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REPORT
106–416

FSC REPEAL AND EXTRATERRITORIAL INCOME EXCLUSION ACT OF 2000

SEPTEMBER 20, 2000.—Ordered to be printed

Mr. ROTH, from the Committee on Finance,
submitted the following

REPORT

[To accompany H.R. 4986]

[Including cost estimate of the Congressional Budget Office]

The Committee on Finance, to whom was referred the bill (H.R. 4986) to amend the Internal Revenue Code of 1986 to repeal the provisions relating to foreign sales corporations and to exclude extraterritorial income from gross income, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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I. SUMMARY AND BACKGROUND

A. Purpose And Summary

PURPOSE

The bill, H.R. 4986, the "FSC Repeal and Extraterritorial Income Exclusion Act of 2000," repeals the foreign sales corporation provisions of the Internal Revenue Code to comply with decisions of a World Trade Organization dispute panel and Appellate Body regarding a dispute brought before the World Trade Organization ("WTO") by the European Union. To retain a competitive balance for U.S. businesses that compete in the world market, the bill modifies the taxation of foreign trade income to comply with the standards set forth in the decisions of the WTO dispute panel and Appellate Body.

SUMMARY

H.R. 4986 repeals sections 921 through 927 of the Internal Revenue Code of 1986 ("the Code"). These sections of the Code relate to foreign sales corporations ("FSCs").

H.R. 4986 provides that gross income for U.S. tax purposes does not include extraterritorial income. Deductions allocated to such excluded income generally are disallowed. Because the exclusion of such extraterritorial income is a means of avoiding double taxation, no foreign tax credit is allowed for income taxes paid with respect to such excluded income. An exception from this general rule is provided for extraterritorial income that is not qualifying foreign trade income.

In general, H.R. 4986 is effective for transactions entered into after September 30, 2000, and no corporation may elect to be a FSC after September 30, 2000.

B. Background and Need for Legislation

In July 1998, the European Union [1] requested that a WTO dispute panel determine whether the FSC regime of sections 921 through 927 of the Code complies with WTO rules, including the Agreement on Subsidies and Countervailing Measures. A WTO dispute settlement panel ("the Panel") was established in September, 1998, to address these issues. On October 8, 1999, the Panel ruled that the FSC regime was not in compliance with WTO obligations.[2] The Panel specified that "FSC subsidies must be withdrawn at the latest with effect from 1 October 2000." [3] On February 24, 2000, the Appellate Body affirmed the lower panel's ruling.[4]

C. Legislative History

The Committee on Finance marked up the provisions of the bill on September 19, 2000, and approved the provisions, with an

[1] The European Union comprises Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom. Canada and Japan made third-party submissions to the subsequently established dispute settlement panel in support of the European Union position.

[2] United States—Tax Treatment for "Foreign Sales Corporations," Report of the Panel, October, 8, 1999 ("Panel Decision").

[3] Panel Decision at 334.

[4] United States—Tax Treatment for "Foreign Sales Corporations," Report of the Appellate Body, February 24, 2000 ("Appellate Body Decision").

amendment, on September 19, 2000, by a voice vote, with a quorum present.

II. EXPLANATION OF THE BILL

A. Repeal of FSC Provisions and Exclusion for Extraterritorial Income

PRESENT LAW

Summary of U.S. income taxation of foreign persons

Income earned by a foreign corporation from its foreign operations generally is subject to U.S. tax only when such income is distributed to any U.S. persons that hold stock in such corporation. Accordingly, a U.S. person that conducts foreign operations through a foreign corporation generally is subject to U.S. tax on the income from those operations when the income is repatriated to the United States through a dividend distribution to the U.S. person.[5] The income is reported on the U.S. person's tax return for the year the distribution is received, and the United States imposes tax on such income at that time. An indirect foreign tax credit may reduce the U.S. tax imposed on such income.

Foreign sales corporations

The income of an eligible FSC is partially subject to U.S. income tax and partially exempt from U.S. income tax. In addition, a U.S. corporation generally is not subject to U.S. tax on dividends distributed from the FSC out of certain earnings.

A FSC must be located and managed outside the United States, and must perform certain economic processes outside the United States. A FSC is often owned by a U.S. corporation that produces goods in the United States. The U.S. corporation either supplies goods to the FSC for resale abroad or pays the FSC a commission in connection with such sales. The income of the FSC, a portion of which is exempt from U.S. tax under the FSC rules, equals the FSC's gross markup or gross commission income, less the expenses incurred by the FSC. The gross markup or the gross commission is determined according to specified pricing rules.

A FSC generally is not subject to U.S. tax on its exempt foreign trade income. The exempt foreign trade income of a FSC is treated as foreign-source income that is not effectively connected with the conduct of a trade or business within the United States.

Foreign trade income other than exempt foreign trade income generally is treated as U.S.-source income effectively connected with the conduct of a trade or business conducted through a permanent establishment within the United States. Thus, a FSC's income other than exempt foreign trade income generally is subject to U.S. tax currently and is treated as U.S.-source income for purposes of the foreign tax credit limitation.

[5] A variety of anti-deferral regimes impose current U.S. tax on income earned by a U.S. person through a foreign corporation. The Code sets forth the following anti-deferral regimes: the controlled foreign corporation rules of subpart F (secs. 951–954), the passive foreign investment company rules (secs. 1291–1298), the foreign personal holding company rules (secs. 551–558), the personal holding company rules (secs. 541–547), the accumulated earnings tax rules (secs. 531–537), and the foreign investment company rules (sec. 1246). Detailed rules for coordination among the anti-deferral regimes are provided to prevent a U.S. person from being subject to U.S. tax on the same item of income under multiple regimes.

Foreign trade income of a FSC is defined as the FSC's gross income attributable to foreign trading gross receipts. Foreign trading gross receipts generally are the gross receipts attributable to the following types of transactions: the sale of export property; the lease or rental of export property; services related and subsidiary to such a sale or lease of export property; engineering and architectural services for projects outside the United States; and export management services. Investment income and carrying charges are excluded from the definition of foreign trading gross receipts.

The term "export property" generally means property (1) which is manufactured, produced, grown or extracted in the United States by a person other than a FSC, (2) which is held primarily for sale, lease, or rental in the ordinary course of a trade or business for direct use or consumption outside the United States, and (3) not more than 50 percent of the fair market value of which is attributable to articles imported into the United States. The term "export property" does not include property leased or rented by a FSC for use by any member of a controlled group of which the FSC is a member; patents, copyrights (other than films, tapes, records, similar reproductions, and other than computer software, whether or not patented), and other intangibles; oil or gas (or any primary product thereof); unprocessed softwood timber; or products the export of which is prohibited or curtailed. Export property also excludes property designated by the President as being in short supply.

If export property is sold to a FSC by a related person (or a commission is paid by a related person to a FSC with respect to export property), the income with respect to the export transactions must be allocated between the FSC and the related person. The taxable income of the FSC and the taxable income of the related person are computed based upon a transfer price determined under section 482 or under one of two formulas.

