puerto Rico.

[(d) DEDUCTIONS.—

[(1) Citizens of the United States entitled to the benefits of this section shall have the same deductions as are allowed by section 873 in the case of a nonresident alien individual engaged in trade or business within the United States.

[(2) Domestic corporations entitled to the benefits of this section shall have the same deductions as are allowed by section 882 (c) in the case of a foreign corporation engaged in trade or business within the United States.]

(d) DEDUCTIONS.—

(1) GENERAL RULE.—Except as otherwise provided in this subsection and subsection (e), in the case of persons entitled to the benefits of this section the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in part I, under regulations prescribed by the Secretary or his delegate.

(2) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income from sources within the United States:

(A) The deduction, for losses not connected with the trade or business if incurred in transactions entered into for profit, allowed by section 165(c)(2), but only if the profit, if such transaction had resulted in a profit, would be taxable under this subtitle.

(B) The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property within the United States.

(C) The deduction for charitable contributions and gifts allowed by section 170.

(3) DEDUCTION DISALLOWED.—

For disallowance of standard deduction, see section 142(b)(2).

(e) DEDUCTION FOR PERSONAL EXEMPTION.—A citizen of the United States entitled to the benefits of this section shall be allowed a deduction for only one exemption under section 151.

(f) ALLOWANCE OF DEDUCTIONS AND CREDITS.—Persons entitled to the benefits of this section shall receive the benefit of the deductions and credits allowed to them in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return of their total income received from all sources in the United States, in the manner prescribed in subtitle F, including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits.

(g) FOREIGN TAX CREDIT.—Persons entitled to the benefits of this section shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

(h) INTERNEES.—In the case of a citizen of the United States interned by the enemy while serving as an employee within a possession of the United States—

(1) if such citizen was confined in any place not within a possession of the United States, such place of confinement shall, for purposes of this section, be considered as within a possession of the United States; and

(2) subsection (b) shall not apply to any compensation received within the United States by such citizen attributable to the period of time during which such citizen was interned by the enemy.

(i) EMPLOYEES OF THE UNITED STATES.—For purposes of this section, amounts paid for services performed by a citizen of the United States as an employee of the United States or any agency thereof shall be deemed to be derived from sources within the United States.

SEC. 932. CITIZENS OF POSSESSIONS OF THE UNITED STATES.

(a) GENERAL RULE.—Any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States shall be subject to taxation under this subtitle [only as to income derived from sources within the United States, and in such case the tax shall be computed and paid] in the same manner and subject to the same conditions as in the case of [other persons who are taxable only as to income derived from such sources] *a nonresident alien individual.* This section shall have no application in the case of a citizen of Puerto Rico.

(b) VIRGIN ISLANDS.—Nothing in this section shall be construed to alter or amend the Act entitled "An Act making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes", approved July 12, 1921 (48 U.S.C. 1397), relating to the imposition of income taxes in the Virgin Islands of the United States.

(c) GUAM.—

For applicability of United States income tax laws in Guam, see section 31 of the Act of August 1, 1950 (48 U.S.C. 1421i); for disposition of the proceeds of such taxes, see section 30 of such Act (48 U.S.C. 1421h).

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Subpart F—Controlled Foreign Corporations

Sec. 951. Amounts included in gross income of United States shareholders.
Sec. 952. Subpart F income defined.
Sec. 953. Income from insurance of United States risks.

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SEC. 952. SUBPART F INCOME DEFINED.

(a) IN GENERAL.—For purposes of this subpart, the term "subpart F income" means, in the case of any controlled foreign corporation, the sum of—

(1) the income derived from the insurance of United States risks (as determined under section 953), and

(2) the foreign base company income (as determined under section 954).

[(b) EXCLUSION OF UNITED STATES INCOME.—Subpart F income does not include any item includible in gross income under this chapter (other than this subpart) as income derived from sources within the United States of a foreign corporation engaged in trade or business in the United States.]

(b) EXCLUSION OF UNITED STATES INCOME.—In the case of a controlled foreign corporation, subpart F income does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States.

(c) LIMITATION.—For purposes of subsection (a), the subpart F income of any controlled foreign corporation for any taxable year shall not exceed the earnings and profits of such corporation for such year reduced by the amount (if any) by which—

(1) an amount equal to—

(A) the sum of the deficits in earnings and profits for prior taxable years beginning after December 31, 1962, plus

(B) the sum of the deficits in earnings and profits for taxable years beginning after December 31, 1959, and before January 1, 1963 (reduced by the sum of the earnings and profits for such taxable years); exceeds

(2) an amount equal to the sum of the earnings and profits for prior taxable years beginning after December 31, 1962, allocated to other earnings and profits under section 959(c)(3).

For purposes of the preceding sentence, any deficit in earnings and profits for any prior taxable year shall be taken into account under paragraph (1) for any taxable year only to the extent it has not been taken into account under such paragraph for any preceding taxable year to reduce earnings and profits of such preceding year.

(d) SPECIAL RULE IN CASE OF INDIRECT OWNERSHIP.—For purposes of subsection (c), if—

(1) a United States shareholder owns (within the meaning of section 958(a)) stock of a foreign corporation, and by reason of such ownership owns (within the meaning of such section) stock of any other foreign corporation, and

(2) any of such foreign corporations has a deficit in earnings and profits for the taxable year,

then the earnings and profits for the taxable year of each such foreign corporation which is a controlled foreign corporation shall, with respect to such United States shareholder, be properly reduced to take into account any deficit described in paragraph (2) in such manner as the Secretary or his delegate shall prescribe by regulations.

SEC. 953. INCOME FROM INSURANCE OF UNITED STATES RISKS.

(a) GENERAL RULE.—For purposes of section 952(a)(1), the term "income derived from the insurance of United States risks" means that income which—

(1) is attributable to the reinsurance or the issuing of any insurance or annuity contract—

(A) in connection with property in, or liability arising out of activity in, or in connection with the lives or health of residents of, the United States, or

(B) in connection with risks not included in subparagraph (A) as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect to any reinsurance or the issuing of any insurance or annuity contract in connection with property in, or liability arising out of activity in, or in connection with the lives or health of residents of, the United States, and

(2) would (subject to the modifications provided by paragraphs (1), (2), and (3) of subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance corporation.

This section shall apply only in the case of a controlled foreign corporation which receives, during any taxable year, premiums or other consideration in respect of the reinsurance, and the issuing, of insurance and annuity contracts described in paragraph (1) in excess of 5 percent of the total of premiums and other consideration received during such taxable year in respect of all reinsurance and issuing of insurance and annuity contracts.

(b) SPECIAL RULES.—For purposes of subsection (a)—

(1) In the application of part I of subchapter L, life insurance company taxable income is the gain from operations as defined in section 809(b).

(2) A corporation which would, if it were a domestic insurance corporation, be taxable under part II of subchapter L shall apply subsection (a) as if it were taxable under part III of subchapter L.

(3) The following provisions of subchapter L shall not apply:

(A) Section 809(d)(4) (operations loss deduction).

(B) Section 809(d)(5) (certain nonparticipating contracts).

(C) Section 809(d)(6) (group life, accident, and health insurance).

(D) Section 809(d)(10) (small business deduction).

(E) Section 817(b) (gain on property held on December 31, 1958, and certain substituted property acquired after 1958).

(F) Section [832(b)(5)] *832(c)(5)* (certain capital losses)

(4) The items referred to in—

(A) section 809(c)(1) (relating to gross amount of premiums and other considerations),

(B) section 809(c)(2) (relating to net decrease in reserves),

(C) section 809(d)(2) (relating to net increase on reserves), and

(D) section 832(b)(4) (relating to premiums earned on insurance contracts),

shall be taken into account only to the extent they are in respect of any reinsurance or the issuing of any insurance or annuity contract described in subsection (a)(1).

(5) All items of income, expenses, losses, and deductions (other than those taken into account under paragraph (4)) shall be properly allocated or apportioned under regulations prescribed by the Secretary or his delegate.

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Subpart H—Income of Certain Nonresident United States Citizens Subject to Foreign Community Property Laws

Sec. 981. Election as to treatment of income subject to foreign community property laws.

SEC. 981. ELECTION AS TO TREATMENT OF INCOME SUBJECT TO FOREIGN COMMUNITY PROPERTY LAWS.

(a) GENERAL RULE.—In the case of any taxable year beginning after December 31, 1966, if—

(1) an individual is (A) a citizen of the United States, (B) a bona fide resident of a foreign country or countries during the entire taxable year, and (C) married at the close of the taxable year to a spouse who is a nonresident alien during the entire taxable year, and

(2) such individual and his spouse elect to have subsection (b) apply to their community income under foreign community property laws,

then subsection (b) shall apply to such income of such individual and such spouse for the taxable year and for all subsequent taxable years for which the requirements of paragraph (1) are met, unless the Secretary or his delegate consents to a termination of the election.

(b) TREATMENT OF COMMUNITY INCOME.—For any taxable year to which an election made under subsection (a) applies, the com-

munity income under foreign community property laws of the husband and wife making the election shall be treated as follows:

(1) Earned income (within the meaning of the first sentence of section 911(b)), other than trade or business income and a partner's distributive share of partnership income, shall be treated as the income of the spouse who rendered the personal services.

(2) Trade or business income, and a partner's distributive share of partnership income, shall be treated as provided in section 1402(a)(5).

(3) Community income not described in paragraph (1) or (2) which is derived from the separate property (as determined under the applicable foreign community property law) of one spouse shall be treated as the income of such spouse.

(4) All other such community income shall be treated as provided in the applicable foreign community property law.

(c) ELECTION FOR PRE-1967 YEARS.—

(1) ELECTION.—If an individual meets the requirements of subsection (a)(1)(A) and (C) for any taxable year beginning before January 1, 1967, and if such individual and the spouse referred to in subsection (a)(1)(C) elect under this subsection, then paragraph (2) of this subsection shall apply to their community income under foreign community property laws for all open taxable years beginning before January 1, 1967 (whether under this chapter, the corresponding provisions of the Internal Revenue Code of 1939, or the corresponding provisions of prior revenue laws), for which the requirements of subsection (a)(1)(A) and (C) are met.

(2) EFFECT OF ELECTION.—For any taxable year to which an election made under this subsection applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as provided by subsection (b), except that the other community income described in paragraph (4) of subsection (b) shall be treated as the income of the spouse who, for such taxable year, had gross income under paragraphs (1), (2), and (3) of subsection (b), plus separate gross income, greater than that of the other spouse.

(d) TIME FOR MAKING ELECTIONS; PERIOD OF LIMITATIONS; ETC.—

(1) TIME.—An election under subsection (a) or (c) for a taxable year may be made at any time while such year is still open, and shall be made in such manner as the Secretary or his delegate shall by regulations prescribe.

(2) EXTENSION OF PERIOD FOR ASSESSING DEFICIENCIES AND MAKING REFUNDS.—If any taxable year to which an election under subsection (a) or (c) applies is open at the time such election is made, the period for assessing a deficiency against, and the period for filing claim for credit or refund of any overpayment by, the husband and wife for such taxable year, to the extent such deficiency or overpayment is attributable to such an election, shall not expire before 1 year after the date of such election.

(3) ALIEN SPOUSE NEED NOT JOIN IN SUBSECTION (c) ELECTION IN CERTAIN CASES.—If the Secretary or his delegate determines—

(A) that an election under subsection (c) would not affect the liability for Federal income tax of the spouse referred to in subsection (a)(1)(C) for any taxable year, or

(B) that the effect on such liability for tax cannot be ascertained and that to deny the election to the citizen of the United States would be inequitable and cause undue hardship,

such spouse shall not be required to join in such election, and paragraph (2) of this subsection shall not apply with respect to such spouse.

(4) INTEREST.—To the extent that any overpayment or deficiency for a taxable year is attributable to an election made under this section, no interest shall be allowed or paid for any period before the day which is 1 year after the date of such election.

(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) DEDUCTIONS.—Deductions shall be treated in a manner consistent with the manner provided by this section for the income to which they relate.

(2) OPEN YEARS.—A taxable year of a citizen of the United States and his spouse shall be treated as "open" if the period for assessing a deficiency against such citizen for such year has not expired before the date of the election under subsection (a) or (c), as the case may be.

(3) ELECTIONS IN CASE OF DECEDENTS.—If a husband or wife is deceased, his election under this section may be made by his executor, administrator, or other person charged with his property.

(4) DEATH OF SPOUSE DURING TAXABLE YEAR.—In applying subsection (a)(1)(C), and indetermining under subsection (c)(2) which spouse has the greater income for a taxable year, if a husband or wife dies the taxable year of the surviving spouse shall be treated as ending on the date of such death.

Subchapter P—Capital Gains and Losses

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PART IV—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

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SEC. 1248. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS.

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(d) EXCLUSIONS FROM EARNINGS AND PROFITS.—For purposes of this section, the following amounts shall be excluded, with respect to any United States person, from the earnings and profits of a foreign corporation:

* * * * * * *

(4) UNITED STATES INCOME.—Any item includible in gross income of the foreign corporation under this chapter—

(A) for any taxable year beginning before January 1, 1967, as income derived from sources within the United States of a foreign corporation engaged in trade or business [in] *within* the United States, *or*

(B) for any taxable year beginning after December 31, 1966, as income effectively connected with the conduct by such corporation of a trade or business within the United States. This paragraph shall not apply with respect to any item which is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States.

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SEC. 1249. GAIN FROM CERTAIN SALES OR EXCHANGES OF PATENTS ETC., TO FOREIGN CORPORATIONS.

(a) GENERAL RULE.—[Except as provided in subsection (c), gain] *Gain* from the sale or exchange after December 31, 1962, of a patent, an invention, model, or design (whether or not patented), a copyright, a secret formula or process, or any other similar property right to any foreign corporation by any United States person (as defined in section 7701(a)(30)) which controls such foreign corporation shall, if such gain would (but for the provisions of this subsection) be gain from the sale or exchange of a capital asset or of property described in section 1231, be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

(b) CONTROL.—For purposes of subsection (a), control means, with respect to any foreign corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote. For purposes of this subsection, the rules for determining ownership of stock prescribed by section 958 shall apply.

SEC. 1250. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.

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(d) Exceptions and Limitations.—

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(3) CERTAIN TAX-FREE TRANSACTIONS.—If the basis of property in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371(a), 374(a), 721, or 731, then the amount of gain taken into account by the transferor under subsection (a)(1) shall not exceed the amount of gain recognized to the transferor on the transfer of such property (determined without regard to this section). This paragraph shall not apply to—

(A) a disposition to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter, *or*

(B) a transfer of property by a nonresident alien individual, a foreign estate or trust, or a foreign partnership, to a

domestic corporation in exchange for stock or securities in such corporation in a transaction to which section 351 applies.

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CHAPTER 3—WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS AND TAX-FREE COVENANT BONDS

SUBCHAPTER A. Nonresident aliens and foreign corporations.
SUBCHAPTER B. Tax-free covenant bonds.
SUBCHAPTER C. Application of withholding provisions.

Subchapter A—Nonresident Aliens and Foreign Corporations

Sec. 1441. Withholding of tax on nonresident aliens.
Sec. 1442. Withholding of tax on foreign corporations.
Sec. 1443. Foreign tax-exempt organizations.

SEC. 1441. WITHHOLDING OF TAX ON NONRESIDENT ALIENS.

(a) GENERAL RULE.—Except as otherwise provided in subsection (c), all persons, in whatever capacity acting (including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States) having the control, receipt, custody, disposal, or payment of any of the items of income specified in subsection (b) (to the extent that any of such items constitutes gross income from sources within the United States), of any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens, shall (except in the cases provided for in section 1451 and except as otherwise provided in regulations prescribed by the Secretary or his delegate under section 874) deduct and withhold from such items a tax equal to 30 percent thereof, except that in the case of any item of income specified in the second sentence of subsection (b), the tax shall be equal to 14 percent of such item.

(b) INCOME ITEMS. —The items of income referred to in subsection (a) are interest [(except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States)], dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits and income, [and amounts described in section 402(a)(2), section 403(a)(2), section 631 (b) and (c), and section 1235, which are considered to be gains from the sale or exchange of capital assets.] *and gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), and gains on transfers described in section 1235.* The items of income referred to in subsection (a) from which tax shall be deducted and withheld at the rate of 14 percent are—

(1) that portion of any scholarship or fellowship grant which is received by a nonresident alien individual who is temporarily present in the United States as a nonimmigrant under subpara-

graph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended, and which is not excluded from gross income under section 117(a)(1), solely by reason of section 117(b)(2)(B); and

(2) amounts described in subparagraphs (A), (B), (C), and (D) of section 117(a)(2) which are received by any such nonresident alien individual and which are incident to a scholarship or fellowship grant to which section 117(a)(1) applies, but only to the extent such amounts are includible in gross income.

(c) EXCEPTIONS.—

[(1) DIVIDENDS OF FOREIGN CORPORATIONS.—No deduction or withholding under subsection (a) shall be required in the case of dividends paid by a foreign corporation unless (A) such corporation is engaged in trade or business within the United States, and (B) more than 85 percent of the gross income of such corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under part I of subchapter N of chapter 1.]

(1) INCOME CONNECTED WITH UNITED STATES BUSINESS.—No deduction or withholding under subsection (a) shall be required in the case of any item of income (other than compensation for personal services) which is effectively connected with the conduct of a trade or business within the United States and on which a tax is imposed for the taxable year pursuant to section 871(b)(1).

(2) OWNER UNKNOWN.—The Secretary or his delegate may authorize the tax under subsection (a) to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

(3) BONDS WITH EXTENDED MATURITY DATES.—The deduction and withholding in the case of interest on bonds, mortgages, or deeds of trust or other similar obligations of a corporation, within subsections (a), (b), and (c) of section 1451 were it not for the fact that the maturity date of such obligations has been extended on or after January 1, 1934, and the liability assumed by the debtor exceeds 27½ percent of the interest, shall not exceed the rate of 27½ percent per annum.

(4) COMPENSATION OF CERTAIN ALIENS.—Under regulations prescribed by the Secretary or his delegate, [there] *compensation for personal services* may be exempted from deduction and withholding under subsection (a) [the compensation for personal services of—

[(A) nonresident alien individuals who enter and leave the United States at frequent intervals, and

[(B) a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended].

(5) SPECIAL ITEMS.—In the case of [amounts described in section 402(a)(2), section 403(a)(2), section 631 (b) and (c), and section 1235, which are considered to be gains from the sale or

exchange of capital assets,] *gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), and gains on tranfers described in section 1235*, the amount required to be deducted and withheld shall, if the amount of such gain is not known to the withholding agent, be such amount, not exceeding 30 percent of the [proceeds from such sale or exchange] *amount payable*, as may be necessary to assure that the tax deducted and withheld shall not be less than 30 percent of such gain.

(6) PER DIEM OF CERTAIN ALIENS.—No deduction or withholding under subsection (a) shall be required in the case of amounts of per diem for subsistence paid by the United States Government (directly or by contract) to any nonresident alien individual who is engaged in any program of training in the United States under the Mutual Security Act of 1954, as amended.

(d) ALIEN RESIDENT OF PUERTO RICO.—For purposes of this section, the term "nonresident alien individual" includes an alien resident of Puerto Rico.

SEC. 1442. WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.

(*a*) *GENERAL RULE.*—In the case of foreign corporations subject to taxation under this subtitle [not engaged in trade or business within the United States], there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 or section 1451 a tax equal to 30 percent thereof; except that, in the case of interest described in section 1451 (relating to tax-free covenant bonds), the deduction and withholding shall be at the rate specified therein. *For purposes of the preceding sentence, the reference in section 1441(c)(1) to section 871(b)(1) shall be treated as referring to section 842 or section 882(a), as the case may be.*

(*b*) *EXEMPTION.—Subject to such terms and conditions as may be provided by regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply in the case of a foreign corporation engaged in trade or business within the United States if the Secretary or his delegate determines that the requirements of subsection (a) imposes an undue administrative burden and that the collection of the tax imposed by section 881 on such corporation will not be jeopardized by the exemption.*

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Subchapter C—Application of Withholding Provisions

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SEC. 1461. [RETURN AND PAYMENT OF] *LIABILITY FOR* WITHHELD TAX.

Every person required to deduct and withhold any tax under this chapter [shall, on or before March 15 of each year, make return thereof and pay the tax to the officer designated in section 6151. Every such person] is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this chapter.

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Subtitle B—Estate and Gift Taxes

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CHAPTER 11—ESTATE TAX

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Subchapter A—Estates of Citizens or Residents

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PART I—TAX IMPOSED

Sec. 2001. Rate of tax.
Sec. 2002. Liability for payment.

SEC. 2001. RATE OF TAX.

A tax computed in accordance with the following table is hereby imposed on the transfer of the taxable estate, determined as provided in section 2051, of every decedent, citizen or resident of the United States dying after the date of enactment of this title:

If the taxable estate is:	The tax shall be:
Not over $5,000	3% of the taxable estate.
Over $5,000 but not over $10,000	$150, plus 7% of excess over $5,000.
Over $10,000 but not over $20,000	$500, plus 11% of excess over $10,000.
Over $20,000 but not over $30,000	$1,600, plus 14% of excess over $20,000.
Over $30,000 but not over $40,000	$3,000, plus 18% of excess over $30,000.
Over $40,000 but not over $50,000	$4,800, plus 22% of excess over $40,000.
Over $50,000 but not over $60,000	$7,000, plus 25% of excess over $50,000.
Over $60,000 but not over $100,000	$9,500, plus 28% of excess over $60,000.
Over $100,000 but not over $250,000	$20,700, plus 30% of excess over $100,000.
Over $250,000 but not over $500,000	$65,700, plus 32% of excess over $250,000.
Over $500,000 but not over $750,000	$145,700, plus 35% of excess over $500,000.
Over $750,000 but not over $1,000,000	$233,200, plus 37% of excess over $750,000.
Over $1,000,000 but not over $1,250,000	$325,700, plus 39% of excess over $1,000,000.
Over $1,250,000 but not over $1,500,000	$423,200, plus 42% of excess over $1,250,000.
Over $1,500,000 but not over $2,000,000	$528,200, plus 45% of excess over $1,500,000.
Over $2,000,000 but not over $2,500,000	$753,200, plus 49% of excess over $2,000,000.
Over $2,500,000 but not over $3,000,000	$998,200, plus 53% of excess over $2,500,000.
Over $3,000,000 but not over $3,500,000	$1,263,200, plus 56% of excess over $3,000,000.
Over $3,500,000 but not over $4,000,000	$1,543,200, plus 59% of excess over $3,500,000.

If the taxable estate is—Continued	The tax shall be—Continued
Over $4,000,000 but not over $5,000,000	$1,838,200, plus 63% of excess over $4,000,000.
Over $5,000,000 but not over $6,000,000	$2,468,200, plus 67% of excess over $5,000,000.
Over $6,000,000 but not over $7,000,000	$3,138,200, plus 70% of excess over $6,000,000.
Over $7,000,000 but not over $8,000,000	$3,838,200, plus 73% of excess over $7,000,000.
Over $8,000,000 but not over $10,000,000	$4,568,200, plus 76% of excess over $8,000,000.
Over $10,000,000	$6,088,200, plus 77% of excess over $10,000,000.

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PART II—CREDITS AGAINST TAX

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SEC. 2014. CREDIT FOR FOREIGN DEATH TAXES.

(a) IN GENERAL.—The tax imposed by section 2001 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any foreign country in respect of any property situated within such foreign country and included in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent). [If the decedent at the time of his death was not a citizen of the United States, credit shall not be allowed under this section unless the foreign country of which such decedent was a citizen or subject, in imposing such taxes, allows a similar credit in the case of a citizen of the United States resident in such country.] The determination of the country within which property is situated shall be made in accordance with the rules applicable under subchapter B (sec. 2101 and following) in determining whether property is situated within or without the United States.

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[(h) *SIMILAR CREDIT REQUIRED FOR CERTAIN ALIEN RESIDENTS.—Whenever the President finds that—*

(1) a foreign country, in imposing estate, inheritance, legacy, or succession taxes, does not allow to citizens of the United States resident in such foreign country at the time of death a credit similar to the credit allowed under subsection (a),

(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death, and

(3) it is in the public interest to allow the credit under subsection (a) in the case of citizens or subjects of such foreign country only if it allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death,

the President shall proclaim that, in the case of citizens or subjects of such foreign country dying while the proclamation remains in effect, the credit under subsection (a) shall be allowed only if such foreign country allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death.

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Subchapter B—Estates of Nonresidents Not Citizens

Sec. 2101. Tax imposed.
Sec. 2102. Credits against tax.
Sec. 2103. Definition of gross estate.
Sec. 2104. Property within the United States.
Sec. 2105. Property without the United States.
Sec. 2106. Taxable estate.
Sec. 2107. Expatriation to avoid tax.
Sec. 2108. Application of pre-1967 estate tax provisions.

SEC. 2101. TAX IMPOSED.

[(a) IN GENERAL.—A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States dying after the date of enactment of this title.]

(a) RATE OF TAX.—Except as provided in section 2107, a tax computed in accordance with the following table is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States:

If the taxable estate is:	*The tax shall be:*
Not over $100,000	*5% of the taxable estate.*
Over $100,000 but not over $500,000	*$5,000, plus 10% of excess over $100,000.*
Over $500,000 but not over $1,000,000	*$45,000, plus 15% of excess over $500,000.*
Over $1,000,000 but not over $2,000,000	*$120,000, plus 20% of excess over $1,000,000.*
Over $2,000,000	*$320,000, plus 25% of excess over $2,000,000.*

(b) PROPERTY HELD BY ALIEN PROPERTY CUSTODIAN.—

For taxes in connection with property or interests transferred to or vested in the Alien Property Custodian, see section 36 of the Trading with the Enemy Act, as added by the Act of August 8, 1946 (60 Stat. 929; 50 U.S.C. App. 36).

SEC. 2102. CREDITS AGAINST TAX.

(a) IN GENERAL.—The tax imposed by section 2101 shall be credited with the amounts determined in accordance with sections 2011 to 2013, inclusive (relating to State death taxes, gift tax, and tax on prior transfers), *subject to the special limitation provided in subsection (b).*

(b) SPECIAL LIMITATION.—The maximum credit allowed under section 2011 against the tax imposed by section 2101 for State death taxes paid shall be an amount which bears the same ratio to the credit computed as provided in section 2011(b) as the value of the property, as determined for purposes of this chapter, upon which State death taxes were paid and which is included in the gross estate under section 2103 bears to the value of the total gross estate under section 2103. For purposes of this subsection, the term "State death taxes" means the taxes described in section 2011(a).

SEC. 2103. DEFINITION OF GROSS ESTATE.

For the purpose of the tax imposed by section 2101, the value of the gross estate of every decedent nonresident not a citizen of the United States shall be that part of his gross estate (determined as provided in section 2031) which at the time of his death is situated in the United States.

SEC. 2104. PROPERTY WITHIN THE UNITED STATES.

(a) STOCK IN CORPORATION.—For purposes of this subchapter shares of stock owned and held by a nonresident not a citizen of the United States shall be deemed property within the United States only if issued by a domestic corporation.

(b) REVOCABLE TRANSFERS AND TRANSFERS IN CONTEMPLATION OF DEATH.—For purposes of this subchapter, any property of which the decedent has made a transfer, by trust or otherwise, within the meaning of sections 2035 to 2038, inclusive, shall be deemed to be situated in the United States, if so situated either at the time of the transfer or at the time of the decedent's death.

(c) DEBT OBLIGATIONS.—For purposes of this subchapter, debt obligations of—

(1) a United States person, or

(2) the United States, a State or any political subdivision thereof, or the District of Columbia,

owned by a nonresident not a citizen of the United States shall be deemed property within the United States. This subsection shall not apply to a debt obligation of a domestic corporation if any interest on such obligation, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(B) as income from sources without the United States.

SEC. 2105. PROPERTY WITHOUT THE UNITED STATES.

(a) PROCEEDS OF LIFE INSURANCE.—For purposes of this subchapter, the amount receivable as insurance on the life of a nonresident not a citizen of the United States shall not be deemed property within the United States.

[(b) BANK DEPOSITS.—For purposes of this subchapter, any moneys deposited with any person carrying on the banking business, by or for a nonresident not a citizen of the United States who was not engaged in business in the United States at the time of his death shall not be deemed property within the United States.]

(b) DEPOSITS IN CERTAIN FOREIGN BRANCHES.—For purposes of this subchapter, deposits with a foreign branch of a domestic corporation, if such branch is engaged in the commercial banking business, shall not be deemed property within the United States.

(c) WORKS OF ART ON LOAN FOR EXHIBITION.—For purposes of this subchapter, works of art owned by a nonresident not a citizen of the United States shall not be deemed property within the United States if such works of art are—

(1) imported into the United States solely for exhibition purposes,

(2) loaned for such purposes, to a public gallery or museum, no part of the net earnings of which inures to the benefit of any private stockholder or individual, and

(3) at the time of the death of the owner, on exhibition, or en route to or from exhibition, in such a public gallery or museum.

SEC. 2106. TAXABLE ESTATE.

(a) DEFINITION OF TAXABLE ESTATE.—For purposes of the tax imposed by section 2101, the value of the taxable estate of every decedent nonresident not a citizen of the United States shall be determined by deducting from the value of that part of his gross estate which at the time of his death is situated in the United States—

* * * * * * *

(3) EXEMPTION.—

(A) GENERAL RULE.—An exemption of [$2,000] *$30,000.*

(B) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a "non-resident not a citizen of the United States" under the provisions of section 2209, the exemption shall be the greater of (i) [$2,000] *$30,000*, or (ii) that proportion of the exemption authorized by section 2052 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated.

(b) CONDITION OF ALLOWANCE OF DEDUCTION.—No deduction shall be allowed under paragraphs (1) and (2) of subsection (a) in the case of a nonresident not a citizen of the United States unless the executor includes in the return required to be filed under section 6018 the value at the time of his death of that part of the gross estate of such non-resident not situated in the United States.

(c) UNITED STATES BONDS.—For purposes of section 2103, the value of the gross estate (determined as provided in section 2031) of a decedent who was not engaged in business in the United States at the time of his death—

(1) shall not include obligations issued by the United States before March 1, 1941; and

(2) shall include obligations issued by the United States on or after March 1, 1941.

SEC. 2107. EXPATRIATION TO AVOID TAX.

(a) RATE OF TAX.—A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States dying after the date of enactment of this section, if after March 8, 1965, and within the 10-year period ending with the date of death such decedent lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

(b) GROSS ESTATE.—For purposes of the tax imposed by subsection (a), the value of the gross estate of every decedent to whom subsection (a) applies shall be determined as provided in section 2103, except that—

(1) if such decedent owned (within the meaning of section 958(a)) at the time of his death 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation, and

(2) if such decedent owned (within the meaning of section 958(a)), or is considered to have owned (by applying the ownership rules of section 958(b)), at the time of his death, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of such foreign corporation,

then that proportion of the fair market value of the stock of such foreign corporation owned (within the meaning of section 958(a)) by such decedent at the time of his death, which the fair market value of any assets owned by such foreign corporation and situated in the United States, at the time of his death, bears to the total fair market value of all assets owned by such foreign corporation at the time of his death, shall be included in the gross estate of such decedent. For purposes of the preceding sentence, a decedent shall be treated as owning stock of a foreign corporation at the time of his death if, at the time of a transfer, by trust or otherwise, within the meaning of sections 2035 to 2038, inclusive, he owned such stock.

(c) CREDITS.—The tax imposed by subsection (a) shall be credited with the amounts determined in accordance with section 2102.

(d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to the transfer of the estate of a decedent whose loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487).

(e) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction in the estate, inheritance, legacy, and succession taxes in respect of the transfer of his estate, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on the executor of such individual's estate.

SEC. 2108. APPLICATION OF PRE-1967 ESTATE TAX PROVISIONS.

(a) IMPOSITION OF MORE BURDENSOME TAX BY FOREIGN COUNTRY.—Whenever the President finds that—

(1) under the laws of any foreign country, considering the tax system of such foreign country, a more burdensome tax is imposed by such foreign country on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country,

(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such tax so that it is no more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, and

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(3) it is in the public interest to apply pre-1967 tax provisions in accordance with this section to the transfer of estates of decedents who were residents of such foreign country,

the President shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to amendments made to section 2101 (relating to tax imposed), 2102 (relating to credits against tax), 2106 (relating to taxable estate), and 6018 (relating to estate tax returns) on or after the date of enactment of this section.

(b) ALLEVIATION OF MORE BURDENSOME TAX.—Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that the tax on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country is no longer more burdensome that the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, he shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to subsection (a).

(c) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

(d) IMPLEMENTATION BY REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary or appropriate to implement this section.

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CHAPTER 12—GIFT TAX

Subchapter A. Determination of tax liability.
Subchapter B. Transfers.
Subchapter C. Deductions.

Subchapter A—Determination of Tax Liability

Sec. 2501. Imposition of tax.
Sec. 2502. Rate of tax.
Sec. 2503. Taxable gifts.
Sec. 2504. Taxable gifts for preceding years.

SEC. 2501. IMPOSITION OF TAX.

(a) *TAXABLE TRANSFERS.*—

(1) GENERAL RULE.—For the calendar year 1955 and each calendar year thereafter a tax, computed as provided in section 2502, is hereby imposed on the transfer of property by gift during such calendar year by any individual, resident or nonresident [except transfers].

(2) TRANSFERS OF INTANGIBLE PROPERTY.—Except as provided in paragraph (3), paragraph (1) shall not apply to the transfer of intangible property by a nonresident not a citizen of the United States [who was not engaged in business in the United States during such calendar year].

(3) EXCEPTIONS.—Paragraph (2) shall not apply in the case of a donor who at any time after March 8, 1965, and within the 10-year period ending with the date of transfer lost United States citizenship unless—

(A) such donor's loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401 (b), 1482, or 1487), or

(B) such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

(4) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for paragraph (3), result in a substantial reduction for the calendar year in the taxes on the transfer of property by gift, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on such individual.

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Subchapter B—Transfers

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SEC. 2511. TRANSFERS IN GENERAL.

(a) SCOPE.—Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States.

[(b) STOCK IN CORPORATION.—Shares of stock owned and held by a nonresident not a citizen of the United States shall be deemed property within the United States only if issued by a domestic corporation.]

(b) INTANGIBLE PROPERTY.—For purposes of this chapter, in the case of a nonresident not a citizen of the United States who is excepted from the application of section 2501(a)(2)—

(1) shares of stock issued by a domestic corporation, and

(2) debt obligations of—

(A) a United States person, or

(B) the United States, a State or any political subdivision thereof, or the District of Columbia,

which are owned by such nonresident shall be deemed to be property situated within the United States.

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CHAPTER 24—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

Sec. 3401. Definitions.
Sec. 3402. Income tax collected at source.
Sec. 3403. Liability for tax.
Sec. 3404. Return and payment by governmental employer.

SEC. 3401. DEFINITIONS.

(a) WAGES.—For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include remuneration paid—

* * * * * * *

[(6) for services performed by a nonresident alien individual, other than—

[(A) a resident of a contiguous country who enters and leaves the United States at frequent intervals; or

[(B) a resident of Puerto Rico if such services are performed as an employee of the United States or any agency thereof; or

[(C) an individual who is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended, if such remuneration is exempt, under section 1441(c)(4)(B), from deduction and withholding under section 1441(a), and is not exempt from taxation under section 872(b)(3); or]

[(7)] *(6)* for such services, performed by a nonresident alien individual [who is a resident of a contiguous country and who enters and leaves the United States at frequent intervals], as may be designated by regulations prescribed by the Secretary or his delegate; or

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Subtitle F—Procedure and Administration

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CHAPTER 61—INFORMATION AND RETURNS

Subchapter A—Returns and Records

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PART II—TAX RETURNS OR STATEMENTS

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Subpart B—Income Tax Returns

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SEC. 6015. DECLARATION OF ESTIMATED INCOME TAX BY INDIVIDUALS.

(a) REQUIREMENT OF DECLARATION.—[Every] *Except as otherwise provided in subsection (i), every* individual [(other than a nonresident alien with respect to whose wages, as defined in section 3401(a),

withholding under chapter 24 is not made applicable, but including every alien individual who is a resident of Puerto Rico during the entire taxable year)] shall make a declaration of his estimated tax for the taxable year if—

(1) the gross income for the taxable year can reasonably be expected to exceed—

(A) $5,000, in the case of—

(i) a single individual other than a head of a household (as defined in section 1(b)(2)) or a surviving spouse (as defined in section 2(b));

(ii) a married individual not entitled under subsection (b) to file a joint declaration with his spouse; or

(iii) a married individual entitled under subsection (b) to file a joint declaration with his spouse, but only if the aggregate gross income of such individual and his spouse for the taxable year can reasonably be expected to exceed $10,000; or

(B) $10,000, in the case of—

(i) a head of a household (as defined in section 1(b)(2)); or

(ii) a surviving spouse (as defined in section 2(b)); or

(2) the gross income can reasonably be expected to include more than $200 from sources other than wages (as defined in section 3401(a)).

Notwithstanding the provisions of this subsection, no declaration is required if the estimated tax (as defined in subsection (c)) can reasonably be expected to be less than $40.

* * * * * * *

(i) NONRESIDENT ALIEN INDIVIDUALS.—No declaration shall be required to be made under this section by a nonresident alien individual unless—

(1) withholding under chapter 24 is made applicable to the wages, as defined in section 3401(a), of such individual,

(2) such individual has income (other than compensation for personal services subject to deduction and withholding under section 1441) which is effectively connected with the conduct of a trade or business within the United States, or

(3) such individual is a resident of Puerto Rico during the entire taxable year.

[(i)] (j) APPLICABILITY.—This section shall be applicable only with respect to taxable years beginning after December 31, 1954; and sections 58, 59, and 60 of the Internal Revenue Code of 1939 shall continue in force with respect to taxable years beginning before January 1, 1955.

SEC. 6016. DECLARATIONS OF ESTIMATED INCOME TAX BY CORPORATIONS.

(a) REQUIREMENT OF DECLARATION.—Every corporation subject to taxation under section 11 or 1201 (a), or subchapter L of chapter 1 (relating to insurance companies), shall make a declaration of esti-

mated tax under chapter 1 for the taxable year if its income tax imposed by section 11 or 1201 (a), or such subchapter L, for such taxable year, reduced by the credits against tax provided by part IV of subchapter A of chapter 1, can reasonably be expected to exceed $100,000.

(b) ESTIMATED TAX.—For purposes of this title, in the case of a corporation, the term "estimated tax" means the excess of—

(1) the amount which the corporation estimates as the amount of the income tax imposed by section 11 or 1201 (a), or subchapter L of chapter 1, whichever is applicable, over

(2) the sum of—

(A) $100,000, and

(B) the amount which the corporation estimates as the sum of any credits against tax provided by part IV of subchapter A of chapter 1.

(c) CONTENTS OF DECLARATION.—The declaration shall contain such pertinent information as the Secretary or his delegate may by forms or regulations prescribe.

(d) AMENDMENT OF DECLARATION.—A corporation may make amendments of a declaration filed during the taxable year under regulations prescribed by the Secretary or his delegate.

(e) SHORT TAXABLE YEAR.—A corporation with a taxable year of less than 12 months shall make a declaration in accordance with regulations prescribed by the Secretary or his delegate.

(f) CERTAIN FOREIGN CORPORATIONS.—For purposes of this section and section 6655, in the case of a foreign corporation subject to taxation under section 11 or 1201(a), or under subchapter L of chapter 1, the tax imposed by section 881 shall be treated as a tax imposed by section 11.

[(f)] *(g)* CROSS REFERENCE.—

For provisions relating to the number of amendments which may be filed, see section 6074(b).

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SEC. 6018. ESTATE TAX RETURNS.

(a) RETURNS BY EXECUTOR.—

(1) CITIZENS OR RESIDENTS.—In all cases where the gross estate at the death of a citizen or resident exceeds $60,000, the executor shall make a return with respect to the estate tax imposed by subtitle B.

(2) NONRESIDENTS NOT CITIZENS OF THE UNITED STATES.—In the case of the estate of every nonresident not a citizen of the United States if that part of the gross estate which is situated in the United States exceeds [$2,000] *$30,000*, the executor shall make a return with respect to the estate tax imposed by subtitle B.

(b) RETURNS BY BENEFICIARIES.—If the executor is unable to make a complete return as to any part of the gross estate of the decedent, he shall include in his return a description of such part and the name of every person holding a legal or beneficial interest therein. Upon notice from the Secretary or his delegate such person shall in like manner make a return as to such part of the gross estate.

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CHAPTER 79—DEFINITIONS

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SEC. 7701. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * * * *

(31) FOREIGN ESTATE OR TRUST.—The terms "foreign estate" and "foreign trust" mean an estate or trust, as the case may be, the income of which [from sources without the United States] *from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States*, is not includible in gross income under subtitle A.

* * * * * * *

SECTION 18

HOUSE FLOOR DEBATE

(From the daily Congressional Record)

[P. 12669]

PROVIDING EQUITABLE TAX TREATMENT FOR FOREIGN INVESTMENTS IN THE UNITED STATES

Mr. MADDEN. Mr. Speaker, by direction of the Committee on Rules, I call up the resolution (H. Res. 880) providing for the consideration of H.R. 13103, a bill to amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States, and ask for its immediate consideration.

The Clerk read the resolution, as follows:

H. RES. 880

Resolved, That upon the adoption of this resolution it shall be in order to move that the House resolve itself into the Committee of the Whole House on the State of the Union for the consideration of the bill (H.R. 13103) to amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States, and all points of order against said bill are hereby waived. After general debate, which shall be confined to the bill and shall continue not to exceed three hours, to be equally divided and controlled by the chairman and ranking minority member of the Committee on Ways and Means, the bill shall be considered as having been read for amendment. No amendment shall be in order to said bill except amendments offered by direction of the Committee on Ways and Means, and said amendments shall be in order, any rule of the House to the contrary notwithstanding. Amendments offered by direction of the Committee on Ways and Means may be offered to any section of the bill at the conclusion of the general debate, but said amendments shall not be subject to amendment. At the conclusion of the consideration of the bill for amendment, the Committee shall rise and report the bill to the House with such amendments as may have been adopted, and the previous question shall be considered as ordered on the bill and amendments thereto to final passage without intervening motion except one motion to recommit.

The SPEAKER. The Chair recognizes the gentleman from Indiana [Mr. MADDEN] for 1 hour.

Mr. MADDEN. Mr. Speaker, I yield 30 minutes to the gentleman from California [Mr. SMITH] and pending that yield myself such time as I may require.

[Mr. MADDEN addressed the House. His remarks will appear hereafter in the Appendix.]

(Mr. SMITH of California asked and was given permission to revise and extend his remarks.)

Mr. SMITH of California. Mr. Speaker, I yield myself such time as I may use. As stated by the distinguished gentleman from Indiana, House Resolution 880 provides a 3-hour rule for the consideration of H.R. 13103, the Foreign Investors Tax Act of 1966. It is a closed rule and points of order are waived.

In addition to what the gentleman from Indiana stated, you will find that the committee has listed 23 principal changes in the law and these are summarized in the report on pages 2 through 5.

A key to several changes in the bill is whether income is to be subjected to a flat 30-percent rate or taxed substantially the same as income earned here by a U.S. citizen or domestic corporation. The decision turns on whether or not the income is effectively connected with a U.S. business. If so, it is treated about the same as income from a domestic business. If not, it is subjected to the flat 30-percent rate of taxation, or the lower treaty rate in some cases.

I know of no objection to the rule and have no requests for time.

Mr. MADDEN. Mr. Speaker, I move the previous question.

The previous question was ordered.

The resolution was agreed to.

A motion to reconsider was laid on the table.

[P. 12679]

FOREIGN INVESTORS TAX ACT OF 1966

Mr. MILLS. Mr. Speaker, I move that the House resolve itself into the Committee of the Whole House on the State of the Union for the consideration of the bill (H.R. 13103) to amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States.

The SPEAKER pro tempore. The question is on the motion offered by the gentleman from Arkansas.

The motion was agreed to.

IN THE COMMITTEE OF THE WHOLE

Accordingly, the House resolved itself into the Committee of the Whole House on the State of the Union for the consideration of the bill H.R. 13103, with Mr. MADDEN in the chair.

The Clerk read the title of the bill.

By unanimous consent, the first reading of the bill was dispensed with.

The CHAIRMAN. Under the rule the gentleman from Arkansas [Mr. MILLS] will be recognized for 1½ hours and the gentleman from Wisconsin [Mr. BYRNES] will be recognized for 1½ hours.

The Chair recognizes the gentleman from Arkansas [Mr. MILLS].

Mr. MILLS. Mr. Chairman, I yield myself 10 minutes.

(Mr. MILLS asked and was given permission to revise and extend his remarks.)

Mr. MILLS. Mr. Chairman, the bill H.R. 13103, in my opinion represents a major revision of the U.S. tax laws with reference to the treatment of nonresident

aliens and foreign corporations. It is the first systematic reappraisal in this area of our tax law which has been undertaken, as I remember the record, for approximately 25 years.

Mr. Chairman, although this bill will have only a slight effect on revenue and will not directly affect U.S. citizens or groups, in my opinion it represents a substantial effort on the part of the Committee on Ways and Means.

PURPOSE AND BACKGROUND OF BILL

Mr. Chairman, in October 1963, the President, as a part of his program to improve the U.S. balance of payments appointed a task force on "Promoting Increased Foreign Investment in United States Corporate Securities and Increased Foreign Financing for United States Corporations Operating Abroad." Among the recommendations of the task force were a series of proposals designed to modify the U.S. taxation of foreign investors. The Treasury Department studied the recommendations of the task force, and in March of 1965 submitted to the Congress proposed legislation designed to increase foreign investment in the United States.

Public hearings were held on this legislation during 1965 and again in 1966. During this same period, your committee extensively considered the proposal in executive session on numerous occasions. Your committee concluded that this area of the tax law was in need of change, but your committee altered the primary objective of the legislation suggested by the Treasury Department.

The bill, as modified by your committee, seeks as its primary objective the equitable tax treatment by the United States of nonresident aliens and foreign corporations. While, as I indicated, the initial proposals of the Treasury Department were concerned only with part of the tax provisions of the present law affecting nonresident aliens and foreign corporations—primarily those which could be modified to stimulate investments by foreigners in the United States—your committee considered more broadly the appropriateness of all the provisions of the present law affecting these foreign persons.

REVENUE ESTIMATES

It is expected the bill will result in a revenue gain at current income and investment levels of slightly over $1 million a year. In addition, the provision of the bill under which the Treasury is authorized to require quarterly payments of withheld taxes—instead of annual payments as now provided—is expected to increase collections on a one-shot basis in the fiscal 1967 by $22½ million.

MAJOR PROVISIONS OF THE BILL

Let me now talk about the major provisions of the bill. In this connection I ask unanimous consent, Mr. Chairman, to include at the end of my discussion a summary of these principal provisions of this bill. This summary reduces them, I believe, to as simple terms as it is possible in view of the complexity of the matters involved here.

The CHAIRMAN. Without objection, it is so ordered.

There was no objection.

