

Calendar No. 500106TH CONGRESS
2^D SESSION**H. R. 4986****[Report No. 106-845]**

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.

IN THE HOUSE OF REPRESENTATIVES

JULY 27, 2000

Mr. ARCHER introduced the following bill; which was referred to the Committee on Ways and Means

SEPTEMBER 13, 2000

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

[Strike out all after the enacting clause and insert the part printed in italics]

[For text of introduced bill, see copy of bill as introduced on July 27, 2000]

A BILL

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,*

1 **SECTION 1. SHORT TITLE.**

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

5 (b) *AMENDMENT OF 1986 CODE.*—*Except as otherwise*
6 *expressly provided, whenever in this Act an amendment or*
7 *repeal is expressed in terms of an amendment to, or repeal*
8 *of, a section or other provision, the reference shall be consid-*
9 *ered to be made to a section or other provision of the Inter-*
10 *nal Revenue Code of 1986.*

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

12 *Subpart C of part III of subchapter N of chapter 1*
13 *(relating to taxation of foreign sales corporations) is hereby*
14 *repealed.*

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

16 (a) *IN GENERAL.*—*Part III of subchapter B of chapter*
17 *1 (relating to items specifically excluded from gross income)*
18 *is amended by inserting before section 115 the following new*
19 *section:*

20 **“SEC. 114. EXTRATERRITORIAL INCOME.**

21 *“(a) EXCLUSION.*—*Gross income does not include*
22 *extraterritorial income.*

23 *“(b) EXCEPTION.*—*Subsection (a) shall not apply to*
24 *extraterritorial income which is not qualifying foreign*
25 *trade income as determined under subpart E of part III*
26 *of subchapter N.*

1 “(c) *DISALLOWANCE OF DEDUCTIONS.*—

2 “(1) *IN GENERAL.*—*Any deduction of a taxpayer*
3 *allocated under paragraph (2) to extraterritorial in-*
4 *come of the taxpayer excluded from gross income*
5 *under subsection (a) shall not be allowed.*

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

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

14 “(B) *the extraterritorial income derived*
15 *from such transaction which is not so excluded.*

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

23 “(e) *EXTRATERRITORIAL INCOME.*—*For purposes of*
24 *this section, the term ‘extraterritorial income’ means the*

1 *gross income of the taxpayer attributable to foreign trading*
 2 *gross receipts (as defined in section 942) of the taxpayer.”*

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

6 **“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.

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

8 *“(a) QUALIFYING FOREIGN TRADE INCOME.—For pur-*
 9 *poses of this subpart and section 114—*

10 *“(1) IN GENERAL.—The term ‘qualifying foreign*
 11 *trade income’ means, with respect to any transaction,*
 12 *the amount of gross income which, if excluded, will*
 13 *result in a reduction of the taxable income of the tax-*
 14 *payer from such transaction equal to the greatest of—*

15 *“(A) 30 percent of the foreign sale and leas-*
 16 *ing income derived by the taxpayer from such*
 17 *transaction,*

18 *“(B) 1.2 percent of the foreign trading gross*
 19 *receipts derived by the taxpayer from the trans-*
 20 *action, or*

21 *“(C) 15 percent of the foreign trade income*
 22 *derived by the taxpayer from the transaction.*

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 Sec-*
18 *retary shall prescribe regulations setting forth rules*
19 *for the allocation of expenditures in computing for-*
20 *oreign trade income under paragraph (1)(C) in those*
21 *cases where a taxpayer is seeking to establish or*
22 *maintain a market for qualifying foreign trade prop-*
23 *erty.*

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(c))*
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 this*
13 *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 tax-*
17 *payer.*

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 mar-*
21 *keting of agricultural or horticultural products sells*
22 *qualifying foreign trade property, in computing the*
23 *taxable income of such cooperative, there shall not be*
24 *taken into account any deduction allowable under*
25 *subsection (b) or (c) of section 1382 (relating to pa-*

1 *tronage dividends, per-unit retain allocations, and*
2 *nonpatronage distributions).*

3 “(c) *FOREIGN SALE AND LEASING INCOME.*—*For pur-*
4 *poses 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 allocable*
9 *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 (or*
13 *any person acting under a contract with*
14 *such taxpayer) outside the United States, or*

