

cases the 30 percent tax would substantially exceed the regular tax on this income.

The types of income referred to under present law as scholarship or fellowship grants received by a nonresident alien individual temporarily present in the United States as a nonimmigrant (under subpar. (F) or (J) of sec. 101(a)(15) of the Immigration and Nationality Act) or received by a citizen or resident, are, subject to a dollar limitation, exempt from U.S. tax.

Present law (sec. 872(b)(3)) also excludes from gross income compensation paid by a foreign employer to a nonresident alien for the period he is temporarily present in the United States as a nonimmigrant for the purposes of participating in a cultural or training program. Under present law this is available where the "foreign employer" is a foreign person or a domestic corporation having an office in a foreign country or U.S. possession. The bill extends this to also cover a domestic partnership or a U.S. citizen or resident with such a foreign office.

(ii) *Income from real property.*—Under present law, it is not clear as to what situations or arrangements for the ownership by a nonresident alien of real property located in the United States will cause the nonresident alien to be considered as engaging in a trade or business within this country. This, of course, is important since the question of whether or not the alien is engaging in a trade or business in the United States determines whether his U.S. source capital gains are subject to U.S. tax and whether his other U.S. source income is taxable at the regular individual income rates, with allocable deductions, or at the flat 30-percent rate on the gross amount. Taxing income on real property at a flat 30-percent rate without the allowance of allocable deductions—which in the case of this type of income may be relatively large—may result in quite heavy tax burdens on this type of income. Your committee agrees with the House that the law in this area should be clarified and doubts whether the disallowance of deductions in such cases is appropriate. Moreover, the disallowance of deductions in such cases would tend to discourage foreign investment in U.S. realty.

The bill deals with the problem described above by providing that nonresident aliens deriving income from real property held for the production of income and located in this country, or from an interest in this type of real property located in this country, may elect to treat all the income as effectively connected to the conduct of a U.S. trade or business. This permits the nonresident alien to utilize the deductions attributable to this real estate income with the result that he is taxed on only his net income from these sources.

The election is applicable with respect to gains from the sale or exchange of real property held for the production of income (or an interest therein) and rents or royalties from mines, wells, or other natural deposits, as well as certain timber, iron ore, and coal royalties. The election is not applicable to income not specifically covered by these provisions, such as distributions by real estate investment trusts. If the election is made, it applies to all of the alien's income from U.S. real property for the taxable year which is not otherwise "effectively connected" with the conduct of a trade or business in this country. The election applies for all subsequent taxable years until