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S. 96

To amend the Internal Revenue Code of 1986 to ensure a fairer and simpler method of taxing controlled foreign corporations of United States shareholders, to treat certain foreign corporations managed and controlled in the United States as domestic corporations, to codify the economic substance doctrine, and to eliminate the top corporate income tax rate, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 4, 2007

Mr. KERRY introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to ensure a fairer and simpler method of taxing controlled foreign corporations of United States shareholders, to treat certain foreign corporations managed and controlled in the United States as domestic corporations, to codify the economic substance doctrine, and to eliminate the top corporate income tax rate, and for other purposes.

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; AMENDMENT OF 1986 CODE.**

2 (a) SHORT TITLE.—This Act may be cited as the
3 “Export Products Not Jobs Act”.

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

10 **TITLE I—FOREIGN TAX REFORM**
11 **AND SIMPLIFICATION**

12 **SEC. 101. REFORM AND SIMPLIFICATION OF SUBPART F.**

13 (a) IN GENERAL.—Subpart F of part III of sub-
14 chapter N of chapter 1 (relating to controlled foreign cor-
15 porations) is amended by striking sections 952, 953, and
16 954 and inserting the following:

17 **“SEC. 952. SUBPART F INCOME DEFINED.**

18 “(a) IN GENERAL.—For purposes of this subpart, ex-
19 cept as provided in this section, the term ‘subpart F in-
20 come’ means the gross income of the controlled foreign
21 corporation.

22 “(b) EXCEPTIONS FOR CERTAIN TYPES OF IN-
23 COME.—Subpart F income shall not include—

24 “(1) the active home country income (as de-
25 fined in section 953) of the controlled foreign cor-
26 poration for the taxable year, or

1 “(2) any item of income for the taxable year
2 from sources within the United States which is effec-
3 tively connected with the conduct by the controlled
4 foreign corporation of a trade or business within the
5 United States unless such item is exempt from tax-
6 ation (or is subject to a reduced rate of tax) pursu-
7 ant to a treaty obligation of the United States.

8 For purposes of paragraph (2), income described in para-
9 graph (2) or (3) of section 921(d) shall be treated as de-
10 rived from sources within the United States and any ex-
11 emption (or reduction) with respect to the tax imposed by
12 section 884 shall not be taken into account.

13 “(c) LIMITATION BASED ON EARNINGS AND PROF-
14 ITS.—

15 “(1) IN GENERAL.—For purposes of subsection
16 (a), the subpart F income of any controlled foreign
17 corporation for any taxable year shall not exceed the
18 earnings and profits of such corporation for such
19 taxable year.

20 “(2) RECHARACTERIZATION IN SUBSEQUENT
21 TAXABLE YEARS.—If the subpart F income of any
22 controlled foreign corporation for any taxable year
23 was reduced by reason of paragraph (1), any excess
24 of the earnings and profits of such corporation for
25 any subsequent taxable year over the subpart F in-

1 come of such foreign corporation for such taxable
2 year shall be recharacterized as subpart F income
3 under rules similar to the rules applicable under sec-
4 tion 904(f)(5).

5 “(3) SPECIAL RULE FOR DETERMINING EARN-
6 INGS AND PROFITS.—For purposes of this sub-
7 section, earnings and profits of any controlled for-
8 eign corporation shall be determined without regard
9 to paragraphs (4), (5), and (6) of section 312(n).
10 Under regulations, the preceding sentence shall not
11 apply to the extent it would increase earnings and
12 profits by an amount which was previously distrib-
13 uted by the controlled foreign corporation.

14 “(d) DE MINIMIS EXCEPTION.—If the subpart F in-
15 come of a controlled foreign corporation for any taxable
16 year (determined without regard to this subsection and
17 section 954(a)) is less than the lesser of—

18 “(1) 5 percent of gross income, or

19 “(2) \$1,000,000,

20 the subpart F income of such corporation for such taxable
21 year shall be treated as being equal to zero.

22 “(e) SPECIAL RULES RELATING TO BOYCOTTS,
23 BRIBES, AND CERTAIN FOREIGN COUNTRIES.—

24 “(1) IN GENERAL.—Subpart F income of a con-
25 trolled foreign corporation for any taxable year (de-

1 terminated without regard to this subsection) shall be
2 increased by the sum of—

3 “(A) the product of—

4 “(i) the gross income of the corpora-
5 tion reduced by its subpart F income (as
6 so determined), and

7 “(ii) the international boycott factor
8 (as determined under section 999),

9 “(B) the sum of the amounts of any illegal
10 bribes, kickbacks, or other payments (within the
11 meaning of section 162(c)) paid by or on behalf
12 of the corporation during the taxable year of
13 the corporation directly or indirectly to an offi-
14 cial, employee, or agent in fact of a govern-
15 ment, and

16 “(C) the gross income of such corporation
17 which is derived from any foreign country dur-
18 ing any period during which section 901(j) ap-
19 plies to such foreign country and which is not
20 otherwise treated as subpart F income (as so
21 determined).

