

is any relationship between the different types of incomes (business and investment) from the United States.

*Reasons for provision.*—Under the rule described above, one foreigner may be taxed on investment income at the regular individual or corporate rates while another, with an identical portfolio investment, is taxed on his investment income at the flat 30-percent (or lower treaty) rate. The difference in treatment arises from the fact that one is engaged in business in the United States and the other is not, even though the investment portfolio of the former is wholly unrelated to his U.S. business. Your committee agrees with the House that it is neither equitable nor logical for this substantial difference in tax treatment of investment income to depend on the presence or absence of an unrelated business. In addition, the Presidential Task Force on Promoting Increased Foreign Investment in U.S. Corporate Securities has pointed out that the present scheme deters foreign businessmen operating in the United States from investing in the United States, and also deters foreigners already investing in the United States from commencing a trade or business here.

The present scheme for taxing foreigners engaged in business in the United States also is defective in another respect. The interplay between the tax rules of certain foreign countries and the United States has in some cases permitted the use of the United States as a tax haven. The tax avoidance in such a case can be illustrated by a foreign corporation which is organized in a country which does not tax its domestic corporations on income derived from the conduct of a business outside the country. If such a corporation desires to sell products into countries, other than the United States or the country of its incorporation, it can, in many instances, avoid all or most taxation on the income from these sales by establishing a sales office in the United States. The income from the sales in such cases is not taxed by the United States because (under the title passage rule) it is not derived from sources within the United States. The income may not be taxed by countries where the products are sold because the corporation does not have a permanent establishment there, and the income is not taxed by the country of incorporation because the business is not conducted there. Moreover, a similar tax avoidance scheme can be utilized with respect to sales arranged in the United States concerning goods destined for use in this country. In addition, U.S. tax may be avoided in the case of rents and royalties from a licensing business and income from banking, financing or investment company businesses carried on in the United States. Your committee agrees with the House that foreign corporations carrying on substantial activities in the United States, in such cases, should not be able to cast their transactions in such a form as to avoid both all U.S. tax and most foreign taxes. Also, it is believed that foreign corporations should pay a U.S. tax on the income generated from U.S. business activities. There appears to be no national policy to be served by allowing foreign persons to operate in this country without paying their share of our governmental expenses.

To meet both types of problems described above the bill provides for the taxation of nonresident aliens and foreign corporations at the regular U.S. graduated individual rates or corporate rates on their income which is effectively connected with the conduct of a