

111TH CONGRESS  
2D SESSION

# H. R. 5962

To amend the Internal Revenue Code of 1986 to reduce the maximum corporate income tax rate and to offset the revenue cost by repealing certain corporate tax benefits.

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## IN THE HOUSE OF REPRESENTATIVES

JULY 29, 2010

Mr. MAFFEI 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 reduce the maximum corporate income tax rate and to offset the revenue cost by repealing certain corporate tax benefits.

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; AMENDMENT OF 1986 CODE.**

4       (a) SHORT TITLE.—This Act may be cited as the  
5       “American Business Competitiveness Act of 2010”.

6       (b) AMENDMENT OF 1986 CODE.—Except as other-  
7       wise expressly provided, whenever in this Act an amend-  
8       ment or repeal is expressed in terms of an amendment

1 to, or repeal of, a section or other provision, the reference  
 2 shall be considered to be made to a section or other provi-  
 3 sion of the Internal Revenue Code of 1986.

4 (c) TABLE OF CONTENTS.—

Sec. 1. Short title; amendment of 1986 code.

TITLE I—CORPORATE INCOME TAX RATE REDUCTION

Sec. 101. Reduction in top corporate marginal rate.

TITLE II—PROVISIONS RELATED TO FOREIGN SOURCE INCOME

Sec. 201. Allocation of expenses and taxes on basis of repatriation of foreign income.

Sec. 202. Repeal of worldwide allocation of interest.

Sec. 203. Limitation on treaty benefits for certain deductible payments.

TITLE III—MODIFICATION OF ACCOUNTING RULES

Sec. 301. Repeal of last-in, first-out method of inventory.

Sec. 302. Repeal of lower of cost or market method of inventory.

Sec. 303. Special rule for service providers on accrual method not applicable to C corporations.

TITLE IV—MODIFICATION TO EXPENSING AND DEPRECIATION RULES

Sec. 401. Small business expensing provisions made permanent.

Sec. 402. Amortization of goodwill and other intangibles.

TITLE V—CODIFICATION OF ECONOMIC SUBSTANCE DOCTRINE

Sec. 501. Codification of economic substance doctrine.

TITLE VI—MODIFICATIONS TO DEDUCTIONS FOR DIVIDENDS RECEIVED

Sec. 601. Modifications to deductions for dividends received.

TITLE VII—OTHER PROVISIONS

Sec. 701. Recognition of ordinary income on sale or exercise of stock option in S corporation with an ESOP.

Sec. 702. Treatment of securities of a controlled corporation exchanged for assets in certain reorganizations.

1     **TITLE I—CORPORATE INCOME**  
2             **TAX RATE REDUCTION**

3     **SEC. 101. REDUCTION IN TOP CORPORATE MARGINAL**  
4             **RATE.**

5             (a) GENERAL RULE.—Paragraph (1) of section 11(b)  
6     (relating to amount of tax) is amended—

7                 (1) by inserting “and” at the end of subpara-  
8     graph (A),

9                 (2) by striking subparagraphs (B), (C), and (D)  
10     and inserting the following:

11                     “(B) 23 percent of so much of the taxable  
12     income as exceeds \$50,000.”, and

13                 (3) by striking “\$11,750” and all that follows  
14     and inserting “\$9,500.”.

15             (b) PERSONAL SERVICE CORPORATIONS.—Para-  
16     graph (2) of section 11(b) is amended by striking “35 per-  
17     cent” and inserting “23 percent”.

18             (c) CONFORMING AMENDMENTS.—

19                 (1) Section 1201 is amended by striking “35  
20     percent” each place it appears and inserting “23  
21     percent”.

22                 (2) Paragraphs (1) and (2) of section 1445(e)  
23     are each amended by striking “35 percent” and in-  
24     serting “23 percent”.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2010, except that the amendments made by subsection (c) shall take effect on January 1, 2011.

## **TITLE II—PROVISIONS RELATED TO FOREIGN SOURCE INCOME**

### **SEC. 201. ALLOCATION OF EXPENSES AND TAXES ON BASIS OF REPATRIATION OF FOREIGN INCOME.**

(a) IN GENERAL.—Part III of subchapter N of chapter 1 is amended by inserting after subpart G the following new subpart:

#### **“Subpart H—Special Rules for Allocation of Foreign-Related Deductions and Foreign Tax Credits**

“Sec. 975. Deductions allocated to deferred foreign income may not offset United States source income.

“Sec. 976. Amount of foreign taxes computed on overall basis.

“Sec. 977. Application of subpart.

### **“SEC. 975. DEDUCTIONS ALLOCATED TO DEFERRED FOREIGN INCOME MAY NOT OFFSET UNITED STATES SOURCE INCOME.**

“(a) CURRENT YEAR DEDUCTIONS.—For purposes of this chapter, foreign-related deductions for any taxable year—

“(1) shall be taken into account for such taxable year only to the extent that such deductions are allocable to currently-taxed foreign income, and

1 “(2) to the extent not so allowed, shall be taken  
2 into account in subsequent taxable years as provided  
3 in subsection (b).