22 “(2) SPECIAL RULE FOR ILLEGAL PAYMENTS.—

23 The payments referred to in paragraph (1)(B) are
24 payments which would be unlawful under the For-

1 eign Corrupt Practices Act of 1977 if the payor were
2 a United States person.

3 “(3) INCOME DERIVED FROM FOREIGN COUN-
4 TRY.—The Secretary shall prescribe such regulations
5 as may be necessary or appropriate to carry out the
6 purposes of paragraph (1)(C), including regulations
7 which treat income paid through 1 or more entities
8 as derived from a foreign country to which section
9 901(j) applies if such income was, without regard to
10 such entities, derived from such country.

11 **“SEC. 953. ACTIVE HOME COUNTRY INCOME.**

12 “(a) IN GENERAL.—For purposes of section 952(b),
13 the term ‘active home country income’ means, with respect
14 to any controlled foreign corporation, income derived from
15 the active and regular conduct of 1 or more trades or busi-
16 nesses within the home country of such corporation which
17 constitutes—

18 “(1) qualified property income, or

19 “(2) qualified services income.

20 “(b) QUALIFIED PROPERTY INCOME.—For purposes
21 of this section—

22 “(1) IN GENERAL.—The term ‘qualified prop-
23 erty income’ means income derived in connection
24 with—

1 “(A) the manufacture, production, growth,
2 or extraction (in whole or in substantial part)of
3 any personal property within the home country
4 of the controlled foreign corporation, or

5 “(B) the resale by the controlled foreign
6 corporation within its home country of personal
7 property manufactured, produced, grown, or ex-
8 tracted (in whole or in substantial part) within
9 that home country.

10 “(2) PROPERTY MUST BE USED OR CONSUMED
11 IN HOME COUNTRY.—Paragraph (1) shall only apply
12 to income if the personal property is sold for use or
13 consumption within the home country.

14 “(c) QUALIFIED SERVICES INCOME.—For purposes
15 of this section—

16 “(1) IN GENERAL.—The term ‘qualified services
17 income’ means income (other than qualified property
18 income) derived in connection with the providing of
19 services in transactions with customers which, at the
20 time the services are provided, are located in the
21 home country of such corporation.

22 “(2) SERVICES MUST BE USED IN HOME COUN-
23 TRY.—Paragraph (1) shall only apply to income if
24 the services—

1 “(A) are used or consumed in the home
2 country of the controlled foreign corporation, or

3 “(B) are used in the active conduct of a
4 trade or business by the recipient and substan-
5 tially all of the activities in connection with the
6 trade or business are conducted by the recipient
7 in such home country.

8 “(3) SPECIAL RULE FOR INSURANCE INCOME.—
9 If income of a controlled foreign corporation—

10 “(A) is attributable to the issuing (or rein-
11 suring) of an insurance or annuity contract,
12 and

13 “(B) would (subject to the modifications
14 under section 954(c)(2)(B)) be taxed under
15 subchapter L of this chapter if such income
16 were the income of a domestic corporation,
17 such income shall be treated as qualified services in-
18 come only if the contract covers only risks in connec-
19 tion with property in, liability arising out of activity
20 in, or lives or health of residents of, the home coun-
21 try of such corporation.

22 “(4) ANTI-ABUSE RULE.—For purposes of this
23 subsection, there shall be disregarded any item of in-
24 come of a controlled foreign corporation derived in
25 connection with any trade or business if, in the con-

1 duct of the trade or business, the corporation is not
 2 engaged in regular and continuous transactions with
 3 customers which are not related persons.

4 “(d) HOME COUNTRY.—For purposes of this section,
 5 the term ‘home country’ means, with respect to a con-
 6 trolled foreign corporation, the country in which such cor-
 7 poration is created or organized.

8 **“SEC. 954. OTHER RULES AND DEFINITIONS RELATING TO**
 9 **SUBPART F INCOME.**

10 “(a) DEDUCTIONS TO BE TAKEN INTO ACCOUNT.—
 11 For purposes of determining the subpart F income of a
 12 controlled foreign corporation for any taxable year, gross
 13 income, and any category of income described in sub-
 14 section (b) or (c) of section 953, shall be reduced by de-
 15 ductions (including taxes) properly allocable to such in-
 16 come or category. The Secretary shall prescribe regula-
 17 tions for the application of this subsection.

18 “(b) ELECTION BY CONTROLLED FOREIGN COR-
 19 PORATION TO BE TREATED AS DOMESTIC CORPORA-
 20 TION.—

21 “(1) IN GENERAL.—If—

22 “(A) a foreign corporation is a controlled
 23 foreign corporation which makes an election to
 24 have this subsection apply and waives all bene-

1 fits to such corporation granted by the United
2 States under any treaty, and

3 “(B) such foreign corporation meets such
4 requirements as the Secretary shall prescribe to
5 ensure that the taxes imposed by this chapter
6 on such foreign corporation are paid,

7 such corporation shall be treated as a domestic cor-
8 poration for purposes of this title.