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

19 “(2) *SPECIAL RULES FOR LEASED PROPERTY.*—

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

1 “(B) *LIMITATION IN CERTAIN CASES.*—*Except as*
2 *provided in regulations, in the case of property*
3 *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 was*
8 *not determined in accordance with the rules*
9 *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 described*
22 *in subparagraph (B) of section 943(a)(3) (relat-*
23 *ing to intangibles).*

24 “(B) *ONLY DIRECT EXPENSES TAKEN INTO*
25 *ACCOUNT.*—*For purposes of this subsection, any*

1 *expense other than a directly allocable expense*
2 *shall not be taken into account in computing for-*
3 *foreign trade income.*

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

5 **“(a) FOREIGN TRADING GROSS RECEIPTS.—**

6 **“(1) IN GENERAL.—***Except as otherwise provided*
7 *in this section, for purposes of this subpart, the term*
8 *‘foreign trading gross receipts’ means the gross re-*
9 *ceipts 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 sub-**
16 *sidary 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 subpara-*
22 *graph (B) by such taxpayer,*

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

1 “(E) for the performance of managerial
2 services for a person other than a related person
3 in furtherance of the production of foreign trad-
4 ing gross receipts described in subparagraph (A),
5 (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 derived
10 from activities described in subparagraph (A), (B), or
11 (C).

12 “(2) CERTAIN RECEIPTS EXCLUDED ON BASIS OF
13 USE; SUBSIDIZED RECEIPTS EXCLUDED.—The term
14 ‘foreign trading gross receipts’ shall not include re-
15 ceipts 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 use
22 of qualifying foreign trade property or serv-
23 ices 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, pro-*
3 *duced, 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 a*
7 *transaction if the taxpayer elects not to have such re-*
8 *ceipts taken into account for purposes of this subpart.*

9 “(b) *FOREIGN ECONOMIC PROCESS REQUIREMENTS.—*

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

16 “(2) *REQUIREMENT.—*

17 “(A) *IN GENERAL.—The requirements of*
18 *this paragraph are met with respect to the gross*
19 *receipts of a taxpayer derived from any trans-*
20 *action if—*

21 “(i) *such taxpayer (or any person act-*
22 *ing under a contract with such taxpayer)*
23 *has participated outside the United States*
24 *in the solicitation (other than advertising),*

1 *the negotiation, or the making of the con-*
2 *tract relating to such transaction, and*

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

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

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

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

1 *any person acting under a contract with*
2 *such taxpayer.*

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

9 “(3) *ACTIVITIES RELATING TO QUALIFYING FOR-*
10 *EIGN TRADE PROPERTY.*—*The activities described in*
11 *this paragraph are any of the following with respect*
12 *to qualifying foreign trade property—*

13 “(A) *advertising and sales promotion,*

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

16 “(C) *transportation outside the United*
17 *States in connection with delivery to the cus-*
18 *tomers,*

19 “(D) *the determination and transmittal of*
20 *a final invoice or statement of account or the re-*
21 *ceipt of payment, and*

22 “(E) *the assumption of credit risk.*

23 “(4) *ECONOMIC PROCESSES PERFORMED BY RE-*
24 *LATED PERSONS.*—*A taxpayer shall be treated as*
25 *meeting the requirements of this subsection with re-*

1 *spect to any sales transaction involving any property*
2 *if any related person has met such requirements in*
3 *such transaction or any other sales transaction in-*
4 *volving such property.*

5 *“(c) EXCEPTION FROM FOREIGN ECONOMIC PROCESS*
6 *REQUIREMENT.—*

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

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

17 *“(3) SPECIAL RULE FOR PASS-THRU ENTITIES.—*
18 *In the case of a partnership, S corporation, or other*
19 *pass-thru entity, the limitation under paragraph (1)*
20 *shall apply with respect to the partnership, S cor-*
21 *poration, or entity and with respect to each partner,*
22 *shareholder, or other owner.*

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

24 *“(a) QUALIFYING FOREIGN TRADE PROPERTY.—For*
25 *purposes of this subpart—*

1 “(1) *IN GENERAL.*—*The term ‘qualifying foreign*
2 *trade property’ means property—*

