

[WAYS AND MEANS DISCUSSION DRAFT]

OCTOBER 26, 2011

112TH CONGRESS
1ST SESSION

H. R. _____

To amend the Internal Revenue Code of 1986 to provide for comprehensive income tax reform.

IN THE HOUSE OF REPRESENTATIVES

M. _____ introduced the following bill; which was referred to the Committee on _____

A BILL

To amend the Internal Revenue Code of 1986 to provide for comprehensive income tax reform.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE; ETC.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “Tax Reform Act of 2011”.

6 (b) AMENDMENT OF 1986 CODE.—Except as other-
7 wise expressly provided, whenever in this Act an amend-
8 ment or repeal is expressed in terms of an amendment

1 to, or repeal of, a section or other provision, the reference
2 shall be considered to be made to a section or other provi-
3 sion of the Internal Revenue Code of 1986.

4 (c) TABLE OF CONTENTS.—The table of contents of
5 this Act is as follows:

Sec. 1. Short title; etc.

TITLE I—TAX REFORM FOR INDIVIDUALS

Sec. 101. [individual tax reforms to be provided].

TITLE II—TAX REFORM FOR BUSINESSES

Subtitle A—Corporate Income Tax Rate Reduction

Sec. 201. Corporate income tax rate reduction.

Subtitle B—[other Business Reforms to Be Provided]

TITLE III—PARTICIPATION EXEMPTION SYSTEM FOR THE TAXATION OF FOREIGN INCOME

Subtitle A—Establishment of Exemption System

Sec. 301. Deduction for dividends received by domestic corporations from cer-
tain foreign corporations.

Sec. 302. Treatment of gains and losses on disposition by United States share-
holders of stock of certain active foreign corporations.

Sec. 303. Treatment of deferred foreign income upon transition to participation
exemption system of taxation.

Subtitle B—Modifications Related to Foreign Tax Credit System

Sec. 311. Repeal of section 902 indirect foreign tax credits; determination of
section 960 credit on current year basis.

Sec. 312. Foreign tax credit limitation applied by allocating only directly allo-
cable deductions to foreign source income.

Sec. 313. Elimination of foreign tax credit baskets.

Sec. 314. Repeal of rule suspending foreign taxes and credits until related in-
come is taken into account.

Subtitle C—Rules Related to Passive Income

PART 1—MODIFICATION OF SUBPART F PROVISIONS

Sec. 321. Termination of current year inclusion based on investments in United
States property.

Sec. 322. Repeal of exclusion of previously taxed earnings and profits.

PART 2—PREVENTION OF BASE EROSION

Sec. 331A. [Option A:] Excess income from transfers of intangibles to low-
taxed affiliates treated as subpart F income.

- Sec. 331B. **[Option B:]** Low-taxed cross-border foreign income treated as subpart F income.
- Sec. 331C. **[Option C:]** Foreign intangible income subject to taxation at reduced rate; intangible income treated as subpart F income.
- Sec. 332. Denial of deduction for interest expense of United States shareholders which are members of worldwide affiliated groups with excess domestic indebtedness.

TITLE IV—OTHER REFORMS

- Sec. 401. **[other reforms to be provided]**.

1 **TITLE I—TAX REFORM FOR**
2 **INDIVIDUALS**

3 **SEC. 101. [INDIVIDUAL TAX REFORMS TO BE PROVIDED].**

4 **TITLE II—TAX REFORM FOR**
5 **BUSINESSES**

6 **Subtitle A—Corporate Income Tax**
7 **Rate Reduction**

8 **SEC. 201. CORPORATE INCOME TAX RATE REDUCTION.**

9 (a) GENERAL RULE.—Paragraph (1) of section 11(b)
10 (relating to amount of tax) is amended—

11 (1) by inserting “and” at the end of subpara-
12 graph (A),

13 (2) by striking subparagraphs (B), (C), and (D)
14 and inserting the following:

15 “(B) 25 percent of so much of the taxable
16 income as exceeds \$50,000.”, and

17 (3) by striking “\$11,750” and all that follows
18 and inserting “\$5,000.”.

19 (b) CONFORMING AMENDMENTS.—

1 (1) Paragraph (2) of section 11(b) is amended
2 by striking “35 percent” and inserting “25 per-
3 cent”.

4 (2) Paragraphs (1) and (2) of section 1445(e)
5 are each amended by striking “35 percent” and in-
6 serting “25 percent”.

7 (3) Subparagraph (A) of section 7518(g)(6) is
8 amended by striking “34 percent” and inserting “25
9 percent”.

10 (4) Paragraph (2) of section 53511(f) of title
11 46, United States Code, is mended by striking “34
12 percent” and inserting “25 percent”.

13 (c) REPEAL OF DEADWOOD ALTERNATIVE CAPITAL
14 GAINS TAX FOR CORPORATIONS.—

15 (1) IN GENERAL.—Part I of subchapter P of
16 chapter 1 is amended by striking section 1201 (and
17 by striking the item relating to such section in the
18 table of sections for such part).

19 (2) CONFORMING AMENDMENTS.—

20 (A) Section 12 is amended by striking
21 paragraph (4) and by redesignating paragraphs
22 (5) through (7) as paragraphs (4) through (6)
23 respectively.

24 (B) Section 55(b) is amended by striking
25 paragraph (4).

1 (C) Section 453A(c)(3) is amended by
2 striking “or 1201 (whichever is appropriate)”.

3 (D) Section 527(b) is amended—

4 (i) by striking paragraph (2), and

5 (ii) by striking all that precedes “is
6 hereby imposed” and inserting:

7 “(b) TAX IMPOSED.—A tax”.

8 (E) Sections 594(a) is amended by striking
9 “taxes imposed by section 11 or 1201(a)” and
10 inserting “tax imposed by section 11”.

11 (F) Section 691(c)(4) is amended by strik-
12 ing “1201,”.

13 (G) Section 801(a) is amended—

14 (i) by striking paragraph (2), and

15 (ii) by striking all that precedes “is
16 hereby imposed” and inserting:

17 “(a) TAX IMPOSED.—A tax”.

18 (H) Section 831(d) is amended by striking
19 paragraph (1) and by redesignating paragraphs
20 (2) and (3) as paragraphs (1) and (2), respec-
21 tively.

22 (I) Sections 832(c)(5) and 834(b)(1)(D)
23 are each amended by striking “sec. 1201 and
24 following,”.

1 (J) Sections 852(b)(3)(A) and
2 857(b)(3)(A)(ii) are each amended by striking
3 “section 1201(a)” and inserting “section
4 11(b)”.

5 (K) Section 882(a)(1) is amended by strik-
6 ing “, or 1201(a)”.

7 (L)(i) Section 904(b)(2)(B) is amended by
8 inserting “any taxpayer other than a corpora-
9 tion for” after “In the case of”.

10 (ii) Subparagraph (D) of section 904(b)(3)
11 is amended to read as follows:

12 “(D) CAPITAL GAIN RATE DIFFEREN-
13 TIAL.—There is a capital gain rate differential
14 for any taxable year if section 1(h) applies to
15 such taxable year.”.

16 (iii) Subparagraph (E) of section 904(b)(3)
17 is amended to read as follows:

18 “(E) RATE DIFFERENTIAL PORTION.—The
19 rate differential portion of foreign source net
20 capital gain, net capital gain, or the excess of
21 net capital gain from sources within the United
22 States over net capital gain, as the case may
23 be, is the same proportion of such amount as—

24 “(i) the excess of—

1 “(I) the highest rate of tax set
2 forth in subsection (a), (b), (c), (d), or
3 (e) of section 1 (whichever applies),
4 over

5 “(II) the alternative rate of tax
6 determined under section 1(h), bears
7 to

8 “(ii) that rate referred to in subclause
9 (I).”.

10 (M) Section 954(b)(2)(C) is amended by
11 striking “or 1201(a)”.

12 (N) Section 1374(b) is amended by strik-
13 ing paragraph (4).

14 (O) Section 1381(b) is amended by strik-
15 ing “or 1201”.

16 (P) Sections 6425(c)(1)(A)(i) and
17 6655(g)(1)(A)(i) are each amended by striking
18 “or 1201(a),”.

19 (Q) Section 7518(g)(6)(A) is amended by
20 striking “or section 1201(a)”.

21 (R) Section 53511(f)(2) of title 46, United
22 States Code, is amended by striking “section
23 1(h) or 1201(a) of such Code (26 U.S.C. 1(h),
24 1201(a))” and inserting “section 1(h) of such
25 Code (26 U.S.C. 1(h))”.

1 (d) EFFECTIVE DATE.—

2 (1) IN GENERAL.—Except as otherwise pro-
3 vided in this subsection, the amendments made by
4 this section shall apply to taxable years beginning
5 after December 31, 2012.

