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IN THE SENATE OF THE UNITED STATES

SEPTEMBER 14, 2000

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Reported by Mr. ROTH with amendments

[Omit the part struck through and insert the part printed in italic]

AN ACT

To amend the Internal Revenue Code of 1986 to repeal the provisions relating to foreign sales corporations (FSCs) and to exclude extraterritorial income from gross income.

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.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “FSC Repeal and Extraterritorial Income Exclusion Act
6 of 2000”.

1 (b) AMENDMENT OF 1986 CODE.—Except as other-
2 wise expressly provided, whenever in this Act an amend-
3 ment or repeal is expressed in terms of an amendment
4 to, or repeal of, a section or other provision, the reference
5 shall be considered to be made to a section or other provi-
6 sion of the Internal Revenue Code of 1986.

7 **SEC. 2. REPEAL OF FOREIGN SALES CORPORATION RULES.**

8 Subpart C of part III of subchapter N of chapter 1
9 (relating to taxation of foreign sales corporations) is here-
10 by repealed.

11 **SEC. 3. TREATMENT OF EXTRATERRITORIAL INCOME.**

12 (a) IN GENERAL.—Part III of subchapter B of chap-
13 ter 1 (relating to items specifically excluded from gross
14 income) is amended by inserting before section 115 the
15 following new section:

16 **“SEC. 114. EXTRATERRITORIAL INCOME.**

17 “(a) EXCLUSION.—Gross income does not include
18 extraterritorial income.

19 “(b) EXCEPTION.—Subsection (a) shall not apply to
20 extraterritorial income which is not qualifying foreign
21 trade income as determined under subpart E of part III
22 of subchapter N.

23 “(c) DISALLOWANCE OF DEDUCTIONS.—

24 “(1) IN GENERAL.—Any deduction of a tax-
25 payer allocated under paragraph (2) to

1 extraterritorial income of the taxpayer excluded from
2 gross income under subsection (a) shall not be al-
3 lowed.

4 “(2) ALLOCATION.—Any deduction of the tax-
5 payer properly apportioned and allocated to the
6 extraterritorial income derived by the taxpayer from
7 any transaction shall be allocated on a proportionate
8 basis between—

9 “(A) the extraterritorial income derived
10 from such transaction which is excluded from
11 gross income under subsection (a), and

12 “(B) the extraterritorial income derived
13 from such transaction which is not so excluded.

14 “(d) DENIAL OF CREDITS FOR CERTAIN FOREIGN
15 TAXES.—Notwithstanding any other provision of this
16 chapter, no credit shall be allowed under this chapter for
17 any income, war profits, and excess profits taxes paid or
18 accrued to any foreign country or possession of the United
19 States with respect to extraterritorial income which is ex-
20 cluded from gross income under subsection (a).

21 “(e) EXTRATERRITORIAL INCOME.—For purposes of
22 this section, the term ‘extraterritorial income’ means the
23 gross income of the taxpayer attributable to foreign trad-
24 ing gross receipts (as defined in section 942) of the tax-
25 payer.”.

1 (b) QUALIFYING FOREIGN TRADE INCOME.—Part III
 2 of subchapter N of chapter 1 is amended by inserting after
 3 subpart D the following new subpart:

4 **“Subpart E—Qualifying Foreign Trade Income**

“Sec. 941. Qualifying foreign trade income.

“Sec. 942. Foreign trading gross receipts.

“Sec. 943. Other definitions and special rules.

5 **“SEC. 941. QUALIFYING FOREIGN TRADE INCOME.**

6 “(a) QUALIFYING FOREIGN TRADE INCOME.—For
 7 purposes of this subpart and section 114—

8 “(1) IN GENERAL.—The term ‘qualifying for-
 9 eign trade income’ means, with respect to any trans-
 10 action, the amount of gross income which, if ex-
 11 cluded, will result in a reduction of the taxable in-
 12 come of the taxpayer from such transaction equal to
 13 the greatest of—

14 “(A) 30 percent of the foreign sale and
 15 leasing income derived by the taxpayer from
 16 such transaction,

17 “(B) 1.2 percent of the foreign trading
 18 gross receipts derived by the taxpayer from the
 19 transaction, or

20 “(C) 15 percent of the foreign trade in-
 21 come derived by the taxpayer from the trans-
 22 action.

1 In no event shall the amount determined under sub-
2 paragraph (B) exceed 200 percent of the amount de-
3 termined under subparagraph (C).