1. TAXABLE STATUS OF INCOME

Mr. MILLS. Mr. Chairman, the first part of the bill deals with the taxable status of income. Undoubtedly, the most important proposal from the standpoint of tax policy is the amendment which separates the U.S. investment income from the U.S. business income of a nonresident alien or foreign corporation and taxes these two types of income on different bases.

Income of a foreigner derived from a U.S. business is to be taxed substantially in the same manner as if the business income were received by a U.S. citizen or a domestic corporation—that is, at the regular individual or corporate rates with all of the appropriate deductions.

On the other hand, investment income of a nonresident alien or foreign corporation, unless it is related to a U.S. business, is to be taxed at a flat rate of 30 percent or a lesser rate applicable where we have treaties with the foreign countries involved.

Your committee believes this method of taxing nonresident aliens and foreign corporations is more equitable and reasonable than the present law which taxes these persons at the regular rates or a flat 30 percent on their U.S. source income, depending on whether or not they are engaged in trade or business in the United States. In other words, under present law, investment income of a nonresident alien or foreign corporation is taxed at the regular rates, with the attributable reductions, if the recipient is engaged in business in the United States whether or not there is any relationship between the U.S. business and the U.S. investment income.

Additionally, your committee's attention was directed to the fact as a result of the interplay between the tax rules of certain foreign countries and the United States, foreign corporations which carry on substantial business activities in the United States, in some cases, have been able to cast their transactions in a form which may avoid all or most U.S. and foreign taxes on income generated from U.S. business activities. The provisions provided by this legislation will subject certain income generated by the U.S. business activities of these foreign corporations to U.S. tax.

The benchmark used in determining whether or not income is related to a U.S. business and, therefore taxable at regular rates rather than at the flat 30-

percent rate, is whether or not the income is effectively connected with the U.S. business.

In the case of investment and other fixed or determinable income and capital gains from U.S. sources the income is to be treated as effectively connected with the U.S. business if the income is derived from assets used, or held for use, in the conduct of U.S. business or if the activities of the U.S. business were a material factor in the realization of the income. All other types of U.S. source income are to be considered to be effectively connected if there is a U.S. business.

Income from sources without the United States will not be treated as effectively connected with a U.S. business unless the nonresident alien or foreign corporation has a fixed place of business in the United States and the income is attributable to that place of business.

Moreover, even in such cases the only types of foreign source income which may be subject to U.S. tax under the bill are rents or royalties from licensing operations, income from banking and similar type operations, or certain types of sales income. Moreover, neither "Subpart F" income nor dividends, interest or royalties derived from a foreign corporation more than 50 percent owned by the nonresident alien or foreign corporation, will be considered effectively connected under any circumstances.

2. INCOME TAX SOURCE RULES

The bill proposes an amendment with respect to the taxation of the interest paid to nonresident aliens and foreign corporations on their U.S. bank deposits. Presently this type of interest income is subject to U.S. tax only if the foreign recipient is engaged in trade or business in the United States.

Your committee believes that it is questionable whether interest income of this type, which is so clearly derived from U.S. sources, should be treated as though derived from sources without the United States and thereby escape U.S. taxation. At the same time, however, your committee realizes that immediate alteration of the present rule might have an adverse effect upon our balance of payments. To meet these two quite different objectives your commmittee's bill repeals this special foreign source rule, but postpones the repeal until after 1971. At that time your committee will have an opportunity to reconsider any balance of payments problem that then exists.

The bill also provides that as long as bank deposit interest is treated as foreign source income, similar types of interest income are to be given the same treatment.

On the other hand, the present rule with respect to interest paid to nonresident alien individuals or foreign corporations on deposits with foreign branches of U.S. banks would be changed. As amended, this type of interest would be treated as from sources without the United States, and therefore not subject to U.S. tax. Your committee believes that it was appropriate to treat this type of interest as from sources without the United States, since in reality that is what it is. Also it is believed that this amendment was necessary to place these foreign branches of U.S. banks in a competitive position with the other banks in the foreign countries in which they are located.

3. ESTATE TAX PROVISIONS

Another major amendment would modify the United States estate taxation of nonresident aliens. Although the U.S. estates of nonresident aliens are presently subject to the same estate tax rates as citizens or residents, the deductions, exemptions, and credit available to them are substantially less than those allowed to citizens or residents of the United States. Therefore, the estate of a nonresident alien frequently pays a heavier tax on its U.S. assets—and, in some instances, a much heavier tax—than would

[*P. 12681*]

be true in the case of a similar estate of a U.S. citizen or resident. In an effort to more closely equate the taxation of the U.S. estates of nonresident aliens with the estates of U.S. citizens or residents, the bill would establish a new scale of graduated estate tax rates applicable to nonresident aliens, which would tax those estates in an amount which would be generally equivalent to the tax imposed upon an estate of similar value of a U.S. citizen entitled to a martial deduction. Also, the bill would raise the estate tax exemption of nonresident aliens from $2,000 to $30,000.

The present rule, which excludes deposits in U.S. banks from the gross U.S. estate of a nonresident alien, would be amended by this bill so as to include these assets in the gross estate of such a persons since they are includible in the estates of American citizens and residents.

Additionally, as in the case of the income tax amendments in this bill, a new provision is added to the estate tax provisions which excludes the deposits by foreigners in foreign branches of U.S. banks from the U.S. taxable estates of nonresident aliens. This is done for the simple reason that those assets never enter the United States.

4. EXPATRIATION PROVISIONS

The bill also provides an amendment which establishes special tax treatment for U.S. citizens who expatriate in order to avoid U.S. taxes. Your committee considers such an amendment necessary since—although there are undoubtedly few Americans who would avail themselves of such a maneuver—but for this provision, the bill does make such a scheme more advantageous. Therefore,

we wish to foreclose the possibility that this bill would serve as an encouragement to such people. Generally, the expatriation provisions of this bill provide that U.S. source income and the effectively connected income of a citizen received within 5 years after expatriation is to be taxed at the regular U.S. tax rates if a principal purpose of the expatriation was the avoidance of U.S. taxes.

5. OTHER AMENDMENTS

The remaining amendments, which I will not discuss in detail, do not, in my opinion, constitute major changes. In any event I would like to include in the RECORD at this point the summary of the principal changes and previously referred to:

SUMMARY OF PRINCIPAL PROVISIONS

A. TAXATION OF FOREIGN CORPORATIONS

1. The regular corporate income tax is to apply to all income of foreign corporations which is "effectively connected" with a U.S. business. Under present law, the regular corporate rate applies to all U.S. source income of a foreign corporation which is engaged in a trade or business in this country, whether or not the income in question is connected with that business.

2. Income of a foreign corporation which is not "effectively connected" with a U.S. business is to be taxed at a flat 30 percent rate (or lower treaty rate).

3. In general, income is to be treated as "effectively connected" with a U.S. business if the underlying assets were used or held for use in a U.S. business or if the activities of the U.S. business were a material factor in producing the income. Income from foreign sources will be treated as "effectively connected" only in the case of rents and royalties from licensing, certain banking income, and sales income, but only to the extent that this income is not "subpart F" income.

4. Foreign corporations carrying on a life insurance business in the United States are to be taxed as life insurance companies on income "effectively connected" with this U.S. business. Other income from U.S. sources is to be subject to the flat 30 percent rate (or lower treaty rate).

B. TAXATION OF NONRESIDENT ALIENS

1. Investment and other fixed or determinable income of nonresident aliens which is not "effectively connected" with a U.S. business is to be taxed at a flat 30 percent rate (or lower treaty rate). Under present law the regular rates generally apply with respect to this type of income where it is over $21,200.

2. Investment and other fixed or determinable income which is "effectively connected" with a U.S. business is to be taxed at the regular graduated individual rates. For purposes of determining whether the income is "effectively connected" the same rules apply as set forth above with respect to foreign corporations.

3. U.S. source capital gains which are not "effectively connected" with a U.S. business will be taxed to a nonresident alien only if he is in the United States for 183 days or more during the year. Presently capital gains are taxed if the nonresident alien is physically present when the sale is made or if he has been in the United States for 90 days or more during the year. Capital gains which are "effectively connected" with a U.S. business are to be taxed at the regular rates.

C. ESTATE AND GIFT TAX PROVISIONS

1. A separate schedule of estate tax rates is to apply to estates of nonresident aliens. The rates are graduated from 5 percent on the first $100,000 to 25 percent on the excess over $2 million. The exemption is raised from $2,000 to $30,000. These changes accord approximately the same tax treatment in the case of an estate of a nonresident alien as presently applies for a U.S. citizen eligible for the marital deduction.

2. Bonds of a U.S. person or corporation even though owned by foreigners are to be considered property within the United States and, therefore, subject to U.S. estate tax.

3. Bank deposits of nonresident aliens are to be treated as property within the United States and, therefore, subject to U.S. estate tax (except for deposits in foreign branches of U.S. banks).

4. Transfers of intangible property by nonresident aliens are not to be subject to gift tax whether or not they are engaged in a U.S. business.

D. MISCELLANEOUS PROVISIONS

1. Interest on U.S. bank deposits of foreigners is to be taxed after 1971; until then interest on accounts with mutual savings banks, etc., and on deposits with insurance companies are to be treated as foreign source income.

2. The Treasury Department is authorized to require payments of amounts withheld from nonresident aliens and foreign corporations on a quarterly basis.

3. Except in the case of dealers and certain investment companies, trading in stocks or securities in the United States, for one's own account, whether by a foreign investor physically present in the United States, through an employee located here, or through a resident agent (whether or not the agent has discretionary authority) is not to constitute a trade or business in the United States for income tax purposes. A parallel rule is provided for those trading in commodities.

4. U.S. source income and the effectively connected income of a citizen received for 5 years after expatriation is, in most cases, to be taxed at the regular U.S. tax rates if a principal purpose of the expatriation was the avoidance of U.S. income, estate, or gift taxes.

CONCLUSION

In conclusion, I would like to reiterate that this bill was primarily designed to provide equitable tax treatment for nonresident aliens and foreign corporations, treating them generally on a basis which is consistent with the tax treatment of American citizens and domestic corporations. It is believed that this more equitable treatment will, to some extent, encourage foreigners to invest in the United States, but this is not the principal purpose of the legislation before the House.

The bill was reported favorably by the committee. It is supported by the Treasury Department. I therefore urge the Members to support the measure here today.

Mr. GROSS. Mr. Chairman, will the gentleman yield?

Mr. MILLS. I yield to the gentleman from Iowa.

Mr. GROSS. Mr. Chairman, if I understood, did the gentleman say that the exemptions on estates were increased from $2,000 to $60,000?

Mr. MILLS. The exemption is increased from $2,000 to $30,000 to treat them more nearly like U.S. citizens or residents. However, the American citizen is still better off since his exemption is $60,000, instead of $30,000.

Mr. GROSS. That is a tremendous increase.

The next question is: What are the foreigners doing by way of equal treatment for American investors in foreign countries?

Mr. MILLS. Let me say to my friend that most foreign countries do not impose estate taxes on assets of Americans which are located in their countries. Those that do usually impose relatively low rate taxes. In addition we have provisions in this bill which permit the President to raise income or estate taxes with respect to citizens or residents of foreign countries which impose more burdensome taxes on Americans with income or assets from sources within their countries.

Mr. BATTIN. Mr. Chairman, will the gentleman yield?

Mr. MILLS. I yield to the gentleman from Montana.

Mr. BATTIN. Mr. Chairman, it seems to me that during the hearings on this matter it was pointed out that one of the compelling reasons to equate our taxes as we did—at least as recommended in this bill—was to put us more on a par with some of the foreign powers, so as to attract capital—rather than have capital go into their countries—because they receive a fair tax treatment.

Mr. MILLS. The gentleman is entirely correct. However, we also tried to make sure that the foreign country treated our citizens or residents fairly.

Mr. CURTIS. Mr. Chairman, will the gentleman yield?

[*P. 12682*]

Mr. MILLS. I yield to the gentleman from Missouri.

Mr. CURTIS. Mr. Chairman, I simply want to recall that this was a point a number of us made in the executive session with the Treasury Department. We hoped there would be real reciprocity in these tax concessions.

I can assure the gentleman from Iowa that this point was uppermost in the minds of the members of the Ways and Means Committee. I believe most of us were satisfied with the results. Certainly I was satisfied that under the bill we were moving toward more reciprocity.

Mr. MILLS. I think my friend from Missouri would agree that even if we pass this bill, the estate tax we impose on the assets of these foreigners located in the United States would in most cases still be higher, in all probability, than the taxes we impose on our own citizens.

Mr. CURTIS. I agree with the gentleman.

Mr. GROSS. Mr. Chairman, will the gentleman yield?

Mr. MILLS. I yield to the gentleman from Iowa.

Mr. GROSS. I merely used that as an example. I did not mean to confine it to the estate tax.

Mr. MILLS. On the income tax side, too, we will still be taxing foreigners at relatively high rates. Of course, we have treaties with some countries that fix the rate of tax on certain types of income at 15 percent or in some cases at lower rates. Those countries in turn, however, generally apply similar low rates to citizens of the United States deriving income from those countries.

Mr. GROSS. Suppose an alien bought Government securities, such as E or H bonds, or something of that kind, or, as someone suggests, participation certificates under the legislation recently enacted. What would happen under those circumstances? Would he pay tax to this country, or be exempt?

Mr. MILLS. Those are not exempt. They are subject to U.S. tax.

Mr. GROSS. None of them are exempt?

Mr. MILLS. This is interest income developed within the United States, and it is subject to U.S. tax.

If that is all the individual received from U.S. sources or if it is not effectively connected to a U.S. business, he would pay tax on that income at the flat rate of 30 percent or lower applicable treaty rate. An American citizen would be likely to be taxed on similar income at, say, a 14-percent rate or a 20-percent rate, but a nonresident alien would be taxed at 30 percent, unless we had a treaty with his country making it less.

If there were business income—if the individual had a business establishment developing business income in the United States—that business income would be taxed just as any other business income would be taxed in the United States. This would also be true of income effectively connected with this business income.

Mr. GROSS. I thank the gentleman.

Mr. DE LA GARZA. Mr. Chairman, will the gentleman yield?

Mr. MILLS. I yield to the gentleman from Texas.

Mr. DE LA GARZA. I come from the border country, as the gentleman knows. There are commercial banks which derive deposits from both sides of the border, in Mexico and the United States.

A nonresident alien might have a commercial banking account on the U.S. side. Would interest income on that account be touched by this legislation?

Mr. MILLS. If he had a bank account in the United States, until after

1971 interest on this account would not be taxed by the United States. Moreover, interest on deposits in U.S. branches in foreign countries by foreigners will not be taxed under the bill at any time. I should also say that there are no special rules in this bill applicable exclusively to Mexico. Mexico is treated the same as any other foreign country.

Mr. DE LA GARZA. I understand what the bill does, and I am glad it does not tax interest on deposits of Mexican residents in U.S. banks until after 1971. I wish it did not do so after that time. Mexico is a matter of interest to me, since it is close to me.

Mr. MILLS. I understand.

Mr. BYRNES of Wisconsin. Mr. Chairman, I yield myself 5 minutes.

(Mr. BYRNES of Wisconsin asked and was given permission to revise and extend his remarks.)

Mr. BYRNES of Wisconsin. Mr. Chairman, the bill before us deals primarily with the taxation of the income derived from U.S. sources by nonresident aliens, both individuals and foreign corporations. The bill is largely technical in nature. Many of these matters are covered by tax treaty. However, the bill will provide rules to apply in the absence of treaty, and in areas which may not be covered with the foreign country if we have such a treaty.

According to the estimates submitted by the Treasury Department and incorporated in the committee report, you will note that the bill shows a net revenue gain when fully effective of about $1 million.

In order to encourage investment in the United States, the bill seeks to eliminate progressive taxation of nonresident aliens not engaged in a trade or business in the United States and to place a ceiling on the estate tax rates applicable to the investments producing such an income. Added together, these provisions result in a revenue loss of about $3,800,000.

This is largely offset by a provision modifying the rules for taxing the income of foreign life insurance companies doing business in the United States—mainly Canadian—which results in a revenue gain of about $3 million. This change cures an admitted deficiency in existing law in the taxation of foreign life insurance companies.

The bill further provides for the payment on a quarterly basis, or more frequently if the Treasury should elect, of taxes withheld from foreigners. Under present law, such taxes are paid to the Treasury only once each year. As you know, the Treasury has taken steps to have taxes withheld on American citizens paid over to the Treasury twice a month. I see no reason why taxes withheld on nonresident aliens and foreign corporations should not be turned over to the Treasury more often than once each year. If the Treasury collects these taxes quarterly, the provision will raise about $22,500,000 on a "one-shot" basis. In turn, the savings in interest on this amount is estimated at about $1,600,000 annually thereafter.

Under existing law, interest derived by a nonresident alien on bank deposits in the United States is exempt from tax. However, interest on savings and loan deposits or on funds deposited with an insurance company are taxable. Under the bill interest from all three sources is treated in the same manner. Up to December 31, 1971, all such interest would be exempt from tax. After December 31, 1971, all such interest would be taxable in the same manner as any other income derived by nonresident aliens from U.S. sources. When this provision goes into effect, it is estimated that an additional $300,000 in revenue will be realized.

Admittedly, in terms of revenue loss or revenue gain, the bill has only minor significance. The bill is not designed, and is not intended either to grant any tax concession or incentives for investments in the United States or to raise revenues by imposing additional taxes on the income derived from foreign investments in the United States.

After very careful study and review, and extensive hearings, the committee put together this bill primarily to do "equity" to foreign investors. You will note that the bill incorporates some 22 new tax rules dealing with investments from abroad. When taken together, it is hoped that the bill will provide a better climate—and more certainty and clarification—for those from abroad who are presently investing their funds in the United States, as well as new investors from abroad. As far as I know, everyone conversant with this field agrees that the bill is fair and equitable and deserves support.

Mr. BYRNES of Wisconsin. Mr. Chairman, I yield 3 minutes to the gentleman from Missouri [Mr. CURTIS].

Mr. CURTIS. Mr. Chairman, I only take this time to play a pleasant role, because I so often find myself playing an unpleasant role. I wish to say that not only am I in accord with the bill that has been presented here in detail, and it is a very technical bill, the result of considerable work, but also to point out that the procedures followed by the committee, in considering and drafting this bill in my judgment, were exemplary. There were extensive public hearings. To those who are interested in the Congress exercising initiative, I would underline the remarks of the chairman of the committee that when this bill was presented to us it was on a policy of stimulating investments by foreigners in the United States. This

policy was changed substantially so as to make the bill's primary objective the equitable tax treatment by the United States of alien investors vis-a-vis the U.S.

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investor. Undoubtedly this kind of equitable treatment provided in the bill will increase foreign investment in the United States.

The only other observation I have to make relates to the reason I asked the chairman to yield during his presentation. The reciprocity aspect of how foreign countries treat our citizens taxwise was foremost in your committee's mind during our deliberations on this bill. I am satisfied a very fine job was done here. I certainly can commend this bill wholeheartedly for favorable action by the committee of the whole House.

Mr. MILLS. Mr. Chairman, I have no further requests for time.

Mr. BYRNES of Wisconsin. Mr. Chairman, I have no further requests for time.

The CHAIRMAN. Under the rule, the bill is considered as having been read for amendment.

The bill is as follows:

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Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Foreign Investors Tax Act of 1966".

(b) TABLE OF CONTENTS.—

SEC. 1. Short title, etc.
(a) Short title.
(b) Table of contents.
(c) Amendment of 1954 Code.
SEC. 2. Source of income.
(a) Interest.
(b) Dividends.
(c) Personal services.
(d) Definitions.
(e) Effective dates.
SEC. 3. Nonresident alien individuals.
(a) Tax on nonresident alien individuals:
"SEC. 871. Tax on nonresident alien individuals.
"(a) Income not connected with United States business—30 percent tax.
"(b) Income connected with United States business—graduated rate of tax.
"(c) Participants in certain exchange or training programs.
"(d) Election to treat real property income as income connected with United States business.
"(e) Cross references."
(b) Gross income.
(c) Deductions.
(d) Allowance of deductions and credits.
(e) Expatriation to avoid tax:
"SEC. 877. Expatriation to avoid tax.
"(a) In general.
"(b) Alternative tax.
"(c) Special rules of source.
"(d) Exception for loss of citizenship for certain causes.
"(e) Burden of proof."
(f) Partial exclusion of dividends.
(g) Withholding of tax on nonresident aliens.
(h) Liability for withheld tax.
(i) Declaration of estimated income tax by individuals.
(j) Gain from dispositions of certain depreciable realty.
(k) Collection of income tax at source on wages.
(l) Definition of foreign estate or trust.
(m) Conforming amendment.
(n) Effective dates.
SEC. 4. Foreign corporations.
(a) Tax on income not connected with United States business:
"SEC. 881. Income of foreign corporations not connected with United States business.
"(a) Imposition of tax.
"(b) Doubling of tax."
(b) Tax on income connected with United business:
"SEC. 882. Income of foreign corporations connected with United States business.
"(a) Normal tax and surtax.
"(b) Gross income.
"(c) Allowance of deductions and credits.
"(d) Election to treat real property income as income connected with United States business.
"(e) Returns of tax by agent.
"(f) Foreign corporations."
(c) Withholding of tax on foreign corporations.
(d) Dividends received from certain foreign corporations.
(e) Unrelated business taxable income.
(f) Corporations subject to personal holding company tax.
(g) Amendments with respect to foreign corporations carrying on insurance business in United States.
(h) Subpart F income.
(i) Gain from certain sales or exchanges of stock in certain foreign corporations.
(j) Declaration of estimated income tax by corporations.
(k) Technical amendments.
(l) Effective dates.
SEC. 5. Special tax provisions.
(a) Income affected by treaty.
(b) Application of pre-1967 income tax provisions:
"SEC. 896. Application of pre-1967 income tax provisions.
"(a) Imposition of more burdensome taxes by foreign country.
"(b) Alleviation of more burdensome taxes.
"(c) Notification of Congress required.
"(d) Implementation by regulations."
(c) Clerical amendments.
(d) Effective date.
SEC. 6. Foreign tax credit.
(a) Allowance of credit to certain nonresident aliens and foreign corporations.
(b) Alien residents of the United States or Puerto Rico.
SEC. 7. Amendment to preserve existing law on deductions under section 931.
(a) Deductions.
(b) Effective date.

SEC. 8. Estates of nonresidents not citizens.
(a) Rate of tax.
(b) Credits against tax.
(c) Property within the United States.
(d) Property without the United States.
(e) Definition of taxable estate.
(f) Special methods of computing tax:
"SEC. 2107. Expatriation to avoid tax.
"(a) Rate of tax.
"(b) Gross estate.
"(c) Credits.
"(d) Exception for loss of citizenship for certain causes.
"(e) Burden of proof.
"SEC. 2108. Application of pre-1967 estate tax provisions.
"(a) Imposition of more burdensome tax by foreign country.
"(b) Alleviation of more burdensome tax.
"(c) Notification of Congress required.
"(d) Implementation by regulations."
(g) Estate tax returns.
(h) Clerical amendment.
(i) Effective date.
SEC. 9. Tax on gifts of nonresidents not citizens.
(a) Imposition of tax.
(b) Transfers in general.
(c) Effective date.
SEC. 10. Treaty obligations.

(c) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference is to a section or other provision of the Internal Revenue Code of 1954.

SEC. 2. SOURCE OF INCOME.

(a) INTEREST.—

(1)(A) Subparagraph (A) of section 861(a)(1) (relating to interest from sources within the United States) is amended to read as follows:

"(A) interest on amounts described in subsection (c) received by a nonresident alien individual or a foreign corporation, if such interest is not effectively connected with the conduct of a trade or business within the United States,".

(B) Section 861 is amended by adding at the end thereof the following new subsection:

"(c) INTEREST ON DEPOSITS, ETC.—For purposes of subsection (a)(1)(A), the amounts described in this subsection are—

"(1) deposits with persons carrying on the banking business,

"(2) deposits or withdrawable accounts with savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, but only to the extent that amounts paid or credited on such deposits or accounts are deductible under section 591 in computing the taxable income of such institutions, and

"(3) amounts held by an insurance company under an agreement to pay interest thereon.

Effective with respect to amounts paid or credited after December 31, 1971, subsection (a)(1)(A) and this subsection shall cease to apply."

(2) Section 861(a)(1) is amended by striking out "and" at the end of subparagraph (B), by striking out the period at the end of subparagraph (C) and inserting in lieu thereof ", and", and by adding at the end thereof the following new subparagraph:

"(D) interest on deposits with a foreign branch of a domestic corporation, if such branch is engaged in the commercial banking business."

(3)(A) Section 895 (relating to income derived by a foreign central bank of issue from obligations of the United States) is amended—

(i) by striking out "shall not be included" and inserting in lieu thereof ", or from interest on deposits with persons carrying on the banking business, shall not be included";

(ii) by striking out "such obligations" and inserting in lieu thereof "such obligations or deposits";

(iii) by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, the Bank for International Settlements shall be treated as a foreign central bank of issue with respect to interest on deposits with persons carrying on the banking business."; and

(iv) by striking out the heading and inserting in lieu thereof the following:

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"SEC. 895. INCOME DERIVED BY A FOREIGN BANK OF ISSUE FROM OBLIGATIONS OF THE UNITED STATES OR FROM BANK DEPOSITS."

(B) The table of sections for subpart C of part II of subchapter N of chapter 1 is amended by striking out the item relating to section 895 and inserting in lieu thereof the following:

"Sec. 895. Income derived by a foreign central bank of issue from obligations of the United States or from bank deposits."

(b) DIVIDENDS.—

(1) Section 861(a)(2)(B) (relating to dividends from sources within the United States) is amended to read as follows:

"(B) from a foreign corporation unless less than 80 percent of the gross income from all sources of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period which is effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources; but dividends from a foreign corporation shall, for purposes of subpart A of part III (relating to foreign tax credit), be treated as income from sources without the United States to the extent (and only to the extent) exceeding the amount which is 100/85ths of the amount of the deduction allowable under section 245 in respect of such dividends, or".

(2) Section 861(a)(2) is amended by adding after subparagraph (C) the following: "For purposes of subparagraph (B), the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of

a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States."

(c) PERSONAL SERVICES.—Section 861(a)(3)(C)(ii) (relating to income from personal services) is amended to read as follows:

"(ii) an individual who is a citizen or resident of the United States, a domestic partnership, or a domestic corporation, if such labor or services are performed for an office or place of business maintained in a foreign country or in a possession of the United States by such individual, partnership, or corporation."

(d) DEFINITIONS.—Section 864 (relating to definitions) is amended—

(1) by striking out "For purposes of this part," and inserting in lieu thereof

"(a) SALE, ETC.—For purposes of this part,"; and

(2) by adding at the end thereof the following new subsections:

"(b) TRADE OR BUSINESS WITHIN THE UNITED STATES.—For purposes of this part, part II, and chapter 3, the term 'trade or business within the United States' includes the performance of personal services within the United States at any time within the taxable year, but does not include—

"(1) PERFORMANCE OF PERSONAL SERVICES FOR FOREIGN EMPLOYER.—The performance of personal services—

"(A) for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

"(B) for an office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation,

by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000.

"(2) TRADING IN SECURITIES OR COMMODITIES.—

"(A) STOCKS AND SECURITIES.—

"(i) Except in the case of a dealer in stocks or securities, trading in stocks or securities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a corporation (other than a corporation which is, or but for section 542(c)(7) would be, a personal holding company) the principal business of which is trading in stocks or securities for its own account, if its principal office is in the United States.

"(ii) In the case of a person who is a dealer in stocks or securities, trading in stocks or securities for his own account through a resident broker, commission agent, custodian, or other independent agent.

"(B) COMMODITIES.—

"(i) Except in the case of a dealer in commodities, trading in commodities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such agent has discretionary authority to make decisions in effecting the transactions.

"(ii) In the case of a person who is a dealer in commodities, trading in commodities for his own account through a resident broker, commission agent, custodian, or other independent agent.

"(iii) Clauses (i) and (ii) apply only if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place.

"(C) LIMITATION.—Subparagraphs (A)(ii) and (B)(ii) shall apply only if, at no time during the taxable year, the taxpayer has an office or place of business in the United States through which or by the direction of which the transactions in stocks or securities, or in commodities, as the case may be, are effected.

"(c) EFFECTIVELY CONNECTED INCOME, ETC.

"(1) GENERAL RULE.—For purposes of this title—

"(A) In the case of a nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year, the rules set forth in paragraphs (2), (3), and (4) shall apply in determining the income, gain, or loss which shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(B) Except as provided in section 871(d) or section 882(d), in the case of a nonresident alien individual or a foreign corporation not engaged in trade or business within the United States during the taxable year, no income, gain, or loss shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(2) PERIODICAL, ETC., INCOME FROM SOURCES WITHIN UNITED STATES—FACTORS.—In determining whether income from sources within the United States of the types described in section 871(a)(1) or section 881(a), or whether gain or loss from sources within the United States from the sale or exchange of capital assets, is effectively connected with the conduct of a trade or business within the United States, the factors taken into account shall include whether—

"(A) the income, gain, or loss is derived from assets used in or held for use in the conduct of such trade or business, or

"(B) the activities of such trade or business were a material factor in the realization of the income, gain, or loss.

In determining whether an asset is used in or held for use in the conduct of such trade or business or whether the activities of such trade or business were a material factor in realizing an item of income, gain, or loss, due regard shall be given to whether or not such asset or such income, gain, or loss was accounted for through such trade or business. In applying this paragraph and paragraph (4), interest referred to in section 861(a)(1)(A) shall be considered income from sources within the United States.

"(3) OTHER INCOME FORM SOURCES WITHIN UNITED STATES.—All income, gain, or loss from sources within the United States (other than income, gain, or loss to which paragraph (2) applies) shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(4) INCOME FROM SOURCES WITHOUT UNITED STATES.—

"(A) Except as provided in subparagraph (B), no income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(B) Income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States by a nonresident alien individual or a foreign corporation if such person has an office or other fixed place of business within the United States to which such income, gain, or loss is attributable and such income, gain, or loss—

"(i) consists of rents or royalties for the use of or for the privilege of using intangible property described in section 862(a)(4) (including any gain or loss realized on the sale of such property) derived in the active conduct of such trade or business;

"(ii) consists of dividends or interest, or gain or loss from the sale or exchange of stock or notes, bonds, or other evidences of indebtedness, and either is derived in the active conduct of a banking, financing, or similar business within the United States or is received by a corporation the principal business of which is trading in stock or securities for its own account; or

"(iii) is derived from the sale (without the United States) through such office or fixed place of business of personal property described in section 1221(1), except that this clause shall not apply if the property is sold for use, consumption, or disposition outside the United States and an office or other fixed place of business of the taxpayer outside the United States participated materially in such sale.

In the case of a sale described in clause (iii), the income which shall be treated as attributable to the office or other fixed place of business within the United States shall not exceed the income which would be derived from sources within the United States if the sale were made in the United States.

"(C) No income, gain; or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States if it either—

"(i) consists of dividends, interest, or royalties paid by a foreign corporation in which the taxpayer owns (within the meaning of section 958(a)), or is considered as owning (by applying the ownership rules of section 958(b)), more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or

"(ii) is subpart F income within the meaning of section 952(a)."

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(e) EFFECTIVE DATES.—

(1) The amendments made by subsections (a), (c), and (d) shall apply with respect to taxable years beginning after December 31, 1966.

(2) The amendments made by subsection (b) shall apply with respect to amounts received after December 31, 1966.

SEC. 3. NONRESIDENT ALIEN INDIVIDUALS.

(a) TAX ON NONRESIDENT ALIEN INDIVIDUALS.—

(1) Section 871 (relating to tax on nonresident alien individuals) is amended to read as follows:

"SEC. 871. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

"(a) INCOME NOT CONNECTED WITH UNITED STATES BUSINESS—30 PERCENT TAX.—

"(1) INCOME OTHER THAN CAPITAL GAINS.—There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United State by a nonresident alien individual as—

"(A) interest, dividends, rents, salaries wages, premiums, annuities, compensations remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

"(B) gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), and gains on transfers described in section 1235, and

"(C) amounts which under section 341, or under section 1232 (in the case of bonds or other evidences of indebtedness issued after September 28, 1965), are treated as gains from the sale or exchange of property which is not a capital asset,

but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

"(2) CAPITAL GAINS OF ALIENS PRESENT IN THE UNITED STATES 183 DAYS OR MORE.—In the case of a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year, there is hereby imposed for such year a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from the sale or exchange at any time during such year of capital assets exceed his losses, allocable to sources within the United States, from the sale or exchange at any time during such year of capital assets. For purposes of this paragraph, gains and losses shall be taken into account only if, and to the extent that, they would be recognized and taken into account if such gains and losses were effectively connected with the conduct of a trade or business within the United States, except that such gains and losses shall be determined without regard to section 1202 (relating to deduction for capital gains) and such losses shall be determined without the benefits of the capital loss carryover provided in section 1212. Any gain or loss which is taken into account in determining the tax under paragraph (1) or subsection (b) shall not be taken into account in determining the tax under this paragraph. For purposes of the 183-day requirement of this paragraph, a nonresident alien individual not engaged in trade or business within the United States who has not established a taxable year for any prior period shall be treated as having a taxable year which is the calendar year.

"(b) INCOME CONNECTED WITH UNITED STATES BUSINESS—GRADUATED RATE OF TAX.—

"(1) IMPOSITION OF TAX.—A nonresident alien individual engaged in trade or business within the United States during the txable year shall be taxable as provided in section 1 or 1201(b) on his taxable income which is effectively connected with the conduct of a trade or business within the United States.

"(2) DETERMINATION OF TAXABLE INCOME.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

"(c) PARTICIPANTS IN CERTAIN EXCHANGE OR TRAINING PROGRAMS.—For purposes of this section, a nonresident alien individual who (without regard to this subsection) is not engaged in trade or business within the United States and who is temporarily present in the United States as a nonimmigrant under subparargaph (F) or (J) of section 101(a)(15) of the Immigration and Nation-

ality Act, as amended (8 U.S.C. 1101(a)(15)(F) or (J)), shall be treated as a nonresident alien individual engaged in trade or business within the United States, and any income described in section 1441(b)(1) or (2) which is received by such individual shall, to the extent derived from sources within the United States, be treated as effectively connected with the conduct of a trade or business within the United States.

"(d) ELECTION TO TREAT REAL PROPERTY INCOME AS INCOME CONNECTED WITH UNITED STATES BUSINESS.—

"(1) IN GENERAL.—A nonresident alien individual who during the taxable year derives any income—

"(A) from real property located in the United States, or from any interest in such real property, including (i) gains from the sale or exchange of real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631 (b) or (c), and

"(B) which, but for this subsection, would not be treated as income which is effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (b)(1) whether or not such individual is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

"(2) ELECTION AFTER REVOCATION.—If an election has been made under paragraph (1) and such election has been revoked, a new election may not be made under such paragraph for any taxable year before the 5th taxable year which begins after the first taxable year for which such revocation is effective, unless the Secretary or his delegate consents to such new election.

"(3) FORM AND TIME OF ELECTION AND REVOCATION.—An election under paragraph (1), and any revocation of such an election, may be made only in such manner and at such time as the Secretary or his delegate may by regulations prescribe.

"(e) CROSS REFERENCES.—

"(1) For tax treatment of certain amounts distributed by the United States to nonresident alien individuals, see section 402(a)(4).

"(2) For taxation of nonresident alien individuals who are expatriate United States citizens, see section 877.

"(3) For doubling of tax on citizens of certain foreign countries, see section 891.

"(4) For reinstatement of pre-1967 income tax provisions in the case of residents of certain foreign countries, see section 896.

"(5) For withholding of tax at source on nonresident alien individuals, see section 1441.

"(6) For the requirement of making a declaration of estimated tax by certain nonresident alien individuals, see section 6015(i).

"(7) For taxation of gains realized upon certain transfers to domestic corporations, see section 1250(d)(3)."

(2) Section 1 (relating to tax on individuals) is amended by redesignating subsection (d) as subsection (e), and by inserting after subsection (c) the following new subsection:

"(d) NONRESIDENT ALIENS.—In the case of a nonresident alien individual, the tax imposed by subsection (a) shall apply only as provided by section 871 or 877."

(b) GROSS INCOME.—

(1) Subsection (a) of section 872 (relating to gross income of nonresident alien individuals) is amended to read as follows:

"(a) GENERAL RULE.—In the case of a nonresident alien individual, gross income includes only—

"(1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and

"(2) gross income which is effectively connected with the conduct of a trade or business within the United States."

(2) Subparagraph (B) of section 872(b)(3) (relating to compensation of participants in certain exchange or training programs) is amended by striking out "by a domestic corporation" and inserting in lieu thereof "by a domestic corporation, a domestic partnership, or an individual who is a citizen or resident of the United States".

(3) Subsection (b) of section 872 (relating to exclusions from gross income) is amended by adding at the end thereof the following new paragraph:

"(4) BOND INTEREST OF RESIDENTS OF THE RYUKYU ISLANDS OR THE TRUST TERRITORY OF THE PACIFIC ISLANDS.—Income derived by a nonresident alien individual from a series E or series H United States savings bond, if such individual acquired such bond while a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands."

(c) DEDUCTIONS.—

(1) Section 873 (relating to deductions allowed to nonresident alien individuals) is amended to read as follows:

"SEC. 873. DEDUCTIONS.

"(a) GENERAL RULE.—In the case of a nonresident alien individual, the deductions shall be allowed only for purposes of section 871(b) and (except as provided by subsection (b)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary or his delegate.

"(b) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income which is effectively connected with the conduct of a trade or business within the United States:

"(1) LOSSES.—The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property located within the United States.

"(2) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts allowed by section 170.

"(3) PERSONAL EXEMPTION.—The deduction for personal exemptions allowed by section 151, except that in the case of a nonresident alien individual who is not a resident of a contiguous country only one exemption shall be allowed under section 151.

"(c) CROSS REFERENCES.—

"(1) For disallowance of standard deduction, see section 142(b)(1).

(2) Section 154(3) (relating to cross references in respect of deductions for personal exemptions) is amended to read as follows:

"(3) For exemptions of nonresident aliens, see section 873(b)(3)."

(d) ALLOWANCE OF DEDUCTIONS AND CREDITS.—Subsection (a) of section 874 (relating to filing of returns) is amended to read as follows:

"(a) RETURN PREREQUISITE TO ALLOWANCE.—A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return, in the manner prescribed in subtitle F (sec. 6001 and following, relating to procedure and administration), including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. This subsection shall not be construed to deny the credits provided by sections 31 and 32 for tax withheld at source or the credit provided by section 39 for certain uses of gasoline and lubricating oil."

(e) EXPATRIATION TO AVOID TAX.—

(1) Subpart A of part II of subchapter N of chapter 1 (relating to nonresident alien individuals) is amended by redesignating section 877 as section 878, and by inserting after section 876 the following new section:

"SEC. 877. EXPATRIATION TO AVOID TAX.

"(a) IN GENERAL.—Every nonresident alien individual who at any time after March 8, 1965, and within the five-year period immediately preceding the close of the taxable year lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B, shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection exceeds the tax which, without regard to this section, is imposed pursuant to section 871.

"(b) ALTERNATIVE TAX.—A nonresident alien individual described in subsection (a) shall be taxable for the taxable year as provided in section 1 or section 1201(b), except that—

"(1) the gross income shall include only the gross income described in section 872(a) (as modified by subsection (c) of this section), and

"(2) the deductions shall be allowed if and to the extent that they are connected with the gross income included under this section, except that the capital loss carryover provided by section 1212(b) shall not be allowed; and the proper allocation and apportionment of the deductions for this purpose shall be determined as provided under regulations prescribed by the Secretary or his delegate.

For purposes of paragraph (2), the deductions allowed by section 873(b) shall be allowed; and the deduction (for losses not connected with the trade or business if incurred in transactions entered into for profit) allowed by section 165(c)(2) shall be allowed, but only if the profit, if such transaction had resulted in a profit, would be included in gross income under this section.

"(c) SPECIAL RULES OF SOURCE.—For purposes of subsection (b), the following items of gross income shall be treated as income from sources within the United States:

"(1) SALE OF PROPERTY.—Gains on the sale or exchange of property (other than stock or debt obligations) located in the United States.

"(2) STOCK OR DEBT OBLIGATIONS.—Gains on the sale or exchange of stock issued by a domestic corporation or debt obligations of United States persons or of the United States, a State or political subdivision thereof, or the District of Columbia.

"(d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to a non-resident alien individual whose loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487).

"(e) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction for the taxable year in the taxes on his probable income for such year, the burden of proving for such taxable year that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B shall be on such individual."

(2) The table of sections for subpart A of part II of subchapter N of chapter 1 (relating to nonresident alien individuals) is amended by striking out the item relating to section 877 and inserting in lieu thereof the following:

"Sec. 877. Expatriation to avoid tax.
"Sec. 878. Foreign educational, charitable, and certain other exempt organizations."

(f) PARTIAL EXCLUSION OF DIVIDENDS.—Subsection (d) of section 116 (relating to certain nonresident aliens ineligible for exclusion) is amended to read as follows:

"(d) CERTAIN NONRESIDENT ALIENS INELIGIBLE FOR EXCLUSION.—In the case of a nonresident alien individual, subsection (a) shall apply only—

"(1) in determining the tax imposed for the taxable year pursuant to section 871(b)(1) and only in respect of dividends which are effectively connected with the conduct of a trade or business within the United States, or

"(2) in determining the tax imposed for the taxable year pursuant to section 877(b)."

(g) WITHHOLDING OF TAX ON NONRESIDENT ALIENS.—Section 1441 (relating to withholding of tax on nonresident aliens) is amended—

(1) by striking out "(except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States)" in subsection (b);

(2) by striking out "and amounts described in section 402(a)(2)" and all that follows in the first sentence of subsection (b) and inserting in lieu thereof "and gains described in section 402(a)(2), 403(a)(2), or 631(b) or (c), and gains on transfers described in section 1235.";

(3) by striking out paragraph (1) of sub-

section (c) and inserting in lieu thereof the following new paragraph:

"(1) INCOME CONNECTED WITH UNITED STATES BUSINESS.—No deduction or withholding under subsection (a) shall be required in the case of any item of income (other than compensation for personal services) which is effectively connected with the conduct of a trade or business within the United States and on which a tax is imposed for the taxable year pursuant to section 871(b)(1).";

(4) by amending paragraph (4) of subsection (c) to read as follows:

"(4) COMPENSATION OF CERTAIN ALIENS.—Under regulations prescribed by the Secretary or his delegate, compensation for personal services may be exempted from deduction and withholding under subsection (a).";

and

(5) by striking out "amounts described in section 402(a)(2), section 403(a)(2), section 631 (b) and (c), and section 1235, which are considered to be gains from the sale or exchange of capital assets," in paragraph (5) of subsection (c) and inserting in lieu thereof "gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), and gains on transfers described in section 1235,", and by striking out "proceeds from such sale or exchange," in such paragraph and inserting in lieu thereof "amount payable,".

(h) LIABILITY FOR WITHHELD TAX.—Section 1461 (relating to return and payment of witheld tax) is amended to read as follows:

"SEC. 1461. LIABILITY FOR WITHHELD TAX.

"Every person required to deduct and withhold any tax under this chapter is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this chapter."

(i) DECLARATION OF ESTIMATED INCOME TAX BY INDIVIDUALS.—Section 6015 (relating to declaration of estimated income tax by individuals) is amended—

(1) by striking out that portion of subsection (a) which precedes paragraph (1) and inserting in lieu thereof the following:

"(a) REQUIREMENT OF DECLARATION.—Except as otherwise provided in subsection (i), every individual shall make a declaration of his estimated tax for the taxable year if—";

(2) by redesignating subsection (i) as subsection (j); and

(3) by inserting after subsection (h) the following new subsection:

"(i) NONRESIDENT ALIEN INDIVIDUALS.—No declaration shall be required to be made under this section by a nonresident alien individual unless—

"(1) withholding under chapter 24 is made applicable to the wages, as defined in section 3401(a), of such individual,

"(2) such individual has income (other than compensation for personal services subject to deduction and withholding under section 1441) which is effectively connected with the conduct of a trade or business within the United States, or

"(3) such individual is a resident of Puerto Rico during the entire taxable year."

(j) GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.—The second sentence of paragraph (3) of section 1250(d) (relating to certain tax-free transactions) is amended to read as follows: "This paragraph shall not apply to—

"(A) a disposition to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter, or

"(B) a transfer of property by a nonresident alien individual, a foreign estate or trust, or a foreign partnership, to a domestic corporation in exchange for stock or securities in such corporation in a transaction to which section 351 applies."

(k) COLLECTION OF INCOME TAX AT SOURCE ON WAGES.—Subsection (a) of section 3401 (relating to definition of wages for purposes of collection of income tax at source) is amended by striking out paragraphs (6) and (7) and inserting in lieu thereof the following:

"(6) for such services, performed by a nonresident alien individual, as may be designated by regulations prescribed by the Secretary or his delegate; or"

(l) DEFINITION OF FOREIGN ESTATE OR TRUST.—Section 7701(a)(31) (defining foreign estate or trust) is amended by striking out "from sources without the United States" and inserting in lieu thereof ", from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States,".

(m) CONFORMING AMENDMENT.—The first sentence of section 932(a) (relating to citi-

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zens of possessions of the United States) is amended to read as follows: "Any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States shall be subject to taxation under this subtitle in the same manner and subject to the same conditions as in the case of a nonresident alien individual."

(n) EFFECTIVE DATES.—

(1) The amendments made by this section (other than the amendments made by subsections (h) and (k)) shall apply with respect to taxable years beginning after December 31, 1966.

(2) The amendments made by subsection (h) shall apply with respect to payments occuring after December 31, 1966.

(3) The amendments made by subsection (k) shall apply with respect to remuneration paid after December 31, 1966.

SEC. 4. FOREIGN CORPORATIONS.

(a) TAX ON INCOME NOT CONNECTED WITH UNITED STATES BUSINESS.—Section 881 (relating to tax on foreign corporations not engaged in business in the United States) is amended to read as follows:

"SEC. 881. INCOME OF FOREIGN CORPORATIONS NOT CONNECTED WITH UNITED STATES BUSINESS.

"(a) IMPOSITION OF TAX.—There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as—

"(1) interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

"(2) gains described in section 631 (b) or (c), and

"(3) amounts which under section 341, or under section 1232 (in the case of bonds or other evidences of indebtedness issued after September 28, 1965), are treated as gains from the sale or exchange of property which is not a capital asset,

but only to the extent the amount so re-

ceived is not effectively connected with the conduct of a trade or business within the United States.

"(b) DOUBLING OF TAX.—

"For doubling of tax on corporations of certain foreign countries, see section 891."

(b) TAX ON INCOME CONNECTED WITH UNITED STATES BUSINESS.—

(1) Section 822 (relating to tax on resident foreign corporations) is amended to read as follows:

"SEC. 882. INCOME OF FOREIGN CORPORATIONS CONNECTED WITH UNITED STATES BUSINESS.

"(a) NORMAL TAX AND SURTAX.—

"(1) IMPOSITION OF TAX.—A foreign corporation engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 11 or 1201(a) on its taxable income which is effectively connected with the conduct of a trade or business within the United States.