3 “(A) *manufactured, produced, grown, or ex-*
4 *tracted within or outside the United States,*

5 “(B) *held primarily for sale, lease, or rent-*
6 *al, in the ordinary course of trade or business for*
7 *direct use, consumption, or disposition outside*
8 *the United States, and*

9 “(C) *not more than 50 percent of the fair*
10 *market value of which is attributable to—*

11 “(i) *articles manufactured, produced,*
12 *grown, or extracted outside the United*
13 *States, and*

14 “(ii) *direct costs for labor (determined*
15 *under the principles of section 263A) per-*
16 *formed outside the United States.*

17 *For purposes of subparagraph (C), the fair market*
18 *value of any article imported into the United States*
19 *shall be its appraised value, as determined by the Sec-*
20 *retary under section 402 of the Tariff Act of 1930 (19*
21 *U.S.C. 1401a) in connection with its importation,*
22 *and the direct costs for labor under clause (ii) do not*
23 *include costs that would be treated under the prin-*
24 *ciples of section 263A as direct labor costs attrib-*
25 *utable to articles described in clause (i).*

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

8 “(A) *a domestic corporation,*

9 “(B) *an individual who is a citizen or resi-*
10 *dent of the United States,*

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

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

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

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

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

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

10 “(C) oil or gas (or any primary product
11 thereof),

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

16 “(E) any unprocessed timber which is a
17 softwood.

18 For purposes of subparagraph (E), the term ‘unproc-
19 essed timber’ means any log, cant, or similar form of
20 timber.

21 “(4) PROPERTY IN SHORT SUPPLY.—If the Presi-
22 dent determines that the supply of any property de-
23 scribed in paragraph (1) is insufficient to meet the
24 requirements of the domestic economy, the President
25 may by Executive order designate the property as in

1 *short supply. Any property so designated shall not be*
2 *treated as qualifying foreign trade property during*
3 *the period beginning with the date specified in the*
4 *Executive order and ending with the date specified in*
5 *an Executive order setting forth the President's deter-*
6 *mination that the property is no longer in short sup-*
7 *ply.*

8 “(b) *OTHER DEFINITIONS AND RULES.—For purposes*
9 *of this subpart—*

10 “(1) *TRANSACTION.—*

11 “(A) *IN GENERAL.—The term ‘transaction’*
12 *means—*

13 “(i) *any sale, exchange, or other dis-*
14 *position,*

15 “(ii) *any lease or rental, and*

16 “(iii) *any furnishing of services.*

17 “(B) *GROUPING OF TRANSACTIONS.—To the*
18 *extent provided in regulations, any provision of*
19 *this subpart which, but for this subparagraph,*
20 *would be applied on a transaction-by-trans-*
21 *action basis may be applied by the taxpayer on*
22 *the basis of groups of transactions based on*
23 *product lines or recognized industry or trade*
24 *usage. Such regulations may permit different*
25 *groupings for different purposes.*

1 “(2) *UNITED STATES DEFINED.*—*The term*
2 *‘United States’ includes the Commonwealth of Puerto*
3 *Rico. The preceding sentence shall not apply for pur-*
4 *poses of determining whether a corporation is a do-*
5 *mestic corporation.*

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

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

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

23 “(1) *in the case of a taxpayer computing its*
24 *qualifying foreign trade income under section*
25 *941(a)(1)(B), the amount of the taxpayer’s foreign*

1 *trade income which would (but for this subsection)*
2 *be treated as from sources without the United States*
3 *if the foreign trade income were reduced by an*
4 *amount equal to 4 percent of the foreign trading gross*
5 *receipts with respect to the transaction, and*

6 *“(2) in the case of a taxpayer computing its*
7 *qualifying foreign trade income under section*
8 *941(a)(1)(C), 50 percent of the amount of the tax-*
9 *payer’s foreign trade income which would (but for*
10 *this subsection) be treated as from sources without the*
11 *United States.*

12 *“(d) TREATMENT OF WITHHOLDING TAXES.—*

13 *“(1) IN GENERAL.—For purposes of section*
14 *114(d), any withholding tax shall not be treated as*
15 *paid or accrued with respect to extraterritorial in-*
16 *come which is excluded from gross income under sec-*
17 *tion 114(a). For purposes of this paragraph, the term*
18 *‘withholding tax’ means any tax which is imposed on*
19 *a basis other than residence and for which credit is*
20 *allowable under section 901 or 903.*