9 “(2) PERIOD DURING WHICH ELECTION IS IN
10 EFFECT.—

11 “(A) IN GENERAL.—Except as provided in
12 subparagraph (B), an election under paragraph
13 (1) shall apply to the taxable year for which
14 made and all subsequent taxable years unless
15 revoked with the consent of the Secretary.

16 “(B) TERMINATION.—If a corporation
17 which made an election under paragraph (1) for
18 any taxable year fails to meet the requirements
19 of subparagraph (B) of paragraph (1) for any
20 subsequent taxable year, such election shall not
21 apply to such subsequent taxable year and all
22 succeeding taxable years.

23 “(3) TREATMENT OF LOSSES.—If any corpora-
24 tion treated as a domestic corporation under this
25 subsection is treated as a member of an affiliated

1 group for purposes of chapter 6 (relating to consoli-
2 dated returns), any loss of such corporation shall be
3 treated as a dual consolidated loss for purposes of
4 section 1503(d) without regard to paragraph (2)(B)
5 thereof.

6 “(4) EFFECT OF ELECTION.—

7 “(A) IN GENERAL.—For purposes of sec-
8 tion 367, any foreign corporation making an
9 election under paragraph (1) shall be treated as
10 transferring (as of the 1st day of the 1st tax-
11 able year to which such election applies) all of
12 its assets to a domestic corporation in connec-
13 tion with an exchange to which section 354 ap-
14 plies.

15 “(B) EXCEPTION FOR PRE-2008 EARNINGS
16 AND PROFIT.—

17 “(i) IN GENERAL.—Earnings and
18 profits of the foreign corporation accumu-
19 lated in taxable years beginning before
20 January 1, 2008, shall not be included in
21 the gross income of the persons holding
22 stock in such corporation by reason of sub-
23 paragraph (A).

24 “(ii) TREATMENT OF DISTRIBUTIONS.—For purposes of this title, any dis-
25

1 tribution made by a corporation to which
2 an election under paragraph (1) applies
3 out of earnings and profits accumulated in
4 taxable years beginning before January 1,
5 2008, shall be treated as a distribution
6 made by a foreign corporation.

7 “(iii) CERTAIN RULES TO CONTINUE
8 TO APPLY TO PRE-2008 EARNINGS.—The
9 provisions specified in clause (iv) shall be
10 applied without regard to paragraph (1),
11 except that, in the case of a corporation to
12 which an election under paragraph (1) ap-
13 plies, only earnings and profits accumu-
14 lated in taxable years beginning before
15 January 1, 2008, shall be taken into ac-
16 count.

17 “(iv) SPECIFIED PROVISIONS.—The
18 provisions specified in this clause are:

19 “(I) Section 1248 (relating to
20 gain from certain sales or exchanges
21 of stock in certain foreign corpora-
22 tions).

23 “(II) Subpart F of part III of
24 subchapter N to the extent such sub-
25 part relates to earnings invested in

1 United States property or amounts re-
2 ferred to in clause (ii) or (iii) of sec-
3 tion 951(a)(1)(A).

4 “(5) EFFECT OF TERMINATION.—For purposes
5 of section 367, if—

6 “(A) an election is made by a corporation
7 under paragraph (1) for any taxable year, and

8 “(B) such election ceases to apply for any
9 subsequent taxable year,

10 such corporation shall be treated as a domestic cor-
11 poration transferring (as of the 1st day of such sub-
12 sequent taxable year) all of its property to a foreign
13 corporation in connection with an exchange to which
14 section 354 applies.

15 “(c) SPECIAL RULE FOR CERTAIN CAPTIVE INSUR-
16 ANCE COMPANIES.—

17 “(1) IN GENERAL.—Solely for purposes of ap-
18 plying this subpart to related person insurance in-
19 come—

20 “(A) the term ‘United States shareholder’
21 means, with respect to any foreign corporation,
22 a United States person (as defined in section
23 957(c)) who owns (within the meaning of sec-
24 tion 958(a)) any stock of the foreign corpora-
25 tion,

1 “(B) the term ‘controlled foreign corpora-
2 tion’ has the meaning given to such term by
3 section 957(a) determined by substituting ‘25
4 percent or more’ for ‘more than 50 percent’,
5 and

6 “(C) the pro rata share referred to in sec-
7 tion 951(a)(1)(A)(i) shall be determined under
8 paragraph (5) of this subsection.