4 “(2) ALTERNATIVE COMPUTATION.—A taxpayer
5 may compute its qualifying foreign trade income
6 under a subparagraph of paragraph (1) other than
7 the subparagraph which results in the greatest
8 amount of such income.

9 “(3) LIMITATION ON USE OF FOREIGN TRADING
10 GROSS RECEIPTS METHOD.—If any person computes
11 its qualifying foreign trade income from any trans-
12 action with respect to any property under paragraph
13 (1)(B), the qualifying foreign trade income of such
14 person (or any related person) with respect to any
15 other transaction involving such property shall be
16 zero.

17 “(4) RULES FOR MARGINAL COSTING.—The
18 Secretary shall prescribe regulations setting forth
19 rules for the allocation of expenditures in computing
20 foreign trade income under paragraph (1)(C) in
21 those cases where a taxpayer is seeking to establish
22 or maintain a market for qualifying foreign trade
23 property.

24 “(5) PARTICIPATION IN INTERNATIONAL BOY-
25 COTTS, ETC.—Under regulations prescribed by the

1 Secretary, the qualifying foreign trade income of a
2 taxpayer for any taxable year shall be reduced (but
3 not below zero) by the sum of—

4 “(A) an amount equal to such income mul-
5 tiplied by the international boycott factor deter-
6 mined under section 999, and

7 “(B) any illegal bribe, kickback, or other
8 payment (within the meaning of section 162(e))
9 paid by or on behalf of the taxpayer directly or
10 indirectly to an official, employee, or agent in
11 fact of a government.

12 “(b) FOREIGN TRADE INCOME.—For purposes of
13 this subpart—

14 “(1) IN GENERAL.—The term ‘foreign trade in-
15 come’ means the taxable income of the taxpayer at-
16 tributable to foreign trading gross receipts of the
17 taxpayer.

18 “(2) SPECIAL RULE FOR COOPERATIVES.—In
19 any case in which an organization to which part I
20 of subchapter T applies which is engaged in the
21 marketing of agricultural or horticultural products
22 sells qualifying foreign trade property, in computing
23 the taxable income of such cooperative, there shall
24 not be taken into account any deduction allowable
25 under subsection (b) or (c) of section 1382 (relating

1 to patronage dividends, per-unit retain allocations,
2 and nonpatronage distributions).

3 “(c) FOREIGN SALE AND LEASING INCOME.—For
4 purposes of this section—

5 “(1) IN GENERAL.—The term ‘foreign sale and
6 leasing income’ means, with respect to any
7 transaction—

8 “(A) foreign trade income properly allo-
9 cable to activities which—

10 “(i) are described in paragraph
11 (2)(A)(i) or (3) of section 942(b), and

12 “(ii) are performed by the taxpayer
13 (or any person acting under a contract
14 with such taxpayer) outside the United
15 States, or

16 “(B) foreign trade income derived by the
17 taxpayer in connection with the lease or rental
18 of qualifying foreign trade property for use by
19 the lessee outside the United States.

20 “(2) SPECIAL RULES FOR LEASED PROP-
21 ERTY.—

22 “(A) SALES INCOME.—The term ‘foreign
23 sale and leasing income’ includes any foreign
24 trade income derived by the taxpayer from the
25 sale of property described in paragraph (1)(B).

1 “(B) LIMITATION IN CERTAIN CASES.—Ex-
2 cept as provided in regulations, in the case of
3 property which—

4 “(i) was manufactured, produced,
5 grown, or extracted by the taxpayer, or

6 “(ii) was acquired by the taxpayer
7 from a related person for a price which
8 was not determined in accordance with the
9 rules of section 482,

10 the amount of foreign trade income which may be
11 treated as foreign sale and leasing income under
12 paragraph (1)(B) or subparagraph (A) of this para-
13 graph with respect to any transaction involving such
14 property shall not exceed the amount which would
15 have been determined if the taxpayer had acquired
16 such property for the price determined in accordance
17 with the rules of section 482.

18 “(3) SPECIAL RULES.—

19 “(A) EXCLUDED PROPERTY.—Foreign sale
20 and leasing income shall not include any income
21 properly allocable to excluded property de-
22 scribed in subparagraph (B) of section
23 943(a)(3) (relating to intangibles).