6 (2) AMENDMENTS RELATED TO WITH-
7 HOLDING.— The amendments made by paragraphs
8 (2), (3), and (4) of subsection (b) shall take effect
9 on January 1, 2013.

10 **Subtitle B—[Other Business**
11 **Reforms to Be Provided]**

12 **TITLE III—PARTICIPATION EX-**
13 **EMPTION SYSTEM FOR THE**
14 **TAXATION OF FOREIGN IN-**
15 **COME**

16 **Subtitle A—Establishment of**
17 **Exemption System**

18 **SEC. 301. DEDUCTION FOR DIVIDENDS RECEIVED BY DO-**
19 **MESTIC CORPORATIONS FROM CERTAIN FOR-**
20 **EIGN CORPORATIONS.**

21 (a) IN GENERAL.—Part VIII of subchapter B of
22 chapter 1 is amended by inserting after section 245 the
23 following new section:

1 **“SEC. 245A. DIVIDENDS RECEIVED BY DOMESTIC CORPORA-**
2 **TIONS FROM CERTAIN FOREIGN CORPORA-**
3 **TIONS.**

4 “(a) IN GENERAL.—In the case of any dividend re-
5 ceived from a controlled foreign corporation by a domestic
6 corporation which is a United States shareholder with re-
7 spect to such controlled foreign corporation, there shall be
8 allowed as a deduction an amount equal to **[95]** percent
9 of the foreign-source portion of such dividend.

10 “(b) TREATMENT OF CERTAIN ENTITIES AS CON-
11 TROLLED FOREIGN CORPORATIONS.—

12 “(1) ELECTING 10/50 CORPORATIONS TREATED
13 AS CONTROLLED FOREIGN CORPORATIONS.—

14 “(A) IN GENERAL.—Each noncontrolled
15 10/50 corporation with respect to a domestic
16 corporation shall be treated for purposes of this
17 title as a controlled foreign corporation with re-
18 spect to such domestic corporation if such do-
19 mestic corporation elects the application of this
20 paragraph. Any domestic corporation which
21 elects the application of this paragraph shall be
22 treated for purposes of this title as a United
23 States shareholder with respect to each such
24 noncontrolled 10/50 corporation.

25 “(B) ELECTION.—

1 “(i) TIME OF ELECTION.—Any elec-
2 tion under this paragraph shall be made
3 not later than the due date for filing the
4 return of tax for the first taxable year of
5 the taxpayer described in section 301(f) of
6 the Tax Reform Act of 2011 with respect
7 to which there are one or more noncon-
8 trolled 10/50 corporations with respect to
9 the taxpayer.

10 “(ii) REVOCATION OF ELECTION.—
11 Any election under this paragraph, once
12 made, may be revoked only with the con-
13 sent of the Secretary.

14 “(iii) CONTROLLED GROUPS.—If a do-
15 mestic corporation making an election
16 under this subsection is a member of a
17 controlled group of corporations (within
18 the meaning of section 1563(a), except
19 that ‘more than 50 percent’ shall be sub-
20 stituted for ‘at least 80 percent’ each place
21 it appears therein), then, except as other-
22 wise provided by the Secretary, such elec-
23 tion shall apply to all members of such
24 group.

1 “(2) FOREIGN BRANCHES OF DOMESTIC COR-
2 PORATIONS.—

3 “(A) IN GENERAL.—In the case of a for-
4 eign branch of a domestic corporation—

5 “(i) such branch shall be treated for
6 purposes of this title as a separate cor-
7 poration which is a controlled foreign cor-
8 poration, and

9 “(ii) such domestic corporation shall
10 be treated for purposes of this title as a
11 United States shareholder with respect to
12 such controlled foreign corporation.

13 “(B) FOREIGN BRANCH DEFINED.—For
14 purposes of this paragraph, a foreign branch of
15 a domestic corporation is any trade or business
16 of such domestic corporation in a foreign coun-
17 try.

18 【“(C) APPLICATION TO PARTNERSHIPS,
19 ETC.—To the extent provided by the Secretary,
20 rules similar to the rules of this paragraph shall
21 apply with respect to any interest held by a do-
22 mestic corporation in a partnership (or other
23 pass-thru entity specified by the Secretary) with
24 a trade or business in a foreign country. The
25 preceding sentence shall not apply with respect

1 to any interest held by a domestic corporation
2 unless such domestic corporation would be a
3 United States shareholder if such interest were
4 stock in a foreign corporation.】

5 “(c) FOREIGN-SOURCE PORTION.—For purposes of
6 this section—

7 “(1) IN GENERAL.—The foreign-source portion
8 of any dividend is an amount which bears the same
9 ratio to such dividends as—

10 “(A) the undistributed foreign earnings,
11 bears to

12 “(B) the undistributed earnings.

13 “(2) UNDISTRIBUTED EARNINGS.—The term
14 ‘undistributed earnings’ means the amount of the
15 earnings and profits of the controlled foreign cor-
16 poration (computed in accordance with sections
17 964(a) and 986)—

18 “(A) as of the close of the taxable year of
19 the controlled foreign corporation in which the
20 dividend is distributed, and

21 “(B) without diminution by reason of divi-
22 dends distributed during such taxable year.

23 “(3) UNDISTRIBUTED FOREIGN EARNINGS.—
24 The term ‘undistributed foreign earnings’ means the

1 portion of the undistributed earnings which is attrib-
2 utable to neither—

3 “(A) income described in subparagraph (A)
4 of section 245(a)(5), nor

5 “(B) dividends described in subparagraph
6 (B) of such section.

7 “(d) NONCONTROLLED 10/50 CORPORATION.—

8 “(1) IN GENERAL.—For purposes of this sec-
9 tion, the term ‘noncontrolled 10/50 corporation’
10 means, with respect to any domestic corporation,
11 any foreign corporation if—

12 “(A) such domestic corporation meets the
13 ownership requirements of paragraph (2) or (3)
14 with respect to such foreign corporation, and

15 “(B) such corporation is not a controlled
16 foreign corporation with respect to such domes-
17 tic corporation (determined without regard to
18 subsection (b)).

19 “(2) DIRECT OWNERSHIP.—A domestic cor-
20 poration meets the ownership requirements of this
21 paragraph with respect to a foreign corporation if
22 such domestic corporation owns 10 percent or more
23 of the voting stock of such foreign corporation.

24 “(3) INDIRECT OWNERSHIP.—

1 “(A) IN GENERAL.—A domestic corpora-
2 tion meets the ownership requirements of this
3 paragraph with respect to a foreign corporation
4 if such foreign corporation is a member of the
5 same qualified group as a foreign corporation
6 described in paragraph (2) with respect to such
7 domestic corporation.

8 “(B) QUALIFIED GROUP.—For purposes of
9 subparagraph (A), the term ‘qualified group’
10 means—

11 “(i) the foreign corporation described
12 in paragraph (2), and

13 “(ii) any other foreign corporation
14 if—

15 “(I) the domestic corporation
16 owns at least 5 percent of the voting
17 stock of such other foreign corpora-
18 tion indirectly through a chain of for-
19 eign corporations connected through
20 stock ownership of at least 10 percent
21 of their voting stock,

22 “(II) the foreign corporation de-
23 scribed in paragraph (2) is the first
24 tier corporation in such chain, and

1 “(III) such other foreign corpora-
2 tion is not below the third tier in such
3 chain.

4 “(e) DISALLOWANCE OF FOREIGN TAX CREDIT,
5 ETC.—

6 “(1) IN GENERAL.—No credit shall be allowed
7 under section 901 for any taxes paid or accrued (or
8 treated as paid or accrued) with respect to any divi-
9 dend for which a deduction is allowed under this sec-
10 tion.

11 “(2) DENIAL OF DEDUCTION.—No deduction
12 shall be allowed under this chapter for any tax for
13 which credit is not allowable under section 901 by
14 reason of paragraph (1).

15 “(f) APPLICATION TO TIERED CONTROLLED FOR-
16 EIGN CORPORATIONS.—

17 “(1) IN GENERAL.—The amount which would
18 otherwise be included in the gross income of any do-
19 mestic corporation under section 951(a)(1) as such
20 corporation’s pro rata share of any controlled for-
21 eign corporation’s subpart F income shall be reduced
22 by so much of such pro rata share as is attributable
23 to dividends received by such controlled foreign cor-
24 poration from any other controlled foreign corpora-

1 tion with respect to which such domestic corporation
2 is also a United States shareholder.

3 “(2) HOLDING PERIOD REQUIREMENT.—Para-
4 graph (1) shall not apply with respect to any divi-
5 dend on any share of stock unless the holding period
6 requirements under section 246(c) (other than para-
7 graph (5)(B) thereof) which apply for purposes of
8 this section are satisfied with respect to such stock.
9 For purposes of the preceding sentence, the holding
10 period shall be determined by including any period
11 such stock was held by a related person (within the
12 meaning of section 954(d)(3)).

