

The bill has also clarified the language of present law which includes certain timber, coal, and iron ore royalties in the 30-percent list.

(B) *Income effectively connected*.—Income of a foreign corporation which is effectively connected with the conduct of a trade or business within the United States is taxable, under the bill, at the regular corporate income tax rates. In determining “taxable income” for this purpose, gross income includes only gross income which is “effectively connected” with the conduct of the trade or business within the United States.

(C) *Income from real property*.—Under present law (as explained with respect to nonresident alien individuals) it is not clear as to what situations or arrangements for the ownership by a foreign corporation of real property located in the United States will cause the foreign corporation to be considered as engaging in a trade or business within the United States. This is important to know because if a foreign corporation not engaged in a trade or business in the United States receives rents from U.S. real property, this rental income is taxable at the flat 30-percent rate (or applicable treaty rate) on the gross amount of such rents, without the allowance of any deductions attributable to the rental income. Consequently, the tax liability generated by this rental income may exceed the net rental income the corporation receives. Your committee agrees with the House that the law in this area should be clarified and doubts whether it is appropriate to tax the gross amount of this type of income.

Since the provisions of this amendment parallel the amendment provided in the case of real estate income of nonresident alien individuals, the explanation is not repeated here (see No. 3(a)(C)(ii)).

(D) *Certain interest received by banks in U.S. possessions*.—The application of the flat 30-percent rate to U.S. source income which is not effectively connected with a U.S. trade or business results in a high effective rate of tax on interest received by banks located in U.S. possessions with respect to U.S. Government obligations which they must necessarily hold to meet reserve requirements. This result is due to the fact that these banks must pay interest on the amounts invested in the U.S. Government obligations. Therefore, the net profit margin on the interest received from these U.S. Government obligations is small relative to the gross amount of interest received. It was also brought to the attention of your committee that the usual method of effecting a mitigation of the flat 30-percent rate in the case of interest—an income tax treaty providing a lower rate (0, 5, or 15)—is, of course, not possible in the case of a possession.

In view of the facts set forth above your committee has added an amendment to the House bill which provides that interest received by banks located in a U.S. possession from U.S. government obligations will be treated as effectively connected with a U.S. trade or business whether or not the bank has such a business. Consequently, the interest received by a bank in a possession from U.S. Government obligations will be taxed on a net basis—gross interest income less allocable expenses.

(E) *Deductions*.—Under the bill, deductions are allowed in computing the tax imposed at the regular corporate rates only to the extent that they are properly attributable to income which is effectively connected with the conduct of a trade or business within the United