"(2) DETERMINATION OF TAXABLE INCOME.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

"(b) GROSS INCOME.—In the case of a foreign corporation, gross income includes only—

"(1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and

"(2) gross income which is effectively connected with the conduct of a trade or business within the United States.

"(c) ALLOWANCE OF DEDUCTIONS AND CREDITS.—

"(1) ALLOCATION OF DEDUCTIONS.—

"(A) GENERAL RULE.—In the case of a foreign corporation, the deductions shall be allowed only for purposes of subsection (a) and (except as provided by subparagraph (B)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary or his delegate.

"(B) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts provided by section 170 shall be allowed whether or not connected with income which is effectively connected with the conduct of a trade or business within the United States.

"(2) DEDUCTIONS AND CREDITS ALLOWED ONLY IF RETURN FILED.—A foreign corporation shall receive the benefit of the deductions and credits allowed to it in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return, in the manner prescribed in subtitle F, including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. This paragraph shall not be construed to deny the credit provided by section 32 for tax withheld at source or the credit provided by section 39 for certain uses of gasoline and lubricating oil.

"(3) FOREIGN TAX CREDIT.—Except as provided by section 906, foreign corporations shall not be allowed the credit against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

"(4) CROSS REFERENCE.—

"For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1).

"(d) ELECTION TO TREAT REAL PROPERTY INCOME AS INCOME CONNECTED WITH UNITED STATES BUSINESS.—

"(1) IN GENERAL.—A foreign corporation which during the taxable year derives any income—

"(A) from real property located in the United States, or from any interest in such real property, including (i) gains from the sale or exchange of real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631 (b) or (c), and

"(B) which, but for this subsection, would not be treated as income effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

"(2) ELECTION AFTER REVOCATION, ETC.—Paragraphs (2) and (3) of section 871(d) shall apply in respect of elections under this subsection in the same manner and to the same extent as they apply in respect of elections under section 871(d).

"(e) RETURNS OF TAX BY AGENT.—If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return required under section 6012 shall be made by the agent."

(2)(A) Subsection (e) of section 11 (relating to exceptions from tax on corporations) is amended by inserting "or" at the end of paragraph (2), by striking out ", or" at the end of paragraph (3) and inserting a period in lieu thereof, and my striking out paragraph (4).

(B) Section 11 (relating to tax on corporations) is amended by adding at the end thereof the following new subsection:

"(f) FOREIGN CORPORATIONS.—In the case of a foreign corporation, the tax imposed by subsection (a) shall apply only as provided by section 882."

(3) The table of sections for subpart B of part II of subchapter N of chapter 1 is amended by striking out the items relating to sections 881 and 882 and inserting in lieu thereof the following:

"Sec. 881. Income of foreign corporations not connected with United States business.

"Sec. 882. Income of foreign corporations connected with United States business."

(c) WITHOLDING OF TAX ON FOREIGN CORPORATIONS.—Section 1442 (relating to withholding of tax on foreign corporations) is amended to read as follows:

"SEC. 1442. WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.

"(a) GENERAL RULE.—In the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and with-

held at the source in the same manner and on the same items of income as is provided in section 1441 or section 1451 a tax equal to 30 percent thereof; except that, in the case of interest described in section 1451 (relating to tax-free covenant bonds), the deduction and withholding shall be at the rate specified therein. For purposes of the preceding sentence, the reference in section 1441(c)(1) to section 871(b)(1) shall be treated as referring to section 842 or section 882(a), as the case may be.

"(b) EXEMPTION.—Subject to such terms and conditions as may be provided by regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply in the case of a foreign corporation engaged in trade or business within the United States if the Secretary or his delegate determines that the requirements of subsection (a) imposes an undue administrative burden and that the collection of the tax imposed by section 881 on such corporation will not be jeopardized by the exemption."

(d) DIVIDENDS RECEIVED FROM CERTAIN FOREIGN CORPORATIONS.—Subsection (a) of section 245 (relating to the allowance of a deduction in respect of dividends received from a foreign corporation) is amended—

(1) by striking out "and has derived 50 percent or more of its gross income from sources within the United States," in that portion of subsection (a) which precedes paragraph (1) and by inserting in lieu thereof "and if 50 percent or more of the gross income of such corporation from all sources for such period is effectively connected with the conduct of a trade or business within the United States,";

(2) by striking out "from sources within the United States" in paragraph (1) and inserting in lieu thereof "which is effectively connected with the conduct of a trade or business within the United States";

(3) by striking out "from sources within the United States" in paragraph (2) and inserting in lieu thereof ", which is effectively connected with the conduct of a trade or business within the United States,"; and

(4) by adding after paragraph (2) the following new sentence:

"For purposes of this subsection, the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States."

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(e) UNRELATED BUSINESS TAXABLE INCOME.—The last sentence of section 512(a) (relating to definition) is amended to read as follows: "In the case of an organization described in section 511 which is a foreign organization, the unrelated business taxable income shall be its unrelated business taxable income which is effectively connected with the conduct of a trade or business within the United States."

(f) CORPORATIONS SUBJECT TO PERSONAL HOLDING COMPANY TAX.—Paragraph (7) of section 542(c) (relating to corporations not subject to the personal holding company tax) is amended to read as follows:

"(7) a foreign corporation, if all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations;".

(g) AMENDMENTS WITH RESPECT TO FOREIGN CORPORATIONS CARRYING ON INSURANCE BUSINESS IN UNITED STATES.—

(1) Section 842 (relating to computation of gross income) is amended to read as follows:

"SEC. 842. FOREIGN CORPORATIONS CARRYING ON INSURANCE BUSINESS.

"If a foreign corporation carrying on an insurance business within the United States would qualify under part I, II, or III of this subchapter for the taxable year if (without regard to income not effectively connected with the conduct of any trade or business within the United States) it were a domestic corporation, such corporation shall be taxable under such part on its income effectively connected with its conduct of any trade or business within the United States. With respect to the remainder of its income, which is from sources within the United States, such a foreign corporation shall be taxable as provided in section 881."

(2) The table of sections for part IV of subchapter L of chapter 1 is amended by striking out the item relating to section 842 and inserting in lieu thereof the following:

"Sec. 842. Foreign corporations carrying on insurance business."

(3) Section 819 (relating to foreign life insurance companies) is amended—

(A) by striking out subsections (a) and (d) and by redesignating subsections (b) and (c) as subsections (a) and (b),

(B) by striking out "In the case of any company described in subsection (a)," in subsection (a)(1) (as redesignated by subparagraph (A)) and inserting in lieu thereof "In the case of any foreign corporation taxable under this part,",

(C) by striking out "subsection (c)" in the last sentence of subsection (a)(2) (as redesignated by subparagraph (A)) and inserting in lieu thereof "subsection (b)",

(D) by adding at the end of subsection (a) (as redesignated by subparagraph (A)) the following new paragraph:

"(3) REDUCTION OF SECTION 881 TAX.—In the case of any foreign corporation taxable under this part, there shall be determined—

"(A) the amount which would be subject to tax under section 881 if the amount taxable under such section were determined without regard to sections 103 and 894, and

(B) the amount of the reduction provided by paragraph (1).

The tax under section 881 (determined without regard to this paragraph) shall be reduced (but not below zero) by an amount which is the same proportion of such tax as the amount referred to in subparagraph (B) is of the amount referred to in subparagraph (A); but such reduction in tax shall not exceed the increase in tax under this part by reason of the reduction provided by paragraph (1).",

(E) by striking out "for purposes of subsection (a)" each place it appears in subsection (b) (as redesignated by subparagraph (A)) and inserting in lieu thereof "with respect to a foreign corporation",

(F) by striking out "foreign life insurance company" each place it appears in such subsection (b) and inserting in lieu thereof "foreign corporation",

(G) by striking out "subsection (b)(2)(A)" each place it appears in such subsection

(b) and inserting in lieu thereof "subsection (a)(2)(A)",

(H) by striking out "subsection (b)(2)(B)" in paragraph (2)(B)(ii) of such subsection (b) and inserting in lieu thereof "subsection (a)(2)(B)", and

(I) by adding at the end thereof the following new subsection:

"(c) CROSS REFERENCE.—

"For taxation of foreign corporations carrying on life insurance business within the United States, see section 842."

(4) Section 821 (relating to tax on mutual insurance companies to which part II applies) is amended—

(A) by striking out subsection (e) and by redesignating subsections (f) and (g) as subsections (e) and (f), and

(B) by adding at the end of subsection (f) (as redesignated by subparagraph (A)) the following:

"(3) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842."

(5) Section 822 (relating to determination of taxable investment income) is amended by striking out subsection (e) and by redesignating subsection (f) as subsection (e).

(6) Section 831 (relating to tax on certain other insurance companies) is amended—

(A) by striking out subsection (b) and by redesignating subsection (c) as subsection (b), and

(B) by amending subsection (d) to read as follows:

"(c) CROSS REFERENCES.—

"(1) For alternative tax in case of capital gains, see section 1201(a).

"(2) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842."

(7) Section 832 (relating to insurance company taxable income) is amended by striking out subsection (d) and by redesignating subsection (e) as subsection (d).

(8) The second sentence of section 841 (relating to credit for foreign taxes) is amended by striking out "sentence," and inserting in lieu thereof "sentence (and for purposes of applying section 906 with respect to a foreign corporation subject to tax under this subchapter),".

(h) SUBPART F INCOME.—Section 952(b) (relating to exclusion of United States income) is amended to read as follows:

"(b) EXCLUSION OF UNITED STATES INCOME.—In the case of a controlled foreign corporation, subpart F income does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States."

(i) GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS.—Paragraph (4) of section 1248(d) (relating to exclusions from earnings and profits) is amended to read as follows:

"(4) UNITED STATES INCOME.—Any item includible in gross income of the foreign corporation under this chapter—

"(A) for any taxable year beginning before January 1, 1967, as income derived from sources within the United States of a foreign corporation engaged in trade or business within the United States, or

"(B) for any taxable year beginning after December 31, 1966, as income effectively connected with the conduct by such corporation of a trade or business within the United States.

This paragraph shall not apply with respect to any item which is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States."

(j) DECLARATION OF ESTIMATED INCOME TAX BY CORPORATIONS.—Section 6016 (relating to declarations of estimated income tax by corporations) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (c) the following new subsection:

"(f) CERTAIN FOREIGN CORPORATIONS.—For purposes of this section and section 6655, in the case of a foreign corporation subject to taxation under section 11 or 1201(a), or under subchapter L of chapter 1, the tax imposed by section 881 shall be treated as a tax imposed by section 11."

(k) TECHNICAL AMENDMENTS.—

(1) Section 884 is amended to read as follows:

"SEC. 884. CROSS REFERENCES.

"(1) For special provisions relating to unrelated business income of foreign educational, charitable, and certain other exempt organizations, see section 512(a).

"(2) For special provisions relating to foreign corporations carrying on an insurance business within the United States, see section 842.

"(3) For rules applicable in determining whether any foreign corporation is engaged in trade or business within the United States, see section 864(b).

"(4) For reinstatement of pre-1967 income tax provisions in the case of corporations of certain foreign countries, see section 896.

"(5) For allowance of credit against the tax in case of a foreign corporation having income effectively connected with the conduct of a trade or business within the United States, see section 906.

"(6) For withholding at source of tax on income of foreign corporations, see section 1442."

(2) Section 953(b)(3)(F) is amended by striking out "832(b)(5)" and inserting in lieu thereof "832(c)(5)".

(3) Section 1249(a) is amended by striking out "Except as provided in subsection (c), gain" and inserting in lieu thereof "Gain".

(l) EFFECTIVE DATES.—The amendments made by this section (other than subsection (i)) shall apply with respect to taxable years beginning after December 31, 1966. The amendment made by subsection (i) shall apply with respect to sales or exchanges occurring after December 31, 1966.

SEC. 5. SPECIAL TAX PROVISIONS.

(a) INCOME AFFECTED BY TREATY.—Section 894 (relating to income exempt under treaties) is amended to read as follows:

"SEC. 294. INCOME AFFECTED BY TREATY.

"(a) INCOME EXEMPT UNDER TREATY.—Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

"(b) PERMANENT ESTABLISHMENT IN UNITED STATES.—For purposes of applying any exemption from, or reduction of, any tax provided by any treaty to which the United States is a party with respect to income which is not effectively connected with the conduct of a trade or business within the

United States, a nonresident alien individual or a foreign corporation shall be deemed not to have a permanent establishment in the United States at any time during the taxable year. This subsection shall not apply in respect of the tax computed under section 877(b)."

(b) APPLICATION OF PRE-1967 INCOME TAX PROVISIONS.—Subpart C of part II of sub-

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chapter N of chapter 1 (relating to miscellaneous provisions applicable to nonresident aliens and foreign corporations) is amended by adding at the end thereof the following new section:

"SEC. 896. APPLICATION OF PRE-1967 INCOME TAX PROVISIONS.

"(a) IMPOSITION OF MORE BURDENSOME TAXES BY FOREIGN COUNTRY.—Whenever the President finds that—

"(1) under the laws of any foreign country, considering the tax system of such foreign country, citizens of the United States not residents of such foreign country or domestic corporations are being subjected to more burdensome taxes, on any item of income received by such citizens or corporations from sources within such foreign country, than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country.

"(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such taxes so that they are no more burdensome than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country, and

"(3) it is in the public interest to apply pre-1967 tax provisions in accordance with the provisions of this section to residents or corporations of such foreign country,

the President shall proclaim that the tax on such similar income derived from sources within the United States by residents or corporations of such foreign country shall, for taxable years beginning after such proclamation, be determined under this subtitle without regard to amendments made to this subchapter and chapter 3 on or after the date of enactment of this section.

"(b) ALLEVIATION OF MORE BURDENSOME TAXES.—Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that citizens of the United States not residents of such foreign country or domestic corporations are no longer subject to more burdensome taxes on such item of income derived by such citizens or corporations from sources within such foreign country, he shall proclaim that the tax on such similar income derived from sources within the United States by residents or corporations of such foreign country shall, for any taxable year beginning after such proclamation, be determined under this subtitle without regard to subsection (a).

"(c) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

"(d) IMPLEMENTATION BY REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as he deems necessary or appropriate to implement this section."

(c) CLERICAL AMENDMENTS.—The table of sections for subpart C of part II of subchapter N of chapter 1 is amended—

(1) by striking out the item relating to section 894 and inserting in lieu thereof

"Sec. 894. Income affected by treaty.";

(2) by adding at the end of such table the following:

"Sec. 896. Application of pre-1967 income tax provisions."

(d) EFFECTIVE DATE.—The amendments made by this section (other than subsection (e)) shall apply with respect to taxable years beginning after December 31, 1966.

SEC. 6. FOREIGN TAX CREDIT.

(a) ALLOWANCE OF CREDIT TO CERTAIN NONRESIDENT ALIENS AND FOREIGN CORPORATIONS.—

(1) Subpart A of part III of subchapter N of chapter 1 (relating to foreign tax credit) is amended by adding at the end thereof the following new section:

"SEC. 906. NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.

"(a) ALLOWANCE OF CREDIT.—A nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year shall be allowed a credit under section 901 for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year (or deemed, under section 902, paid or accrued during the taxable year) to any foreign country or possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States.

"(b) SPECIAL RULES.—

"(1) For purposes of subsection (a) and for purposes of determining the deductions allowable under sections 873(a) and 882(c), in determining the amount of any tax paid or accrued to any foreign country or possession there shall not be taken into account any amount of tax to the extent the tax so paid or accrued is imposed with respect to income which would not be taxed by such foreign country or possession but for the fact that—

"(A) in the case of a nonresident alien individual, such individual is a citizen or resident of such foreign country or possession, or

"(B) in the case of a foreign corporation, such corporation was created or organized under the law of such foreign country or possession or is domiciled for tax purposes in such country or possession.

"(2) For purposes of subsection (a), in applying section 904 the taxpayer's taxable income shall be treated as consisting only of the taxable income effectively connected with the taxpayer's conduct of a trade or business within the United States.

"(3) The credit allowed pursuant to subsection (a) shall not be allowed against any tax imposed by section 871(a) (relating to income of nonresident alien individual not connected with United States business) or 881 (relating to income of foreign corporations not connected with United States business).

"(4) For purposes of sections 902(a) and 78, a foreign corporation choosing the benefits of this subpart which receives divi-

dends shall, with respect to such dividends, be treated as a domestic corporation."

(2) The table of sections for such subpart A is amended by adding at the end thereof the following:

"Sec. 906. Nonresident alien individuals and foreign corporations."

(3) Section 874(c) is amended by striking out

"(c) FOREIGN TAX CREDIT NOT ALLOWED.—A non-resident" and inserting in lieut thereof the following:

"(c) FOREIGN TAX CREDIT.—Except as provided in section 906, a nonresident."

(4) Subsection (b) of section 901 (relating to amount allowed) is amended by redesignating paragraph (4) as paragraph (5), and by inserting after paragraph (a) the following new paragraph:

"(4) NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.—In the case of any nonresident alien individual not described in section 876 and in the case of any foreign corporation, the amount determined pursuant to section 906; and".

(5) Paragraph (5) (as redesignated) of section 901(b) is amended by striking out "or (3)," and inserting in lieu thereof "(3), or (4),".

(6) The amendments made by this subsection shall apply with respect to taxable years beginning after December 31, 1966. In applying section 904 of the Internal Revenue Code of 1954 with respect to section 906 of such Code, no amount may be carried from or to any taxable year beginning before January 1, 1967, and no such year shall be taken into account.

(b) ALIEN RESIDENTS OF THE UNITED STATES OR PUERTO RICO.—

(1) Paragraph (3) of section 901(b) (relating to amount of foreign tax credit allowed in case of alien resident of the United States or Puerto Rico) is amended by striking out ", if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country".

(2) Section 901 is amended by redesignating subsections (c) and (d) as subsections (d) and (e), and by inserting after subsection (b) the following new subsection:

"(c) SIMILAR CREDIT REQUIRED FOR CERTAIN ALIEN RESIDENTS.—Whenever the President finds that—

"(1) a foreign country, in imposing income, war profits, and excess profits taxes, does not allow to citizens of the United States residing in such foreign country a credit for any such taxes paid or accrued to the United States or any foreign country, as the case may be, similar to the credit allowed under subsection (b)(3),

"(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit to citizens of the United States residing in such foreign country, and

"(3) it is in the public interest to allow the credit under subsection (b)(3) to citizens or subjects of such foreign country only if it allows such a similar credit to citizens of the United States residing in such foreign country.

the President shall proclaim that, for taxable years beginning while the proclamation remains in effect, the credit under subsection (b)(3) shall be allowed to citizens or subjects of such foreign country only if such foreign country, in imposing income, war profits, and excess profits taxes, allows to citizens of the United States residing in such foreign country such a similar credit."

(3) Section 2014 (relating to credit for foreign death taxes) is amended by striking out the second sentence of subsection (a), and by adding at the end of such section the following new subsection:

"(h) SIMILAR CREDIT REQUIRED FOR CERTAIN ALIEN RESIDENTS.—Whenever the President finds that—

"(1) a foreign country, in imposing estate, inheritance, legacy, or succession taxes, does not allow to citizens of the United States resident in such foreign country at the time of death a credit similar to the credit allowed under subsection (a),

"(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death, and

"(3) it is in the public interest to allow the credit under subsection (a) in the case of citizens or subjects of such foreign country only if it allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death,

the President shall proclaim that, in the case of citizens or subjects of such foreign country dying while the proclamation remains in effect, the credit under subsection (a) shall be allowed only if such foreign country al-

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lows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death."

(4) The amendments made by this subsection (other than paragraph (3)) shall apply with respect to taxable years beginning after December 31, 1966. The amendment made by paragraph (3) shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

SEC. 7. AMENDMENT TO PRESERVE EXISTING LAW ON DEDUCTIONS UNDER SECTION 931.

DEDUCTIONS.—Subsection (d) of section 931 (relating to deductions) is amended to read as follows:

"(d) DEDUCTIONS.—

"(1) GENERAL RULE.—Except as otherwise provided in this subsection and subsection (e), in the case of persons entitled to the benefits of this section the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in part I, under regulations prescribed by the Secretary or his delegate.

"(2) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income from sources within the United States:

"(A) The deduction, for losses not connected with the trade or business if incurred in transactions entered into for profit, allowed by section 165(c)(2), but only if the profit, if such transaction had resulted in a profit, would be taxable under this subtitle.

"(B) The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property within the United States.

"(C) The deduction for charitable contributions and gifts allowed by section 170.

"(3) DEDUCTION DISALLOWED.—

"For disallowance of standard deduction, see section 142(b)(2)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to taxable years beginning after December 31, 1966.

SEC. 8. ESTATES OF NONRESIDENTS NOT CITIZENS.

(a) RATE OF TAX.—Subsection (a) of section 2101 (relating to tax imposed in case of estates of nonresidents not citizens) is amended to read as follows:

"(a) RATE OF TAX.—Except as provided in section 2107, a tax computed in accordance with the following table is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States:

"If the taxable estate is:	
Not over $100,000	5% of the taxable estate.
Over $100,000 but not over $500,000	$5,000 plus 10% of excess over $100,000.
Over $500,000 but not over $1,000,000	$45,000, plus 15% of excess over $500,000.
Over $1,000,000 but not over $2,000,000	$120,000, plus 20% of excess over $1,000,000.
Over $2,000,000	$320,000, plus 25% of excess over $2,000,000."

(b) CREDITS AGAINST TAX.—Section 2102 (relating to credits allowed against estate tax) is amended to read as follows:

"SEC. 2102. CREDITS AGAINST TAX.

"(a) IN GENERAL.—The tax imposed by section 2101 shall be credited with the amounts determined in accordance with sections 2011 to 2013, inclusive (relating to State death taxes, gift tax, and tax on prior transfers), subject to the special limitation provided in subsection (b).

"(b) SPECIAL LIMITATION.—The maximum credit allowed under section 2011 against the tax imposed by section 2101 for State death taxes paid shall be an amount which bears the same ratio to the credit computed as provided in section 2011(b) as the value of the property, as determined for purposes of this chapter, upon which State death taxes were paid and which is included in the gross estate under section 2103 bears to the value of the total gross estate under section 2103. For purposes of this subsection, the term 'State death taxes' means the taxes described in section 2011(a)."

(c) PROPERTY WITHIN THE UNITED STATES.—Section 2104 (relating to property within the United States) is amended by adding at the end thereof the following new subsection:

"(c) DEBT OBLIGATIONS.—For purposes of this subchapter, debt obligations of—

"(1) a United States person, or

"(2) the United States, a State or any political subdivision thereof, or the District of Columbia,

owned by a nonresident not a citizen of the United States shall be deemed property within the United States. This subsection shall not apply to a debt obligation of a domestic corporation if any interest on such obligation, were such interest received by the decedent at the time of his death, would be treated under section 862(a)(1) as income from sources without the United States."

(d) PROPERTY WITHOUT THE UNITED STATES.—Subsection (b) of section 2105 (relating to bank deposits) is amended to read as follows:

"(b) DEPOSITS IN CERTAIN FOREIGN BRANCHES.—For purposes of this subchapter, deposits with a foreign branch of a domestic corporation, if such branch is engaged in the commercial banking business, shall not be deemed property within the United States."

(e) DEFINITION OF TAXABLE ESTATE.—Paragraph (3) of section 2106(a) (relating to deduction of exemption from gross estate) is amended to read as follows:

"(3) EXEMPTION.—

"(A) GENERAL RULE.—An exemption of $30,000.

"(B) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a 'nonresident not a citizen of the United States' under the provisions of section 2209, the exemption shall be the greater of (i) $30,000, or (ii) that proportion of the exemption authorized by section 2052 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated."

(f) SPECIAL METHODS OF COMPUTING TAX.—Subchapter B of chapter 11 (relating to estates of nonresidents not citizens) is amended by adding at the end thereof the following new sections:

"SEC 2107. EXPATRIATION TO AVOID TAX.

"(a) RATE OF TAX.—A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States dying after the date of enactment of this section, if after March 8, 1965, and within the 10-year period ending with the date of death such decedent lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

"(b) GROSS ESTATE.—For purposes of the tax imposed by subsection (a), the value of the gross estate of every decendent to whom subsection (a) applies shall be determined as provided in section 2103, except that—

"(1) if such decedent owned (within the meaning of section 958(a)) at the time of his death 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation, and

"(2) if such decedent owned (within the meaning of section 958(a)), or is considered to have owned (by applying the ownership rules of section 958(b)), at the time of his death, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of such foreign corporation, then that proportion of the fair market value of the stock of such foreign corporation owned (within the meaning of section 958(a)) by such decedent at the time of his death, which the fair market value of any assets owned by such foreign corporation and situated in the United States, at the time

of his death, bears to the total fair market value of all assets owned by such foreign corporation at the time of his death, shall be included in the gross estate of such decedent. For purposes of the preceding sentence, a decedent shall be treated as owning stock of a foreign corporation at the time of his death if, at the time of a transfer, by trust or otherwise, within the meaning of sections 2035 to 2038, inclusive, he owned such stock.

"(c) CREDITS.—The tax imposed by subsection (a) shall be credited with the amounts determined in accordance with section 2102.

"(d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to the transfer of the estate of a decedent whose loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401 (b), 1482, or 1487).

"(e) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction in the estate, inheritance, legacy, and succession taxes in respect of the transfer of his estate, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on the executor of such individual's estate.

"SEC. 2108. APPLICATION OF PRE-1967 ESTATE TAX PROVISIONS.

"(a) IMPOSITION OF MORE BURDENSOME TAX BY FOREIGN COUNTRY.—Whenever the President finds that—

"(1) under the laws of any foreign country, considering the tax system of such foreign country, a more burdensome tax is imposed by such foreign country on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country,

"(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such tax so that it is no more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, and

"(3) it is in the public interest to apply pre-1967 tax provisions in accordance with this section to the transfer of estates of decedents who were residents of such foreign country,

the President shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to amendments made to sections 2101 (relating to tax

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imposed), 2102 (relating to credits against tax), and 6018 (relating to estate tax returns) on or after the date of enactment of this section.

"(b) ALLEVIATION OF MORE BURDENSOME TAX.—Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that the tax on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country is no longer more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, he shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to subsection (a).

"(c) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

"(d) IMPLEMENTATION BY REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary or appropriate to implement this section."

(g) ESTATE TAX RETURNS.—Paragraph (2) of section 6018(a) (relating to estates of nonresidents not citizens) is amended by striking out "$2,000" and inserting in lieu thereof "$30,000".

(h) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 11 (relating to estates of nonresidents not citizens) is amended by adding at the end thereof the following:

"Sec. 2107. Expatriation to avoid tax.
"Sec. 2108. Application of pre-1967 estate tax provisions."

(i) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

SEC. 9. TAX ON GIFTS OF NONRESIDENTS NOT CITIZENS.

(a) IMPOSITION OF TAX.—Subsection (a) of section 2501 (relating to general rule for imposition of tax) is amended to read as follows:

"(a) TAXABLE TRANSFERS.—

"(1) GENERAL RULE.—For the calendar year 1955 and each calendar year thereafter a tax, computed as provided in section 2502, is hereby imposed on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

"(2) TRANSFERS OF INTANGIBLE PROPERTY.—Except as provided in paragraph (3), paragraph (1) shall not apply to the transfer of intangible property by a nonresident not a citizen of the United States.

"(3) EXCEPTIONS.—Paragraph (2) shall not apply in the case of a donor who at any time after March 8, 1965, and within the ten-year period ending with the date of transfer lost United States citizenship unless—

"(A) such donor's loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487), or

"(B) such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

"(4) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for paragraph (3), result in a substantial reduction for the calendar year in the taxes on the transfer of property by gift, the burden

of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on such individual."

(b) TRANSFERS IN GENERAL.—Subsection (b) of section 2511 (relating to situs rule for stock in a corporation) is amended to read as follows:

"(b) INTANGIBLE PROPERTY.—For purposes of this chapter, in the case of a nonresident not a citizen of the United States who is excepted from the application of section 2501(a)(2)—

"(1) shares of stock issued by a domestic corporation, and

"(2) debt obligations of—

"(A) a United States person, or

"(B) the United States, a State or any political subdivision thereof, or the District of Columbia,

which are owned by such nonresident shall be deemed to be property situated within the United States."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to the calendar year 1967 and all calendar years thereafter.

SEC. 10. TREATY OBLIGATIONS.

No amendment made by this Act shall apply in any case where its application would be contrary to any treaty obligation of the United States. For purposes of the preceding sentence, the extension of a benefit provided by any amendment made by this Act shall not be deemed to be contrary to a treaty obligation of the United States.

The CHAIRMAN. No amendments to the bill are in order except amendments offered by direction of the Committee on Ways and Means.

Mr. MILLS. Mr. Chairman, permit me to make a unanimous-consent request. There are a number of amendments to this bill developed within the committee. As my friend the gentleman from Wisconsin [Mr. BYRNES] and my friend the gentleman from Missouri [Mr. CURTIS] know, those amendments are printed in the report and they are also printed in the bill as reported by the committee. They are very technical and very numerous. I am going to ask unanimous consent, Mr. Chairman, that these amendments be considered en bloc and that they be considered as read and printed in the RECORD at this point.

The CHAIRMAN. Is there objection to the request of the gentleman from Arkansas?

There was no objection.

The committee amendments are as follows:

Page 14, line 16, strike out "(B)," and insert "(B) and (C),"

Page 16, line 11, insert:

"'(C) In the case of a foreign corporation taxable under part I of subchapter L, any income from sources without the United States which is attributable to its United States business shall be treated as effectively connected with the conduct of a trade or business within the United States."

Page 16, line 17, strike "(C)" and insert "(D)".

Page 17, line 11, after "1966" insert: "; except that in applying section 864(c)(4)(B)(iii) of the Internal Revenue Code of 1954 (as added by subsection (d)) with respect to a binding contract entered into on or before February 24, 1966, activities in the United States on or before such date in negotiating or carrying out such contract shall not be taken into account."

Page 20, line 8, strike "taxable" and insert "taxable".

Page 21, line 14, after "property" insert "held for the production of income and".

Page 21, line 17, after "of" insert "such".

Page 56, line 4, insert:

"(e) ELECTIONS BY NONRESIDENT UNITED STATES CITIZENS WHO ARE SUBJECT TO FOREIGN COMMUNITY PROPERTY LAWS.—

"(1) Part III of subchapter N of chapter 1 (relating to income from sources without the United States) is amended by adding at the end thereof the following new subpart:

"'SUBPART H—INCOME OF CERTAIN NONRESIDENT UNITED STATES CITIZENS SUBJECT TO FOREIGN COMMUNITY PROPERTY LAWS

"'SEC. 981. Elections as to treatment of income subject to foreign community property laws.

"'SEC. 981. ELECTION AS TO TREATMENT OF INCOME SUBJECT TO FOREIGN COMMUNITY PROPERTY LAWS.

"'(a) GENERAL RULE.—In the case of any taxable year beginning after December 31, 1966, if—

"'(1) an individual is (A) a citizen of the United States, (B) a bona fide resident of a foreign country or countries during the entire taxable year, and (C) married at the close of the taxable year to a spouse who is a nonresident alien during the entire taxable year, and

"'(2) such individual and his spouse elect to have subsection (b) apply to their community income under foreign community property laws,

then subsection (b) shall apply to such income of such individual and such spouse for the taxable year and for all subsequent taxable years for which the requirements of paragraph (1) are met, unless the Secretary or his delegate consents to a termination of the election.

"'(b) TREATMENT OF COMMUNITY INCOME.—For any taxable year to which an etlection made under subsection (a) applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as follows:

"'(1) Earned income (within the meaning of the first sentence of section 911(b)), other than trade or business income and a partner's distributive share of partnership income, shall be treated as the income of the spouse who rendered the personal services.

"'(2) Trade or business income, and a partner's distributive share of partnership income, shall be treated as provided in section 1402(a)(5).

"'(3) Community income not described in paragraph (1) or (2) which is derived from the separate property (as determined under the applicable foreign community property law) of one spouse shall be treated as the income of such spouse.

"'(4) All other such community income shall be treated as provided in the applicable foreign community property law.

"'(c) ELECTION FOR PRE-1967 YEARS.—

"'(1) ELECTION.—If an individual meets the requirements of subsection (a)(1) (A) and (C) for any taxable year beginning before January 1, 1967, and if such individual

and the spouse referred to in subsection (a)(1)(C) elect under this subsection, then paragraph (2) of this subsection shall apply to their community income under foreign community property laws for all open taxable years beginning before January 1, 1967 (whether under this chapter, the corresponding provisions of the Internal Revenue Code of 1939, or the corresponding provisions of prior revenue laws), for which the requirements of subsection (a)(1)(A) and (C) are met.

"'(2) EFFECT OF ELECTION.—For any taxable year to which an election made under this subsection applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as provided by subsection (b), except that the other community income described in paragraph (4) of subsection (b)

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shall be treated as the income of the spouse who, for such taxable year, had gross income under paragraphs (1), (2), and (3) of subsection (b), plus separate gross income, greater than that of the other spouse.

"'(d) TIME FOR MAKING ELECTIONS; PERIOD OF LIMITATIONS; ETC.—

"'(1) TIME.—An election under subsection (a) or (c) for a taxable year may be made at any time while such year is still open, and shall be made in such manner as the Secretary or his delegate shall by regulations prescribe.

"'(2) EXTENSION OF PERIOD FOR ASSESSING DEFICIENCIES AND MAKING REFUNDS—If any taxable year to which an election under subsection (a) or (c) applies is open at the time such election is made, the period for assessing a deficiency against, and the period for filing claim for credit or refund of any overpayment by, the husband and wife for such taxable year, to the extent such deficiency or overpayment is attributable to such an election, shall not expire before 1 year after the date of such election.

"'(3) ALIEN SPOUSE NEED NOT JOIN IN SUBSECTION (c) ELECTION IN CERTAIN CASES.—If the Secretary or his delegate determines—

"'(A) that an election under subsection (c) would not affect the liability for Federal income tax of the spouse referred to in subsection (a)(1)(C) for any taxable year, or

"'(B) that the effect on such liability for tax cannot be ascertained and that to deny the election to the citizen of the United States would be inequitable and cause undue hardship,

such spouse shall not be required to join in such election, and paragraph (2) of this subsection shall not apply with respect to such spouse.

"'(4) INTEREST.—To the extent that any overpayment or deficiency for a taxable year is attributable to an election made under this section, no interest shall be allowed or paid for any period before the day which is 1 year after the date of such election.

"'(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"'(1) DEDUCTIONS.—Deductions shall be treated in a manner consistent with the manner provided by this section for the income to which they relate.

"'(2) OPEN YEARS.—A taxable year of a citizen of the United States and his spouse shall be treated as "open" if the period for assessing a deficiency against such citizen for such year has not expired before the date of the election under subsection (a) or (c), as the case may be.

"'(3) ELECTIONS IN CASE OF DECENDENTS.—If a husband or wife is decreased his election under this section may be made by his executor, administrator, or other person charged with his property.

"'(4) DEATH OF SPOUSE DURING TAXABLE YEAR.—In applying subsection (a)(1)(C), and in determining under subsection (c)(2) which spouse has the greater income for a taxable year, if a husband or wife dies the taxable year of the surviving spouse shall be treated as ending on the date of such death.'

"(2) The table of subparts for such part III is amended by adding at the end thereof the following:

"'Subpart H. Income of certain nonresident United States citizens subject to foreign community property laws.'

"(3) Section 911(d) (relating to earned income from sources without the United States) is amended—

"(A) by striking out 'For administrative' and inserting in lieu thereof the following: '(1) For administrative'; and

"(B) by adding at the thereof the following:

"'(2) For elections as to treatment of income subject to foreign community property laws, see section 981.'"

Page 68, line 9, insert:

"(c) FOREIGN TAX CREDIT IN CASE OF CERTAIN OVERSEAS OPERATIONS FUNDING SUBSIDIARIES.—

"(1) Section 904(f)(2) (relating to application of limitations on foreign tax credit in case of certain interest income) is amended—

"(A) by striking out "or" at the end of subparagraph (C),

"(B) by striking out the period at the end of subparagraph (D) and inserting in lieu thereof ", or", and

"(C) by adding at the end thereof the following new subparagraph:

"'(E) received by an oversea operations funding subsidiary on obligations of a related foreign corporation.'

"(2) Section 904(f) is amended by adding at the end thereof the following new paragraph:

"'(5) DEFINITIONS FOR PURPOSES OF PARAGRAPH (1)(E).—For purposes of paragraph (1)(E).—

"'(A) the term "overseas operations funding subsidiary" means a domestic corporation which (i) is a member of an affiliated group (within the meaning of section 1504) and is not the common parent corporation, and (ii) was formed and is availed of for the principal purpose of raising funds outside the United States through public offerings to foreign persons and of using such funds to finance the operations in foreign countries of one or more related foreign corporations, and

"'(B) a foreign corporation is, with respect to an overseas operations funding subsidiary, a related foreign corporation if the affiliated group of which such subsidiary is a member owns 50 percent or more of the voting stock of such foreign corporation either directly or through ownership of the voting stock of another foreign corporation.'

"(3) The amendments made by paragraphs (1) and (2) shall apply to interest received after December 31, 1965, in taxable years ending after such date."

Page 73, line 20, strike "under section 862 (a)(1)" and insert "by reason of section 861 (a)(1)(B)".

Page 78, line 15, after "tax)," insert "2106 (relating to taxable estate),".

The committee amendments were agreed to.

The CHAIRMAN. Under the rule, the Committee rises.

Accordingly, the Committee rose; and the Speaker pro tempore (Mr. ALBERT) having resumed the chair, Mr. MADDEN, Chairman of the Committee of the Whole House on the State of the Union, reported that that Committee, having had under consideration the bill (H.R. 13103) to amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States, pursuant to House Resolution 880, he reported the bill back to the House with sundry amendments adopted by the Committee of the Whole.

The SPEAKER pro tempore. Under the rule, the previous question is ordered.

Is a separate vote demanded on any amendment? If not, the Chair will put them en gros.

The amendments were agreed to.

The SPEAKER pro tempore. The question is on the engrossment and third reading of the bill.

The bill was ordered to be engrossed and read a third time, and was read the third time.

The SPEAKER pro tempore. The question is on the passage of the bill.

The bill was passed.

A motion to reconsider was laid on the table.

SECTION 19

BILL AS PASSED BY THE HOUSE AND REFERRED TO THE SENATE COMMITTEE ON FINANCE

(See Section 21 of this document, page 887)

SECTION 20

PRESS RELEASE OF THE SENATE COMMITTEE ON FINANCE DATED JULY 29, 1966, ANNOUNCING HEARINGS ON FOREIGN INVESTORS TAX ACT OF 1966

PRESS RELEASE

FOR IMMEDIATE RELEASE
JULY 29, 1966

COMMITTEE ON FINANCE
UNITED STATES SENATE
2227 New Senate Office Bldg.
Phone: 225-4515

RUSSELL B. LONG (D., LA.), CHAIRMAN, COMMITTEE ON FINANCE, ANNOUNCES HEARINGS ON FOREIGN INVESTORS TAX ACT OF 1966

Chairman Russell B. Long today announced that the Committee on Finance has scheduled hearings on H. R. 13103, the Foreign Investors Tax Act of 1966.

Hearings on this bill, he said, would begin at 10:00 a.m., Monday, August 8, Room 2221, New Senate Office Building. The Secretary of the Treasury, Henry H. Fowler, is to be the lead-off witness.

Persons desiring to be heard on this important measure should submit requests to Tom Vail, Chief Counsel, Committee on Finance, no later than Friday, August 5.

In order to facilitate the hearing, those with similar interests are urged to designate a single spokesman to present their testimony.

Witnesses who are scheduled to appear are further urged to make their statements as brief as possible to conserve the time of the Committee. In order to further conserve time, the Committee will be pleased to receive from any interested person a written statement for inclusion in the printed record of the hearings in lieu of a personal appearance. These statements will be given the same full consideration as though they had been delivered orally.

All statements should include a summary sheet and subject headings and should be received in the Finance Committee office the day prior to scheduled appearance.

P. R. # 20

SECTION 21

HEARINGS BEFORE THE SENATE COMMITTEE ON FINANCE

FOREIGN INVESTORS TAX ACT OF 1966

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

EIGHTY-NINTH CONGRESS

SECOND SESSION

ON

H.R. 13103

AN ACT TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO PROVIDE EQUITABLE TAX TREATMENT FOR FOREIGN INVESTMENT IN THE UNITED STATES

AUGUST 8, 9, AND 10, 1966

Printed for the use of the Committee on Finance



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1966

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FOREIGN INVESTORS TAX ACT OF 1966

MONDAY, AUGUST 8, 1966

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:10 a.m., in room 2221, New Senate Office Building, Senator Russell B. Long (chairman) presiding.

Present: Senators Long, Anderson, Talmadge, Ribicoff, Williams, Carlson, Curtis, and Dirksen.

The CHAIRMAN. The hearing will come to order.

This morning we begin 3 days of hearings on the Foreign Investors Tax Act of 1966.

In 1963 President Kennedy appointed a task force on promoting increased foreign investment in U.S. corporate securities and increased foreign financing for U.S. corporations operating abroad. It was the hope of the administration that the task force would suggest additional measures to improve the U.S. balance of payments.

The report of the task force in 1964 recommended modifications in the U.S. tax law with regard to foreign investors. Based upon these recommendations legislation was submitted to Congress in 1965. After many months of working on the recommendations, the Ways and Means Committee of the House reported H.R. 13103. It passed the House on June 15. Rather than having as its purpose the encouragement of foreign investment in the United States though, the bill passed by the House is concerned with providing taxation of nonresident aliens and foreign corporations comparable to that of U.S. individuals and corporations.

(The bill, H.R. 13103 follows:)

[H.R. 13103, 89th Cong., 2d sess.]

AN ACT To amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Foreign Investors Tax Act of 1966".

(2) TABLE OF CONTENTS.—

SEC. 1. Short title, etc.
(a) Short title.
(b) Table of contents.
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(b) Dividends.
(c) Personal services.
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(f) Partial exclusion of dividends.
(g) Withholding of tax on nonresident aliens.
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(i) Declaration of estimated income tax by individuals.
(j) Gain from dispositions of certain depreciable realty.
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"SEC. 896. Application of pre-1967 income tax provisions.
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(b) Alien residents of the United States or Puerto Rico.
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(a) Deductions.
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(b) Credits against tax.
(c) Property within the United States.
(d) Property without the United States.
(e) Definition of taxable estate.
(f) Special methods of computing tax:

SEC. 8. Estates of nonresidents not citizens—Continued
(f) Special methods of computing tax—Continued
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SEC. 9. Tax on gifts of nonresidents not citizens.
(a) Imposition of tax.
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(c) Effective date.
SEC. 10. Treaty obligations.

(c) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference is to a section or other provision of the Internal Revenue Code of 1954.

SEC. 2. SOURCE OF INCOME.

(a) INTEREST.—

(1)(A) Subparagraph (A) of section 861(a)(1) (relating to interest from sources within the United States) is amended to read as follows:

"(A) interest on amounts described in subsection (c) received by a nonresident alien individual or a foreign corporation, if such interest is not effectively connected with the conduct of a trade or business within the United States,".

"(c) INTEREST ON DEPOSITS, ETC.—For purposes of subsection (a)(1)(A),

(B) Section 861 is amended by adding at the end thereof the following new subsection:

the amounts described in this subsection are—

"(1) deposits with persons carrying on the banking business,

"(2) deposits or withdrawable accounts with savings institutions chartered and supervised as savings and loan or similar association under Federal or State law, but only to the extent that amounts paid or credited on such deposits or accounts are deductible under section 591 in computing the taxable income of such institutions, and

"(3) amounts held by an insurance company under an agreement to pay interest thereon.

Effective with respect to amounts paid or credited after December 31, 1971, subsection (a)(1)(A) and this subsection shall cease to apply."

(2) Section 861(a)(1) is amended by striking out "and" at the end of subparagraph (B), by striking out the period at the end of subparagraph (C) and inserting in lieu thereof ", and", and by adding at the end thereof the following new subparagraph:

"(D) interest on deposits with a foreign branch of a domestic corporation, if such branch is engaged in the commercial banking business."

(3)(A) Section 895 (relating to income derived by a foreign central bank of issue from obligations of the United States) is amended—

(i) by striking out "shall not be included" and inserting in lieu thereof ", or from interest on deposits with persons carrying on the banking business, shall not be included";

(ii) by striking out "such obligations" and inserting in lieu thereof "such obligations or deposits";

(iii) by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, the Bank for International Settlements shall be treated as a foreign central bank of issue with respect to interest on deposits with persons carrying on the banking business."; and

(iv) by striking out the heading and inserting in lieu thereof the following:

"SEC. 895. INCOME DERIVED BY A FOREIGN CENTRAL BANK OF ISSUE FROM OBLIGATIONS OF THE UNITED STATES OR FROM BANK DEPOSITS."

(B) The table of sections for subpart C of part II of subchapter N of chapter 1 is amended by striking out the item relating to section 895 and inserting in lieu thereof the following:

"Sec. 895. Income derived by a foreign central bank of issue from obligations of the United States or from bank deposits."

(b) DIVIDENDS.—

(1) Section 861(a)(2)(B) (relating to dividends from sources within the United States) is amended to read as follows:

"(B) from a foreign corporation unless less than 80 percent of the gross income from all sources of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States; but only in an amount which bears the same ratio to such dividends as the gross income of the corporation for such period which is effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources; but dividends from a foreign corporation shall, for purposes of subpart A of part III (relating to foreign tax credit), be treated as income from sources without the United States to the extent (and only to the extent) exceeding the amount which is 100/85ths of the amount of the deduction allowable under section 245 in respect of such dividends, or".

(2) Section 861(a)(2) is amended by adding after subparagraph (C) the following:

"For purposes of subparagraph (B), the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States."

(c) PERSONAL SERVICES.—Section 861(a)(3)(C)(ii) (relating to income from personal services) is amended to read as follows:

"(ii) an individual who is a citizen or resident of the United States, a domestic partnership, or a domestic corporation, if such labor or services are performed for an office or place of business maintained in a foreign country or in a possession of the United States by such individual, partnership, or corporation."

(d) DEFINITIONS.—Section 864 (relating to definitions) is amended—

(1) by striking out "For purposes of this part," and inserting in lieu thereof

"(a) SALE, ETC.—For purposes of this part,"; and

(2) by adding at the end thereof the following new subsections:

"(b) TRADE OR BUSINESS WITHIN THE UNITED STATES.—For purposes of this part, part II, and chapter 3, the term 'trade or business within the United States' includes the performance of personal services within the United States at any time within the taxable year, but does not include—

"(1) PERFORMANCE OF PERSONAL SERVICES FOR FOREIGN EMPLOYERS.—The performance of personal services—

"(A) for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or

"(B) for an office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation,

by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000.