13 “(g) REGULATIONS.—The Secretary shall prescribe
14 such regulations as may be necessary or appropriate to
15 carry out the provisions of this section.”.

16 (b) APPLICATION OF HOLDING PERIOD REQUIRE-
17 MENT.—Subsection (c) of section 246 is amended—

18 (1) by striking “or 245” in paragraph (1) and
19 inserting “245, or 245A”, and

20 (2) by adding at the end the following new
21 paragraph:

22 “(5) SPECIAL RULES FOR FOREIGN SOURCE
23 PORTION OF DIVIDENDS RECEIVED FROM CON-
24 TROLLED FOREIGN CORPORATIONS.—

1 “(A) 1-YEAR HOLDING PERIOD REQUIRE-
2 MENT.—For purposes of section 245A—

3 “(i) paragraph (1)(A) shall be ap-
4 plied—

5 “(I) by substituting ‘365 days’
6 for ‘45 days’ each place it appears, and

7 “(II) by substituting ‘731-day pe-
8 riod’ for ‘91-day period’, and

9 “(ii) paragraph (2) shall not apply.

10 “(B) STATUS MUST BE MAINTAINED DUR-
11 ING HOLDING PERIOD.—For purposes of section
12 245A, the holding period requirement of this
13 subsection shall be treated as met only if—

14 “(i) the controlled foreign corporation
15 referred to in section 245A(a) is a con-
16 trolled foreign corporation at all times dur-
17 ing such period, and

18 “(ii) the taxpayer is a United States
19 shareholder with respect to such controlled
20 foreign corporation at all times during
21 such period.”.

22 (c) APPLICATION OF RULES GENERALLY APPLICA-
23 BLE TO DEDUCTIONS FOR DIVIDENDS RECEIVED.—

24 (1) TREATMENT OF DIVIDENDS FROM CERTAIN
25 CORPORATIONS.—Paragraph (1) of section 246(a) is

1 amended by striking “and 245” and inserting “245,
2 and 245A”.

3 (2) ASSETS GENERATING TAX-EXEMPT PORTION
4 OF DIVIDEND NOT TAKEN INTO ACCOUNT IN ALLO-
5 CATING AND APPORTIONING DEDUCTIBLE EX-
6 PENSES.—Paragraph (3) of section 864(e) is amend-
7 ed by striking “or 245(a)” and inserting “, 245(a),
8 or 245A”.

9 (3) COORDINATION WITH SECTION 1059.—Sub-
10 paragraph (B) of section 1059(b)(2) is amended by
11 striking “or 245” and inserting “245, or 245A”.

12 (d) CONFORMING AMENDMENTS.—

13 (1) Clause (vi) of section 56(g)(4)(C) is amend-
14 ed by inserting “245A or” before “965”.

15 (2) Paragraph (3) of section 245(a) is amend-
16 ed—

17 (A) by striking “post-1986” in subpara-
18 graph (A), and

19 (B) by striking “total post-1986” in sub-
20 paragraph (B).

21 (3) Paragraph (4) of section 245(a) is amended
22 to read as follows:

23 “(4) UNDISTRIBUTED EARNINGS.—For pur-
24 poses of this subsection, the term ‘undistributed

1 earnings' has the meaning given such term by sec-
2 tion 245A(c)(2).”.

3 (4) Paragraph (5) of section 245(a) is amend-
4 ed—

5 (A) by striking “post-1986” both places it
6 appears in the matter preceding subparagraph
7 (A), and

8 (B) by striking “POST-1986 UNDISTRIB-
9 UTED” in the heading thereof and inserting
10 “UNDISTRIBUTED”.

11 (5) Paragraph (6) of section 245(a) is amend-
12 ed—

13 (A) by striking “beginning after December
14 31, 1986” and inserting “which is after the
15 first taxable year of such corporation”, and

16 (B) by striking “post-1986” both places it
17 appears..

18 (6) Subsection (b) of section 951 is amended—

19 (A) by striking “subpart” and inserting
20 “title”, and

21 (B) by adding at the end the following:
22 “Such term shall include, with respect to any
23 entity treated as a controlled foreign corpora-
24 tion under section 245A(b), any domestic cor-
25 poration treated as a United States shareholder

1 with respect to such entity under such sec-
2 tion.”.

3 (7) Subsection (a) of section 957 is amended—

4 (A) by striking “subpart” in the matter
5 preceding paragraph (1) and inserting “title”,
6 and

7 (B) by adding at the end the following:

8 “Such term shall include any entity treated as
9 a controlled foreign corporation under section
10 245A(b).”.

11 (8) The table of sections for part VIII of sub-
12 chapter B of chapter 1 is amended by inserting after
13 the item relating to section 245 the following new
14 item:

“Sec. 245A. Dividends received by domestic corporations from certain foreign
corporations.”.

15 (e) EFFECTIVE DATE.—The amendments made by
16 this section shall apply to taxable years of foreign corpora-
17 tions beginning after December 31, 2012, and to taxable
18 years of United States shareholders in which or with which
19 such taxable years of foreign corporations end.

1 **SEC. 302. TREATMENT OF GAINS AND LOSSES ON DISPOSI-**
2 **TION BY UNITED STATES SHAREHOLDERS OF**
3 **STOCK OF CERTAIN ACTIVE FOREIGN COR-**
4 **PORATIONS.**

5 (a) IN GENERAL.—Part IV of subchapter P of chap-
6 ter 1 is amended by inserting before section 1248 the fol-
7 lowing new section:

8 **“SEC. 1247. SALE OR EXCHANGE OF QUALIFIED STOCK BY**
9 **UNITED STATES SHAREHOLDERS OF CER-**
10 **TAIN ACTIVE FOREIGN CORPORATIONS.**

11 “(a) IN GENERAL.—In the case of any sale or ex-
12 change of stock of a qualified foreign corporation held for
13 1 year or more by a domestic corporation which is a
14 United States shareholder (within the meaning of section
15 245A) with respect to such qualified foreign corporation—

16 “(1) gross income shall not include **[95]** per-
17 cent of any gain from such sale or exchange, and

18 “(2) no deduction shall be allowed in respect of
19 any loss from such sale or exchange.

20 “(b) QUALIFIED FOREIGN CORPORATION.—

21 “(1) IN GENERAL.—For purposes of this sec-
22 tion, the term ‘qualified foreign corporation’ means
23 any controlled foreign corporation (within the mean-
24 ing of section 245A) if at least **[70]** percent of the
25 assets of such corporation were active assets deter-
26 mined—

1 “(A) at the time of the sale or exchange
2 referred to in subsection (a), and

3 “(B) as of the close of each quarter of any
4 taxable year of the taxpayer if such quarter
5 ends during the 3-year period ending on the
6 date of such sale or exchange.

7 “(2) ACTIVE ASSETS.—For purposes of this
8 subsection, the term ‘active asset’ means any asset
9 of a kind which does not produce foreign personal
10 holding company income (as defined in section
11 954(c)).

12 “(3) NOT IN EXISTENCE FOR ENTIRE 3-YEAR
13 PERIOD.—If a corporation was not in existence for
14 the entire 3-year period referred to in paragraph (1),
15 such paragraph shall be applied on the basis of the
16 period during which such corporation was in exist-
17 ence.

18 “(4) TREATMENT OF PREDECESSORS.—Any
19 reference in this subsection to a corporation shall in-
20 clude a reference to any predecessor of such corpora-
21 tion.

22 “(c) COORDINATION WITH SECTION 1248.—Section
23 1248 shall not apply with respect to any sale or exchange
24 to which this section applies.”.

1 (b) CLERICAL AMENDMENT.—The table of sections
2 for part IV of subchapter P of chapter 1 is amended by
3 inserting before the item relating to section 1248 the fol-
4 lowing new item:

“Sec. 1247. Sale or exchange of qualified stock by United States shareholders
of certain active foreign corporations.”.

5 (c) EFFECTIVE DATE.—

6 (1) IN GENERAL.—Except as provided in para-
7 graph (2), the amendments made by this section
8 shall apply to sales and exchanges after December
9 31, 2012.

10 (2) TRANSITION RULE.—The amendments
11 made by this section shall not apply to the sale or
12 exchange of stock of a foreign corporation in exist-
13 ence on December 31, 2012, if such sale or exchange
14 is before the beginning of the first taxable year of
15 such foreign corporation beginning after December
16 31, 2012.