24 “(B) ONLY DIRECT EXPENSES TAKEN
25 INTO ACCOUNT.—For purposes of this sub-

1 section, any expense other than a directly allo-
2 cable expense shall not be taken into account in
3 computing foreign trade income.

4 **“SEC. 942. FOREIGN TRADING GROSS RECEIPTS.**

5 “(a) FOREIGN TRADING GROSS RECEIPTS.—

6 “(1) IN GENERAL.—Except as otherwise pro-
7 vided in this section, for purposes of this subpart,
8 the term ‘foreign trading gross receipts’ means the
9 gross receipts of the taxpayer which are—

10 “(A) from the sale, exchange, or other dis-
11 position of qualifying foreign trade property,

12 “(B) from the lease or rental of qualifying
13 foreign trade property for use by the lessee out-
14 side the United States,

15 “(C) for services which are related and
16 subsidiary to—

17 “(i) any sale, exchange, or other dis-
18 position of qualifying foreign trade prop-
19 erty by such taxpayer, or

20 “(ii) any lease or rental of qualifying
21 foreign trade property described in sub-
22 paragraph (B) by such taxpayer,

23 “(D) for engineering or architectural serv-
24 ices for construction projects located (or pro-
25 posed for location) outside the United States, or

1 “(E) for the performance of managerial
2 services for a person other than a related per-
3 son in furtherance of the production of foreign
4 trading gross receipts described in subpara-
5 graph (A), (B), or (C).

6 Subparagraph (E) shall not apply to a taxpayer for
7 any taxable year unless at least 50 percent of its for-
8 eign trading gross receipts (determined without re-
9 gard to this sentence) for such taxable year is de-
10 rived from activities described in subparagraph (A),
11 (B), or (C).

12 “(2) CERTAIN RECEIPTS EXCLUDED ON BASIS
13 OF USE; SUBSIDIZED RECEIPTS EXCLUDED.—The
14 term ‘foreign trading gross receipts’ shall not in-
15 clude receipts of a taxpayer from a transaction if—

16 “(A) the qualifying foreign trade property
17 or services—

18 “(i) are for ultimate use in the United
19 States, or

20 “(ii) are for use by the United States
21 or any instrumentality thereof and such
22 use of qualifying foreign trade property or
23 services is required by law or regulation, or

24 “(B) such transaction is accomplished by a
25 subsidy granted by the government (or any in-

1 strumentality thereof) of the country or posses-
2 sion in which the property is manufactured,
3 produced, grown, or extracted.

4 “(3) ELECTION TO EXCLUDE CERTAIN RE-
5 CEIPTS.—The term ‘foreign trading gross receipts’
6 shall not include gross receipts of a taxpayer from
7 a transaction if the taxpayer elects not to have such
8 receipts taken into account for purposes of this sub-
9 part.

10 “(b) FOREIGN ECONOMIC PROCESS REQUIRE-
11 MENTS.—

12 “(1) IN GENERAL.—Except as provided in sub-
13 section (c), a taxpayer shall be treated as having for-
14 eign trading gross receipts from any transaction only
15 if economic processes with respect to such trans-
16 action take place outside the United States as re-
17 quired by paragraph (2).

18 “(2) REQUIREMENT.—

19 “(A) IN GENERAL.—The requirements of
20 this paragraph are met with respect to the
21 gross receipts of a taxpayer derived from any
22 transaction if—

23 “(i) such taxpayer (or any person act-
24 ing under a contract with such taxpayer)
25 has participated outside the United States

1 in the solicitation (other than advertising),
2 the negotiation, or the making of the con-
3 tract relating to such transaction, and

4 “(ii) the foreign direct costs incurred
5 by the taxpayer attributable to the trans-
6 action equal or exceed 50 percent of the
7 total direct costs attributable to the trans-
8 action.

9 “(B) ALTERNATIVE 85-PERCENT TEST.—A
10 taxpayer shall be treated as satisfying the re-
11 quirements of subparagraph (A)(ii) with respect
12 to any transaction if, with respect to each of at
13 least 2 subparagraphs of paragraph (3), the
14 foreign direct costs incurred by such taxpayer
15 attributable to activities described in such sub-
16 paragraph equal or exceed 85 percent of the
17 total direct costs attributable to activities de-
18 scribed in such subparagraph.