21 *“(2) EXCEPTION.—Paragraph (1) shall not*
22 *apply to any taxpayer with respect to extraterritorial*
23 *income from any transaction if the taxpayer com-*
24 *putes its qualifying foreign trade income with respect*
25 *to the transaction under section 941(a)(1)(A).*

1 “(e) *ELECTION TO BE TREATED AS DOMESTIC COR-*
2 *PORATION.*—

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

10 “(2) *APPLICABLE FOREIGN CORPORATION.*—*For*
11 *purposes of paragraph (1), the term ‘applicable for-*
12 *ign corporation’ means any foreign corporation if—*

13 “(A) *such corporation manufactures, pro-*
14 *duces, grows, or extracts property in the ordi-*
15 *nary course of such corporation’s trade or busi-*
16 *ness, or*

17 “(B) *substantially all of the gross receipts of*
18 *such corporation may reasonably be expected to*
19 *be foreign trading gross receipts.*

20 “(3) *PERIOD OF ELECTION.*—

21 “(A) *IN GENERAL.*—*Except as otherwise*
22 *provided in this paragraph, an election under*
23 *paragraph (1) shall apply to the taxable year for*
24 *which made and all subsequent taxable years un-*
25 *less revoked by the taxpayer. Any revocation of*

1 *such election shall apply to taxable years begin-*
2 *ning after such revocation.*

3 “(B) *TERMINATION.*—*If a corporation*
4 *which made an election under paragraph (1) for*
5 *any taxable year fails to meet the requirements*
6 *of subparagraph (A) or (B) of paragraph (2) for*
7 *any subsequent taxable year, such election shall*
8 *not apply to any taxable year beginning after*
9 *such subsequent taxable year.*

10 “(C) *EFFECT OF REVOCATION OR TERMI-*
11 *NATION.*—*If a corporation which made an elec-*
12 *tion under paragraph (1) revokes such election*
13 *or such election is terminated under subpara-*
14 *graph (B), such corporation (and any successor*
15 *corporation) may not make such election for any*
16 *of the 5 taxable years beginning with the first*
17 *taxable year for which such election is not in ef-*
18 *fect as a result of such revocation or termination.*

19 “(4) *SPECIAL RULES.*—

20 “(A) *REQUIREMENTS.*—*This subsection*
21 *shall not apply to an applicable foreign corpora-*
22 *tion if such corporation fails to meet the require-*
23 *ments (if any) which the Secretary may pre-*
24 *scribe to ensure that the taxes imposed by this*
25 *chapter on such corporation are paid.*

1 “(B) *EFFECT OF ELECTION, REVOCATION,*
2 *AND TERMINATION.*—

3 “(i) *ELECTION.*—*For purposes of sec-*
4 *tion 367, a foreign corporation making an*
5 *election under this subsection shall be treat-*
6 *ed as transferring (as of the first day of the*
7 *first taxable year to which the election ap-*
8 *plies) all of its assets to a domestic corpora-*
9 *tion in connection with an exchange to*
10 *which section 354 applies.*

11 “(ii) *REVOCATION AND TERMI-*
12 *NATION.*—*For purposes of section 367, if—*

13 “(I) *an election is made by a cor-*
14 *poration under paragraph (1) for any*
15 *taxable year, and*

16 “(II) *such election ceases to apply*
17 *for any subsequent taxable year,*

18 *such corporation shall be treated as a domestic*
19 *corporation transferring (as of the 1st day of the*
20 *first such subsequent taxable year to which such*
21 *election ceases to apply) all of its property to a*
22 *foreign corporation in connection with an ex-*
23 *change to which section 354 applies.*

24 “(C) *ELIGIBILITY FOR ELECTION.*—*The Sec-*
25 *retary may by regulation designate one or more*

1 *classes of corporations which may not make the*
2 *election under this subsection.*

3 “(f) *RULES RELATING TO ALLOCATIONS OF QUALI-*
4 *FYING FOREIGN TRADE INCOME FROM SHARED PARTNER-*
5 *SHIPS.—*

6 “(1) *IN GENERAL.—If—*

7 “(A) *a partnership maintains a separate*
8 *account for transactions (to which this subpart*
9 *applies) with each partner,*