The portion of a FSC's foreign trade income that is treated as exempt foreign trade income depends on the pricing rule used to determine the income of the FSC. If the amount of income earned by the FSC is based on section 482 pricing, the exempt foreign trade income generally is 30 percent of the foreign trade income the FSC derives from a transaction. If the income earned by the FSC is determined under one of the two formulas specified in the FSC provisions, the exempt foreign trade income generally is $^{15}/_{23}$ of the foreign trade income the FSC derives from the transaction.

A FSC is not required or deemed to make distributions to its shareholders. Actual distributions are treated as being made first out of earnings and profits attributable to foreign trade income, and then out of any other earnings and profits. Any distribution made by a FSC out of earnings and profits attributable to foreign trade income to a foreign shareholder is treated as U.S.-source income that is effectively connected with a business conducted through a permanent establishment of the shareholder within the United States. Thus, the foreign shareholder is subject to U.S. tax on such a distribution.

A U.S. corporation generally is allowed a 100 percent dividends-received deduction for amounts distributed from a FSC out of earnings and profits attributable to foreign trade income. The 100 percent dividends-received deduction is not allowed for nonexempt foreign trade income determined under section 482 pricing.

REASONS FOR CHANGE

The Chairman and Ranking Member began a process of reviewing the international provisions of the Code with hearings early in the 106th Congress. Among the issues identified in the testimony was the need to reexamine the U.S. tax treatment of foreign income.

In the interim, a dispute settlement panel of the WTO found that the FSC provisions conferred an export subsidy barred by WTO rules. That decision was affirmed by the WTO Appellate Body.

This legislation addresses both the broader issue of U.S. taxation of income derived from foreign sales, i.e., "extraterritorial income," as well as complying with the WTO rulings. The legislation repeals the FSC provisions of the Code that the Panel and Appellate Body found to be prohibited export subsidies. At the same time, the legislation revises the Code in a manner that rationalizes tax treatment for extraterritorial income.

The legislation modifies the general rule of U.S. taxation by fundamentally amending the definition of gross income. Under the Code, the definition of "gross income" defines the outer boundaries of U.S. income taxation. The bill excludes income derived from certain activities performed outside the United States, referred to as extraterritorial income, from the definition of gross income and, thus, modifies the extent to which the United States seeks to tax such income. This new general rule thus becomes the normative benchmark for taxing income derived in connection with certain activities performed outside the United States.

The Committee believes that, in order to ensure WTO compatibility, it is important that the new regime not confer export-contingent benefits. Accordingly, the Committee has determined that it is appropriate to treat all foreign sales alike. The general exclusion, therefore, applies to foreign trade income, whether the goods are manufactured in the United States or abroad—a substantially broader category of income than that which was exempted from tax under the FSC provisions. A taxpayer would receive the same U.S. tax treatment with respect to its foreign sales regardless of whether it exports.

The Committee notes that the extraterritorial income excluded by this legislation from the scope of U.S. income taxation parallels the foreign-source income excluded under most territorial tax systems, particularly those employed by European Union member states. Under neither the U.S. tax system as modified by this legislation nor many European tax systems is the income excluded from taxation limited to income earned through exporting. At the same time, under both systems, exporting is one way to earn foreign source income that is excluded from taxation, and exporters under both systems are among those who can avail themselves of the limitations on the taxing authority of both systems.

The Committee believes that this legislation, which fundamentally changes the U.S. tax treatment of extraterritorial income, complies with the WTO decisions and honors U.S. obligations under the WTO.

EXPLANATION OF PROVISIONS

Repeal of the FSC rules

The bill repeals the present-law FSC rules found in sections 921 through 927 of the Code.

Exclusion of extraterritorial income

The bill provides that gross income for U.S. tax purposes does not include extraterritorial income. Because the exclusion of such extraterritorial income is a means of avoiding double taxation, no foreign tax credit is allowed for income taxes paid with respect to such excluded income. Extraterritorial income is eligible for the exclusion to the extent that it is "qualifying foreign trade income." Because U.S. income tax principles generally deny deductions for expenses related to exempt income, otherwise deductible expenses that are allocated to qualifying foreign trade income generally are disallowed.

The bill applies in the same manner with respect to both individuals and corporations who are U.S. taxpayers. In addition, the exclusion from gross income applies for individual and corporate alternative minimum tax purposes.

Qualifying foreign trade income

Under the bill, qualifying foreign trade income is the amount of gross income that, if excluded, would result in a reduction of taxable income by the greatest of (1) 1.2 percent of the "foreign trading gross receipts" derived by the taxpayer from the transaction,[6] (2) 15 percent of the "foreign trade income" derived by the taxpayer from the transaction, or (3) 30 percent of the "foreign sale and leasing income" derived by the taxpayer from the transaction. The amount of qualifying foreign trade income determined using 1.2 percent of the foreign trading gross receipts is limited to 200 percent of the qualifying foreign trade income that would result using 15 percent of the foreign trade income. Notwithstanding the general rule that qualifying foreign trade income is based on one of the three calculations that results in the greatest reduction in taxable income, a taxpayer may choose instead to use one of the other two calculations that does not result in the greatest reduction in taxable income. Although these calculations are determined by reference to a reduction of taxable income (a net income concept), qualifying foreign trade income is an exclusion from gross income. Hence, once a taxpayer determines the appropriate reduction of taxable income, that amount must be "grossed up" for related expenses in order to determine the amount of gross income excluded.[7]

If a taxpayer uses 1.2 percent of foreign trading gross receipts to determine the amount of qualifying foreign trade income with respect to a transaction, the taxpayer or any other related persons will be treated as having no qualifying foreign trade income with respect to any other transaction involving the same property.[8] For example, assume that a manufacturer and a distributor of the

[6] The term "transaction" means (1) any sale, exchange, or other disposition; (2) any lease or rental, and (3) any furnishing of services.

[7] For an example of these calculations, see the General Example, below.

[8] Persons are considered to be related if they are treated as a single employer under section 52(a) or (b) (determined without taking into account section 1563(b), thus including foreign corporations) or section 414(m) or (o).

same product are related persons. The manufacturer sells the product to the distributor at an arm's-length price of $80 (generating $30 of profit) and the distributor sells the product to an unrelated customer outside of the United States for $100 (generating $20 of profit). If the distributor chooses to calculate its qualifying foreign trade income on the basis of 1.2 percent of foreign trading gross receipts, then the manufacturer will be considered to have no qualifying foreign trade income and, thus, would have no excluded income. The distributor's qualifying foreign trade income would be 1.2 percent of $100, and the manufacturer's qualifying foreign trade income would be zero. This limitation is intended to prevent a duplication of exclusions from gross income because the distributor's $100 of gross receipts includes the $80 of gross receipts of the manufacturer. Absent this limitation, $80 of gross receipts would have been double counted for purposes of the exclusion. If both persons were permitted to use 1.2 percent of their foreign trading gross receipts in this example, then the related-person group would have an exclusion based on $180 of foreign trading gross receipts notwithstanding that the related-person group really only generated $100 of gross receipts from the transaction. However, if the distributor chooses to calculate its qualifying foreign trade income on the basis of 15 percent of foreign trade income (15 percent of $20 of profit), then the manufacturer would also be eligible to calculate its qualifying foreign trade income in the same manner (15 percent of $30 of profit).[9] Thus, in the second case, each related person may exclude an amount of income based on their respective profits. The total foreign trade income of the related-person group is $50. Accordingly, allowing each person to calculate the exclusion based on their respective foreign trade income does not result in duplication of exclusions.

