

**DRAFT OF STATUTORY LANGUAGE, WITH
ACCOMPANYING EXPLANATION, OF
AMENDMENTS PROPOSED BY THE
SECRETARY OF THE TREASURY
ON MAY 10, 1962, TO SECTIONS
13, 15, 16, AND 20 OF
H.R. 10650**

(LANGUAGE SUBMITTED BY THE TREASURY
DEPARTMENT AS A WORKING DRAFT
FOR THE CONSIDERATION OF THE
COMMITTEE ON FINANCE)

COMMITTEE ON FINANCE
UNITED STATES SENATE

MAY 31, 1962

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LETTER OF TRANSMITTAL

THE SECRETARY OF THE TREASURY,
Washington.

HON. HARRY F. BYRD,
*Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: In accordance with your request we submit drafts of statutory language. These drafts amend sections of H.R. 10650 as follows:

1. The draft of an amended section 13 (controlled foreign corporations) embodies an approach to impose tax on tax-haven income. The Treasury recommends in accordance with the President's message of April 20, 1961, and my statement of April 2, 1962, before your committee that deferral of taxation of income of controlled foreign corporations be eliminated. However, we are submitting the enclosed draft of an amended section 13 as an aid to the committee if it prefers the more limited tax-haven approach. The draft embodies those technical improvements in the application and mechanics of the House bill which I recommended in my statement before you on May 10, 1962, which were in response to suggestions of witnesses during your hearings.

2. The draft of section 15 (foreign investment companies) makes minor technical amendments in the House bill which the representatives of foreign investment companies suggested to you during the hearings.

3. The drafts of section 16 (gain from certain sales or exchanges of stock in certain foreign corporations) and section 20 (information with respect to certain foreign entities) make the changes which I recommended to you on the first day of the hearings and certain other improvements in response to the suggestions of witnesses who appeared before you.

Sincerely yours,

DOUGLAS DILLON.



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PART 1A

Explanation of Amendments Recommended by Treasury Department to Section 13 of H.R. 10650

GENERAL DESCRIPTION

1. *Certain income of controlled foreign corporations taxed to 10-percent U.S. shareholders.*—The draft legislation provides that certain undistributed income of controlled foreign companies is to be included in the income of U.S. shareholders in the year the income is earned by the foreign corporation, whether or not it is distributed. In these cases, the shareholders are permitted foreign tax credits to the same extent as if actual distributions had been made. Only U.S. shareholders having a 10-percent interest are taxed and counted in determining whether the corporation is to be classified as a “controlled foreign corporation.” A foreign corporation is controlled for this purpose when more than 50 percent of the combined voting power of all classes of stock is owned directly or indirectly (with certain stock attribution rules) by U.S. persons on any date of the taxable year of the corporation. The basic pattern here is largely the same as in section 13 of H.R. 10650.

2. *Description of income taxed to U.S. shareholders.*—The income which would be taxed to U.S. shareholders is described as “subpart F income.” This income consists of (1) income from insurance of U.S. risks on property or persons and (2) income of foreign base companies. In addition, any increase in earnings invested in certain U.S. property by a controlled foreign corporation, which constitutes an attempt to repatriate earnings to the United States without the payment of tax, would result in tax to the U.S. shareholders of the corporation.

A separate provision taxes the sale of a patent, copyright, or like property to a controlled foreign corporation at ordinary income rates in cases where only capital gains or no tax would be paid under present law. This provision, which imposes tax at the time of transfer of a patent, etc., abroad, is complementary to subpart F but is not part of that subpart. It replaces the provision in section 13 of H.R. 10650 for taxing on a current basis the annual income from U.S. patents, etc.

3. *Income derived from insurance of U.S. risks.*—The income derived from insurance of U.S. risks provision is the same as that which was included in section 13 of H.R. 10650, except for minor technical changes.

4. *Foreign base company income.*—Foreign base company income includes several elements:

(a) *Foreign personal holding company income.*—This category covers mainly dividends, interest, rents, and royalties when they constitute “passive” income or “tax haven” type income. Passive dividends, interest, rents, and royalties are those received from

unrelated persons not in connection with the active conduct of a trade or business. Tax-haven dividends, interest, rents, and royalties are those received from related persons in connection with income-producing activities located outside the country of incorporation of recipients.

Foreign base company income does not include dividends and interest received from less-developed country corporations which are reinvested in less-developed country corporations. Deferral with respect to this income derived from less-developed countries is, however, ended when investment of the earnings in less-developed countries is finally terminated.

(b) *Foreign base company sales income.*— This is income derived in connection with the purchase and sale of personal property where the property is purchased outside the country under the laws of which the controlled foreign corporation is created or organized and is sold for use, consumption, or disposition outside such foreign country. This rule is substantially the same as that which was contained in section 13 of H.R. 10650, with the addition of provisions to cover situations in which a controlled foreign corporation acts as an agent and in which a branch or similar establishment acts in the same manner as a controlled foreign corporation. These additions serve to clarify and to complete coverage with respect to tax haven sales income.

(c) *Foreign base company service income.*— Income derived in connection with the performance or furnishing of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services is treated as foreign base company income if the services are performed or furnished for or on behalf of a related person in connection with business activities outside the country of incorporation of the controlled foreign corporation. Foreign base company service income is a significant form of tax haven income, and its omission from section 13 of H.R. 10650 presented a serious gap in the base company provisions of that bill.

The draft legislation also adds an overall exception to deal with situations where use of a controlled foreign corporation covered by the provisions of the bill has not resulted in substantial reduction of taxes. This provision adds flexibility to insure a fair application of the base company income provisions.

5. *Increase in earnings invested in certain U.S. property.*— The provision for taxing the increase in investment in certain U.S. property is, with technical changes, substantially the same as in section 13 of H.R. 10650. Now, however, this is the only type of investment which constitutes nonqualified property (within the terms of sec. 13 of H.R. 10650), the remaining provisions having been eliminated. Thus non-tax-haven profits, such as those of a manufacturing operation, would not be taxed under section 13 unless they were invested in certain U.S. property.

6. *Technique for taxing U.S. shareholders.*— The mechanical features of the draft for taxing income to U.S. shareholders are in large part the same as in section 13 of H.R. 10650 but have been improved in certain respects. Thus, losses of a taxable year are permitted to offset earnings of other taxable years. Losses of one controlled foreign corporation in a chain of controlled foreign corporations are permitted to

offset gains in the current year of other controlled foreign corporations. These provisions for losses make more equitable the taxing mechanism of section 13 of H.R. 10650. Further, the constructive ownership rules have been limited somewhat by providing that, in lieu of attributing to a shareholder all of the stock owned by a corporation in which he owns stock, attribution will only take place if he owns 10 percent of the stock. There are also various minor technical changes designed to make more clear and workable the mechanics of the draft.

MAJOR CHANGES FROM SECTION 13 OF H.R. 10650

There are listed below the major changes which the draft makes in section 13 of H.R. 10650.

1. *Elimination of provision for taxing income from U.S. patents, etc., to U.S. shareholders on current basis and substitution of provision for taxing the sale of U.S. patents, etc., to controlled foreign corporations.*

This change obviates the need under the House bill to determine the amount of income generated by the use of U.S. patents, etc. It eliminates abuse by insuring that patents will be transferred abroad in arm's-length transactions producing a full U.S. tax at the time of transfer or on an annual basis.

2. *Elimination of provision restricting the use of earnings by operating companies, except that such earnings cannot be invested in certain U.S. property.*—Operating companies will, under the draft, not be faced with the difficulty of determining whether or not earnings are invested in the same trade or business that gave rise to them. Also, other problems such as determining when a trade or business would be considered to have been conducted by substantially the same interests, will be eliminated.

3. *Dividends, interest, rents, and royalties derived in connection with active business operations with unrelated persons are removed from coverage as foreign base company income.* This change would remove the objection that section 13 treats certain types of operating income as "passive" income in non-tax-haven situations. Thus, companies engaged in the active business with unrelated persons of banking, financing, shipping, insurance, and leasing of property, would not be covered by the foreign base company income provisions.

4. *Addition of a provision to eliminate coverage under foreign base company provisions where the controlled foreign corporation is not used to effect a substantial reduction in taxes.*—This provision permits flexibility to deal with situations where a controlled foreign corporation technically covered by the provisions of the bill does not differ from a non-tax-haven operation for which deferral of taxation is permitted. It insures a fair application of the foreign base company income provisions.

5. *Changes in the determination of when a foreign corporation is considered to be "controlled" so that (a) only 10-percent U.S. shareholders are counted in determining control and (b) there will be attribution of ownership of stock owned by a corporation to shareholders of that corporation only where such shareholders own a 10-percent interest.*—These changes remove objections that the coverage of foreign corporations was too broad, reaching situations where ownership was widely scattered and no U.S. group was in effective control.

6. *Greater recognition of losses under which (a) losses of one year may offset profits of future years and (b) losses of one controlled foreign corporation in a chain of controlled foreign corporations may in the current year offset gains of the other corporations.* These provisions provide for an equitable application of the taxing mechanism in situations where losses are involved.