17 **SEC. 303. TREATMENT OF DEFERRED FOREIGN INCOME**
18 **UPON TRANSITION TO PARTICIPATION EX-**
19 **EMPTION SYSTEM OF TAXATION.**

20 (a) IN GENERAL.—Section 965 is amended to read
21 as follows:

1 **“SEC. 965. TREATMENT OF DEFERRED FOREIGN INCOME**
2 **UPON TRANSITION TO PARTICIPATION EX-**
3 **EMPTION SYSTEM OF TAXATION.**

4 “(a) TREATMENT OF DEFERRED FOREIGN INCOME
5 AS SUBPART F INCOME.—In the case of the last taxable
6 year of a specified 10-percent owned foreign corporation
7 which ends before January 1, 2013, the subpart F income
8 of such foreign corporation (as otherwise determined for
9 such taxable year under section 952) shall be increased
10 by the accumulated deferred foreign income of such cor-
11 poration determined as of the close of such taxable year.

12 “(b) APPLICATION OF PARTICIPATION EXEMPTION
13 TO INCLUDED INCOME.—In the case of a United States
14 shareholder with respect to a specified 10-percent owned
15 foreign corporation to which subsection (a) applies, there
16 shall be allowed as a deduction for the taxable year in
17 which the income described in subsection (a) is included
18 in the gross income of such United States shareholder
19 under section 951 an amount equal to **[85]** percent of
20 the amount of the income so included.

21 “(c) ACCUMULATED DEFERRED FOREIGN IN-
22 COME.—For purposes of this section—

23 “(1) IN GENERAL.—The term ‘accumulated de-
24 ferred foreign income’ means the portion of the un-
25 distributed earnings which is not attributable to in-

1 come of the specified 10-percent owned foreign cor-
2 poration which is—

3 “(A) effectively connected with the conduct
4 of a trade or business within the United States
5 and subject to tax under this chapter, or

6 “(B) in the case of a controlled foreign
7 corporation, subpart F income (determined
8 without regard to this section)—

9 “(i) which is included in the gross in-
10 come of a United States shareholder of
11 such controlled foreign corporation under
12 section 951, and

13 “(ii) with respect to which the con-
14 trolled foreign corporation has not made
15 distributions which are excludable from
16 gross income under section 959.

17 “(2) **UNDISTRIBUTED EARNINGS.**—The term
18 ‘undistributed earnings’ means the earnings and
19 profits of the foreign corporation (computed in ac-
20 cordance with sections 964(a) and 986) as of the
21 close the taxable year referred to in subsection (a).

22 “(d) **SPECIFIED 10-PERCENT OWNED FOREIGN COR-**
23 **PORATION.**—

1 “(1) IN GENERAL.—For purposes of this sec-
2 tion, the term ‘specified 10-percent owned foreign
3 corporation’ means—

4 “(A) any controlled foreign corporation,
5 and

6 “(B) any noncontrolled 10/50 corporation
7 (as defined in section 245A(e)(3), without re-
8 gard to whether such section is in effect for the
9 taxable year to which this section applies).

10 “(2) APPLICATION TO NONCONTROLLED 10/50
11 CORPORATIONS.—For purposes of this subpart, a
12 noncontrolled 10/50 corporation (as so defined) shall
13 be treated as a controlled foreign corporation solely
14 for purposes of taking into account the subpart F
15 income of such corporation under subsection (a).

16 “(e) DISALLOWANCE OF FOREIGN TAX CREDIT,
17 ETC.—

18 “(1) IN GENERAL.—No credit shall be allowed
19 under section 901 for **【85】** percent of any taxes
20 paid or accrued (or treated as paid or accrued) with
21 respect to any amount for which a deduction is al-
22 lowed under this section.

23 “(2) DENIAL OF DEDUCTION.—No deduction
24 shall be allowed under this chapter for any tax for

1 which credit is not allowable under section 901 by
2 reason of paragraph (1).

3 “(3) COORDINATION WITH SECTION 78.—Sec-
4 tion 78 shall not apply to any tax for which credit
5 is not allowable under section 901 by reason of para-
6 graph (1).

7 “(f) ELECTION TO PAY LIABILITY IN INSTALL-
8 MENTS.—

9 “(1) IN GENERAL.—In the case of a United
10 States shareholder with respect to one or more spec-
11 ified 10-percent owned foreign corporations to which
12 subsection (a) applies, such United States share-
13 holder may elect to pay the net tax liability under
14 this section in 2 or more (but not exceeding **[8]**)
15 equal installments.

16 “(2) DATE FOR PAYMENT OF INSTALLMENTS.—
17 If an election is made under paragraph (1), the first
18 installment shall be paid on the due date (deter-
19 mined without regard to any extension of time for
20 filing the return) for the return of tax for the tax-
21 able year described in subsection (b) and each suc-
22 ceeding installment shall be paid on the due date (as
23 so determined) for the return of tax for the taxable
24 year following the taxable year with respect to which
25 the preceding installment was made.

1 “(3) ACCELERATION OF PAYMENT.—If there is
2 an addition to tax for failure to pay timely assessed
3 with respect to any installment required under this
4 subsection, a liquidation or sale of substantially all
5 the assets of the taxpayer (including in a title 11 or
6 similar case), a cessation of business by the tax-
7 payer, or any similar circumstance, then the unpaid
8 portion of all remaining installments shall be due on
9 the date of such event (or in the case of a title 11
10 or similar case, the day before the petition is filed).

11 “(4) PRORATION OF DEFICIENCY TO INSTALL-
12 MENTS.—If an election is made under paragraph (1)
13 to pay the net tax liability under this section in in-
14 stallments and a deficiency has been assessed, the
15 deficiency shall be prorated to the installments pay-
16 able under paragraph (1). The part of the deficiency
17 so prorated to any installment the date for payment
18 of which has not arrived shall be collected at the
19 same time as, and as a part of, such installment.
20 The part of the deficiency so prorated to any install-
21 ment the date for payment of which has arrived
22 shall be paid upon notice and demand from the Sec-
23 retary. This subsection shall not apply if the defi-
24 ciency is due to negligence, to intentional disregard

1 of rules and regulations, or to fraud with intent to
2 evade tax.

3 “(5) TIME FOR PAYMENT OF INTEREST.—Inter-
4 est payable under section 6601 on the unpaid por-
5 tion of any amount of tax the time for payment of
6 which as been extended under this subsection shall
7 be paid annually at the same time as, and as part
8 of, each installment payment of such tax. In the case
9 of a deficiency to which paragraph (4) applies, inter-
10 est with respect to such deficiency which is assigned
11 under the preceding sentence to any installment the
12 date for payment of which has arrived on or before
13 the date of the assessment of the deficiency, shall be
14 paid upon notice and demand from the Secretary.

15 “(6) ELECTION.—Any election under paragraph
16 (1) shall be made not later than the due date for the
17 return of tax for the taxable year described in sub-
18 section (b) and shall be made in such manner as the
19 Secretary may provide.

20 “(7) NET TAX LIABILITY UNDER THIS SEC-
21 TION.—For purposes of this subsection—

22 “(A) IN GENERAL.—The net tax liability
23 under this section with respect to any United
24 States shareholder is the excess (if any) of—

1 “(i) such taxpayer’s net income tax
2 for the taxable year described in subsection
3 (b), over

4 “(ii) such taxpayer’s net income tax
5 for such taxable year determined without
6 regard to this section.

7 “(B) NET INCOME TAX.—The term ‘net
8 income tax’ means the net income tax (as de-
9 fined in section 38(c)(1)) reduced by the credit
10 allowed under section 38.”.

11 (b) CONFORMING AMENDMENTS.—

12 (1) Clause (vi) of section 56(g)(4)(C), as
13 amended by section 301, is amended—

14 (A) by striking “965” and inserting
15 “965(b)”, and

16 (B) by inserting “AND INCLUSIONS” after
17 “CERTAIN DISTRIBUTIONS” in the heading
18 thereof.

19 (2) Paragraph (2) of section 6601(b) is amend-
20 ed—

21 (A) by striking “section 6156(a)” in the
22 matter preceding subparagraph (A) and insert-
23 ing “section 965(f)(1) or 6156(a)”, and

1 (B) by striking “section 6156(b)” in sub-
2 paragraph (A) and inserting “section 965(f)(2)
3 or 6156(b), as the case may be”.

4 (3) The table of section for subpart F of part
5 III of subchapter N of chapter 1 is amended by
6 striking the item relating to section 965 and insert-
7 ing the following:

“Sec. 965. Treatment of deferred foreign income upon transition to participa-
tion exemption system of taxation.”.

8 **Subtitle B—Modifications Related**
9 **to Foreign Tax Credit System**

10 **SEC. 311. REPEAL OF SECTION 902 INDIRECT FOREIGN TAX**
11 **CREDITS; DETERMINATION OF SECTION 960**
12 **CREDIT ON CURRENT YEAR BASIS.**

13 (a) REPEAL OF SECTION 902 INDIRECT FOREIGN
14 TAX CREDITS.—Subpart A of part III of subchapter N
15 of chapter 1 is amended by striking section 902.

