

dividual to deductions allocable to income which is effectively connected with the conduct of a trade or business in the United States. The allowance of deductions is limited in this manner, since it is only effectively connected income which under the bill is subject to the regular income tax.

In addition, the bill deletes the provision relating to the deduction of losses not connected with a trade or business but incurred in transactions entered into for profit since the criteria for the allowance of deductions under the bill is whether or not they are effectively connected with the conduct of a trade or business in the United States. However, the casualty loss deduction is to be available even if the property which gives rise to the loss is not effectively connected with the conduct of a trade or business in the United States if the property is located in this country. Also, the charitable contribution deduction is available even though not related to the trade or business.

Effective date.—These amendments apply with respect to taxable years beginning after December 31, 1966.

c. Expatriation to avoid tax (sec 103(f) of the bill and new sec. 877 of the code)

Present law.—The U.S. individual income tax applies to U.S. citizens, U.S. residents, and to nonresident aliens, but in this latter case, generally only with respect to income derived from sources within the United States. Under present law, if an individual who has been a U.S. citizen gives up this citizenship and becomes a nonresident, no tax is then imposed with respect to income he derives from sources without the United States. Moreover, under present law the regular graduated rates applicable to a citizen apply in the case of an expatriate, only if he is engaged in a trade or business in the United States or his income exceeds \$21,200.

Reasons for the provision.—The bill, by the elimination of progressive taxation with respect to the income of nonresident aliens which is not effectively connected with the conduct of a trade or business within the United States (as well as the reduction of the estate tax rates—described subsequently—applicable to the estates of nonresident aliens), may encourage some individuals to surrender their U.S. citizenship and move abroad. As indicated above, by doing so an expatriate would avoid the graduated tax rates on his U.S. investment income (and in certain cases, avoid some estate taxes).

Explanation of provision.—For the reasons stated above, the House bill adds a new section to the code which, in general, taxes both effectively connected income and any other U.S. source income of an expatriate at regular income tax rates, if he lost his citizenship within 5 years of the taxable year in question (and after March 8, 1965) and if one of the principal purposes of the expatriation was the avoidance of U.S. income, estate, or gift taxes. This treatment is not to apply if it results in a smaller U.S. income tax than would otherwise be imposed. Your committee's bill adopts the general rules provided in the House bill but extends the effective period during which the provisions can apply from 5 years, as provided by the House bill, to 10 years.

In addition to imposing this tax on both the expatriate's U.S. source income not effectively connected with the conduct of a U.S. trade or business and his income that is "effectively connected", regardless of its source, the new section contains special source rules to be used in de-