19 “(C) DEFINITIONS.—For purposes of this
20 paragraph—

21 “(i) TOTAL DIRECT COSTS.—The term
22 ‘total direct costs’ means, with respect to
23 any transaction, the total direct costs in-
24 curred by the taxpayer attributable to ac-
25 tivities described in paragraph (3) per-

1 formed at any location by the taxpayer or
2 any person acting under a contract with
3 such taxpayer.

4 “(ii) FOREIGN DIRECT COSTS.—The
5 term ‘foreign direct costs’ means, with re-
6 spect to any transaction, the portion of the
7 total direct costs which are attributable to
8 activities performed outside the United
9 States.

10 “(3) ACTIVITIES RELATING TO QUALIFYING
11 FOREIGN TRADE PROPERTY.—The activities de-
12 scribed in this paragraph are any of the following
13 with respect to qualifying foreign trade property—

14 “(A) advertising and sales promotion,

15 “(B) the processing of customer orders
16 and the arranging for delivery,

17 “(C) transportation outside the United
18 States in connection with delivery to the cus-
19 tomer,

20 “(D) the determination and transmittal of
21 a final invoice or statement of account or the
22 receipt of payment, and

23 “(E) the assumption of credit risk.

24 “(4) ECONOMIC PROCESSES PERFORMED BY
25 RELATED PERSONS.—A taxpayer shall be treated as

1 meeting the requirements of this subsection with re-
2 spect to any sales transaction involving any property
3 if any related person has met such requirements in
4 such transaction or any other sales transaction in-
5 volving such property.

6 “(c) EXCEPTION FROM FOREIGN ECONOMIC PROC-
7 ESS REQUIREMENT.—

8 “(1) IN GENERAL.—The requirements of sub-
9 section (b) shall be treated as met for any taxable
10 year if the foreign trading gross receipts of the tax-
11 payer for such year do not exceed \$5,000,000.

12 “(2) RECEIPTS OF RELATED PERSONS AGGRE-
13 GATED.—All related persons shall be treated as one
14 person for purposes of paragraph (1), and the limi-
15 tation under paragraph (1) shall be allocated among
16 such persons in a manner provided in regulations
17 prescribed by the Secretary.

18 “(3) SPECIAL RULE FOR PASS-THRU ENTI-
19 TIES.—In the case of a partnership, S corporation,
20 or other pass-thru entity, the limitation under para-
21 graph (1) shall apply with respect to the partner-
22 ship, S corporation, or entity and with respect to
23 each partner, shareholder, or other owner.

1 **“SEC. 943. OTHER DEFINITIONS AND SPECIAL RULES.**

2 “(a) QUALIFYING FOREIGN TRADE PROPERTY.—For
3 purposes of this subpart—

4 “(1) IN GENERAL.—The term ‘qualifying for-
5 eign trade property’ means property—

6 “(A) manufactured, produced, grown, or
7 extracted within or outside the United States,

8 “(B) held primarily for sale, lease, or rent-
9 al, in the ordinary course of trade or business
10 for direct use, consumption, or disposition out-
11 side the United States, and

12 “(C) not more than 50 percent of the fair
13 market value of which is attributable to—

14 “(i) articles manufactured, produced,
15 grown, or extracted outside the United
16 States, and

17 “(ii) direct costs for labor (determined
18 under the principles of section 263A) per-
19 formed outside the United States.

20 For purposes of subparagraph (C), the fair market
21 value of any article imported into the United States
22 shall be its appraised value, as determined by the
23 Secretary under section 402 of the Tariff Act of
24 1930 (19 U.S.C. 1401a) in connection with its im-
25 portation, and the direct costs for labor under clause
26 (ii) do not include costs that would be treated under

1 the principles of section 263A as direct labor costs
2 attributable to articles described in clause (i).

3 “(2) U.S. TAXATION TO ENSURE CONSISTENT
4 TREATMENT.—Property which (without regard to
5 this paragraph) is qualifying foreign trade property
6 and which is manufactured, produced, grown, or ex-
7 tracted outside the United States shall be treated as
8 qualifying foreign trade property only if it is manu-
9 factured, produced, grown, or extracted by—

10 “(A) a domestic corporation,

11 “(B) an individual who is a citizen or resi-
12 dent of the United States,

13 “(C) a foreign corporation with respect to
14 which an election under subsection (e) (relating
15 to foreign corporations electing to be subject to
16 United States taxation) is in effect, or

17 “(D) a partnership or other pass-thru enti-
18 ty all of the partners or owners of which are de-
19 scribed in subparagraph (A), (B), or (C).

