

As indicated above, this provision applies only to three specific types of income from without the United States. Furthermore, in no event does it apply with respect to income which is "subpart F" income or to dividend, interest or royalty income derived from a foreign corporation more than 50 percent owned by a nonresident alien or foreign corporation receiving the income. Of course, the subpart F income exception extends to income which is subpart F income but is excepted from its taxing provisions by the minimum distribution and export trade exceptions. The three types of income with respect to which this provision applies are:

- (i) Rents and royalties derived from the active conduct of a licensing business;
- (ii) Dividends, interest, or gain from stock or bond or debt obligations derived in the active conduct of a banking, financing or similar business; and
- (iii) Certain sales income attributable to a U.S. sales office.

The sales income referred to above is not to be considered as "effectively connected" to a U.S. trade or business if the property is sold for use outside the United States and an office of the foreign person outside the United States contributes materially to the sale. In the case of foreign source income where the products are destined for the United States, the income will be treated as effectively connected with a U.S. business to the extent the sales activity is carried on by the U.S. office.

*(B) Determining Factors.*—This provision also contains rules regarding what is to be considered a sufficient nexus for assertion of U.S. tax jurisdiction as well as what foreign source income is to be subject to U.S. tax. In general, for purposes of determining whether a foreign corporation or nonresident alien has an office, the office or other fixed place of business of an agent is to be disregarded unless the agent is other than an independent agent operating in the ordinary course of his trade or business and unless he either has authority (regularly exercised) to negotiate binding contracts or has a stock of merchandise from which he regularly fills orders. This agency concept regarding the degree of economic activities which will subject a foreign corporation or nonresident alien to U.S. taxation on foreign source income is substantially similar to the permanent establishment concept present in many of the existing income tax treaties. It is not intended, however, that the interpretation of this provision be limited by the judicial decisions of foreign governments regarding such treaty provisions.

With respect to the determination of the income to be subject to U.S. tax, the rules provide that foreign source income will not be considered to be effectively connected with a U.S. business of a foreign corporation or nonresident alien if (a) a U.S. office of that business was not a material factor in the production of the income, (b) the income was not derived from the usual business activities of the U.S. business or (c) the income was not properly allocable to the activities of the U.S. business.

These rules delimit the application of the general rules of this provision, thereby subjecting to U.S. tax only income which has its economic genesis in the United States. For purposes of this provision, the activities of the U.S. office will not be considered to constitute a "material factor" unless it provides a significant contribution to the production of the income. Thus, the activities of the U.S. office must be an essential economic element in the production of the income.