16 (b) DETERMINATION OF SECTION 960 CREDIT ON
17 CURRENT YEAR BASIS.—Section 960 is amended to read
18 as follows:

19 **“SEC. 960. DEEMED PAID CREDIT FOR SUBPART F INCLU-**
20 **SIONS.**

21 “(a) IN GENERAL.—For purposes of this subpart, if
22 there is included in the gross income of a domestic cor-
23 poration any amount under section 951(a) with respect
24 to any controlled foreign corporation with respect to which

1 such domestic corporation is a United States shareholder,
2 such domestic corporation shall be deemed to have paid
3 so much of such foreign corporation's foreign income taxes
4 as are properly attributable to the amount so included.

5 “(b) FOREIGN INCOME TAXES.—The term ‘foreign
6 income taxes’ means any income, war profits, or excess
7 profits taxes paid or accrued by the controlled foreign cor-
8 poration to any foreign country or possession of the
9 United States.

10 “(c) REGULATIONS.—The Secretary shall provide
11 such regulations as may be necessary or appropriate to
12 carry out the provisions of this section.”.

13 (c) CONFORMING AMENDMENTS.—

14 (1) Subclause (III) of section 56(g)(4)(C)(iii) is
15 amended by inserting “as in effect before its repeal”
16 after “section 902”.

17 (2) Section 78 is amended by striking “section
18 902(a) (relating to credit for corporate stockholder
19 in foreign corporation) or under section 960(a)(1)
20 (relating to taxes paid by foreign corporation)” and
21 inserting “section 960”.

22 (3) Sections 535(b)(1) and 545(b)(1) are each
23 amended by striking “section 902(a) or 960(a)(1)”
24 and inserting “section 960”.

1 (4) Paragraph (1) of section 814(f) is amended
2 by striking subparagraph (B).

3 (5) Subsection (a) of section 901 is amended by
4 striking “sections 902 and 960” and inserting “sec-
5 tion 960”.

6 (6) Paragraph (2) of section 901(e) is amended
7 by striking “but is not limited to—” and all that fol-
8 lows through “that portion” and inserting “but is
9 not limited to that portion”.

10 (7) Subsection (f) of section 901 is amended by
11 striking “sections 902 and 960” and inserting “sec-
12 tion 960”.

13 (8) Subparagraph (A) of section 901(j)(1) is
14 amended by striking “902 or”.

15 (9) Subparagraph (A) of section 904(h)(10) is
16 amended by striking “sections 902, 907, and 960”
17 and inserting “sections 907 and 960”.

18 (10) Subsection (l) of section 904 is amended
19 to read as follows:

20 “(l) CROSS REFERENCE.—For modification of limita-
21 tion under subsection (a) for purposes of determining the
22 amount of credit which can be taken against the alter-
23 native minimum tax, see section 59(a).”.

24 (11) Paragraph (1) of section 905(c) is amend-
25 ed by striking the last sentence.

1 (12) Subclause (I) of section 905(c)(2)(B) is
2 amended by striking “902 or”.

3 (13) Subsection (a) of section 906 is amended
4 by striking “(or deemed, under section 902, paid or
5 accrued during the taxable year)”.

6 (14) Subsection (b) of section 906 is amended
7 by striking paragraph (5).

8 (15) Subparagraph (B) of section 907(b)(2) is
9 amended by striking “902 or”.

10 (16) Paragraph (3) of section 907(c) is amend-
11 ed—

12 (A) by striking subparagraph (A) and re-
13 designating subparagraphs (B) and (C) as sub-
14 paragraphs (A) and (B), respectively, and

15 (B) by striking “section 960(a)” in sub-
16 paragraph (A) (as so redesignated) and insert-
17 ing “section 960”.

18 (17) Paragraph (5) of section 907(c) is amend-
19 ed by striking “902 or”.

20 (18) Clause (i) of section 907(f)(2)(B) is
21 amended by striking “902 or”.

22 (19) Subsection (a) of section 908 is amended
23 by striking “902 or”.

24 (20) Paragraph (1) of section 958(a) is amend-
25 ed by striking “960(a)(1)” and inserting “960”.

1 (21) Subparagraph (A) of section 1291(g)(2) is
2 amended by striking “any distribution—” and all
3 that follows through “but only if” and inserting
4 “any distribution, any withholding tax imposed with
5 respect to such distribution, but only if”.

6 (22) Section 1293 is amended by striking sub-
7 section (f).

8 (23) Subparagraph (B) of section 6038(c)(1) is
9 amended by striking “sections 902 (relating to for-
10 eign tax credit for corporate stockholder in foreign
11 corporation) and 960 (relating to special rules for
12 foreign tax credit)” and inserting “section 960”.

13 (24) Paragraph (4) of section 6038(c) is
14 amended by striking subparagraph (C).

15 (25) The table of sections for subpart A of part
16 III of subchapter N of chapter 1 is amended by
17 striking the item relating to section 902.

18 (26) The table of sections for subpart F of part
19 III of subchapter N of chapter 1 is amended by
20 striking the item relating to section 960 and insert-
21 ing the following:

“Sec. 960. Deemed paid credit for subpart F inclusions.”.

22 (d) EFFECTIVE DATE.—The amendments made by
23 this section shall apply to taxable years of foreign corpora-
24 tions beginning after December 31, 2012, and to taxable

1 years of United States shareholders in which or with which
2 such taxable years of foreign corporations end.

3 **SEC. 312. FOREIGN TAX CREDIT LIMITATION APPLIED BY**
4 **ALLOCATING ONLY DIRECTLY ALLOCABLE**
5 **DEDUCTIONS TO FOREIGN SOURCE INCOME.**

6 (a) IN GENERAL.—Subsection (b) of section 904 is
7 amended by redesignating paragraphs (3) and (4) as para-
8 graphs (4) and (5) and by inserting after paragraph (2)
9 the following new paragraph:

10 “(3) DEDUCTIONS ALLOCABLE TO FOREIGN
11 SOURCE INCOME ONLY IF DIRECTLY ALLOCABLE.—
12 For purposes of subsection (a), the taxpayer’s tax-
13 able income from sources without the United States
14 shall be determined by allocating deductions to such
15 income only if such deductions are directly allocable
16 to such income.”.

17 (b) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to taxable years of foreign corpora-
19 tions beginning after December 31, 2012, and to taxable
20 years of United States shareholders in which or with which
21 such taxable years of foreign corporations end.

22 **SEC. 313. ELIMINATION OF FOREIGN TAX CREDIT BASKETS.**

23 (a) IN GENERAL.—Section 904 is amended by strik-
24 ing subsection (d).

25 (b) CONFORMING AMENDMENTS.—

1 (1) Clause (iii) of 56(g)(4)(C) is amended by
2 striking subclause (IV) and redesignating subclauses
3 (V) and (VI) as subclauses (IV) and (V), respec-
4 tively.

5 (2) Subsection (a) of section 245(a) is amended
6 by striking paragraph (10).

7 (3) Subparagraph (C) of section 367(d)(3) is
8 amended by striking the last sentence thereof.

9 (4) Subsection (d) of section 864 is amended—
10 (A) by striking “the provisions set forth in
11 paragraph (2)” in paragraph (1) and inserting
12 “subpart F of part III (relating to controlled
13 foreign corporations)”,

14 (B) by striking paragraph (2), and

15 (C) by striking clause (i) of paragraph
16 (5)(A) and redesignating clauses (ii), (iii), and
17 (iv) of such paragraph as clauses (i), (ii), and
18 (iii), respectively.

19 (5) Subparagraph (C) of section 864(e)(7) is
20 amended by striking “and various categories of in-
21 come described in section 904(d)(1)”.

22 (6) Subparagraph (B) of section 864(f)(5) is
23 amended by inserting “(as in effect before its re-
24 peal)” after “section 904(d)(2)(D)(ii)”.

1 (7) Paragraph (1) of section 865(h) is amended
2 by striking “applies—” and all that follows and in-
3 serting “applies, such gain shall be sourced outside
4 the United States.”.

5 (8) Paragraph (1) of section 901(j) is amended
6 by striking all that follows subparagraph (A) and in-
7 serting the following:

8 “(B) section 245A shall be applied by re-
9 ducing (but not below zero) the undistributed
10 foreign earnings by any income attributable to
11 such a period from sources within such coun-
12 try.”.

13 (9) Subsection (c) of section 907 is amended by
14 inserting “as in effect before its repeal” after “sec-
15 tion 904(d)(2)(A)” both places it appears.

16 (10) Paragraph (5) of section 954(b) is amend-
17 ed by inserting “as in effect before its repeal” after
18 “section 904(d)(2)”.

19 (11) Subparagraph (B) of section 954(c)(2) is
20 amended by inserting “as in effect before its repeal”
21 after “section 904(d)(2)(G)”.