9 “(2) RELATED PERSON INSURANCE INCOME.—
10 For purposes of this subsection—

11 “(A) IN GENERAL.—The term ‘related per-
12 son insurance income’ means any income
13 which—

14 “(i) is attributable to a policy of in-
15 surance or reinsurance with respect to
16 which the person (directly or indirectly) in-
17 sured is a United States shareholder in the
18 foreign corporation or a related person to
19 such a shareholder, and

20 “(ii) would (subject to the modifica-
21 tions provided by subparagraph (B)) be
22 taxed under subchapter L of this chapter
23 if such income were the income of a do-
24 mestic insurance company.

1 “(B) SPECIAL RULES.—For purposes of
2 subparagraph (A)—

3 “(i) The following provisions of sub-
4 chapter L shall not apply:

5 “(I) The small life insurance
6 company deduction.

7 “(II) Section 805(a)(5) (relating
8 to operations loss deduction).

9 “(III) Section 832(c)(5) (relating
10 to certain capital losses).

11 “(ii) The items referred to in—

12 “(I) section 803(a)(1) (relating
13 to gross amount of premiums and
14 other considerations),

15 “(II) section 803(a)(2) (relating
16 to net decrease in reserves),

17 “(III) section 805(a)(2) (relating
18 to net increase in reserves), and

19 “(IV) section 832(b)(4) (relating
20 to premiums earned on insurance con-
21 tracts),

22 shall be taken into account only to the ex-
23 tent they are in respect of any reinsurance
24 or the issuing of any insurance or annuity
25 contract described in subparagraph (A).

1 “(iii) Reserves for any insurance or
2 annuity contract shall be determined in the
3 same manner as if the controlled foreign
4 corporation were subject to tax under sub-
5 chapter L, except that in applying such
6 subchapter—

7 “(I) the interest rate determined
8 for the functional currency of the cor-
9 poration and which, except as pro-
10 vided by the Secretary, is calculated
11 in the same manner as the Federal
12 mid-term rate under section 1274(d),
13 shall be substituted for the applicable
14 Federal interest rate,

15 “(II) the highest assumed inter-
16 est rate permitted to be used in deter-
17 mining foreign statement reserves
18 shall be substituted for the prevailing
19 State assumed interest rate, and

20 “(III) tables for mortality and
21 morbidity which reasonably reflect the
22 current mortality and morbidity risks
23 in the corporation’s home country
24 shall be substituted for the mortality

1 and morbidity tables otherwise used
2 for such subchapter.

3 “(iv) All items of income, expenses,
4 losses, and deductions shall be properly al-
5 located or apportioned under regulations
6 prescribed by the Secretary.

7 “(3) EXCEPTION FOR CORPORATIONS NOT
8 HELD BY INSUREDS.—Paragraph (1) shall not apply
9 to any foreign corporation if at all times during the
10 taxable year of such foreign corporation—

11 “(A) less than 20 percent of the total com-
12 bined voting power of all classes of stock of
13 such corporation entitled to vote, and

14 “(B) less than 20 percent of the total
15 value of such corporation,

16 is owned (directly or indirectly under the principles
17 of section 883(c)(4)) by persons who are (directly or
18 indirectly) insured under any policy of insurance or
19 reinsurance issued by such corporation or who are
20 related persons to any such person.

21 “(4) TREATMENT OF MUTUAL INSURANCE COM-
22 PANIES.—In the case of a mutual insurance com-
23 pany—

24 “(A) this subsection shall apply,

1 “(B) policyholders of such company shall
2 be treated as shareholders, and

3 “(C) appropriate adjustments in the appli-
4 cation of this subpart shall be made under reg-
5 ulations prescribed by the Secretary.

6 “(5) DETERMINATION OF PRO RATA SHARE.—

7 “(A) IN GENERAL.—The pro rata share
8 determined under this paragraph for any
9 United States shareholder is the lesser of—

10 “(i) the amount which would be deter-
11 mined under paragraph (2) of section
12 951(a) if—

13 “(I) only related person insur-
14 ance income were taken into account,

15 “(II) stock owned (within the
16 meaning of section 958(a)) by United
17 States shareholders on the last day of
18 the taxable year were the only stock
19 in the foreign corporation, and

20 “(III) only distributions received
21 by United States shareholders were
22 taken into account under subpara-
23 graph (B) of such paragraph (2), or

24 “(ii) the amount which would be de-
25 termined under paragraph (2) of section

1 951(a) if the entire earnings and profits of
2 the foreign corporation for the taxable year
3 were subpart F income.

4 “(B) COORDINATION WITH OTHER PROVI-
5 SIONS.—The Secretary shall prescribe regula-
6 tions providing for such modifications to the
7 provisions of this subpart as may be necessary
8 or appropriate by reason of subparagraph (A).

9 “(6) RELATED PERSON.—For purposes of this
10 subsection—

11 “(A) IN GENERAL.—Except as provided in
12 subparagraph (B), the term ‘related person’ has
13 the meaning given such term by subsection
14 (d)(3).