7. *Provision so that tax will not be payable in situations in which the presence of blocked income means that earnings of a controlled foreign corporation could not be distributed to U.S. shareholders.* This change meets the objection that shareholders might be taxed on constructive distributions in situations in which there could not be actual distributions.

8. *Provision for the establishment of guidelines, under regulations, for the computation of earnings and profits in accordance with the rules which have been developed for domestic corporations.* Among other matters, provision will be made so that elections similar to those which are available to domestic corporations will be available. These guidelines will facilitate compliance with the legislation from the standpoint of taxpayers and will meet certain criticism that great difficulty will be involved in determining tax liability under subpart F.

9. *Elimination of provision permitting a pour-over of profits from developed areas to less developed areas.*—This change, in large part, follows from the elimination of certain restrictions with respect to the earnings of operating co. if aces and permits considerable simplification in the application of this part of the draft. The only reinvestment which qualifies to reduce foreign base company income involves dividends and interest derived from less developed country corporations. Less developed country corporations are, in general, corporations carrying on an active trade or business within a less developed country or countries and whose assets are located in such countries. The terms on which such reinvestment may take place have been liberalized so that minority stock (10 percent) and certain debt interests may qualify and, also, the time in which the investment may be made has been extended from 75 days after the close of the taxable year to 1 year or such longer period as may be designated by the Secretary or his delegate. Also, investments made at a time when a country is classified as a less developed country shall be treated as a qualified investment even if that country ceases to be a less developed country.

10. *Clarification of terms and minor technical improvements.* In general, the provisions of the draft meet various technical points which were raised with respect to the meaning of terms and the mechanical features of section 13.

11. *Elimination of coverage of corporations in the Commonwealth of Puerto Rico and the Virgin Islands.* The draft leaves these corporations subject to the rules of existing law with, however, provision to insure that such corporations will not be availed of for tax haven activities.

12. *Rounding out of coverage with respect to tax haven activities.*—Provision has been made to treat certain service income derived from related parties as foreign base company and to prevent avoidance of the foreign base company sales income provisions in certain situations which are like those which are covered by the House bill. These changes are in accordance with the purpose of the bill to effectively eliminate deferral of taxation for tax haven activities.

PART 1B

Draft of Statutory Language Incorporating Amendments Recommended by Treasury Department to Section 13 of H.R. 10650

On page 103, beginning with line 14, strike out all through line 18, on page 137 (sec. 13 of the bill) and in lieu thereof insert the following:

SEC. 13. CONTROLLED FOREIGN CORPORATIONS.

(a) IN GENERAL. --Part III of subchapter N of chapter 1 (relating to income from sources without the United States) is amended by adding at the end thereof the following new subpart:

"Subpart F--Controlled Foreign Corporations

- "Sec. 951. Amounts included in gross income of United States shareholders.
- "Sec. 952. Subpart F income defined.
- "Sec. 953. Income from insurance of United States risks.
- "Sec. 954. Foreign base company income.
- "Sec. 955. Withdrawal of previously excluded subpart F income from qualified investment.
- "Sec. 956. Investment of earnings in United States property.
- "Sec. 957. Controlled foreign corporations.
- "Sec. 958. Rules for determining stock ownership.
- "Sec. 959. Exclusion from gross income of previously taxed earnings and profits.
- "Sec. 960. Special rules for foreign tax credit.
- "Sec. 961. Adjustments to basis of stock in controlled foreign corporations and of other property.
- "Sec. 962. Miscellaneous provisions.

"SEC. 951. AMOUNTS INCLUDED IN GROSS INCOME OF UNITED STATES SHAREHOLDERS.

"(a) AMOUNTS INCLUDED.--

"(1) IN GENERAL.--If a foreign corporation is a controlled corporation on any day of a taxable year beginning after December 31, 1962, every person who is a United States shareholder (as defined in subsection (b)) of such corporation and who owns (within the meaning of section 958(a)) stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends --

"(A) the sum of --

"(i) his pro rata share (determined under paragraph (2)) of the corporation's subpart F income for such year, and

"(ii) his pro rata share (determined under section 955(a)(3)) of the corporation's previously excluded subpart F income withdrawn from investment in less developed country corporations for such year; and

“(B) his pro rata share (determined under section 956(a)(2)) of the corporation's increase in earnings invested in United States property for such year (but only to the extent not excluded from gross income under section 959(a)(2)).

“(2) **PRO RATA SHARE OF SUBPART F INCOME.** The pro rata share referred to in paragraph (1)(A)(i) in the case of any United States shareholder is the amount —

“(A) which would have been distributed with respect to the stock which such shareholder owns (within the meaning of section 958(a)) in such corporation if on the last day, in its taxable year, on which the corporation is a controlled foreign corporation it had distributed pro rata to its shareholders an amount (i) which bears the same ratio to its subpart F income for the taxable year, as (ii) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year, reduced by

“(B) the amount of any distribution received by any other United States person during such year as a dividend with respect to such stock.

“(3) **LIMITATION ON PRO RATA SHARE OF PREVIOUSLY EXCLUDED SUBPART F INCOME WITHDRAWN FROM INVESTMENT.** — For purposes of paragraph (1)(A)(ii), the pro rata share of any United States shareholder of the previously excluded subpart F income of a controlled foreign corporation withdrawn from investment in less developed country corporations shall not exceed an amount (A) which bears the same ratio to his pro rata share of such income withdrawn (as determined under section 955(a)(3)) for the taxable year, as (B) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year.

“(4) **LIMITATION ON PRO RATA OF INVESTMENT IN UNITED STATES PROPERTY.** — For purposes of paragraph (1)(B), the pro rata share of any United States shareholder in the increase of the earnings of a controlled foreign corporation invested in United States property shall not exceed an amount (A) which bears the same ratio to his pro rata share of such increase (as determined under section 956(a)(2)) for the taxable year, as (B) the part of such year during which the corporation is a controlled foreign corporation bears to the entire year.

“(b) **UNITED STATES SHAREHOLDER DEFINED.** — For purposes of this subpart, the term ‘United States shareholder’ means, with respect to any foreign corporation, a United States person (as defined in section 7701(a)(30)) who owns (within the meaning of section 958(a)), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock, or of the total value of shares of all classes of stock, of such foreign corporation.

“(c) **COORDINATION WITH ELECTION OF A FOREIGN INVESTMENT COMPANY TO DISTRIBUTE INCOME.** — A United States shareholder who, for his taxable year, is a qualified shareholder (within the meaning of section 1247(c)) of a foreign investment company with respect to which an election under section 1247 is in effect shall not be required to include in gross income, for such taxable year, any amount under subsection (a) with respect to such company.

"SEC. 952. SUBPART F INCOME DEFINED.

"(a) **IN GENERAL.** For purposes of this subpart, the term 'subpart F income' means, in the case of any controlled foreign corporation, the sum of—

"(1) the income derived from the insurance of United States risks (as determined under section 953), and

"(2) the foreign base company income (as determined under section 954).

"(b) **EXCLUSION OF UNITED STATES INCOME.** Subpart F income does not include any item includible in gross income under this chapter (other than this subpart) as income derived from sources within the United States of a foreign corporation engaged in trade or business in the United States.

"(c) **LIMITATION.** For purposes of subsection (a), the subpart F income of any controlled foreign corporation for any taxable year shall not exceed the earnings and profits of such corporation for such year reduced by the amount (if any) by which—

"(1) the sum of the deficits in earnings and profits for prior taxable years beginning after December 31, 1962 exceeds

"(2) an amount equal to the earnings and profits described in section 959(c)(3) accumulated for taxable years beginning after December 31, 1962 (determined as of the close of the taxable year).

For purposes of the preceding sentence, any deficit in earnings and profits for any prior taxable year shall be taken into account under paragraph (1) for any taxable year only to the extent it has not been taken into account under such paragraph for any preceding taxable year to reduce earnings and profits of such preceding year.

"(d) **SPECIAL RULE IN CASE OF INDIRECT OWNERSHIP.** For purposes of subsection (c), if—

"(1) a United States shareholder owns (within the meaning of section 958(a)) stock of a foreign corporation, and by reason of such ownership owns (within the meaning of such section) stock of any other foreign corporation, and

"(2) any of such foreign corporations has a deficit in earnings and profits for the taxable year,

then the earnings and profits for the taxable year of each such foreign corporation which is a controlled foreign corporation shall, with respect to such United States shareholder, be properly reduced to take into account any deficit described in paragraph (2) in such manner as the Secretary or his delegate shall prescribe by regulations.

"SEC. 953. INCOME FROM INSURANCE OF UNITED STATES RISKS.

