the United States. In general, these deductions are: (1) Those connected with U.S. source income, (2) those allocated or apportioned under regulations with respect to deductions related to income which is partially from within and without the United States, (3) losses not connected with the trade or business but incurred in transactions entered into for profit (if the profit, had the transaction resulted in a profit, would have been taxable by the United States), (4) casualty losses (if the loss is of property within the United States), and (5) the charitable contribution deduction.

The bill does not change the tax treatment of income qualifying for the exclusion relating to income from U.S. possessions but because it allows deductions to nonresident aliens and foreign corporations engaged in a trade or business in the United States only where the deductions are allocable to income effectively connected with this trade or business, it is now necessary in this provision to specify the deductions which may be taken. The bill therefore makes applicable to U.S. citizens and domestic corporations engaged in trade or business in possessions, who qualify for the special tax treatment under existing law, the provisions of present law which allow deductions to nonresident aliens or foreign corporations engaged in trade or business in the United States.

This amendment is effective for taxable years beginning after December 31, 1966.

6. ESTATE TAX PROVISIONS

a. Estate tax rates (sec. 108(a) of the bill and sec. 2101(a) of the code)

Present law.—The estate of a nonresident alien is taxed only on the transfer of property situated or deemed to be situated in the United States at the time of his death. While the tax rates are the same as for citizens and residents of the United States, the deductions, credits, and exemptions are different: No marital deduction is allowed with respect to the estate of a nonresident alien; the specific exemption in determining the taxable estate is $2,000 instead of the $60,000 applicable in the case of U.S. citizens; no credit is allowed for foreign death taxes paid; and the expenses, losses, etc., are generally limited to the same proportion of these expenses which the alien's gross estate situated within the United States is of his entire gross estate.

Reason for provision.—The fact that a marital deduction of up to 50 percent of the adjusted gross estate is not allowed in the case of the estate tax liability of a nonresident alien, in effect nearly doubles the size of the taxable estate of many aliens over that of similarly situated citizens. The $2,000 exemption, instead of the $60,000 exemption applying to citizens, also leads to a higher estate tax base. This, of course, means that the estate of a nonresident alien is likely to pay heavier taxes on its U.S. assets than would be true in the case of the estate of a U.S. citizen of similar size. Your committee agrees with the House that this is not appropriate. In addition it has been suggested that the high U.S. estate tax on the U.S. assets of a nonresident alien tends to discourage foreign persons from investing in the United States. Any increase in foreign investment in this country which may be brought about by this change will, of course, have a favorable effect on this country's balance of payments.