15 “(B) TREATMENT OF CERTAIN LIABILITY
16 INSURANCE POLICIES.—In the case of any pol-
17 icy of insurance covering liability arising from
18 services performed as a director, officer, or em-
19 ployee of a corporation or as a partner or em-
20 ployee of a partnership, the person performing
21 such services and the entity for which such
22 services are performed shall be treated as re-
23 lated persons.

1 “(7) REGULATIONS.—The Secretary shall pre-
2 scribe such regulations as may be necessary to carry
3 out the purposes of this subsection, including—

4 “(A) regulations preventing the avoidance
5 of this subsection through cross insurance ar-
6 rangements or otherwise, and

7 “(B) regulations which may provide that a
8 person will not be treated as a United States
9 shareholder under paragraph (1) with respect
10 to any foreign corporation if neither such per-
11 son (nor any related person to such person) is
12 (directly or indirectly) insured under any policy
13 of insurance or reinsurance issued by such for-
14 eign corporation.

15 “(d) OTHER DEFINITIONS AND RULES.—For pur-
16 poses of this section—

17 “(1) TREATMENT OF BRANCHES.—If—

18 “(A) a controlled foreign corporation car-
19 ries on activities through a branch or similar
20 establishment with a home country other than
21 the home country of such corporation, and

22 “(B) the carrying on of such activities in
23 such manner has substantially the same effect
24 as if such branch or similar establishment were
25 a wholly owned subsidiary of such corporation,

1 this subpart shall, under regulations prescribed by
2 the Secretary, be applied as if such branch or other
3 establishment were a wholly owned subsidiary of
4 such corporation.

5 “(2) HOME COUNTRY.—For purposes of para-
6 graph (1)—

7 “(A) IN GENERAL.—The term ‘home coun-
8 try’ has the meaning given such term by section
9 953(d).

10 “(B) BRANCH.—In the case of a branch or
11 similar establishment, the term ‘home country’
12 means the foreign country in which—

13 “(i) the principal place of business of
14 the branch or similar establishment is lo-
15 cated, and

16 “(ii) separate books and accounts are
17 maintained.

18 “(3) RELATED PERSON DEFINED.—For pur-
19 poses of this section, a person is a related person
20 with respect to a controlled foreign corporation, if—

21 “(A) such person is an individual, corpora-
22 tion, partnership, trust, or estate which con-
23 trols, or is controlled by, the controlled foreign
24 corporation, or

1 “(B) such person is a corporation, partner-
2 ship, trust, or estate which is controlled by the
3 same person or persons which control the con-
4 trolled foreign corporation.

5 For purposes of the preceding sentence, control
6 means, with respect to a corporation, the ownership,
7 directly or indirectly, of stock possessing more than
8 50 percent of the total voting power of all classes of
9 stock entitled to vote or of the total value of stock
10 of such corporation. In the case of a partnership,
11 trust, or estate, control means the ownership, di-
12 rectly or indirectly, of more than 50 percent (by
13 value) of the beneficial interests in such partnership,
14 trust, or estate. For purposes of this paragraph,
15 rules similar to the rules of section 958 shall
16 apply.”.

17 (b) CONFORMING AMENDMENT.—The table of sec-
18 tions for subpart F of part III of subchapter N of chapter
19 1 is amended by striking the items relating to sections
20 953 and 954 and inserting:

“Sec. 953. Active home country income.

“Sec. 954. Other rules and definitions relating to subpart F income.”.

21 (c) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to taxable years of controlled for-
23 eign corporations beginning after December 31, 2007, and

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

3 **SEC. 102. TREATMENT OF FOREIGN CORPORATIONS MAN-**
4 **AGED AND CONTROLLED IN THE UNITED**
5 **STATES AS DOMESTIC CORPORATIONS.**

6 (a) IN GENERAL.—Section 7701(a)(4) of the Internal
7 Revenue Code of 1986 (defining domestic) is amended to
8 read as follows:

9 “(4) DOMESTIC.—

10 “(A) IN GENERAL.—The term ‘domestic’
11 means, when applied to a corporation or part-
12 nership, a corporation or partnership which is
13 created or organized in the United States or
14 under the law of the United States or of any
15 State unless, in the case of a partnership, the
16 Secretary provides otherwise by regulations.

17 “(B) INCOME TAX EXCEPTION FOR PUB-
18 LICLY-TRADED CORPORATIONS MANAGED AND
19 CONTROLLED IN THE UNITED STATES.—Not-
20 withstanding subparagraph (A), in the case of
21 a corporation the stock of which is regularly
22 traded on an established securities market, if—

23 “(i) the corporation would not other-
24 wise be treated as a domestic corporation
25 for purposes of this title, but

1 “(ii) the management and control of
2 the corporation occurs primarily within the
3 United States,
4 then, solely for purposes of chapter 1 (and any
5 other provision of this title relating to chapter
6 1), the corporation shall be treated as a domes-
7 tic corporation.