"(a) **GENERAL RULE.**—For purposes of section 952(a)(1), the term 'income derived from the insurance of United States risks' means that income which—

"(1) is attributable to the reinsurance or the issuing of any insurance or annuity contract—

"(A) in connection with property or liability arising out of activity in, or in connection with the lives or health of residents of, the United States, or

"(B) in connection with risks not included in subparagraph (A) as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums

or other consideration in respect of any reinsurance or the issuing of any insurance or annuity contract in connection with property or liability arising out of activity in, or in connection with the lives or health of residents of, the United States, and

“(2) would (subject to the modifications provided by paragraphs (1), (2), and (3) of subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance corporation.

This section shall apply only in the case of a controlled foreign corporation which receives during any taxable year premiums or other consideration in respect of any reinsurance or the issuing of any insurance or annuity contract described in paragraph (1) in excess of 5 percent of the total of premiums and other consideration received by it during such taxable year in respect of all reinsurance and issuing of insurance and annuity contracts.

“(b) SPECIAL RULES.—For purposes of subsection (a)—

“(1) In the application of part I of subchapter L, life insurance company taxable income is the gain from operations as defined in section 809(b).

“(2) A corporation which would, if it were a domestic insurance corporation, be taxable under part II of subchapter L shall apply subsection (a) as if it were taxable under part III of subchapter L.

“(3) The following provisions of subchapter L shall not apply:

“(A) Section 809(d)(4) (operations loss deduction).

“(B) Section 809(d)(5) (certain nonparticipating contracts).

“(C) Section 809(d)(6) (group life, accident, and health insurance).

“(D) Section 809(d)(10) (small business deduction).

“(E) Section 817(b) (gain on property held on December 31, 1958, and certain substituted property acquired after 1958).

“(F) Section 832(b)(5) (certain capital losses).

“(4) The items referred to in—

“(A) section 809(c)(1) (relating to gross amount of premiums and other consideration).

“(B) section 809(c)(2) (relating to net decrease in reserves).

“(C) section 809(d)(2) (relating to net increase in reserves), and

“(D) section 832(b)(4) (relating to premiums earned on insurance contracts),

shall be taken into account only to the extent they are in respect of any reinsurance or the issuing of any insurance or annuity contract described in paragraph (1).

“(5) All items of income, expenses, losses, and deductions (other than those taken into account under paragraph (4)) shall be properly allocated or apportioned under regulations prescribed by the Secretary or his delegate.

“SEC. 954. FOREIGN BASE COMPANY INCOME.

“(a) FOREIGN BASE COMPANY INCOME.—For purposes of section 952(a)(2), the term ‘foreign base company income’ means for any taxable year the sum of—

“(1) the foreign personal holding company income for the taxable year (determined under subsection (c) and reduced as provided in subsection (b)(5)),

“(2) the foreign base company sales income for the taxable year (determined under subsection (d) and reduced as provided in subsection (b)(5)), and

“(3) the foreign base company services income for the taxable year (determined under subsection (e) and reduced as provided in subsection (b)(5)).

“(b) EXCLUSIONS AND SPECIAL RULES.—

“(1) **CERTAIN DIVIDENDS AND INTEREST FROM LESS DEVELOPED COUNTRY CORPORATIONS EXCLUDED.**—For purposes of subsection (a), foreign base company income does not include dividends and interest received during the taxable year by a controlled foreign corporation from qualified investments in less developed country corporations (as defined in section 955(b)), to the extent that such dividends and interest do not exceed the increase for the taxable year in qualified investments in less developed country corporations of the controlled foreign corporation (as determined under subsection (f)).

“(2) **CERTAIN INSURANCE INCOME EXCLUDED.**—For purposes of subsection (a), foreign base company income does not include any income derived from the insurance of United States risks (as defined in section 953(a)).

“(3) **SPECIAL RULE WHERE FOREIGN BASE COMPANY INCOME IS LESS THAN 20 PERCENT OR MORE THAN 80 PERCENT OF GROSS INCOME.**—For purposes of subsection (a)—

“(A) If the foreign base company income (determined without regard to paragraph (5)) is less than 20 percent of gross income, no part of the gross income of the taxable year shall be treated as foreign base company income.

“(B) If the foreign base company income (determined without regard to paragraph (5)) exceeds 80 percent of gross income, the entire gross income of the taxable year shall, subject to the provisions of paragraphs (1), (2), (4), and (5), be treated as foreign base company income.

“(4) **EXCEPTION FOR FOREIGN CORPORATIONS NOT AVAILED OF TO REDUCE TAXES.**—For purposes of subsection (a), foreign base company income does not include any item of income received by a controlled foreign corporation if it is established to the satisfaction of the Secretary or his delegate with respect to such item that the creation or organization of the controlled foreign corporation receiving such item under the laws of the foreign country in which it is incorporated does not have the effect of substantial reduction of income, war profits, excess profits or similar taxes.

“(5) **DEDUCTIONS TO BE TAKEN INTO ACCOUNT.**—For purposes of subsection (a), the foreign personal holding company income, the foreign base company sales income, the foreign base company services income, and gross income to which paragraph (3)(B) applies shall be reduced, under regulations prescribed by the Secretary or his delegate, so as to take into account deductions (including taxes) properly allocable to such income.

“(6) **ITEMS OF INCOME TO BE INCLUDED ONLY ONCE.**—If an item of income would, but for the provisions of this paragraph, be includible as an item of income under more than one paragraph of subsection (a), such item shall be included under the paragraph specified by regulations prescribed by the Secretary or his delegate.

“(c) **FOREIGN PERSONAL HOLDING COMPANY INCOME.**—

“(1) **IN GENERAL.**—For purposes of subsection (a) (1), the term ‘foreign personal holding company income’ means the foreign personal holding company income (as defined in section 553), modified and adjusted as provided in paragraph (2), (3), and (4).

“(2) **RENTS INCLUDED WITHOUT REGARD TO 50 PERCENT LIMITATION.**—For purposes of paragraph (1), all rents shall be included in foreign personal holding company income without regard to whether or not such rents constitute more than 50 percent of gross income.

“(3) **CERTAIN INCOME DERIVED IN ACTIVE CONDUCT OF TRADE OR BUSINESS.**—For purposes of paragraph (1), foreign personal holding company income does not include dividends, interest, rents, and royalties which—

“(A) are derived in the active conduct of a trade or business; and

“(B) are received from a person other than a related person (within the meaning of subsection (d) (3)).

“(4) **CERTAIN INCOME RECEIVED FROM RELATED PERSONS.**—For purposes of paragraph (1), foreign personal holding company income does not include—

“(A) dividends and interest received from a related person which (i) is organized under the laws of the same foreign country under the laws of which the controlled foreign corporation is created or organized, and (ii) has a substantial part of its assets used in its trade or business located in such same foreign country; or

“(B) rents, royalties, and similar amounts received from a related person for the use of, or the privilege of using, property within the country under the laws of which the controlled foreign corporation is created or organized.

“(d) **FOREIGN BASE COMPANY SALES INCOME.**—

“(1) **IN GENERAL.**—For purposes of subsection (a)(2), the term ‘foreign base company sales income’ means income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person where—

“(A) the property which is purchased (or in the case of property sold on behalf of a related person, the property which is sold) is manufactured, produced, grown, or extracted outside the country under the laws of which the controlled foreign corporation is created or organized, and

“(B) the property is sold for use, consumption, or disposition outside such foreign country, or, in the case of property

purchased on behalf of a related person, is purchased for use, consumption, or disposition outside such foreign country.

“(2) CERTAIN BRANCH INCOME.—For purposes of determining foreign base company sales income (within the terms of paragraph (1)), in situations in which the carrying on of activities by a controlled foreign corporation through a branch or similar establishment outside the country of incorporation of the controlled foreign corporation has substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary corporation deriving such income, then, under regulations prescribed by the Secretary or his delegate, the income attributable to the carrying on of such activities of such branch or similar establishment shall be treated as income derived by a wholly owned subsidiary of the controlled foreign corporation and shall constitute foreign base company sales income of the controlled foreign corporation.

“(3) RELATED PERSON DEFINED.—For purposes of this section, a person is a related person with respect to a controlled foreign corporation, if—

“(A) such person is an individual, partnership, trust, or estate which controls the controlled foreign corporation;

“(B) such person is a corporation which controls, or is controlled by, the controlled foreign corporation; or

“(C) such person is a corporation which is controlled by the same person or persons which control the controlled foreign corporation.

For purposes of the preceding sentence, control means the ownership, directly or indirectly, of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote. For purposes of this paragraph, the rules for determining ownership of stock prescribed by section 958 shall apply.

“(e) FOREIGN BASE COMPANY SERVICES INCOME.—For purposes of subsection (a)(3), the term ‘foreign base company services income’ means income (whether in the form of compensation, commissions, fees, or otherwise) derived in connection with the performance of furnishing of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which are—

“(1) performed or furnished for or on behalf of any related person (within the meaning of subsection (d)(3)), and

“(2) are performed or furnished for or in connection with business activities carried on by such related person outside the country under the laws of which the controlled foreign corporation is created or organized.

