

indirectly by or for a foreign corporation is to be considered as owned proportionately by its shareholders.

Effective date.—The amendments made by this provision apply to interest received after December 31, 1965, in taxable years ending after that date.

g. Amendment to preserve existing law on deductions under section 931 (sec. 107 of the act and sec. 931(d) of the code)

Under existing law, U.S. citizens or domestic corporations earning income in possessions of the United States generally are taxable only on their U.S. source income (plus amounts received in the United States) if they meet certain requirements.⁵ In general, these requirements are that the citizen or corporation derive 80 percent of its gross income from sources within such a possession and 50 percent of its gross income from the active conduct of a trade or business within such a possession (both of these tests being applied with respect to income received in the prior 3 years).

A U.S. citizen or domestic corporation which qualifies for this treatment may exclude from its U.S. tax base gross income from sources without the United States (in the same way as nonresident aliens and foreign corporations not engaged in trade or business within the United States). The deductions allowed a U.S. person who qualifies for this exclusion are those which were allowable under prior law to nonresident aliens and foreign corporations engaged in trade or business in the United States. In general, these deductions were: (1) Those connected with U.S. source income, (2) those allocated or apportioned under regulations with respect to deductions related to income which is partially from within and without the United States, (3) losses not connected with the trade or business but incurred in transactions entered into for profit (if the profit, had the transaction resulted in a profit, would have been taxable by the United States), (4) casualty losses (if the loss is of property within the United States), and (5) the charitable contribution deduction.

Explanation of provision.—The act does not change the tax treatment of income qualifying for the exclusion relating to income from U.S. possessions but because it allows deductions to nonresident aliens and foreign corporations engaged in a trade or business in the United States only where the deductions are allocable to income effectively connected with this trade or business, it is now necessary in this provision to specify the deductions which may be taken. The act therefore makes applicable to U.S. citizens and domestic corporations engaged in trade or business in possessions, who qualify for the special tax treatment under existing law, the provisions of prior law which allow deductions to nonresident aliens or foreign corporations engaged in trade or business in the United States.

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

6. ESTATE TAX PROVISIONS

a. Estate tax rates (sec. 108(a) of the act and sec. 2101(a) of the code)

Prior law.—Under existing law and that in effect prior to this act, the estate of a nonresident alien is taxed only on the transfer of prop-

⁵ Possession for purposes of this provision does not include the Virgin Islands or, in the case of U.S. citizens does not include Puerto Rico.