20 Except as otherwise provided by the Secretary,
21 tiered partnerships or pass-thru entities shall be
22 treated as described in subparagraph (D) if each of
23 the partnerships or entities is directly or indirectly
24 wholly owned by persons described in subparagraph
25 (A), (B), or (C).

1 “(3) EXCLUDED PROPERTY.—The term ‘quali-
2 fying foreign trade property’ shall not include—

3 “(A) property leased or rented by the tax-
4 payer for use by any related person,

5 “(B) patents, inventions, models, designs,
6 formulas, or processes whether or not patented,
7 copyrights (other than films, tapes, records, or
8 similar reproductions, and other than computer
9 software (whether or not patented), for com-
10 mercial or home use), goodwill, trademarks,
11 trade brands, franchises, or other like property,

12 “(C) oil or gas (or any primary product
13 thereof),

14 “(D) products the transfer of which is pro-
15 hibited or curtailed to effectuate the policy set
16 forth in paragraph (2)(C) of section 3 of Public
17 Law 96–72, or

18 “(E) any unprocessed timber which is a
19 softwood.

20 For purposes of subparagraph (E), the term ‘un-
21 processed timber’ means any log, cant, or similar
22 form of timber.

23 “(4) PROPERTY IN SHORT SUPPLY.—If the
24 President determines that the supply of any prop-
25 erty described in paragraph (1) is insufficient to

1 meet the requirements of the domestic economy, the
2 President may by Executive order designate the
3 property as in short supply. Any property so des-
4 ignated shall not be treated as qualifying foreign
5 trade property during the period beginning with the
6 date specified in the Executive order and ending
7 with the date specified in an Executive order setting
8 forth the President's determination that the prop-
9 erty is no longer in short supply.

10 “(b) OTHER DEFINITIONS AND RULES.—For pur-
11 poses of this subpart—

12 “(1) TRANSACTION.—

13 “(A) IN GENERAL.—The term ‘transaction’
14 means—

15 “(i) any sale, exchange, or other dis-
16 position,

17 “(ii) any lease or rental, and

18 “(iii) any furnishing of services.

19 “(B) GROUPING OF TRANSACTIONS.—To
20 the extent provided in regulations, any provision
21 of this subpart which, but for this subpara-
22 graph, would be applied on a transaction-by-
23 transaction basis may be applied by the tax-
24 payer on the basis of groups of transactions
25 based on product lines or recognized industry or

1 trade usage. Such regulations may permit dif-
2 ferent groupings for different purposes.

3 “(2) UNITED STATES DEFINED.—The term
4 ‘United States’ includes the Commonwealth of Puer-
5 to Rico. The preceding sentence shall not apply for
6 purposes of determining whether a corporation is a
7 domestic corporation.

8 “(3) RELATED PERSON.—A person shall be re-
9 lated to another person if such persons are treated
10 as a single employer under subsection (a) or (b) of
11 section 52 or subsection (m) or (o) of section 414,
12 except that determinations under subsections (a)
13 and (b) of section 52 shall be made without regard
14 to section 1563(b).

15 “(4) GROSS AND TAXABLE INCOME.—Section
16 114 shall not be taken into account in determining
17 the amount of gross income or foreign trade income
18 from any transaction.

19 “(c) SOURCE RULE.—Under regulations, in the case
20 of qualifying foreign trade property manufactured, pro-
21 duced, grown, or extracted within the United States, the
22 amount of income of a taxpayer from any sales transaction
23 with respect to such property which is treated as from
24 sources without the United States shall not exceed—

1 “(1) in the case of a taxpayer computing its
2 qualifying foreign trade income under section
3 941(a)(1)(B), the amount of the taxpayer’s foreign
4 trade income which would (but for this subsection)
5 be treated as from sources without the United
6 States if the foreign trade income were reduced by
7 an amount equal to 4 percent of the foreign trading
8 gross receipts with respect to the transaction, and

9 “(2) in the case of a taxpayer computing its
10 qualifying foreign trade income under section
11 941(a)(1)(C), 50 percent of the amount of the tax-
12 payer’s foreign trade income which would (but for
13 this subsection) be treated as from sources without
14 the United States.