8 “(C) MANAGEMENT AND CONTROL.—For
9 purposes of this paragraph, the management
10 and control of a corporation shall be treated as
11 primarily occurring within the United States if
12 substantially all of the executive officers and
13 senior management of the corporation who ex-
14 ercise day-to-day responsibility for making deci-
15 sions involving strategic, financial, and oper-
16 ational policies of the corporation are primarily
17 located within the United States. The Secretary
18 may by regulations include other individuals not
19 described in the preceding sentence in the de-
20 termination of whether the management and
21 control of the corporation occurs primarily with-
22 in the United States if such other individuals
23 exercise the day-to day responsibilities described
24 in the preceding sentence.”.

25 (b) EFFECTIVE DATES.—

1 (1) IN GENERAL.—The amendments made by
2 this section shall apply to taxable years beginning on
3 or after the date which is 2 years after the date of
4 the enactment of this Act.

5 (2) TRANSITION RULE FOR CORPORATIONS OR-
6 GANIZED IN TREATY COUNTRIES.—If—

7 (A) a corporation is in existence on the
8 date of the enactment of this Act, and

9 (B) the corporation was created or orga-
10 nized under the laws of a foreign country with
11 which the United States has, on such date, a
12 comprehensive income tax treaty which the Sec-
13 retary of the Treasury determines is satisfac-
14 tory for purposes of this paragraph and which
15 includes an exchange of information program,
16 section 7701(a)(4)(B) of the Internal Revenue Code
17 of 1986 (as added by the amendments made by this
18 section) shall not apply to the corporation with re-
19 spect to taxable years ending in any continuous pe-
20 riod beginning on such date during which the cor-
21 poration is eligible for the benefits of such treaty (or
22 any successor treaty with such foreign country meet-
23 ing the requirements of this paragraph).

1 **TITLE II—ECONOMIC**
 2 **SUBSTANCE DOCTRINE**

3 **SEC. 201. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**
 4 **TRINE.**

5 (a) IN GENERAL.—Section 7701 is amended by re-
 6 designating subsection (o) as subsection (p) and by insert-
 7 ing after subsection (n) the following new subsection:

8 “(o) CLARIFICATION OF ECONOMIC SUBSTANCE
 9 DOCTRINE; ETC.—

10 “(1) GENERAL RULES.—

11 “(A) IN GENERAL.—In any case in which
 12 a court determines that the economic substance
 13 doctrine is relevant for purposes of this title to
 14 a transaction (or series of transactions), such
 15 transaction (or series of transactions) shall have
 16 economic substance only if the requirements of
 17 this paragraph are met.

18 “(B) DEFINITION OF ECONOMIC SUB-
 19 STANCE.—For purposes of subparagraph (A)—

20 “(i) IN GENERAL.—A transaction has
 21 economic substance only if—

22 “(I) the transaction changes in a
 23 meaningful way (apart from Federal
 24 tax effects) the taxpayer’s economic
 25 position, and

1 “(II) the taxpayer has a substan-
2 tial nontax purpose for entering into
3 such transaction and the transaction
4 is a reasonable means of accom-
5 plishing such purpose.

6 In applying subclause (II), a purpose of
7 achieving a financial accounting benefit
8 shall not be taken into account in deter-
9 mining whether a transaction has a sub-
10 stantial nontax purpose if the origin of
11 such financial accounting benefit is a re-
12 duction of income tax.

13 “(ii) SPECIAL RULE WHERE TAX-
14 PAYER RELIES ON PROFIT POTENTIAL.—A
15 transaction shall not be treated as having
16 economic substance by reason of having a
17 potential for profit unless—

18 “(I) the present value of the rea-
19 sonably expected pre-tax profit from
20 the transaction is substantial in rela-
21 tion to the present value of the ex-
22 pected net tax benefits that would be
23 allowed if the transaction were re-
24 spected, and

1 “(II) the reasonably expected
2 pre-tax profit from the transaction ex-
3 ceeds a risk-free rate of return.

4 “(C) TREATMENT OF FEES AND FOREIGN
5 TAXES.—Fees and other transaction expenses
6 and foreign taxes shall be taken into account as
7 expenses in determining pre-tax profit under
8 subparagraph (B)(ii).

9 “(2) SPECIAL RULES FOR TRANSACTIONS WITH
10 TAX-INDIFFERENT PARTIES.—

11 “(A) SPECIAL RULES FOR FINANCING
12 TRANSACTIONS.—The form of a transaction
13 which is in substance the borrowing of money
14 or the acquisition of financial capital directly or
15 indirectly from a tax-indifferent party shall not
16 be respected if the present value of the deduc-
17 tions to be claimed with respect to the trans-
18 action is substantially in excess of the present
19 value of the anticipated economic returns of the
20 person lending the money or providing the fi-
21 nancial capital. A public offering shall be treat-
22 ed as a borrowing, or an acquisition of financial
23 capital, from a tax-indifferent party if it is rea-
24 sonably expected that at least 50 percent of the

1 offering will be placed with tax-indifferent par-
2 ties.