"(2) TRADING IN SECURITIES OR COMMODITIES.—

"(A) STOCKS AND SECURITIES.—

"(i) Except in the case of a dealer in stocks or securities, trading in stocks or securities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such agent has discretionary authority to make decesions in effecting the transactions. This clause shall not apply in the case of a corporation (other than a corporation which is, or but for section 542(c)(7) would be, a personal holding company) the principal business of which is trading in stocks or securities for its own account, if its principal office is in the United States.

"(ii) In the case of a person who is a dealer in stocks or securities, trading in stocks or securities for his own account through a resident broker, commission agent, custodian, or other independent agent.

"(B) COMMODITIES.—

"(i) Except in the case of a dealer in commodities, trading in commodities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such agent has discretionary authority to make decisions in effecting the transactions.

"(ii) In the case of a person who is a dealer in commodities, trading in commodities for his own account through a resident broker, commission agent, custodian, or other independent agent.

"(iii) Clauses (i) and (ii) apply only if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place.

"(C) LIMITATION.—Subparagraphs (A)(ii) and (B)(ii) shall apply only if, at no time during the taxable year, the taxpayer has an office or place of business in the United States through which or by the direction of which the transactions in stocks or securities, or in commodities, as the case may be, are effected.

"(c) EFFECTIVELY CONNECTED INCOME, ETC.—

"(1) GENERAL RULE.—For purposes of this title—

"(A) In the case of a nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year, the rules set forth in paragraphs (2), (3), and (4) shall apply in determining the income, gain, or loss which shall be treated as effectively connected with the conduct of a trade or business with the United States.

"(B) Except as provided in section 871(d) or section 882(d), in the case of a nonresident alien individual or a foreign corporation not engaged in trade or business within the United States during the taxable year, no income, gain, or loss shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(2) PERIODICAL, ETC., INCOME FROM SOURCES WITHIN UNITED STATES—FACTORS.—In determining whether income from sources within the United States of the types described in section 871(a)(1) or section 881(a), or whether gain or loss from sources within the United States from the sale or exchange of capital assets, is effectively connected with the conduct of a trade or business within the United States, the factors taken into account shall include whether—

"(A) the income, gain, or loss is derived from assets used in or held for use in the conduct of such trade or business, or

"(B) the activities of such trade or business were a material factor in the realization of the income, gain, or loss.

In determining whether an asset is used in or held for use in the conduct of such trade or business or whether the activities of such trade or business were a material factor in realizing an item of income, gain, or loss, due regard shall be given to whether or not such asset or such income, gain, or loss was accounted for through such trade or business. In applying this paragraph and paragraph (4), interest referred to in section 861(a)(1)(A) shall be considered income from sources within the United States.

"(3) OTHER INCOME FROM SOURCES WITHIN UNITED STATES.—All income, gain, or loss from sources within the United States (other than income, gain, or loss to which paragraph (2) applies) shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(4) INCOME FROM SOURCES WITHOUT UNITED STATES.—

"(A) Except as provided in subparagraph (B) and (C), no income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(B) Income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States by a nonresident alien individual or a foreign corporation if such person has an office or other fixed place of business within the United States to which such income, gain, or loss is attributable and such income, gain, or loss—

"(i) consists of rents or royalties for the use of or for the privilege of using intangible property described in section 862(a)(4) (including any gain or loss realized on the sale of such property) derived in the active conduct of such trade or business;

"(ii) consists of dividends or interest, or gain or loss from the sale or exchange of stock or notes, bonds, or other evidences of indebtedness, and either is derived in the active conduct of a banking, financing, or similar business within the United States or is received by a corporation the principal business of which is trading in stock or securities for its own account; or

"(iii) is derived from the sale (without the United States) through such office or fixed place of business of personal property described in section 1221(1), except that this clause shall not apply if the property is sold for use, consumption, or disposition outside the United States and an office or other fixed place of business of the taxpayer outside the United States participated materially in such sale.

In the case of a sale described in clause (iii), the income which shall be treated as attributable to the office or other fixed place of business within the United States shall not exceed the income which would be derived from sources within the United States if the sale were made in the United States.

"(C) In the case of a foreign corporation taxable under part I of subchapter L, any income from sources without the United States which is attributable to its United States business shall be treated as effectively connected with the conduct of a trade or business within the United States.

"(D) No income, gain, or loss from sources without the United States shall be treated as effectively connected with the conduct of a trade or business within the United States if it either—

"(i) consist of dividends, interest, or royalties paid by a foreign corporation in which the taxpayer owns (within the meaning of section 958(a)), or is considered as owning (by applying the ownership rules of section 958(b)), more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or

"(ii) is subpart F income within the meaning of section 952(a)."

(e) EFFECTIVE DATES.—

(1) The amendments made by subsections (a), (c), and (d) shall apply with respect to taxable years beginning after December 31, 1966; except that in applying section 864(c)(4)(B)(iii) of the Internal Revenue Code of 1954 (as added by subsection (d)) with respect to a binding contract entered into on or before February 24, 1966, activities in the United States on or before such date in negotiating or carrying out such contract shall not be taken into account.

(2) The amendments made by subsection (d) shall apply with respect to amounts received after December 31, 1966.

SEC. 3. NONRESIDENT ALIEN INDIVIDUALS.

(a) TAX ON NONRESIDENT ALIEN INDIVIDUALS.—

(1) Section 871 (relating to tax on nonresident alien individuals) is amended to read as follows:

"SEC. 871. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

"(a) INCOME NOT CONNECTED WITH UNITED STATES BUSINESS—30 PERCENT TAX.—

"(1) INCOME OTHER THAN CAPITAL GAINS.—There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual as—

"(A) interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income,

"(B) gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), and gains on transfers described in section 1235, and

"(C) amounts which under section 341, or under section 1232 (in the case of bonds or other evidences of indebtedness issued after September 28, 1965), are treated as gains from the sale or exchange of property which is not a capital asset,

but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

"(2) CAPITAL GAINS OF ALIENS PRESENT IN THE UNITED STATES 183 DAYS OR MORE.—In the case of a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year, there is hereby imposed for such year a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from the sale or exchange at any time during such year of capital assets exceed his losses, allocable to sources within the United States, from the sale or exchange at any time during such year of capital assets. For purposes of this paragraph, gains and losses shall be taken into account only if, and to the extent that, they would be recognized and taken into account if such gains and losses were effectively connected with the conduct of a trade or business within the United States, except that such gains and losses shall be determined without regard to section 1202 (relating to deduction for capital gains) and such losses shall be determined without the benefits of the capital loss carryover provided in section 1212. Any gain or loss which is taken into account in determining the tax under paragraph (1) or subsection (b) shall not be taken into account in determining the tax under this paragraph. For purposes of the 183-day requirement of this paragraph, a nonresident alien individual not engaged in trade or business within the United States who has not established a taxable year for any prior period shall be treated as having a taxable year which is the calendar year.

"(b) INCOME CONNECTED WITH UNITED STATES BUSINESS—GRADUATED RATE OF TAX.—

"(1) IMPOSITION OF TAX.—A nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 1 or 1201(b) on his taxable income which is effectively connected with the conduct of a trade or business within the United States.

"(2) DETERMINATION OF TAXABLE INCOME.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

"(c) PARTICIPANTS IN CERTAIN EXCHANGE OR TRAINING PROGRAMS—For purposes of this section, a nonresident alien individual who (without regard to this subsection) is not engaged in trade or business within the United States and who is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act, as amended (8 U.S.C. 1101(a)(15) (F) or (J)), shall be treated as a nonresident alien individual engaged in trade or business within the

United States, and any income described in section 1441(b) (1) or (2) which is received by such individual shall, to the extent derived from sources within the United States, be treated as effectively connected with the conduct of a trade or business within the United States.

"(d) ELECTION TO TREAT REAL PROPERTY INCOME AS INCOME CONNECTED WITH UNITED STATES BUSINESS.—

"(1) IN GENERAL.—A nonresident alien individual who during the taxable year derives any income—

"(A) from real property held for the production of income and located in the United States, or from any interest in such real property, including (1) gains from the sale or exchange of such real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631 (b) or (c), and

"(B) which, but for this subsection, would not be treated as income which is effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (b)(1) whether or not such individual is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

"(2) ELECTION AFTER REVOCATION.—If an election has been made under paragraph (1) and such election has been revoked, a new election may not be made under such paragraph for any taxable year before the 5th taxable year which begins after the first taxable year for which such revocation is effective, unless the Secretary or his delegate consents to such new election.

"(3) FORM AND TIME OF ELECTION AND REVOCATION.—An election under paragraph (1), and any revocation of such an election, may be made only in such manner and at such time as the Secretary or his delegate may by regulations prescribe.

"(e) CROSS REFERENCES.—

"(1) For tax treatment of certain amounts distributed by the United States to nonresident alien individuals, see section 402(a)(4).

"(2) For taxation of nonresident alien individuals who are expatriate United States citizens, see section 877.

"(3) For doubling of tax on citizens of certain foreign countries, see section 891.

"(4) For reinstatement of pre-1967 income tax provisions in the case of residents of certain foreign countries, see section 896.

"(5) For withholding of tax at source on nonresident alien individuals, see section 1441.

"(6) For the requirement of making a declaration of estimated tax by certain nonresident alien individuals, see section 6015(i).

"(7) For taxation of gains realized upon certain transfers to domestic corporations, see section 1250(d)(3)."

(2) Section 1 (relating to tax on individuals) is amended by redesignating subsection (d) as subsection (e), and by inserting after subsection (c) the following new subsection:

"(d) NONRESIDENT ALIENS.—In the case of a nonresident alien individual, the tax imposed by subsection (a) shall apply only as provided by section 871 or 877."

(b) GROSS INCOME.—

(1) Subsection (a) of section 872 (relating to gross income of nonresident alien individuals) is amended to read as follows:

"(a) GENERAL RULE.—In the case of a nonresident alien individual, gross income includes only—

"(1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and

"(2) gross income which is effectively connected with the conduct of a trade or business within the United States."

(2) Subparagraph (B) of section 872(b)(3) (relating to compensation of participants in certain exchange or training programs) is amended by striking out "by a domestic corporation" and inserting in lieu thereof "by a

domestic corporation, a domestic partnership, or an individual who is a citizen or resident of the United States".

(3) Subsection (b) of section 872 (relating to exclusions from gross income) is amended by adding at the end thereof the following new paragraph:

"(4) BOND INTEREST OF RESIDENTS OF THE RYUKYU ISLANDS OR THE TRUST TERRITORY OF THE PACIFIC ISLANDS.—Income derived by a nonresident alien individual from a series E or series H United States savings bond, if such individual acquired such bond while a resident of the Ryukyu Islands or the Trust Territory of the Pacific Island."

(c) DEDUCTIONS.—

(1) Section 873 (relating to deductions allowed to nonresident alien individuals) is amended to read as follows:

"SEC. 873. DEDUCTIONS.

"(a) GENERAL RULE.—In the case of a nonresident alien individual, the deductions shall be allowed only for purposes of section 871(b) and (except as provided by subsection (b)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary or his delegate.

"(b) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income which is effectively connected with the conduct of a trade or business within the United States:

"(1) LOSSES.—The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 165(c)(3), but only if the loss is of property located within the United States.

"(2) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts allowed by section 170.

"(3) PERSONAL EXEMPTION.—The deduction for personal exemptions allowed by section 151, except that in the case of a nonresident alien individual who is not a resident of a contiguous country only one exemption shall be allowed under section 151.

"(c) CROSS REFERENCES.—

"(1) For disallowance of standard deduction, see section 142(b)(1).

"(2) For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1)."

(2) Section 154(3) (relating to cross references in respect of deductions for personal exemptions) is amended to read as follows:

"(3) For exemptions of nonresident aliens, see section 873(b)(3)."

(d) ALLOWANCE OF DEDUCTIONS AND CREDITS.—Subsection (a) of section 874 (relating to filing of returns) is amended to read as follows:

"(a) RETURN PREREQUISITE TO ALLOWANCE.—A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return, in the manner prescribed in subtitle F (sec. 6001 and following, relating to procedure and administration), including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. This subsection shall not be construed to deny the credits provided by sections 31 and 32 for tax withheld at source or the credit provided by section 39 for certain uses of gasoline and lubricating oil."

(e) EXPATRIATION TO AVOID TAX.—

(1) Subpart A of part II of subchapter N of chapter 1 (relating to nonresident alien individuals) is amended by redesignating section 877 as section 878, and by inserting after section 876 the following new section:

"SEC. 877. EXPATRIATION TO AVOID TAX.

"(a) IN GENERAL.—Every nonresident alien individual who at any time after March 8, 1965, and within the 5-year period immediately preceding the close of the taxable year lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B, shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection exceeds the tax which, without regard to this section, is imposed pursuant to section 871.

"(b) ALTERNATIVE TAX.—A nonresident alien individual described in subsection (a) shall be taxable for the taxable year as provided in section 1 or section 1201(b), except that—

"(1) the gross income shall include only the gross income described in section 872(a) (as modified by subsection (c) of this section), and

"(2) the deductions shall be allowed if and to the extent that they are connected with the gross income included under this section, except that the capital loss carryover provided by section 1212(b) shall not be allowed; and the proper allocation and apportionment of the deductions for this purpose shall be determined as provided under regulations prescribed by the Secretary or his delegate.

For purposes of paragraph (2), the deductions allowed by section 873(b) shall be allowed; and the deduction (for losses not connected with the trade or business if incurred in transactions entered into for profit) allowed by section 165(c)(2) shall be allowed, but only if the profit, if such transaction had resulted in a profit, would be included in gross income under this section.

"(c) SPECIAL RULES OF SOURCE.—For purposes of subsection (b), the following items of gross income shall be treated as income from sources within the United States:

"(1) SALE OF PROPERTY.—Gains on the sale or exchange of property (other than stock or debt obligations) located in the United States.

"(2) STOCK OF DEBT OBLIGATIONS.—Gains on the sale or exchange of stock issued by a domestic corporation or debt obligations of United States persons or of the United States, a State or political subdivision thereof, or the District of Columbia.

"(d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to a nonresident alien individual whose loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487).

"(e) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction for the taxable year in the taxes on his probable income for such year, the burden of proving for such taxable year that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B shall be on such individual."

(2) The table of sections for subpart A of part II of subchapter N of chapter 1 (relating to nonresident alien individuals) is amended by striking out the item relating to section 877 and inserting in lieu thereof the following:

"Sec. 877. Expatriation to avoid tax.
"Sec. 878. Foreign educational, charitable, and certain other exempt organizations."

(f) PARTIAL EXCLUSION OF DIVIDENDS.—Subsection (d) of section 116 (relating to certain nonresident aliens ineligible for exclusion) is amended to read as follows:

"(d) CERTAIN NONRESIDENT ALIENS INELIGIBLE FOR EXCLUSION.—In the case of a nonresident alien individual, subsection (a) shall apply only—

"(1) in determining the tax imposed for the taxable year pursuant to section 871(b)(1) and only in respect of dividends which are effectively connected with the conduct of a trade or business within the United States, or

"(2) in determining the tax imposed for the taxable year pursuant to section 877(b)."

(g) WITHHOLDING OF TAX ON NONRESIDENT ALIENS.—Section 1441 (relating to withholding of tax on nonresident aliens) is amended—

(1) by striking out "(except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States)" in subsection (b);

(2) by striking out "and amounts described in section 402(a)(2)" and all that follows in the first sentence of subsection (b) and inserting in lieu thereof "and gains described in section 402(a)(2), 403(a)(2), or 631(b) or (c), and gains on transfers described in section 1235.";

(3) by striking out paragraph (1) of subsection (c) and inserting in lieu thereof the following new paragraph:

"(1) INCOME CONNECTED WITH UNITED STATES BUSINESS.—No deduction or withholding under subsection (a) shall be required in the case of any item

of income (other than compensation for personal services) which is effectively connected with the conduct of a trade or business within the United States and on which a tax is imposed for the taxable year pursuant to section 871(b)(1).";

(4) by amending paragraph (4) of subsection (c) to read as follows:

"(4) COMPENSATION OF CERTAIN ALIENS.—Under regulations prescribed by the Secretary or his delegate, compensation for personal services may be exempted from deduction and withholding under subsection (a)."; and

(5) by striking out "amounts described in section 402(a)(2), section 403(a)(2), section 631 (b) and (c), and section 1235, which are considered to be gains from the sale or exchange of capital assets," in paragraph (5) of subsection (c) and inserting in lieu thereof "gains described in section 402(a)(2), 403(a)(2), or 631 (b) or (c), and gains on transfers described in section 1235,", and by striking out "proceeds from such sale or exchange," in such paragraph and inserting in lieu thereof "amount payable,".

(h) LIABILITY FOR WITHHELD TAX.—Section 1461 (relating to return and payment of withheld tax) is amended to read as follows:

"SEC. 1461. LIABILITY FOR WITHHELD TAX.

"Every person required to deduct and withhold any tax under this chapter is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this chapter."

(i) DECLARATION OF ESTIMATED INCOME TAX BY INDIVIDUALS.—Section 6015 (relating to declaration of estimated income tax by individuals) is amended—

(1) by striking out that portion of subsection (a) which precedes paragraph (1) and inserting in lieu thereof the following:

"(a) REQUIREMENT OF DECLARATION.—Except as otherwise provided in subsection (i), every individual shall make a declaration of his estimated tax for the taxable year if—";

(2) by redesignating subsection (i) as subsection (j); and

(3) by inserting after subsection (h) the following new subsection:

"(i) NONRESIDENT ALIEN INDIVIDUALS.—No declaration shall be required to be made under this section by a nonresident alien individual unless—

"(1) withholding under chapter 24 is made applicable to the wages, as defined in section 3401(a), of such individual,

"(2) such individual has income (other than compensation for personal services subject to deduction and withholding under section 1441) which is effectively connected with the conduct of a trade or business within the United States, or

"(3) such individual is a resident of Puerto Rico during the entire taxable year."

(j) GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.—The second sentence of paragraph (3) of section 1250(d) (relating to certain tax-free transactions) is amended to read as follows: "This paragraph shall not apply to—

"(A) a disposition to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter, or

"(B) a transfer of property by a nonresident alien individual, a foreign estate or trust, or a foreign partnership, to a domestic corporation in exchange for stock or securities in such corporation in a transaction to which section 351 applies."

(k) COLLECTION OF INCOME TAX AT SOURCE ON WAGES.—Subsection (a) of section 3401 (relating to definition of wages for purposes of collection of income tax at source) is amended by striking out paragraphs (6) and (7) and inserting in lieu thereof the following:

"(6) for such services, performed by a nonresident alien individual, as may be designated by regulations prescribed by the Secretary or his delegate; or".

(l) DEFINITION OF FOREIGN ESTATE OR TRUST.—Section 7701(a)(31) (defining foreign estate or trust) is amended by striking out "from sources without the United States" and inserting in lieu thereof ", from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States,".

(m) CONFORMING AMENDMENT.—The first sentence of section 932(a) (relating to citizens of possessions of the United States) is amended to read as follows: "Any individual who is a citizen of any possession of the United States (but

not otherwise a citizen of the United States) and who is not a resident of the United States shall be subject to taxation under this subtitle in the same manner and subject to the same conditions as in the case of a nonresident alien individual."

(n) EFFECTIVE DATES.—

(1) The amendments made by this section (other than the amendments made by subsections (h) and (k)) shall apply with respect to taxable years beginning after December 31, 1966.

(2) The amendments made by subsection (h) shall apply with respect to payments occurring after December 31, 1966.

(3) The amendments made by subsection (k) shall apply with respect to remuneration paid after December 31, 1966.

SEC. 4. FOREIGN CORPORATIONS.

(a) TAX ON INCOME NOT CONNECTED WITH UNITED STATES BUSINESS.—Section 881 (relating to tax on foreign corporations not engaged in business in the United States) is amended to read as follows:

"SEC. 881. INCOME OF FOREIGN CORPORATIONS NOT CONNECTED WITH UNITED STATES BUSINESS.

"(a) IMPOSITION OF TAX.—There is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as—

"(1) interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income.

"(2) gains described in section 631(b) or (c), and

"(3) amounts which under section 341, or under section 1232 (in the case of bonds or other evidences of indebtedness issued after September 28, 1965), are treated as gains from the sale or exchange of property which is not a capital asset,

but only to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States.

"(b) DOUBLING OF TAX.—

"For doubling of tax on corporations of certain foreign countries, see section 891."

(b) TAX ON INCOME CONNECTED WITH UNITED STATES BUSINESS.—

(1) Section 882 (relating to tax on resident foreign corporations) is amended to read as follows:

"SEC. 882. INCOME OF FOREIGN CORPORATIONS CONNECTED WITH UNITED STATES BUSINESS.

"(a) NORMAL TAX AND SURTAX.—

"(1) IMPOSITION OF TAX.—A foreign corporation engaged in trade or business within the United States during the taxable year shall be taxable as provided in section 11 or 1201(a) on its taxable income which is effectively connected with the conduct of a trade or business within the United States.

"(2) DETERMINATION OF TAXABLE INCOME.—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States.

"(b) GROSS INCOME.—In the case of a foreign corporation, gross income includes only—

"(1) gross income which is derived from sources within the United States and which is not effectively connected with the conduct of a trade or business within the United States, and

"(2) gross income which is effectively connected with the conduct of a trade or business within the United States.

"(c) ALLOWANCE OF DEDUCTIONS AND CREDITS.—

"(1) ALLOCATION OF DEDUCTIONS—

"(A) GENERAL RULE.—In the case of a foreign corporation, the deductions shall be allowed only for purposes of subsection (a) and (except as provided by subparagraph (B)) only if and to the extent that they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this

purpose shall be determined as provided in regulations prescribed by the Secretary or his delegate.

"(B) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions and gifts provided by section 170 shall be allowed whether or not connected with income which is effectively connected with the conduct of a trade or business within the United States.

"(2) DEDUCTIONS AND CREDITS ALLOWED ONLY IF RETURN FILED.—A foreign corporation shall receive the benefit of the deductions and credits allowed to it in this subtitle only by filing or causing to be filed with the Secretary or his delegate a true and accurate return, in the manner prescribed in subtitle F, including therein all the information which the Secretary or his delegate may deem necessary for the calculation of such deductions and credits. This paragraph shall not be construed to deny the credit provided by section 32 for tax withheld at source or the credit provided by section 39 for certain uses of gasoline and lubricating oil.

"(3) FOREIGN TAX CREDIT.—Except as provided by section 906, foreign corporations shall not be allowed the credit against the tax for taxes of foreign countries and possessions of the United States allowed by section 901.

"(4) CROSS REFERENCE.—

"For rule that certain foreign taxes are not to be taken into account in determining deduction or credit, see section 906(b)(1).

"(d) ELECTION TO TREAT REAL PROPERTY INCOME AS INCOME CONNECTED WITH UNITED STATES BUSINESS.—

"(1) IN GENERAL.—A foreign corporation which during the taxable year derives any income—

"(A) from real property located in the United States, or from any interest in such real property, including (i) gains from the sale or exchange of real property or an interest therein, (ii) rents or royalties from mines, wells, or other natural deposits, and (iii) gains described in section 631 (b) or (c), and

"(B) which, but for this subsection, would not be treated as income effectively connected with the conduct of a trade or business within the United States,

may elect for such taxable year to treat all such income as income which is effectively connected with the conduct of a trade or business within the United States. In such case, such income shall be taxable as provided in subsection (a)(1) whether or not such corporation is engaged in trade or business within the United States during the taxable year. An election under this paragraph for any taxable year shall remain in effect for all subsequent taxable years, except that it may be revoked with the consent of the Secretary or his delegate with respect to any taxable year.

"(2) ELECTION AFTER REVOCATION, ETC.—Paragraphs (2) and (3) of section 871(d) shall apply in respect of elections under this subsection in the same manner and to the same extent as they apply in respect of elections under section 871(d).

"(e) RETURNS OF TAX BY AGENT.—If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return required under section 6012 shall be made by the agent."

(2)(A) Subsection (e) of section 11 (relating to exceptions from tax on corporations) is amended by inserting "or" at the end of paragraph (2), by striking out ", or" at the end of paragraph (3) and inserting a period in lieu thereof, and by striking out paragraph (4).

(B) Section 11 (relating to tax on corporations) is amended by adding at the end thereof the following new subsection:

"(f) FOREIGN CORPORATIONS.—In the case of a foreign corporation, the tax imposed by subsection (a) shall apply only as provided by section 882."

(3) The table of sections for subpart B of part II of subchapter N of chapter 1 is amended by striking out the items relating to sections 881 and 882 and inserting in lieu thereof the following:

"Sec. 881. Income of foreign corporations not connected with United States business.
"Sec. 882. Income of foreign corporations connected with United States business."

(c) WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.—Section 1442 (relating to withholding of tax on foreign corporations) is amended to read as follows:

"SEC. 1442. WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.

"(a) GENERAL RULE.—In the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 or section 1451 a tax equal to 30 percent thereof; except that, in the case of interest described in section 1451 (relating to tax-free covenant bonds), the deduction and withholding shall be at the rate specified therein. For purposes of the preceding sentence, the reference in section 1441(c)(1) to section 871(b)(1) shall be treated as referring to section 842 or section 882 (a) as the case may be.

"(b) EXEMPTION.—Subject to such terms and conditions as may be provided by regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply in the case of a foreign corporation engaged in trade or business within the United States if the Secretary or his delegate determines that the requirements of subsection (a) imposes an undue administrative burden and that the collection of the tax imposed by section 881 on such corporation will not be jeopardized by the exemption."

(d) DIVIDENDS RECEIVED FROM CERTAIN FOREIGN CORPORATIONS.—Subsection (a) of section 245 (relating to the allowance of a deduction in respect of dividends received from a foreign corporation) is amended—

(1) by striking out "and has derived 50 percent or more of its gross income from sources within the United States," in that portion of subsection (a) which precedes paragraph (1) and by inserting in lieu thereof "and if 50 percent or more of the gross income of such corporation from all sources for such period is effectively connected with the conduct of a trade or business within the United States,";

(2) by striking out "from sources within the United States" in paragraph (1) and inserting in lieu thereof "which is effectively connected with the conduct of a trade or business within the United States";

(3) by striking out "from sources within the United States" in paragraph (2) and inserting in lieu thereof ", which is effectively connected with the conduct of a trade or business within the United States,"; and

(4) by adding after paragraph (2) the following new sentence:

"For purposes of this subsection, the gross income of the foreign taxable corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States."

(e) UNRELATED BUSINESS TAXABLE INCOME.—The last sentence of section 512 (a) (relating to definition) is amended to read as follows: "In the case of an organization described in section 511 which is a foreign organization, the unrelated business taxable income shall be its unrelated business taxable income which is effectively connected with the conduct of a trade or business within the United States."

(f) CORPORATIONS SUBJECT TO PERSONAL HOLDING COMPANY TAX.—Paragraph (7) of section 542(c) (relating to corporations not subject to the personal holding company tax) is amended to read as follows:

"(7) a foreign corporation, if all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations;".

(g) AMENDMENTS WITH RESPECT TO FOREIGN CORPORATIONS CARRYING ON INSURANCE BUSINESS IN UNITED STATES.—

(1) Section 842 (relating to computation of gross income) is amended to read as follows:

"SEC. 842. FOREIGN CORPORATIONS CARRYING ON INSURANCE BUSINESS.

"If a foreign corporation carrying on an insurance business within the United States would qualify under part I, II, or III of this subchapter for the taxable year if (without regard to income not effectively connected with the conduct of any trade or business within the United States) it were a domestic corporation, such corporation shall be taxable under such part on its income effectively connected with its conduct of any trade or business within the United States. With respect to the remainder of its income, which is from sources within the

United States, such a foreign corporation shall be taxable as provided in section 881."

(2) The table of sections for part IV of subchapter L of chapter 1 is amended by striking out the item relating to section 842 and inserting in lieu thereof the following:

"Sec. 842. Foreign corporations carrying on insurance business."

(3) Section 819 (relating to foreign life insurance companies) is amended—

(A) by striking out subsections (a) and (d) and by redesignating subsections (b) and (c) as subsections (a) and (b),

(B) by striking out "In the case of any company described in subsection (a)," in subsection (a)(1) (as redesignated by subparagraph (A)) and inserting in lieu thereof "In the case of any foreign corporation taxable under this part,",

(C) by striking out "subsection (c)" in the last sentence of subsection (a)(2) (as redesignated by subparagraph (A)) and inserting in lieu thereof "subsection (b)",

(D) by adding at the end of subsection (a) (as redesignated by subparagraph (A)) the following new paragraph:

"(3) REDUCTION OF SECTION 881 TAX.—In the case of any foreign corporation taxable under this part, there shall be determined—

"(A) the amount which would be subject to tax under section 881 if the amount taxable under such section were determined without regard to sections 103 and 894, and

"(B) the amount of the reduction provided by paragraph (1).

The tax under section 881 (determined without regard to this paragraph) shall be reduced (but not below zero) by an amount which is the same proportion of such tax as the amount referred to in subparagraph (B) is of the amount referred to in subparagraph (A); but such reduction in tax shall not exceed the increase in tax under this part by reason of the reduction provided by paragraph (1).",

(E) by striking out "for purposes of subsection (a)" each place it appears in subsection (b) (as redesignated by subparagraph (A)) and inserting in lieu thereof "with respect to a foreign corporation",

(F) by striking out "foreign life insurance company" each place it appears in such subsection (b) and inserting in lieu thereof "foreign corporation",

(G) by striking out "subsection (b)(2)(A)" each place it appears in such subsection (b) and inserting in lieu thereof "subsection (a)(2)(A)",

(H) by striking out "subsection (b)(2)(B)" in paragraph (2)(B)(ii) of such subsection (b) and inserting in lieu thereof "subsection (a)(2)(B)", and

(I) by adding at the end thereof the following new subsection:

"(c) CROSS REFERENCE.—

"For taxation of foreign corporations carrying on life insurance business within the United States, see section 842."

(4) Section 821 (relating to tax on mutual insurance companies to which part II applies) is amended—

(A) by striking out subsection (e) and by redesignating subsections (f) and (g) as subsections (e) and (f), and

(B) by adding at the end of subsection (f) (as redesignated by subparagraph (A)) the following:

"(3) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842."

(5) Section 822 (relating to determination of taxable investment income) is amended by striking out subsection (e) and by redesignating subsection (f) as subsection (e).

(6) Section 831 (relating to tax on certain other insurance companies) is amended—

(A) by striking out subsection (b) and by redesignating subsection (c) as subsection (b), and

(B) by amending subsection (d) to read as follows:

"CROSS REFERENCES.—

"(1) For alternative tax in case of capital gains, see section 1201(a).

"(2) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842."

(7) Section 832 (relating to insurance company taxable income) is amended by striking out subsection (d) and by redesignating subsection (e) as subsection (d).

(8) The second sentence of section 841 (relating to credit for foreign taxes) is amended by striking out "sentence," and inserting in lieu thereof "sentence (and for purposes of applying section 906 with respect to a foreign corporation subject to tax under this subchapter),".

(h) SUBPART F INCOME.—Section 952(b) (relating to exclusion of United States income) is amended to read as follows:

"(b) EXCLUSION OF UNITED STATES INCOME.—In the case of a controlled foreign corporation, subpart F income does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States."

(i) GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS.—Paragraph (4) of section 1248(d) (relating to exclusions from earnings and profits) is amended to read as follows:

"(4) UNITED STATES INCOME.—Any item includible in gross income of the foreign corporation under this chapter—

"(A) for any taxable year beginning before January 1, 1967, as income derived from sources within the United States of a foreign corporation engaged in trade or business within the United States, or

"(B) for any taxable year beginning after December 31, 1966, as income effectively connected with the conduct by such corporation of a trade or business within the United States.

This paragraph shall not apply with respect to any item which is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States."

(j) DECLARATION OF ESTIMATED INCOME TAX BY CORPORATIONS.—Section 6016 (relating to declarations of estimated income tax by corporations) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) CERTAIN FOREIGN CORPORATIONS.—For purposes of this section and section 6655, in the case of a foreign corporation subject to taxation under section 11 or 1201(a), or under subchapter L of chapter 1, the tax imposed by section 881 shall be treated as a tax imposition by section 11."

(k) TECHNICAL AMENDMENTS.—

(1) Section 884 is amended to read as follows:

"SEC. 884. CROSS REFERENCES.

"(1) For special provisions relating to unrelated business income of foreign educational, charitable, and certain other exempt organizations, see section 512(a).

"(2) For special provisions relating to foreign corporations carrying on an insurance business within the United States, see section 842.

"(3) For rules applicable in determining whether any foreign corporation is engaged in trade or business within the United States, see section 864(b).

"(4) For reinstatement of pre-1967 income tax provisions in the case of corporations of certain foreign countries, see section 896.

"(5) For allowance of credit against the tax in case of a foreign corporation having income effectively connected with the conduct of a trade or business within the United States, see section 906.

"(6) For withholding at source of tax on income of foreign corporations, see section 1442."

(2) Section 953(b)(3)(F) is amended by striking out "832(b)(5)" and inserting in lieu thereof "832(c)(5)".

(3) Section 1249(a) is amended by striking out "Except as provided in subsection (c), gain" and inserting in lieu thereof "Gain".

(l) EFFECTIVE DATES.—The amendments made by this section (other than subsection (i)) shall apply with respect to taxable years beginning after December 31, 1966. The amendment made by subsection (i) shall apply with respect to sales or exchanges occurring after December 31, 1966.

SEC. 5. SPECIAL TAX PROVISIONS.

(a) INCOME AFFECTED BY TREATY.—Section 894 (relating to income exempt under treaties) is amended to read as follows:

"SEC. 894. INCOME AFFECTED BY TREATY.

"(a) INCOME EXEMPT UNDER TREATY.—Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

"(b) PERMANENT ESTABLISHMENT IN UNITED STATES.—For purposes of applying any exemption from, or reduction of, any tax provided by any treaty to which the United States is a party with respect to income which is not effectively connected with the conduct of a trade or business within the United States, a nonresident alien individual or a foreign corporation shall be deemed not to have a permanent establishment in the United States at any time during the taxable year. This subsection shall not apply in respect of the tax computed under section 877(b)."

(b) APPLICATION OF PRE-1967 INCOME TAX PROVISIONS.—Subpart C of part II of subchapter N of chapter 1 (relating to miscellaneous provisions applicable to nonresident aliens and foreign corporations) is amended by adding at the end thereof the following new section:

"SEC. 896. APPLICATION OF PRE-1967 INCOME TAX PROVISIONS.

"(a) IMPOSITION OF MORE BURDENSOME TAXES BY FOREIGN COUNTRY.—Whenever the President finds that—

"(1) under the laws of any foreign country, considering the tax system of such foreign country, citizens of the the United States not residents of such foreign country or domestic corporations are being subjected to more burdensome taxes, on any item of income received by such citizens or corporations from sources within such foreign country, than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country,

"(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such taxes so that they are no more burdensome than taxes imposed by the provisions of this subtitle on similar income derived from sources within the United States by residents or corporations of such foreign country, and

"(3) it is in the public interest to apply pre-1967 tax provisions in accordance with the provisions of this section to residents or corporations of such foreign country,

the President shall proclaim that the tax on such similar income derived from sources within the United States by residents or corporations of such foreign country shall, for taxable years beginning after such proclamation, be determined under this subtitle without regard to amendments made to this subchapter and chapter 3 on or after the date of enactment of this section.

"(b) ALLEVIATION OF MORE BURDENSOME TAXES.—Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that citizens of the United States not residents of such foreign country or domestic corporations are no longer subject to more burdensome taxes on such item of income derived by such citizens or corporations from sources within such foreign country, he shall proclaim that the tax on such similar income derived from sources within the United States by residents or corporations of such foreign country shall, for any taxable year beginning after such proclamation, be determined under this subtitle without regard to subsection (a).

"(c) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

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"(d) IMPLEMENTATION BY REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as he deems necessary or appropriate to implement this section."

(c) CLERICAL AMENDMENTS.—The table of sections for subpart C of part II of subchapter N of chapter 1 is amended—

(1) by striking out the item relating to section 894 and inserting in lieu thereof

"Sec. 894. Income affected by treaty.";

(2) by adding at the end of such table the following:

"Sec. 896. Application of pre-1967 income tax provisions."

(d) EFFECTIVE DATE.—The amendments made by this section (other than subsection (e)) shall apply with respect to taxable years beginning after December 31, 1966.

(e) ELECTIONS BY NONRESIDENT UNITED STATES CITIZENS WHO ARE SUBJECT TO FOREIGN COMMUNITY PROPERTY LAWS.—

(1) Part III of subchapter N of chapter 1 (relating to income from sources without the United States) is amended by adding at the end thereof the following new subpart:

"Subpart H—Income of Certain Nonresident United States Citizens Subject to Foreign Community Property Laws

"Sec. 981. Elections as to treatment of income subject to foreign community property laws.

"SEC. 981. ELECTION AS TO TREATMENT OF INCOME SUBJECT TO FOREIGN COMMUNITY PROPERTY LAWS.

"(a) GENERAL RULE.—In the case of any taxable year beginning after December 31, 1966, if—

"(1) an individual is (A) a citizen of the United States, (B) a bona fide resident of a foreign country or countries during the entire taxable year, and (C) married at the close of the taxable year to a spouse who is a nonresident alien during the entire taxable year, and

"(2) such individual and his spouse elect to have subsection (b) apply to their community income under foreign community property laws,

then subsection (b) shall apply to such income of such individual and such spouse for the taxable year and for all subsequent taxable years for which the requirements of paragraph (1) are met, unless the Secretary or his delegate consents to a termination of the election.

"(b) TREATMENT OF COMMUNITY INCOME.—For any taxable year to which an election made under subsection (a) applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as follows:

"(1) Earned income (within the meaning of the first sentence of section 911(b)), other than trade or business income and a partner's distributive share of partnership income, shall be treated as the income of the spouse who rendered the personal services.

"(2) Trade or business income, and a partner's distributive share of partnership income, shall be treated as provided in section 1402(a)(5).

"(3) Community income not described in paragraph (1) or (2) which is derived from the separate property (as determined under the applicable foreign community property law) of one spouse shall be treated as the income of such spouse.

"(4) All other such community income shall be treated as provided in the applicable foreign community property law.

"(c) ELECTION FOR PRE-1967 YEARS.—

"(1) ELECTION.—If an individual meets the requirements of subsection (a)(1)(A) and (C) for any taxable year beginning before January 1, 1967, and if such individual and the spouse referred to in subsection (a)(1)(C) elect under this subsection, then paragraph (2) of this subsection shall apply to their community income under foreign community property laws for all open taxable years beginning before January 1, 1967

(whether under this chapter, the corresponding provisions of the Internal Revenue Code of 1939, or the corresponding provisions of prior revenue laws), for which the requirements of subsection (a)(1) (A) and (C) are met.

"(2) EFFECT OF ELECTION.—For any taxable year to which an election made under this subsection applies, the community income under foreign community property laws of the husband and wife making the election shall be treated as provided by subsection (b), except that the other community income described in paragraph (4) of subsection (b) shall be treated as the income of the spouse who, for such taxable year, had gross income under paragraphs (1), (2), and (3) of subsection (b), plus separate gross income, greater than that of the other spouse.

"(d) TIME FOR MAKING ELECTIONS; PERIOD OF LIMITATIONS; ETC.—

"(1) TIME.—An election under subsection (a) or (c) for a taxable year may be made at any time while such year is still open, and shall be made in such manner as the Secretary or his delegate shall by regulations prescribe.

"(2) EXTENSION OF PERIOD FOR ASSESSING DEFICIENCIES AND MAKING REFUNDS.—If any taxable year to which an election under subsection (a) or (c) applies is open at the time such election is made, the period for assessing a deficiency against, and the period for filing claim for credit or refund of any overpayment by, the husband and wife for such taxable year, to the extent such deficiency or overpayment is attributable to such an election, shall not expire before 1 year after the date of such election.

"(3) ALIEN SPOUSE NEED NOT JOIN IN SUBSECTION (C) ELECTION IN CERTAIN CASES.—If the Secretary or his delegate determines—

"(A) that an election under subsection (c) would not affect the liability for Federal income tax of the spouse referred to in subsection (a)(1) (C) for any taxable year, or

"(B) that the effect on such liability for tax cannot be ascertained and that to deny the election to the citizen of the United Sates would be inequitable and cause undue hardship.

such spouse shall not be required to join in such election, and paragraph (2) of this subsection shall not apply with respect to such spouse.

"(4) INTEREST.—To the extent that any overpayment or deficiency for a taxable year is attributable to an election made under this section, no interest shall be allowed or paid for any period before the day which is 1 year after the date of such election.

"(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) DEDUCTIONS.—Deductions shall be treated in a manner consistent with the manner provided by this section for the income to which they relate.

"(2) OPEN YEARS.—A taxable year of a citizen of the United States and his spouse shall be treated as 'open' if the period for assessing a deficiency against such citizen for such year has not expired before the date of the election under subsection (a) or (c), as the case may be.

"(3) ELECTIONS IN CASE OF DECEDENTS.—If a husband or wife is deceased his election under this section may be made by his executor, administrator, or other person charged with his property.

"(4) DEATH OF SPOUSE DURING TAXABLE YEAR.—In applying subsection (a)(1)(C), and in determining under subsection (c)(2) which spouse has the greater income for a taxable year, if a husband or wife dies the taxable year of the surviving spouse shall be treated as ending on the date of such death."

(2) The table of subparts for such part III is amended by adding at the end thereof the following:

Subpart H. Income of certain nonresident United States citizens subject to foreign community property laws."

(3) Section 911(d) (relating to earned income from sources without the United States) is amended—

(A) by striking out "For administrative" and inserting in lieu thereof the following: "(1) For administrative"; and

(B) by adding at the end thereof the following:

"(2) For elections as to treatment of income subject to foreign community property laws, see section 981."

SEC. 6. FOREIGN TAX CREDIT.

(a) ALLOWANCE OF CREDIT TO CERTAIN NONRESIDENT ALIENS AND FOREIGN CORPORATIONS.—

(1) Subpart A of part III of subchapter N of chapter 1 (relating to foreign tax credit) is amended by adding at the end thereof the following new section:

"SEC. 906. NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.

"(a) ALLOWANCE OF CREDIT.—A nonresident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year shall be allowed a credit under section 901 for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year (or deemed, under section 902, paid or accrued during the taxable year) to any foreign country or possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States.

"(b) SPECIAL RULES.—

"(1) For purposes of subsection (a) and for purposes of determining the deductions allowable under sections 873(a) and 882(c), in determining the amount of any tax paid or accrued to any foreign country or possession there shall not be taken into account any amount of tax to the extent the tax so paid or accrued is imposed with respect to income which would not be taxed by such foreign country or possession but for the fact that—

"(A) in the case of a nonresidential alien individual, such individual is a citizen or resident of such foreign country or possession, or

"(B) in the case of a foreign corporation, such corporation was created or organized under the law of such foreign country or possession or is domiciled for tax purposes in such country or possession.

"(2) For purposes of subsection (a), in applying section 904 the taxpayer's taxable income shall be treated as consisting only of the taxable income effectively connected with the taxpayer's conduct of a trade or business within the United States.

"(3) The credit allowed pursuant to subsection (a) shall not be allowed against any tax imposed by section 871(a) (relating to income of nonresident alien individual not connected with United States business) or 881 (relating to income of foreign corporations not connected with United States business).

"(4) For purposes of sections 902(a) and 78, a foreign corporation choosing the benefits of this subpart which receives dividends shall, with respect to such dividends, be treated as a domestic corporation."

(2) The table of sections for such subpart A is amended by adding at the end thereof the following:

"Sec. 906. Nonresident alien individuals and foreign corporations."

(3) Section 874(c) is amended by striking out

"(c) FOREIGN TAX CREDIT NOT ALLOWED.—A nonresident" and inserting in lieu thereof the following:

"(c) FOREIGN TAX CREDIT.—Except as provided in section 906, a nonresident".

(4) Subsection (b) of section 901 (relating to amount allowed) is amended by redesignating paragraph (4) as paragraph (5), and by inserting after paragraph (3) the following new paragraph:

"(4) NONRESIDENT ALIEN INDIVIDUALS AND FOREIGN CORPORATIONS.—In the case of any nonresident alien individual not described in section 876 and in the case of any foreign corporation, the amount determined pursuant to section 906; and".

(5) Paragraph (5) (as redesignated) of section 901(b) is amended by striking out "or (3)," and inserting in lieu thereof "(3), or (4),".

(6) The amendments made by this subsection shall apply with respect to taxable years beginning after December 31, 1966. In applying section 904 of the Internal Revenue Code of 1954 with respect to section 906 of such Code, no amount may be carried from or to any taxable year beginning before January 1, 1967, and no such year shall be taken into account.

(b) ALIEN RESIDENTS OF THE UNITED STATES OR PUERTO RICO.—

(1) Paragraph (3) of section 901(b) (relating to amount of foreign tax credit allowed in case of alien resident of the United States or Puerto Rico) is amended by striking out ", if the foreign country of which such alien

resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country".

(2) Section 901 is amended by redesignating subsections (c) and (d) as subsections (d) and (e), and by inserting after subsection (b) the following new subsection:

"(c) SIMILAR CREDIT REQUIRED FOR CERTAIN ALIEN RESIDENTS.—Whenever the President finds that—

"(1) a foreign country, in imposing income, war profits, and excess profits taxes, does not allow to citizens of the United States residing in such foreign country a credit for any such taxes paid or accrued to the United States or any foreign country, as the case may be, similar to the credit allowed under subsection (b)(3),

"(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit to citizens of the United States residing in such foreign country, and

"(3) it is in the public interest to allow the credit under subsection (b)(3) to citizens or subjects of such foreign country only if it allows such a similar credit to citizens of the United States residing in such foreign country,

the President shall proclaim that, for taxable years beginning while the proclamation remains in effect, the credit under subsection (b)(3) shall be allowed to citizens or subjects of such foreign country only if such foreign country, in imposing income, war profits, and excess profits taxes, allows to citizens of the United States residing in such foreign country such a similar credit."

(3) Section 2014 (relating to credit for foreign death taxes) is amended by striking out the second sentence of subsection (a), and by adding at the end of such section the following new subsection:

"(h) SIMILAR CREDIT REQUIRED FOR CERTAIN ALIEN RESIDENTS.—Whenever the President finds that—

"(1) a foreign country, in imposing estate, inheritance, legacy, or succession taxes, does not allow to citizens of the United States resident in such foreign country at the time of death a credit similar to the credit allowed under subsection (a),

"(2) such foreign country, when requested by the United States to do so, has not acted to provide such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death, and

"(3) it is in the public interest to allow the credit under subsection (a) in the case of citizens or subjects of such foreign country only if it allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death,

the President shall proclaim that, in the case of citizens or subjects of such foreign country dying while the proclamation remains in effect, the credit under subsection (a) shall be allowed only if such foreign country allows such a similar credit in the case of citizens of the United States resident in such foreign country at the time of death."

(4) The amendments made by this subsection (other than paragraph (3)) shall apply with respect to taxable years beginning after December 31, 1966. The amendment made by paragraph (3) shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

(c) FOREIGN TAX CREDIT IN CASE OF CERTAIN OVERSEAS OPERATIONS FUNDING SUBSIDIARIES.—

(1) Section 904(f)(2) (relating to application of limitations on foreign tax credit in case of certain interest income) is amended—

(A) by striking out "or" at the end of subparagraph (C),

(B) by striking out the period at the end of subparagraph (D) and inserting in lieu thereof ", or", and

(C) by adding at the end thereof the following new subparagraph:

"(E) received by an overseas operations funding subsidiary on obligations of a related foreign corporation."