15 “(d) TREATMENT OF WITHHOLDING TAXES.—

16 “(1) IN GENERAL.—For purposes of section
17 114(d), any withholding tax shall not be treated as
18 paid or accrued with respect to extraterritorial in-
19 come which is excluded from gross income under
20 section 114(a). For purposes of this paragraph, the
21 term ‘withholding tax’ means any tax which is im-
22 posed on a basis other than residence and for which
23 credit is allowable under section 901 or 903.

24 “(2) EXCEPTION.—Paragraph (1) shall not
25 apply to any taxpayer with respect to extraterritorial

1 income from any transaction if the taxpayer com-
2 putes its qualifying foreign trade income with re-
3 spect to the transaction under section 941(a)(1)(A).

4 “(e) ELECTION TO BE TREATED AS DOMESTIC COR-
5 PORATION.—

6 “(1) IN GENERAL.—An applicable foreign cor-
7 poration may elect to be treated as a domestic cor-
8 poration for all purposes of this title if such corpora-
9 tion waives all benefits to such corporation granted
10 by the United States under any treaty. No election
11 under section 1362(a) may be made with respect to
12 such corporation.

13 “(2) APPLICABLE FOREIGN CORPORATION.—
14 For purposes of paragraph (1), the term ‘applicable
15 foreign corporation’ means any foreign corporation
16 if—

17 “(A) such corporation manufactures, pro-
18 duces, grows, or extracts property in the ordi-
19 nary course of such corporation’s trade or busi-
20 ness, or

21 “(B) substantially all of the gross receipts
22 of such corporation may reasonably be expected
23 to be foreign trading gross receipts.

24 “(3) PERIOD OF ELECTION.—

1 “(A) IN GENERAL.—Except as otherwise
2 provided in this paragraph, an election under
3 paragraph (1) shall apply to the taxable year
4 for which made and all subsequent taxable
5 years unless revoked by the taxpayer. Any rev-
6 ocation of such election shall apply to taxable
7 years beginning after such revocation.

8 “(B) TERMINATION.—If a corporation
9 which made an election under paragraph (1) for
10 any taxable year fails to meet the requirements
11 of subparagraph (A) or (B) of paragraph (2)
12 for any subsequent taxable year, such election
13 shall not apply to any taxable year beginning
14 after such subsequent taxable year.

15 “(C) EFFECT OF REVOCATION OR TERMI-
16 NATION.—If a corporation which made an elec-
17 tion under paragraph (1) revokes such election
18 or such election is terminated under subpara-
19 graph (B), such corporation (and any successor
20 corporation) may not make such election for
21 any of the 5 taxable years beginning with the
22 first taxable year for which such election is not
23 in effect as a result of such revocation or termi-
24 nation.

25 “(4) SPECIAL RULES.—

1 “(A) REQUIREMENTS.—This subsection
2 shall not apply to an applicable foreign corpora-
3 tion if such corporation fails to meet the re-
4 quirements (if any) which the Secretary may
5 prescribe to ensure that the taxes imposed by
6 this chapter on such corporation are paid.

7 “(B) EFFECT OF ELECTION, REVOCATION,
8 AND TERMINATION.—

9 “(i) ELECTION.—For purposes of sec-
10 tion 367, a foreign corporation making an
11 election under this subsection shall be
12 treated as transferring (as of the first day
13 of the first taxable year to which the elec-
14 tion applies) all of its assets to a domestic
15 corporation in connection with an exchange
16 to which section 354 applies.

17 “(ii) REVOCATION AND TERMI-
18 NATION.—For purposes of section 367,
19 if—

20 “(I) an election is made by a cor-
21 poration under paragraph (1) for any
22 taxable year, and

23 “(II) such election ceases to
24 apply for any subsequent taxable year,

1 such corporation shall be treated as a domestic
2 corporation transferring (as of the 1st day of
3 the first such subsequent taxable year to which
4 such election ceases to apply) all of its property
5 to a foreign corporation in connection with an
6 exchange to which section 354 applies.

7 “(C) ELIGIBILITY FOR ELECTION.—The
8 Secretary may by regulation designate one or
9 more classes of corporations which may not
10 make the election under this subsection.

11 “(f) RULES RELATING TO ALLOCATIONS OF QUALI-
12 FYING FOREIGN TRADE INCOME FROM SHARED PART-
13 NERSHIPS.—

14 “(1) IN GENERAL.—If—

15 “(A) a partnership maintains a separate
16 account for transactions (to which this subpart
17 applies) with each partner,

18 “(B) distributions to each partner with re-
19 spect to such transactions are based on the
20 amounts in the separate account maintained
21 with respect to such partner, and

22 “(C) such partnership meets such other re-
23 quirements as the Secretary may by regulations
24 prescribe,

1 then such partnership shall allocate to each partner
2 items of income, gain, loss, and deduction (including
3 qualifying foreign trade income) from any trans-
4 action to which this subpart applies on the basis of
5 such separate account.