4 Foreign-related deductions shall be allocated to currently-  
5 taxed foreign income in the same proportion which cur-  
6 rently-taxed foreign income bears to the sum of currently-  
7 taxed foreign income and deferred foreign income.

8 “(b) DEDUCTIONS RELATED TO REPATRIATED DE-  
9 FERRED FOREIGN INCOME.—

10 “(1) IN GENERAL.—If there is repatriated for-  
11 eign income for a taxable year, the portion of the  
12 previously deferred deductions allocated to the repa-  
13 triated foreign income shall be taken into account  
14 for the taxable year as a deduction allocated to in-  
15 come from sources outside the United States. Any  
16 such amount shall not be included in foreign-related  
17 deductions for purposes of applying subsection (a) to  
18 such taxable year.

19 “(2) PORTION OF PREVIOUSLY DEFERRED DE-  
20 Ductions.—For purposes of paragraph (1), the por-  
21 tion of the previously deferred deductions allocated  
22 to repatriated foreign income is—

23 “(A) the amount which bears the same  
24 proportion to such deductions, as

1                   “(B) the repatriated income bears to the  
2                   previously deferred foreign income.

3           “(c) DEFINITIONS AND SPECIAL RULE.—For pur-  
4 poses of this section—

5                   “(1) FOREIGN-RELATED DEDUCTIONS.—The  
6           term ‘foreign-related deductions’ means the total  
7           amount of deductions and expenses which would be  
8           allocated or apportioned to gross income from  
9           sources without the United States for the taxable  
10          year if both the currently-taxed foreign income and  
11          deferred foreign income were taken into account.

12                   “(2) CURRENTLY-TAXED FOREIGN INCOME.—  
13          The term ‘currently-taxed foreign income’ means the  
14          amount of gross income from sources without the  
15          United States for the taxable year (determined with-  
16          out regard to repatriated foreign income for such  
17          year).

18                   “(3) DEFERRED FOREIGN INCOME.—The term  
19          ‘deferred foreign income’ means the excess of—

20                   “(A) the amount that would be includible  
21                  in gross income under subpart F of this part  
22                  for the taxable year if—

23                   “(i) all controlled foreign corporations  
24                  were treated as one controlled foreign cor-  
25                  poration, and

1 “(ii) all earnings and profits of all  
2 controlled foreign corporations were sub-  
3 part F income (as defined in section 952),  
4 over

5 “(B) the sum of—

6 “(i) all dividends received during the  
7 taxable year from controlled foreign cor-  
8 porations, plus

9 “(ii) amounts includible in gross in-  
10 come under section 951(a).

11 “(4) PREVIOUSLY DEFERRED FOREIGN IN-  
12 COME.—The term ‘previously deferred foreign in-  
13 come’ means the aggregate amount of deferred for-  
14 eign income for all prior taxable years to which this  
15 part applies, determined as of the beginning of the  
16 taxable year, reduced by the repatriated foreign in-  
17 come for all such prior taxable years.

18 “(5) REPATRIATED FOREIGN INCOME.—The  
19 term ‘repatriated foreign income’ means the amount  
20 included in gross income on account of distributions  
21 out of previously deferred foreign income.

22 “(6) PREVIOUSLY DEFERRED DEDUCTIONS.—  
23 The term ‘previously deferred deductions’ means the  
24 aggregate amount of foreign-related deductions not  
25 taken into account under subsection (a) for all prior

1 taxable years (determined as of the beginning of the  
2 taxable year), reduced by any amounts taken into  
3 account under subsection (b) for such prior taxable  
4 years.

5 “(7) TREATMENT OF CERTAIN FOREIGN  
6 TAXES.—

7 “(A) PAID BY CONTROLLED FOREIGN COR-  
8 PORATION.—Section 78 shall not apply for pur-  
9 poses of determining currently-taxed foreign in-  
10 come and deferred foreign income.

11 “(B) PAID BY TAXPAYER.—For purposes  
12 of determining currently-taxed foreign income,  
13 gross income from sources without the United  
14 States shall be reduced by the aggregate  
15 amount of taxes described in the applicable  
16 paragraph of section 901(b) which are paid by  
17 the taxpayer (without regard to sections 902  
18 and 960) during the taxable year.

19 “(8) COORDINATION WITH SECTION 976.—In  
20 determining currently-taxed foreign income and de-  
21 ferred foreign income, the amount of deemed foreign  
22 tax credits shall be determined with regard to sec-  
23 tion 976.



1 **“SEC. 976. AMOUNT OF FOREIGN TAXES COMPUTED ON**  
2 **OVERALL BASIS.**

3 “(a) **CURRENT YEAR ALLOWANCE.**—For purposes of  
4 this chapter, the amount taken into account as foreign in-  
5 come taxes for any taxable year shall be an amount which  
6 bears the same ratio to the total foreign income taxes for  
7 that taxable year as—

8 “(1) the currently-taxed foreign income for such  
9 taxable year, bears to

10 “(2) the sum of the currently-taxed foreign in-  
11 come and deferred foreign income for such year.

