

h. Citizens of possessions of the United States (sec. 103(m) of the bill and sec. 932(a) of the code)

Under present law, individuals who are citizens of possessions of the United States but not otherwise citizens of the United States, are taxed as nonresident aliens on their U.S. source income. This provision is amended by your committee's and the House bill, effective for taxable years beginning after December 31, 1966, to conform to the changes made to the taxation of nonresident aliens generally.

i. Gain from disposition of certain depreciable realty (sec. 3(j) of the House bill and sec. 1250(d) of the code)

Your committee's bill strikes the House provision which provides that the recapture rule applicable to depreciable realty is to apply to the transfer of depreciable real estate by a foreigner to a domestic corporation in a tax-free exchange for stock or securities of a domestic corporation. Your committee took this action after being advised that the relationship between the House provision and the corresponding provisions of present law affecting U.S. persons make the provision discriminatory.

4. TAXATION OF FOREIGN CORPORATIONS

a. Income tax on foreign corporations (secs. 104 (a) and (b) of the bill and secs. 881 and 882 of the code)

Present law.—Present law taxes foreign corporations not engaged in a trade or business in the United States at a flat rate of 30 percent on fixed or determinable income from sources within the United States. These items are (with a few exceptions) the same as those presently taxed at the 30-percent rate to nonresident alien individuals not engaged in a trade or business in the United States. They are interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits, and income (including certain timber, coal, and iron ore royalties).

The U.S. source income of a foreign corporation engaged in business in the United States is taxed, under present law, at the regular corporate rates. In computing the tax, deductions generally are allowed to the extent that they are properly allocable to the U.S. source income if a true and accurate return is filed by the corporation.

Reasons for provision.—Your committee's and the House bill, both in the case of nonresident aliens and in the case of foreign corporations, provides a consistent pattern of taxation. Nonresident aliens and foreign corporations will be taxed at the regular income tax rates in the case of income which is effectively connected with a U.S. trade or business. In the case of nonresident alien individuals and foreign corporations with U.S. source fixed or determinable income which is not effectively connected with a U.S. trade or business a flat 30-percent rate is applied. The reasons for differentiating the tax treatment on this basis have already been explained to a substantial extent in connection with the definition of effectively connected (No. 2(b), above) and in connection with the explanation of the taxation of nonresident aliens (No. 3(a), above).