6 “(2) SPECIAL RULES.—For purposes of this
7 subpart, in the case of a partnership to which para-
8 graph (1) applies—

9 “(A) any partner’s interest in the partner-
10 ship shall not be taken into account in deter-
11 mining whether such partner is a related person
12 with respect to any other partner, and

13 “(B) the election under section 942(a)(3)
14 shall be made separately by each partner with
15 respect to any transaction for which the part-
16 nership maintains separate accounts for each
17 partner.

18 “(g) EXCLUSION FOR PATRONS OF AGRICULTURAL
19 AND HORTICULTURAL COOPERATIVES.—Any amount de-
20 scribed in paragraph (1) or (3) of section 1385(a)—

21 “(1) which is received by a person from an or-
22 ganization to which part I of subchapter T applies
23 which is engaged in the marketing of agricultural or
24 horticultural products, and

1 “(2) which is designated by the organization as
2 allocable to qualifying foreign trade income in a
3 written notice mailed to its patrons during the pay-
4 ment period described in section 1382(d),
5 shall be treated as qualifying foreign trade income of such
6 person for purposes of section 114. The taxable income
7 of the organization shall not be reduced under section
8 1382 by reason of any amount to which the preceding sen-
9 tence applies.”.

10 **SEC. 4. TECHNICAL AND CONFORMING AMENDMENTS.**

11 (1) The second sentence of section
12 56(g)(4)(B)(i) is amended by inserting before the
13 period “or under section 114”.

14 ~~(2) Section 245 is amended by adding at the~~
15 ~~end the following new subsection:~~

16 ~~“(d) CERTAIN DIVIDENDS ALLOCABLE TO QUALI-~~
17 ~~FYING FOREIGN TRADE INCOME.—In the case of a domes-~~
18 ~~tic corporation which is a United States shareholder (as~~
19 ~~defined in section 951(b)) of a controlled foreign corpora-~~
20 ~~tion (as defined in section 957), there shall be allowed as~~
21 ~~a deduction an amount equal to 100 percent of any divi-~~
22 ~~dend received from such controlled foreign corporation~~
23 ~~which is distributed out of earnings and profits attrib-~~
24 ~~utable to qualifying foreign trade income (as defined in~~
25 ~~section 941(a)).”.~~

1 ~~(2)~~ (2) Section 275(a) is amended—

2 (A) by striking “or” at the end of para-
3 graph (4)(A), by striking the period at the end
4 of paragraph (4)(B) and inserting “, or”, and
5 by adding at the end of paragraph (4) the fol-
6 lowing new subparagraph:

7 “(C) such taxes are paid or accrued with
8 respect to qualifying foreign trade income (as
9 defined in section 941).”; and

10 (B) by adding at the end the following the
11 following new sentence: “A rule similar to the
12 rule of section 943(d) shall apply for purposes
13 of paragraph (4)(C).”.

14 ~~(3)~~ (3) Paragraph (3) of section 864(e) is
15 amended—

16 (A) by striking “For purposes of” and in-
17 serting:

18 “(A) IN GENERAL.—For purposes of”; and

19 (B) by adding at the end the following new
20 subparagraph:

21 “(B) ASSETS PRODUCING EXEMPT
22 EXTRATERRITORIAL INCOME.—For purposes of
23 allocating and apportioning any interest ex-
24 pense, there shall not be taken into account any
25 qualifying foreign trade property (as defined in

1 section 943(a)) which is held by the taxpayer
2 for lease or rental in the ordinary course of
3 trade or business for use by the lessee outside
4 the United States (as defined in section
5 943(b)(2)).”.

6 ~~(5)~~ (4) Section 903 is amended by striking
7 “164(a)” and inserting “114, 164(a),”.

8 ~~(6)~~ (5) Section 999(c)(1) is amended by insert-
9 ing “941(a)(5),” after “908(a),”.

10 ~~(7)~~ (6) The table of sections for part III of sub-
11 chapter B of chapter 1 is amended by inserting be-
12 fore the item relating to section 115 the following
13 new item:

“Sec. 114. Extraterritorial income.”.

