

*Effective date.*—These amendments apply with respect to taxable years beginning after December 31, 1966.

*b. Withholding of tax on foreign corporations (sec. 104(c) of the act and sec. 1442 of code)*

Under prior law, the fixed or determinable U.S. source income of a foreign corporation not engaged in trade or business in the United States, like that of a nonresident alien not engaged in a trade or business in the United States, was subject to a withholding tax of 30 percent. However, foreign corporations engaged in trade or business in the United States were not subject to the withholding tax.

The act amends the withholding provisions of prior law to conform to the effectively connected concept. Thus, under the act a withholding tax at the 30-percent rate will apply in the case of a foreign corporation to items of fixed or determinable U.S. source income which are not effectively connected with the conduct of a trade or business in the United States. It is the understanding of the Congress that the person required to withhold will be relieved of any liability for failure to withhold if the failure is due to reliance upon information (as to whether or not the income was effectively connected) furnished (in accordance with regulations to be issued) by the foreign corporation entitled to the receipt of the income. This 30-percent withholding provision is not to be applied if the Secretary of the Treasury determines that the withholding requirements impose an undue administrative burden and that the collection of the tax will not be jeopardized by an exemption.

*c. Deduction for dividends received from foreign corporations (sec. 104 (d) and (e) of the act and sec. 245 (a) and (b) of the code)*

*Prior law.*—In general, existing law allows corporations an 85-percent dividend-received deduction for dividends received from domestic corporations. Under prior law, in order for this deduction to have been available in the case of dividends from a foreign corporation, the latter must have been engaged in a trade or business in the United States for an uninterrupted period of at least 3 years and 50 percent of its gross income must have been from U.S. sources during that period. Where these conditions existed, an 85-percent dividend-received deduction was available for the same proportion of the dividend as the corporation's gross income, which was from U.S. sources, was of its total gross income.

*Explanation of the provision.*—The act substantially conforms the dividends-received deduction to the effectively connected concept. Under the act 50 percent or more of the foreign corporation's gross income for the uninterrupted period must be from income effectively connected with the conduct of a trade or business within the United States for the deduction to be available. Also, the deduction is limited to 85 percent of the same proportion of the dividend as the foreign corporation's gross income, which is effectively connected with a U.S. trade or business, is of that corporation's total gross income from all sources.

In addition, a 100 percent dividends-received deduction is provided to a domestic corporation for dividends received from a wholly owned foreign subsidiary which has a 100 percent effectively connected income. In such a situation a foreign corporation is subject to U.S. tax on all of its income, just as is a domestic corporation.