12 The portion of the total foreign income taxes for any tax-  
13 able year not taken into account under the preceding sen-  
14 tence for a taxable year shall only be taken into account  
15 as provided in subsection (b) (and shall not be taken into  
16 account for purposes of applying sections 902 and 960).

17 “(b) **ALLOWANCE RELATED TO REPATRIATED DE-**  
18 **FERRED FOREIGN INCOME.**—

19 “(1) **IN GENERAL.**—If there is repatriated for-  
20 eign income for any taxable year, the portion of the  
21 previously deferred foreign income taxes paid or ac-  
22 crued during such taxable year shall be taken into  
23 account for the taxable year as foreign taxes paid or  
24 accrued. Any such taxes so taken into account shall  
25 not be included in foreign income taxes for purposes  
26 of applying subsection (a) to such taxable year.

1           “(2) PORTION OF PREVIOUSLY DEFERRED FOR-  
2       EIGN INCOME TAXES.—For purposes of paragraph  
3       (1), the portion of the previously deferred foreign in-  
4       come taxes allocated to repatriated deferred foreign  
5       income is—

6                   “(A) the amount which bears the same  
7                   proportion to such taxes, as

8                   “(B) the repatriated deferred income bears  
9                   to the previously deferred foreign income.

10       “(c) DEFINITIONS AND SPECIAL RULE.—For pur-  
11       poses of this section—

12                   “(1) PREVIOUSLY DEFERRED FOREIGN INCOME  
13       TAXES.—The term ‘previously deferred foreign in-  
14       come taxes’ means the aggregate amount of total  
15       foreign income taxes not taken into account under  
16       subsection (a) for all prior taxable years (determined  
17       as of the beginning of the taxable year), reduced by  
18       any amounts taken into account under subsection  
19       (b) for such prior taxable years.

20                   “(2) TOTAL FOREIGN INCOME TAXES.—The  
21       term ‘total foreign income taxes’ means the sum of  
22       foreign income taxes paid or accrued during the tax-  
23       able year (determined without regard to section  
24       904(c)) plus the increase in foreign income taxes

1 that would be paid or accrued during the taxable  
 2 year under sections 902 and 960 if—

3 “(A) all controlled foreign corporations  
 4 were treated as one controlled foreign corpora-  
 5 tion, and

6 “(B) all earnings and profits of all con-  
 7 trolled foreign corporations were subpart F in-  
 8 come (as defined in section 952).

9 “(3) FOREIGN INCOME TAXES.—The term ‘for-  
 10 eign income taxes’ means any income, war profits, or  
 11 excess profits taxes paid by the taxpayer to any for-  
 12 eign country or possession of the United States.

13 “(4) CURRENTLY-TAXED FOREIGN INCOME AND  
 14 DEFERRED FOREIGN INCOME.—The terms ‘cur-  
 15 rently-taxed foreign income’ and ‘deferred foreign in-  
 16 come’ have the meanings given such terms by sec-  
 17 tion 975(c).

18 **“SEC. 977. APPLICATION OF SUBPART.**

19 “This subpart—

20 “(1) shall be applied before subpart A, and

21 “(2) shall be applied separately with respect to  
 22 the categories of income specified in section  
 23 904(d)(1).”.

24 (b) CLERICAL AMENDMENT.—The table of subparts  
 25 for part III of subpart N of chapter 1 is amended by in-

1   serting after the item relating to subpart G the following  
 2   new item:

“SUBPART H. SPECIAL RULES FOR ALLOCATION OF FOREIGN-RELATED  
 DEDUCTIONS AND FOREIGN TAX CREDITS”.

3       (c) **EFFECTIVE DATE.**—The amendments made by  
 4   this section shall apply to taxable years beginning after  
 5   December 31, 2010.

6   **SEC. 202. REPEAL OF WORLDWIDE ALLOCATION OF INTER-**  
 7                               **EST.**

8       (a) **IN GENERAL.**—Section 864 is amended by strik-  
 9   ing subsection (f) and by redesignating subsection (g) as  
 10   subsection (f).

11       (b) **EFFECTIVE DATE.**—The amendments made by  
 12   this section shall apply to taxable years beginning after  
 13   December 31, 2010.

14   **SEC. 203. LIMITATION ON TREATY BENEFITS FOR CERTAIN**  
 15                               **DEDUCTIBLE PAYMENTS.**

16       (a) **IN GENERAL.**—Section 894 (relating to income  
 17   affected by treaty) is amended by adding at the end the  
 18   following new subsection:

19       “(d) **LIMITATION ON TREATY BENEFITS FOR CER-**  
 20   **TAIN DEDUCTIBLE PAYMENTS.**—

21               “(1) **IN GENERAL.**—In the case of any deduct-  
 22       ible related-party payment, any withholding tax im-  
 23       posed under chapter 3 (and any tax imposed under  
 24       subpart A or B of this part) with respect to such

1 payment may not be reduced under any treaty of the  
2 United States unless any such withholding tax would  
3 be reduced under a treaty of the United States if  
4 such payment were made directly to the foreign par-  
5 ent corporation.

