different treatment according to whether their income was under or over $21,200.

Nonresident alien individuals not engaged in trade or business in the United States whose annual U.S. source income of the types specified below was $21,200 or less were taxed at a flat rate of 30 percent (or lower applicable treaty rate), on certain specified items of U.S. source income. This tax was in lieu of the regular U.S. graduated rates applicable to individuals. The items of income included were interest, dividends, rents, salaries, wages, and other fixed or determinable annual or periodical gains, profits, and income. Also specifically included in the income taxable at the flat 30-percent rate were certain amounts otherwise treated in the same manner as capital gains; namely, lump-sum distributions from exempt employees' trusts (sec. 402(a)(2)); amounts paid to beneficiaries under qualified annuity plans (sec. 403(a)(2)); timber, coal, and iron ore royalities (sec. 631 (b) and (c)); and amounts received on transfers of patent rights (sec. 1235).

Nonresident alien individuals not engaged in trade or business in the United States but with an annual U.S. source income of the types indicated above, of more than $21,200, were taxed under prior law (in the absence of an applicable treaty provision) at whichever of the following produced the higher total tax; the regular U.S. rates applicable to individuals, or the flat 30-percent rate. In computing the tax at the regular graduated rates, such a nonresident alien was allowed deductions to the extent they were properly allocable to the income on which he was taxable.

Nonresident aliens not engaged in a trade or business in the United States—whether their income was over or under $21,200—were subject to tax on regular capital gains only if one of two conditions existed: (1) if they were physically present in the United States at the time the capital gain was realized or (2) if they were present in the United States for a period or periods totaling 90 days or more during the year. These capital gains were taxed at the flat 30-percent rate if the individual's income from U.S. sources was $21,200 or less. If his income from U.S. sources exceeded this amount, the regular capital gains tax rate applied, but only if the regular individual income tax rates (including the capital gains tax) on all the taxpayer's U.S. source income resulted in a higher tax than the flat 30-percent tax.

Nonresident alien individuals engaged in trade or business in the United States were taxable at the regular U.S. graduated (and capital gains) rates on their income derived from sources within the United States. In computing the tax, an alien in this category was allowed deductions to the extent attributable to his U.S. source income.

Explanation of provision.—The act substantially revises the prior income tax treatment of nonresident alien individuals by dividing their income, for tax purposes, into two basic categories according to whether or not the income is effectively connected with a U.S. trade or business.

(*A*) *Income not effectively connected with the conduct of a U.S. business.*—Income of a nonresident alien individual which is fixed or determinable (substantially the same categories referred to under prior law) and which is not effectively connected with the conduct of a trade or business in the United States is to be taxed at a flat 30-percent rate (or lower treaty rate).