Under the bill, a taxpayer may determine the amount of qualifying foreign trade income either on a transaction-by-transaction basis or on an aggregate basis for groups of transactions, so long as the groups are based on product lines or recognized industry or trade usage. Under the grouping method, the Committee intends that taxpayers be given reasonable flexibility to identify product lines or groups on the basis of recognized industry or trade usage. In general, provided that the taxpayer's grouping is not unreasonable, it will not be rejected merely because the grouped products fall within more than one of the two-digit Standard Industrial Classification codes.[10] The Secretary of the Treasury is granted authority to prescribe rules for grouping transactions in determining qualifying foreign trade income.

Qualifying foreign trade income must be reduced by illegal bribes, kickbacks and similar payments, and by a factor for operations in or related to a country associated in carrying out an international boycott, or participating or cooperating with an international boycott.

In addition, the bill directs the Secretary of the Treasury to prescribe rules for marginal costing in those cases in which a taxpayer

[9] The manufacturer also could compute qualifying foreign trade income based on 30 percent of foreign sale and leasing income.

[10] By reference to Standard Industrial Classification codes, the Committee intends to include industries as defined in the North American Industrial Classification System.

is seeking to establish or maintain a market for qualifying foreign trade property.

Foreign trading gross receipts

Under the bill, "foreign trading gross receipts" are gross receipts derived from certain activities in connection with "qualifying foreign trade property" with respect to which certain "economic processes" take place outside of the United States. Specifically, the gross receipts must be (1) from the sale, exchange, or other disposition of qualifying foreign trade property; (2) from the lease or rental of qualifying foreign trade property for use by the lessee outside of the United States; (3) for services which are related and subsidiary to the sale, exchange, disposition, lease, or rental of qualifying foreign trade property (as described above); (4) for engineering or architectural services for construction projects located outside of the United States; or (5) for the performance of certain managerial services for unrelated persons. Gross receipts from the lease or rental of qualifying foreign trade property include gross receipts from the license of qualifying foreign trade property. Consistent with the policy adopted in the Taxpayer Relief Act of 1997,[11] this includes the license of computer software for reproduction abroad.

Foreign trading gross receipts do not include gross receipts from a transaction if the qualifying foreign trade property or services are for ultimate use in the United States, or for use by the United States (or an instrumentality thereof) and such use is required by law or regulation. Foreign trading gross receipts also do not include gross receipts from a transaction that is accomplished by a subsidy granted by the government (or any instrumentality thereof) of the country or possession in which the property is manufactured.

A taxpayer may elect to treat gross receipts from a transaction as not foreign trading gross receipts. As a consequence of such an election, the taxpayer could utilize any related foreign tax credits in lieu of the exclusion as a means of avoiding double taxation. It is intended that this election be accomplished by the taxpayer's treatment of such items on its tax return for the taxable year. Provided that the taxpayer's taxable year is still open under the statute of limitations for making claims for refund under section 6511, a taxpayer can make redeterminations as to whether the gross receipts from a transaction constitute foreign trading gross receipts.

Foreign economic processes

Under the bill, gross receipts from a transaction are foreign trading gross receipts only if certain economic processes take place outside of the United States. The foreign economic processes requirement is satisfied if the taxpayer (or any person acting under a contract with the taxpayer) participates outside of the United States in the solicitation (other than advertising), negotiation, or making of the contract relating to such transaction and incurs a specified amount of foreign direct costs attributable to the transaction.[12] For this purpose, foreign direct costs include only those costs incurred

[11] The Taxpayer Relief Act of 1997, Public Law 105–34.

[12] The foreign direct costs attributable to the transaction generally must exceed 50 percent of the total direct costs attributable to the transaction, but the requirement also will be satisfied if, with respect to at least two categories of direct costs, the foreign direct costs equal or exceed 85 percent of the total direct costs attributable to each category.

in the following categories of activities: (1) advertising and sales promotion; (2) the processing of customer orders and the arranging for delivery; (3) transportation outside of the United States in connection with delivery to the customer; (4) the determination and transmittal of a final invoice or statement of account or the receipt of payment; and (5) the assumption of credit risk. An exception from the foreign economic processes requirement is provided for taxpayers with foreign trading gross receipts for the year of $5 million or less.[13]

The foreign economic processes requirement must be satisfied with respect to each transaction and, if so, any gross receipts from such transaction could be considered as foreign trading gross receipts. For example, all of the lease payments received with respect to a multi-year lease contract, which contract met the foreign economic processes requirement at the time it was entered into, would be considered as foreign trading gross receipts. On the other hand, a sale of property that was formerly a leased asset, which was not sold pursuant to the original lease agreement, generally would be considered a new transaction that must independently satisfy the foreign economic processes requirement.

A taxpayer's foreign economic processes requirement is treated as satisfied with respect to a sales transaction (solely for the purpose of determining whether gross receipts are foreign trading gross receipts) if any related person has satisfied the foreign economic processes requirement in connection with another sales transaction involving the same qualifying foreign trade property.

Qualifying foreign trade property

Under the bill, the threshold for determining if gross receipts will be treated as foreign trading gross receipts is whether the gross receipts are derived from a transaction involving "qualifying foreign trade property." Qualifying foreign trade property is property manufactured, produced, grown, or extracted ("manufactured") within or outside of the United States that is held primarily for sale, lease, or rental,[14] in the ordinary course of a trade or business, for direct use, consumption, or disposition outside of the United States.[15] In addition, not more than 50 percent of the fair market value of such property can be attributable to the sum of (1) the fair market value of articles manufactured outside of the United States plus (2) the direct costs of labor performed outside of the United States.[16]

The bill excludes certain property from the definition of qualifying foreign trade property. The excluded property is (1) property leased or rented by the taxpayer for use by a related person, (2)

[13] For this purpose, the receipts of related persons are aggregated and, in the case of pass-through entities, the determination of whether the foreign trading gross receipts exceed $5 million is made both at the entity and at the partner/shareholder level.

[14] In addition, consistent with the policy adopted in the Taxpayer Relief Act of 1997, computer software licensed for reproduction is considered as property held primarily for sale, lease, or rental.

[15] "United States" includes Puerto Rico for these purposes because Puerto Rico is included in the customs territory of the United States.