6 “(2) DEDUCTIBLE RELATED-PARTY PAY-  
7 MENT.—For purposes of this subsection, the term  
8 ‘deductible related-party payment’ means any pay-  
9 ment made, directly or indirectly, by any person to  
10 any other person if the payment is allowable as a de-  
11 duction under this chapter and both persons are  
12 members of the same foreign controlled group of en-  
13 tities.

14 “(3) FOREIGN CONTROLLED GROUP OF ENTI-  
15 TIES.—For purposes of this subsection—

16 “(A) IN GENERAL.—The term ‘foreign  
17 controlled group of entities’ means a controlled  
18 group of entities the common parent of which  
19 is a foreign corporation.

20 “(B) CONTROLLED GROUP OF ENTITIES.—  
21 The term ‘controlled group of entities’ means a  
22 controlled group of corporations as defined in  
23 section 1563(a)(1), except that—

1 “(i) ‘more than 50 percent’ shall be  
2 substituted for ‘at least 80 percent’ each  
3 place it appears therein, and

4 “(ii) the determination shall be made  
5 without regard to subsections (a)(4) and  
6 (b)(2) of section 1563.

7 A partnership or any other entity (other than a  
8 corporation) shall be treated as a member of a  
9 controlled group of entities if such entity is con-  
10 trolled (within the meaning of section  
11 954(d)(3)) by members of such group (includ-  
12 ing any entity treated as a member of such  
13 group by reason of this sentence).

14 “(4) FOREIGN PARENT CORPORATION.—For  
15 purposes of this subsection, the term ‘foreign parent  
16 corporation’ means, with respect to any deductible  
17 related-party payment, the common parent of the  
18 foreign controlled group of entities referred to in  
19 paragraph (3)(A).

20 “(5) REGULATIONS.—The Secretary may pre-  
21 scribe such regulations or other guidance as are nec-  
22 essary or appropriate to carry out the purposes of  
23 this subsection, including regulations or other guid-  
24 ance which provide for—

1           “(A) the treatment of two or more persons  
 2           as members of a foreign controlled group of en-  
 3           tities if such persons would be the common par-  
 4           ent of such group if treated as one corporation,  
 5           and

6           “(B) the treatment of any member of a  
 7           foreign controlled group of entities as the com-  
 8           mon parent of such group if such treatment is  
 9           appropriate taking into account the economic  
 10          relationships among such entities.”.

11          (b) EFFECTIVE DATE.—The amendment made by  
 12          this section shall apply to payments made after the date  
 13          of the enactment of this Act.

## 14           **TITLE III—MODIFICATION OF** 15           **ACCOUNTING RULES**

### 16          **SEC. 301. REPEAL OF LAST-IN, FIRST-OUT METHOD OF IN-** 17           **VENTORY.**

18          (a) IN GENERAL.—Subpart D of part II of sub-  
 19          chapter E of chapter 1 is amended by striking sections  
 20          472 (relating to last-in, first-out inventories), 473 (relat-  
 21          ing to qualified liquidations of LIFO inventories), and 474  
 22          (relating to simplified dollar-value LIFO method for cer-  
 23          tain small businesses).

24          (b) CONFORMING AMENDMENTS.—

1           (1)(A) Section 312(n) is amended by striking  
2           paragraph (4) and by redesignating paragraphs (5)  
3           through (8) as paragraphs (4) through (7), respec-  
4           tively.

5           (B) Section 312(n)(7), as redesignated by sub-  
6           paragraph (A), is amended—

7                   (i) by striking “paragraphs (4) and (6)” in  
8                   subparagraph (A) and inserting “paragraph  
9                   (5)”, and

10                   (ii) by striking “paragraph (5)” in sub-  
11                   paragraph (B) and inserting “paragraph (4)”.

12           (C) Section 56(g)(4)(D) is amended by striking  
13           clause (iii) and by redesignating clause (iv) as clause  
14           (iii).

15           (2) Section 1363 is amended by striking sub-  
16           section (d).

17           (c) EFFECTIVE DATE.—

18                   (1) IN GENERAL.—The amendments made by  
19                   this section shall apply to taxable years beginning  
20                   after the date of the enactment of this Act.

21                   (2) CHANGE IN METHOD OF ACCOUNTING.—In  
22                   the case of any taxpayer required by the amend-  
23                   ments made by this section to change its method of  
24                   accounting for its first taxable year beginning after  
25                   the date of the enactment of this Act—



1 (A) such change shall be treated as initi-  
 2 ated by the taxpayer,

3 (B) such change shall be treated as made  
 4 with the consent of the Secretary of the Treas-  
 5 ury, and

6 (C) if the net amount of the adjustments  
 7 required to be taken into account by the tax-  
 8 payer under section 481 of the Internal Rev-  
 9 enue Code of 1986 is positive, such amount  
 10 shall be taken into account over a period of 8  
 11 years beginning with such first taxable year.