(2) Section 904(f) is amended by adding at the end thereof the following new paragraph:

"(5) DEFINITIONS FOR PURPOSES OF PARAGRAPH (1)(E).—For purposes of paragraph (1)(E).—

"(A) the term 'overseas operations funding subsidiary' means a domestic corporation which (i) is a member of an affiliated group (within the meaning of section 1504) and is not the common parent corporation, and (ii) was formed and is availed of for the principal purpose of raising funds outside the United States through public offer-

ings to foreign persons and of using such funds to finance the operationss in foreign countries of one or more related foreign corporations, and

"(B) a foreign corporation is, with respect to an overseas operations funding subsidiary, a related foreign corporation if the affiliated group of which such subsidiary is a member owns 50 percent or more of the voting stock of such foreign corporation either directly or through ownership of the voting stock of another foreign corporation."

(3) The amendments made by paragraphs (1) and (2) shall apply to interest received after December 31, 1965, in taxable years ending after such date.

SEC. 7. AMENDMENT TO PRESERVE EXISTING LAW ON DEDUCTIONS UNDER SECTION 931.

(a) DEDUCTIONS.—Subsection (d) of section 931 (relating to deductions) is amended to read as follows:

"(d) DEDUCTIONS.—

"(1) GENERAL RULE.—Except as otherwise provided in this subsection and subsection (e), in the case of persons entitled to the benefits of this section the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in part I, under regulations prescribed by the Secretary or his delegate.

"(2) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income from sources within the United States:

"(A) The deduction, for losses not connected with the trade or business if incurred in transactions entered into for profit, allowed by section 165(c)(2), but only if the profit, if such transaction had resulted in a profit, would be taxable under this subtitle.

"(B) The deduction, for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by sections 165(c)(3), but only if the loss is of property with the United States.

"(C) The deduction for charitable contributions and gifts allowed by section 170.

"(3) DEDUCTION DISALLOWED.—

"For disallowance of standard deduction, see section 142(b)(2)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to taxable years beginning after December 31, 1966.

SEC. 8. ESTATES OF NONRESIDENTS NOT CITIZENS.

(a) RATE OF TAX.—Subsection (a) of section 2101 (relating to tax imposed in case of estates of nonresidents not citizens) is amended to read as follows:

"(a) RATE OF TAX.—Except as provided in section 2107, a tax computed in accordance with the following table is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States:

"If the taxable estate is:	**The tax shall be:**
Not over $100,000	5% of the taxable estate.
Over $100,000 but not over $500,000	$5,000, plus 10% of excess over $100,000.
Over $500,000 but not over $1,000,000	$45,000, plus 15% of excess over $500,000.
Over $1,000,000 but not over $2,000,000	$120,000, plus 20% of excess over $1,000,000.
Over $2,000,000	$320,000, plus 25% of excess over $2,000,000."

(b) CREDITS AGAINST TAX.—Section 2102 (relating to credits allowed against estate tax) is amended to read as follows:

"SEC. 2102. CREDITS AGAINST TAX.

"(a) IN GENERAL.—The tax imposed by section 2101 shall be credited with the amounts determined in accordance with sections 2011 to 2013, inclusive (relating to State death taxes, gift tax, and tax on prior transfers), subject to the special limitation provided in subsection (b).

"(b) SPECIAL LIMITATION.—The maximum credit allowed under section 2011 against the tax imposed by section 2101 for State death taxes paid shall be an amount which bears the same ratio to the credit computed as provided in section

2011(b) as the value of the property, as determined for purposes of this chapter, upon which State death taxes were paid and which is included in the gross estate under section 2103 bears to the value of the total gross estate under section 2103. For purposes of this subsection, the term 'State death taxes' means the taxes described in section 2011(a)."

(c) PROPERTY WITHIN THE UNITED STATES.—Section 2104 (relating to property within the United States) is amended by adding at the end thereof the following new subsection:

"(c) DEBT OBLIGATIONS.—For purposes of this subchapter, debt obligations of—

"(1) a United States person, or

"(2) the United States, a State or any political subdivision thereof, or the District of Columbia,

owned by a nonresident not a citizen of the United States shall be deemed property within the United States. This subsection shall not apply to a debt obligation of a domestic corporation if any interest on such obligation, were such interest received by the decedent at the time of his death, would be treated by reason of section 861(a)(1)(B) as income from sources without the United States."

(d) PROPERTY WITHOUT THE UNITED STATES.—Subsection (b) of section 2105 (relating to bank deposits) is amended to read as follows:

"(b) DEPOSITS IN CERTAIN FOREIGN BRANCHES.—For purposes of this subchapter, deposits with a foreign branch of a domestic corporation, if such branch is engaged in the commercial banking business, shall not be deemed property within the United States."

(e) DEFINITION OF TAXABLE ESTATE.—Paragraph (3) of section 2106(a) (relating to deduction of exemption from gross estate) is amended to read as follows:

"(3) EXEMPTION.—

"(A) GENERAL RULE.—An exemption of $30,000.

"(B) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a 'nonresident not a citizen of the United States' under the provisions of section 2209, the exemption shall be the greater of (i) $30,000, or (ii) that proportion of the exemption authorized by section 2052 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated."

(f) SPECIAL METHODS OF COMPUTING TAX.—Subchapter B of chapter 11 (relating to estates of nonresidents not citizens) is amended by adding at the end thereof the following new sections:

"SEC. 2107. EXPATRIATION TO AVOID TAX.

"(a) RATE OF TAX.—A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States dying after the date of enactment of this section, if after March 8, 1965, and wihin the 10-year period ending with the date of death such decedent lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

"(b) GROSS ESTATE.—For purposes of the tax imposed by subsection (a), the value of the gross estate of every decedent to whom subsection (a) applies shall be determined as provided in section 2103, except that—

"(1) if such decedent owned (within the meaning of section 958(a)) at the time of his death 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation, and

"(2) if such decedent owned (within the meaning of section 958(a)), or is considered to have owned (by applying the ownership rules of section 958(b)), at the time of his death, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of such foreign corporation,

then that proportion of the fair market value of the stock of such foreign corporation owned (within the meaning of section 958(a)) by such decedent at the time of his death, which the fair market value of any assets owned by such foreign corporation and situated in the United States, at the time of his death, bears to the total fair market value of all assets owned by such foreign corporation at the time of his death, shall be included in the gross estate of such decedent.

For purposes of the preceding sentence, a decedent shall be treated as owning stock of a foreign corporation at the time of his death, if, at the time of a transfer, by trust or otherwise, within the meaning of sections 2035 to 2038, inclusive, he owned such stock.

"(c) CREDITS.—The tax imposed by subsection (a) shall be credited with the amounts determined in accordance with section 2102.

"(d) EXCEPTION FOR LOSS OF CITIZENSHIP FOR CERTAIN CAUSES.—Subsection (a) shall not apply to the transfer of the estate of a decedent whose loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b) 1482, or 1487).

"(e) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for this section, result in a substantial reduction in the estate, inheritance, legacy, and succession taxes in respect of the transfer of his estate, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on the executor of such individual's estate.

"SEC. 2108. APPLICATION OF PRE-1967 ESTATE TAX PROVISIONS.

"(a) IMPOSITION OF MORE BURDENSOME TAX BY FOREIGN COUNTRY.—Whenever the President finds that—

"(1) under the laws of any foreign country, considering the tax system of such foreign country, a more burdensome tax is imposed by such foreign country on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country,

"(2) such foreign country, when requested by the United States to do so, has not acted to revise or reduce such tax so that it is no more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, and

"(3) it is in the public interest to apply pre-1967 tax provisions in accordance with this section to the transfer of estates of decedents who were residents of such foreign country,

the President shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to amendments made to sections 2101 (relating to tax imposed), 2102 (relating to credits against tax), 2106 (relating to taxable estate), and 6018 (relating to estate tax returns) on or after the date of enactment of this section.

"(b) ALLEVIATION OF MORE BURDENSOME TAX.—Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under subsection (a) have been modified so that the tax on the transfer of estates of decedents who were citizens of the United States and not residents of such foreign country is no longer more burdensome than the tax imposed by this subchapter on the transfer of estates of decedents who were residents of such foreign country, he shall proclaim that the tax on the transfer of the estate of every decedent who was a resident of such foreign country at the time of his death shall, in the case of decedents dying after the date of such proclamation, be determined under this subchapter without regard to subsection (a).

"(c) NOTIFICATION OF CONGRESS REQUIRED.—No proclamation shall be issued by the President pursuant to this section unless, at least 30 days prior to such proclamation, he has notified the Senate and the House of Representatives of his intention to issue such proclamation.

"(d) IMPLEMENTATION BY REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary or appropriate to implement this section."

(g) ESTATE TAX RETURNS.—Paragraph (2) of section 6018(a) (relating to estate of nonresidents not citizens) is amended by striking out "$2,000" and inserting in lieu thereof "$30,000".

(h) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 11 (relating to estates of nonresidents not citizens) is amended by adding at the end thereof the following:

"Sec. 2107. Expatriation to avoid tax.
"Sec. 2108. Application of pre-1967 estate tax provisions."

(i) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to estates of decedents dying after the date of the enactment of this Act.

SEC. 9. TAX ON GIFTS OF NONRESIDENTS NOT CITIZENS.

(a) IMPOSITION OF TAX.—Subsection (a) of section 2501 (relating to general rule for imposition of tax) is amended to read as follows:

"(a) TAXABLE TRANSFERS.—

"(1) GENERAL RULE.—For the calendar year 1955 and each calendar year thereafter a tax, computed as provided in section 2502, is hereby imposed on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

"(2) TRANSFERS OF INTANGIBLE PROPERTY.—Except as provided in paragraph (3), paragraph (1) shall not apply to the transfer of intangible property by a nonresident not a citizen of the United States.

"(3) EXCEPTIONS.—Paragraph (2) shall not apply in the case of a donor who at any time after March 8, 1965, and within the 10-year period ending with the date of transfer lost United States citizenship unless—

"(A) such donor's loss of United States citizenship resulted from the application of section 301(b), 350, or 355 of the Immigration and Nationality Act, as amended (8 U.S.C. 1401(b), 1482, or 1487), or

"(B) such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

"(4) BURDEN OF PROOF.—If the Secretary or his delegate establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for paragraph (3), result in a substantial reduction for the calendar year in the taxes on the transfer of property by gift, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on such individual."

(b) TRANSFER IN GENERAL.—Subsection (b) of section 2511 (relating to situs rule for stock in a corporation) is amended to read as follows:

"(b) INTANGIBLE PROPERTY.—For the purposes of this chapter, in the case of a nonresident not a citizen of the United States who is excepted from the application of section 2501(a)(2)—

"(1) shares of stock issued by a domestic corporation, and

"(2) debt obligations of—

"(A) a United States persons, or

"(B) the United States, a State or any political subdivision thereof, or the District of Columbia,

which are owned by such nonresidents shall be deemed to be property situated within the United States."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to the calendar year 1967 and all calendar years thereafter.

SEC. 10. TREATY OBLIGATIONS.

No amendment made by this Act shall apply in any case where its application would be contrary to any treaty obligation of the United States. For purposes of the preceding sentence, the extension of a benefit provided by any amendment made by this Act shall not be deemed to be contrary to a treaty obligation of the United States.

Passed the House of Representatives June 15, 1966.

Attest: RALPH R. ROBERTS,
Clerk.

(Departmental comments on H.R. 13103 follow:)

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., August 10, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance, U.S. Senate,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your request for the views of the Bureau of the Budget on H.R. 13103, an act "To amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States," and on an amendment intended to be proposed by Mr. Dirksen to H.R. 13103.

H.R. 13103 is a modified version of H.R. 5916, a bill introduced in March 1965, to carry out recommendations of the Treasury Department. H.R. 5916 was a part of the President's program to improve the United States balance of payments.

We believe that H.R. 13103, by providing more equitable tax treatment for foreign investors, will tend to enhance the attractiveness of investment in the United States and thereby have a favorable effect on our balance of payments. Accordingly, the Bureau of the Budget recommends enactment of the bill.

The proposed amendment to H.R. 13103 would give the President discretionary authority to impose or remove the interest equalization tax on dollar loans made by foreign branches of U.S. banks. We have no objection to this amendment.

Sincerely yours,

WILFRED H. ROMMEL,
Assistant Director for Legislative Reference.

GENERAL COUNSEL OF THE DEPARTMENT OF COMMERCE,
Washington, D.C., August 18, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: This is in further reply to your request for the views of this Department concerning H.R. 13103, an act to amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investment in the United States.

The act as passed by the House would reduce U.S. tax upon the estates of nonresident aliens, thereby providing more equitable tax treatment in line with that applied to estates of U.S. citizens. The bill would also limit U.S. tax on nonresident aliens' investment income while taxing their trade and business income in the same manner that a U.S. citizen's trade and business income is taxed.

The estate tax applied to estates of aliens domiciled abroad would be reduced considerably by increasing the current $2,000 exemption to $30,000 and by reflecting the new alien estate tax rate schedule a marital deduction of 50 percent of the taxable estate, which deduction currently is not allowed. The present high estate tax on nonresident aliens discourages many of them from investing in the United States. This reduction will make the United States more attractive as a place to invest one's savings and should increase foreign investment here.

The act extends the income tax exemption presently given interest paid on bank deposits to nonresident aliens not engaged in trade or business in the United States to interest and dividends paid on share deposits by savings and loan associations and interest paid by insurance companies. However, beginning in 1972 all such payments would become subject to tax on U.S. source income.

The act would restructure the income tax treatment accorded nonresident aliens and foreign corporations so as to tax their investment income at the flat rate of 30 percent or the lower treaty rate, and to tax their income effectively connected with the carrying on of a U.S. trade or business at the regular income tax rates applied to resident individuals and domestic corporations. Currently nonresident aliens not engaged in trade or business in the United States are taxed at either the 30-percent rate or higher graduated rates, whichever produces more tax, except that if a rate has been fixed by treaty, that rate will apply. Nonresident aliens and foreign corporations engaged in trade or business are taxed at the graduated rates on the net amount of all their U.S. source income.

On the one hand this change would make investment in the United States more attractive to foreign investors not residents of tax treaty countries, since it limits the tax rate to 30 percent. Also, any foreign investor in the higher tax brackets engaged in trade or business here would benefit so far as his U.S. investment income is concerned since under present law this is taxed at the graduated rates regardless of whether a tax treaty is in effect.

On the other hand the change would close the loophole allowed to foreign corporations that in reality are not engaged in business in the United States, but through a minimal amount of activity qualify for the 85-percent dividend deduction accorded to foreign corporations engaged in business. This results in an effective tax rate of less than 7½ percent as opposed to a 15-percent treaty rate or 30-percent rate that would apply under this bill. At the same time, those

foreign corporations carrying on substantial business activities would be similarly affected. At the end of 1964 foreigners held stocks in U.S. corporations valued at about $13.8 billion as portfolio investments. No data are available on the percentage of these holdings owned by foreign corporations. Approximately 90 percent of the foreign investments in the United States are held by Western European and Canadian corporations or individuals. Most of these countries have income tax treaties with the United States limiting tax on U.S. source dividends to 15 percent. It is difficult to tell whether foreign corporations would change their investment policy because of the additional 7½ cents tax on each dollar of dividend. However, where the foreign taxing authority's rate exceeds 15 percent and the U.S. source income is subject to the foreign tax there would be no reason for foreign withdrawal of investment in U.S. stocks, because this change would merely reallocate between taxing authorities the same total amount of tax. Nor would there be any change in investment policy of Swiss banks holding stock as nominees since they are now paying the treaty rate on 30-percent rate where applicable.

As for the nonresident alien individual deriving more than $10,600 annual taxable income from trade or business in the United States, he would pay less tax on that portion of his income derived from investment. However, individuals doing business in the United States with total U.S. income of less than $10,000, including investment income, would pay somewhat more because the 30-percent tax on investment income would be higher than the applicable graduated rate. There are not many nonresident aliens not engaged in business in the United States paying the high graduated rate of tax. Elimination of the graduated rate of tax on investment income should therefore attract considerably more investment on the part of these individuals. The U.S. source capital gains of a nonresident alien not engaged in trade or business in the United States are to be taxed under the bill only if the alien was in the United States for 183 days or more during the year.

Currently nonresident aliens engaged in trade or business in the United States, those not engaged in trade or business but present in the United States 90 days or more, and those present less than 90 days but present at the time of sale, are taxable on their capital gains. The 183-day provision will be a strong inducement for nonresident aliens to invest in stocks and bonds of U.S. companies, particularly since the bill also permits investors to grant U.S. agents the discretionary authority to buy and sell their holdings without thereby being considered as having engaged in trade or business in the United States; being engaged in trade or business in the United States would subject the capital gains to U.S. income tax.

The bill would also give real estate investors an election to be treated as being engaged in trade or business so as to be taxed on net income rather than on gross income as is generally the case now. Currently a real estate investor can deduct interest, taxes, depreciation, etc., from his gross income in determining his taxable income only if he renders services to his tenants.

These tax relief measures would considerably increase the effective rate of return on investments in the United States and therefore should attract additional foreign investment here.

The bill would introduce into law the concept of taxing a foreign corporation on worldwide income of the corporation effectively connected with carrying on the activity of the U.S. branch. This concept would be limited to income attributable to an office in the United States conducting (1) licensing operations in the United States deriving income from the use of their licenses outside the United States; (2) banking or financing operations and some investment operations; or (3) branches in the United States deriving income from the sale of goods except where a branch outside the United States materially participated in the sale of the product for use outside the United States.

This taxing concept is equitable in that it would place the foreign corporation that is essentially a domestic corporation but for having been created in a foreign country, in the same tax position as its U.S. competitor. This change would also prevent foreigners from using the United States as a tax haven. U.S. exports would probably not be affected by this provision.

There apparently is a typographical error on page 69, line 4, in making reference to paragraph (1)(e). The reference should be to paragraph (2)(e) which contains the expression "overseas operations funding subsidiary" that is being defined.

We understand that objections have been raised that two provisions of H.R. 13103 may have some adverse effect upon the balance of payments or U.S. gold

holdings. One of these provisions is the amendment making interest received by foreign investors on bank deposits in the United States subject to income tax after 1972. However, this provision would appear to have little immediate impact in view of the 1972 effective date. The other provision would subject to U.S. estate tax, U.S. bank deposits of deceased foreign investors. This provision would go into effect immediately upon enactment. It is difficult to determine the impact of this provision in view of the increased exemption and reduced rates provided in the bill for estates of foreign investors.

Subject to your consideration of the possible adverse effect of the two bank deposit provisions on the balance of payments and U.S. gold holdings, this Department is of the view that the subject bill would attract foreign investment to the United States. The Department of Commerce therefore recommends enactment of H.R. 13103.

We have been advised by the Bureau of the Budget that there would be no objection to the submission of our report to the Congress from the standpoint of the administration's program.

Sincerely,

ROBERT E. GILES, *General Counsel.*

DEPARTMENT OF STATE,
August 8, 1966.

HON. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate

DEAR MR. CHAIRMAN: This report on H.R. 13103, a bill "to amend the Internal Revenue Code of 1954 to provide equitable tax treatment for foreign investors in the United States," is submitted in response to your letter of June 17, 1966. H.R. 13103 would substantially implement the 1964 proposals of the Presidential task force on "Promoting Increased Foreign Investment in U.S. Corporate Securities and Increased Foreign Financing for U.S. Corporations Operating Abroad."

The Department of State believes that H.R. 13103, if enacted, would have a salutary effect on the U.S. balance of payments. By reducing certain existing tax disincentives to investment in United States assets, the bill would tend to enhance their attractiveness to foreigners. Especially noteworthy in this regard are the provisions in the bill dealing with estate tax rates, exemptions and returns; with the application of a separate tax rate for U.S. source income derived from royalties and investments in U.S. corporate securities as against source income "effectively connected" with the conduct of a United States trade or business; and with the uniform flat rate on fixed or determinable income of nonresident alien individuals.

The Department of State supports the objectives of H.R. 13103 and regards the proposed amendment to the Internal Revenue Code as reasonable and practicable steps for the accomplishment of those objectives. The Department regards Section 10 of the bill, which provides that no amendment is to be applied in contravention of any treaty obligation of the United States, as an essential part of the proposed legislation.

The Bureau of the Budget advises that from the standpoint of the Administration's program there is no objection to the submission of this report.

Sincerely yours,

DOUGLAS MACARTHUR II,
Assistant Secretary for Congressional Relations
(For the Secretary of State).

The CHAIRMAN. We are particularly happy to welcome as the first witness the Secretary of the Treasury, Hon. Henry H. Fowler. It was Mr. Fowler, before he became Secretary of the Treasury, who was asked by President Kennedy to serve as chairman of the task force and it was because of his strong and knowledgeable leadership that the 13-man group has come to be known universally as the Fowler task force.

Mr. Secretary, we are glad to have you. We hope we can expedite your appearance here today. And we ask the other witnesses who will follow you to observe the 15-minute limitation on oral testimony.

We do not propose to hold you to that limitation.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY; ACCOMPANIED BY STANLEY S. SURREY, ASSISTANT SECRETARY FOR TAX POLICY; AND WINTHROP KNOWLTON, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Secretary FOWLER. Thank you.

Mr. Chairman and members of the committee, I am appearing before you to urge prompt and favorable action on H.R. 13103, legislation which is intended to establish equitable tax treatment for foreign investment in the United States. Passage of this bill will serve an important national objective by providing a comprehensive and integrated revision of our present system of taxing foreign individuals and foreign corporations on income derived from the United States. The revision is supportable on tax policy criteria and brings our system of taxing foreigners more into line with the rules existing generally in the other developed countries of the world. A fundamental and enduring consequence of this revision will be increased interest on the part of foreigners generally in investment in the United States. This proposed legislation, therefore, is one of the important positive elements of our long-range balance-of-payments effort.

BACKGROUND OF PROPOSALS

In his balance-of-payments message of July 18, 1963, President Kennedy announced he was appointing a task force to review U.S. Government and private activities which adversely affect foreign purchases of the securities of U.S. companies. The group was composed of representatives of finance, business, and government. This task force, of which I had the privilege of serving as chairman, studied various courses of action which could be adopted in both the private and public sectors to encourage foreign ownership of U.S. securities.

In April 1964, the task force issued its report containing 39 recommendations, which called for a broad range of actions by U. S. international business organizations and financial firms, as well as by the Federal Government, to bring about broader foreign ownership of U.S. corporate securities. Among the recommendations directed toward the Government, those dealing with the taxation of foreign individuals and foreign corporations have the most significant and immediate impact.

Issuance of the task force report prompted a broad and intensive review by the Treasury of rules governing taxation by the United States of foreign individuals and foreign corporations. This review considered these rules not only from the standpoint of the balance of payments but also in view of conventional tax policy considerations. As a result of this review, on March 8, 1965, the Treasury Department submitted to the Congress proposed legislation containing proposals in all of the tax areas dealt with in the task force report, and also in other areas where it appeared that change was desirable to make the present system more consistent with rational tax treatment of foreign investment. The House Ways and Means Committee then thoroughly considered that bill, as well as several areas not covered by the bill, and, following public hearings, a new version of the bill (H.R.

11297) was introduced by Chairman Mills on September 28, 1965, and public comments on the revised bill were invited. The committee then further considered the matter in executive session and Chairman Mills introduced a revised version (H.R. 13103) on February 28, 1966. Following public hearings on March 7, 1966, H.R. 13103 was favorably reported out of the Ways and Means Committee and passed by the House of Representatives without opposition on June 15, 1966.

The Treasury Department agrees with the view expressed by the task force and in the House Ways and Means Committee report that many of the existing rules applicable to foreign investors in the United States are outmoded and inconsistent with sound tax policy and as a result deter foreign investment, to the detriment of our balance-of-payments position. These rules were enacted many years ago and do not reflect the changes in economic conditions which have occurred over the last 15 years.

Examples of tax rules which impede foreign investment in this country are many: The present level of our estate tax—much higher on foreigners than on U.S. citizens—is completely out of line with the rates generally prevailing elsewhere in the world and acts as a significant deterrent to potential foreign investors. Also, the fact that we require income tax returns from foreigners who only make passive investments here is inconsistent with international tax practice and hinders foreign investment in the United States. These and other aspects of our system of taxing foreigners contribute to the widely held view that investment in U.S. securities poses such serious tax problems for the foreign investor that it cannot be undertaken without the benefit of expensive tax advice. At the same time, some of these provisions are extremely difficult, if not impossible, to enforce, or are susceptible of relatively easy avoidance by the sophisticated foreign investor. Since they deter many foreign investors and are avoided by the rest, they give rise to almost no tax revenue.

However, this bill is not intended to convert the United States into a tax haven nor divert investment capital to the United States from less developed counries. The purpose of this bill is to provide equitable tax treatment for foreign investment in the United States. At the same time we recognize that this purpose will not be served if the bill violates proper tax policies or international tax standards, thereby setting off a competitive contest among the developed nations of the world to attract foreign investors through tax devices. To attract foreign investors, the United States must offer not "tax breaks" or "tax gimmicks"—it must offer a growing and dynamic economy. We believe our record of economic growth over the last 6 years and our prospects for the future are sufficient to induce a substantial increase in foreign investment if our tax system does not act as a bar.

Moreover, policies of this bill are consistent with the general policy of the United States which treats foreign capital on a basis of equality with domestic capital. Thus, there generally is no requirement that a foreign investor apply to U.S. authorities for permission to invest; the policy of the United States is to avoid interference with the right of foreigners to engage in particular types of economic activity in the United States; there are no legal provisions requiring the participation of domestic capital in foreign enterprises engaged in business in the United States; and the United States has no exchange controls, there

are no restrictions on the remittance of business profits, or income from passive investments, and U.S. dollars are freely convertible in the market for any currencies and for all purposes; and the U.S. economy offers foreigners a safe, ready, and diversified investment market which has an outstanding record of economic growth.

The United States—with a GNP of $732 billion, personal consumption expenditures of $459 billion, business expenditures on new plant and equipment of $52 billion in 1965; an increase of $28 billion in GNP for the first half of 1966, the sixth year of our economic upswing, an open-door policy under which President Johnson said: "The United States warmly invites businessmen from other industrial countries to explore the many promising investments and licensing opportunities in the U.S.A."—offers to foreign investors an opportunity to take advantage of the potentials of investing in a great and growing marketplace. These investments will contribute to the long-range economic growth of the United States and the investing country. The bill should encourage such investments by removing certain tax obstacles involved in the present system.

Enactment of H.R. 13103 will result in a revenue gain of about $1 million annually. In addition, in the fiscal year 1967 only, it is expected that the bill will produce a revenue gain of approximately $22.5 million by reason of the provision requiring U.S. withholding agents to remit taxes withheld on payments to foreigners more frequently than on an annual basis, as is the case under present law. (See table I on p. 7 of the report of the Committee on Ways and Means on H.R. 13103, entitled "Estimated revenue changes resulting from the foreign investors tax bill.")

IMPACT OF H.R. 13103 ON THE BALANCE OF PAYMENTS

There is no way of estimating with any degree of precision the impact of the bill on foreign investment in the United States or the resulting benefit to our balance of payments. The factors governing securities investment are many and complex. Even in purely domestic transactions, intangibles such as habit, convenience, and past experience may be as important as yields, price-earnings ratios, and other economic indicators.

Although difficult to quantify, there is ample evidence of a sizable potential for attracting foreign investment in U.S. corporate securities, particularly stocks, by residents of the prosperous countries of continental Europe. After more than a decade of rapidly rising incomes, Europeans have to a large extent fulfilled many of their most pressing consumer needs and are accumulating savings at a high rate. Individuals in Europe are turning increasingly toward securities investment, as shown by the rising activity on European stock exchanges, the large number of new offices being opened in Europe by American securities firms, and rising sales of mutual fund shares. Yet, even now, in Europe only 1 person in 30 is a shareowner as compared to 1 in 11 in the United States.

At the end of 1965, foreigners held an estimated $12.5 billion of U.S. corporate stocks valued at market prices. In every year since 1950 except three, foreign purchases of U.S. stocks have exceeded foreign sales and in the 7 years between 1959 and 1965, net purchases by foreigners averaged $175 million (both excluding certain foreign

governmental transactions). These net figures are the residual of total transactions which in recent years have been about $2½ billion to $3½ billion each year for both purchases and sales. A small percentage increase in such purchases, therefore, could have had a substantial effect on the net balance of transactions.

If the amount of additional investment expected to result from H.R. 13103 were merely a function of the amount of tax saved, there would be little improvement in the balance of payments. More important than any tax savings to foreigners, however, is the substantial effect which will result from the simplification and rationalization of our tax treatment of foreign investors. Our high estate tax on foreigners, for example, is widely considered by experts to be one of the biggest barriers to foreign investment. Existing estate tax rates almost certainly deter many foreigners from investing here at all. This is particularly so because the exemption is limited to only $2,000—nearly any investment whatsoever will subject the estate to tax and require filing of an estate tax return. It is not surprising under these complexities that the small foreign investor may avoid purchasing U.S. stocks because of the inconvenience of the estate tax; the big investor also may avoid such purchasing because of the size of the tax itself.

Viewed in this light, it is clear that the changes contained in H.R. 13103 should in time materially increase the volume of foreign investment in the United States. Based on the sizable potential for foreign purchases of U.S. corporate stocks which is known to exist, we expect that the legislation will eventually result in a meaningful additional capital inflow, other factors remaining unchanged. Some time—perhaps 1 to 2 years or maybe more—will be required before foreigners can reorient their reactions to the U.S. tax system and complete the adjustment of their portfolios to take advantage of H.R. 13103, but a substantial impact may be felt in the period ahead.

Mr. Chairman, I would like to interject at this point to say that in addition to the half dozen or so recommendations dealing with tax barriers that were in the task force report, many of the other 39 recommendations had to do with activities carried on by the private sector—industrial corporations marketing their securities abroad, securities firms opening up offices abroad, and many other things designed to further the purposes of this act. I think the committee would be interested in knowing that the private sector, since the report was made, has been very active in trying to implement the nontax recommendations that lie within the report's purview.

In the hearings before the House Ways and Means Committee a year ago last June, Mr. Robert Kinney, who was the executive director of the task force, included in the proceedings a detailed accounting of the efforts of the private sector to carry through these recommendations (beginning at p. 114 of the hearings). So we really come down in this bill to that part of the role of government which was considered most important in the task force report.

SPECIFIC PROPOSALS CONTAINED IN H.R. 13103

I should like to review at this time the principal substantive changes embodied in H.R. 13103.

Capital gains.—The present system of taxing capital gains realized by foreigners has contributed to the view that investment in the

United States is something which should be approached cautiously because of the possibility of inadvertently becoming subject to tax.

The Internal Revenue Code now provides for a general exemption from capital gains tax for nonresident foreigners not doing business in the United States with two exceptions. First, the foreigner's gains are subject to U.S. capital gains tax if he is physically present in the United States when the gain is realized, and second, all gains during the year are taxable if he spends 90 days or more in the United States during that year.

The physical presence restriction can be easily avoided by the experienced foreign investor if he arranges to be outside the country when the gain is realized, but is a potential trap to the foreigner who is not aware of its existence. The bill would eliminate this restriction from the general capital gains exemption.

In addition, the bill would extend the 90-day period which a foreigner may spend here without being subject to capital gains tax to 183 days. This will make the provision more consistent with international standards governing the taxation of foreigners residing in a country for a substantial period. It will also minimize a foreigner's fear that he will be taxed on capital gains realized at the beginning of a taxable year if he later spends a substantial amount of time in the United States during that year.

Graduated income tax rates.—At the present time, foreign individuls not doing business in the United States who derive more than $21,200 of investment income from U.S. sources are subject to regular U.S. income tax graduated rates on that income and are required to file returns. (Below that figure a flat 30-percent rate applies.) These requirements have produced little revenue, in part because we have eliminated graduated rate taxation of investment income in almost all of our treaties with the other industrialized countries and in part because of the relative ease with which this provision is avoided. However, the possibility of being subjected to graduated rate taxation and the accompanying return requirement may be a source of concern to foreigners and consequently act as a substantial deterrent to foreign investment in the United States.

H.R. 13103 eliminates this form of taxation of nonresident foreigners not doing business here and removes the requirement for filing returns in such cases. The liability of foreign investors deriving U.S. investment income would thus be limited to the tax withheld at the statutory 30-percent rate or a lower applicable treaty rate. The legislation would continue graduated rate taxation for foreigners who are doing business in the United States. These rules are consistent with the practices of most other industrialized countries.

Definition of "engaged in trade or business".—H.R. 13103 makes clear that nonresident alien individuals or foreign corporations are not engaged in trade or business in the United States—and thus are subject to tax at the 30 percent withholding rate or lower treaty rate rather than at regular graduated rates—because of investment activities here or because they have granted a discretionary investment power to a U.S. banker, broker or adviser. This provision should have the effect of removing much of the uncertainty which now surrounds the question of what amounts to engaging in trade or business in the United States. Uncertainty of this type is undesirable as a matter of

tax policy and has the effect of limiting foreign investment in the United States. Many foreigners do not desire to invest in U.S. stocks if they cannot give a U.S. bank or broker discretionary authority to act for them.

The bill also changes present law by giving foreign individuals and foreign corporations an election to compute their income from real property on a net income basis at regular U.S. rates rather than at the 30 percent withholding rate or lower treaty rate on gross income. This type of treatment is common in the tax treaties to which the United States is a party and is designed to deal with the problem which arises from the fact that the expenses of operating real property (e.g., taxes, interest, depreciation) may be high and cannot be taken as deductions if the recipient of the income from such real property is not engaged in trade or business in the United States. It is sometimes difficult for a foreigner to determine whether his U.S. real estate activities constitute engaging in trade or business in the United States. Thus, taxation at higher graduated rates on a net basis, i.e., after allowable deductions, frequently results in a lower tax liability than taxation at a 30-percent rate (or lower treaty rate) on gross income without any allowance for deductions.

Segregation of investment and business income.—Under present law, if a foreign individual is doing business in the United States he is subject to tax on all his U.S. income, whether or not connected with his business operations, at regular graduated rates. H.R. 13103 would separate the business income of a foreign individual engaged in business here from his investment income (e.g., dividends, interests, royalties), and would tax the investment income at the 30-percent statutory withholding rate or at the lower appropriate treaty rate. All business income would remain subject to tax at graduated rates.

With respect to foreign corporations doing business in the United States (so-called resident foreign corporations), which also have investments here, H.R. 13103 would likewise separate the investment income from the business income of the foreign corporation. Under the legislation, a resident foreign corporation deriving such investment income from the United States would thus be taxable on such income at the statutory 30-percent rate or at the lower applicable treaty rate.

The bill conforms our treatment of investment income to the general approach followed by many other nations. It also is in accord with the Organization for Economic Cooperation and Development Model Income Tax Convention and the approach followed in our more recent treaties with the United Kingdom, Germany, and the Netherlands, and thus has the advantage of conformity to international practice.

The bill offers guidelines, which are supplemented by the legislative history, to the application of the "effectively connected" concept. A foreigner who is receiving investment income from the United States, under the approach of the bill would no longer have to be concerned that some other activity in the United States will suddenly be considered as attributing to him a trade or business status in the United States, thus subjecting the investment income to business taxation. Instead, as long as the investment income is not effectively connected with the other activity, any uncertainty as to the status of the latter would not color or affect the investment income. The removal of such uncertainty should encourage investments by foreigners in the United States.

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

outside the United States (and it may not be taxed by the country of residence of the taxpayer if it does not tax its residents on income arising outside that country under the source rules of that country). In accordance with this tax treatment, the bill allows a foreigner whose foreign source income is so taxed in the United States a foreign tax credit for creditable foreign taxes paid on such foreign source income if the foreign tax is levied on the basis of source jurisdiction by the foreign country.

Personal holding companies and "second dividend tax."—H.R. 13103 changes the personal holding company provisions of the Internal Revenue Code as applied to the U.S. investment income of foreign corporations and also modifies the application of the so-called second dividend tax. Under the bill, foreign corporations owned entirely by foreigners would be exempt from the personal holding company tax as respects their U.S. income. This is desirable because of the elimination of graduated rates as applied to individual foreigners which is contained elsewhere in the bill, and which makes the application of the personal holding company provisions to corporations wholly owned by foreigners no longer appropriate since a withholding tax on its income has already been collected.

Under the bill, the "second dividend tax" (which under present law is levied on dividends distributed by a foreign corporation to its shareholders (whether foreigners or U.S. citizens) if the corporation derives 50 percent or more of its gross income from the United States) would be applied only to the dividend distributions of foreign corporations doing business in the United States which derive 80 percent or more of their business income from their U.S. business. It is desirable to retain this part of the tax to cover those cases where a resident foreign corporation has the great bulk of its business operations in the United States, so as to treat dividends of such a corporation as being from U.S. sources.

These changes should have the effect of eliminating application of the personal holding company tax and "second dividend tax" in many cases where they now apply, and where they may now act as a deterrent to foreign investment.

Bank deposits.—Under present law, interest on deposits with U.S. banks paid to foreigners not doing business within the United States is not subject to U.S. income tax and the deposit is not subject to estate tax. This is an exception to the general rule which subjects to U.S. income tax all interest paid by residents of the United States, corporate or individual. The House saw from the standpoint of tax equity no basis for such an exception but, because of balance-of-payments considerations, deferred the repeal of this bank deposit interest income tax exception until 1972. The repeal of the bank deposit estate tax exemption will become effective for decedents dying after the date of the enactment of the bill.

Where the interest is paid on a deposit of a foreigner in a foreign branch of a U.S. bank, the House liberalized the present bank deposit rule by providing that interest from such deposits with foreign branches of U.S. banks shall no longer be subject to U.S. tax except under limited circumstances. Under present law such interest income is subject to income tax when received by foreigners engaged in business within the United States; and subject to U.S. estate tax in the hands of nonresidents not citizens.

Senator TALMADGE. Mr. Secretary, would you yield at this point for a question or would you prefer to finish your statement?

Secretary FOWLER. Whatever the committee wishes.

Senator TALMADGE. I have received several letters from individuals both inside and outside my State strenuously objecting to this particular portion of the bill on the theory that at the end of 1965 we had some $13 billion worth of bank deposits in the United States, and they claim that if we imposed this tax it will have a very adverse effect on our balance of payments which this bill is supposedly designed to correct. They say particularly since an inheritance tax would be imposed immediately that many of them would withdraw their funds immediately. As I understand this provision, these funds would be taxable under the House bill in the year 1971 which would result in a most serious effect on our balance of payments. I would like to hear your comment on that.

Secretary FOWLER. Well, Senator Talmadge, as I indicated, the decision to terminate in 1972, the income tax exemption in the present law for bank deposit interest derived by foreigners not engaged in trade or business in the United States was made by the House Ways and Means Committee. It was not dealt with in the task force report.

The Ways and Means Committee felt, in effect, that no valid tax reason existed for continuing the exemption in the case of foreigners when U.S. citizens and residents are required to pay U.S. income tax on such interest.

As a matter solely of tax equity, I think the House Ways and Means conclusion appears to be correct.

However, because that decision may have current balance-of-payments implications—and recognizing that—the Ways and Means Committee postponed the effective date of the income tax until 1972, and said that at that time it would have an opportunity to reconsider the balance-of-payments situation. It is our understanding, Senator, that representatives of the banking community will appear before your committee and testify on this provision of the bill. They are, of course, much closer and much more familiar with the actual impact of this 1972 provision, and the current impact of the estate tax provision, than we are. Therefore, we are going to listen very carefully to their testimony. I am sure that it will be helpful to all of us in considering just what the effect is of this change in the law.

I do not have a concrete response to your question, except to urge that the committee give careful consideration to the testimony to be given by those who are more intimately familiar and directly concerned with this matter.

Senator TALMADGE. If I understand your reply correctly, you are neither for nor against the House provision.

Secretary FOWLER. Precisely.

Senator TALMADGE. Thank you.

Senator ANDERSON. Since there has been a pause here, where does this money come from in these banks?

Secretary FOWLER. It comes from all over, Senator Anderson.

Senator ANDERSON. Principally South America?

Secretary FOWLER. I was going to give you what information we have on this. I am now speaking of interest on deposits in U.S. banks paid to private foreigners as distinct from foreign central banks and foreign governmental institutions.

These time deposits, interest on which would become subject to income tax, according to our information, amounted to $2.5 billion at the end of May 1966. Of that amount, about $1.3 billion was held by Latin American residents. About half the Latin American holdings are in three countries—Argentina, Mexico, and Venezuela—which have free foreign exchange systems allowing residents to hold deposits in the United States or elsewhere.

Senator ANDERSON. Thank you.

Senator CURTIS. May I ask one question?

Senator ANDERSON. Surely, Senator Curtis.

Senator CURTIS. If these foreign deposits, deposits by foreigners in American banks become subject to tax, and as a result the depositors remove their money to other countries to have it free of the tax, in what countries could they make their deposits?

Secretary FOWLER. What are the other countries?

Senator CURTIS. Yes. Venezuela deposits money in Switzerland. Will the interest be subject to a tax?

Secretary FOWLER. The treatment varies. Our information indicates that in France they would be exempt from French tax if payable in a currency other than francs; in Germany, they would also be exempt; in Italy they would be taxable; in the Netherlands they would be exempt; in Switzerland they would be taxable. In the United Kingdom they would be——

Senator WILLIAMS. May I ask at what rate would they be taxed?

Secretary FOWLER. In Italy and Switzerland at a 27-percent rate.

Senator WILLIAMS. What rate would be proposed under the House bill?

Secretary FOWLER. Sir?

Senator WILLIAMS. What rate would the House bill propose?

Secretary FOWLER. Thirty percent unless the rate was reduced by treaty. In some countries with which we have treaties, Senator Williams, the interest would be exempt from tax.

Senator ANDERSON. Just a minute. What countries are principally treaty countries, then? Is Great Britain one?

Senator WILLIAMS. Those are the exempt treaty countries you are speaking of?

Senator ANDERSON. He put that in the answer so I thought it might all go in the answer at one time.

Secretary FOWLER. If I may, I would like to complete the answer to Senator Curtis' question giving the tax rates in three other countries and then answer the treaty question. In the United Kingdom, interest from bank deposits of foreigners are taxable at the rate of 41¼ percent, and in Canada at 15 percent—but I should note that in Canada when the deposit has been made in a foreign currency, and the interest is payable in a foreign courrency, no tax is withheld. The last country is Japan where bank interest of foreigners would be taxable at a 20-percent rate. So there are three major countries in which they are exempt, and five in which they are taxable.

Now, as to the countries with which the United States has treaties. Interest on U.S. bank deposits would be exempt in the case of payments to residents of the United Kingdom and taxed at 5 percent in the case of payments to residents of Switzerland under our treaty with Switzerland.

Senator WILLIAMS. Is that a reciprocal arrangement?

Secretary FOWLER. Yes, sir.

Senator WILLIAMS The same rate applies both ways?

Secretary FOWLER. Yes, sir; 10 percent with Japan; 15 percent with Belgium, France, and Canada; 30 percent with—well, 30 percent would apply to the Latin American countries, Argentina, Mexico, and Venezuela.

Senator WILLIAMS. Is it not true that——

Secretary FOWLER. May I make one comment on the United Kingdom. I am told, and I will have to defer to Mr. Surrey for this, that the United Kingdom apparently exempts interest on bank deposits in practice although in theory under the law it appears to be taxable at a 41¼-percent rate.

Senator WILLIAMS. Is it not true that if, for example, the Latin American investments should be deposited in Switzerland rather than here, the interest rates that they would receive would be relatively low, maybe 1 or 2 percent. In some cases don't they actually pay for the privilege of depositing their money over there? Secrecy is the point, not the interest rates.

Secretary FOWLER. That is my general understanding, Senator Williams.

Senator ANDERSON (presiding). Proceed, Mr. Secretary.

Senator CURTIS. May I ask one more question.

How long has the exemption existed?

Secretary FOWLER. I believe it was in the Revenue Act of 1921. According to the legislative history we have on it, it seemed to reflect concern for the competitive aspects—whether the banks here would be placed at a competitive disadvantage if it were not exempt.

Senator CARLSON. Mr. Secretary——

Senator ANDERSON. May I ask one question. Did that have anything to do with the financial condition in which this country found itself in 1921, with banks closing all over the country?

Secretary FOWLER. I cannot really give you a good answer to that Senator; I do not know. The only thing we have found is a reflection of a concern for the competitive situation of the American banks.

Senator ANDERSON. I know of one community which had six banks, and five of them closed. We kept the other one open by brute strength. Could that have had any effect, could that have played any part in this decision?

Secretary FOWLER. It might well have.

Senator ANDERSON. Senator Carlson.

Senator CARLSON. Mr. Secretary, on this income we have from deposits in banks, deposits from foreign countries, assuming we pass H.R. 13103, what would be the proposed rate?

Secretary FOWLER. In the nontreaty countries it would be 30 percent. I have indicated the rates for the treaty countries. Five percent in the case of Switzerland, 10 percent in the case of Japanese depositors, 15 percent for Belgium, France, and Canada, United Kingdom, and certain other European countries would be exempt, and in Latin American countries the full 30-percent rate would apply.

Senator CARLSON. The reason I bring that up, we, of course, have negotiated many treaties, but there are pending presently treaties before the Senate Foreign Relations Committee, and not only that, but

a great number of treaties are being negotiated, as I understand it, all over the world at the present time.

Assuming we in the Congress approved those treaties, would that not substantially change this 30-percent provision?

Secretary FOWLER. I do not think it would because the so-called less-developed-country treaties do not normally carry an exemption or reduction on interest.

Senator CARLSON. They normally do not carry interest?

Secretary FOWLER. They normally do not exempt interest from tax in the source country or reduce the tax on interest.

Senator CARLSON. My thought was if we approved this legislation that is pending and then enter into treaties with foreign countries we would actually vitiate what we thought we were doing on a 30-percent basis, was my point.

Secretary FOWLER. Yes. You would with a certain number of the developed countries, as I have indicated.

Senator CARLSON. That is all.

Senator ANDERSON. You may proceed, Mr. Secretary.

Secretary FOWLER. Estate tax. It is generally felt that our current system of taxing the U.S. estates (involving only the U.S. assets) of foreign decedents is inequitable and constitutes a significant barrier in our tax laws to increasing foreign investment in U.S. corporate securities. Under present law, a foreign decedent is taxable at regular U.S. estate tax rates, ranging up to 77 percent, on U.S. property held at death. Moreover, the U.S. estates of foreign decedents are entitled only to a $2,000 exemption compared with a $60,000 exemption available to U.S. citizen decedents. In addition, foreign decedents are not entitled to the marital deduction available to U.S. citizen decedents. As a consequence, a foreign decedent's estate must pay far heavier estate taxes on its U.S. assets than would the estate of a U.S. citizen owning the same assets. Moreover, U.S. estate tax rates applied to nonresidents are in most cases considerably higher than those of other countries and therefore foreigners who invest in the United States suffer an estate tax burden.