22 (12) Subparagraph (A) of section 954(c)(6) is
23 amended by inserting “as in effect before its repeal”
24 after “section 904(d)(3)”.

1 (13) Clause (ii) of section 1291(g)(1)(C) is
2 amended by striking “(subject to the principles of
3 section 904(d) and not below zero)” and inserting
4 “(but not below zero)”.

5 (c) EFFECTIVE DATE.—

6 (1) IN GENERAL.—The amendments made by
7 this section shall apply to taxable years of foreign
8 corporations beginning after December 31, 2012,
9 and to taxable years of United States shareholders
10 in which or with which such taxable years of foreign
11 corporations end.

12 (2) TREATMENT OF CARRYFORWARDS AND
13 CARRYBACKS.—For purposes of section 904 of the
14 Internal Revenue Code of 1986—

15 (A) the amendments made by this section
16 shall apply to any taxes carried from any tax-
17 able year beginning before January 1, 2013, to
18 any taxable year beginning on or after such
19 date, and

20 (B) the Secretary of the Treasury, or his
21 designee, may by regulations provide for the al-
22 location of any carryback of taxes with respect
23 to income from a taxable year beginning on or
24 after January 1, 2013, to a taxable year begin-
25 ning before such date for purposes of allocating

1 such income among the separate categories in
2 effect under section 904(d) for the taxable year
3 to which carried.

4 **SEC. 314. REPEAL OF RULE SUSPENDING FOREIGN TAXES**
5 **AND CREDITS UNTIL RELATED INCOME IS**
6 **TAKEN INTO ACCOUNT.**

7 (a) IN GENERAL.—Subpart A of part III of sub-
8 chapter N of chapter 1 is amended by striking section 909.

9 (b) CLERICAL AMENDMENT.—The table of sections
10 for subpart A of part III of subchapter N of chapter 1
11 is amended by striking the item relating to section 909.

12 (c) EFFECTIVE DATE.—The amendments made by
13 this section shall apply to taxable years of foreign corpora-
14 tions beginning after December 31, 2012, and to taxable
15 years of United States shareholders in which or with which
16 such taxable years of foreign corporations end.

17 **Subtitle C—Rules Related to**
18 **Passive Income**

19 **PART 1—MODIFICATION OF SUBPART F**
20 **PROVISIONS**

21 **SEC. 321. TERMINATION OF CURRENT YEAR INCLUSION**
22 **BASED ON INVESTMENTS IN UNITED STATES**
23 **PROPERTY.**

24 (a) IN GENERAL.—Subpart F of part III of sub-
25 chapter N of chapter 1 is amended by striking section 956.

1 (b) CONFORMING AMENDMENTS.—

2 (1) Paragraph (8) of section 864(d) is amended
3 by striking “or section 956(b)(3)”.

4 (2) Paragraph (1) of section 951(a) is amend-
5 ed—

6 (A) by striking “, and” at the end of sub-
7 paragraph (A)(iii) and inserting a period, and

8 (B) by striking subparagraph (B).

9 (3) Clause (ii) of section 954(c)(2)(C) is
10 amended by inserting “as in effect before its repeal”
11 after “section 956(c)(2)(I)”.

12 (4) Subsection (b) of section 958 is amended—

13 (A) by striking “to treat the stock of a do-
14 mestic corporation as owned by a United States
15 shareholder of the controlled foreign corpora-
16 tion for purposes of section 956(c)(2),”, and

17 (B) by striking the last sentence thereof.

18 (5) Section 960 is amended by striking sub-
19 section (c).

20 (6) Subsection (b) of section 964 is amended by
21 striking “952, 955, and 956” and inserting “952
22 and 955”.

23 (7) The table of sections for subpart F of part
24 III of subchapter N of chapter 1 is amended by
25 striking the item relating to section 956.

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to taxable years of foreign corpora-
3 tions beginning after December 31, 2012, and to taxable
4 years of United States shareholders in which or with which
5 such taxable years of foreign corporations end.

6 **SEC. 322. REPEAL OF EXCLUSION OF PREVIOUSLY TAXED**
7 **EARNINGS AND PROFITS.**

8 (a) IN GENERAL.—Subpart F of part III of sub-
9 chapter N of chapter 1 is amended by striking section 959.

10 (b) REPEAL OF ADJUSTMENTS TO BASIS.—Subpart
11 F of part III of subchapter N of chapter 1 is amended
12 by striking section 961.

13 (c) CONFORMING AMENDMENTS.—

14 (1) Paragraph (6) of section 304(b) is amended
15 by striking “(including modifications to the applica-
16 tion of sections 959 and 961)”.

17 (2) Subsection (b) of section 851 is amended by
18 striking the first sentence of the flush material
19 which follows paragraph (3) thereof.

20 (3) Section 951 is amended by striking sub-
21 section (c).

22 (4) Subsection (d) of section 962 is amended by
23 striking “, notwithstanding the provisions of section
24 959(a)(1),”.

1 (5) Section 986 is amended by striking sub-
2 section (c).

3 (6) Subsection (a) of section 1016 is amended
4 by striking paragraph (18).

5 (7) Subsection (d) of section 1248 is amended
6 by striking paragraph (1).

7 (8) Section 1248 is amended by striking sub-
8 section (j).

9 (9) Subparagraph (B) of section 1291(d)(2) is
10 amended by striking clause (iii).

11 (10) Section 1293 is amended by striking sub-
12 section (c).

13 (11) Paragraph (5) of section 1298(b) is
14 amended to read as follows:

15 “(5) APPLICATION OF PART WHERE STOCK
16 HELD BY OTHER ENTITY.—Under regulations, in
17 any case in which a United States person is treated
18 as owning stock in a passive foreign investment com-
19 pany by reason of subsection (a)—

20 “(A) any disposition by the United States
21 person or the person owning such stock which
22 results in the United States person being treat-
23 ed as no longer owning such stock, or

1 “(B) any distribution of property in re-
2 spect of such stock to the person holding such
3 stock,
4 shall be treated as a disposition by, or distribution
5 to, the United States person with respect to the
6 stock in the passive foreign investment company.”.

7 (12) The table of sections for subpart F of part
8 III of subchapter N of chapter 1 is amended by
9 striking the items relating to sections 959 and 961.

10 (d) EFFECTIVE DATE.—The amendments made by
11 this section shall apply to taxable years of foreign corpora-
12 tions beginning after December 31, 2012, and to taxable
13 years of United States shareholders in which or with which
14 such taxable years of foreign corporations end.

15 **PART 2—PREVENTION OF BASE EROSION**

16 **SEC. 331A. [OPTION A:] EXCESS INCOME FROM TRANSFERS**
17 **OF INTANGIBLES TO LOW-TAXED AFFILIATES**
18 **TREATED AS SUBPART F INCOME.**

19 (a) IN GENERAL.—Subsection (a) of section 954 is
20 amended by inserting after paragraph (3) the following
21 new paragraph:

22 “(4) the foreign base company excess intangible
23 income for the taxable year (determined under sub-
24 section (f) and reduced as provided in subsection
25 (b)(5)), and”.

1 (b) FOREIGN BASE COMPANY EXCESS INTANGIBLE
2 INCOME.—Section 954 is amended by inserting after sub-
3 section (e) the following new subsection:

4 “(f) FOREIGN BASE COMPANY EXCESS INTANGIBLE
5 INCOME.—For purposes of subsection (a)(4) and this sub-
6 section:

7 “(1) FOREIGN BASE COMPANY EXCESS INTAN-
8 GIBLE INCOME DEFINED.—

9 “(A) IN GENERAL.—The term ‘foreign
10 base company excess intangible income’ means,
11 with respect to any covered intangible, the ex-
12 cess of—

13 “(i) the sum of—

14 “(I) gross income from the sale,
15 lease, license, or other disposition of
16 property in which such covered intan-
17 gible is used directly or indirectly, and

18 “(II) gross income from the pro-
19 vision of services related to such cov-
20 ered intangible or in connection with
21 property in which such covered intan-
22 gible is used directly or indirectly,
23 over

24 “(ii) 150 percent of the costs properly
25 allocated and apportioned to the gross in-

1 come taken into account under clause (i)
2 other than expenses for interest and taxes
3 and any expenses which are not directly al-
4 locable to such gross income.

5 “(B) SAME COUNTRY INCOME NOT TAKEN
6 INTO ACCOUNT.—If—

7 “(i) the sale, lease, license, or other
8 disposition of the property referred to in
9 subparagraph (A)(i)(I) is for use, con-
10 sumption, or disposition in the country
11 under the laws of which the controlled for-
12 eign corporation is created or organized, or

13 “(ii) the services referred to in sub-
14 paragraph (A)(i)(II) are performed in such
15 country,

16 the gross income from such sale, lease, license,
17 or other disposition, or provision of services,
18 shall not be taken into account under subpara-
19 graph (A)(i).