“(f) INCREASE IN QUALIFIED INVESTMENTS IN LESS DEVELOPED COUNTRY CORPORATIONS.—For purposes of subsection (b)(1), the increase for any taxable year in qualified investments in less developed country corporations of any controlled foreign corporation is the amount by which—

“(1) the qualified investments in less developed country corporations (as defined in section 955(b)) of the controlled foreign corporation at the close of the taxable year, exceeds

“(2) the qualified investments in less developed country corporations (as so defined) of the controlled foreign corporation at the close of the preceding taxable year.

“SEC. 955. WITHDRAWAL OF PREVIOUSLY EXCLUDED SUBPART F INCOME FROM QUALIFIED INVESTMENT.

“(a) GENERAL RULES.—

“(1) **AMOUNT WITHDRAWN.**—For purposes of this subpart, the amount of previously excluded subpart F income of any controlled corporation withdrawn from investment in less developed country corporations for any taxable year is an amount equal to the decrease in the amount of qualified investments in less developed country corporations of the controlled foreign corporation for such year, but only to the extent that the amount of such decrease does not exceed an amount equal to—

“(A) the sum of the amounts excluded under section 954(b)(1) from the foreign base company income of such corporation for all prior taxable years, reduced by

“(B) the sum of the amounts of previously excluded subpart F income withdrawn from investment in less developed country corporations of such corporation determined under this subsection for all prior taxable years.

“(2) **DECREASE IN QUALIFIED INVESTMENTS.**—For purposes of paragraph (1), the amount of the decrease in qualified investments in less developed country corporations of any controlled foreign corporation for any taxable year is the amount by which—

“(A) the amount of qualified investments in less developed country corporations of the controlled foreign corporation at the close of the preceding taxable year, exceeds

“(B) the amount of qualified investments in less developed country corporations of the controlled foreign corporation at the close of the taxable year,

to the extent the amount of such decrease does not exceed the sum of the earnings and profits for the taxable year and the earnings and profits accumulated for prior taxable years beginning after December 31, 1962. For purposes of this paragraph, if qualified investments in less developed country corporations are disposed of by the controlled foreign corporation during the taxable year, the amount of the decrease in qualified investments in less developed country corporations of such controlled foreign corporation for such year shall be reduced by an amount equal to the amount (if any) by which the losses on such dispositions during such year exceed the gains on such dispositions during such year.

“(3) **PRO RATA SHARE OF AMOUNT WITHDRAWN.**—In the case of any United States shareholder, the pro rata share of the amount of previously excluded subpart F income of any controlled foreign corporation withdrawn from investment in less developed country corporations for any taxable year is his pro rata share of the amount determined under paragraph (1).

“(b) QUALIFIED INVESTMENTS IN LESS DEVELOPED COUNTRY CORPORATIONS.—

“(1) **IN GENERAL.**—For purposes of this subpart, the term ‘qualified investments in less developed country corporations’ means property acquired after December 31, 1962, which is—

“(A) stock of a less developed country corporation held by the controlled foreign corporation, but only if the controlled foreign corporation owns 10 percent or more of the total combined voting power of all classes of stock, or of the total value of shares of all classes of stock, of such less developed country corporation; or

“(B) an obligation of a less developed country corporation held by the controlled foreign corporation, which, at the time of its acquisition by the controlled foreign corporation, has a maturity of 5 years or more, but only if the controlled foreign corporation owns 10 percent or more of the total combined voting power of all classes of stock, or of the total value of shares of all classes of stock, of such less developed country corporation.

“(2) COUNTRY CEASES TO BE LESS DEVELOPED COUNTRY.—For purposes of this subpart, property which would be a qualified investment in less developed country corporations, but for the fact that a foreign country has, after the acquisition of such property by the controlled foreign corporation, ceased to be a less developed country, shall be treated as a qualified investment in less developed country corporations.

“(3) INVESTMENTS AFTER CLOSE OF YEAR.—For purposes of this subpart, a controlled foreign corporation may, under regulations prescribed by the Secretary or his delegate, elect to treat property described in paragraph (1) or (2) which was acquired after the close of a taxable year and on or before the close of the following taxable year, or on or before such day after the close of the following taxable year as such regulations may prescribe, as having been acquired on the last day of such year.

“(4) AMOUNT ATTRIBUTABLE TO PROPERTY.—The amount taken into account under this subpart with respect to any property described in paragraph (1) or (2) shall be its adjusted basis, reduced by any liability to which such property is subject.

“(c) LESS DEVELOPED COUNTRY CORPORATIONS.—

“(1) IN GENERAL.—For purposes of this subpart, the term ‘less developed country corporation’ means a foreign corporation which during the taxable year is engaged in the active conduct of one or more trades or businesses and—

“(A) 80 percent or more of the gross income of which for the taxable year is derived from sources within less developed countries,

“(B) 80 percent or more in value of the assets of which on each day if the taxable year consists of—

“(i) property used in such trades or businesses and located in less developed countries,

“(ii) money, and deposits with persons carrying on the banking business, located in less developed countries,

“(iii) stock, and obligations which, at the time of their acquisition, have a maturity of 5 years or more, of any other less developed country corporation,

“(iv) obligations of the government of a less developed country,

“(v) an investment which is required because of restrictions imposed by a less developed country, and

“(vi) property described in section 956(b)(2); and

“(C) is created or organized under the laws of one of the less developed countries in which property described in subparagraph (B)(i) is located.

For purposes of subparagraph (A), the determination as to whether income is derived from sources within less developed countries shall be made under regulations prescribed by the Secretary or his delegate.

“(2) **LESS DEVELOPED COUNTRY DEFINED.** For purposes of this subpart, the term ‘less developed country’ means (in respect of any foreign corporation) any foreign country (other than an area within the Sino-Soviet bloc) or any possession of the United States, with respect to which on the first day of the taxable year, there is in effect an Executive order by the President of the United States designating such country or possession as an economically less developed country for purposes of this subpart. For purposes of the preceding sentence, an overseas territory, department, province, or possession may be treated as a separate country. No designation shall be made under this paragraph with respect to—

Australia	Liechtenstein
Austria	Luxembourg
Belgium	Monaco
Canada	Netherlands
Denmark	New Zealand
France	Norway
Germany (Federal Republic)	Union of South Africa
Hong Kong	San Marino
Italy	Sweden
Japan	Switzerland
	United Kingdom

“SEC. 956. INVESTMENT OF EARNINGS IN UNITED STATES PROPERTY.

“(a) **GENERAL RULES.**—For purposes of this subpart—

“(1) **AMOUNT OF INVESTMENT.**—The amount of earnings of a controlled foreign corporation invested in United States property at the close of any taxable year is the aggregate amount of such property held, directly or indirectly, by the controlled foreign corporation at the close of the taxable year, to the extent such amount would have constituted a dividend (determined after the application of section 955(a)) if it had been distributed.

“(2) **PRO RATA SHARE OF INCREASE FOR YEAR.**—In the case of any United States shareholder, the pro rata share of the increase for any taxable year in the earnings of a controlled foreign corporation invested in United States property is the amount determined by subtracting—

“(A) his pro rata share of the amount determined under paragraph (1) for the close of the preceding taxable year, reduced by amounts paid during the taxable year to which section 959(c)(1) applies, from

“(B) his pro rata share of the amount determined under paragraph (1) for the close of the taxable year.

“(3) **AMOUNT ATTRIBUTABLE TO PROPERTY.**—The amount taken into account under paragraph (1) or (2) with respect to any property shall be its adjusted basis, reduced by any liability to which the property is subject.

“(b) **UNITED STATES PROPERTY DEFINED.**

“(1) **IN GENERAL.**—For purposes of subsection (a), the term ‘United States property’ means any property acquired after December 31, 1962, which is —

“(A) tangible property located in the United States;

“(B) stock of a domestic corporation; or

“(C) an obligation of a United States person.

“(2) **EXCEPTIONS.**—For purposes of subsection (a), the term ‘United States property’ does not include —

“(A) money, or deposits with persons carrying on the banking business, located in the United States;

“(B) property located in the United States which is purchased in the United States for export to, or use in, foreign countries;

“(C) any obligation of a United States person arising in connection with the sale of property if the amount of such obligation outstanding at no time during the taxable year exceeds the amount which would be ordinary and necessary to carry on the trade or business of both the other party to the sale transaction and the United States person had the sale been made between unrelated persons;

“(D) any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States; or

“(E) the amount of assets of an insurance company equivalent to the unearned premiums on outstanding business with respect to contracts which are not described in section 953(a)(1).

“(c) **PLEDGES AND GUARANTEES.** For purposes of subsection (a), a controlled foreign corporation shall, under regulations prescribed by the Secretary or his delegate, be considered as holding an obligation of a United States person if it is a pledgor or guarantor of such obligation.

“**SEC. 957. CONTROLLED FOREIGN CORPORATIONS.**

“(a) **GENERAL RULE.**—For purposes of this subpart, the term ‘controlled foreign corporation’ means any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation.