H.R. 13103 would increase the exemption for the U.S. estates of foreign decedents from $2,000 to $30,000 and would tax such estates on the basis of a 5- to 25-percent rate schedule. With this significant increase in the exemption and sharp reduction in rates, the effective U.S. estate tax rate on foreign decedents would be generally comparable to the effective rate of tax of a U.S. citizen who can utilize the $60,000 exemption and the marital deduction. This effective rate would no longer be considerably higher than most other countries, and would be more closely comparable to the rates prevailing elsewhere.

Senator WILLIAMS. Would not that formula give foreign decedents a lower rate than U.S. citizen decedents when the reduction in the rates on the larger estates is taken into consideration.

Secretary FOWLER. This would be on the higher——

Senator WILLIAMS. Yes; I am speaking of the 5- to 25-percent rate if we change that schedule. That would change it.

Secretary FOWLER. Let us take a U.S. gross estate of $500,000. Under the proposed law the effective rate on a nonresident alien would be 7.4 percent. In the case of a U.S. citizen with a marital deduction the rate would be 8 percent. In the case of a U.S. citizen without a marital deduction the rate would be 22 percent.

If the gross estate was $1 million, the effective rate of tax on a nonresident alien under the proposed law would be 10.1 percent. For the U.S. citizen with a marital deduction the rate would be 11.1 percent and for the U.S. citizen without a marital deduction the rate would be 26.7 percent.

Senator WILLIAMS. As to the person with a gross estate of $5 million, I notice in the table on page 43 that this bill would cut the estate tax to about 30 percent of the existing rate, and would put it at about half of the rate paid by American citizens.

Secretary FOWLER. Without the marital deduction.

Senator WILLIAMS. Yes.

Secretary FOWLER. A fair summary would be they are comparable where there is the marital deduction. The U.S. citizen without the marital deduction would pay a substantially higher rate.

Senator WILLIAMS. There is not such a reduction in the smaller estates, but in the larger estates there is practically a 50- to 60-percent reduction under this bill.

Secretary FOWLER. Yes; however, moving the exemption from $2,000 up to $30,000 would exempt the smaller estates.

Senator WILLIAMS. Of course, there has been a suggestion, and I do not know but there may be an amendment offered here, to raise the exemption in this country from its present $60,000 to $120,000. When was the present $60,000 exemption put into effect?

Secretary FOWLER. I do not recall.

Senator WILLIAMS. There has been quite a change in the value of the dollar since that time.

Senator ANDERSON. You would get a lot of support for that amendment.

Senator WILLIAMS. What would be the Treasury's position to the changing of that exemption, because I know that is going to be proposed to this bill?

Secretary FOWLER. Senator, I do not know what it would be at the moment. We have been engaged in a thoroughgoing study in the whole estate tax area, and we have not as yet arrived at a conclusion.

Senator WILLIAMS. This has been mentioned for the last 2 or 3 years. I think you would admit, would you not, if $60,000 was fair when it was first initiated it is far out of date under the existing valuation of the dollar?

Secretary FOWLER. I would prefer to say that I think that rather than deal with just one particular aspect of the estate tax, I think the whole area justifies a thorough reworking. At least that is the conclusion we have come to after about a year of fairly intensive study. That would be one aspect of it.

Senator ANDERSON. That is not an answer to Senator Williams' question.

Secretary FOWLER. No, sir.

Senator WILLIAMS. I gather it is somewhat like the answer you gave to Senator Talmadge before, you are neither for nor against?

Secretary FOWLER. That is right.

Senator WILLIAMS. We will settle for that answer, no position.

Secretary FOWLER. Well, I would be inclined to say that many other things ought to be taken into account before you act on one aspect of the estate tax.

Senator WILLIAMS. I think the whole rate structure of the estate tax should be studied carefully.

Secretary FOWLER. We think so, too.

Senator WILLIAMS. But I am not too sure it would be necessary to wait on that particular point because it is one that can very readily be understood and the merits can be appreciated on their own irrespective of what we may do with the other phase of it.

Secretary FOWLER. It could be quite expensive, and I am always concerned that when we remove some inequity we also try to compensate wherever we can by getting back the revenue. That is one aspect of the problem that disturbs me.

Senator WILLIAMS. I compliment you on the statement you just made. I only wish you felt the same way when we were cutting taxes. We would have been together then, too.

Senator ANDERSON. Mr. Secretary, on the amount that is available, by passing the marital reduction, didn't we substantially increase our $60,000?

Secretary FOWLER. It is about $120,000 as a practical matter now.

Senator ANDERSON. Yes.

Secretary FOWLER. And the marital deduction was adopted, I believe, in 1948.

Senator ANDERSON. 1948.

Secretary FOWLER. Since the war; yes, sir.

To get back to my statement, the change in the estate tax rates on nonresident aliens should have an important effect on foreigners contemplating investment in U.S. securities. Where the gross U.S. estate would be less than $30,000, there would be no estate tax, and no need to file an estate tax return. In those instances where the estate is larger, the effective rates would be substantially reduced. Thus, the top rate would drop from 77 to 25 percent, and the effective rates would be only 3 percent on a U.S. estate of $100,000 (the present effective rate is 17 percent), 7 percent on a U.S. estate of $500,000 (the present effective rate is 26 percent), 10 percent on a U.S. estate of $1 million (the present effective rate is 29 percent) and 18 percent on a U.S. estate of $5 million (the present effective rate is 43 percent).

Expatriate American citizens.—The provisions of H.R. 13103 which eliminate graduated income tax rates for foreign individuals and substantially reduce the estate tax liability of foreign decedents may create a substantial tax incentive to U.S. citizens who might wish to surrender their citizenship in order to take advantage of these changes in the law. While it is doubtful whether there are many who would be willing to take such a step, still the incentive would be present and might be utilized. In 1936 when the Congress eliminated graduated rates of tax on the U.S. income of former citizens, this action was reversed within 1 year because it was believed that this change had provided an incentive for expatriation to avoid tax. H.R. 13103 deals with this problem by providing that in the future an individual who has surrendered his U.S. citizenship for tax reasons within a preceding 5-year period shall be subject to U.S. taxation with respect to his U.S. income and assets at the rates applicable to U.S. citzens. Such individuals will therefore not receive the benefits of this legislation during such 5-year period but will be taxed substantially as nonresident foreigners are at present. These provisions will not apply unless

the avoidance of U.S. taxes was one of the principal reasons for his surrender of citizenship.

Retaining treaty bargaining position.—By unilaterally making the changes applicable to foreigners provided in H.R. 13103, the United States could be placed at a considerable disadvantage in negotiating similar rules in other countries for Americans with income from foreign sources. In order, therefore, to protect the bargaining position of the United States in international tax treaty negotiations, H.R. 13103 authorizes the President, where he determines such action to be in the public interest, to reapply present law to the residents of any foreign country which he finds has not acted to provide our citzens with substantially the same benefits for investment in that country as those enjoyed by its citizens on their investments in the United States as a result of this legislation. If this authority were invoked, it could be limited to those investment situations as to which U.S. citizens were not being given comparable treatment. This provision of the bill is patterned on provisions presently contained in the Internal Revenue Code which attempt to assure U.S. persons appropriate tax treatment by foreign countries, e.g., section 891 which provides for doubling of U.S. rates on foreigners under certain circumstances; section 901(b)(3) which denies a foreign tax credit to alien residents of the United States unless a similar credit is allowed U.S. persons by their home countries. We believe that the presence of such a provision will be a material aid in our securing appropriate provisions respecting these matters in our international tax treaties.

In addition to the comments I have made on the existing bill I wish to recommend to the committee two amendments which will further the purpose of this proposed legislation.

The first of these would clarify the tax exemption on income from investments held by foreign central banks in securities or other obligations issued or guaranteed by the various agencies of the U.S. Government. The present language of section 895 of the code which provides for tax exemption on income received by foreign central banks on "obligations of the United States" leaves in doubt the status of some obligations of Federal agencies other than those of the Treasury. Interest in such investments has been shown by various central banks and it is clearly desirable to provide the broadest possible spectrum of investment possibilities in the United States in order to attract and hold foreign dollars which otherwise might be converted into gold. Also from the standpoint of marketing such issues it is in our interest to broaden the market by making them attractive to this type of large investor.

The second amendment would expand the authority of the Secretary of the Treasury to issue foreign currency denominated securities in the same range of maturities and interest rates as is authorized for regular dollar issues and in a manner which could benefit our balance of payments. The present legislation permits the sale of such foreign currency denominated issues only in the form of bonds and certificates of indebtedness whereas regular dollar issues may be offered in the form of certificates, bonds, and notes. Offerings in the 1- to 5-year maturity range are in the form of notes. The ability to issue notes in the foreign currency series of securities will make it possible for us to offer an attractive investment in the medium-term range of maturities since interest could be paid at rates comparable to that on regular

U.S. issues of similar maturity. I, therefore, propose that the word "notes" be added to present language of section 16 of the second Liberty Bond Act of 1917, as amended.

The Treasury Department also recommends certain amendments to the bill developed jointly by our staff and the staff of the Joint Committee on Internal Revenue Taxation. These proposals are described in a printed pamphlet entitled "Summary of House Bill and Suggested Technical Amendments," prepared for your use by these staffs, and therefore I will not describe them now.

CONCLUSION

Our current system of taxing foreign investors in the United States contains elements which are inconsistent with generally accepted international tax policy principles and which, at the same time, act to discourage foreign investment in the United States. H.R. 13103 is designed to reshape our present system in order to make it a more rational and equitable vehicle for taxing foreign individuals and corporations.

The legislation is an important element of the President's comprehensive program for dealing with our balance-of-payments problem. Foreigners will invest in this country as long as our economy remains prosperous and stable. However, it cannot be expected that the level of foreign investment will reach its full potential so long as provisions exist in our tax laws which, while serving no sound tax purpose, discourage foreign investors. H.R. 13103 will eliminate or modify these provisions and provide an up-to-date system of taxing foreigners which is in accord with international tax standards.

Adoption of H.R. 13103 will lead to a simpler, more rational, and more equitable method of taxing foreigners. It will also be an important step in improving our balance-of-payments deficit and the strengthening of the international position of the dollar. Because this legislation will contribute to these two vital national objectives, I urge you to support it.

Members of the committee, I have with me at the table Assistant Secretary Surrey, who has labored long and hard both in preparing the Treasury recommendations and working in executive session with the House Ways and Means Committee and the staff of that committee. This is a technical subject, and I will call upon Secretary Surrey from time to time to deal with some questions.

Assistant Secretary Winthrop Knowlton is here to assist in connection with questions that might involve balance-of-payments information.

Senator ANDERSON. Thank you for your statement, Mr. Secretary.

I think I can ask my questions by showing what Saturday's mail brought in on the subject. It is good reading, I might say.

Have you seen these documents put out by the New York State Bar Association and various firms?

Secretary FOWLER. No, sir, I have not. Perhaps Mr. Surrey is familiar with some of them.

Senator ANDERSON. It just seems to me that Mr. Surrey or somebody ought to go through some of these and try to decide whether their arguments are good or bad. I was quite impressed with the arguments.

Mr. SURREY. Senator, our staff is going through those documents with the joint committee staff to see if there are any technical changes we would like to recommend in addition to those listed in the pamphlet that has already been prepared for the committee.

Senator ANDERSON. I think that when somebody goes to the effort of preparing a 100-page pamphlet with what sounds like very good arguments in it, that the Treasury might supply us with a brief answer if they wished to do so.

Senator WILLIAMS. In line with that same question, it seems to me, Mr. Secretary, you are dealing here with a very far-reaching bill, and one which completely revises the present method of taxing foreign investment in this country. It is a complete revision, and a substantial reduction, for estate taxes, and income taxes as they will be paid by foreigners owning American investments, and I am wondering if this particular reduction in the estate tax provision, and some of these other reductions, should not be considered in light of what we are going to do in a revised tax proposal for our American citizens, and I——

Secretary FOWLER. Senator, I would hope you would not defer action on this bill. This bill, it seems to me, is long overdue. It is one which is designed to deal with the balance-of-payments problem—not in an emergency way, but as one of the paths to a long-term solution of the problem.

The task force report was originally made in the spring of 1964. The House committee thoroughly considered the bill all last summer, and comments were invited. There were hearings in June of 1965. This bill has been around a good long time. I would certainly hope that for balance-of-payments reasons, if for no other reason, that you would deal with it fairly promptly.

This does not mean that the estate tax problem as it applies to domestic persons is not an important one. As I have indicated to you, we have been working fairly intensively on it over the past year or so. But if we are going to try to review all the provisions of the code that affect domestic taxpayers, and get into that kind of a reform along with revising the tax on foreigners, we will never get this bill through.

Senator WILLIAMS. I am not saying that we should postpone it indefinitely, but I think you have given an excellent argument for the position I just suggested, because you said yourself that your task force studied this extensively in 1964, and that the House studied it throughout last year, and the early part of this year. But in the Finance Committee and in the Senate we are being presented with it here in the middle of August, just ahead of what we hope is going to be an adjournment and I am wondering if this committee has the time to really study and understand exactly what is proposed.

I was wondering if it would not be better if we worked out an agreement that this proposal, perhaps substantially in the form in which it presently is, could be presented to us in the early part of next year when we could give it the study it deserves rather than for us just to rubber stamp the proposal on a lot of suggestions which we are not going to have time to analyze.

Secretary FOWLER. Well, I really think that from the standpoint of the balance of payments, as I indicated earlier in my testimony, the private sector has been very energetic in trying to carry out their

part of this task force report. Most of the comment that I get, quite frankly, is, "Why is the Congress holding this up?"

There seems to be no great disagreement about it. There was no opposition to it in the House. As far as the estate tax matter, the task force report recommended a revision which I am sure the Congress would never come to in dealing with estate taxes of domestic citizens. It recommended that you eliminate U.S. estate taxes on intangible personal property of nonresident alien decedents, and the grounds for it are contained on page 24 of the task force Report, which are simply that the balance-of-payments benefits that would be achieved so far outweighs the questions of whether or not this is in the proper equity relationship to domestic citizens that the members of the task force unanimously felt that it ought to be eliminated.

I signed that particular report feeling that way myself.

Senator WILLIAMS. When did you sign it?

Secretary FOWLER. That was in April 1964.

Senator WILLIAMS. That is right. That is 2 years ago, over 2 years ago, and now, this is the first time that I have had anyone from the Treasury Department suggest to me that this was an important measure to be dealt with this year.

Secretary FOWLER. It was in the President's message of February of 1965, Senator Williams. I would like to bring your attention to the specific paragraph, because it——

Senator WILLIAMS. That is the same message in which he said he was going to balance the budget; I think I remember the message.

Secretary FOWLER. No, this was the one of February 10, 1965, which outlined the whole balance-of-payments program. It included the so-called voluntary program on direct investment and on foreign bank loans. On page 7 of the report the President said:

> A truly worldwide market for capital among industrialized countries requires a two-way flow of investment in order to stimulate a greater inflow of capital from advanced industrial countries. The Secretary of the Treasury will shortly request legislation generally along the lines recommended by a Presidential task force to remove the deterrents to foreign investment in U.S. securities. This action will be reinforced and encouraged by the efforts of American business and finance to market U.S. stocks and bonds to foreign investors.

This proposal has been a matter of very great responsibility on the part of the financial community, both here and abroad, and it is viewed as a key element in dealing long term with our balance-of-payments problem.

Senator WILLIAMS. I do not question that the balance-of-payments problem is serious. In fact, I sometimes wonder if I am not more concerned than the Treasury, because one of my criticisms is that the Treasury does a lot of talking about the problem, but does little in the way of acting on the problem.

Now, Treasury recommends this bill as the solution to the balance-of-payments problem, but as always, it seems too little, too late. This is not going to provide the solution to the problem of the balance of payments.

Secretary FOWLER. There is not one solution. You have to deal with many facets of it, and this is an important facet of a long-term treatment of the problem. It is one which, in my judgment, is overdue as far as the Congress is concerned, if I may speak quite frankly. The Treasury has been pushing this. We have been anxious to get it through.

We have tried to do what we could to impress this upon the Congress. Obviously it was futile to ask this committee to hear it until the House finally acted. The House finally acted in June, and we have been urging that it be scheduled as soon as possible for hearings before this committee.

Senator WILLIAMS. I will withhold further questions at this moment.

Senator ANDERSON. May I comment here for just a second once again. One of these documents I received is from Brown Bros. & Harriman, sent to me by a former very fine member of the Senate, Prescott Bush, and I want to read just one part of it:

> We, therefore, urge that H.R. 13103 be amended by dropping the provisions of the tax on bank deposits; namely, that interest on such deposits will continue to remain exempt from Federal income tax and withholding and that such deposits continue to remain exempt from Federal and estate taxation.

That is the big item they have that is going to be the big fight before the committee before they report a bill out.

Can you tell me what your attitude would be on this if the bill was reported out without that provision, would you be for it?

Secretary FOWLER. Yes.

Answering Senator Talmadge's comments on it, I made note of the fact that this was a decision of the House Ways and Means Committee and that from the standpoint of tax equity the conclusion appears to be a correct one. But the decision also has very serious current balance-of-payments implications, according to the banking community who deal in this particular area. I would hope, without taking a position one way or another—because I am not in a position to make a judgment about this matter—that this committee would pay very careful attention to representations such as the one you referred to, and to the testimony which, I think, will be forthcoming from representatives of the banking community as to the impact of this deferred intention to remove the exemption which becomes effective in 1972.

Senator ANDERSON. I understand that you do not violently object.

Secretary FOWLER. No, sir; I do not either object——

Senator ANDERSON. If it should develop, Mr. Secretary, that we got stuck on these, you would not object in regard to the rest of this bill?

Secretary FOWLER. No, sir.

Senator CARLSON. Mr. Secretary, in your statement you mentioned that the Internal Revenue Code now provides for a general exemption in capital gains tax for nonresident foreigners doing business in the United States with two exceptions. These two exceptions you mentioned are, first, the foreigners' gains are subject to the capital gains tax if he is physically present in the United States when the gain is realized and, second, all gains during the year are taxable if he has spent 90 days or more in the United States during that year. This raises a question in my mind.

You mentioned in your statement, too, that many invest in mutual funds, they pay capital gains. How does that fit in under this bill? Would they be subject to tax under mutual funds, investments in mutual funds?

Secretary FOWLER. A foreigner investing in a mutual fund?

Senator CARLSON. Mutual fund. Presently they are not.

Mr. SURREY. Under this bill, if he is not present in the United States for 183 days during a taxable year he would not be subject to tax.

Consequently, a foreigner who lives abroad—one who does not come to the United States at all, which, I think, is the example you had in mind—would not be subject to tax.

Senator CARLSON. In other words, a foreigner could continue to invest in mutual funds and receive capital gains without tax.

Mr. SURREY. That is right.

Senator WILLIAMS. But if he lived in the United States 183 days, then he would be taxable under this bill.

Mr. SURREY. That is right. Today, if he lived in the United States 90 days he would be subject to tax.

Secretary FOWLER. If he were physically present when he sold out he would also be taxable under present law.

Senator CARLSON. You have been stressing your interest in our balance of payments, and I think we can all share this with you. But I was interested to read in the last issue of Business Week that—

> The Internal Revenue Service proposal to clarify tax laws affecting U.S. companies and their foreign affiliates is expected to boost shipments abroad.

And, of course, that is to boost exports which would be helpful in the balance of payments.

Secretary FOWLER. Yes.

Senator CARLSON (reading):

> The Treasury Department this week moved to clarify the hazy tax picture on transactions between a company and its domestic and foreign subsidiaries. The law, section 482 of this law, permits the Internal Revenue Service to adjust or allocate the incomes of various members of a group of firms under common control in order to reflect accurately the true income of the members to prevent tax avoidance.

What can you do, what have you done, under that particular section of the tax law?

Secretary FOWLER. We have announced and issued proposed regulations which will be subject to a hearing and comment over the weeks ahead.

The particular regulations that have been published for hearing and consideration are designed to deal with the concern that many American companies who do business with affiliates abroad have concerning the action of the Internal Revenue Service in levying an additional tax on the domestic company on the ground that too much of the profit, so to speak, has been passing over to the foreign affiliates. There has been a great deal of concern in the exporting community about section 482 and the proposed regulations are primarily designed to give clarity to the situation, to avoid any rigid hard-and-fast rules, and to provide guidelines for areas which seem to be causing most of the trouble.

We have tried in the regulations to stay clearly within the policy of law as the Congress intended, and yet, at the same time, to interpret the law and apply it in such a way as to clear up the confusion and to encourage the venturing out into the export field of American concerns and businesses. We will, of course, hear the comments from those who specialize in these areas, and then, in the light of those comments, the regulations will become effective.

I should say also, Senator, that we have studied carefully in this connection the report of the National Export Expansion Committee which is a committee established by the Department of Commerce. It has made three very substantial reports on how to encourage ex-

ports. We have taken the one dealing with this particular area very much into account.

Senator CARLSON. Under existing law, then, you are authorized and permited to deal administratively with this particular section of the law?

Secretary FOWLER. That is right—to allocate income and deductions between the domestic seller and his foreign affiliate.

Senator CARLSON. Then I get back just to one other question and that deals with treaties. Now, when we begin to negotiate treaties between countries, as we are doing and have done, does this section have any effect in this way, in a way that we will either take care of it in a treaty——

Secretary FOWLER. Not until fairly recently. Lately, however, it is my understanding that provisions have been included in our income tax conventions which in essence provides that the treaty countries will get together in an effort to prevent them from both taxing the same income if there is a section 482 type adjustment made which affects related companies.

Senator CARLSON. That is all, Mr. Chairman.

Senator ANDERSON. Senator Talmadge.

Senator TALMADGE. Mr. Secretary, do you know how much money foreigners have on deposit in banks, savings and loan associations, and insurance companies in the United States?

Secretary FOWLER. We have the figure on time deposits, Senator Talmadge, and that is two and a half billion dollars.

Senator TALMADGE. Do you have figures for other type deposits? One of my correspondents said the sum total of the three was $13 billion.

Secretary FOWLER. I think that includes all short-term banking liabilities to private foreigners, of which bank time deposits are only a part.

Within that larger total the private time deposits are two and a half billion dollars.

Senator TALMADGE. Let us look further into this problem and see how it might affect our balance of payments.

Assume that a citizen of South America has had deposits, for example in the Chase National Bank in certificates of deposit in the amount of $1 million. The interest rate now on this type deposit I think, is 5½ percent.

Secretary FOWLER. Yes, sir.

Senator TALMADGE. The interest on the $1 million over a period of 1 year would be $55,000, would it not?

Secretary FOWLER. That is right.

Senator TALMADGE. Now, if this bill passes in its present form it would be subject in 1971 to a 30-percent flat tax rate, would it not?

Secretary FOWLER. In 1972, it would be subject to a 30-percent U.S. tax rate. That is correct, sir.

Senator TALMADGE. That would be $16,500 he would pay on his certificate of deposit.

Assuming a citizen did not want to pay that tax, what would prevent him from withdrawing his money in the New York bank and transferring it to the same bank in Paris, France?

Secretary FOWLER. Nothing whatsoever.

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Senator TALMADGE. In other words, that would mean if he were wise enough and had foresight enough and wanted to avoid this tax he would simply withdraw the $1 million he has on deposit in New York and transfer it to the Paris bank, thereby avoiding the tax and getting the same return, would he not?

Secretary FOWLER. That is correct, and I think I should add to that that most banks in Europe do accept dollar deposits from foreigners and pay about the same rate as is paid in the Euro dollar market, as it is called. The interest rate over the past year there has been ranging about a half percent higher than in the United States.

Senator TALMADGE. In other words, he would earn $5,000 more and escape the tax.

Secretary FOWLER. That is right, and to carry out the mathematics of your questioning, according to our computation the net return on deposits in these countries, if it is equal to the gross interest rate currently payable would be about 6½ percent on 3-month Euro dollar deposits compared to a gross yield in the United States of about 5½ percent and a net yield to a foreigner after application of the withholding tax, of about 3.85 percent.

Senator TALMADGE. Doesn't it seem to you logical that this particular foreigner would choose this course of action and increase his income by escaping the tax?

Secretary FOWLER. From my own simple knowledge of the situation I think it does present a case.

Senator WILLIAMS. Would the Senator yield at that point?

Senator TALMADGE. Yes.

Senator WILLIAMS. Assuming that the individual did that and deposited it in France, would he be subject to a tax in France, and would he have the same privileges of withdrawal and convertibility as he would have in this country or would he lose some of those advantages?

Secretary FOWLER. Insofar as the tax goes, Senator Williams, my earlier comments indicated that in France, Germany, and the Netherlands, he would not be subject to a tax in the source country. Insofar as convertibility goes, that is a much more complicated question. I do not want to hazard a comment on that, although my impression is that there is fairly free movement insofar as bank deposits are concerned.

Senator TALMADGE. Assuming, Mr. Secretary, that he made that transfer from the New York bank to the Paris branch of the same bank, would not that $1 million certificate of deposit be a factor in the further drain of our gold supply?

Secretary FOWLER. That is one of the consequences. There is a possibility of a gold impact from shifted dollar deposits.

Senator TALMADGE. Mr. Secretary, I listened to your testimony very carefully, and I think the main thrust of this bill would accomplish desirable ends, to increase investment in this country, and curtail our dollar drain. However, it seems to me that this particular provision of the bill which we have been discussing is calculated to do just exactly the opposite. Bank deposits are highly mobile in character. People are going to look for the highest possible short-range return, and if they can get a better return elsewhere and escape the tax, it is unquestionable that most foreigners would immediately transfer their deposits elsewhere to avoid the tax and get the higher return.

This probability is fraught with very grave danger, and so far as our dollar deficit is concerned, I would hope the Treasury would look into that aspect of it very carefully and be prepared to recommend to this committee, one way or another, what we ought to do about it.

Secretary FOWLER. Well, I think, Senator, it is a question of weighing the balance-of-payments consideration with the tax equity consideration—two very valid considerations. The House Ways and Means Committee gave a preeminence to considerations of tax equity as between domestic citizens and the other——

Senator TALMADGE. I would agree with that aspect of it completely. Certainly I would hate to see the United States of America grant preferential treatment to foreigners that is not given its own citizens. But the fact remains we have jurisdiction over American citizens and we do not over foreigners.

Secretary FOWLER. That is the observation I was going to make. The foreigner has an option—he can leave his money here or he can take it someplace else.

Senator TALMADGE. An American does not.

Secretary FOWLER. The American has a much lesser option, shall we say and, therefore, looking at it from a balance-of-payments standpoint, I think one views this provision with a considerable amount of concern.

Senator TALMADGE. Then you would have the further inequity that results from some American banks having foreign branches and some not.

Secretary FOWLER. That is another aspect of the problem.

Senator TALMADGE. So the American bank with foreign branches might not lose any deposits. It would merely shift from the American branch to the foreign branch. The foreigner would get increased income on his deposit, and escape the tax at the same time. But if the American bank had no foreign branches it would lose the deposit, which would also further complicate the dollar deficit crisis.

Secretary FOWLER. I think that is true. And I would imagine that one of the considerations that led the House to defer the effective date of this provision until 1972 was so that banks without foreign branches that were interested in this business could arrange to open foreign branches.

Senator TALMADGE. Thank you, Mr. Secretary.

Senator ANDERSON. Senator Dirksen.

Senator DIRKSEN. Mr. Secretary, I have one question. All the representations and all the mail I have received concern section (2) (c) (1) on page 12. The words are "effectively connected." They point out that foreign corporations doing business in this country but, at the same time, out of their home office in their own country they do an investment business, but they permit their New York office to collect a return, interest and principal, on foreign loan repayments and so forth. They are uneasy about what the interpretation of the proposed "effectively connected" is going to be. I have had mail from Asia, Europe, and any number of people in this country, and I swear that all the letters deal with just that item. I understand that it is on page 12 of the bill.

Secretary FOWLER. Yes, Senator Dirksen, this has been a phrase that has given rise to some concern. I am going to ask Secretary Surrey if he would deal with it. My understanding is that in the legis-

lative history of the House bill an attempt has been made, in discussing this particular provision, to deal with many of the fears that might otherwise arise. Whether that has been effectively and adequately done in the legislative history, I do not know. I would defer to Mr. Surrey about that. But I would also think that in that connection the Senate report might well direct itself to an interpretation or a meaning of this phrase that would allay some of the concern that ought really not be there.

Mr. SURREY. Yes.

I think the Secretary's statement indicates the situation. In the case you gave where the foreign investor is doing business in the United States and is also investing in the United States, we were trying to achieve a device which would not subject his investment income to the higher rates of business tax except in those cases where that investment income was, as the bill says, tied in or effectively connected with his business.

It is a phrase which we are now using in our treaties with the Western European countries in conformity with the model draft which the OECD has written. We are extending it in this bill to all of the countries without waiting for treaties on this particular point.

Now, it is a new phrase in our tax language, and, consequently, there will be doubts at the borderline until some more experience is gained.

If we could look at the particular problems that have been addressed to you, Senator, we could see whether there could be language put in the Senate committee report to further clarify this phrase. We would be glad to help in that regard, although we had thought that the House report had removed most of the difficulties. As I say, it is a rule which is now evolving in our treaties, as well as in European treaties, when those countries are dealing with each other.

Senator DIRKSEN. Would it be advisable to expand the definition in the statute itself so that they would be fully on notice without having to depend on any Treasury regulations?

Mr. SURREY. If the language could be found, Senator. It is like the situation today where, for example, we use the phrase "engaged in trade or business in the United States." It is rather hard to expand upon language of that nature. It takes time to gain experience with the borderline cases. The phrase "effectively connected" is defined to some extent in the statute on page 13, so that there are some guides there.

We would not be adverse to improving the language in the bill or to adding language in the committee report if it would give people more guidance.

Senator DIRKSEN. That is all.

Senator ANDERSON. Senator Curtis.

Senator CURTIS. Mr. Secretary, is the provision inserted by the House with respect to bank deposits the only portion of H.R. 13103 which increases the tax burden?

Secretary FOWLER. No. There are some other provisions, Senator Curtis. For example, one has to do with insurance. I think foreign insurance companies have enjoyed a considerable competitive advantage over U.S. insurance companies under present law and the bill attempts to equalize the competitive position of foreign insurance companies, primarily Canadian companies, with U.S. insurance companies. That results in some increased revenue.

Senator CURTIS. Are there any others of significance?

Mr. SURREY. There is one other situation where a foreign corporation is engaged in business activities in the United States but because of our technical source rules the income is technically not within the present taxing jurisdiction of the United States. In three or four limited cases the United States under this bill will assert tax in these situations. It is impossible to estimate the revenue gain from that, but there will be some revenue gain.

Senator CURTIS. What will be the revenue gain from the House provisions in reference to bank deposits?

Secretary FOWLER. $300,000 is the only estimate currently. That has to do with the estate tax that now excludes bank deposits, but would, after the law is passed, include bank deposits. That is not an estimate of what would be the effect of the law in 1972 when the interest on bank deposits would become taxable.

On page 7 of the House report the elements of gain are calculated: $300,000 from the estate tax on excluded bank deposits; $3 million from taxation of foreign life insurance company income from nontrustee investments in the United States; and $1,593,000 from savings on interest costs to the U.S. Government resulting from the quarterly payment of withheld taxes. That last provision changes the rules on when taxes withheld from foreign persons are to be returned to the Treasury by the person collecting the tax. It accelerates that process.

Senator CURTIS. Is that a one-time gain or reoccurring?

Secretary FOWLER. Sir?

Senator CURTIS. Is that a one-time gain?

Secretary FOWLER. The interest costs each year are an annual gain. The one-shot benefit is about $22 million.

Senator CURTIS. So the gain on the table on page 7 of $4,893,000, is the continuing gain.

Secretary FOWLER. That is the continuing gain.

Senator CURTIS. I guess that is all, Mr. Chairman.

Senator WILLIAMS. I had one question. I passed before because the staff was working up a hypothetical case. But the question deals with this point, that under existing law a foreigner who has investments in this country is taxed pretty much at American individual tax rates, is he not?

Secretary FOWLER. Yes; I think that is a fair statement, subject to treaty arrangements.

Senator WILLIAMS. That is right.

A question has been raised as to whether or not, if this bill is passed in the form in which it is presented, we would be inviting the extremely wealthy individual in this country who wished to escape some of his income taxes and inheritance taxes to give up his American citizenship, go down to Nassau, spend 6 months of the year there, and return to the United States. Suppose such an individual had $100 million in investments in this country—and some of them do—with an annual income of $5 million from those investments. Instead of paying income tax at American rates, after he had lived abroad 5 years, he would be able to pay income tax at the lower rate under this bill. If he lived abroad for 10 years, his estate tax would be about one-tenth of what it is under existing law. I have asked the staff to provide a hypothetical case and to determine just how much difference it would mean on the annual tax rate, and on the estate tax for some individual.

Have you given any consideration to that point?

Secretary FOWLER. Yes.

Senator WILLIAMS. Now, there is a similar problem when an individual gives up his residence in one State and goes to another State to take advantage of a better tax climate. That is not so serious as an inducement for an American citizen to go abroad and to take advantage of a provision that in effect creates a special tax haven in the United States for foreign investment. Would that be possible, to what extent, and have you given it any consideration?

Secretary FOWLER. Yes, Senator Williams; we worried about this considerably. As a matter of fact, I think we, in executive sessions and in discussion of it, asked that the House committee provide 10 years in both cases. It is a matter of judgment as to what the appropriate period of years would be to be sufficient to meet this problem. The House committee came out with a recommendation that 5 years in the case of income tax, and 10 years in the case of the estate tax, would be the appropriate period. I have no particular quarrel with that judgment. I think the situation is as you presented it, and if this committee saw fit to make that period of time a longer period in order to deal with the problem, we certainly would not object.

Senator WILLIAMS. For the moment, we will skip the time element. As I understand the existing law it has no such loophole in it, but the adoption of this particular provision, in effect, creates a loophole whereby you are handing out an incentive for the wealthy of this country to give up their American citizenship and yet have the same protection of all their investments in this country without having to contribute toward the defense in the form of taxes. Do you think that is a wise policy for us to adopt for the first time here in America?

Secretary FOWLER. Under present law you still have this particular problem, because now a person can give up his citizenship, renounce it, and rid himself, so to speak, of his responsibilities under present law.

Senator WILLIAMS. Well, now, can he, assuming this same hypothetical case——

Secretary FOWLER. Perhaps you will give me this hypothetical case.

Senator WILLIAMS. This individual keeps his investments in this country and gives up his American citizenship under existing law, and say he complies with all the rules of living out of this country the specified time but when he dies, that individual will be taxed. If he had a gross estate of $10 million, he would be taxed at 53.3 percent, whereas under this bill he would be taxed at 20 percent or have his taxes reduced by around 60 percent. Now, there is a difference here. I mean under existing law he would pay the higher tax, would he not?

Secretary FOWLER. I would like to have Mr. Surrey answer that.

Mr. SURREY. It is a question of degree, Senator. If he is so determined as to give up his American citizenship to save taxes, then he can go on and be sufficiently resourceful in all probability as to make it very difficult for us to effectively collect those taxes, because foreigners today can, through the formation of corporations, in large part escape our estate tax, and also, in large part, escape our progressive rates of tax above 30 percent. So if he is sufficiently resourceful today he can do it.

This bill makes it harder for him to do it for 10 years in the case of an estate tax. It is harder for him to do it under this bill than it would be under present law in the estate tax cases. As I indicated, Senator, a foreigner today can escape our estate tax through a corporation. Now if an American wants to become an expatriate, and wants to really give up his citizenship to avoid our tax, he can do it through a corporation. Under this bill it will be harder because for a period of 10 years we look through a corporation to the assets underlying the corporation in the case of expatriates. So in that sense it will be harder for him, rather than easier, under this bill for a 10-year period.

Senator WILLIAMS. I agree with that, but I am speaking about the bill, that part of the bill which would make it easier.

Now the staff has just furnished me the figures on this hypothetical case of an individual who has an estate of $100 million, entirely with investments here in this country.

Now, according to the staff, under existing law this individual, even if he renounced his citizenship and died but with investments in this country, would pay an estate tax, with deductions of 10 percent and a $2,000 exemption, $67.7 million. Under this bill that estate tax would be reduced to $22.3 million.

Secretary FOWLER. If he had a good tax lawyer, Senator, he would form the foreign corporation that Mr. Surrey refers to, do it under present law, and be in better shape than he would be under this law.

Senator WILLIAMS. But we are plugging that loophole as you just said.

Mr. SURREY. For a 10-year period.

Secretary FOWLER. For a 10-year period, right.

Senator WILLIAMS. As we plug that loophole, why open up another one, because, according to the staff, this same citizen—and we are assuming that this $100 million investment here produces an income of $5 million—would be taxed at $3.1 million annually. After 5 years, by giving up his U.S. citizenship, he could reduce his tax to $1.5 million. He could cut it in half under this bill.

Is it wise to close one loophole and open another one at the same time? I form no opinion on it. I am just raising this question because it has been raised and the staff has just confirmed that we are, in effect, opening the possibility for wealthy individuals, and they are the only ones who change their residences from State to State, to give up their residence, live in Nassau, down in the islands, travel around the world for half the year, come back to this country half the time, and by so doing reduce their estate tax liability by approximately 70 percent and reduce their income tax liability by about half. I question the advisability of that at this time.

Mr. SURREY. Senator, the difficulty is that that person would subject himself to a 30-percent rate of withholding tax.

It has been very difficult for us, in practice, to enforce our progressive rates of tax beyond that on foreigners. Wealthy foreigners who want to invest in the United States and want to avoid their obligations to the United States have found ways through nominees, and through corporations and the like, to effectively reduce their U.S. income tax to 30 percent. It is doubtful if we can do better than that. So consequently today this person would likely find himself as a practical matter paying an effective 30-percent U.S. tax rate. This

bill is likely for a period of 5 years to make us much more energetic and careful with respect to the expatriate because he is the fellow we are looking for in particular, and on whom we would concentrate. As Secretary Fowler said, we suggested the period be 10 years in the House.

All I am saying is that it is a conscious policy in this bill to do all that can be done within reasonable limits to reach the expatriate, but it is very difficult to go beyond a certain point. If people want to give up their citizenship, and in many cases wait for 5 or 10 years after that before they really receive a commensurate benefit, they are free to make that choice. I do not think there will be many who would want to do that.

Senator WILLIAMS. I do not question that, and I agree fully, as I understand it, that the bill would provide that greater control for the 5-year period, but why open it after a 5-year period? That is the point that disturbs me.

Secretary FOWLER. I think that——

Senator WILLIAMS. Why dangle a carrot for them to use later.

Secretary FOWLER. The whole purpose of the bill is to make it attractive for foreigners to invest in the United States. Now if you are going to achieve that particular objective, and if it is a desirable one, you have this incidental problem of the expatriate to deal with. We have tried to deal with it in the manner described because we think the advantage of the bill in terms of the authentic foreign investor far outweighs the disadvantage that might accrue by the fact that sporadically an American might renounce his citizenship in order to achieve some tax advantage.

However, we have gone further than that and not just left it on that particular balance, but by these 10-year and 5-year provisions—10-year for the estate tax and 5-year for the income tax—tried to weight the scales against that judgment.

Now, if it is the judgment of this committee that these yearly periods do not put sufficient weight on the scale. I think the Treasury's instincts would be to extend the number of years. That was our position in the House.

Senator WILLIAMS. That is the point. What years did you suggest or do you suggest?

Secretary FOWLER. Ten and ten.

Senator WILLIAMS. Ten and ten.

Secretary FOWLER. In the House, yes.

Senator WILLIAMS. What about 10 and 20? Do you think you should leave any financial attraction at all to an American citizen to give up his citizenship?

Secretary FOWLER. I certainly have no desire to propose that there be some limit. If the committee feels that the 10- and 5-year periods selected by the House are not adequate, I would not object and would go along with it if the committee wished to extend the period.

Senator WILLIAMS. As I understand it, you recognize this could be a potential loophole and you would have no objections to it being tightened or closed if this committee saw fit.

Secretary FOWLER. No, sir.

Senator WILLIAMS. I appreciate that.

Senator ANDERSON. Senator Curtis.

Senator CURTIS. I have one question.

Coming back to the increased revenue by taxing interest on deposits in U.S. banks, let us assume that the interest paid on deposits to foreigners in the year 1962 remains at the present rate, at the present level, and that the tax rates remain the same. What would be the increase in revenue in 1972?

Secretary FOWLER. About $22.5 million. That is if all the deposits remained here—I had better give you my assumptions—if all the deposits remained here and the rate of interest was 4 percent, the tax on such interest would total about $22.5 million.

Senator CURTIS. Did I understand Senator Carlson to say that the return paid on mutual funds falls under this same provision of the bill? That is not regarded as interest, is it?

Mr. SURREY. No, sir.

Senator CURTIS. That is treated as an equity investment.

Mr. SURREY. Yes.

Secretary FOWLER. Thank you.

Senator CURTIS. Thank you, Mr. Secretary.

Senator ANDERSON. Mr. Chapman, I regret you waited so long, but we had a long examination of the Secretary. We have some important bills on the floor. You go right ahead.

STATEMENT OF ALGER B. CHAPMAN, VICE PRESIDENT, NEW YORK STOCK EXCHANGE; ACCOMPANIED BY STANLEY WEST, RESEARCH DIRECTOR

Mr. CHAPMAN. Thank you, Senator Anderson. My name is Alger B. Chapman. I am a vice president of the New York Stock Exchange. With me today is Stan West, research director of the exchange.

I want to thank the committee for affording the exchange this opportunity to appear on behalf of its membership in support of the proposed Foreign Investors Tax Act of 1966. Unfortunately, when the committee's announcement of the hearings was received last week, Mr. Funston, president of the exchange, was on board ship between California and Hawaii, and his plans were such that it was impossible for him to be here today. He has asked me to make his personal apologies to the committee because if it had been possible, he would have wanted to deliver his statement in person.

As a member of the Presidential task force on promoting foreign investment and increased foreign financing, Mr. Funston feels very strongly that this bill should be enacted. But he also urges adoption of the amendments suggested in his statement, so that foreign investment will be further encouraged in the United States with a resulting beneficial effect on our balance of payments.

I have filed for the committee's information, and ask that it be included in the record, copies of Mr. Funston's statement, and accordingly I do not plan to read it to the committee. However, I would like to take just a few minutes to summarize the various points it contains.

First, the bill with the modifications we suggest can be a decisive factor in increasing the flow of foreign funds to this country. If U.S. taxation of foreign investors is eased, other inhibiting factors are alleviated, and our private selling efforts are reinforced, the savings flowing here for investments from other countries should increase substantially the benefits to our balance of payments.

A number of provisions in the bill remove barriers to increased foreign investments, and we urge that they be adopted. They are elimination of the requirement that foreigners file a tax return for income above $21,200; elimination of the risks that a foreigner may be treated as doing business in the United States if he gives power of attorney to a U.S. resident; application of capital gains taxation to a foreigner only if he is present in the United States for 183 days or more per year; and, finally, reduction of the estate tax rates on foreigners.

The committee should be alerted to the risk that some of the restrictive provisions of the bill could lead to large withdrawals of foreign funds from U.S. banks, thus hurting our balance-of-payments position. The committee should also be aware that a number of provisions in the bill may act as a deterrent to foreign investment in the United States, rather than providing a stimulus which is intended to help our balance of payments. Certain changes would avoid these dangers.

In the estate tax, the simplest and most effective step would be to eliminate the estate tax on foreigners completely. This would provide a much greater stimulus for foreign investment in the United States than a rate reduction, and it would help our balance of payments because many people feel that elimination of an estate tax would open up the vaults of Europe, and would produce a dramatic inflow of funds into the United States.

Second, if estates continue to be taxed, retain the situs rule on bonds. Under the present law, bonds issued by U.S. persons are only subject to the estate tax if located in the United States. Under H.R. 13103, all debt obligations of a U.S. person, U.S. Government, or State or local governments and owned by foreigners, will be subject to the estate tax no matter where their physical location.

Under the administration's voluntary program to reduce capital outflow, American companies are being urged to finance their oversea investments through local borrowing. During 1965 and in the first quarter of 1966, some $600 million of such borrowings were financed through bond issues outside of this country. The proposed changes in the situs rule would jeopardize this program by making foreign investors reluctant to purchase these bonds, as well as others issued in the United States, if they will be subject to U.S. estate taxation.

Third, exclude from property consideration taxable customers' cash balances at brokerage houses awaiting investment or reinvestment. These balances are similar to deposits in banks and savings and loan associations and—for estate tax purposes—they should be treated in the same way.

Fourth, exempt permanently bank deposits of foreigners. In the area of the income tax, delete the provisions of the bill which, after 1971, would impose income tax on deposits of foreigners not doing business in the United States.

Fifth, reduce and consider discontinuing the withholding tax levied on interest and dividends paid to foreigners. As a minimum step, the committee should urge the administration to press for mutual reductions with other countries in the percentage withheld through treaty arrangements.

Sixth, eliminate the tax imposed on foreign pension trusts and similar institutional investors, such as charitable organizations, and at

the very least urge the administration to ease the procedures involved in qualifying these organizations for tax exemption. The difficulty in qualifying for tax exemption, even though it is afforded under the tax laws, is such that many foreign institutions refrain from investment in U.S. securities.

Permit foreign bank branches in this country to treat income from investment portfolios of U.S. securities as effectively connected with the trade or business in the United States, so that they can continue to take the deductions they are permitted under current law. Failure to do this could lead to a substantial liquidation of their holdings of U.S. securities.

The theme of Mr. Funston's statement is quite basic. The bill before the committee eliminates a number of tax deterrents to foreign investment in the United States. However, at the same time, it creates some new deterrents. In order to obtain the maximum impact on our balance-of-payments position, we recommend that the new deterrents to foreign investments should be eliminated from the bill and the additional incentives we propose be incorporated in the bill.

Thank you very much. If there are any questions, Mr. West and I will try to answer them.

Senator ANDERSON. In the statement of Mr. Funston, he refers again to this "effectively connected."

Mr. CHAPMAN. Yes.

Senator ANDERSON. You heard some discussion of it. Did that satisfy you?

Mr. CHAPMAN. Yes.

Senator ANDERSON. You think we ought to get a definition so everybody could understand it.

Senator Curtis?

Senator CURTIS. I think not. In light of the hour, I will refrain from questioning.

Senator ANDERSON. Thank you very much, Mr. Chapman. It is a good statement and we will include Mr. Funston's statement in the record.

Mr. CHAPMAN. Thank you very much.

(Mr. Funston's statement referred to above follows:)

STATEMENT OF G. KEITH FUNSTON, PRESIDENT, NEW YORK STOCK EXCHANGE, ON H.R. 13103

SUMMARY

The New York Stock Exchange vigorously supports the basic philosophy of H.R. 13103—"The Foreign Investors Tax Act of 1966"—to increase incentives for foreigners to invest in the United States. The bill, with the modifications we suggest, can be a decisive factor in increasing the flow of foreign funds to this country. If U.S. taxation of foreign investors is eased, other inhibiting factors are alleviated, and our private selling efforts are reinforced, the savings flowing here for investment from other countries should increase substantially—to the benefit of our balance of payments.