12 **SEC. 302. REPEAL OF LOWER OF COST OR MARKET METH-**  
 13 **OD OF INVENTORY.**

14 (a) IN GENERAL.—Section 471 is amended by redes-  
 15 ignating subsection (c) as subsection (d) and by inserting  
 16 after subsection (b) the following new subsection:

17 “(c) INVENTORIES TAKEN INTO ACCOUNT AT  
 18 COST.—A method of determining inventories shall not be  
 19 treated as clearly reflecting income unless such method  
 20 provides that inventories shall be taken into account at  
 21 cost.”.

22 (b) EFFECTIVE DATE.—

23 (1) IN GENERAL.—The amendments made by  
 24 this section shall apply to taxable years beginning  
 25 after the date of the enactment of this Act.

1           (2) CHANGE IN METHOD OF ACCOUNTING.—In  
 2           the case of any taxpayer required by the amend-  
 3           ments made by this section to change its method of  
 4           accounting for its first taxable year beginning after  
 5           the date of the enactment of this Act—

6                   (A) such change shall be treated as initi-  
 7                   ated by the taxpayer,

8                   (B) such change shall be treated as made  
 9                   with the consent of the Secretary of the Treas-  
 10                  ury, and

11                  (C) if the net amount of the adjustments  
 12                  required to be taken into account by the tax-  
 13                  payer under section 481 of the Internal Rev-  
 14                  enue Code of 1986 is positive, such amount  
 15                  shall be taken into account over a period of 8  
 16                  years beginning with such first taxable year.

17 **SEC. 303. SPECIAL RULE FOR SERVICE PROVIDERS ON AC-**  
 18 **CRUAL METHOD NOT APPLICABLE TO C COR-**  
 19 **PORATIONS.**

20           (a) IN GENERAL.—Subparagraph (A) of section  
 21 448(d)(5) is amended by inserting “(other than a C cor-  
 22 poration)” after “any person”.

23           (b) EFFECTIVE DATE.—

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

4           (2) CHANGE IN METHOD OF ACCOUNTING.—In  
5       the case of any taxpayer required by the amend-  
6       ments made by this section to change its method of  
7       accounting for its first taxable year beginning after  
8       the date of the enactment of this Act—

9                   (A) such change shall be treated as initi-  
10          ated by the taxpayer,

11                   (B) such change shall be treated as made  
12          with the consent of the Secretary of the Treas-  
13          ury, and

14                   (C) if the net amount of the adjustments  
15          required to be taken into account by the tax-  
16          payer under section 481 of the Internal Rev-  
17          enue Code of 1986 is positive, such amount  
18          shall be taken into account over a period of 8  
19          years beginning with such first taxable year.

1 **TITLE IV—MODIFICATION TO EX-**  
2 **PENSING AND DEPRECIATION**  
3 **RULES**

4 **SEC. 401. SMALL BUSINESS EXPENSING PROVISIONS MADE**  
5 **PERMANENT.**

6 (a) INCREASE IN SMALL BUSINESS EXPENSING  
7 MADE PERMANENT.—Subsection (b) of section 179 is  
8 amended—

9 (1) by striking “\$25,000 (\$250,000 in the case  
10 of taxable years beginning after 2007 and before  
11 2011)” in paragraph (1) and inserting “\$250,000”,  
12 and

13 (2) by striking “\$200,000 (\$800,000 in the  
14 case of taxable years beginning after 2007 and be-  
15 fore 2011)” in paragraph (2) and inserting  
16 “\$800,000”.

17 (b) EXPENSING FOR COMPUTER SOFTWARE MADE  
18 PERMANENT.—Clause (ii) of section 179(d)(1)(A) is  
19 amended by striking “and which is placed in service in  
20 a taxable year beginning after 2002 and before 2011,”.

21 (c) EFFECTIVE DATE.—

22 (1) IN GENERAL.—Except as provided in para-  
23 graph (2), the amendments made by this section  
24 shall apply to taxable years beginning after the date  
25 of the enactment of this Act.

1           (2) COMPUTER SOFTWARE.—The amendment  
 2       made by subsection (b) shall apply to property  
 3       placed in service after the date of the enactment of  
 4       this Act.

5 **SEC. 402. AMORTIZATION OF GOODWILL AND OTHER IN-**  
 6                           **TANGIBLES.**

7       (a) IN GENERAL.—Subsection (a) of section 197 (re-  
 8       lating to general rule) is amended by striking “15-year”  
 9       and inserting “20-year”.

10       (b) CERTAIN INTERESTS OR RIGHTS ACQUIRED SEP-  
 11       ARATELY.—Clause (i) of section 197(e)(4)(D) is amended  
 12       by striking “15 years” and inserting “20 years”.

