

tax at the regular graduated rates, such a nonresident alien is allowed deductions to the extent they are properly allocable to the income on which he is taxable.

Nonresident aliens not engaged in a trade or business in the United States—whether their income is over or under \$21,200—are subject to tax on regular capital gains only if one of two conditions exist: (1) if they are physically present in the United States at the time the capital gain is realized or (2) if they are present in the United States for a period or periods totaling 90 days or more during the year. These capital gains are taxed at the flat 30-percent rate, if the individual's income from U.S. sources is \$21,200 or less. If his income from U.S. sources exceeds this amount, the regular capital gains tax rate will apply if the regular individual income tax rates (including the capital gains tax) on all the taxpayer's U.S. source income results in a higher tax than the flat 30-percent tax.

Nonresident alien individuals engaged in trade or business in the United States are taxable at the regular U.S. graduated (and capital gains) rates on their income derived from sources within the United States. In computing the tax, an alien in this category is allowed deductions to the extent attributable to his U.S. source income.

Reasons for provision.—Your committee agrees with the House that the present tax treatment of nonresident aliens is unnecessarily complicated and also makes arbitrary distinctions based upon the size of the individual's income and whether or not the individual has a trade or business in the United States which may be wholly unrelated to the specific income in question. The bill has retained the rule of present law which provides that U.S. trade or business income of nonresident aliens is subject to the regular individual income tax rates. However, other income is to be subject to the regular rates only if it is effectively connected with the U.S. trade or business. U.S.-source fixed or determinable income of nonresident aliens which is not so connected is to be subject to a flat 30-percent rate (or lower treaty rate). This removes the arbitrary rule of present law which would vary the treatment of investment income depending upon whether the individual has an unrelated trade or business in the United States.

The flat 30-percent rate of tax in the case of certain nonresident aliens has been applied under present law, and is continued under the bill, because the United States does not have jurisdiction over all of such an individual's income. These taxpayers are not allowed the deductions that are available to U.S. citizens and the 30-percent rate is considered an appropriate effective rate in such cases. In addition, it has been found in practice that only a small amount of tax has been collected as a result of imposing the graduated rates. It is also thought that applying the uniform flat rate with respect to income not effectively connected with a trade or business in the United States would tend to encourage investment here by foreigners. To the extent this occurs, there will, of course, be an improvement in our balance of payments.

In the case of capital gain, it was the opinion of your committee and the House that the present rule that taxes a nonresident alien if present in the United States when the gain is realized is an arbitrary rule which constitutes only a trap for the unwary. Also, your committee agrees with the House view that the exclusion for nonresident aliens