The bill, as originally introduced, embodied many of the recommendations of the Presidential Task Force (headed by now Secretary of the Treasury Fowler) on Promoting Foreign Investment and Increased Foreign Financing. One of the stated objectives of the Task Force was "to help establish conditions under which restraining influences on capital flows between the industrially advanced nations * * * can be removed, diminished or allowed to expire."

The problem of these capital flows is forcefully demonstrated by what happened during the last two years. In 1964 and 1965, partly because of the

indirect effects of the Interest Equalization Tax, foreigners were net sellers of $635 million of U.S. corporate stocks and bonds. Even before imposition of the Interest Equalization Tax, however, the outflow of U.S. funds for investment in foreign securities almost invariably exceeded the inflow of foreign funds for investment in U.S. securities. There is clearly a need, therefore, to take steps which will attract more foreign investment to the U.S.

In general, H.R. 13103 simplifies the present complicated and sometimes unenforceable tax law governing foreign individuals and corporations. This is accomplished in the bill by changing the existing law to:

(1) Relieve foreigners of the need to file a return for income above $21,200.

(2) Eliminate the risk that a foreigner may be treated as doing business in the United States by giving a power of attorney to a United States resident.

(3) Exempt a foreigner from capital gains taxation unless he is present in the United States for at least 183 days.

Although the Exchange applauds the bill in principle, we are impelled to point out serious reservations about a number of provisions which conflict with the bill's over-all objective—aiding our balance of payments position and stimulating foreign investment in the United States. The Committee should be alerted to the risks that some of the restrictive provisions of the bill could lead to large withdrawals of foreign funds from United States banks in favor of either of foreign branches of such United States banks or foreign banks. This could mean an outflow of dollars unfavorable to our balance of payments position.

The Exchange, therefore, suggests the following deletions, amendments and additions to H.R. 13103:

(1) Eliminate the estate tax on nonresident aliens completely, rather than providing only a rate reduction.

(2) If estates continue to be taxed, retain the situs rule on bonds.

(3) Exclude brokerage customers' cash balances awaiting investment or reinvestment from property considered taxable for estate tax purposes.

(4) Permanently exempt from the estate tax bank deposits of foreigners and also delete the provision which would make interest on deposits of foreigners not doing business in the U.S. subject to income tax after 1971.

(5) Discontinue or reduce the withholding tax levied on interest and dividends paid to foreigners. As a minimum step, press for mutual reductions with other countries in the percentage withheld through treaty arrangements.

(6) Eliminate or ease taxes imposed on foreign pension trusts and similar institutional investors.

(7) Permit foreign bank branches in this country to treat income from investment portfolios of U.S. securities as "effectively connected" with a trade or business in the U.S.

The Exchange specifically endorses the language in Section 2 of the bill referring to "Trading in Securities and Commodities," as revised from the original Administration proposals. The revised language of H.R. 13103 clarifies the intent of the legislation and eliminates any risk of misinterpretation.

OBJECTIVES OF PENDING BILL

H.R. 13103, "The Foreign Investors Tax Act of 1966," accepts the basic philosophy and recommendations of the Presidential Task Force on the Balance of Payments, of which I was a member. The Task Force recommendations were originally embodied in H.R. 5916, submitted by the Administration to the Congress for consideration in 1965. In its statement on H.R. 5916, the Exchange noted that:

"Adoption of this legislation would do much to stimulate the long-term flow of foreign capital to the U.S., in part by removing archaic restrictions on the flows. The securities industry has long advocated removal of such restrictions. The Exchange applauds the fact that the proposed legislation will enhance the freedom of movement in the international flow of capital funds."

The legislation, appropriately cast, should aid our balance of payments problem. As the late President Kennedy observed in his last balance of payments message to the Congress, "Securities of U.S. private firms could be and should be one of our best selling exports." This proposed legislation, by removing some bothersome and complex restraints, should make the sale of American securities to foreign investors considerably easier.

While the Exchange supports the basic philosophy of the bill, and the bill includes a number of desirable features, we do have serious reservations about several provisions which are not consistent with the bill's over-all objective—aiding our balance of payments and stimulating foreign investment in the United States. The Committee should be aware of the possibility that some of the bill's restrictive provisions could lead to large withdrawals of foreign funds from United States banks in favor either of foreign branches of such United States banks or foreign banks. This could mean an outflow of dollars unfavorable to our balance of payments position. Therefore, if these provisions are not modified, the legislation might well produce unfavorable, rather than favorable, reactions in the financial markets of the world and on our balance of payments.

SUGGESTED REVISIONS

Although the unfavorable impact of the changes effected between the original bill (H.R. 5916) and its second version (H.R. 11297) has been softened in the current version, the legislation's basic purpose of stimulating foreign investment in the U.S. may well be blunted if further changes are not made.

The legislation as written can be materially strengthened in several ways, as discussed below, and moved closer to its objective, as outlined by the Balance of Payments Task Force, of removing existing deterrents to foreign investment. In addition, the effectiveness of a program to encourage foreign investment in U.S. securities may be enhanced by adoption of several measures not included in the tax bill.

Consequently, the Exchange suggests the following adjustments and additions:

I. ELIMINATION OF ESTATE TAX ON NONRESIDENT ALIENS

Under present law, the estates of nonresident aliens are taxed at rates ranging from 3% to 77%, with a specific exemption of $2,000. Section 8 of the bill, by raising the specific exemption and lowering tax rates, reduces the estate tax rates to between 0% and 40% of present levels, thereby taxing nonresident aliens at about the same rates as U.S. citizens who claim a marital deduction. We feel the bill should go further and completely eliminate estate taxes on nonresident aliens. This would provide a much greater stimulus to foreign investment in the U.S. than a rate reduction, and be a much greater help to our balance of payments. Many feel elimination of estate taxes would open up the vaults of Europe and produce a dramatic inflow of funds to the U.S. The reasons are twofold: First, many foreigners are discouraged from investing here by the existing requirement that they file estate tax returns. This deterrent would be removed if the tax were eliminated. Second, since even the proposed lower tax rates are higher than those now levied in many other countries, investment by residents of those countries would continue to be discouraged.

The rates proposed in the bill are higher than the ones originally suggested by the Administration, and stop far short of the Task Force recommendation to "eliminate U.S. estate taxes on all intangible personal property of nonresident alien decedents." Though the proposed rates would be below those levied on resident estates in the United Kingdom, Canada and Italy, they would be higher than those imposed in Switzerland, Germany, France and The Netherlands. Thus, the legislation favors the residents of some countries while discriminating against those of others.

Elimination of the estate tax on nonresident aliens would lead to a very small revenue loss. The tax has produced revenues of $4 to $5 million annually in recent years, and would probably yield no more than $2 million under the proposed legislation. An additional revenue loss of $2 million would be a small price to pay for the removal of a major deterrent to foreign investment in the U.S. The benefits of the change to our balance of payments would be ample compensation for the revenue loss.

II. RETENTION OF "SITUS RULE" ON BONDS

Under the present law, bonds issued by United States persons are subject to the estate tax only if such bonds are located in the United States. Under H.R. 13103 all debt obligations (including bonds) of a United States person, the United States, state governments or any political subdivision of a state are deemed to be property within the United States independent of their physical location, and as such, are subject to the estate tax.

The stimulus given to foreign investment in the U.S. by the reductions in the estate tax rates could in part be negated by this change in the situs rule. The result of a change in the rule would be decidedly adverse to the U.S. balance of payments. Therefore, the Exchange urges that the situs rule regarding bonds not be changed.

Under President Johnson's voluntary program to reduce capital outflows, American companies are being urged to finance their overseas investment through local borrowing. About $600 million worth of bonds were floated abroad in 1965 and the first quarter of 1966 in response to the President's appeal. The proposed change in the situs rule could jeopardize this program by impeding the efforts of American firms to finance their overseas expansion in foreign capital markets. Foreign investors would clearly become reluctant to purchase bonds of American companies if this exposed them to United States estate taxation.

Moreover, it would be extremely difficult administratively to enforce this change in the law. Since bonds are generally issued in bearer form, we know of no practical way of identifying their owners for tax collection purposes.

III. EXCLUSION OF CUSTOMER'S CASH BALANCES FROM ESTATE TAXATION

Under present law, foreign customers' cash balances with brokers are subject to U.S. estate taxation. The Exchange suggests that, if foreigners remain subject to the estate tax, Section 2105 of the Internal Revenue Code should be amended so that *all* funds awaiting investment not be considered property within the U.S. for estate tax purposes. This should apply not only to deposits in banks and savings and loan associations, as discussed below, but also to the "counterpart" to such deposits in the securities industry—customers' cash balances held by brokers awaiting investment or reinvestment.

IV. REVISED TREATMENT OF BANK DEPOSITS OF FOREIGNERS

Under the present law, interest received by foreigners from funds on deposit in the U.S. with persons engaged in the banking business or with some state-chartered savings and loan associations is considered as non-U.S. income and is currently exempt from United States taxes. Similarly, the principal amount held for foreigners by all banking institutions is exempt from United States estate taxes. H.R. 13103 changes these provisions and makes such interest taxable, whether or not the foreigner is engaged in business here, and also subjects the principal to the estate tax. But, in recognition of the current balance of payments problem, the bill defers the taxation of such interest until after December 31, 1971.

This recognition of the balance of payments problem, however, is not carried forward in the estate tax provision. Even though the interest collected is not subject to income tax until after 1971, the deposit itself becomes subject to estate tax on the effective date of H.R. 13103.

Both of these changes would surely lead to a sizable outflow of foreign capital. Knowledgeable bank officials have estimated that several billion dollars of bank deposits would be potentially subject to either the estate tax or to annual taxation of interest income if the proposed legislation becomes law. It seems reasonable to assume that a large part of these deposits would then be withdrawn over time from banks within the U.S. There is every reason to assume that these deposits would not be shifted to foreign branches of U.S. banks. Even if they were, the transfer would represent a capital outflow in the balance of payments.

Consequently, the Exchange strongly urges that the proposed legislation be revised to omit those sections which change the treatment of bank deposits of foreigners. An impediment to the free flow of international capital funds would thereby be avoided, and our balance of payments position remain unaffected.

V. DISCONTINUATION OF WITHHOLDING TAXES ON INTEREST AND DIVIDEND PAYMENTS

Present law requires the withholding of income tax on dividend and interest payments to foreigners. This acts as a deterrent to foreign investment in U.S. securities. To remove this obstacle and help improve the balance of payments, the Exchange recommends that the pending bill be amended to eliminate these withholdings taxes.

If the potential revenue loss makes repeal undesirable, the U.S. should press through treaty arrangements for mutual reduction in the withholding tax with

as many foreign countries as possible. Since transactions in outstanding securities have generally produced an inflow of funds to the U.S., mutual reductions in the withholding rate could be expected to stimulate foreign purchases of U.S. securities to a greater extent than they would U.S. purchases of foreign securities—even when the adverse effect of the Interest Equalization Tax is taken into account.

VI. ELIMINATION OR EASING OF TAXES ON FOREIGN PENSION TRUSTS

U.S. income taxes imposed on foreign pension trusts and similar investors should be eased. Domestic pension funds enjoy a tax exemption on their investment income. Foreign pension funds, even though qualified for an exemption, can obtain it only by going through the difficult procedure of obtaining approval from numerous agencies of the U.S. government. As a result, these investors are discouraged from investing here, especially if they are exempt from taxes in their country of domicile.

Pension funds in some foreign countries have grown dramatically in recent years. For example, the Joint Economic Committee study of European capital markets showed that pension funds in Great Britain have been one of the fastest growing institutions in that country's financial structure, and had investments of $10 billion at the end of 1962.[1] Further growth is fully expected. It seems reasonable to assume that a considerable capital flow into the U.S. might be stimulated if foreign pension funds were accorded a tax treatment similar to that enjoyed by domestic funds. Further, the Treasury in its regulations can provide any safeguards necessary to prevent abuse of this legislation.

Consequently, taxes on the income of foreign pension funds and similar institutional investors should be eliminated by law. As a minimum step, the U.S. should work with other countries toward the mutual elimination of taxes on these types of investors.

VII. TREATMENT OF FOREIGN BRANCH BANKS' PORTFOLIO INCOME AS "EFFECTIVELY CONNECTED"

The present law generally taxes nonresident aliens and foreign corporations at the regular individual or corporate rates on all their U.S. source income, if they are engaged in trade or business in this country. If not so engaged, they are taxed at a flat 30% rate or lower treaty rate on all fixed or determinable income. The bill would generally subject the income of a nonresident alien or foreign corportation to the flat 30% or lower treaty rate, if the income is not effectively connected with the conduct of a trade or business in the United States.

Some foreign banks with branches in the United States may suffer adverse effects under the different tax treatment proposed for income "effectively connected" and that "not effectively connected" with the conduct of a "trade or business" under Sections 881 and 882. The income from their investment portfolios of U.S. securities is usual and necessary to an ordinary commercial banking operation. If it is treated as "not effectively connected," the tax will be on the gross income without the allowance of any deductions properly allocable to such income. Such a tax on gross income could have a confiscatory effect upon the portfolio income of foreign banks, since there are generally significant deductions which would otherwise be attributable to such income.

The Exchange believes that foreign banks with branches in the U.S. should have the election of treating the income from their investment portfolios of U.S. securities as "effectively connected" with a trade or business, so that they can have the benefit of deductions which are allocable to such income. Unless an amendment of this type is included, treating such income as "not effectively connected" with the conduct of a trade or business would have a substantial adverse effect on the willingness of such foreign banks to have their U.S. branches hold domestic securities.

CONCLUSION

As noted in the Report of the House Ways & Means Committee, "H.R. 13103 is designed to provide more equitable tax treatment for foreign investment in the U.S." The purpose of the legislation, as initially introduced, was to "stimulate foreign investment in the United States by modifying existing tax rules which

[1] U.S. Congress, Joint Economic Committee, *A Description and Analysis of Certain European Capital Markets*, 1964, page 238.

are not consistent with sound tax policy and act as barriers to such investment."

The Exchange, in endorsing the spirit of the bill, believes that our suggested changes, amendments, and additions would greatly enhance the effectiveness of the legislation. Through the adoption of these suggestions, the Congress would be better able to achieve the original objective of aiding our balance of payments position by removing present deterrents and in addition providing positive incentives for foreign investors.

Senator ANDERSON. Robert Norris.

STATEMENT OF ROBERT M. NORRIS, PRESIDENT, THE NATIONAL FOREIGN TRADE COUNCIL, INC.; ACCOMPANIED BY CHARLES R. CARROLL, COUNSEL TO THE BOARD OF DIRECTORS

Mr. NORRIS. Senator, my name is Robert M. Norris, president, National Foreign Trade Council, and I am accompanied by Charles R. Carroll, counsel to the board of directors.

The National Foreign Trade Council appreciates your invitation to present its views on H.R. 13103 at these hearings.

The National Foreign Trade Council has been engaged for 53 years in the promotion and protection of American foreign trade and investment and therefore in recent years has been vitally concerned with the need to remedy the recurring deficits in the balance of payments of the United States. Consequently, the recommendations of the Fowler task force were welcomed as a step to end the imbalance by attracting foreign investment in U.S. securities. Implementing these recommendations could be an important factor in eliminating the deficit in our payments position and a significant move toward achieving the ultimate objective of greater freedom of international movement of capital.

The council and its highly diversified membership considered the introduction last year of H.R. 5916 to implement the tax part of the Fowler Committee recommendations to be a most important forward step. The council favored the provisions of H.R. 5916 for encouragement of foreign investment in the United States and recommended its enactment with certain modifications. However, the introduction of H.R. 11297 and H.R. 13103, in turn, as substitutes for H.R. 5916 has presented matters of grave concern to the council. H.R. 13103, as now pending, has changed the original provisions of H.R. 5916 with regard to income and estate taxes on foreign corporations and nonresident aliens, and is less favorable in this respect than the original bill—H.R. 5916.

Furthermore, there has been embodied in H.R. 13103 an objective which is in direct conflict with the purposes of the Fowler report; that is, a general revision and broadening of U.S. taxation of nonresident aliens and foreign corporations which would be treated as "effectively connected" with an office in the United States. The council believes that the adoption of this new taxing system would be unwise and inequitable; that rather than raise additional revenue it would lead foreign corporations to reduce their investment and employment in the United States; that it would come into conflict with the prevailing pattern of taxation of international business by the principal trading nations of the world; and that it would produce serious problems of double taxation. Moreover, in our estimation, the enactment of these provisions would adversely affect the U.S. balance of pay-

nents not only from reduction in business investment but also from he foreseeable liquidation of foreign holdings of American short-erm obligations and the liquidation of bank deposits of foreigners. The council has grave concern over the inclusion in the bill of these provisions which represent a radical departure from the objective of the original bill, and which the council considers would defeat the very purposes of the Fowler committee's recommendations.

The council, through its tax committee, has given thorough consideration to H.R. 13103 and has prepared a detailed statement based upon the results of their deliberations. Copies of this statement have been filed with your committee. It is requested that it be made a part of the record of these hearings and that full consideration be given to the views of the council, particularly because of the importance of this legislation as it may affect the international balance-of-payments position of the United States.

Senator ANDERSON. Is this the document?

Mr. NORRIS. Yes.

Senator ANDERSON. It will be placed in the record.

Mr. NORRIS. In summary, then, Senator, the council's principal reservations with respect to this legislation are:

(1) Concern about the possible adverse effect of this legislation on international trade and commerce through the introduction of the "effectively connected" concept relating to taxation of foreign enterprises; and

(2) The adverse effect to which I have alluded—and the filed statement more fully covers the subject—that certain portions of this legislation would have on the balance-of-payments position of the United States.

I would merely like to conclude by saying that there have been introduced two additional amendments in the Secretary's statement this morning, and also the report of the joint staff, and we would like the opportunity, obviously, to examine these, and to have the opportunity to present our views if they are indicated at the future time.

Senator ANDERSON. We certainly will, Mr. Norris. You take those with you, and if you have comments, send them to the committee as soon as possible because I understand we will be working on this bill within the next week or 10 days.

Mr. NORRIS. Thank you.

Senator ANDERSON. Thank you. I am sorry the other members of the committee have gone, but I appreciate your coming very much.

Mr. NORRIS. Thank you.

(The pamphlet referred to above follows:)

STATEMENT
Of The

NATIONAL FOREIGN TRADE COUNCIL, INC.

With Respect To

H.R. 13103

FOREIGN INVESTORS TAX ACT OF 1966

Presented to the Committee on Finance
of the United States Senate
August 8, 1966

NATIONAL FOREIGN TRADE COUNCIL, INC.
10 Rockefeller Plaza, New York, N. Y. 10020

SUMMARY

A. Effectively Connected Concept.

1. *Foreign Source Income.* — The purposes stated by the Report of the Ways and Means Committee for taxing specified rents and royalties, specified dividends, interest, and gains, and certain income from sales of goods made through a U.S. office, if "effectively connected" with the conduct of a trade or business in the U.S., are to prevent the use of the U.S. as a "tax haven" with respect to certain types of transactions and to impose tax on "income generated from U.S. business activities."

2. *"Tax Haven" Purpose.* — This purpose appears to be specious in that (1) the scope of the bill goes beyond "tax haven" situations; (2) any abuses which exist could more appropriately be corrected by other countries; and (3) legislation by the U.S. would only drive the activities affected to countries which impose no taxes.

3. *Purpose of Taxing "Income Generated from U.S. Business Activities".* — The bill would change the U.S. method of taxing the income of foreign corporations from one which meshes well into the established international system which has been developed in the income tax laws of the principal trading nations into one which would conflict with that system and create unwarranted double taxation. Income tax laws of most countries do not seek to tax income from sources outside their borders merely because of incidental and ancillary activities within their borders. It still is in the self-interest of the U.S. to adhere to this generally recognized principle. Taxation based on the "effectively connected" concept would tend to discourage purchasing within the country and would prompt the removal of offices which now furnish investment and employment in the country.

The bill applies the "effectively connected" concept in a one-sided manner, and does not recognize the right of other countries to apply a similar rule, in that it does not permit U.S.-source income of foreign corporations to be exempt to the extent that foreign offices and activities help to generate the income and does not even modify the limitations on U.S. foreign tax credits so as to allow credit for foreign taxes imposed on U.S.-source income "effectively connected" with foreign business activities.

4. *Conflict with U.S. Tax Treaties.* — The bill would come into conflict with most, if not all, of the existing tax treaties to which the U.S. is a party. Some treaties prohibit the taxation of foreign source income as attributable to a U.S. office; two of the recently proposed treaties expressly embody our existing source rules. Others limit such taxation to cases where the office qualifies as a permanent establishment and then limit the amount

of income which can be taxed to that which the activities would have earned if carried on by an independent corporation. The bill does not conform to these rules.

5. *Effect on Controlled Foreign Corporations.* — Congress in 1962 reviewed the "tax haven" possibilities of U.S.-controlled foreign corporations and enacted subpart F of the Code, prescribing the types of income of such corporations which should be taxed immediately and deferring taxation of other classes of income until remitted to the shareholders. The bill would impose immediate U.S. tax on income as to which the policy of subpart F was to continue deferment. It is believed that consistency with the policy of subpart F should be maintained by making the new provisions inapplicable to income of controlled foreign corporations which were excluded from subpart F.

6. *Income of Banking and Similar Corporations.* — The bill exempts dividends and interest from foreign sources, received by a foreign corporation from corporations in which it has a 50% stock interest. It is suggested that a 10% stock ownership requirement would be more appropriate.

7. *Sales to Foreign Customers.* — The bill would not tax income from sales for use, consumption, or disposition outside of the U.S., even though the income would otherwise be "effectively connected" with a U.S. office, "if an office or other place of business of the taxpayer outside the U.S. participated materially in such sale." The Council is concerned that this language will not be construed to give proper recognition to foreign activities other than selling—for example, manufacture, extraction, or production of goods and purchasing and related activities.

8. *Sales to Foreign Customers of U.S. Exports.* — It is not believed that the U.S. should seek to tax any income of foreign corporations from sales outside the U.S. to foreign customers of goods purchased in the U.S., nor to tax more than the profit attributable to manufacture or production on such foreign sales of goods manufactured or produced here. Such taxation would run counter to our national policy of encouraging exports.

9. *Sales to U.S. Customers.* — In the case of foreign source income from sales to U.S. customers, it should be made clear that the income deemed to be "effectively connected" with a U.S. office will not exceed that which would be allocable to that office if its activities had been carried on by a separate subsidiary of the foreign corporation.

10. *Foreign Sales with No Foreign Office.* — Where a foreign corporation has substantial foreign economic activities outside the U.S. but no office outside the U.S., the foreign source income deemed to be "effectively connected" with its U.S. office should be limited as suggested in paragraph 9 above.

11. *Credit for Foreign Income Taxes.* — Foreign corporations would suffer serious double taxation with respect to income "effectively con-

nected" with a U.S. office, because of failure of the bill to allow a credit against the U.S. tax for all foreign taxes imposed on the "effectively connected" income. Such credit should be given regardless of whether the taxing country is the country of source, the country of domicile, or both.

12. *Rental and Royalty Income.* — The bill appears to go much further in attributing rental or royalty income to U.S. offices than it does in the case of sales income, since it does not seem to give recognition to the activities of foreign offices in negotiating and making leases or licenses. It also seems unrealistic to regard royalties paid for the use of a valuable right as being generated entirely by the making of the contract. It is the making of the invention or its use in manufacturing which should be considered to generate the income.

13. *Section 245.* — Under the bill, 15% of any dividends paid by a foreign corporation, out of its "effectively connected" foreign source income, to a U.S. corporate shareholder, would be subject to U.S. tax if 50% or more of the foreign corporation's gross income was "effectively connected" with its U.S. trade or business. However, no foreign tax credits would be allowed to reduce the U.S. income tax on such dividends. It is not believed that the bill should introduce double taxation in this situation.

B. Balance of Payments Considerations.

1. *U.S. Estate Tax.* — The bill gives some reduction in estate tax rates on estates of nonresident aliens, but does not give as great a reduction as was proposed in H.R. 5916, the original bill introduced to implement the Fowler Report.

By including certain classes of intangible property which is excluded from the taxable estate under present law, the bill would have an adverse effect on foreign investment in the U.S.

2. *Interest on U.S. Bank Deposits.* — The bill proposes to terminate, effective at the end of 1971, the long-standing exemption of interest on bank deposits paid to nonresident aliens and foreign corporations, even though the recipient is not engaged in trade or business in the U.S. It is believed that this change will not actually produce additional revenue but that it will rather cause withdrawal of such deposits from the U.S., with a substantial adverse effect on our balance of payments.

3. *Short-Term Promissory Notes.* — Proposed section 881(a)(3) would tax foreign corporations not engaged in trade or business in the U.S. on amounts of original issue discount which are treated as ordinary income received on retirement or sale or exchange of bonds or other evidences of indebtedness issued after September 28, 1965 if held for more than six months. To subject such discount to U.S. income tax will cause foreign corporations not engaged in trade or business in the U.S. to cease to furnish a market for commercial paper, especially since it is feared by

some that the new provision may be construed to apply whether or not such commercial paper is held for more than six months. The annual market for short-term (9 months and under) commercial paper sold in the U.S. to nonresidents is estimated to be in excess of $1 billion. The loss of this market would have a severe adverse effect on our balance of payments.

4. *Section 904(f).* — The bill would make the special limitation on foreign tax credits with respect to interest income inapplicable to interest income received by an "overseas operations funding subsidiary" on obligations of a "related foreign corporation." The Council supports the general purpose of this amendment, although it believes the exception in existing 904(f) (2) (C) should be construed to apply where a U.S. parent uses a domestic affiliate to finance the operations of a foreign affiliate owned by such domestic parent to the extent of at least 10%, whether such ownership is direct or indirect.

The proposed definition of the terms "overseas operations funding subsidiary" and "related foreign corporation" contained in the bill are unduly restrictive, and should be liberalized. The Council urges that section 904 (f) (2) (C) be clarified so as to exclude interest received from a corporation in which the recipient (or another member of the same affiliated group, as defined in section 1504) owns directly or indirectly 10% or more of the total combined voting power of all classes of stock.

The present law also contains an exception of interest on obligations acquired on disposition of stock or obligations of a corporation in which the taxpayer owns at least 10%. This should be extended to obligations acquired as a result of disposition of stock of a wholly-owned subsidiary of such a 10% owned corporation.

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INTRODUCTION

In October of 1963 the President appointed a Task Force on "Promoting Increased Foreign Investment in U.S. Corporate Securities and Increased Foreign Financing for U.S. Corporations Operating Abroad" (Fowler Committee) to stimulate investments in the United States by foreigners. The increased inflow of investment funds from abroad would have an immediately favorable effect on reducing the pressure on the U.S. balance of payments. For this reason the Council welcomed H.R. 5916 which was proposed by the Treasury Department to carry out several of the Fowler Committee recommendations. However, as stated in its Report on H.R. 13103, the House Committee on Ways and Means has modified considerably the objectives of the earlier bill. On Page 6 the Report states: "While . . . the initial bill proposed by the Treasury Department was designed primarily to stimulate investments by foreigners in the United States, your Committee considered more generally the tax provisions of present law affecting nonresident aliens and foreign corporations."

For equity reasons and because of the potential adverse effect on our balance of payments position the Council is deeply concerned over a number of provisions in the bill as presently drafted. These provisions include those relating to:

1) the taxation of foreign source income of foreign corporations under the "effectively connected" concept;

2) the inclusion of the U.S. bank deposits and U.S. debt obligations in the taxable estate of a nonresident alien;

3) the taxation of interest on bank deposits received after 1971 by nonresident aliens and foreign corporations even though not "effectively connected" with the conduct of a trade or business in the U.S.;

4) the taxation of certain evidences of indebtedness described in proposed sections 871 (a) (i) and 881 (a) (3);

5) the overly restrictive application of the provisions relating to the treatment of interest received by an "overseas operations funding subsidiary."

There follows a detailed presentation of these five areas of concern.

EFFECTIVELY CONNECTED CONCEPT

Foreign Source Income

H.R. 13103 as passed by the House of Representatives would amend the Internal Revenue Code to broaden the present rules for U.S. taxation of foreign corporations to include not only income from sources within the United States but also certain types of foreign source income "effectively connected" with the conduct of a trade or business in the United States. These are:

(i) Rents and royalties derived from the active conduct of a licensing business;

(ii) Dividends, interest, or gain from stock or bond or debt obligations derived in the active conduct of a banking, financing, or similar business; and

(iii) Certain income from sales of goods made through a U.S. office.

The purpose of this feature of the bill is described in the Ways and Means Committee's Report primarily as prevention of the use of the United States as a "tax haven" with respect to certain types of transactions which might escape tax in other countries if certain activities are carried on in the United States. The Report states further (at P. 15) that "it is believed that foreign corporations should pay a U.S. tax on the income generated from U.S. business activities."

"Tax Haven" Purpose

The National Foreign Trade Council believes that the "tax haven" aspect of these purposes is specious in that: (a) any abuses which exist could more appropriately be corrected by other countries; (b) the scope of the bill goes beyond "tax haven" situations; and (c) legislation by the United States would only drive the activities affected to countries which impose no taxes.

The Report of the Ways and Means Committee describes the "tax haven" purpose as relating to cases in which international sales, licensing and financial activities can be carried on with an office in the United States without payment of income taxes to any country because (1) the foreign corporation is organized in a country which does not tax its corporations on income derived from the conduct of business outside the country; (2) the income may not be taxed where the goods are sold because the corporation does not have a permanent establishment there; and (3) the United States will not tax the income because under United States rules the income is not derived from sources within the United States. The Report

does not state how widely this triple combination of circumstances has been found to exist.

The Council does not believe that the elimination of the alleged abuses is properly a matter for legislative action by the United States. The examples cited in the House Committee report could more appropriately be corrected by changes in the tax laws of other countries. Thus, the country of incorporation could adopt the long-standing U.S. practice of taxing locally-organized corporations on their world-wide income. Alternatively, the country in which the sale is made could logically impose a tax on the transaction. Finally, the country where the controlling shareholders reside could impose tax under provisions similar to subpart F enacted as a part of the U.S. Revenue Act of 1962. However, the failure of these countries to act does not furnish a sound reason for the United States to reach out and tax income more properly within the jurisdiction of other countries.

The fallacy of the "tax haven" purpose of the bill is indicated by the fact that its application would not be limited to cases in which income is escaping taxation by other countries. In fact, the question of whether some other country taxes the income would be given no effect in determining whether the new U.S. tax would apply.

The only cases in which income of the three specified types, treated as "attributable" to a United States office, would not be taxed under the bill are those in which goods are sold for use outside of the United States and there is also a foreign office participating materially in the sale. However, no exceptions whatever are recognized with respect to "effectively connected" income from licensing operations, dividends and interest, or income from sales of goods for use in the United States.

It is probable that in most cases the foreign source income which the bill subjects to United States tax will be taxed by the country of source of the income or the country of incorporation. The bill not only applies in these non-tax haven situations; it would not even give a foreign tax credit for a tax imposed by the country of incorporation unless it was also the source of the income and then not in all such cases.[1] Even when credit is given for a tax imposed by the country of source of the income, the bill may still have the effect of imposing a residual U.S. tax on foreign source income in a non-tax haven situation.

Even if the bill is enacted, the "tax haven" purpose will not be accomplished, since the U.S. offices whose activities will be considered to generate United States taxable income can be removed to genuine "tax haven" countries which would impose no income taxes. Thus the bill would accomplish neither elimination of international tax avoidance nor an

[1] Because of ill-chosen phraseology, the proposed statute may fail to allow a credit where the country imposing the foreign income tax is both the country of "source" and the country of domicile, unless a similar tax would have been imposed by that country if the corporation had been domiciled in another country.

increase the United States revenues. It would simply cause the United States economy and balance of payments to lose the benefit of the employment and expenditures of United States offices of foreign corporations.

It is therefore apparent that, although H.R. 13103 uses the same "tax haven" label as a subpart F, its real thrust is in the opposite direction, i.e., to discourage foreign corporations from conducting activities within the United States rather than to discourage U.S. taxpayers from conducting activities in foreign countries.

The foreign corporations that would be affected by H.R. 13103 are not used to siphon off capital or employment from the United States. On the contrary, the use by such corporations of a U.S. office tends to augment both capital and employment in the United States.

Purpose of Taxing "Income Generated from U.S. Business Activities"

On first impression it seems difficult to disagree with the statement that there should be a U.S. tax on the "income generated from U.S. business activities" conducted through an office located within the United States. However, on analysis, it will be seen that the real issue is as to what income is "generated" from U.S. activities.

The bill as drafted would change the United States method of taxation of the income of foreign corporations from one which meshes well into the established international system which has been developed in the income tax laws of the principal trading nations into one which would conflict with that system and create unwarranted double taxation. It would detract from the degree of international harmony which now exists as to rules of source of income and provisions for foreign tax credits.

Under existing tax systems, including the U.S. system, income of the types affected by the bill is generally treated as entirely taxable by a single country which is regarded as the source of the income. A country other than the country of source does not seek to tax a portion of the income simply because that portion might be regarded as "generated" by activities within its borders. General recognition of this principle is necessary to avert the double taxation that results from conflict between the laws of different countries.

The income tax laws of most countries apply to income attributable to local manufacture and production of commodities. Income from selling is usually attributed by existing tax systems entirely to a single country, i.e., the place of title passage or the place of contract. Income from licensing intangibles is generally considered to have its source in the country where the right is exercised or, under recent treaties, the domicile of the owner. Similarly, dividend or interest income is generally attributed to the situs of the payor or the source of the payor's income, except for some treaties which attribute it to the domicile of the owner of the shares of stock or the debt claim.

There are many reasons why governments should abstain from basing income taxes on incidental and ancillary activities occurring within their borders. For example, this policy prevents the taxation of a portion of income derived from foreign selling of goods which are purchased in the country, even though, from the "activity" point of view, the purchasing side of the business may be more substantial than the selling side of the business in terms of assets, personnel and skills devoted to it. Most governments understand that it would not be in their own interest to attempt to levy income taxes which would burden the purchase of their products. As to local offices in charge of other ancillary activities such as warehousing, transportation, and technical assistance to suppliers in the country, and even offices for solicitation and negotiation of sales, governments generally understand that such offices could readily be removed, if threatened with the burden of a tax on the income from sales. This is also true as to local offices engaged in the licensing of patents and other intangibles.

It is still in the self-interest of the United States to adhere to the generally recognized principle of not trying to derive revenue from offices and activities which are likely to be driven away rather than to pay tax.

In addition, in the case of income from the licensing of such intangibles, the bill is particularly unrealistic in attributing the income to the activity of negotiating and concluding license contracts rather than to the ownership of the intangible or its actual use in operations,

Substantial double taxation would also result from the imposition of the proposed tax by the United States on foreign source income "effectively connected" with a U.S. office. The situation would be chaotic if other countries also adopted a similar rule, unless entirely new apportionment formulas were consistently applied by all countries. It seems unlikely that international tax consistency could be re-established until after years of international negotiations, if ever.

As a generally accepted international rule, an "activities" test could work satisfactorily only as a *substitute* for existing source rules. In the case of the United States, the bill does not propose such substitution. It uses the "activities" test to impose U.S. tax on income which is not now taxable under the existing source rules, but it does not permit the "activities" test to excuse from U.S. tax any U.S.-source income "effectively connected" with a foreign office.

Moreover, the bill would thus tax a foreign corporation on U.S. source income generated by foreign business activities without, in most cases, giving a credit against the U.S. tax for the foreign tax on such U.S. source income.

The bill also ignores the corollary of its stated purpose, i.e., that a foreign country would then be entitled to tax a U.S. domestic corporation on its U.S. source income "effectively connected" with an office located within the foreign country. The bill ignores this situation since it fails to

modify the existing limitations under section 904 which would normally disallow any U.S. credit for foreign taxes levied on U.S. source income.

To summarize, the bill treats its new "activities" test as taking precedence over the existing source rules when the activities occur within the United States but not when the activities occur within a foreign country. This inconsistency is compounded by the bill's adherence, in determining the limitation on U.S. credits for foreign taxes, to existing source rules instead of using its new "activities" test to attribute income to a foreign country.

The Council therefore submits that, if the purpose of the bill is to set a precedent for a reform of tax laws throughout the world, the bill should at least apply its new "activities" test in an even-handed manner, which might work if other countries were to follow this new concept, rather than on a one-sided basis which could only produce numerous cases of double taxation if other countries followed the lead of the United States. If the activities test as contained in the bill is not valid as a precedent for for other countries, the United States is not justified in adopting it.

Conflict with U.S. Tax Treaties

The United States has concluded numerous tax treaties which prohibit the taxation, as attributable to a United States office, of income from sources outside the United States. (Significantly, two of the most recently proposed treaties—with Israel and Thailand—specifically set forth our existing source rules for this purpose).

It is true that other U.S. tax treaties do not expressly prohibit U.S. taxation of foreign source income attributable to an office in the United States, if that office qualifies as a "permanent establishment". But even those treaties expressly limit the amount of income which could be so attributed to the amount which the particular activities would earn if carried on by an independent corporation with no other activities. The bill, in contrast, would apply in many cases where there was no such permanent establishment and is ambiguous as to whether the amount of income which would be attributed to the U.S. office of the foreign corporation is limited to only the amount fairly allocable to the U.S. activities.

The bill thus would come in conflict with most, if not all, of the existing tax treaties to which the United States is a party. While the proposed section 894 makes the bill inoperative to that extent, it nevertheless seems fair to question the need either (1) to renegotiate these numerous treaties or (2) to discriminate against foreign corporations belonging to the many non-treaty countries of the world, which include most of the "less developed countries." These unfortunate alternatives would seem to be justified only by some inherently desirable and necessary policy.

We submit that no such policy is furnished either: (1) by the idea that the United States is entitled to move into any vacuum created by supposed

loopholes in foreign tax laws, or (2) by the idea that all income should be fragmented into as many pieces as there are countries in which some "activities" are performed. Much less does it seem a tenable position that the United States alone is entitled to apply these ideas, the universal application of which could only result in years of conflict between the tax systems of the nations of the world.

Effect on Controlled Foreign Corporations

The new provisions of H.R. 13103 would be particularly objectionable in their application to foreign corporations controlled by U.S. persons.

In enacting the Revenue Act of 1962, the Congress conducted an extensive review of the "tax haven" possibilities of such controlled foreign corporations. Subpart F of the 1962 Act reflects the decision of Congress to tax certain types of income immediately and to allow the taxation of certain other classes of income to be deferred until such income is remitted to the shareholders. It would appear that the exclusion of all income of controlled foreign corporations would be appropriate since Congress has carefully prescribed just what income of such controlled foreign corporations should be currently taxed.

It should also be noted that various classes of income are excluded from immediate taxation under subpart F, including:

1) Dividends, interest and gains realized by a corporation engaged in a banking, financing or similar business:
2) Dividends, interest and gains from qualified investments in less developed countries:
3) Income which would otherwise be subpart F income but which constitutes less than 30% of the foreign corporation's gross income:
4) Income of a foreign corporation not availed of to reduce taxes:
5) Royalty income derived in the active conduct of a trade or business which is received from unrelated persons.

H.R. 13103 would in some cases impose an immediate U.S. tax on the above classes of income and thus appears inconsistent with the policies excluding those classes of income under subpart F. The Council believes that consistency with those policies would require a similar exemption of such classes of income from tax under H.R. 13103.

The exclusion of such classes of income of controlled foreign corporations from coverage under the bill would not be a discrimination in favor of U.S. controlled corporations because such exclusion would only mitigate the existing discrimination against U.S. controlled foreign corporations created by subpart F.

Income of Banking and Similar Corporations

The provisions of H.R. 13103 for taxing dividends and interest received

by foreign corporations engaged in banking, financing or similar business would exempt dividends and interest received by such corporations from corporations in which they have a stock ownership of more than 50%. A 10% ownership requirement would be consistent with the stock ownership requirement for qualified investments in less developed countries and with the realities of present-day foreign investment. Many countries do not permit 50% foreign ownership, and such a high percentage of foreign ownership would tend to discourage participation by local investors in necessary industries.

It is noted that the bill does not define what is meant by "banking, financing, or similar business." Presumably this provision is intended to be correlated with the provision in section 954 (c) (3) (B).

Sales to Foreign Customers

If the foreign corporation maintains an office in the United States and a second office outside the United States, the proposed statute would exempt from U.S. tax the entire profit from the sale of goods arranged through the U.S. office "if the property is sold for use, consumption or disposition outside the United States and an office or other place of business of the taxpayer outside the United States participated materially in such sale."

The Report of the Ways and Means Committee indicates (at P. 16) that the purpose of the phrase "participated materially in such sale" is to assure that "foreign source sales income will be attributed to the U.S. trade or business only when the U.S. office is the primary place of the activity giving rise to the income."

The Council is concerned that the proposed statute will not be interpreted to effectuate this purpose. This concern stems primarily from the ambiguity of the word "sale" as it is used in the phrase "office or other fixed place of business of the taxpayer outside the United States participated materially in such sale."

One possible interpretation is that the term "sale" refers solely to selling activities. Under this interpretation, a foreign office or other place of business would be considered to have "participated materially in such sale" only if its activities were selling activities as contrasted with the performance of other economic activities essential to earn the ultimate profit, such as the manufacture, extraction, or production of the goods or their procurement by purchasing activities.

The practical effect of this restrictive interpretation can be illustrated by the case of a Philippine corporation engaged in the business of purchasing hand-embroidered household linens, blouses, etc., for export to overseas customers. The Philippine corporation maintains its principal office in Manila, where a staff of employees places orders with numerous small Philippine factories to which the corporation furnishes technical

and stylistic advice as well as working capital. The Philippine corporation takes title to the goods at the factory and arranges for temporary warehousing, insurance, transportation to the dock, and all of the formalities required for exportation. Sales to customers in Canada as well as the United States are negotiated by a single employee working from a sales office maintained by the Philippine corporation in Seattle, Washington. Title to the merchandise normally passes to the customer at the time of shipment from Manila, so that none of the resultant profit is from a "source" within the United States.

Under these facts, the Philippine corporation is clearly subject to whatever income taxes the Philippine Government may see fit to impose. (Moreover, Philippine tax would also be imposed if the above described business were conducted by a Philippine branch of a Panamanian corporation.) Thus, this case cannot properly be considered to involve the type of "tax avoidance" at which H.R. 13103 is said to be aimed.

The Council therefore submits that the office in Manila should be considered as having "participated materially in [the] sale" of the goods sold through the Seattle office, so that the tax imposed by H.R. 13103 would not apply to profits from those sales made to Canadian customers.[2] This interpretation of "sale" would be essential to carry out the stated objective of the Ways and Means Committee that "foreign source sales income will be attributed to the U.S. trade or business only when the U.S. office is the primary place of the activity giving rise to the income."

In support of this position, it should be pointed out that, under the House version of H.R. 13103, it is clear that, where a foreign office of a foreign corporation participates materially in the selling activities, no U.S. tax would then be imposed on any profits from sales to foreign customers negotiated through its U.S. office.[3] If selling activities by a foreign

[2] This hypothetical example also serves to highlight the fact that H.R. 13103 could not impose U.S. tax on foreign source income of a Philippine corporation without renegotiation of the Income Tax Convention with the Philippines. Article 3(1) of that Convention (as submitted to the Senate on July 29, 1965) provides, in effect, that the United States may tax a Philippine corporation only on income derived from "sources" within the United States. As previously noted, however, H.R. 13103 does not recharacterize income "effectively connected" with a U.S. office as income having its "source" within the United States. On the contrary, it is clear from the proposed section 864 (c) (4) of the Code that no change in existing "source" rules is intended.

Enactment of H.R. 13103 would therefore have one of the two undesirable consequences: (1) it would require renegotiation of the Income Tax Convention with the Philippines and 17 other countries, i.e., Australia, Austria, Denmark, Finland, Greece, Honduras, India (proposed), Ireland, Israel (proposed), Italy, Japan, Luxembourg, New Zealand, Norway, Pakistan (proposed), Switzerland, Thailand (proposed), or (2) it would not apply to foreign corporations having their domicile or seat of management in the foregoing countries and thus would create a capricious discrimination in favor of those foreign corporations as distinguished from foreign corporations belonging to all of the other nations of the world.

[3] This is true both of goods exported from the United States and goods exported from one foreign country to another.

office furnish a valid reason for not imposing U.S. tax, it would be anomalous to impose U.S. tax where the activities of the foreign office (although not a sales office) are *more substantial* than those of the typical sales office, e.g., where the foreign activities are as extensive as the Philippine activities of the Philippine corporation described above.

It is believed that the foregoing analysis also leads to the conclusion that, where a foreign corporation engages in the manufacture, extraction, growth, or production of goods outside the United States, it should not be subject to any U.S. tax merely because it uses a U.S. office to arrange for sales of those goods to foreign customers.

It is clear, therefore, that an office or other place of business outside the United States should be considered to have "participated materially in the sale" of goods in all cases where those goods have been procured by substantial purchasing or productive activities conducted by the foreign corporation at its office or other place of business outside the United States.

U.S. Export Sales

Different policy considerations lead to a similar conclusion where the goods sold to foreign customers are either produced by the foreign corporation within the United States or purchased from suppliers within the United States. Here the imposition of any U.S. income tax by reason of selling activities of a U.S. office would clearly run counter to our national policy of encouraging U.S. exports, a policy essential to the strengthening of the U.S. balance of payments.

The Council believes that the selling of goods to foreign customers through a U.S. office should not give rise to any U.S. tax on the sale by a foreign corporation which either produces those goods within the United States or purchases them from suppliers within the United States. As under existing law, the sale of such goods, if produced by the foreign corporation, would give rise to U.S. tax on the portion of the total profit treated as U.S.-source income from production (as distinguished from selling) activities. (See Regulation 1.863-3(b)).

Sales to U.S. Customers

The bill fails to specify any method for determining the portion of the total profit taxable by the United States with respect to sales made through a U.S. office to customers located within the United States. Thus it may not give effect to the intention expressed in the Report of the Ways and Means Committee at P. 16:

> "In the case of foreign source income where the products are destined for the United States, the income will be treated as effectively connected with a U.S. business *to the extent* the sales activity is carried on by the U.S. office.

"The amount of income attributable to the U.S. sales office is not to be more than would have been attributable to it if the sale had been made in this country.[4] This gives assurance, for example, that the sales income attributable to a U.S. business will *not include income properly attributable to* manufacturing *or any other activities* (apart from sales) *occurring outside the United States.*" (Emphasis added)

The general intention is clearly to exempt "income properly attributable to . . . activities . . . occurring outside the United States."

The Council is concerned, however, that the U.S. Treasury might try to tax the entire profit, without allocation, in cases where the foreign corporation imports into the United States goods which it has purchased (rather than manufactured, extracted, grown or produced) through an office or place of business maintained by it abroad, e.g., the case of the Philippine corporation using a Seattle office to sell hand-embroidered linens purchased through its extensive home-office facilities in the Philippines (described above).