3 “(B) ARTIFICIAL INCOME SHIFTING AND
4 BASIS ADJUSTMENTS.—The form of a trans-
5 action with a tax-indifferent party shall not be
6 respected if—

7 “(i) it results in an allocation of in-
8 come or gain to the tax-indifferent party in
9 excess of such party’s economic income or
10 gain, or

11 “(ii) it results in a basis adjustment
12 or shifting of basis on account of over-
13 stating the income or gain of the tax-indif-
14 ferent party.

15 “(3) DEFINITIONS AND SPECIAL RULES.—For
16 purposes of this subsection—

17 “(A) ECONOMIC SUBSTANCE DOCTRINE.—
18 The term ‘economic substance doctrine’ means
19 the common law doctrine under which tax bene-
20 fits under subtitle A with respect to a trans-
21 action are not allowable if the transaction does
22 not have economic substance or lacks a business
23 purpose.

24 “(B) TAX-INDIFFERENT PARTY.—The
25 term ‘tax-indifferent party’ means any person

1 or entity not subject to tax imposed by subtitle
2 A. A person shall be treated as a tax-indifferent
3 party with respect to a transaction if the items
4 taken into account with respect to the trans-
5 action have no substantial impact on such per-
6 son’s liability under subtitle A.

7 “(C) EXCEPTION FOR PERSONAL TRANS-
8 ACTIONS OF INDIVIDUALS.—In the case of an
9 individual, this subsection shall apply only to
10 transactions entered into in connection with a
11 trade or business or an activity engaged in for
12 the production of income.

13 “(D) TREATMENT OF LESSORS.—In apply-
14 ing paragraph (1)(B)(ii) to the lessor of tan-
15 gible property subject to a lease—

16 “(i) the expected net tax benefits with
17 respect to the leased property shall not in-
18 clude the benefits of—

19 “(I) depreciation,

20 “(II) any tax credit, or

21 “(III) any other deduction as
22 provided in guidance by the Secretary,
23 and

24 “(ii) subclause (II) of paragraph
25 (1)(B)(ii) shall be disregarded in deter-

1 mining whether any of such benefits are al-
2 lowable.

3 “(4) OTHER COMMON LAW DOCTRINES NOT AF-
4 FECTED.—Except as specifically provided in this
5 subsection, the provisions of this subsection shall not
6 be construed as altering or supplanting any other
7 rule of law, and the requirements of this subsection
8 shall be construed as being in addition to any such
9 other rule of law.

10 “(5) REGULATIONS.—The Secretary shall pre-
11 scribe such regulations as may be necessary or ap-
12 propriate to carry out the purposes of this sub-
13 section. Such regulations may include exemptions
14 from the application of this subsection.”.

15 (b) EFFECTIVE DATE.—The amendments made by
16 this section shall apply to transactions entered into after
17 the date of the enactment of this Act.

18 **SEC. 202. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
19 **UTABLE TO TRANSACTIONS LACKING ECO-**
20 **NOMIC SUBSTANCE, ETC.**

21 (a) IN GENERAL.—Subchapter A of chapter 68 is
22 amended by inserting after section 6662A the following
23 new section:

1 **“SEC. 6662B. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
2 **UTABLE TO TRANSACTIONS LACKING ECO-**
3 **NOMIC SUBSTANCE, ETC.**

4 “(a) IMPOSITION OF PENALTY.—If a taxpayer has an
5 noneconomic substance transaction understatement for
6 any taxable year, there shall be added to the tax an
7 amount equal to 40 percent of the amount of such under-
8 statement.

9 “(b) REDUCTION OF PENALTY FOR DISCLOSED
10 TRANSACTIONS.—Subsection (a) shall be applied by sub-
11 stituting ‘20 percent’ for ‘40 percent’ with respect to the
12 portion of any noneconomic substance transaction under-
13 statement with respect to which the relevant facts affect-
14 ing the tax treatment of the item are adequately disclosed
15 in the return or a statement attached to the return.

16 “(c) NONECONOMIC SUBSTANCE TRANSACTION UN-
17 DERSTATEMENT.—For purposes of this section—

18 “(1) IN GENERAL.—The term ‘noneconomic
19 substance transaction understatement’ means any
20 amount which would be an understatement under
21 section 6662A(b)(1) if section 6662A were applied
22 by taking into account items attributable to non-
23 economic substance transactions rather than items
24 to which section 6662A would apply without regard
25 to this paragraph.

1 “(2) NONECONOMIC SUBSTANCE TRANS-
2 ACTION.—The term ‘noneconomic substance trans-
3 action’ means any transaction if—

4 “(A) there is a lack of economic substance
5 (within the meaning of section 7701(o)(1)) for
6 the transaction giving rise to the claimed ben-
7 efit or the transaction was not respected under
8 section 7701(o)(2), or

9 “(B) the transaction fails to meet the re-
10 quirements of any similar rule of law.

