

holding of tax on foreign corporations) is amended to read as follows:

"SEC. 1442. WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.

"(a) GENERAL RULE.—In the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 or section 1451 a tax equal to 30 percent thereof; except that, in the case of interest described in section 1451 (relating to tax-free covenant bonds), the deduction and withholding shall be at the rate specified therein. For purposes of the preceding sentence, the references in section 1441(b) to sections 871(a)(1) (C) and (D) shall be treated as referring to sections 881 (a) (3) and (4), the reference in section 1441 (c) (1) to section 871(b) (1) shall be treated as referring to section 842 or section 882(a), as the case may be, and the reference in section 1441(c)(5) to section 871(a)(1)(D) shall be treated as referring to section 881 (a) (4).

"(b) EXEMPTION.—Subject to such terms and conditions as may be provided by regulations prescribed by the Secretary or his delegate, subsection (a) shall not apply in the case of a foreign corporation engaged in trade or business within the United States if the Secretary or his delegate determines that the requirements of subsection (a) impose an undue administrative burden and that the collection of the tax imposed by section 881 on such corporation will not be jeopardized by the exemption."

(d) DIVIDENDS RECEIVED FROM CERTAIN FOREIGN CORPORATIONS.—Subsection (a) of section 245 (relating to the allowance of a deduction in respect of dividends received from a foreign corporation) is amended—

(1) by striking out "and has derived 50 percent or more of its gross income from sources within the United States," in that portion of subsection (a) which precedes paragraph (1) and by inserting in lieu thereof "and if 50 percent or more of the gross income of such corporation from all sources for such period is effectively connected with the conduct of a trade or business within the United States,";

(2) by striking out "from sources within the United States" in paragraph (1) and inserting in lieu thereof "which is effectively connected with the conduct of a trade or business within the United States,";

(3) by striking out "from sources within the United States" in paragraph (2) and inserting in lieu thereof ", which is effectively connected with the conduct of a trade or business within the United States,"; and

(4) by adding after paragraph (2) the following new sentence:

"For purposes of this subsection, the gross income of the foreign corporation for any period before the first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States."

(e) DIVIDENDS RECEIVED FROM CERTAIN WHOLLY-OWNED FOREIGN SUBSIDIARIES.—

(1) Section 245 (relating to dividends received from certain foreign corporations) is amended by redesignating subsection (b) as (c), and by inserting after subsection (a) the following new subsection:

"(b) CERTAIN DIVIDENDS RECEIVED FROM WHOLLY-OWNED FOREIGN SUBSIDIARIES.—

"(1) IN GENERAL.—In the case of dividends described in paragraph (2) received from a foreign corporation by a domestic corporation which, for its taxable year in which such dividends are received, owns (directly or indirectly) all of the outstanding stock of such foreign corporation, there shall be allowed as a deduction (in lieu of the deduction provided by subsection (a)) an amount equal to 100 percent of such dividends.

"(2) ELIGIBLE DIVIDENDS.—Paragraph (1) shall apply only to dividends which are paid out of the earnings and profits of a foreign corporation for a taxable year during which—

"(A) all of its outstanding stock is owned (directly or indirectly) by the domestic corporation to which such dividends are paid; and

"(B) all of its gross income from all sources is effectively connected with the conduct of a trade or business within the United States.

"(3) EXCEPTION.—Paragraph (1) shall not apply to any dividends if an election under section 1562 is effective for either—

"(A) the taxable year of the domestic corporation in which such dividends are received, or

"(B) the taxable year of the foreign corporation out of the earnings and profits of which such dividends are paid."

(2) Subsection (a) of such section 245 is amended by adding at the end thereof (after the sentence added by subsection (d) (4)) the following new sentence: "For purposes of paragraph (2), there shall not be taken into account any taxable year within such uninterrupted period if, with respect to dividends paid out of the earnings and profits of such year, the deduction provided by subsection (b) would be allowable."

(3) Subsection (c) of such section 245 (as redesignated by paragraph (1)) is amended by striking out "subsection (a)" and inserting in lieu thereof "subsections (a) and (b)".

(f) DISTRIBUTIONS OF CERTAIN FOREIGN CORPORATIONS.—Section 301(b)(1)(C) (relating to certain corporate distributees of foreign corporations) is amended—

(1) by striking out "gross income from sources within the United States" in clause (i) and inserting in lieu thereof "gross income which is effectively connected with the conduct of a trade or business within the United States";

(2) by striking out "gross income from sources without the United States" in clause (ii) and inserting in lieu thereof "gross income which is not effectively connected with the conduct of a trade or business within the United States"; and

(3) by adding at the end thereof the following new sentences: "For purposes of clause (i), the gross income of a foreign corporation for any period before its first taxable year beginning after December 31, 1966, which is effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources within the United States. For purposes of clause (ii), the gross income of a foreign corporation for any period before its first taxable year beginning after December 31, 1966, which is not effectively connected with the conduct of a trade or business within the United States is an amount equal to the gross income for such period from sources without the United States."