[16] For this purpose, the fair market value of any article imported into the United States is its appraised value as determined under the Tariff Act of 1930. In addition, direct labor costs are determined under the principles of section 263A and do not include costs that would be treated as direct labor costs attributable to "articles," again applying principles of section 263A.

certain intangibles,[17] (3) oil and gas (or any primary product thereof), (4) unprocessed softwood timber, (5) certain products the transfer of which are prohibited or curtailed to effectuate the policy set forth in Public Law 96–72, and (6) property designated by Executive order as in short supply. In addition, it is the intention of the Committee that property that is leased or licensed to a related person who is the lessor, licensor, or seller of the same property in a sublease, sublicense, sale, or rental to an unrelated person for the ultimate and predominate use by the unrelated person outside of the United States is not excluded property by reason of such lease or license to a related person.

With respect to property that is manufactured outside of the United States, rules are provided to ensure consistent U.S. tax treatment with respect to manufacturers. The bill requires that property manufactured outside of the United States be manufactured by (1) a domestic corporation, (2) an individual who is a citizen or resident of the United States, (3) a foreign corporation that elects to be subject to U.S. taxation in the same manner as a U.S. corporation, or (4) a partnership or other pass-through entity all of the partners or owners of which are described in (1), (2), or (3) above.[18]

Foreign trade income

Under the bill, "foreign trade income" is the taxable income of the taxpayer (determined without regard to the exclusion of qualifying foreign trade income) attributable to foreign trading gross receipts. Certain dividends-paid deductions of cooperatives are disregarded in determining foreign trade income for this purpose.

Foreign sale and leasing income

Under the bill, "foreign sale and leasing income" is the amount of the taxpayer's foreign trade income (with respect to a transaction) that is properly allocable to activities that constitute foreign economic processes (as described above). For example, a distribution company's profit from the sale of qualifying foreign trade property that is associated with sales activities, such as solicitation or negotiation of the sale, advertising, processing customer orders and arranging for delivery, transportation outside of the United States, and other enumerated activities, would constitute foreign sale and leasing income.

Foreign sale and leasing income also includes foreign trade income derived by the taxpayer in connection with the lease or rental of qualifying foreign trade property for use by the lessee outside of the United States. Income from the sale, exchange, or other disposition of qualifying foreign trade property that is or was subject

[17] The intangibles that are treated as excluded property under the bill are: patents, inventions, models, designs, formulas, or processes whether or not patented, copyrights (other than films, tapes, records, or similar reproductions, and other than computer software (whether or not patented), for commercial or home use), goodwill, trademarks, trade brands, franchises, or other like property. Computer software that is licensed for reproduction outside of the United States is not excluded from the definition of qualifying foreign trade property.

[18] Except as provided by the Secretary of the Treasury, tiered partnerships or pass-through entities will be considered as partnerships or pass-through entities for purposes of this rule if each of the partnerships or entities is directly or indirectly wholly-owned by persons described in (1), (2), or (3) above.

to such a lease[19] (i.e., the sale of the residual interest in the leased property) gives rise to foreign sale and leasing income. Except as provided in regulations, a special limitation applies to leased property that (1) is manufactured by the taxpayer or (2) is acquired by the taxpayer from a related person for a price that was other than arm's length. In such cases, foreign sale and leasing income may not exceed the amount of foreign sale and leasing income that would have resulted if the taxpayer had acquired the leased property in a hypothetical arm's-length purchase and then engaged in the actual sale or lease of such property. For example, if a manufacturer leases qualifying foreign trade property that it manufactured, the foreign sale and leasing income derived from that lease may not exceed the amount of foreign sale and leasing income that the manufacturer would have earned with respect to that lease had it purchased the property for an arm's-length price on the day that the manufacturer entered into the lease. For purposes of calculating the limit on foreign sale and leasing income, the manufacturer's basis and, thus, depreciation would be based on this hypothetical arm's-length price. This limitation is intended to prevent foreign sale and leasing income from including profit associated with manufacturing activities.

For purposes of determining foreign sale and leasing income, only directly allocable expenses are taken into account in calculating the amount of foreign trade income. In addition, income properly allocable to certain intangibles is excluded for this purpose.

General example

The following is an example of the calculation of qualifying foreign trade income.

XYZ Corporation, a U.S. corporation, manufactures property that is sold to unrelated customers for use outside of the United States. XYZ Corporation satisfies the foreign economic processes requirement through conducting activities such as solicitation, negotiation, transportation, and other sales-related activities outside of the United States with respect to its transactions. During the year, qualifying foreign trade property was sold for gross proceeds totaling $1,000. The cost of this qualifying foreign trade property was $600. XYZ Corporation incurred $275 of costs that are directly related to the sale and distribution of qualifying foreign trade property. XYZ Corporation paid $40 of income tax to a foreign jurisdiction related to the sale and distribution of the qualifying foreign trade property. XYZ Corporation also generated gross income of $7,600 (gross receipts of $24,000 and cost of goods sold of $16,400) and direct expenses of $4,225 that relate to the manufacture and sale of products other than qualifying foreign trade property. XYZ Corporation also incurred $500 of overhead expenses. XYZ Corporation's financial information for the year is summarized as follows:

	Total	Other property	QFTP[20]
Gross receipts	$25,000.00	$24,000.00	$1,000.00

[19] For this purpose, such a lease includes a lease that gave rise to exempt foreign trade income under the FSC provisions.

	Total	Other property	QFTP[20]
Cost of goods sold	17,000.00	16,400.00	600.00
Gross income	8,000.00	7,600.00	400.00
Direct expenses	4,500.00	4,225.00	275.00
Overhead expenses	500.00		
Net income	3,000.00		

[20] "QFTP" refers to qualifying foreign trade property.

Illustrated below is the computation of the amount of qualifying foreign trade income that is excluded from XYZ Corporation's gross income and the amount of related expenses that are disallowed. In order to calculate qualifying foreign trade income, the amount of foreign trade income first must be determined. Foreign trade income is the taxable income (determined without regard to the exclusion of qualifying foreign trade income) attributable to foreign trading gross receipts. In this example, XYZ Corporation's foreign trading gross receipts equal $1,000. This amount of gross receipts is reduced by the related cost of goods sold, the related direct expenses, and a portion of the overhead expenses in order to arrive at the related taxable income.[21] Thus, XYZ Corporation's foreign trade income equals $100, calculated as follows:

Foreign trading gross receipts	$1,000.00
Cost of goods sold	600.00
Gross income	400.00
Direct expenses	275.00
Apportioned overhead expenses	25.00
Foreign trade income	100.00

Foreign sale and leasing income is defined as an amount of foreign trade income (calculated taking into account only directly-related expenses) that is properly allocable to certain specified foreign activities. Assume for purposes of this example that of the $125 of foreign trade income ($400 of gross income from the sale of qualifying foreign trade property less only the direct expenses of $275), $35 is properly allocable to such foreign activities (e.g., solicitation, negotiation, advertising, foreign transportation, and other enumerated sales-like activities) and, therefore, is considered to be foreign sale and leasing income.

