

fied are the same as under prior law with the same two additions provided in the case of nonresident aliens: (1) contingent income received from the sale of patents and other intangibles, and (2) amounts of original issue discount which are treated as ordinary income received on retirement or sale or exchange of bonds or other evidences of indebtedness issued after September 28, 1965. As indicated in the case of the taxation of nonresident aliens, the source of this original issue discount is to be determined by the same rules as those applicable to interest income. As a result, if the corporation with respect to whose bonds the original issue discount arises is a domestic corporation which for the 3-year period preceding the year of redemption derives 80 percent or more of its income from foreign sources, then the original issue discount (interest), at the time of the retirement or sale or exchange of the bonds, also will be considered as foreign source income.

The act also clarifies the language of existing law which includes certain timber, coal, and iron ore royalties in the 30-percent list.

(B) *Income effectively connected*.—Income of a foreign corporation which is effectively connected with the conduct of a trade or business within the United States is taxable, under the act, at the regular corporate income tax rates. In determining “taxable income” for this purpose, gross income includes only gross income which is “effectively connected” with the conduct of the trade or business within the United States.

(C) *Income from real property*.—Under prior law (as explained with respect to nonresident alien individuals) it was not clear what situations or arrangements for the ownership by a foreign corporation of real property located in the United States would cause the foreign corporation to be considered as engaging in a trade or business within the United States. This was important because if a foreign corporation not engaged in a trade or business in the United States received rents from U.S. real property, this rental income was taxable at the flat 30-percent rate (or applicable treaty rate) on the gross amount of such rents, without the allowance of any deductions attributable to the rental income. Consequently, the tax liability generated by this rental income might have exceeded the net rental income the corporation received.

Since the provisions of this amendment parallel the amendment provided in the case of real estate income of nonresident alien individuals, the explanation is not repeated here (see No. 3(a)(C)(ii)).

(D) *Certain interest received by banks in U.S. possessions*.—The act provides that interest received by banks located in a U.S. possession from U.S. Government obligations will be treated as effectively connected with a U.S. trade or business whether or not the bank has such a business. Consequently, the interest received by a bank in a possession from U.S. Government obligations will be taxed on a net basis—gross interest income less allocable expenses.

(E) *Deductions*.—Deductions are allowed in computing the tax imposed at the regular corporate rates only to the extent that they are properly attributable to income which is effectively connected with the conduct of a trade or business within the United States. The deduction for charitable contributions, however, is allowed whether or not attributable to income which is effectively connected. Generally, as under prior law, deductions are permitted only if a true and accurate income tax return is filed.