“(b) **SPECIAL RULE FOR INSURANCE.**—For purposes only of taking into account income described in section 953(a) (relating to income derived from insurance of United States risks), the term ‘controlled foreign corporation’ includes not only a foreign corporation as defined by subsection (a) but also one of which more than 25 percent of the total combined voting power of all classes of stock is owned (within the meaning of section 958(a)), or is considered as owned by applying

the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such corporation, if the gross amount of premiums or other consideration in respect of the reinsurance or the issuing of insurance or annuity contracts described in section 953(a)(1) exceeds 75 percent of the gross amount of all premiums or other consideration in respect of all risks.

“(c) CORPORATIONS ORGANIZED IN UNITED STATES POSSESSIONS.— For purposes of this subpart, the term ‘controlled foreign corporation’ does not include any corporation created or organized in the Commonwealth of Puerto Rico or a possession of the United States or under the law of the Commonwealth of Puerto Rico or a possession of the United States if—

“(1) 80 percent or more of the gross income of such corporation (computed without regard to section 931) for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within the Commonwealth of Puerto Rico or a possession of the United States; and

“(2) 50 percent or more of the gross income of such corporation (computed without regard to section 931) for such period, or for such part thereof, was derived from the active conduct within the Commonwealth of Puerto Rico or a possession of the United States of any trades or businesses constituting the manufacture or processing of goods, wares, merchandise, or other tangible personal property; the processing of agricultural or horticultural products or commodities (including but not limited to livestock, poultry or fur-bearing animals); the catching or taking of any kind of fish or the mining or extraction of natural resources, or any manufacturing or processing of any products or commodities obtained from such activities; or the ownership or operation of hotels.”

For purposes of paragraphs (1) and (2), the determination as to whether income was derived from sources within the Commonwealth of Puerto Rico or a possession of the United States and was derived from the active conduct of a described trade or business within the Commonwealth of Puerto Rico or a possession of the United States shall be made under regulations prescribed by the Secretary or his delegate.

“SEC. 958. RULES FOR DETERMINING STOCK OWNERSHIP.

“(a) DIRECT AND INDIRECT OWNERSHIP.

“(1) **GENERAL RULE.** For purposes of this subpart (other than sections 955(b)(1) (A) and (B)), stock owned means—

“(A) stock owned directly, and

“(B) stock owned with the application of paragraph (2).

“(2) **STOCK OWNERSHIP THROUGH FOREIGN ENTITIES.**— For purposes of subparagraph (B) of paragraph (1), stock owned, directly or indirectly, by or for a foreign corporation, foreign partnership, or foreign trust or foreign estate (within the meaning of section 7701(a)(31)) shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person.

“(3) **SPECIAL RULE FOR MUTUAL INSURANCE COMPANIES.** For purposes of applying paragraph (1) in the case of a foreign mutual insurance company, the term ‘stock’ shall include any certificate entitling the holder to voting power in the corporation.

“(b) **CONSTRUCTIVE OWNERSHIP.** For purposes of sections 951(b), 954(d)(3), and 957, section 318(a) (relating to constructive ownership of stock) shall apply to the extent that the effect is to treat any United States person as a United States shareholder within the meaning of section 951(b), to treat a person as a related person within the meaning of section 954(d)(3), or to treat a foreign corporation as a controlled foreign corporation under section 957, except—

“(1) In applying paragraph (1)(A) of section 318(a), stock owned by a nonresident alien individual (other than a foreign trust or foreign estate) shall not be considered as owned by a citizen or by a resident alien individual.

“(2) In applying the first sentence of subparagraphs (A) and (B), and in applying clause (i) of subparagraph (C), of section 318 (a)(2)—

“(A) if a partnership, estate, trust, or corporation owns, directly or indirectly, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of a corporation, it shall be considered as owning all the stock entitled to vote, and

“(B) if a partnership, estate, trust, or corporation owns, directly or indirectly, more than 50 percent of the total value of shares of all classes of stock of a corporation, it shall be considered as owning the total value of all of the outstanding stock of such corporation. The application of this subparagraph shall not have the effect of increasing voting power of a partner, beneficiary, or shareholder, for purposes of subparagraph (A).

“(3) Stock owned by a partnership, estate, trust, or corporation, by reason of the application of the second sentence of subparagraphs (A) and (B), and the application of clause (ii) of subparagraph (C), of section 318(a)(2), shall not be considered as owned by such partnership, estate, trust, or corporation, for the purposes of applying the first sentence of subparagraphs (A) and (B), and in applying clause (i) of subparagraph (C), of section 318(a)(2).

“(4) In applying clause (i) of subparagraph (C) of section 318(a)(2), the phrase ‘10 percent’ shall be substituted for the phrase ‘50 percent’ used in subparagraph (C).

“SEC. 959. EXCLUSION FROM GROSS INCOME OF PREVIOUSLY TAXED EARNINGS AND PROFITS.

“(a) **EXCLUSION FROM GROSS INCOME OF UNITED STATES PERSONS.** For purposes of this chapter, the earnings and profits for a taxable year of a foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a) shall not, when—

“(1) such amounts are distributed to, or

“(2) such amounts would, but for this subsection, be included under section 951(a)(1)(B) in the gross income of, such shareholder (or any other United States person who acquires from any person any portion of the interest of such United States

shareholder in such foreign corporation, but only to the extent of such portion, and subject to such proof of the identity of such interest as the Secretary or his delegate may by regulations prescribe) directly, or indirectly through a chain of ownership described under section 958(a), be again included in the gross income of such United States shareholder (or of such other United States person).

“(b) **EXCLUSION FROM GROSS INCOME OF CERTAIN FOREIGN SUBSIDIARIES.** For purposes of section 951(a), the earnings and profits for a taxable year of a controlled foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a), shall not, when distributed through a chain of ownership described under section 958(a), be also included in the gross income of another controlled foreign corporation in such chain for purposes of the application of section 951(a) to such other controlled foreign corporation with respect to such United States shareholder (or to any other United States shareholder who acquires from any person any portion of the interest of such United States shareholder in the controlled foreign corporation, but only to the extent of such portion, and subject to such proof of identity of such interest as the Secretary or his delegate may prescribe by regulations).

“(c) **ALLOCATION OF DISTRIBUTIONS.** For purposes of subsections (a) and (b), section 316(a) shall be applied by applying paragraph (2) thereof, and then paragraph (1) thereof

“(1) first to earnings and profits attributable to amounts included in gross income under section 951(a)(1)(B) (or which would have been included except for subsection (a)(2)),

“(2) then to earnings and profits attributable to amounts included in gross income under section 951(a)(1)(A) (but reduced by amounts not included under section 951(a)(1)(B) because of the exclusion in subsection (a)(2)), and

“(3) then to other earnings and profits.

“(d) **DISTRIBUTIONS EXCLUDED FROM GROSS INCOME NOT TO BE TREATED AS DIVIDENDS.** Except as provided in section 960(a)(3), any distribution excluded from gross income under subsection (a) shall be treated, for purposes of this chapter, as a distribution which is not a dividend.

“SEC. 960. SPECIAL RULES FOR FOREIGN TAX CREDIT.

“(a) **TAXES PAID BY A FOREIGN CORPORATION.**

“(1) **GENERAL RULE.** For purposes of subpart A of this part, if there is included, under section 951(a), in the gross income of a domestic corporation any amount attributable to earnings and profits

“(A) of a foreign corporation at least 10 percent of the voting stock of which is directly owned by such domestic corporation, or

“(B) of a foreign corporation at least 50 percent of the voting stock of which is directly owned by a foreign corporation at least 10 percent of the voting stock of which is in turn directly owned by such domestic corporation,

then, under regulations prescribed by the Secretary or his delegate, such domestic corporation shall be deemed to have paid the same proportion of the total income, war profits, and excess profits taxes paid (or deemed paid, if, paragraph (4) applies) by such

foreign corporation to a foreign country or possession of the United States for the taxable year which the amount of earnings and profits of such foreign corporation so included in gross income of the domestic corporation bears to the entire amount of the total earnings and profits of such foreign corporation for such taxable year.

"(2) TAXES PREVIOUSLY DEEMED PAID BY DOMESTIC CORPORATION.—If a domestic corporation receives a distribution from a foreign corporation, any portion of which is excluded from gross income under section 959, the income, war profits, and excess profits taxes paid or deemed paid by such foreign corporation to any foreign country or to any possession of the United States in connection with the earnings and profits of such foreign corporation from which such distribution is made shall not be taken into account for purposes of section 902, to the extent such taxes were deemed paid by such domestic corporation under paragraph (1) for any prior taxable year.

"(3) TAXES PAID BY FOREIGN CORPORATION AND NOT PREVIOUSLY DEEMED PAID BY DOMESTIC CORPORATION.—Any portion of a distribution from a foreign corporation received by a domestic corporation which is excluded from gross income under section 959(a) shall be treated by the domestic corporation as a dividend, solely for purposes of taking into account under section 902 any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such distribution is made, which were not deemed paid by the domestic corporation under paragraph (1) for any prior taxable year.