Qualifying foreign trade income is the amount of gross income that, if excluded, will result in a reduction of taxable income equal to the greatest of (1) 30 percent of foreign sale and leasing income, (2) 1.2 percent of foreign trading gross receipts, or (3) 15 percent of foreign trade income. Thus, in order to calculate the amount that is excluded from gross income, taxable income must be determined and then "grossed up" for allocable expenses in order to arrive at the appropriate gross income figure. First, for each method of calculating qualifying foreign trade income, the reduction in taxable

[21] Overhead expenses must be apportioned in a reasonable manner that does not result in a material distortion of income. In this example, the apportionment of the $500 of overhead expenses on the basis of gross income is assumed not to result in a material distortion of income and is assumed to be a reasonable method of apportionment. Thus, $25 ($500 of total overhead expenses multiplied by 5 percent, i.e., $400 of gross income from the sale of qualifying foreign trade property divided by $8,000 of total gross income) is apportioned to qualifying foreign trading gross receipts. The remaining $475 ($500 of total overhead expenses less the $25 apportioned to qualifying income) is apportioned to XYZ Corporation's other income.

income is determined. Then, the $275 of direct and $25 of overhead expenses, totaling $300, attributable to foreign trading gross receipts is apportioned to the reduction in taxable income based on the proportion of the reduction in taxable income to foreign trade income. This apportionment is done for each method of calculating qualifying foreign trade income. The sum of the taxable income reduction and the apportioned expenses equals the respective qualifying foreign trade income (i.e., the amount of gross income excluded) under each method, as follows:

	1.2% FTGR[22]	15% FTI[23]	30% FS&LI[24]
Reduction of taxable income:			
1.2% of FTGR (1.2% * $1,000)	12.00		
15% of FTI (15% * $100)		15.00	
30% of FS&LI (30% * $35)			10.50
Gross-up for disallowed expenses:			
$300 * ($12/$100)	36.00		
$300 * ($15/$100)		45.00	
$275 * ($10.50/$100)[25]			28.88
Qualifying foreign trade income	48.00	60.00	39.38

[22] "FTGR" refers to foreign trading gross receipts.
[23] "FTI" refers to foreign trade income.
[24] "FS&LI" refers to foreign sale and leasing income.
[25] Because foreign sale and leasing income only takes into account direct expenses, it is appropriate to take into account only such expenses for purposes of this calculation.

In the example, the $60 of qualifying foreign trade income is excluded from XYZ Corporation's gross income (determined based on 15 percent of foreign trade income).[26] In connection with excluding $60 of gross income, certain expenses that are allocable to this income are not deductible for U.S. Federal income tax purposes. Thus, $45 ($300 of related expenses multiplied by 15 percent, i.e., $60 of qualifying foreign trade income divided by $400 of gross income from the sale of qualifying foreign trade property) of expenses are disallowed.[27]

	Other Property	QFTP	Excluded/disallowed	Total
Gross receipts	$24,000.00	$1,000.00		
Cost of goods sold	16,400.00	600.00		
Gross income	7,600.00	400.00	(60.00)	7,940.00
Direct expenses	4,225.00	275.00	(41.25)	4,458.75
Overhead expenses	475.00	25.00	(3.75)	496.25
Taxable income				2,985.00

XYZ Corporation paid $40 of income tax to a foreign jurisdiction related to the sale and distribution of the qualifying foreign trade property. A portion of this $40 of foreign income tax is treated as paid with respect to the qualifying foreign trade income and, therefore, is not creditable for U.S. foreign tax credit purposes. In this case, $6 of such taxes paid ($40 of foreign taxes multiplied by 15

[26] Note that XYZ Corporation could choose to use one of the other two methods notwithstanding that they would result in a smaller exclusion.
[27] The $300 of allocable expenses includes both the $275 of direct expenses and the $25 of overhead expenses. Thus, the $45 of disallowed expenses represents the sum of $41.25 of direct expenses plus $3.75 of overhead expenses. If qualifying foreign trade income was determined using 30 percent of foreign sale and leasing income, the disallowed expenses would include only the appropriate portion of the direct expenses.

percent, i.e., $60 of qualifying foreign trade income divided by $400 of gross income from the sale of qualifying foreign trade property) is treated as paid with respect to the qualifying foreign trade income and, thus, is not creditable.

The results in this example are the same regardless of whether XYZ Corporation manufactures the property within the United States or outside of the United States through a foreign branch. If XYZ Corporation were an S corporation or limited liability company, the results also would be the same, and the exclusion would pass through to the S corporation owners or limited liability company owners as the case may be.

Other rules

Foreign-source income limitation

The bill provides a limitation with respect to the sourcing of taxable income applicable to certain sale transactions giving rise to foreign trading gross receipts. This limitation only applies with respect to sale transactions involving property that is manufactured within the United States. The special source limitation does not apply when qualifying foreign trade income is determined using 30 percent of the foreign sale and leasing income from the transaction.

This foreign-source income limitation is determined in one of two ways depending on whether the qualifying foreign trade income is calculated based on 1.2 percent of foreign trading gross receipts or on 15 percent of foreign trade income. If the qualifying foreign trade income is calculated based on 1.2 percent of foreign trading gross receipts, the related amount of foreign-source income may not exceed the amount of foreign trade income that (without taking into account this special foreign-source income limitation) would be treated as foreign-source income if such foreign trade income were reduced by 4 percent of the related foreign trading gross receipts.

For example, assume that foreign trading gross receipts are $2,000 and foreign trade income is $100. Assume also that the taxpayer chooses to determine qualifying foreign trade income based on 1.2 percent of foreign trading gross receipts. Taxable income after taking into account the exclusion of the qualifying foreign trade income and the disallowance of related deductions is $76. Assume that the taxpayer manufactured its qualifying foreign trade property in the United States and that title to such property passed outside of the United States. Absent a special sourcing rule, under section 863(b) (and the regulations thereunder) the $76 of taxable income would be sourced as $38 U.S. source and $38 foreign source. Under the special sourcing rule, the amount of foreign-source income may not exceed the amount of the foreign trade income that otherwise would be treated as foreign source if the foreign trade income were reduced by 4 percent of the related foreign trading gross receipts. Reducing foreign trade income by 4 percent of the foreign trading gross receipts (4 percent of $2,000, or $80) would result in $20 ($100 foreign trade income less $80). Applying section 863(b) to the $20 of reduced foreign trade income would result in $10 of foreign-source income and $10 of U.S.-source income. Accordingly, the limitation equals $10. Thus, although under the general sourcing rule $38 of the $76 taxable income would be treated as foreign source, the special sourcing rule limits foreign-source income in this example to $10 (with the remaining $66 being treated as U.S.-source income).

If the qualifying foreign trade income is calculated based on 15 percent of foreign trade income, the amount of related foreign-source income may not exceed 50 percent of the foreign trade income that (without taking into account this special foreign-source income limitation) would be treated as foreign-source income.