10 “(B) *distributions to each partner with re-*
11 *spect to such transactions are based on the*
12 *amounts in the separate account maintained*
13 *with respect to such partner, and*

14 “(C) *such partnership meets such other re-*
15 *quirements as the Secretary may by regulations*
16 *prescribe,*

17 *then such partnership shall allocate to each partner*
18 *items of income, gain, loss, and deduction (including*
19 *qualifying foreign trade income) from any trans-*
20 *action to which this subpart applies on the basis of*
21 *such separate account.*

22 “(2) *SPECIAL RULES.—For purposes of this sub-*
23 *part, in the case of a partnership to which paragraph*
24 *(1) applies—*

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

5 “(B) the election under section 942(a)(3)
6 shall be made separately by each partner with
7 respect to any transaction for which the partner-
8 ship maintains separate accounts for each part-
9 ner.

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

13 “(1) which is received by a person from an orga-
14 nization to which part I of subchapter T applies
15 which is engaged in the marketing of agricultural or
16 horticultural products, and

17 “(2) which is designated by the organization as
18 allocable to qualifying foreign trade income in a writ-
19 ten notice mailed to its patrons during the payment
20 period described in section 1382(d),

21 shall be treated as qualifying foreign trade income of such
22 person for purposes of section 114. The taxable income of
23 the organization shall not be reduced under section 1382
24 by reason of any amount to which the preceding sentence
25 applies.”

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

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

5 (2) *Section 245 is amended by adding at the end*
6 *the following new subsection:*

7 “(d) *CERTAIN DIVIDENDS ALLOCABLE TO QUALIFYING*
8 *FOREIGN TRADE INCOME.—In the case of a domestic cor-*
9 *poration which is a United States shareholder (as defined*
10 *in section 951(b)) of a controlled foreign corporation (as*
11 *defined in section 957), there shall be allowed as a deduction*
12 *an amount equal to 100 percent of any dividend received*
13 *from such controlled foreign corporation which is distrib-*
14 *uted out of earnings and profits attributable to qualifying*
15 *foreign trade income (as defined in section 941(a)).”*

16 (3) *Section 275(a) is amended—*

17 (A) *by striking “or” at the end of para-*
18 *graph (4)(A), by striking the period at the end*
19 *of paragraph (4)(B) and inserting “, or”, and by*
20 *adding at the end of paragraph (4) the following*
21 *new subparagraph:*

22 “(C) *such taxes are paid or accrued with re-*
23 *spect to qualifying foreign trade income (as de-*
24 *fined in section 941).”, and*

25 (B) *by adding at the end the following new*
26 *sentence: “A rule similar to the rule of section*

1 943(d) shall apply for purposes of paragraph
2 (4)(C).”

3 (4) Paragraph (3) of section 864(e) is
4 amended—

5 (A) by striking “For purposes of” and in-
6 serting:

7 “(A) *IN GENERAL.*—For purposes of”, and

8 (B) by adding at the end the following new
9 subparagraph:

10 “(B) *ASSETS PRODUCING EXEMPT*
11 *EXTRATERRITORIAL INCOME.*—For purposes of
12 allocating and apportioning any interest ex-
13 pense, there shall not be taken into account any
14 qualifying foreign trade property (as defined in
15 section 943(a)) which is held by the taxpayer for
16 lease or rental in the ordinary course of trade or
17 business for use by the lessee outside the United
18 States (as defined in section 943(b)(2)).”

19 (5) Section 903 is amended by striking “164(a)”
20 and inserting “114, 164(a),”.

21 (6) Section 999(c)(1) is amended by inserting
22 “941(a)(5),” after “908(a),”.

23 (7) The table of sections for part III of sub-
24 chapter B of chapter 1 is amended by inserting before

1 *the item relating to section 115 the following new*
2 *item:*

“Sec. 114. Extraterritorial income.”

3 (8) *The table of subparts for part III of sub-*
4 *chapter N of chapter 1 is amended by striking the*
5 *item relating to subpart E and inserting the following*
6 *new item:*

“Subpart E. Qualifying foreign trade income.”