14 ~~(8)~~ (7) The table of subparts for part III of
15 subchapter N of chapter 1 is amended by striking
16 the item relating to subpart E and inserting the fol-
17 lowing new item:

“Subpart E. Qualifying foreign trade income.”.

18 ~~(9)~~ (8) The table of subparts for part III of
19 subchapter N of chapter 1 is amended by striking
20 the item relating to subpart C.

21 **SEC. 5. EFFECTIVE DATE.**

22 (a) IN GENERAL.—The amendments made by this
23 Act shall apply to transactions after September 30, 2000.

1 (b) NO NEW FSCS; TERMINATION OF INACTIVE
2 FSCS.—

3 (1) NO NEW FSCS.—No corporation may elect
4 after September 30, 2000, to be a FSC (as defined
5 in section 922 of the Internal Revenue Code of
6 1986, as in effect before the amendments made by
7 this Act).

8 (2) TERMINATION OF INACTIVE FSCS.—If a
9 FSC has no foreign trade income (as defined in sec-
10 tion 923(b) of such Code, as so in effect) for any pe-
11 riod of 5 consecutive taxable years beginning after
12 December 31, 2001, such FSC shall cease to be
13 treated as a FSC for purposes of such Code for any
14 taxable year beginning after such period.

15 (c) TRANSITION PERIOD FOR EXISTING FOREIGN
16 SALES CORPORATIONS.—

17 (1) IN GENERAL.—In the case of a FSC (as so
18 defined) in existence on September 30, 2000, and at
19 all times thereafter, the amendments made by this
20 Act shall not apply to any transaction in the ordi-
21 nary course of trade or business involving a FSC
22 which occurs—

23 (A) before January 1, 2002; or

24 (B) after December 31, 2001, pursuant to
25 a binding contract—

1 (i) which is between the FSC (or any
2 related person) and any person which is
3 not a related person; and

4 (ii) which is in effect on September
5 30, 2000, and at all times thereafter.

6 For purposes of this paragraph, a binding contract
7 shall include a purchase option, renewal option, or
8 replacement option which is included in such con-
9 tract and which is enforceable against the seller or
10 lessor.

11 (2) ELECTION TO HAVE AMENDMENTS APPLY
12 EARLIER.—A taxpayer may elect to have the amend-
13 ments made by this Act apply to any transaction by
14 a FSC or any related person to which such amend-
15 ments would apply but for the application of para-
16 graph (1). Such election shall be effective for the
17 taxable year for which made and all subsequent tax-
18 able years, and, once made, may be revoked only
19 with the consent of the Secretary of the Treasury.

20 (3) RELATED PERSON.—For purposes of this
21 subsection, the term “related person” has the mean-
22 ing given to such term by section 943(b)(3) of such
23 Code, as added by this Act.

24 (d) SPECIAL RULES RELATING TO LEASING TRANS-
25 ACTIONS.—

1 (1) SALES INCOME.—If foreign trade income in
2 connection with the lease or rental of property de-
3 scribed in section 927(a)(1)(B) of such Code (as in
4 effect before the amendments made by this Act) is
5 treated as exempt foreign trade income for purposes
6 of section 921(a) of such Code (as so in effect), such
7 property shall be treated as property described in
8 section 941(c)(1)(B) of such Code (as added by this
9 Act) for purposes of applying section 941(c)(2) of
10 such Code (as so added) to any subsequent trans-
11 action involving such property to which the amend-
12 ments made by this Act apply.

13 (2) LIMITATION ON USE OF GROSS RECEIPTS
14 METHOD.—If any person computed its foreign trade
15 income from any transaction with respect to any
16 property on the basis of a transfer price determined
17 under the method described in section 925(a)(1) of
18 such Code (as in effect before the amendments made
19 by this Act), then the qualifying foreign trade in-
20 come (as defined in section 941(a) of such Code, as
21 in effect after such amendment) of such person (or
22 any related person) with respect to any other trans-
23 action involving such property (and to which the
24 amendments made by this Act apply) shall be zero.

Calendar No. 817

106TH CONGRESS
2D SESSION

H. R. 4986

[Report No. 106-416]

AN ACT

To amend the Internal Revenue Code of 1986 to repeal the provisions relating to foreign sales corporations (FSCs) and to exclude extraterritorial income from gross income.

SEPTEMBER 20, 2000

Reported with amendments