For example, assume that foreign trade income is $100 and the taxpayer chooses to determine its qualifying foreign trade income based on 15 percent of foreign trade income. Taxable income after taking into account the exclusion of the qualifying foreign trade income and the disallowance of related deductions is $85. Assume that the taxpayer manufactured its qualifying foreign trade property in the United States and that title to such property passed outside of the United States. Absent a special sourcing rule, under section 863(b) the $85 of taxable income would be sourced as $42.50 U.S. source and $42.50 foreign source. Under the special sourcing rule, the amount of foreign-source income may not exceed 50 percent of the foreign trade income that otherwise would be treated as foreign source. Applying section 863(b) to the $100 of foreign trade income would result in $50 of foreign-source income and $50 of U.S.-source income. Accordingly, the limitation equals $25, which is 50 percent of the $50 foreign-source income. Thus, although under the general sourcing rule $42.50 of the $85 taxable income would be treated as foreign source, the special sourcing rule limits foreign-source income in this example to $25 (with the remaining $60 being treated as U.S.-source income).[28]

Treatment of withholding taxes

The bill generally provides that no foreign tax credit is allowed for foreign taxes paid or accrued with respect to qualifying foreign trade income (i.e., excluded extraterritorial income). In determining whether foreign taxes are paid or accrued with respect to qualifying foreign trade income, foreign withholding taxes generally are treated as not paid or accrued with respect to qualifying foreign trade income.[29] Accordingly, the bill's denial of foreign tax credits would not apply to such taxes. For this purpose, the term "withholding tax" refers to any foreign tax that is imposed on a basis other than residence and that is otherwise a creditable foreign tax under sections 901 or 903.[30] It is intended that such taxes would be similar in nature to the gross-basis taxes described in sections 871 and 881.

If, however, qualifying foreign trade income is determined based on 30 percent of foreign sale and leasing income, the special rule for withholding taxes is not applicable. Thus, in such cases foreign withholding taxes may be treated as paid or accrued with respect to qualifying foreign trade income and, accordingly, are not creditable under the bill.

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[28] The foreign-source income limitation provisions also apply when source is determined solely in accordance with section 862 (e.g., a distributor of qualifying foreign trade property that is manufactured in the United States by an unrelated person and sold for use outside of the United States).

[29] With respect to the withholding taxes that are paid or accrued (a prerequisite to the taxes being otherwise creditable), the provision in the bill treats such taxes as not being paid or accrued with respect to qualifying foreign trade income.

[30] This also would apply to any withholding tax that is creditable for U.S. foreign tax credit purposes under an applicable treaty.

Election to be treated as a U.S. corporation

The bill provides that certain foreign corporations may elect, on an original return, to be treated as domestic corporations. The election applies to the taxable year when made and all subsequent taxable years unless revoked by the taxpayer or terminated for failure to qualify for the election. Such election is available for a foreign corporation (1) that manufactures property in the ordinary course of such corporation's trade or business, or (2) if substantially all of the gross receipts of such corporation reasonably may be expected to be foreign trading gross receipts. For this purpose, "substantially all" is based on the relevant facts and circumstances.

In order to be eligible to make this election, the foreign corporation must waive all benefits granted to such corporation by the United States pursuant to a treaty.[31] Absent such a waiver, it would be unclear, for example, whether the permanent establishment article of a relevant tax treaty would override the electing corporation's treatment as a domestic corporation under this provision. A foreign corporation that elects to be treated as a domestic corporation is not permitted to make an S corporation election. The Secretary is granted authority to prescribe rules to ensure that the electing foreign corporation pays its U.S. income tax liabilities and to designate one or more classes of corporations that may not make such an election.[32] If such an election is made, for purposes of section 367 the foreign corporation is treated as transferring (as of the first day of the first taxable year to which the election applies) all of its assets to a domestic corporation in connection with an exchange to which section 354 applies.

If a corporation fails to meet the applicable requirements, described above, for making the election to be treated as a domestic corporation for any taxable year beginning after the year of the election, the election will terminate. In addition, a taxpayer, at its option and at any time, may revoke the election to be treated as a domestic corporation. In the case of either a termination or a revocation, the electing foreign corporation will not be considered as a domestic corporation effective beginning on the first day of the taxable year following the year of such termination or revocation. For purposes of section 367, if the election to be treated as a domestic corporation is terminated or revoked, such corporation is treated as a domestic corporation transferring (as of the first day of the first taxable year to which the election ceases to apply) all of its property to a foreign corporation in connection with an exchange to which section 354 applies. Moreover, once a termination occurs or a revocation is made, the former electing corporation may not again elect to be taxed as a domestic corporation under the provisions of the bill for a period of five tax years beginning with the first taxable year that begins after the termination or revocation.

For example, assume a U.S. corporation owns 100 percent of a foreign corporation. The foreign corporation manufactures outside of the United States and sells what would be qualifying foreign trade property were it manufactured by a person subject to U.S. taxation. Such foreign corporation could make the election under

[31] The waiver of treaty benefits applies to the corporation itself and not, for example, to employees of or independent contractors associated with the corporation.

[32] For example, the Secretary of the Treasury may prescribe rules to prevent "per se" corporations under the entity-classification rules from making such an election.

this provision to be treated as a domestic corporation. As a result, its earnings no longer would be deferred from U.S. taxation. However, by electing to be subject to U.S. taxation, a portion of its income would be qualifying foreign trade income.[33] The requirement that the foreign corporation be treated as a domestic corporation (and, therefore, subject to U.S. taxation) is intended to provide parity between U.S. corporations that manufacture abroad in branch form and U.S. corporations that manufacture abroad through foreign subsidiaries. The election, however, is not limited to U.S.-owned foreign corporations. A foreign-owned foreign corporation that wishes to qualify for the treatment provided under the bill could avail itself of such election (unless otherwise precluded from doing so by Treasury regulations).

Shared partnerships

The bill provides rules relating to allocations of qualifying foreign trade income by certain shared partnerships. To the extent that such a partnership (1) maintains a separate account for transactions involving foreign trading gross receipts with each partner, (2) makes distributions to each partner based on the amounts in the separate account, and (3) meets such other requirements as the Treasury Secretary may prescribe by regulations, such partnership then would allocate to each partner items of income, gain, loss, and deduction (including qualifying foreign trade income) from such transactions on the basis of the separate accounts. It is intended that with respect to, and only with respect to, such allocations and distributions (i.e., allocations and distributions related to transactions between the partner and the shared partnership generating foreign trading gross receipts), these rules would apply in lieu of the otherwise applicable partnership allocation rules such as those in section 704(b). For this purpose, a partnership is a foreign or domestic entity that is considered to be a partnership for U.S. Federal income tax purposes.

Under the bill, any partner's interest in the shared partnership is not taken into account in determining whether such partner is a "related person" with respect to any other partner for purposes of the bill's provisions. Also, the election to exclude certain gross receipts from foreign trading gross receipts must be made separately by each partner with respect to any transaction for which the shared partnership maintains a separate account.

Certain assets not taken into account for purposes of interest expense allocation

The bill also provides that qualifying foreign trade property that is held for lease or rental, in the ordinary course of a trade or business, for use by the lessee outside of the United States is not taken into account for interest allocation purposes.