13       (c) EFFECTIVE DATE.—The amendments made by  
 14       this section shall apply to property acquired after the date  
 15       of the enactment of this Act.

16 **TITLE       V—CODIFICATION       OF**  
 17       **ECONOMIC SUBSTANCE DOC-**  
 18       **TRINE**

19 **SEC. 501. CODIFICATION OF ECONOMIC SUBSTANCE DOC-**  
 20                           **TRINE.**

21       (a) IN GENERAL.—Section 7701 is amended by re-  
 22       designating subsection (p) as subsection (q) and by insert-  
 23       ing after subsection (o) the following new subsection:

24       “(p) CLARIFICATION OF ECONOMIC SUBSTANCE  
 25       DOCTRINE.—

1           “(1) APPLICATION OF DOCTRINE.—In the case  
2 of any transaction to which the economic substance  
3 doctrine is relevant, such transaction shall be treated  
4 as having economic substance only if—

5           “(A) the transaction changes in a mean-  
6 ingful way (apart from Federal income tax ef-  
7 fects) the taxpayer’s economic position, and

8           “(B) the taxpayer has a substantial pur-  
9 pose (apart from Federal income tax effects)  
10 for entering into such transaction.

11           “(2) SPECIAL RULE WHERE TAXPAYER RELIES  
12 ON PROFIT POTENTIAL.—

13           “(A) IN GENERAL.—The potential for  
14 profit of a transaction shall be taken into ac-  
15 count in determining whether the requirements  
16 of subparagraphs (A) and (B) of paragraph (1)  
17 are met with respect to the transaction only if  
18 the present value of the reasonably expected  
19 pre-tax profit from the transaction is substan-  
20 tial in relation to the present value of the ex-  
21 pected net tax benefits that would be allowed if  
22 the transaction were respected.

23           “(B) TREATMENT OF FEES AND FOREIGN  
24 TAXES.—Fees and other transaction expenses  
25 and foreign taxes shall be taken into account as

1 expenses in determining pre-tax profit under  
2 subparagraph (A).

3 “(3) STATE AND LOCAL TAX BENEFITS.—For  
4 purposes of paragraph (1), any State or local income  
5 tax effect which is related to a Federal income tax  
6 effect shall be treated in the same manner as a Fed-  
7 eral income tax effect.

8 “(4) FINANCIAL ACCOUNTING BENEFITS.—For  
9 purposes of paragraph (1)(B), achieving a financial  
10 accounting benefit shall not be taken into account as  
11 a purpose for entering into a transaction if such  
12 transaction results in a Federal income tax benefit.

13 “(5) DEFINITIONS AND SPECIAL RULES.—For  
14 purposes of this subsection—

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

22 “(B) EXCEPTION FOR PERSONAL TRANS-  
23 ACTIONS OF INDIVIDUALS.—In the case of an  
24 individual, paragraph (1) shall apply only to  
25 transactions entered into in connection with a

1 trade or business or an activity engaged in for  
2 the production of income.

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

11 “(D) DETERMINATION OF APPLICATION OF  
12 DOCTRINE NOT AFFECTED.—The determination  
13 of whether the economic substance doctrine is  
14 relevant to a transaction shall be made in the  
15 same manner as if this subsection had never  
16 been enacted.

17 “(6) REGULATIONS.—The Secretary shall pre-  
18 scribe such regulations as may be necessary or ap-  
19 propriate to carry out the purposes of this sub-  
20 section. Such regulations may include exemptions  
21 from the application of this subsection.”.

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



1 **TITLE VI—MODIFICATIONS TO**  
2 **DEDUCTIONS FOR DIVIDENDS**  
3 **RECEIVED**

4 **SEC. 601. MODIFICATIONS TO DEDUCTIONS FOR DIVI-**  
5 **DENDS RECEIVED.**

6 (a) GENERAL REDUCTION IN PERCENTAGE OF DE-  
7 Duction.—

8 (1) IN GENERAL.—Sections 243(a)(1),  
9 243(c)(1), 244(a)(3), 244(b)(2), 245(c)(1)(B),  
10 246(b)(3)(B), and 246A(a)(1), before amendment by  
11 subsection (c), are each amended by striking “70  
12 percent” and inserting “60 percent”.

13 (2) CONFORMING AMENDMENTS.—Paragraph  
14 (2) of section 861(a), before amendment by sub-  
15 section (c), is amended by striking “100/70th” both  
16 places it appears and inserting “100/60th”.

17 (b) REDUCTION IN PERCENTAGE FOR 20-PERCENT  
18 OWNED CORPORATIONS.—

19 (1) IN GENERAL.—Sections 243(c)(1),  
20 245(c)(1)(B), 246(b)(3)(A), 246A(a)(1) is amended  
21 by striking “80 percent” and inserting “70 per-  
22 cent”.

23 (2) CONFORMING AMENDMENT.—Paragraph (2)  
24 of section 861(a) is amended by striking “100/80th”  
25 and inserting “100/70th”.