20 “(C) SPECIAL RULE FOR RESEARCH AND
21 DEVELOPMENT EXPENSES.—Research and de-
22 velopment costs for any taxable year shall be
23 treated for purposes of subparagraph (A) as
24 properly allocable to gross income derived from
25 a covered intangible if such costs are properly

1 allocable to the line of business in which such
2 gross income is earned.

3 “(2) EXCEPTION BASED ON EFFECTIVE FOR-
4 EIGN INCOME TAX RATE.—

5 “(A) IN GENERAL.—Foreign base company
6 excess intangible income shall not include the
7 applicable percentage of any item of income re-
8 ceived by a controlled foreign corporation if the
9 taxpayer establishes to the satisfaction of the
10 Secretary that such income was subject to an
11 effective rate of income tax imposed by a for-
12 eign country in excess of 10 percent.

13 “(B) APPLICABLE PERCENTAGE.—For
14 purposes of subparagraph (A), the term ‘appli-
15 cable percentage’ means the ratio (expressed as
16 a percentage), not greater than 100 percent,
17 of—

18 “(i) the number of percentage points
19 by which the effective rate of income tax
20 referred to in subparagraph (A) exceeds 10
21 percentage points, over

22 “(ii) 5 percentage points.

23 “(C) TREATMENT OF LOSSES IN DETER-
24 MINING EFFECTIVE RATE OF FOREIGN INCOME
25 TAX.—For purposes of determining the effective

1 rate of income tax imposed by any foreign
2 country—

3 “(i) such effective rate shall be deter-
4 mined without regard to any losses carried
5 to the relevant taxable year, and

6 “(ii) to the extent the income with re-
7 spect to such intangible reduces losses in
8 the relevant taxable year, such effective
9 rate shall be treated as being the effective
10 rate which would have been imposed on
11 such income without regard to such losses.

12 “(3) COVERED INTANGIBLE.—The term ‘cov-
13 ered intangible’ means, with respect to any con-
14 trolled foreign corporation, any intangible property
15 (as defined in section 936(h)(3)(B))—

16 “(A) which is sold, leased, licensed, or oth-
17 erwise transferred (directly or indirectly) to
18 such controlled foreign corporation from a
19 United States related person, or

20 “(B) with respect to which such controlled
21 foreign corporation and one or more related
22 persons has (directly or indirectly) entered into
23 any shared risk or development agreement (in-
24 cluding any cost sharing agreement).

1 “(4) RELATED PERSON.—The term ‘related
2 person’ has the meaning given such term in sub-
3 section (d)(3).”.

4 (c) CONFORMING AMENDMENTS.—

5 (1) Paragraph (4) of section 954(b) is amended
6 by inserting “foreign base company excess intangible
7 income described in subsection (a)(4) or” before
8 “foreign base company oil-related income” in the
9 last sentence thereof.

10 (2) Paragraph (5) of section 954(b) is amended
11 by inserting “the foreign base company excess intan-
12 gible income,” before “and the foreign base company
13 oil related income”.

14 (3) Subsection (b) of section 954 is amended by
15 adding at the end the following new paragraph:

16 “(7) FOREIGN BASE COMPANY EXCESS INTAN-
17 GIBLE INCOME NOT TREATED AS ANOTHER KIND OF
18 BASE COMPANY INCOME.—Income of a corporation
19 which is foreign base company excess intangible in-
20 come shall not be considered foreign base company
21 income of such corporation under paragraph (2),
22 (3), or (5) of subsection (a).”.

23 (d) EFFECTIVE DATE.—The amendments made by
24 this section shall apply to income from transactions con-

1 nected with or benefitting from covered intangibles in tax-
2 able years beginning on or after January 1, 2013.

3 **SEC. 331B. [OPTION B:] LOW-TAXED CROSS-BORDER FOR-**
4 **EIGN INCOME TREATED AS SUBPART F IN-**
5 **COME.**

6 (a) IN GENERAL.—Subsection (a) of section 952 is
7 amended by redesignating paragraphs (3), (4), and (5) as
8 paragraphs (4), (5), and (6), respectively, and by inserting
9 after paragraph (2) the following new paragraph:

10 “(3) low-taxed cross-border income (as defined
11 under subsection (e)),”.

12 (b) LOW-TAXED CROSS-BORDER INCOME.—Section
13 952 is amended by adding at the end the following new
14 subsection:

15 “(e) LOW-TAXED CROSS-BORDER INCOME.—

16 “(1) IN GENERAL.—For purposes of subsection
17 (a), the term ‘low-taxed cross-border income’ means
18 the gross income of the controlled foreign corpora-
19 tion unless the taxpayer establishes to the satisfac-
20 tion of the Secretary that—

21 “(A) such income was derived in the home
22 country of the controlled foreign corporation, or

23 “(B) such income was subject to an effec-
24 tive rate of income tax imposed by a foreign
25 country in excess of **[10]** percent.

1 “(2) RULES RELATED TO INCOME DERIVED IN
2 HOME COUNTRY.—For purposes of paragraph
3 (1)(A), income shall be treated as derived in the
4 home country of a controlled foreign corporation
5 only if—

6 “(A) such income is derived in the conduct
7 of a trade or business of such corporation in
8 the country in which such corporation is created
9 or organized,

10 “(B) such corporation maintains an office
11 or other fixed place of business in such country,
12 and

13 “(C) such income is derived in connection
14 with—

15 “(i) property which is sold for use,
16 consumption, or disposition in such coun-
17 try, or

18 “(ii) services provided with respect to
19 persons or property located in such coun-
20 try.

21 “(3) RULES RELATED TO DETERMINATION OF
22 EFFECTIVE RATE OF FOREIGN INCOME TAX.—

23 “(A) COUNTRY-BY-COUNTRY DETERMINA-
24 TION.—Paragraph (1)(B) shall be applied—

1 “(i) separately with respect to each
2 foreign country in which a controlled for-
3 eign corporation conducts any trade or
4 business, and

5 “(ii) with respect to the aggregate
6 gross income derived with respect to such
7 country.

8 “(B) TREATMENT OF LOSSES.—For pur-
9 poses of determining the effective rate of in-
10 come tax imposed by any foreign country under
11 paragraph (1)(B)—

12 “(i) such effective rate shall be deter-
13 mined without regard to any losses carried
14 to the relevant taxable year, and

15 “(ii) to the extent the income of the
16 controlled foreign corporation reduces
17 losses in the relevant taxable year, such ef-
18 fective rate shall be treated as being the
19 effective rate which would have been im-
20 posed on such income without regard to
21 such losses.

22 “(4) DEDUCTIONS TO BE TAKEN INTO AC-
23 COUNT.—The gross income of a controlled foreign
24 corporation taken into account under this subsection
25 shall be reduced, under regulations prescribed by the

1 Secretary, so as to take into account deductions (in-
2 cluding taxes) properly allocable to such income.”.

3 (c) EFFECTIVE DATE.—The amendments made by
4 this section shall apply to taxable years of foreign corpora-
5 tions beginning after December 31, 2012, and to taxable
6 years of United States shareholders in which or with which
7 such taxable years of foreign corporations end.

8 **SEC. 331C. [OPTION C:] FOREIGN INTANGIBLE INCOME**
9 **SUBJECT TO TAXATION AT REDUCED RATE;**
10 **INTANGIBLE INCOME TREATED AS SUBPART**
11 **F INCOME.**

12 (a) IN GENERAL.—Part VIII of subchapter B of
13 chapter 1 is amended by adding at the end the following
14 new section:

15 **“SEC. 250. FOREIGN INTANGIBLE INCOME.**

16 “(a) IN GENERAL.—In the case of a domestic cor-
17 poration, there shall be allowed as a deduction an amount
18 equal to **[40]** percent of the sum of—

19 “(1) the foreign intangible income of such do-
20 mestic corporation for the taxable year, plus

21 “(2) in the case of a domestic corporation
22 which is a United States shareholder with respect to
23 any controlled foreign corporation, the lesser of—

24 “(A) any foreign base company intangible
25 income (as defined in section 954(f)) of such

1 controlled foreign corporation which is included
2 in the gross income of such United States
3 shareholder under section 951 for the taxable
4 year, or

5 “(B) the amount of foreign base company
6 intangible income which would be so included
7 with respect to such controlled foreign corpora-
8 tion if ‘foreign intangible income (as defined in
9 section 250(b))’ were substituted for ‘intangible
10 income’ in section 954(f)(1).

11 “(b) FOREIGN INTANGIBLE INCOME.—For purposes
12 of this section, the term ‘foreign intangible income’ means
13 any intangible income (as defined in section 954(f)(2))
14 which is derived in connection with—

15 “(1) property which is sold for use, consump-
16 tion, or disposition outside the United States, or

17 “(2) services provided with respect to persons
18 or property located outside the United States.”.

