The act also contains a transitional rule which makes it unnecessary to apply the effectively connected income concept when any of the years which is taken into account for the 50-percent test is a pre-1967 year. This rule provides that, for purposes of computing this deduction, all of a foreign corporation's U.S. source income, for any period before its first taxable year beginning after December 31, 1966, is to be considered to be effectively connected income.

Effective date.—These amendments apply for taxable years beginning after December 31, 1966.

d. Unrelated business taxable income of certain foreign charitable organizations (sec. 104(g) of the act and sec. 512(a) of the code)

Under prior law the unrelated business taxable income of foreign charities was subject to tax if it was derived from sources within the United States.

The act conforms this provision to the effectively connected concept by providing that the unrelated business taxable income of a foreign charity is to be subject to tax only if it is effectively connected with the conduct of a trade or business in the United States.

This amendment applies for taxable years beginning after December 31, 1966.

e. Foreign corporations subject to personal holding company tax (sec. 104(h) of the act and sec. 542(c), 543(b), and 545 (a) and (d) of the code)

Prior law.—Under prior law any foreign corporation with U.S. investment income, whether or not doing business here, could be taxed as a personal holding company unless all its outstanding stock was owned (directly and indirectly) by nonresident alien individuals and its U.S. source gross income was less than 50 percent of its total gross income for that year. If taxable as a personal holding company the foreign corporation was subject to a special 70-percent tax on its undistributed U.S. source personal holding company income in addition to the flat rate 30-percent tax (or possibly the regular corporate tax). Also, if a foreign corporation was determined to constitute a personal holding company and the foreign corporation had not filed a return or had not filed a true and accurate return, the 70-percent personal holding company tax was assessed without allowance of the dividends paid deduction. In such cases, the combination of the regular 30-percent tax and the 70-percent personal holding company tax could have constituted a tax of about 80 percent of the income of the foreign corporation.

Explanation of provision.—The act modifies the provision in prior law excluding from the personal holding company definition only those foreign corporations whose U.S. source gross income was less than 50 percent of their total gross income and all of whose stock was held directly or indirectly by nonresident aliens. It substitutes a broader exemption which applies to any foreign corporation all of whose outstanding stock during the last half of its taxable year is owned by nonresident alien individuals (directly or indirectly through foreign estates, trusts, partnerships, or other foreign corporations).

This general rule contains three refinements. The first provides that the general exclusion from the personal holding company provision is not to be available to a foreign personal holding company if it has income from personal services which is personal holding company