1       (c) REPEAL OF NOL EXCEPTION TO LIMITATION ON  
2 AGGREGATE DEDUCTIONS; ESTABLISHMENT OF  
3 CARRYFORWARD.—

4           (1) IN GENERAL.—Paragraph (2) of section  
5 246(b) is amended to read as follows:

6           “(2) CARRYFORWARD.—The aggregate amount  
7 of deductions disallowed under paragraph (1) for  
8 any taxable year shall be treated as an increase in  
9 the amount allowable as a deduction under section  
10 243(a)(1) for the following taxable year (subject to  
11 the application of paragraph (1) to such following  
12 taxable year).”.

13       (2) CONFORMING AMENDMENTS.—

14           (A) Subsection (d) of section 172 is  
15 amended by striking paragraph (5) and by re-  
16 designating paragraph (6) as paragraph (5).

17           (B) Subparagraph (A) of section 172(b)(2)  
18 is amended by striking “paragraphs (1), (4),  
19 and (5)” and inserting “paragraphs (1) and  
20 (4)”.

21           (C) Paragraph (1) of section 246(b) is  
22 amended by striking “Except as provided in  
23 paragraph (2), the” and inserting “The”.

1 (D) Paragraph (3) of section 246(b) is  
 2 amended by striking “paragraph (1)” and in-  
 3 serting “paragraphs (1) and (2)”.

4 (E) Subparagraph (B) of section 805(a)(4)  
 5 is amended by striking “section 1212(a)(1),”  
 6 and all that follows and inserting “section  
 7 1212(a)(1).”.

8 (d) EFFECTIVE DATE.—The amendments made by  
 9 this section shall apply to taxable years beginning after  
 10 December 31, 2008.

## 11 **TITLE VII—OTHER PROVISIONS**

### 12 **SEC. 701. RECOGNITION OF ORDINARY INCOME ON SALE** 13 **OR EXERCISE OF STOCK OPTION IN S COR-** 14 **PORATION WITH AN ESOP.**

15 (a) IN GENERAL.—Subpart A of part I of subchapter  
 16 D of chapter 1 is amended by adding at the end the fol-  
 17 lowing new section:

### 18 **“SEC. 409B. RECOGNITION OF ORDINARY INCOME ON SALE** 19 **OR EXERCISE OF STOCK OPTION IN S COR-** 20 **PORATION WITH AN ESOP.**

21 “(a) IN GENERAL.—If an S corporation in which an  
 22 employee stock ownership plan is a stockholder grants an  
 23 option with respect to its stock and such option is sold  
 24 or exercised, there shall be included in the gross income  
 25 of the holder of such option (determined immediately be-

1 fore such sale or exercise) as ordinary income an amount  
2 equal to the income inclusion amount.

3 “(b) INCOME INCLUSION AMOUNT.—For purposes of  
4 this section, the term ‘income inclusion amount’ means,  
5 with respect to the holder of any option, the excess (if  
6 any) of—

7 “(1) the sum of the net income amounts with  
8 respect to such option for all taxable years of the S  
9 corporation ending during the taxpayer’s holding pe-  
10 riod, over

11 “(2) the sum of the net loss amounts with re-  
12 spect to such option for all such taxable years.

13 “(c) NET INCOME AND LOSS AMOUNTS.—For pur-  
14 poses of this section, with respect to any taxable year of  
15 the S corporation—

16 “(1) NET INCOME AMOUNT.—The term ‘net in-  
17 come amount’ means the excess (if any) of—

18 “(A) the pass-thru income share for such  
19 taxable year, over

20 “(B) the pass-thru loss share for such tax-  
21 able year.

22 “(2) NET LOSS AMOUNT.—The term ‘net loss  
23 amount’ means the excess (if any) of the amount de-  
24 scribed in paragraph (1)(B) over the amount de-  
25 scribed in paragraph (1)(A).

1       “(d) PASS-THRU INCOME AND LOSS SHARES.—For  
2 purposes of this section, with respect to any taxable year  
3 of the S corporation—

4           “(1) PASS-THRU INCOME SHARE.—The term  
5 ‘pass-thru income share’ means the excess (if any)  
6 of—

7           “(A) the aggregate items of income taken  
8 into account under section 1366 by the em-  
9 ployee stock ownership plan for such taxable  
10 year, over

11           “(B) the aggregate items of income which  
12 would have been so taken into account if such  
13 option had been exercised upon being granted.

14           “(2) PASS-THRU LOSS SHARE.—The term  
15 ‘pass-thru loss share’ means the excess (if any) of—

16           “(A) the aggregate items of deduction and  
17 loss taken into account under section 1366 by  
18 the employee stock ownership plan for such tax-  
19 able year, over

20           “(B) the aggregate items of deduction and  
21 loss which would have been so taken into ac-  
22 count if such option had been exercised upon  
23 being granted.