19 (b) FOREIGN BASE COMPANY INTANGIBLE IN-
20 COME.—

21 (1) TREATMENT AS SUBPART F INCOME.—Sub-
22 section (a) of section 954 is amended by inserting
23 after paragraph (3) the following new paragraph:

24 “(4) the foreign base company intangible in-
25 come for the taxable year (determined under sub-

1 section (f) and reduced as provided in subsection
2 (b)(5)), and”.

3 (2) FOREIGN BASE COMPANY INTANGIBLE IN-
4 COME DEFINED.—Section 954 of such Code is
5 amended by inserting after subsection (e) the fol-
6 lowing new subsection:

7 “(f) FOREIGN BASE COMPANY INTANGIBLE IN-
8 COME.—For purposes of this section—

9 “(1) IN GENERAL.—The term ‘foreign base
10 company intangible income’ means the intangible in-
11 come of the controlled foreign corporation for the
12 taxable year.

13 “(2) INTANGIBLE INCOME.—The term ‘intan-
14 gible income’ means gross income from—

15 “(A) the sale, lease, license, or other dis-
16 position of property in which intangible prop-
17 erty is used directly or indirectly, or

18 “(B) the provision of services related to in-
19 tangible property or in connection with property
20 in which intangible property is used directly or
21 indirectly,

22 to the extent that such gross income is properly at-
23 tributable to such intangible property.

1 “(3) INTANGIBLE PROPERTY.—The term ‘in-
2 tangible property’ has the meaning given such term
3 by section 936(h)(3)(B).”.

4 (c) CONFORMING AMENDMENTS.—

5 (1) Paragraph (4) of section 954(b) is amended
6 by adding at the end the following: “In the case of
7 foreign base company intangible income, this para-
8 graph shall be applied by treating the maximum rate
9 of tax specified in section 11 as being **[60]** percent
10 of such rate.”.

11 (2) Paragraph (5) of section 954(b) is amended
12 by inserting “the foreign base company intangible
13 income,” before “and the foreign base company oil
14 related income”.

15 (3) Subsection (b) of section 954 is amended by
16 adding at the end the following new paragraph:

17 “(7) FOREIGN BASE COMPANY EXCESS INTAN-
18 GIBLE INCOME NOT TREATED AS ANOTHER KIND OF
19 BASE COMPANY INCOME.—Income of a corporation
20 which is foreign base company intangible income
21 shall not be considered foreign base company income
22 of such corporation under paragraph (2), (3), or (5)
23 of subsection (a).”.

24 (d) EFFECTIVE DATE.—

1 (1) IN GENERAL.—Except as otherwise pro-
2 vided in this subsection, the amendments made by
3 this section shall apply to taxable years of foreign
4 corporations beginning after December 31, 2012,
5 and to taxable years of United States shareholders
6 in which or with which such taxable years of foreign
7 corporations end.

8 (2) DEDUCTION FOR FOREIGN INTANGIBLE IN-
9 COME EARNED DIRECTLY BY DOMESTIC CORPORA-
10 TION.—The deduction provided under paragraph (1)
11 of section 250(a) of the Internal Revenue Code of
12 1986, as added by this section, shall apply to taxable
13 years of the domestic corporation beginning after
14 December 31, 2012.

15 **SEC. 332. DENIAL OF DEDUCTION FOR INTEREST EXPENSE**
16 **OF UNITED STATES SHAREHOLDERS WHICH**
17 **ARE MEMBERS OF WORLDWIDE AFFILIATED**
18 **GROUPS WITH EXCESS DOMESTIC INDEBTED-**
19 **NESS.**

20 (a) IN GENERAL.—Section 163 is amended by redess-
21 ignating subsection (n) as subsection (o) and by inserting
22 after subsection (m) the following new subsection:

23 “(n) DISALLOWANCE OF DEDUCTION FOR INTEREST
24 EXPENSE OF UNITED STATES SHAREHOLDERS WHICH

1 ARE MEMBERS OF WORLDWIDE AFFILIATED GROUPS
2 WITH EXCESS DOMESTIC INDEBTEDNESS.—

3 “(1) IN GENERAL.—In the case of any domestic
4 corporation which is a United States shareholder (as
5 defined in section 951(b)) with respect to any for-
6 eign corporation both of which are members of the
7 same worldwide affiliated group, the deduction al-
8 lowed under this chapter for interest paid or accrued
9 by such domestic corporation during the taxable year
10 shall be reduced by the lesser of—

11 “(A) the product of—

12 “(i) such net interest expense, multi-
13 plied by

14 “(ii) the debt-to-equity differential
15 percentage of such worldwide affiliated
16 group, or

17 “(B) the excess (if any) of—

18 “(i) such net interest expense, over

19 “(ii) **[X]** percent of the adjusted tax-
20 able income (as defined in subsection
21 (j)(6)(A)) of such domestic corporation.

22 “(2) CARRYFORWARD.—Any amount disallowed
23 under paragraph (1) for any taxable year shall be
24 treated as interest paid or accrued in the succeeding

1 taxable year (and shall not be treated as disqualified
2 interest for purposes of applying subsection (j)).

3 “(3) DEBT-TO-EQUITY DIFFERENTIAL PER-
4 CENTAGE.—

5 “(A) IN GENERAL.—For purposes of this
6 subsection, the term ‘debt-to-equity differential
7 percentage’ means, with respect to any world-
8 wide affiliated group, the percentage which the
9 excess domestic indebtedness of such group
10 bears to the total indebtedness of the domestic
11 corporations which are members of such group.

12 “(B) EXCESS DOMESTIC INDEBTED-
13 NESS.—For purposes of subparagraph (A), the
14 term ‘excess domestic indebtedness’ means, with
15 respect to any worldwide affiliated group, the
16 excess (if any) of—

17 “(i) the total indebtedness of the do-
18 mestic corporations which are members of
19 such group, over

20 “(ii) **[100]** percent of the amount
21 which the total indebtedness of such do-
22 mestic corporations would be if the ratio of
23 such indebtedness to the total equity of
24 such domestic corporations equaled the
25 ratio which—

1 “(I) the total indebtedness of
2 such group, bears to

3 “(II) the total equity of such
4 group.

5 “(C) TOTAL EQUITY.—For purposes of
6 subparagraph (B), the term ‘total equity’
7 means, with respect to one or more corpora-
8 tions, the excess (if any) of—

9 “(i) the money and all other assets of
10 such corporations, over

11 “(ii) the total indebtedness of such
12 corporations.

13 “(D) SPECIAL RULES FOR DETERMINING
14 DEBT AND EQUITY.—For purposes of this para-
15 graph—

16 “(i) APPLICATION OF CERTAIN GEN-
17 ERAL RULES.—Rules similar to the rules
18 of clauses (i), (ii), and (iii) of subsection
19 (j)(2)(C) shall apply.

20 “(ii) INTRAGROUP DEBT AND EQUITY
21 INTERESTS DISREGARDED.—The total in-
22 debtedness, and the assets, of any group of
23 corporations shall be determined by treat-
24 ing all members of such group as one cor-
25 poration.

1 “(iii) DETERMINATION OF ASSETS OF
2 DOMESTIC GROUP.—The assets of the do-
3 mestic corporations which are members of
4 any worldwide affiliated group shall be de-
5 termined by disregarding any interest held
6 by any such domestic corporation in any
7 foreign corporation which is a member of
8 such group.

9 “(4) OTHER DEFINITIONS.—For purposes of
10 this subsection—

11 “(A) WORLDWIDE AFFILIATED GROUP.—
12 The term ‘worldwide affiliated group’ has the
13 meaning which would be given such term by
14 section 864(f)(1)(C) if section 1504(a) were ap-
15 plied by substituting ‘more than 50 percent’ for
16 ‘at least 80 percent’ each place it appears.

17 “(B) NET INTEREST EXPENSE.—The term
18 ‘net interest expense’ has the meaning given
19 such term by subsection (j)(6)(B).”.

20 (b) COORDINATION WITH LIMITATION ON RELATED
21 PARTY INDEBTEDNESS.—Paragraph (1) of section 163(j)
22 is amended by adding at the end the following new sub-
23 paragraph:

24 “(C) COORDINATION WITH LIMITATION ON
25 EXCESS DOMESTIC INDEBTEDNESS.—The

1 amount disallowed under subparagraph (A)
2 with respect to any corporation for any taxable
3 year shall be reduced by any amount disallowed
4 under subsection (n)(1) with respect to such
5 corporation for such taxable year.”.

6 (c) EFFECTIVE DATE.—The amendments made by
7 this section shall apply to taxable years beginning after
8 December 31, 2012.

9 **TITLE IV—OTHER REFORMS**

10 **SEC. 401. [OTHER REFORMS TO BE PROVIDED].**