This concern stems from an existing Regulation[5] which would, under present law, cause a foreign corporation to be taxable upon its entire profit from the purchase and sale, if it were to pass title to U.S. customers when the goods arrive in the United States rather than when the goods are shipped from the foreign country. This Regulation might lead the U.S. Treasury to argue that under H.R. 13103 the same amount, i.e., the entire profit, should be taxed in cases where title to the goods passes to the U.S. customer in the foreign country rather than in the United States.

It is submitted that any such interpretation would be unjustified: (a) on equitable grounds, (b) in view of the stated purposes of H.R. 13103, and (c) in view of the conflicting treaty obligations of the United States.

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[4] This sentence appears to be directed to cases where the foreign corporation manufactures, extracts, or produces outside the United States the goods marketed to U.S. customers through its U.S. sales office. There the foreign corporation would pay U.S. tax under existing law on only an allocated part of its total profit from such sales if it were to pass title to the goods within the United States. (The method of allocation is described in Regulation Sec. 1.863-3(b)). Since H.R. 13103 would extend U.S. taxation to cases in which title to such U.S. imports passes outside the United States, the above-quoted sentence assures that the amount taxable under H.R. 13103 would not exceed the allocated part of the profit taxable under existing law where title passes within the United States.

[5] Regulation Sec. 1.861-7 provides:

"(a) General. Gains, profits, and income derived from the purchase and sale of personal property shall be treated as derived *entirely* from the country in which the property is sold. Thus, gross income from sources within the United States includes gains, profits, and income derived from the purchase of personal property without the United States and its sale within the United States." . . .

"(c) Country in which sold. For the purposes of part I (section 861 and following), subchapter N, chapter 1 of the Code, and the regulations thereunder, a sale of personal property is consummated at the time when, and the place where, the rights, title, and interest of the seller in the property are transferred to the buyer." (Emphasis added).

a. *Equitable Considerations*

It would be highly inequitable for the United States—solely because the selling activities of the single employee stationed at the Seattle office—to attempt to tax the entire profit of the Philippine corporation from sales to U.S. customers. Such taxation would be unfair because it would ignore the much larger volume of activities and assets having their situs in the Philippines.

The case of the Philippine corporation is very different from the type of case to which the existing Regulation is addressed. The latter may be illustrated by an English corporation operating a retail shoe store in New York where it sells shoes purchased from suppliers in England. Here title to the shoes necessarily passes to U.S. customers within the United States, causing the entire profit from their sale to be taxable by the United States. This result is reasonable because the English corporation's business is substantially similar to that of a U.S. domestic corporation selling shoes from an inventory maintained within the United States.

This type of business is very different, however, from the type of business to which H.R. 13103 is directed. Thus, the nature of the Philippine corporation's business does not require it to land and warehouse its goods within the United States. Accordingly, the fact that title to the goods passes to the U.S. customer when the goods are shipped from Manila (rather than when they arrive in Seattle) is no mere technicality. On the contrary, this fact flows from the nature of the business of the Philippine corporation: that its economic "center of gravity" is in the Philippines rather than in the United States. There is, therefore, no valid reason for the United States to tax the Philippine corporation *as if* it had been required by business exigencies to defer passing title to the goods until their arrival in Seattle.

b. *Objective of Ways and Means Committee*

U.S. taxation of the entire profit of the foreign corporation would also conflict with the stated objective of the Ways and Means Committee to tax "income generated by U.S. business activities." Clearly, the aim of taxing "income generated by U.S. business activities" does not justify the taxation of profit from other activities performed by a foreign corporation outside the United States.

As previously noted, the Report of the Ways and Means Committee is explicit "that the sales income attributable to a U.S. business will not include income attributable to manufacturing *or any other activities* (apart from sales) occurring outside the United States." (Emphasis added). This intention is stated even more emphatically at P. 64:

". . . if only a part of the income, gain, or loss from a transaction, or series of transactions, is properly considered attributable to such

office, or other fixed place of business within the United States, *only that part* shall be treated as effectively connected with the conduct of a trade or business within the United States." (Emphasis added)

While these statements of Congressional intent are helpful, it is believed there should be no possible ground for a contrary interpretation.

c. *U.S. Tax Treaty Commitments*

A fair apportionment of the foreign corporation's income is also required by many of the income tax treaties to which the United States is a party.

As indicated above under these treaties,[6] the U.S. is clearly barred from taxing the U.S. branch office of a foreign corporation (having its domicile or seat of management in the treaty country) on more than that portion of the profit arising from its U.S. activities "which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length" with its home office in the treaty country.

It is submitted that the United States should not attempt to tax a greater amount to those foreign corporations belonging to countries having no such tax treaty with the United States. Most of the non-treaty countries are the "less developed countries" of Latin America, Africa and Asia. It is the policy of the United States to assist the economic development of these "less developed countries." Consistency with that policy would prohibit the United States from imposing more stringent taxes on those countries' corporations engaged in importing their products into the United States than on corporate importers belonging to treaty countries.

The Council believes that H.R. 13103 should provide that the amount of income of a foreign corporation attributable to sales to U.S. customers made through a U.S. office should not exceed the amount which would be allocable to that office if it had been maintained by a separate subsidiary corporation of the foreign corporation.

Foreign Sales With No Foreign Office

In addition, a similar allocation should be permitted with respect to sales by a foreign corporation, which has substantial economic activities outside the United States but no office outside the United States, of goods of foreign origin sold for use, consumption or disposition outside the United States. The corporation should not be subject to U.S. tax on its entire income from sales negotiated through its U.S. office if part of its income is economically attributable to other factors.

For example, the foreign corporation may purchase goods in one for-

[6] Provisions of this type appear, for example, in the U.S. Tax Treaties with Belgium, Germany, Netherlands, the United Kingdom, and South Africa.

eign country and transport them to another country for sale there. If part of its profit is fairly attributable to its transportation activities or other factors, it should be subject to U.S. tax only on the portion of its profit attributable to the selling functions performed at its U.S. office.

Credit For Foreign Income Taxes

A major defect of the House version of H.R. 13103 is its failure to provide adequate relief from international double taxation of income "effectively connected" with a U.S. office or other fixed place of business.

This problem may also be illustrated by the example (set forth above) of the Philippine corporation purchasing hand-embroidered linens in the Philippines and selling them through a U.S. office to both U.S. and Canadian customers.

In this typical case, the country of purchase (the Philippines) will impose its tax on the entire profit either: (i) because the corporation is domiciled or has its seat of management in that country or (ii) because the corporation passes title to the goods within the country of purchase. In addition, H.R. 13103 would cause the United States to tax the same profit.

The resultant double taxation should be alleviated by allowing the foreign corporation a credit against its U.S. tax for the foreign tax on the double-taxed income.

Under H.R. 13103, such a credit would be allowed, however, only where the foreign tax is imposed by the country in which the income has its "source", i.e., the country in which title to the goods passes,[7] but not where the foreign tax is imposed by the country in which the foreign corporation has its domicile or seat of management, i.e., by its home country.[8]

The apparent rationale of this distinction is that the right of the United States to tax income "effectively connected" with a U.S. office should take precedence over the right of the foreign corporation's home country to tax such income. Under this theory, double taxation would be averted by allowance by the home country of a credit against its tax for the U.S. tax (rather than by allowance by the United States of a credit against the U.S. tax for the home country's tax).

While this new theory may at first appear plausible, there are several reasons why it is not likely, in practice, to avert double taxation.

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[7] As mentioned above, the proposed statute may fail to allow a credit where the country imposing the foreign income tax is both the country of "source" and the country of domicile, unless a similar tax would have been imposed by that country if the corporation had been domiciled in another country.

[8] Thus, for example, no credit would be allowed for the Philippine tax if the United States were to tax the Philippine corporation on sales to Canadian customers negotiated by its U.S. office and if those customers were to take title to the goods upon their arrival in Canada rather than upon their shipment from the Philippines. On those facts, credit would be denied because the foreign tax would be imposed by the country of domicile (the Philippines) rather than the country of "source" (Canada).

A serious practical objection is that some foreign countries, such as Sweden, tax their local corporations on world-wide income without allowing appropriate credits for taxes paid to other countries.

Moreover, even if the foreign corporation's home country does, in general, allow credit for income tax paid to other countries, it may well deny a credit in those cases where title to the goods passes at the point of shipment within the home country because the income would then have its "source" within that country (rather than within the United States where the sales office is located). Since the U.S. Treasury does not allow any credit to U.S. corporations for foreign taxes on domestic source income, how can it reasonably expect that foreign governments will allow credit to their corporations for a U.S. tax on *their* domestic source income?

Finally, the foreign corporation's home country may restrict the credit allowed to its local corporations for taxes paid to other countries by means of a "per-country limitation" similar to that under the U.S. tax law. Such a "per-country limitation" would often operate to eliminate the foreign country's credit for any U.S. tax imposed on profits from sales to foreign customers whenever the income would have its "source" in the customer's country, e.g., when title passes upon arrival of the goods.

It is therefore apparent that foreign corporations would frequently suffer serious double taxation with respect to income "effectively connected" with a U.S. office, if the United States were not to allow a credit against its tax for all foreign taxes imposed on such income, regardless of whether the taxing country is the country of "source", the country of domicile, or both.

In this connection, it is noted that H.R. 13103 would impose on foreign corporations a *greater* tax burden than is borne by domestic corporations. Since a domestic corporation is allowed a credit against its U.S. tax for foreign taxes on its income from sources outside the United States, a foreign corporation should, if taxed under H.R. 13103, likewise be allowed a credit against its U.S. tax for foreign taxes on its income from sources outside the United States (to the extent that such income is "effectively connected" with a U.S. office).

Even if the United States were to allow a credit for income tax imposed by the home country, the foreign corporation might still suffer a serious detriment from the new U.S. tax proposed by H.R. 13103. That is because the credit would automatically be reduced to reflect any income tax benefits which the home country may see fit to grant.

For example, the home country might well confer a variety of tax advantages on a local corporation engaged in activities promoting the expansion of local exports, e.g., construction of new warehouse facilities, by means of "tax holidays", deductions for reinvested profits, rapid depreciation, etc. The economic incentive afforded by these tax benefits would often be completely nullified by the concomitant increase in the

U.S. tax payable by the local corporation. The net result would be particularly harmful for corporations exporting goods from the many "less developed" areas which offer such tax incentives, e.g., Ireland, Peru, Puerto Rico, Southern Italy, Trinidad, etc.

These inadequacies of the credit approach thus furnish further support for the need: (1) to eliminate the proposed U.S. tax on profits from sales to foreign customers by foreign corporations conducting substantial operations through a local place of business in a foreign country, and (2) to restrict any U.S. tax on profits from sales to U.S. customers to the amount which an independent sales agent would earn by performing services similar to those performed by the U.S. branch office of the foreign corporation.

Rental and Royalty Income

The bill includes as one of the types of income from sources without the United States which will be treated as "effectively connected" income, if attributable to a U.S. office of a foreign corporation or nonresident alien individual, rents or royalties for the use of intangible property outside the United States. While the bill itself is silent as to the criteria to be used in determining whether such rents or royalties are to be attributed to a U.S. office, the Ways and Means Report indicates that the test is whether the lease or license is "made by or through" such office. This, in turn, is said to depend upon whether a U.S. office actively participates in soliciting, negotiating or performing other activities required to arrange the license. The place where the invention was developed is immaterial under this test.

The Council firmly believes that it is unrealistic to regard the royalties paid for the use of a valuable right as being generated entirely by the making of the contract. It is either the making of the invention or its use in manufacturing which generates the income; salesmanship or the mere negotiation of the lease or license is generally of minor importance.

If the approach of the proposed statute is to tax rental and royalty income merely because of the presence of negotiating or related activities in the United States, the Council believes that modification of the bill is necessary to bring the rental and royalty provision into line with analogous portions of the bill and to avoid substantial inequity.

As presently formulated, under the test indicated in the Ways and Means Report, rental or royalty income would be attributed to a U.S. office if activities (other than general supervision) incident to the lease or license are performed by or through such office, irrespective of the extent to which a foreign office also participates or where the activities are performed. Thus, for example, royalty income might conceivably be attributed to a U.S. office even though: (1) the intangible property being licensed was developed or acquired entirely outside the United States, (2) the license is negotiated principally by a foreign office, but a tech-

nician assigned to a U.S. office participates in the negotiations or the drafting of the license agreement, and (3) the negotiations or other activities performed by personnel assigned to a U.S. office are performed entirely outside the United States.

As discussed above (Sales to Foreign Customers) in the case of income from sales the approach of the Ways and Means Committee is to attribute foreign source income to a U.S. office only when the U.S. office is the primary place of the activity giving rise to the income. To effectuate this purpose, the proposed statute would exempt from U.S. tax the entire profit from sales arranged through a U.S. office if the property is sold for use, consumption or disposition abroad and an office or other place of business of the taxpayer outside the United States participated materially in the sale. This approach should be equally applicable to income from the leasing or licensing of intangible property for use outside the United States. Thus no U.S. tax should be imposed where an office or other place of business of the taxpayer outside the United States has "participated materially" with respect to the lease or license, either through solicitation, negotiation or other activities related to the making of the lease or license, or through productive or purchasing activities directed toward the creation or acquisition of the intangible property by the taxpayer.

Section 245

H.R. 13103 would amend section 245 to provide an 85% deduction for dividends received from a foreign corporation engaged in trade or business within the United States and having 50% or more of its gross income "effectively connected" with the U.S. trade or business. The deduction would be in proportion to the "effectively connected" income of the paying corporation.

The Council wishes to point out potential double taxation which can occur under the bill where a U.S. corporate shareholder receives a dividend from a foreign subsidiary which has been subject to U.S. tax on its "effectively connected" income.

The following situation should be considered:

> Assume a situation where a wholly-owned foreign subsidiary of a U.S. corporation has only foreign source income but is subject to U.S. income tax on 100% of its income as being "effectively connected" with a U.S. trade or business. Assume also that it pays foreign income tax at a rate greater than the U.S. income tax rate and that the foreign income tax is creditable under proposed section 906 against the subsidiary's U.S. tax.

Under the bill, 15% of every dollar of dividends from the foreign subsidiary would be subject to U.S. income tax. Such taxation is generally referred to as an "upstream dividend tax." No foreign tax credit would be permitted to the U.S. parent under the revised provisions of section

861 (a) (2) (B) since this section would treat dividends from such a foreign corporation as being U.S. source income. Therefore, the section 904 limitation on the foreign tax credit would prevent any available foreign tax credits from being used to reduce the U.S. income tax payable on the dividends. Under existing law, the parent's U.S. income tax on dividends from such a foreign corporation could be offset by available foreign tax credits. It is submitted that to the extent that 15% of such dividends would be subject to the U.S. income taxation under the bill, this would constitute double taxation.

It seems inconsistent with the purpose for which the changes regarding foreign source income which might be "effectively connected" were made to have this result. That is, such changes were intended to prevent tax avoidance by foreign corporations. The effect of this "upstream dividend tax" is to impose an additional tax on U.S. shareholders. The Committee Report submitted by the Committee on Ways and Means does not specifically recognize the possibility of creating an additional tax on U.S. shareholder corporations. It is hoped, therefore, that this is an unintended effect which the Senate will correct.

BALANCE OF PAYMENTS CONSIDERATIONS

U.S. Estate Tax

As compared with H.R. 5916, this bill would increase estate tax rates on estates of nonresident aliens to a maximum of 25%, thus giving less incentive for foreign investment in the United States than was given by H.R. 5916.

H.R. 13103 would include in the taxable estate of a nonresident alien certain intangible personal property which is excluded from the estate under present law. Such property includes: (a) bank deposits in the United States of a nonresident alien not engaged in business in the United States, and (b) debt obligations of a U.S. person (including a U.S. corporation), the United States, a State or political subdivision of a State, or the District of Columbia, even though such obligations are physically located abroad. There is no doubt that these provisions will have an adverse effect on foreign investment in the United States.

Interest on U.S. Bank Deposits

Since the Revenue Act of 1921, interest on deposits with persons carrying on the banking business paid to persons not engaged in trade or business within the United States has been treated as foreign source income and consequently not subject to U.S. income tax. In considering the merits of this exclusion from taxable income, the House Ways and Means Committee Report (67th Cong., 1st Sess.) indicated that "the loss of revenue which would result if this deduction were allowed would be relatively small in amount, while the exemption of such interest from taxation would be in keeping with the action of other countries and would encourage nonresident alien individuals and foreign corporations to transact financial business through institutions located in the United States." H.R. 13103 would completely change this long-standing rule of law in that interest paid on bank deposits in the United States to nonresident aliens and foreign corporations after December 31, 1971, will become subject to income tax even though the recipient may not be doing business in the United States. The technical change in source definitions made by the bill affecting bank interest during the interim period 1966 through 1971 is not objectionable since it is not less favorable than existing law in its treatment of U.S. bank interest paid to foreigners.

It is submitted that the factors prevailing in today's economy are even more compelling than in the 1920's in requiring that interest paid on U.S. bank deposits to nonresident alien individuals and foreign corporations not doing business in the U.S. continue to be exempt from U.S. taxation. The U.S. balance of payments problem would be made more acute

if this interest were taxed since it seems reasonable to believe that a substantial part of the underlying deposits would be transferred to foreign banks. If this were to happen there would be an increased likelihood of these dollars shifting from private to public hands and then becoming a claim on our gold. In addition, it is evident there would be no gain in U.S. tax revenue but in fact a loss, since the shifting of these deposits to foreign banks not subject to U.S. taxation would reduce taxable income otherwise generated by U.S. banks on these deposits.

The House Committee on Ways and Means recognized in its Report that an alteration of this source rule might have a substantial adverse effect on our balance of payments. For this reason the Report indicates that the effective date of this change is being postponed until after 1971 at which time there will be an opportunity to reconsider the balance of payments situation.

For the reasons noted above, the Council is in complete agreement that the proposed change in the source of income rules can have a substantial adverse effect on our balance of payments and that they should not be changed in the context of our present balance of payments difficulties. Indeed, the Council believes that the proposed change would be contrary to the best interest of the United States as a world financial center even in the absence of a balance of payments problem.

Furthermore, the Council does not believe that the present Congress should insert in the law a future date on which the long-standing exemption from tax will be automatically terminated, in view of its recognition that such termination can have serious economic consequences. It would seem that sound legislative procedure dictates that if this exemption is to be terminated at all, despite the continued validity of the reasons for which it was made a part of our law by the Revenue Act of 1921, it should be terminated by positive action of the Congress at the time of termination only after giving thorough consideration to the effect of the change in the light of the then current economic conditions; a situation should not be legislated by the present Congress under which a change in tax law having potentially serious economic consequences can become effective in 1972 by a combination of mere passage of time and inaction on the part of a future Congress.

Moreover, the Council believes that insertion in the law of a termination date for the present exemption will inadvertently negate at least in part the obvious intention of the Congress to reconsider the balance of payments situation *before* withdrawal of foreign-owned deposits from financial institutions in the United States is induced by taxation of the interest on such deposits. The existence of this date in the law will create a psychological barrier to further deposits and induce withdrawal of existing deposits even before the effective date of the tax, thus having a potential adverse balance of payments effect prior to essential Congressional reconsideration of the situation. Accordingly, the Council strongly

urges that this date be deleted from the bill.

The Council agrees that foreign-owned funds on deposit with savings and loan associations and insurance companies should receive similar treatment to that given to bank deposits in the United States.

Short-Term Promissory Notes

Section 881 of the Internal Revenue Code imposes a tax on fixed or determinable income from sources within the United States of foreign corporations not engaged in the conduct of a trade or business within the United States.

Presently, section 881, in addition to taxing fixed or determinable income, imposes a tax on types of income described in section 631 (b) and (c), which relate to gains on the disposal of timber, coal and iron with a retained economic interest. Except as provided in section 631, foreign corporations not engaged in trade or business in the United States are not presently subject to tax on capital gains from United States sources. The Committee on Ways and Means in House Report No. 1450, Page 87, recognized this when it said:

> "Gains from the sale or exchange of a capital asset (other than amounts to which amended sec. 881 (a) (2) and (3) applies) are subject to tax only if they are received by a foreign corporation which is engaged in trade or business within the United States at some time during the taxable year for which the tax is being determined and are effectively connected with the conduct of a trade or business within the United States."

The proposed amendment to section 881 retains the types of income specified under present law as being taxable, but with two additions: (1) gains with respect to the sale of stock of a collapsible corporation, treated as ordinary income (section 341), and (2) amounts of original issue discount which are treated as ordinary income received on retirement or sale or exchange or bonds or other evidences of indebtedness issued after September 28, 1965 (section 1232).

Certain United States corporations, principally finance companies, in the ordinary course of business sell to nonresident aliens short-term (nine months and under) promissory notes (commercial paper) issued in bearer form at a discount without interest. With regard to these sales, the discount on the non-interest bearings notes has, under Revenue Rulings L. O. 1024, 2 CV 189 (1920); I. T. 1398, I-2 CB 149 (1922); I. T. 3889, 1948-1 CB 78 (1948), been considered to be not fixed or determinable and, therefore, not subject to tax. To subject such discount to Federal income tax will, as explained below, have substantial and lasting adverse effect on the United States balance of payments.

Proposed section 881 (a) (3), by reference to section 1232, specifi-

cally taxes income which, under section 1232, is treated as a gain from the sale or exchange of property not considered to be a capital asset and to the extent the amount received is not effectively connected with the conduct of a trade or business within the United States. Under section 1232, any gain realized to the extent of original issue discount from evidences of indebtedness held by the taxpayer more than six months is considered as gain from the sale or exchange of property which is not a capital asset.

Thus, by including a reference to section 1232, proposed section 881 would, in effect, be taxing a nonresident alien corporation on a gain from the sale or exchange of a capital asset which is not effectively connected with the conduct of business in the United States.

It is the Council's understanding that certain nonresident alien corporations which have in the past purchased substantial amounts of such commercial paper fear that the U.S. Treasury might interpret erroneously the proposed section 881 (a) (3) to the effect that the discount on all commercial paper sold to nonresident alien corporations will be taxable, without regard to whether or not such paper is held for more than six months. Thus, if the proposed section 881 (a) (3) is enacted, such corporations will cease to furnish a market for commercial paper. This would have a severe, adverse effect on the United States balance of payments. It is estimated that the annual market in this short-term (nine months and under) commercial paper sold in the United States to nonresidents is in excess of $1 billion. The possibility that the gain on this short-term paper might be subject to United States income tax will result in the permanent loss of a substantial part of such investment in the United States by nonresident foreign corporations. The Council believes the proposed section 881 (a) (3) should not be enacted.

Section 904 (f)

H.R. 13103 proposes to amend section 904 (f) of the Internal Revenue Code by making the present separate "per country" limitation with respect to interest income inapplicable to interest received by an "overseas operations funding subsidiary" on obligations of a "related foreign corporation."

While the Council supports the general purpose of the proposed amendment (set forth in the Report of the Ways and Means Committee at pages 39-40), it wishes to first point out that it believes that the exception in section 904 (f) (2) (C) of the present law should be construed to apply where a U.S. parent uses a domestic affiliate to borrow foreign funds to finance the operations of its (the parent's) foreign subsidiary, despite the doubt expressed on this point on page 40 of the Committee Report.

In addition, the Council wishes to point out that, contrary to the statement on page 40 of the Report to the effect that this exception under

904 (f) (2) (C) is only provided in cases where the U.S. taxpayer receiving this interest directly owns 10% of the borrowing foreign affiliate, it believes that the intent of present law is that such a foreign affiliate may be either directly or indirectly owned by the U.S. company to come within the exception.

It will be recalled that when Secretary Dillon was examined by Senator Long with respect to his recommendation for a separate foreign tax credit limitation for certain investment income, he made it very clear that this provision was directed specifically to passive short-term funds that were invested abroad. This will be seen from the following questions and answers appearing on pages 4259 and 4260 of the record of Senate Hearings on the Revenue Act of 1962:

Senator Long. Mr. Secretary (Dillon), . . . You cited a flow of short-term funds to Canada and I believe you are correct in what you recommended with regard to that.

According to your testimony contained on pages 103 and 104 of the record, [attached hereto as Appendix A] and in greater detail at page 243, this change is intended to cover short-term investments abroad.

Am I correct in my understanding you do not intend this change to apply to dividends received by a U.S. corporation from another corporation, domestic or foreign in which it owns at least 10 percent of the voting stock?

Secretary Dillon. That is correct. No, it would not. It is only meant to handle this one specific short-term problem which I described in my April 2 statement.

Senator Long. Would I also be correct in understanding that you do not intend this change to apply to interest received from investments in such affiliates?

Secretary Dillon. No, it would not apply to interest received from such affiliates.

Senator Long. Now, do you intend this change to apply to interest received on a loan made to a foreign customer to secure an outlet for products to be sold to the lender?

Secretary Dillon. No. This was only meant to apply, in effect, to passive funds that were transferred abroad for the specific purpose of taking advantage of this situation in the law where there is an unused credit which allows totally tax-free treatment of the income from such passive funds by investment abroad.

Senator Long. I have been informed by some corporations occasionally that they are required to buy bonds in a Latin American country. They are not particularly anxious to buy them, but while they have no enthusiasm for the purchase, as a matter of good will in the country they are

more or lesss compelled to do so.

And I take it that you would not intend your recommendation to apply to that either?

Secretary Dillon. No.

Senator Long. As long as it is limited to that, I think the recommendation should receive complete support. At least I would expect to support it.

However, to completely resolve these points, the Council urges that 904 (f) (2) (C) be clarified so as to exclude interest received from a corporation in which the recipient (or one or more includible corporations in an affiliated group, as defined in section 1504, of which such recipient is a member) owns directly or indirectly 10% or more of the total combined voting power of all classes of stock.

This wording is similar to that in section 4915 of the Code whereby direct foreign investments are excluded from the imposition of the Interest Equalization Tax. Direct foreign investments are spelled out by statute as investments of 10% or more of the total combined voting power of all classes of stock held either directly or indirectly by members of an affiliated group of corporations.

While this recommendation would eliminate the need for the special amendment to section 904 (f) for interest received by an "overseas operations funding subsidiary" on obligations of a related foreign corporation, the Council wishes to express its concern over the unduly restrictive proposed definitions of the terms "overseas operations funding subsidiary" and "related foreign corporation" contained in H.R. 13103.

The definition of the term "overseas operations funding subsidiary" as contained in the proposed section 904 (f) (5) (A) requires that such a subsidiary raise its funds through "public offerings." The Council is at a loss to understand why there should be a requirement that the offerings be public. The objectives of the balance of payments program will be satisfied if the funds are raised outside of the United States from foreign persons whether the offerings are public or private.

The definition of a "related foreign corporation" in proposed section 904 (f) (5) (B) requires that at least 50% of the voting stock of the foreign corporation must be owned either directly or through ownership of only one other foreign corporation included in the affiliated group of which the "overseas operations funding subsidiary" is a member.

First, it is felt this definition is too restrictive insofar as it requires the affiliated group to own at least 50% of the voting stock of the foreign corporation from which the interest income is received. This 50% requirement is to be contrasted with the 10% requirement of the existing section 904 (f) (2) (C) which makes the separate "per country" limitation inapplicable to interest income "received from a corporation in which the taxpayer owns at least 10% of the voting stock."

The apparent rationale of this 10% rule is that an interest-bearing loan

to a corporation (earning all or most of its income abroad) is likely to be prompted by legitimate business considerations if the lender owns as much as 10% of the voting stock of the borrowing corporation. If this is the rationale of the present 10% stock ownership requirement, it should apply regardless of whether the loan comes from the 10% shareholder or from another U.S. corporation, such as an "overseas operations funding subsidiary," which is a member of an affiliate group of corporations (as defined in section 1504) to which the 10% shareholder belongs. There does not appear to be any logic in raising the stock ownership requirement from 10% to 50% simply because the loan and the stock are not held by the same member of the affiliated group.

Unless the proposed new 50% requirement is modified to conform to the present 10% requirement, a U.S. taxpayer owning at least 10% but less than 50% of the voting stock of a foreign corporation will find it advantageous to lend U.S. funds to the foreign corporation rather than to utilize an "overseas operations funding subsidiary" to lend foreign funds to the foreign corporation, thus adversely affecting the balance of payments position of the United States.

Second, the Council believes that the proposed amendment is too restrictive insofar as it specifies that the required voting stock of the foreign borrowing corporation be held by a member of the affiliated group either "directly or through ownership of the stock of another foreign corporation." According to the Report of the Ways and Means Committee at Page 41, "This latter requirement, in effect, means that the borrowing subsidiary may be either a first or second tier foreign subsidiary."

The Council can see no logical basis for denying the benefit of the proposed amendment to interest income received from third or fourth tier foreign subsidiaries. While it is true that dividends received from third or fourth tier foreign subsidiaries do not carry "deemed paid" credits under section 902, this does not afford a persuasive analogy because only interest income (and not dividend income) is affected by the separate "per country" limitation imposed by section 904 (f). It is arbitrary to give effect to stock ownership in first and second tier subsidiaries and to ignore the same percentage of stock ownership in third and fourth tier subsidiaries.

Incidentally, the Council has recently indicated its support of H.R. 15139, introduced by Congressman Secrest, which would amend section 902 of the Internal Revenue Code to reduce the 50% ownership requirement to 25% between the first and second levels and extend the benefits of section 902 to dividends received from a third level foreign corporation if the 25% test is met.

As stated above, the 10% stock ownership requirement appears to be premised on the view that an interest-bearing loan to an affiliate is likely to be motivated by genuine business considerations (rather than tax-saving considerations) if the lender is at least a 10% stockholder. If this assumption is valid (as the Council believes it to be), it is equally valid regardless

of whether the 10% stock interest is held directly or through any number of intermediate subsidiaries.

Interest Received In Connection With Certain Dispositions

Under present law an exception to section 904 (f) is provided where the interest received is on an obligation acquired as a result of disposition of stock or obligations of a corporation in which the taxpayer owned at least 10%. However, in the case of a disposition of stock of a wholly-owned subsidiary of a corporation in which the taxpayer owns a 10% interest the latter exception may not apply under present law. It appears that the limitation on the foreign tax credit should apply in the same manner if the obligation is acquired as a result of disposition of the stock of a corporation owned at least 10% whether directly or indirectly.

APPENDIX A

Eliminating Artificial Tax Incentives To Capital Movements Arising Out Of Foreign Tax Credit Computation[9]

Last summer Canada revised its tax laws to provide a 57½% effective rate of Canadian tax applicable to income going to United States corporations operating in branch or subsidiary form in Canada. This Canadian tax rate in excess of the U.S. 52% rate has highlighted the operation of the existing method for computing the foreign tax credit as an artificial inducement to the outflow of short-term U.S. capital. This is harmful to our monetary stability and to our balance of payments position.

Under existing rules, a U.S. company deriving income from business abroad through a branch or a subsidiary may have an unused foreign tax credit where the foreign rate of tax on the income exceeds the U.S. rate. If, however, additional foreign source investment income can be generated which is subjected to a foreign tax rate lower than the U.S. rate, the two kinds of income can be lumped together under the existing foreign tax credit rules. In this way the U.S. tax on the income from such investment funds can be completely eliminated by the excess credit from the tax on the business income of the company.

For example, the 57½% effective rate of Canadian tax applicable to income going to U.S. corporations operating in branch or subsidiary form in Canada leaves an excess credit of 5½% over the U.S. 52% rate. The Canadian rate of tax on interest income flowing to such corporations is only 15%. Consequently, some of these U.S. corporations have transferred to Canada short-term funds, such as bank deposits, which ordinarily would be held in the United States. Since the excess credit from the business income will eliminate the U.S. tax on the interest income, the effect is to leave that income taxable at only a 15% Canadian rate, as compared with the 52% U.S. rate that would apply if the funds were held in the United States. Thus the existence of this situation serves as an artificial inducement to the movement of U.S. capital abroad.

In my report to the President on the balance of payments, transmitted to the Congress on March 28, 1962, I recommended that this situation be corrected. I suggest that the foreign tax credit for certain investment income be computed apart from the foreign tax credit for all other foreign income. In this way a foreign tax credit will be allowed against investment income only for the actual foreign taxes paid on such income. This will result in the same tax rate being paid with respect to short-term investment income of U.S. companies whether it is earned at home or abroad. We believe that this is an effective and fair way to correct this tax-induced disruptive monetary situation. A more detailed explanation of this recommendation and the proposed statutory language is submitted as exhibit III E.

[9] Excerpt from testimony of Secretary Dillon at Hearings before Senate Finance Committee on the Revenue Act of 1962 (Part 1, pages 103 and 104).

(By direction of the Chair, the following communications are made a part of the record at this point:)

NATIONAL ASSOCIATION OF MANUFACTURERS,
Washington, D.C. August 9, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This letter is in response to your Committee's invitation to submit written statements on H.R. 13103, the Foreign Investors Tax Act of 1966. This legislation has been the subject of continued study by the NAM Subcommittee on International Taxation since the original version was first introduced.

Our concern with H.R. 13103 is focused largely on the "effectively connected income" test. On March 4, 1966, we told the House Committee on Ways and means, "* * * that unless this new concept is carefully drawn and applied, it invites a host of questions and uncertainties in the existing U.S. source rules." These "questions and uncertainties" still exist and indeed further study reaffirms our doubts.

The basic purpose of H.R. 13103, with which we have no quarrel, is to attract foreign investment capital to the U.S. The collateral purposes with which we also agree in principle are:

(a) To prevent the U.S. from being used as a tax haven by foreign corporations, and

(b) To impose a U.S. tax on income generated from U.S. business activities—otherwise not taxed—.

It is the implementing provisions to effect these latter purposes about which we have serious doubts. The "effectively connected income" test is a jurisdictional test which would be imposed on and would supplement our present source of income rules. It is subjective and fuzzy in its measurements and application. Taxes would turn on such concepts as: material participation in—activities attributed to—etc. Practical questions of proof are consequently raised. Further, materiality and taint would, in a number of instances lead to multiple taxation.

The present rules, while being jurisdictional themselves, are well understood both here and abroad. The proposed rules seriously lack the precision of the old, and were they superimposed, in many instances, would lead to controversy as to which would apply or, perhaps, to a situation where all would apply.

Other troublesome areas immediately come to mind. What would be done, for example, in the tax treaty area? The proposed rule conflicts with the jurisdictional tests in a number of our tax treaties with other countries. How are the resulting conflicts and inconsistencies to be corrected?

These provisions of the bill, H.R. 13103, are not expected to increase revenues. However, they would add imprecision and confusion to our present well-tested and precise rules of source and jurisdiction. Any changes in these existing rules for any purpose should be the subject of more careful consideration as to their ultimate effect in areas not contemplated or presently considered in the drafting of the bill now before your Committee.

We respectfully request that this letter be made part of the official record of the Committee's hearings.

Sincerely,

D. H. GLEASON,
Chairman, Subcommittee on International Taxation,
NAM Taxation Committeee.

MANUFACTURING CHEMISTS' ASSOCIATION, INC.,
Washington, D.C., August 10, 1966.

Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Reference is made to your Committee's announcement of public hearings on H.R. 13103, The Foreign Investors Tax Act of 1966. The purpose of this letter is to present the views of the Manufacturing Chemists Association (MCA) concerning this bill. For your information, MCA is a nonprofit trade association with 192 U.S. member companies, large and small, which

together account for more than 90% of the productive capacity of the chemical industry in the United States.

This Association is opposed to the provisions contained in H.R. 13103 which embody the concept of "effectively connected" so as to impose United States tax on foreign source income of foreign corporations doing business in this country. It is our belief that sufficient documentation has not been developed as to the necessity of introducing this new and novel concept into the tax laws and that the resulting confusion and burdens would be substantially disproportionate to the abuses which are sought to be remedied. Our specific objections to these provisions are set forth below.

1. The terms "effectively connected" and "participated materially" embodied in H.R. 13103 remain vague and ambiguous despite attempts to clarify them. The numerous issues which will be raised and the extensive litigation which will follow in interpreting their meaning and scope will create undue and unnecessary burdens on taxpayers and the Government alike.

2. Adoption of the present version of H.R. 13103 would create insurmountable accounting and auditing problems for taxpayers and the Internal Revenue Service. For instance, where goods are manufactured by a corporation abroad and sold for consumption abroad through use of a sales office in the United States, the selling profit must be allocated to and taxed in the United States. Since all of the personnel and records of such corporation probably are abroad, except for possibly one salesman, considerable difficulty will be experienced by the Internal Revenue Service in any audit. Even where such audit is conducted, it will be an impossibility to determine the proper income attributable to the United States sale since advertising, selling expenses, etc. incurred at some previous time during the year might have to be allocated to this sale under conditions where no rules have been established.

3. It has been pointed out that H.R. 13103 is designed to tax certain foreign source sales solely because the income therefrom escapes tax completely. However, the net result of the proposal will unnecessarily harm the United States balance of payments since to avoid such tax, a foreign corporation need only move its sales office to a more receptive country, thereby eliminating the present flow of funds into the United States to pay for the sales office and the employees' salaries.

4. While the Association commends the exclusion of subpart F income from being considered "effectively connected" with the conduct of a trade or business in the United States, there is need for further clarification of this relief. For example, if a foreign base company is not subject to subpart F because less than 30% of the gross income of the corporation is subpart F income, does the relief granted under Section 954(b)(3) become nullified through the "effectively connected" provisions of H.R. 13103? It would seem that the intent of the bill is to grant the exclusion under these circumstances, but this should be indicated more clearly.

5. H.R. 13103 brings within its new concept of "effectively connected", rents or royalties derived for use or for the privilege of using intangible property located outside the United States. This is another example where the criteria to be used in determining whether the "effectively connected" concept applies are vague and unclear. Although the House Ways and Means Committee report sets out some general principles, taxpayers will continue to be uncertain as to whether the activities performed in the United States are such as to require these items to be attributed to the United States office. MCA believes that it would be desirable to provide a rent and royalties requirement similar to that which is applicable to foreign income from sales, namely, that rents and royalties will not be considered effectively connected to a United States office where the taxpayer has an office outside of the United States which "participates materially" in the negotiation of the leases and licenses or participates in the servicing of the rights thereunder.

For the above stated reasons, this Association recommends the complete deletion of the "effectively connected" provisions referred to above from H.R. 13103. On the assumption, however, that your Committee may deem it advisable to continue to include these provisions in the bill, it is suggested that the bill be limited to its original purpose of dealing with foreigners by a simple amendment which would exclude from the bill those foreign corporations now subject to United States scrutiny because they are controlled by United States persons. This can be done simply by deleting the present language of Section 864(c)(4)(D)(ii) and substituting the following language:

"(ii) is derived by a foreign corporation more than 50% owned directly or indirectly, by United States persons".

The Association also strongly recommends that H.R. 13103, if enacted, be revised so as to extend a foreign tax credit for foreign income taxes imposed by the home country of the taxpayer on foreign income "effectively connected" with the conduct of a trade or business within the United States. For example, if the country in which a foreign corporation is organized imposes an income tax on foreign income which under H.R. 13103 is considered "effectively connected" with a trade or business in the United States, a foreign tax credit for those taxes should be allowed. It is well known that many nations tax income of their taxpayers whether derived from sources within or without the country. In such cases, H.R. 13103 would cause double taxation by requiring United States taxation of the same income taxes by the home country of the taxpayer. MCA believes that where income under these circumstances is doubly taxed, the United States should grant a foreign tax credit.

We appreciate this opportunity to present our views for your consideration and request that they be made a part of the printed record of the Committee's hearings.

Sincerely,

G. H. DECKER.

Senator ANDERSON. Mr. Seghers.

STATEMENT OF PAUL D. SEGHERS, PRESIDENT, INSTITUTE ON U.S. TAXATION OF FOREIGN INCOME, INC.

Mr. SEGHERS. Thank you for the opportunity to appear. For the record, my name is Paul D. Seghers, appearing as president of the Institute on U.S. Taxation of Foreign Income, Inc.

I am not reading from my written statement that was filed. We thank you for this opportunity to present our views regarding the Foreign Investors Tax Act of 1966. Before commencing my oral presentation, I wish to mention the magnificent report on this bill submitted by the Interstate Tax Committee, New York State Bar Association. It clearly and dispassionately states the facts regarding the objectionable features of this bill, penalizing exports of U.S. products, and the harmful effects it would have on our economy and our relations with friendly nations.

This is presented in 108 pages of text and 11 pages of summary. This is fortunate, as it would be impossible to begin to deal adequately with these extremely complicated and confusing provisions in an oral presentation.

Very few of us would be here today if this bill were the same as originally introduced, H.R. 5961. In fact, I have a feeling that many of us would not be here today, if the effect of this bill were as stated, in its behalf. However, even the brightest picture reveals clearly that it would impose new burdens on the export and sale abroad of U.S. products.

Limit its effect to foreign investors, and foreign-owned corporations and opposition to this bill would evaporate.

We offer no comments regarding the provisions of this bill which are in harmony with its title and stated purpose and are in fact intended to accomplish its purpose as originally stated by the Treasury, the increased foreign investment in the United States. We are concerned with those provisions that have nothing to do with the stated purpose of this bill but would place further burdens of harassment as well as taxes on U.S.-owned foreign corporations, particularly those selling abroad U.S. products of U.S. parent companies.

Just why such sales are the special target of attack by the Treasury we cannot understand. These sales already have been singled out for

special attack under subpart F of the 1962 revenue act and this bill would impose additional burdens, difficulties and harassment on foreign corporations making such sales abroad.

H.R. 13103 would tax corporations on income earned abroad, on income heretofore believed beyond the taxing power of the United States not even attempted in the 1962 Revenue Act. Yet the Ways and Means Committee report on H.R. 13103, at page 7, shows that these burdensome provisions would produce no tax revenue for the United States. Then why do we protest against them? Because even if they did not extract one penny of taxes these provisions would place heavy burdens of accounting, reporting, and vouchering upon all foreign corporations with any employees or agents in this country.

How complicated and how burdensome these requirements would be are set forth in many pages of the bar association report to which reference has been made.

This bill would not conform to foreign tax systems but would add to the present maze of U.S. tax rules other foreign rules and radical new theories.

Business does not want to be forced to depend on legislative history to explain theories too difficult to explain in the statute. It is not necessary to say "effectively connected" to make clear our objection.

To sum up: It is our hope that your committee will make a thorough study of the provisions of this bill which go beyond its stated purpose. We ask that you give careful consideration to the many excellent statements filed with you regarding the defects and harmful features of this bill as it affects U.S. exports.

The provisions of H.R. 13103 which are aimed at U.S.-owned foreign corporations selling U.S. products abroad would further discriminate against export of U.S. products. It is vastly complicated; unworkable tests applicable to income of foreign corporations from their sales abroad of U.S. products would result in confusion and endless dispute, and to what end? We again emphasize that the Ways and Means Committee report shows no tax revenue from these objectionable provisions.

If it is clear that it will have a harmful effect on our economy and will produce no revenue, why should they be enacted? The Foreign Investors Tax Act of 1966 could accomplish its stated purpose without these provisions as was done in the original bill H.R. 5918. If your committee weighs the facts and arguments against the radical new theories which these provisions would implant in our tax law, we believe you will conclude that they are not desirable and should not be enacted.

U.S. tax incentives for exports are needed, not U.S. tax penalties on U.S. exports.

Thank you.

(Mr. Seghers' prepared statement follows:)

STATEMENT OF PAUL D. SEGHERS, PRESIDENT, INSTITUTE ON U.S. TAXATION OF FOREIGN INCOME, INC.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. This institute heartily agrees with the oft-stated purpose of this Bill—to afford tax incentives for investment in the United States by foreigners.

2. Our objection is to the provisions in this Bill which would impose further U.S. tax burdens on U.S. foreign trade, especially U.S. manufacturers exporting their products for sale through foreign subsidiaries.

3. Despite the substantial improvements in the language of the latest Bill concerning foreign income "effectively connected" with business activities in the United States, we insist that that theory is wrong in principle and will have adverse effects on the U.S. economy.

4. To avoid further handicapping U.S. concerns engaged in foreign trade, it is essential, if the "effectively connected" theory is retained, to provide that this theory is not to be applied to foreign corporations majority-controlled by U.S. persons. We make no *alternative* recommendations for *improving* these very complicated and troublesome provisions, as the one change we recommend will be sufficient to eliminate the harm to U.S. business engaged in foreign trade.

5. The House Ways and Means Committee report on H.R. 13103 (p. 7) shows that its "effectively connected" provisions would produce no tax revenue. Hence, there is no revenue barrier to deter eliminating this complicated source of uncertainty and endless disputes and difficulties.

6. The proposed radically new provisions for disallowance of credit for foreign income taxes would, in certain circumstances, result in severe and unjustifiable hardship through double taxation, even if the "effectively connected" provisions were limited as recommended above.

7. We are convinced that the stated objectives of this Bill could be achieved by the use of very much simpler and more direct language, and doubt that the present provisions of H.R. 13103 regarding U.S. income and activities of foreign-owned foreign corporations would go far towards accomplishing its stated purpose.

1. Stated purpose of H.R. 13103 is heartily approved

This institute heartily approves of the oft-repeated purpose of H.R. 13103 (and its predecessors, H.R. 5916 and H.R. 11297)—"to increase foreign investment in the United States," as expressed in the Treasury Department's March 8, 1965, statement.

This purpose was again stated in the report on H.R. 11297 published by the House Ways & Means Committee for the use of its members, as follows:

"* * * to modernize the present U.S. tax treatment of foreigners and to encourage foreign investment in the United States * * * by removing tax barriers to such investment."

In its report on the present version of this proposed legislation (H.R. 13103) the House Ways & Means Committee is less specific in stating the purpose to encourage foreign investment in the United States and has restated the modified purpose of the bill as:

"* * * designed to increase the equity of the tax treatment accorded foreign investment in the United States."

With both stated purposes we are thoroughly in accord. What concerns us is the provisions in the present bill which would place new and previously believed to be impossible burdens of U.S. income tax on income earned abroad by foreign corporations, particularly those selling abroad U.S. products of U.S. parent companies. Just why such sales are the special target of attack, we can not understand.

2. Objection to use of H.R. 13103 to burden our foreign trade

H.R. 11297 would have constituted an oppressive burden on U.S. foreign trade. While H.R. 13103 goes far to avoid this evil, it still presents a threat to all U.S.-owned foreign subsidiaries engaged in foreign trade, especially in the case of U.S. manufacturers exporting and selling their products abroad through such subsidiaries. Such added burden is in no wise consistent with the purpose of affording incentives for foreign investment in the United States, nor with efforts to encourage export of U.S. manufactured products.

Comments regarding specific ways in which this Bill would impose added burdens on U.S. businesses engaged in foreign trade are given in statements filed with your Committee by other organizations.

We make no comments or recommendation herein regarding the possibly adverse effects of H.R. 13103 on *foreign*-owned foreign corporations. We are concerned here only with its adverse effects on U.S. business and the U.S. economy.

3. The radical new "effectively connected" theory is wrong in principle

The feature of H.R. 11297 which led to a storm of protest against that version of the proposed legislation was the fact that it would have subjected foreign corporations to U.S. tax on income earned by them outside the United States by broadly applying the radical new "effectively connected" theory. That theory seems to be that every foreign corporation should pay U.S. tax on all income