24       “(e) INTEREST AT UNDERPAYMENT RATE.—

1           “(1) IN GENERAL.—In the case of any taxpayer  
 2           who includes any amount in gross income for any  
 3           taxable year under subsection (a), the tax imposed  
 4           by this chapter on such taxpayer for such taxable  
 5           year shall be increased by interest at the under-  
 6           payment rate determined under section 6621 on the  
 7           underpayments that would have occurred had the  
 8           net income amounts with respect to each taxable  
 9           year taken into account under subsection (c) been  
 10          includible in the taxpayer’s gross income for each of  
 11          taxable year of the taxpayer in or with which the  
 12          taxable year so taken into account ends.

13          “(2) REDUCTION FOR PREVIOUS NET LOSS  
 14          AMOUNTS.—For purposes of paragraph (1), the net  
 15          income amount for any taxable year shall be reduced  
 16          by the excess of—

17                 “(A) the aggregate net loss amounts for  
 18                 taxable years taken into account under sub-  
 19                 section (c) with respect to the taxpayer, over

20                 “(B) the amount of such aggregate pre-  
 21                 viously taken into account under this paragraph  
 22                 to reduce any net income amount.

23          “(f) OTHER DEFINITIONS AND SPECIAL RULES.—  
 24          For purposes of this section—

1           “(1) OPTION.—The term ‘option’ includes any  
2       synthetic equity described in section 409(p)(6)(C).

3           “(2) EFFECT OF STARTING OR TERMINATING  
4       AN S CORPORATION ELECTION.—With respect to any  
5       option, a corporation which is an S corporation for  
6       any taxable year which ends while such option is  
7       outstanding shall be treated for purposes of this sec-  
8       tion (other than subsection (d)) as an S corporation  
9       for all taxable years which end while such option is  
10      outstanding.

11          “(3) ADJUSTMENTS TO BASIS.—

12               “(A) INCREASE IN BASIS OF ACQUIRED  
13       STOCK.—The taxpayer’s basis in any stock ac-  
14       quired pursuant to the exercise of an option to  
15       which subsection (a) applies shall be increased  
16       by the amount included in gross income by the  
17       taxpayer under subsection (a) with respect to  
18       such option.

19               “(B) INCREASE IN BASIS OF OPTION ON  
20       SALE.—The taxpayer’s basis in any option shall  
21       be increased by the amount included in gross  
22       income by the taxpayer under subsection (a)  
23       with respect to such option.”.

24          (b) CONFORMING AMENDMENTS.—

1           (1) Section 26(b)(2) is amended by striking  
 2           “and” at the end of subparagraph (W), by striking  
 3           the period at the end of subparagraph (X) and in-  
 4           serting “, and”, and by adding at the end the fol-  
 5           lowing new subparagraph:

6                     “(Y) subsection (e) of section 409B (relat-  
 7           ing to interest on income recognized upon exer-  
 8           cise of a stock option in an S corporation with  
 9           an ESOP).”.

10          (2) Section 1016(a) is amended by striking  
 11          “and” at the end of paragraph (36), by striking the  
 12          period at the end of paragraph (37) and inserting “,  
 13          and”, and by adding at the end the following new  
 14          paragraph:

15                     “(38) to the extent provided in section  
 16          409B(f)(3).”.

17          (3) The table of sections for subpart A of part  
 18          I of subchapter D of chapter 1 is amended by add-  
 19          ing at the end the following new item:

                      “Sec. 409B. Recognition of ordinary income on sale or exercise of stock option  
   in S corporation with an ESOP.”.

20          (c) EFFECTIVE DATE.—The amendments made by  
 21          this section shall apply to options granted after the date  
 22          of the enactment of this Act.



1 **SEC. 702. TREATMENT OF SECURITIES OF A CONTROLLED**  
 2 **CORPORATION EXCHANGED FOR ASSETS IN**  
 3 **CERTAIN REORGANIZATIONS.**

4 (a) IN GENERAL.—Section 361 (relating to non-  
 5 recognition of gain or loss to corporations; treatment of  
 6 distributions) is amended by adding at the end the fol-  
 7 lowing new subsection:

8 “(d) RECEIPT OF SECURITIES, ETC., IN EXCHANGE  
 9 FOR ASSETS IN CERTAIN REORGANIZATIONS.—If—

10 “(1) property is transferred to a corporation  
 11 (hereinafter in this subsection referred to as the  
 12 ‘controlled corporation’) pursuant to a plan of reor-  
 13 ganization described in section 368(a)(1)(D), and

14 “(2) pursuant to such plan of reorganization,  
 15 stock or securities in the controlled corporation are  
 16 distributed in a transaction which qualifies under  
 17 section 355,

18 then any securities and nonqualified preferred stock (as  
 19 defined in section 351(g)(2)) of the controlled corporation  
 20 shall be treated as other property for purposes of sub-  
 21 sections (a) and (b).”.

22 (b) EFFECTIVE DATE.—The amendment made by  
 23 subsection (a) shall apply to distributions after the date  
 24 of the enactment of this Act.

○