"(4) TAXES PAID BY A FOREIGN SUBSIDIARY.—If subparagraph (A) of paragraph (1) applies with respect to an amount included in gross income under section 951(a) for a taxable year, then such amount shall be considered a dividend for purpose of the application of section 902(b).

"(5) INCLUSION IN GROSS INCOME.—

"For inclusion in gross income of amount equal to taxes deemed paid under paragraph (1), see section 78.

"(b) SPECIAL RULES FOR FOREIGN TAX CREDIT IN YEAR OF RECEIPT OF PREVIOUSLY TAXED EARNINGS AND PROFITS.—

"(1) INCREASE IN SECTION 904 LIMITATION.—In the case of any taxpayer who—

"(A) either (i) chose to have the benefits of subpart A of this part for a taxable year in which he was required under section 951(a) to include in his gross income an amount in respect of a controlled foreign corporation, or (ii) did not pay or accrue for such taxable year any income, war profits, or excess profits taxes to any foreign country or to any possession of the United States, and

"(B) chooses to have the benefits of subpart A of this part for the taxable year in which he receives a distribution or amount which is excluded from gross income under section 959(a) and which is attributable to earnings and profits of the controlled foreign corporation which was included in his

gross income for the taxable year referred to in subparagraph (A), and

“(C) for the taxable year in which such distribution or amount is received, pays, or is deemed to have paid, or accrues income, war profits, or excess profits taxes to a foreign country or to any possession of the United States with respect to such distribution or amount.

the applicable limitation under section 904 for the taxable year in which such distribution or amount is received shall be increased as provided in paragraph (2), but such increase shall not exceed the amount of such taxes paid, or deemed paid, or accrued with respect to such distribution or amount.

“(2) AMOUNT OF INCREASE.—The amount of increase of the applicable limitation under section 904(a) for the taxable year in which the distribution or amount referred to in paragraph (1)(B) is received shall be an amount equal to—

“(A) the amount by which the applicable limitation under section 904(a) for the taxable year referred to in paragraph (1)(A) was increased by reason of the inclusion in gross income under section 951(a) of the amount in respect of the controlled foreign corporation, reduced by

“(B) the amount of any income, war profits, and excess profits taxes paid, or deemed paid, or accrued to any foreign country or possession of the United States which were allowable as a credit under section 901 for the taxable year referred to in paragraph (1)(A) and which would not have been allowable but for the inclusion in gross income of the amount described in subparagraph (A).

“(3) CASES IN WHICH TAXES NOT TO BE ALLOWED AS DEDUCTION.—In the case of any taxpayer who—

“(A) chose to have the benefits of subpart A of this part for a taxable year in which he was required under section 951(a) to include in his gross income an amount in respect of a controlled foreign corporation, and

“(B) does not choose to have the benefits of subpart A of this part for the taxable year in which he receives a distribution or amount which is excluded from gross income under section 959(a) and which is attributable to earnings and profits of the controlled foreign corporation which was included in his gross income for the taxable year referred to in subparagraph (A),

no deduction shall be allowed under section 164 for the taxable year in which such distribution or amount is received for any income, war profits, or excess profits taxes paid or accrued to any foreign country or to any possession of the United States on or with respect to such distribution or amount.

“(4) INSUFFICIENT TAXABLE INCOME.—If an increase in the limitation under this subsection exceeds the tax imposed by this chapter for such year, the amount of such excess shall be deemed an overpayment of tax for such year.

“SEC. 961. ADJUSTMENTS TO BASIS OF STOCK IN CONTROLLED FOREIGN CORPORATION AND OF OTHER PROPERTY.

“(a) INCREASE IN BASIS.—Under regulations prescribed by the Secretary or his delegate, the basis of a United States shareholder's

stock in a controlled foreign corporation, and the basis of property of a United States shareholder by reason of which he is considered under section 958(a)(2) as owning stock of a controlled foreign corporation, shall be increased by the amount required to be included in his gross income under section 951(a) with respect to such stock or with respect to such property, as the case may be, but only to the extent to which such amount was included in the gross income of such United States shareholder.

“(b) REDUCTION IN BASIS.

“(1) **IN GENERAL.**—Under regulations prescribed by the Secretary or his delegate, the adjusted basis of stock or other property with respect to which a United States shareholder or a United States person receives an amount which is excluded from gross income under section 959(a) shall be reduced by the amount so excluded.

“(2) **AMOUNT IN EXCESS OF BASIS.** To the extent that an amount excluded from gross income under section 959(a) exceeds the adjusted basis of the stock or other property with respect to which it is received, the amount shall be treated as gain from the sale or exchange of property.

“SEC. 962. MISCELLANEOUS PROVISIONS.

“(a) **EARNINGS AND PROFITS.** For purposes of this subpart, the earnings and profits of any foreign corporation, and the deficit in earnings and profits of any foreign corporation, for any taxable year shall be determined according to rules substantially similar to those applicable to domestic corporations, under regulations prescribed by the Secretary or his delegate.

“(b) **BLOCKED FOREIGN INCOME.** Under regulations prescribed by the Secretary or his delegate, no part of the earnings and profits of a controlled foreign corporation for any taxable year shall be included in earnings and profits for purposes of sections 952, 955, and 956, if it is established to the satisfaction of the Secretary or his delegate that such part could not have been distributed by the controlled foreign corporation to United States shareholders who own (within the meaning of section 958(a)) stock of such controlled foreign corporation because of currency or other restrictions or limitations imposed under the laws of any foreign country.

“(c) **RECORDS AND ACCOUNTS OF UNITED STATES SHAREHOLDERS.**—The Secretary or his delegate may by regulations require each person who is, or has been, a United States shareholder of a controlled foreign corporation to maintain such records and accounts as may be prescribed by such regulations as necessary to carry out the provisions of this subpart.”

(b) TECHNICAL AND CLERICAL AMENDMENTS—.

(1) Section 551(b) (relating to foreign personal holding company income included in gross income of United States shareholders) is amended by adding at the end thereof the following new sentence: “The amount included in the gross income of any United States shareholder for any taxable year under the preceding sentence shall be reduced by such shareholder’s proportionate share of the undistributed personal holding company income which is included in his gross income under section 951(a)(1)(A)(i) (relating to amounts included in gross income of United States

shareholders) for such taxable year as his pro rata share of the subpart F income of the company."

(2) Section 901 (relating to foreign tax credit) is amended by striking out "section 902" and inserting in lieu thereof "sections 902 and 960".

(3) Section 902(e) is amended to read as follows:

"(e) **CROSS REFERENCES.**—

"(1) For application of subsections (a) and (b) with respect to taxes deemed paid in a prior taxable year by a United States shareholder with respect to a controlled foreign corporation, see section 960.

"(2) For reduction of credit with respect to dividends paid out of accumulated profits for years for which certain information is not furnished, see section 6038."

(4) Section 904(f) is amended to read as follows:

"(f) **CROSS REFERENCES.**—

"(1) For increase of applicable limitation under subsection (a) for taxes paid with respect to amounts received which were included in the gross income of the taxpayer for a prior taxable year as a United States shareholder with respect to a controlled foreign corporation, see section 960(b).

"(2) For special rule relating to the application of the credit provided by section 901 in the case of affiliated groups which include Western Hemisphere trade corporations for years in which the limitation provided by subsection (a)(2) applies, see section 1503(d)."

(5) The table of subparts for part III of subchapter N of chapter 1 is amended by adding at the end thereof the following:

"Subpart F. Controlled Foreign Corporations."

(6) Section 1016(a) (relating to adjustments to basis) is amended—

(A) by striking out the period at the end of paragraph (18) and inserting in lieu thereof a semicolon; and

(B) by adding after paragraph (18) the following new paragraph:

"(19) to the extent provided in section 961 in the case of stock in controlled foreign corporations (or foreign corporations which were controlled foreign corporations) and of property by reason of which a person is considered as owning such stock."

(c) **EFFECTIVE DATE.**—The amendments made by this section shall apply with respect to taxable years of foreign corporations beginning after December 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end.

Page 164, after line 18, insert the following new section:

SEC. . SALES AND EXCHANGES OF PATENTS, ETC., TO CERTAIN FOREIGN CORPORATIONS.

(a) **TREATMENT OF GAIN AS ORDINARY INCOME.**—Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) is amended by adding after section 1248 (as added by section 16 of this Act) the following new section:

"SEC. 1249. GAIN FROM CERTAIN SALES OR EXCHANGES OF PATENTS, ETC., TO FOREIGN CORPORATIONS.

"(a) **GENERAL RULE.**—Gain from the sale or exchange after December 31, 1962, of a patent, an invention, model, or design

(whether or not patented), a copyright, a secret formula or process, or any other similar property right to any foreign corporation by any United States person (as defined in section 7701(a)(30)) which controls such foreign corporation shall, if such gain would (but for the provisions of this subsection) be gain from the sale or exchange of a capital asset or of property described in section 1231, be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

“(b) CONTROL.—For purposes of subsection (a), control means, with respect to any foreign corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote. For purposes of this subsection, the rules for determining ownership of stock prescribed by section 958 shall apply.

