

ject to U.S. tax, the rules added by your committee provide that foreign source income will not be considered to be effectively connected with a U.S. business of a foreign corporation or nonresident alien if (a) a U.S. office of that business was not a material factor in the production of the income, (b) the income was not derived from the usual business activities of the U.S. business or (c) the income was not properly allocable to the activities of the U.S. business.

It is the opinion of your committee that these added rules will delimit the application of the general rules of this provision, thereby subjecting to U.S. tax only income which has its economic genesis in the United States. For purposes of this provision, the activities of the U.S. office will not be considered to constitute a "material factor" unless it provides a significant contribution to the production of the income. Thus, the activities of the U.S. office must be an essential economic element in the production of the income. Therefore, the fact that the board of directors of the foreign corporation meets in the U.S. office will not subject the worldwide sales income of that foreign corporation to U.S. taxation. Contrarily, the activities of the U.S. office need not necessarily be a major factor in the production of the income.

The requirement that the income must be derived from the usual business activities of the U.S. office, in effect, provides a de minimus exception. It is intended that this rule will exclude from U.S. tax jurisdiction all foreign income derived from casual sales. Thus, if the foreign corporation is engaged solely in a manufacturing business in the United States, the income derived by the U.S. plant as a result of an occasional foreign sale will not come within the ambit of the foreign source effectively connected rule where the sales operations for the products of the U.S. plant are located outside the United States. On the other hand, if a foreign corporation establishes a U.S. sales office to sell goods produced in Africa into the Western Hemisphere, occasional sales income derived from parts of the world other than the Western Hemisphere would not be excluded under this casual sales rule. In other words, the nature of the U.S. business would be the primary determinative factor for purposes of this exception.

The committee received considerable testimony requesting that the general foreign source effectively connected rules be modified so as to insure in all cases that only income generated in the United States would be subject to U.S. tax. It is your committee's understanding that this was the intention of the House bill and, therefore, the addition of the "properly allocable" test is considered to constitute a clarifying amendment.

(C) *Country of Residence Taxes.*—Your committee's bill extends the foreign tax credit provision of the House bill which applies with respect to foreign source effectively connected income (sec. 906). The House bill would not have extended the foreign tax credit provision to taxes imposed by a foreign country solely on the basis that it has jurisdiction to tax because the taxpayer is a citizen or resident of that country or a corporation created, incorporated, or domiciled in that country. Your committee's amendment extends this foreign tax credit provision to the resident country taxes on foreign source income specifically excepted by the House bill. A further discussion of this