11 “(d) RULES APPLICABLE TO COMPROMISE OF PEN-
12 ALTY.—

13 “(1) IN GENERAL.—If the 1st letter of pro-
14 posed deficiency which allows the taxpayer an oppor-
15 tunity for administrative review in the Internal Rev-
16 enue Service Office of Appeals has been sent with
17 respect to a penalty to which this section applies,
18 only the Commissioner of Internal Revenue may
19 compromise all or any portion of such penalty.

20 “(2) APPLICABLE RULES.—The rules of para-
21 graphs (2) and (3) of section 6707A(d) shall apply
22 for purposes of paragraph (1).

23 “(e) COORDINATION WITH OTHER PENALTIES.—Ex-
24 cept as otherwise provided in this part, the penalty im-

1 posed by this section shall be in addition to any other pen-
2 alty imposed by this title.

3 “(f) CROSS REFERENCES.—

“(1) For coordination of penalty with understatements
under section 6662 and other special rules, see section
6662A(e).

“(2) For reporting of penalty imposed under this section
to the Securities and Exchange Commission, see section
6707A(e).”.

4 (b) COORDINATION WITH OTHER UNDERSTATE-
5 MENTS AND PENALTIES.—

6 (1) The second sentence of section
7 6662(d)(2)(A) is amended by inserting “and without
8 regard to items with respect to which a penalty is
9 imposed by section 6662B” before the period at the
10 end.

11 (2) Subsection (e) of section 6662A is amend-
12 ed—

13 (A) in paragraph (1), by inserting “and
14 noneconomic substance transaction understate-
15 ments” after “reportable transaction under-
16 statements” both places it appears,

17 (B) in paragraph (2)(A), by inserting “and
18 a noneconomic substance transaction under-
19 statement” after “reportable transaction under-
20 statement”,

21 (C) in paragraph (2)(B), by inserting
22 “6662B or” before “6663”,

1 (D) in paragraph (2)(C)(i), by inserting
2 “or section 6662B” before the period at the
3 end,

4 (E) in paragraph (2)(C)(ii), by inserting
5 “and section 6662B” after “This section”,

6 (F) in paragraph (3), by inserting “or non-
7 economic substance transaction understatement”
8 after “reportable transaction understatement”,
9 and

10 (G) by adding at the end the following new
11 paragraph:

12 “(4) NONECONOMIC SUBSTANCE TRANSACTION
13 UNDERSTATEMENT.—For purposes of this sub-
14 section, the term ‘noneconomic substance trans-
15 action understatement’ has the meaning given such
16 term by section 6662B(c).”.

17 (3) Subsection (e) of section 6707A is amend-
18 ed—

19 (A) by striking “or” at the end of subpara-
20 graph (B), and

21 (B) by striking subparagraph (C) and in-
22 serting the following new subparagraphs:

23 “(C) is required to pay a penalty under
24 section 6662B with respect to any noneconomic
25 substance transaction, or

1 with respect to which the requirement of section
2 6664(d)(2)(A) is not met, or

3 “(2) any noneconomic substance transaction
4 understatement (as defined in section 6662B(c)).”,
5 and

6 (2) by inserting “**AND NONECONOMIC SUB-**
7 **STANCE TRANSACTIONS**” in the heading thereof
8 after “**TRANSACTIONS**”.

9 (b) EFFECTIVE DATE.—The amendments made by
10 this section shall apply to transactions after the date of
11 the enactment of this Act in taxable years ending after
12 such date.

13 **TITLE III—ELIMINATION OF**
14 **HIGHEST CORPORATE MAR-**
15 **GINAL INCOME TAX RATE**

16 **SEC. 301. ELIMINATION OF HIGHEST CORPORATE MAR-**
17 **GINAL INCOME TAX RATE.**

18 (a) IN GENERAL.—Section 11(b)(1) (relating to
19 amount of tax imposed on corporations) is amended by
20 striking subparagraphs (C) and (D) and inserting the fol-
21 lowing new subparagraph:

22 “(C) 34 percent of so much of the taxable
23 income as exceeds \$75,000.”.

1 (b) CERTAIN PERSONAL SERVICE CORPORATIONS.—
2 Section 11(b)(2) is amended by striking “35 percent” and
3 inserting “34 percent”.

4 (c) CONFORMING AMENDMENTS.—

5 (1) Section 11(b)(1) is amended by striking the
6 last sentence.

7 (2) Section 1201(a) is amended—

8 (A) by striking “35 percent” each place it
9 appears and inserting “34 percent”, and

10 (B) by striking “last 2 sentences” and in-
11 serting “last sentence”.

12 (3) Paragraphs (1) and (2) of section 1445(e)
13 are each amended by striking “35 percent” and in-
14 serting “34 percent”.

15 (4) Section 1561(a) is amended by striking
16 “last 2 sentences” and inserting “last sentence”.

17 (d) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to taxable years beginning after
19 December 31, 2007.

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