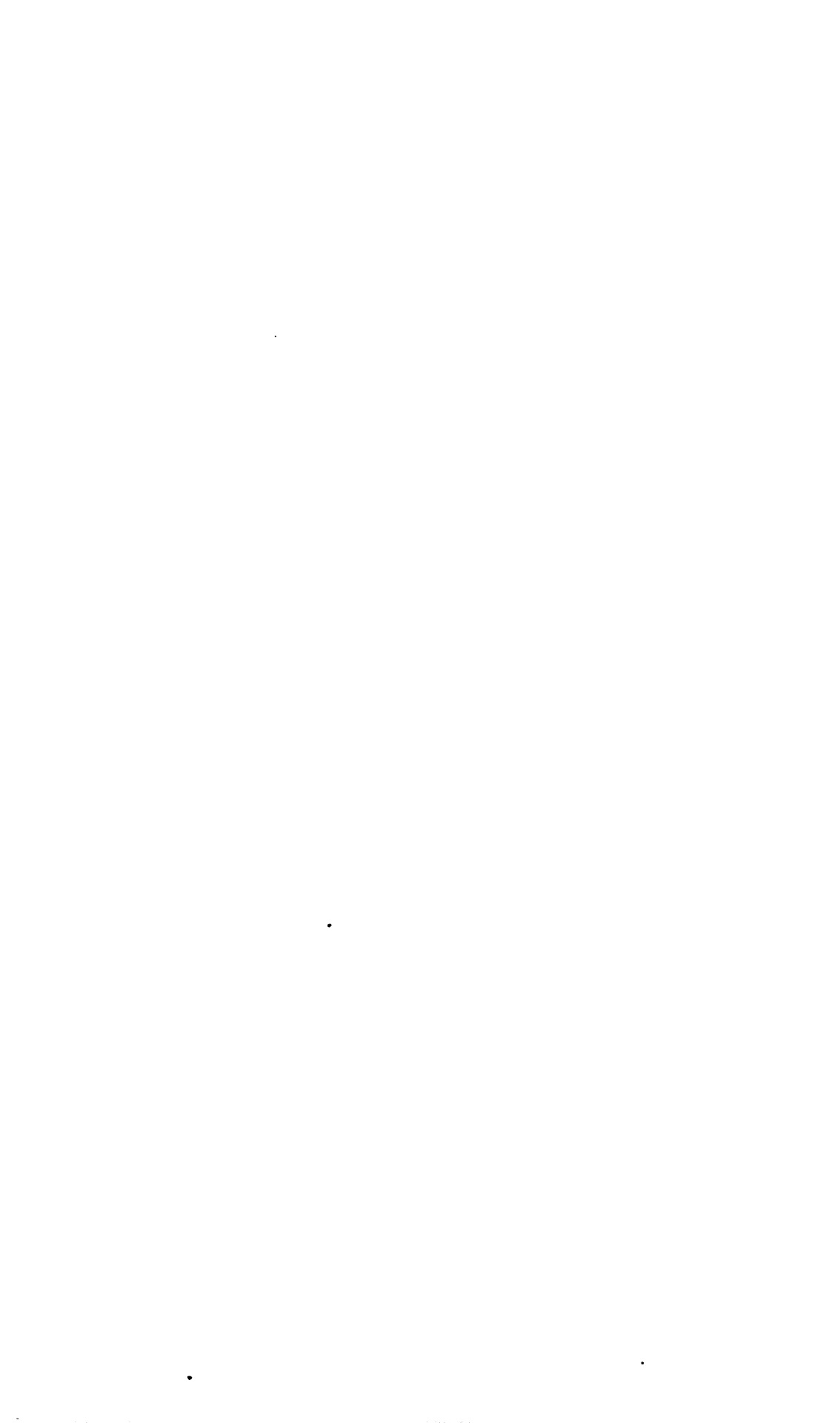
“(c) OTHER TRANSFERS OF PATENT RIGHTS, ETC., TO FOREIGN CORPORATIONS.—

“For allocation, etc., of income by the Secretary or his delegate in case of corporations owned or controlled directly or indirectly by the same interests, see section 482(a).”

(b) CLERICAL AMENDMENT.—The table of sections for such part IV is amended by adding at the end thereof the following:

“Sec. 1249. Gain from certain sales or exchanges of patents, etc., to foreign corporations.”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1962.



PART 2

Explanation and Draft of Amendments Recommended by Treasury Department to Section 15 of H.R. 10650

SECTION 15. FOREIGN INVESTMENT COMPANIES

NOTE REGARDING THE REDRAFT OF SECTION 15

Amendment No. 1 provides that this section applies only to foreign investment companies for taxable years after December 31, 1962.

Amendment No. 2 limits the definition of a foreign investment company in a manner similar to the Investment Companies Act of 1940, by adopting all of the appropriate exceptions provided therein.

Amendments Nos. 3 and 4 limit the earnings and profits taxable on the sale by a successor in interest to a deceased shareholder to those accumulated after December 31, 1962.

Amendment No. 4 extends the time for mailing the written notice by the foreign investment company to its shareholders of their portion of long-term capital gain from 30 to 45 days.

Amendments Nos. 6, 7, 8, 9, and 11 make clerical changes.

Amendment No. 10 makes several changes.

New subsections (d) and (e) of section 1247 are technical changes clarifying the rules respecting shareholder taxation.

New subsections (f) and (g) provide that a foreign investment company may elect to pass through the credit for taxes paid to foreign countries and possessions of United States to its shareholders.

New subsection (i) makes a clerical change.

Amendment No. 1—On page 149, line 25, insert “which, for any taxable year beginning after December 31, 1962, is” after the word “corporation”.

Amendment No. 2—On page 150, line 8, insert “, as limited by paragraphs (2) through (10) (except paragraph (6)(C)) and paragraphs (12) through (15) of section 3(c) thereof” after the word “Act”.

Amendment No. 3—On page 151, beginning on line 24 and continuing to page 152, line 1, strike the word “accumulated”.

Amendment No. 4—On page 152, line 1, insert “accumulated after December 31, 1962” after the word “company”.

Amendment No. 5—On page 153, line 17, insert “45” in lieu of “30”.

Amendment No. 6—On page 153, line 20, strike the word “gains” and insert in lieu thereof the word “gain”.

Amendment No. 7—On page 153, line 21, strike “losses;” and insert in lieu thereof “loss of the taxable year,”.

Amendment No. 8—On page 154, line 9, strike the words “capital gains over losses” and insert in lieu thereof “net long-term capital gain over net short-term capital loss”.

Amendment No. 9—On page 155, line 3, strike “capital gains over losses” and insert in lieu thereof “net long-term capital gain over net short-term capital loss”.

Amendment No. 10—Commencing on page 156, line 18, redesignate subsection (d) as subsection (e), redesignate present subsection (e) as subsection (i), insert the following new subsection (d), change the now subsection (e), and insert the following new subsections (f), (g), and (h):

“(d) TREATMENT OF DISTRIBUTED AND UNDISTRIBUTED CAPITAL GAINS BY SHAREHOLDERS.—

“(1) Every shareholder of a foreign investment company for any taxable year of such company with respect to which an election pursuant to subsection (a) is in effect shall include, in computing his long-term capital gains for his taxable year in which received or accrued, his pro rata share of the distributed portion of the excess of the net long-term capital gain over the net short-term capital loss for such taxable year of the company.

“(2) To the extent that a shareholder of a foreign investment company at the close of any taxable year of such company with respect to which an election pursuant to subsection (a) is in effect includes in his return, for his taxable year in which the last day of the company’s taxable year falls, his pro rata share of the undistributed portion of the excess of the net long-term capital gain over the net short-term capital loss for such taxable year of the company, such share shall be included in his gross income as a long-term capital gain.

“(e) ADJUSTMENTS.—Under regulations prescribed by the Secretary or his delegate, proper adjustment shall be made—

“(1) in the earnings and profits of the electing foreign investment company and a shareholder’s ratable share thereof, and

“(2) in the adjusted basis of stock of such company held by such shareholder (whether or not qualified)

to reflect such shareholder’s inclusion in gross income of undistributed capital gains.”

“(f) ELECTION BY FOREIGN INVESTMENT COMPANY WITH RESPECT TO FOREIGN TAX CREDIT.—A foreign investment company with respect to which an election pursuant to subsection (a) is in effect and more than 50 percent of the value (as defined in section 851(c)(4)) of whose total assets at the close of the taxable year consists of stock or securities in foreign corporations may, for such taxable year, elect the application of this subsection with respect to income, war profits, and excess profits taxes described in section 901(b)(1) which are paid by the foreign investment company during such taxable year to foreign countries and possessions of the United States. If such election is made—

“(1) the foreign investment company—

“(A) shall compute its taxable income, for purposes of subsection (a) (1) (A), without any deductions for taxes paid to foreign countries or possessions of the United States,

“(B) shall treat the amount of such taxes, for purposes of applying subpart A of part III of subchapter N and subsection (g) (1), as having been paid to the country in which the foreign investment company is incorporated, and

“(C) shall treat the amount of such taxes, for purposes of subsection (a) (1) (A), as distributed to its shareholders;

“(2) each qualified shareholder of such foreign investment company—

“(A) shall include in gross income and treat as paid by him his proportionate share of taxes, and

“(B) shall treat as gross income from sources within the country in which the foreign investment company is incorporated, for purposes of applying subpart A of part III of subchapter N, the sum of his proportionate share of such taxes and the portion of any dividend paid by such foreign investment company which represents income from sources without the United States.

