

g. Foreign estates or trusts (sec. 103 (e) and (l) of the act and secs. 875 and 7701a(a) (31) of the code)

Prior law defined the terms "foreign trust" and "foreign estate" to mean a trust or estate whose income from sources without the United States was not included in gross income for U.S. income tax purposes. The act amends this definition to conform it to the effectively connected concept. As amended, the terms refer to estate or trusts whose income from sources without the United States, other than income which is effectively connected with the conduct of a trade or business within the United States, is not included in gross income for U.S. income tax purposes. This amendment applies for taxable years beginning after December 31, 1966.

Another amendment imputes the business activities of a trust or estate to its beneficiaries. In other words, if a trust, whether a foreign or a domestic trust, is engaged in a trade or business in the United States, its beneficiaries are deemed to also be engaged in that trade or business.

h. Citizens of possessions of the United States (sec. 103(m) of the act and sec. 932(a) of the code)

Under prior law, individuals who were citizens of possessions of the United States but not otherwise citizens of the United States, were taxed as nonresident aliens on their U.S. source income. This provision was amended by the act, effective for taxable years beginning after December 31, 1966, to conform to the changes made to the taxation of nonresident aliens generally.

4. TAXATION OF FOREIGN CORPORATIONS

a. Income tax on foreign corporations (secs. 104 (a) and (b) of the act and secs. 881 and 882 of the code)

Prior law.—Prior law taxed foreign corporations not engaged in a trade or business in the United States at a flat rate of 30 percent on fixed or determinable income from sources within the United States. These items, which, with a few exceptions were the same as those previously taxed at the 30-percent rate to nonresident alien individuals not engaged in a trade or business in the United States, included: interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits, and income (including certain timber, coal, and iron ore royalties).

The U.S. source income of a foreign corporation engaged in business in the United States was taxed at the regular corporate rates. In computing the tax, deductions generally were allowed to the extent that they were properly allocable to the U.S. source income if a true and accurate return was filed by the corporation.

Explanation of provision.—The act substantially revises the income tax treatment of foreign corporations. Under the act the income of a foreign corporation is divided into two classifications.

(A) *Income not effectively connected.*—Fixed or determinable income of a foreign corporation from sources within the United States which is not effectively connected with the conduct of a trade or business within the United States is taxable at a flat 30-percent rate (or lower treaty rate). The types of fixed or determinable income speci-