Distributions of qualifying foreign trade income by cooperatives

Agricultural and horticultural producers often market their products through cooperatives, which are member-owned corporations

[33] The sourcing limitation described above would not apply to this example because the property is manufactured outside of the United States.

formed under Subchapter T of the Code. At the cooperative level, the bill provides the same treatment of foreign trading gross receipts derived from products marketed through cooperatives as it provides for foreign trading gross receipts of other taxpayers. That is, the qualifying foreign trade income attributable to those foreign trading gross receipts is excluded from the gross income of the cooperative. Absent a special rule, however, patronage dividends or per-unit retain allocations attributable to qualifying foreign trade income paid to members of cooperatives would be taxable in the hands of those members. The Committee believes that this would disadvantage agricultural and horticultural producers who choose to market their products through cooperatives relative to those individuals who market their products directly or through pass-through entities such as partnerships, limited liability companies, or S corporations. Accordingly, the bill provides that the amount of any patronage dividends or per-unit retain allocations paid to a member of an agricultural or horticultural cooperative (to which Part I of Subchapter T applies), which is allocable to qualifying foreign trade income of the cooperative, is treated as qualifying foreign trade income of the member (and, thus, excludable from such member's gross income). In order to qualify, such amount must be designated by the organization as allocable to qualifying foreign trade income in a written notice mailed to its patrons not later than the payment period described in section 1382(d). The cooperative cannot reduce its income (e.g., cannot claim a "dividends-paid deduction") under section 1382 for such amounts.

Gap period before administrative guidance is issued

The Committee recognizes that there may be a gap in time between the enactment of the bill and the issuance of detailed administrative guidance. It is intended that during this gap period before administrative guidance is issued, taxpayers and the Internal Revenue Service may apply the principles of present-law regulations and other administrative guidance under sections 921 through 927 to analogous concepts under the bill. Some examples of the application of the principles of present-law regulations to the bill are described below. These limited examples are intended to be merely illustrative and are not intended to imply any limitation regarding the application of the principles of other analogous rules or concepts under present law.

Marginal costing and grouping

Under the bill, the Secretary of the Treasury is provided authority to prescribe rules for using marginal costing and for grouping transactions in determining qualifying foreign trade income. It is intended that similar principles under present-law regulations apply for these purposes.[34]

Excluded property

The bill provides that qualifying foreign trade property does not include property leased or rented by the taxpayer for use by a related person. It is intended that similar principles under present-

[34] See, e.g., Treas. Reg. sec. 1.924(d)-1(c)(5) and (e); Treas. Reg. sec. 1.925(a)–1T(c)(8); Treas. Reg. sec. 1.925(b)–1T.

law regulations apply for this purpose. Thus, excluded property does not apply, for example, to property leased by the taxpayer to a related person if the property is held for sublease, or is subleased, by the related person to an unrelated person and the property is ultimately used by such unrelated person predominantly outside of the United States.[35] In addition, consistent with the policy adopted in the Taxpayer Relief Act of 1997, computer software that is licensed for reproduction outside of the United States is not excluded property. Accordingly, the license of computer software to a related person for reproduction outside of the United States for sale, sublicense, lease, or rental to an unrelated person for use outside of the United States is not treated as excluded property by reason of the license to the related person.

Foreign trading gross receipts

Under the bill, foreign trading gross receipts are gross receipts from, among other things, the sale, exchange, or other disposition of qualifying foreign trade property, and from the lease of qualifying foreign trade property for use by the lessee outside of the United States. It is intended that the principles of present-law regulations that define foreign trading gross receipts apply for this purpose. For example, a sale includes an exchange or other disposition and a lease includes a rental or sublease and a license or a sublicense.[36]

Foreign use requirement

Under the bill, property constitutes qualifying foreign trade property if, among other things, the property is held primarily for lease, sale, or rental, in the ordinary course of business, for direct use, consumption, or disposition outside of the United States.[37] It is intended that the principles of the present-law regulations apply for purposes of this foreign use requirement. For example, for purposes of determining whether property is sold for use outside of the United States, property that is sold to an unrelated person as a component to be incorporated into a second product which is produced, manufactured, or assembled outside of the United States will not be considered to be used in the United States (even if the second product ultimately is used in the United States), provided that the fair market value of such seller's components at the time of delivery to the purchaser constitutes less than 20 percent of the fair market value of the second product into which the components are incorporated (determined at the time of completion of the production, manufacture, or assembly of the second product).[38]

In addition, for purposes of the foreign use requirement, property is considered to be used by a purchaser or lessee outside of the United States during a taxable year if it is used predominantly out-

[35] See Treas. Reg. sec. 1.927(a)–1T(f)(2)(i). The bill also provides that oil or gas or primary products from oil or gas are excluded from the definition of qualifying foreign trade property. It is intended that similar principles under present-law regulations apply for these purposes. Thus, for this purpose, petrochemicals, medicinal products, insecticides, and alcohols are not considered primary products from oil or gas and, thus, are not treated as excluded property. See Treas. Reg. sec. 1.927(a)–1T(g)(2)(iv).

[36] See Treas. Reg. sec. 1.924(a)–1T(a)(2).

[37] Foreign trading gross receipts eligible for exclusion from the tax base do not include gross receipts from a transaction if the qualifying foreign trade property is for ultimate use in the United States.

[38] See Treas. Reg. sec. 1.927(a)–1T(d)(4)(ii).

side of the United States.[39] For this purpose, property is considered to be used predominantly outside of the United States for any period if, during that period, the property is located outside of the United States more than 50 percent of the time.[40] An aircraft or other property used for transportation purposes (e.g., railroad rolling stock, a vessel, a motor vehicle, or a container) is considered to be used outside of the United States for any period if, for the period, either the property is located outside of the United States more than 50 percent of the time or more than 50 percent of the miles traveled in the use of the property are traveled outside of the United States.[41] An orbiting satellite is considered to be located outside of the United States for these purposes.[42]

Foreign economic processes

Under the bill, gross receipts from a transaction are foreign trading gross receipts eligible for exclusion from the tax base only if certain economic processes take place outside of the United States. The foreign economic processes requirement compares foreign direct costs to total direct costs. It is intended that the principles of the present-law regulations apply during the gap period for purposes of the foreign economic processes requirement including the measurement of direct costs. The Committee recognizes that the measurement of foreign direct costs under the present-law regulations often depend on activities conducted by the FSC, which is a separate entity. The Committee is aware that some of these concepts will have to be modified when new guidance is promulgated as a result of the bill's elimination of the requirement for a separate entity.

EFFECTIVE DATE

In general

The bill is effective for transactions entered into after September 30, 2000. In addition, no corporation may elect to be a FSC after September 30, 2000.

The bill also provides a rule requiring the termination of a dormant FSC when the FSC has been inactive for a specified period of time. Under this rule, a FSC that generates no foreign trade income for any five consecutive years beginning after December 31, 2001, will cease to be treated as a FSC.

Transition rules

The bill provides a transition period for existing FSCs and for binding contractual agreements. The new rules do not apply to transactions in the ordinary course of business[43] involving a FSC before January 1, 2002. Furthermore, the new rules do not apply to transactions in the ordinary course of business after December 31, 2001, if such transactions are pursuant to a binding contract between a FSC (or a person related to the FSC on September 30, 2000) and any other person (that is not a related person) and such

[39] See Treas. Reg. sec. 1.927(a)–1T(d)(4)(iii), (iv), and (v).
[40] See Treas. Reg. sec. 1.927(a)–1T(d)(4)(vi).
[41] Id.
[42] Id.
[43] The mere entering into of a single transaction, such as a lease, would not, in and of itself, prevent the transaction from being in the ordinary course of business.

contract is in effect on September 30, 2000, and all times thereafter. For this purpose, binding contracts include purchase options, renewal options, and replacement options that are enforceable against a lessor or seller (provided that the options are a part of a contract that is binding and in effect on September 30, 2000).

Similar to the limitation on use of the gross receipts method under the bill's operative provisions, the bill provides a rule that limits the use of the gross receipts method for transactions after the effective date of the bill if that same property generated foreign trade income to a FSC using the gross receipts method. Under the rule, if any person used the gross receipts method under the FSC regime, neither that person nor any related person will have qualifying foreign trade income with respect to any other transaction involving the same item of property.

Notwithstanding the transition period, FSCs (or related persons) may elect to have the rules of the bill apply in lieu of the rules applicable to FSCs. Thus, for transactions to which the transition rules apply, taxpayers may choose to apply either the FSC rules or the amendments made by this bill, but not both. It is also intended that a taxpayer would not be able to avail itself of the rules of the bill in addition to the rules applicable to domestic international sales corporations.

III. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the provisions of the bill, H.R. 4986, as reported.

The bill, as reported, is estimated to have the following effects on budget receipts for fiscal years 2001–2010.

ESTIMATED BUDGET EFFECTS OF H.R. 4986, THE ''FSC REPEAL AND EXTRATERRITORIAL INCOME EXCLUSION ACT OF 2000,'' AS REPORTED BY THE COMMITTEE ON FINANCE

[Fiscal Years 2001–2010, in millions of dollars]

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2001–05	2001–10
Extraterritorial Income Exclusion; FSC Repeal	generally ta 9/30/00	−141	−305	−340	−378	−423	−466	−514	−566	−623	−687	−1,587	−4,443

Legend for ''Effective'' column: ta = transaction after.

Note: Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the provisions of the bill as reported involve no new or increased budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the committee states that the revenue-reducing income tax provisions involve increased tax expenditures (See revenue table in Part III.A., above.)

C. Consultation With the Congressional Budget Office

In accordance with section 403 of the Budget Act, the committee advises that the Congressional Budget Office has submitted a statement on this bill.

U.S. Congress,
Congressional Budget Office,
Washington, DC, September 20, 2000.

Hon. William V. Roth, Jr.,
Chairman, Committee on Finance,
U.S. Senate, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4986, the FSC Repeal and Extraterritorial Income Exclusion Act of 2000.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Erin Whitaker.

Sincerely,

Barry B. Anderson
(For Dan L. Crippen, Director).

Enclosure.

H.R. 4986.—FSC Repeal and Extraterritorial Income Exclusion Act of 2000

Summary: H.R. 4986 would repeal present-law foreign sales corporation (FSC) rules. Under current law, U.S. firms generally are subject to U.S. Tax on their worldwide income, but they are allowed tax credits for a portion of the income taxes they pay to foreign governments on that income. Within that general framework, U.S. law permits the use of FSCs, through which a portion of domestic firms' export income is characterized as foreign source and is exempted from U.S. tax. Under the proposal, U.S. firms could elect to exclude certain qualifying foreign trade income from their taxable income, with qualifying foreign trade income defined to include a portion of income attributable to sales by U.S. taxpayers. To be eligible for the exclusion, firms would not be allowed tax credits for income taxes paid to foreign governments on the qualifying foreign trade income. Qualifying foreign trade income would be calculated by using one of several formulas. The remaining portion of income earned from sources abroad would be taxed in a similar manner as under current law.

The Joint Committee on Taxation (JCT) estimates that the bill would reduce revenues by $141 million in 2001, by about $1.6 billion over the 2001–2005 period, and by about $4.4 billion over the 2001–2010 period. Because the bill would affect receipts, pay-as-you-go procedures would apply.

H.R. 4986 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

Estimated cost to the Federal Government: The estimated budgetary impact of H.R. 4986 is shown in the following table. Estimates of all provisions in the H.R. 4986 were provided by JCT.

	By fiscal year in millions of dollars—					
	2000	2001	2002	2003	2004	2005
CHANGES IN REVENUES						
Estimated Revenues	0	−141	−305	−340	−378	−423

Source: Joint Committee on Taxation.

Pay-as-you-go consideration: The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The net changes in governmental receipts that are subject to pay-as-you-go procedures are shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the effects in the current year, the budget year, and the succeeding four years are counted.

	By fiscal year in millions of dollars—										
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Changes in receipts	0	−141	−305	−340	−378	−423	−466	−514	−566	−623	−687
Changes in outlays	Not applicable										

Intergovernmental and private-sector impact: H.R. 4986 contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

Previous CBO estimate: On September 13, 2000, CBO transmitted a cost estimate for H.R. 4986 as ordered reported by the House Committee on Ways and Means on July 27, 2000, with subsequent amendments provided on September 12, 2000. This estimate reflects the removal of a provision from the earlier version of H.R. 4986 which would allow domestic corporations to receive a tax deduction for certain dividends received from their foreign subsidiaries. This change would decrease the reduction in revenues, relative to the earlier version of H.R. 4986, by $12 million in 2001, $36 million over the 2001–2005 period, and $36 million over the 2001–2010 period.

Estimate prepared by: Erin Whitaker.

Estimate approved by: Roberton C. Williams, Deputy Assistant Director for Tax Analysis.

IV. VOTES OF THE COMMITTEE

In compliance with paragraph 7(b) of rule XXVI of the Standing Rules of the Senate, the following statements are made concerning the rollcall votes in the Committee's consideration of the bill.

MOTION TO REPORT THE BILL

H.R. 4986, the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, was ordered favorably reported by voice vote, as amended.

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

Pursuant to paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of the bill as reported.

Impact on individuals and businesses

The bill repeals the FSC provisions of the Code and provides an exclusion from gross income for certain extraterritorial income.

Impact on personal privacy and paperwork

The bill should not have any adverse impact on personal privacy. Additional paperwork may be required with the respect to the application of the new regime to individuals.

B. Unfunded Mandates Statement

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104–4).

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, and tribal governments.

C. Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the House Committee on Ways and Means, the Senate Committee on Finance, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Code and has "widespread applicability" to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Code and that have widespread applicability to individuals or small businesses.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the Committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill as reported by the Committee).

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