7 (9) *The table of subparts for part III of sub-*
8 *chapter N of chapter 1 is amended by striking the*
9 *item relating to subpart C.*

10 **SEC. 5. EFFECTIVE DATE.**

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

13 (b) *NO NEW FSCS; TERMINATION OF INACTIVE*
14 *FSCS.—*

15 (1) *NO NEW FSCS.—No corporation may elect*
16 *after September 30, 2000, to be a FSC (as defined in*
17 *section 922 of the Internal Revenue Code of 1986, as*
18 *in effect before the amendments made by this Act).*

19 (2) *TERMINATION OF INACTIVE FSCS.—If a FSC*
20 *has no foreign trade income (as defined in section*
21 *923(b) of such Code, as so in effect) for any period*
22 *of 5 consecutive taxable years beginning after Decem-*
23 *ber 31, 2001, such FSC shall cease to be treated as*

1 *a FSC for purposes of such Code for any taxable year*
2 *beginning after such period.*

3 *(c) TRANSITION PERIOD FOR EXISTING FOREIGN*
4 *SALES CORPORATIONS.—*

5 *(1) IN GENERAL.—In the case of a FSC (as so*
6 *defined) in existence on September 30, 2000, and at*
7 *all times thereafter, the amendments made by this Act*
8 *shall not apply to any transaction in the ordinary*
9 *course of trade or business involving a FSC which*
10 *occurs—*

11 *(A) before January 1, 2002, or*

12 *(B) after December 31, 2001, pursuant to a*
13 *binding contract—*

14 *(i) which is between the FSC (or any*
15 *related person) and any person which is not*
16 *a related person, and*

17 *(ii) which is in effect on September 30,*
18 *2000, and at all times thereafter.*

19 *For purposes of this paragraph, a binding contract*
20 *shall include a purchase option, renewal option, or*
21 *replacement option which is included in such contract*
22 *and which is enforceable against the seller or lessor.*

23 *(2) ELECTION TO HAVE AMENDMENTS APPLY*
24 *EARLIER.—A taxpayer may elect to have the amend-*
25 *ments made by this Act apply to any transaction by*

1 *a FSC or any related person to which such amend-*
2 *ments would apply but for the application of para-*
3 *graph (1). Such election shall be effective for the tax-*
4 *able year for which made and all subsequent taxable*
5 *years, and, once made, may be revoked only with the*
6 *consent of the Secretary of the Treasury.*

7 *(3) RELATED PERSON.—For purposes of this*
8 *subsection, the term “related person” has the meaning*
9 *given to such term by section 943(b)(3) of such Code,*
10 *as added by this Act.*

11 *(d) SPECIAL RULES RELATING TO LEASING TRANS-*
12 *ACTIONS.—*

13 *(1) SALES INCOME.—If foreign trade income in*
14 *connection with the lease or rental of property de-*
15 *scribed in section 927(a)(1)(B) of such Code (as in ef-*
16 *fect before the amendments made by this Act) is treat-*
17 *ed as exempt foreign trade income for purposes of sec-*
18 *tion 921(a) of such Code (as so in effect), such prop-*
19 *erty shall be treated as property described in section*
20 *941(c)(1)(B) of such Code (as added by this Act) for*
21 *purposes of applying section 941(c)(2) of such Code*
22 *(as so added) to any subsequent transaction involving*
23 *such property to which the amendments made by this*
24 *Act apply.*

1 (2) *LIMITATION ON USE OF GROSS RECEIPTS*
2 *METHOD.—If any person computed its foreign trade*
3 *income from any transaction with respect to any*
4 *property on the basis of a transfer price determined*
5 *under the method described in section 925(a)(1) of*
6 *such Code (as in effect before the amendments made*
7 *by this Act), then the qualifying foreign trade income*
8 *(as defined in section 941(a) of such Code, as in effect*
9 *after such amendments) of such person (or any re-*
10 *lated person) with respect to any other transaction*
11 *involving such property (and to which the amend-*
12 *ments made by this Act apply) shall be zero.*

Calendar No. 500

106TH CONGRESS
2D SESSION

H. R. 4986

[Report No. 106-845]

A BILL

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 13, 2000

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed