

106TH CONGRESS  
1ST SESSION

# H. R. 2270

To amend the Internal Revenue Code of 1986 to reform the interest allocation rules.

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## IN THE HOUSE OF REPRESENTATIVES

JUNE 17, 1999

Mr. PORTMAN (for himself and Mr. MATSUI) introduced the following bill;  
which was referred to the Committee on Ways and Means

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## A BILL

To amend the Internal Revenue Code of 1986 to reform  
the interest allocation rules.

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

3       **SECTION. 1. SHORT TITLE.**

4       This Act may be cited as the “Interest Allocation Re-  
5       form Act”.

6       **SEC. 2. INTEREST ALLOCATION RULES.**

7       (a) IN GENERAL.—Section 864 of the Internal Rev-  
8       enue Code of 1986 (relating to definitions and special  
9       rules with respect to source rules and general rules relat-  
10      ing to foreign income) is amended by redesignating sub-

1 section (f) as subsection (g) and by inserting after sub-  
 2 section (e) the following new subsection:

3 “(f) ELECTION WITH RESPECT TO INTEREST ALLO-  
 4 CATION.—For purposes of this subchapter—

5 “(1) ELECTION.—

6 “(A) IN GENERAL.—If a member of an af-  
 7 filiated group so elects, this subsection shall  
 8 apply in lieu paragraphs (1) and (5) of sub-  
 9 section (e) for purposes of all allocations and  
 10 apportionments of interest expense.

11 “(B) WHEN MADE; APPLICATION.—An  
 12 election under this paragraph may be made  
 13 only for the taxpayer’s first taxable year for  
 14 which this subsection is effective and for which  
 15 the taxpayer is a member of an affiliated group.  
 16 An election under this paragraph shall apply to  
 17 all members of the affiliated group. An election  
 18 under this paragraph, once made, shall apply to  
 19 the taxable year for which made and all subse-  
 20 quent years unless revoked with the consent of  
 21 the Secretary.

22 “(2) TREATMENT OF AFFILIATED GROUPS.—  
 23 Except as otherwise provided in this subsection, the  
 24 taxable income of an affiliated group from sources  
 25 outside the United States shall be determined by al-

1 locating and apportioning interest expense to such  
2 income in an amount equal to—

3 “(A) the total interest expense of the ex-  
4 panded affiliated group which includes such af-  
5 filiated group, multiplied by

6 “(B) a percentage equal to the ratio which  
7 the foreign assets of the expanded affiliated  
8 group bears to all assets of the expanded affili-  
9 ated group.

10 “(3) TREATMENT OF FOREIGN SUBSIDIARY IN-  
11 TEREST EXPENSE.—Interest expense allocated to  
12 foreign source income under the rules of paragraph  
13 (2) shall be reduced (but not below zero) by any in-  
14 terest expense incurred by any foreign corporation in  
15 the expanded affiliated group to the extent such in-  
16 terest would have been allocated and apportioned to  
17 foreign source income of such corporation if this  
18 subsection were applied to a group consisting of all  
19 the foreign corporations in the expanded affiliated  
20 group. A similar reduction shall be made in the case  
21 of a corporation described in section 1504(b)(4).

22 “(4) BASIS OF STOCK IN CERTAIN CORPORA-  
23 TIONS ADJUSTED FOR EARNINGS AND PROFITS.—  
24 The basis adjustment rules of subsection (e)(4) shall  
25 be applied only to stock in a corporation which is

1 not included in the expanded affiliated group and in  
2 which members of the expanded affiliated group own  
3 10 percent or more of the total combined voting  
4 power of all classes of stock entitled to vote.

5 “(5) EXCEPTION FOR INTEREST EXPENSE OF  
6 CERTAIN DOMESTIC SUBSIDIARIES.—

7 “(A) IN GENERAL.—A domestic corpora-  
8 tion which is a member of an affiliated group  
9 and which incurs interest expense with respect  
10 to qualified indebtedness (as defined in sub-  
11 paragraph (C)) may elect to allocate and appor-  
12 tion interest expense incurred with respect to  
13 such qualified indebtedness under the rules of  
14 this subsection as if such corporation were the  
15 common parent of an expanded affiliated group  
16 consisting of such domestic corporation and any  
17 corporation at a lower level in the chain of cor-  
18 porations that includes such domestic corpora-  
19 tion.

20 “(B) EQUALIZATION RULE.—If an election  
21 under subparagraph (A) is made by any mem-  
22 ber of an affiliated group, all interest expense  
23 of such affiliated group not incurred with re-  
24 spect to qualified indebtedness shall be allo-  
25 cated and apportioned to foreign source income

1 to the extent such expense does not exceed the  
2 amount of all interest expense which, but for  
3 this paragraph, would have been so allocated  
4 and apportioned.

5 “(C) QUALIFIED INDEBTEDNESS.—For  
6 purposes of this paragraph, qualified indebted-  
7 ness means any borrowing from any unrelated  
8 party which is not guaranteed (or otherwise di-  
9 rectly supported) by any corporation within the  
10 same expanded affiliated group as the borrower  
11 (other than a corporation at a lower level in the  
12 chain of includible corporations). If a borrowing  
13 is not treated as qualified indebtedness solely  
14 because it is guaranteed (or otherwise directly  
15 supported) by another corporation, then—

16 “(i) such borrowing shall be treated  
17 as the borrowing of such other corporation  
18 if such other corporation is at a higher  
19 level in the chain of includible corporations  
20 than the borrowing corporation, or

21 “(ii) if such other corporation is in a  
22 different chain of includible corporations,  
23 such borrowing shall be treated as the bor-  
24 rowing of the first common parent of the

1 borrowing corporation and the guaran-  
2 teeing corporation.

3 “(D) EFFECT OF CERTAIN TRANSACTIONS  
4 ON QUALIFIED INDEBTEDNESS.—To the extent  
5 that a domestic corporation allocating interest  
6 expense under the rules of subparagraph (A)—

7 “(i) distributes dividends or makes  
8 other distributions with respect to its stock  
9 in any year to any member of its affiliated  
10 group in excess of the greater of—

11 “(I) its average annual dividend  
12 (expressed as a percentage of current  
13 earnings and profits) during the 5  
14 taxable year period ending with the  
15 taxable year preceding the taxable  
16 year, or

17 “(II) 25 percent of its average  
18 annual earnings and profits for such 5  
19 taxable year period, or

20 “(ii) deals with any related party in  
21 any manner not clearly reflecting the in-  
22 come of the corporation,

23 an amount of qualified indebtedness equal to  
24 the excess distribution or the understatement or  
25 overstatement of income, as the case may be,

1 shall be recharacterized for purposes of this  
 2 paragraph as nonqualified indebtedness. If a  
 3 corporation has not been in existence for 5 tax-  
 4 able years, this subparagraph shall be applied  
 5 with respect to the period it was in existence.

6 “(E) EFFECT OF ELECTION ON GROUP.—

7 If 1 member of an affiliated group makes an  
 8 election under subparagraph (A), all members  
 9 of such group shall be treated as having made  
 10 such election.

11 “(6) TREATMENT OF CERTAIN FINANCIAL IN-  
 12 STITUTIONS.—

13 “(A) IN GENERAL.—Any corporation that  
 14 is predominantly engaged in the active conduct  
 15 of a banking, insurance, financing, or similar  
 16 business may elect to be treated as a member  
 17 of an affiliated or expanded affiliated group  
 18 only for purposes of applying this subsection to  
 19 corporations so engaged.

20 “(B) DEFINITION.—A corporation shall be  
 21 considered to be predominantly engaged in a  
 22 banking, insurance, financing, or similar busi-  
 23 ness if at least 80 percent of its gross income  
 24 is income described in section 904(d)(2)(C)(ii)  
 25 and the regulations thereunder.

“(C) EFFECT OF CERTAIN TRANS-  
 ACTIONS.—Rules similar to the rules of para-  
 graph (5)(D) shall apply in the case of trans-  
 actions between a corporation included in the  
 group described in subparagraph (A) and an-  
 other member of the affiliated group that is not  
 included in the group described in subpara-  
 graph (A).

“(D) EFFECT OF ELECTION ON GROUP.—  
 If 1 member of an affiliated group makes an  
 election under subparagraph (A), all members  
 of such group shall be treated as having made  
 such election.

“(7) AFFILIATED GROUP.—For purposes of this  
 subsection—

“(A) AFFILIATED GROUP.—The term ‘af-  
 filiated group’ has the meaning given by such  
 term in section 1504(a) (determined without re-  
 gard to paragraph (2) of section 1504(b)).

“(B) EXPANDED AFFILIATED GROUP.—  
 The term ‘expanded affiliated group’ means an  
 affiliated group determined without regard to  
 paragraph (2), (3), or (4) of section 1504(b)  
 (but does not include a FSC as defined in sec-  
 tion 922(a)).



1           “(8) REGULATIONS.—The Secretary shall pre-  
2       scribe regulations providing for the direct allocation  
3       of interest expense in other circumstances where  
4       such allocation would be necessary or appropriate to  
5       carry out the purposes of this subsection.”

6       (b) CONFORMING AMENDMENT.—Subsection (e) of  
7       section 864 is amended by striking “subchapter—” and  
8       inserting “subchapter, except as provided in subsection  
9       (f)—”.

10       (c) EFFECTIVE DATE.—The amendments made by  
11       this section shall apply to taxable years ending after De-  
12       cember 31, 1999.

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