“(g) NOTICE TO SHAREHOLDERS.—The amounts to be treated by a qualified shareholder, for purposes of subsection (f)(2), as his proportionate share of—

“(1) taxes paid to the country in which the foreign investment company is incorporated, and

“(2) gross income derived from sources without the United States,

shall not exceed the amounts so designated by the foreign investment company in a written notice mailed to its shareholders not later than 45 days after the close of its taxable year.

“(h) MANNER OF MAKING ELECTION AND NOTIFYING SHAREHOLDERS.—The election provided in subsection (f) and the notice to shareholders required by subsection (g) shall be made in such manner as the Secretary or his delegate may prescribe by regulations.”

Amendment No. 11—On page 158, line 14, strike “paragraphs (1) and (2)” and insert in lieu thereof “paragraph (1)”.

PART 3

Explanation and Draft of Amendments Recommended by Treasury Department to Section 16 of H.R. 10650

SEC. 16. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS

EXPLANATION OF CHANGES

1. *Restriction of coverage to future earnings only.*—The application of section 16 is limited to earnings and profits of controlled foreign corporations accumulated after December 31, 1962. Under H.R. 10650, section 16 applies to earnings accumulated after 1913.

2. *Coordination of treatment of liquidations, redemptions, sales and exchanges.*—The rules applicable to (a) liquidations and redemptions, and (b) sales and exchanges are coordinated. Thus, corporate shareholders selling stock in a transaction would be allowed a foreign tax credit with respect to the portion of gain made taxable as a dividend. Under H.R. 10650, the credit is only available in the case of liquidations or redemptions. Likewise, the amount of earnings to be taxed as a dividend is limited to the shareholder's pro rata portion of the corporation's earnings during the time the stock was held. Under H.R. 10650, this limitation does not apply in the case of liquidations and redemptions.

3. *Limitations on tax of individual shareholders.*—Provision is made so that the amount of tax on individual shareholders on gain made taxable as a dividend is listed to the lesser of (a) an amount equal to U.S. tax that would have been payable by a domestic corporation and the individual shareholder had the individual been a shareholder of a domestic corporation, or (b) a tax equal to an amount that would have been payable by the individual had the foreign corporation distributed its earnings and profits in the years in which earned. Under H.R. 10650, no such limitations were provided and an individual shareholder would be taxable on the gain covered by section 16 at the progressive income tax rates.

4. *Allowance of capital gain treatment for gains realized within the 12 months preceding liquidation.*—Amended section 16 would exempt from the application of this section earnings and profits of a foreign corporation attributable to the sale of assets within a 12-month period ending on the date of the liquidation of the foreign corporation. No such relief is granted under H.R. 10650.

5. *Elimination of coverage of corporations in the Commonwealth of Puerto Rico and the Virgin Islands.*—Amended section 16 would not be applicable to corporations incorporated under the laws of the Commonwealth of Puerto Rico and possessions of the United States, such as the Virgin Islands.

6. *Exemption of gain with respect to the stock of less developed country corporations that has been held for a continuous period of 10 years.*—This

change would make section 16 inapplicable to the gain with respect to certain long-term investments in less developed countries.

SEC. 16. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS.

(a) **TREATMENT OF GAIN FROM THE REDEMPTION, CANCELLATION, OR SALE OF STOCK IN CERTAIN FOREIGN CORPORATIONS.**—Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) is amended by adding after section 1247 (as added by section 15 of this Act) the following new section:

“SEC. 1248. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS.

“(a) **IN GENERAL.**—If—

“(1) a United States person sells or exchanges stock in a foreign corporation, or if a United States person receives a distribution from a foreign corporation which, under section 302 or 331, is treated as an exchange of stock, and

“(2) such person can be considered, by applying the rules of constructive ownership of section 955 (b), as being the owner of 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation at any time during the 5-year period ending on the date of sale or exchange when such foreign corporation was a controlled foreign corporation (as defined in section 954),

then the gain recognized on the sale or exchange of such stock shall, to the extent the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary or his delegate) to the stock sold or exchanged were accumulated in taxable years of the foreign corporation beginning after December 31, 1962 and during the period the stock sold or exchanged was held by such person, be taxed in the manner prescribed in subsection (b).

“(b) **TREATMENT OF GAIN.**—The amount described in subsection (a) shall be included in gross income as a dividend. However, tax attributable to the inclusion of such amount in gross income of an individual or estate or trust shall not be greater than a tax determined under subsection (c).

“(c) **LIMITATION OF TAX APPLICABLE TO INDIVIDUALS, ETC.**—If the amount described in subsection (a) is included in gross income of an individual, or of an estate or trust, the tax attributable to such amount shall not be greater than—

“(1) if the stock sold or exchanged is a capital asset (within the meaning of section 1221) and has been held for more than 6 months, a tax equal to—

“(A) 52 percent of the sum of—

“(i) the amount described in subsection (a), plus

“(ii) an amount equal to the same proportion of any income, war profits, or excess profits taxes paid by the foreign corporation to any foreign country on or with respect to earnings and profits of the foreign corporation for the period the stock sold or exchanged was held by the United States person in taxable years beginning after December 31, 1962, which the amount determined under subsection (a) bears to total earnings and profits of the foreign corporation for the period the stock sold or exchanged was held by the United States person in

taxable years of the foreign corporation beginning after December 31, 1962, reduced by

“(B) the amounts described in (ii) of subparagraph (A), increased by

“(C) an amount equal to a tax that would result by including in gross income 48 percent of the amounts described in (i) and (ii) of subparagraph (A) as gain from the sale or exchange of a capital asset held for more than 6 months; or

“(2) the aggregate of the taxes which would have been attributable to the amount described in subsection (a) had it been included in the gross income of the individual as a dividend in the year or years in which earned by the foreign corporation, adjusted for losses and distributions in a manner prescribed by the Secretary or his delegate.

“(d) SPECIAL RULES.—

“(1) ELIMINATION FROM EARNINGS AND PROFITS OF AMOUNTS INCLUDED IN GROSS INCOME UNDER SECTION 951.—In determining the amount of earnings and profits under subsection (a), there shall be excluded from the earnings and profits attributable to the stock sold or exchanged as determined under subsection (a) any amount previously included in the gross income of such person under section 951, with respect to the stock sold or exchanged, but only to the extent such amount did not result in an exclusion from gross income under section 956.

“(2) ELIMINATION FROM EARNINGS AND PROFITS OF GAIN REALIZED FROM THE SALE OR EXCHANGE OF PROPERTY IN PURSUANCE OF A PLAN OF COMPLETE LIQUIDATION.—If a foreign corporation adopts a plan of complete liquidation in a taxable year of a foreign corporation beginning after December 31, 1962, and, within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then the amount described in subsection (a) shall not include earnings and profits attributable (under regulations prescribed by the Secretary or his delegate) to any net gain from the sale or exchange of property (as defined in section 337(b)) by the foreign corporation within such 12-month period.

“(3) GENERAL EXEMPTIONS.—This section shall not apply to—

“(A) distributions to which section 303 (relating to distributions in redemption of stock to pay death taxes) applies,

“(B) gain realized on exchanges to which section 356 (relating to receipt of additional consideration in certain reorganizations) applies, or

“(C) any amount to the extent that such amount is, under any other provision of this title, treated as—

“(i) a dividend,

“(ii) gain from the sale of an asset which is not a capital asset, or

“(iii) gain from the sale of an asset held for more than 6 months.

“(D) gain described in subsection (a) of any United States person with respect to the stock of a foreign corporation which

has qualified as a less developed country corporation (as defined in section 955(c)) for a continuous period of at least ten years ending with the date on which such gain is recognized. This subparagraph shall apply only to a United States person (if an individual, including his successors by bequest or intestate succession) who has owned such stock during the whole of such continuous period, and, if such United States person is a corporation, only if at no time during the whole of such continuous period has any individual owning 10 percent or more of the value of the outstanding stock of such United States person transferred any of his stock in such United States person other than by bequest or intestate succession. In determining the ownership of stock of a United States person, section 318(a)(1)(C)(i) shall apply but without regard to the 50 percent limitation.

“(e) TAXPAYER TO ESTABLISH EARNINGS AND PROFITS.—Unless the taxpayer establishes the amount of the earnings and profits of the foreign corporation to be taken into account under subsection (a), all gain from the sale or exchange shall be considered a dividend under subsection (a), and unless the taxpayer establishes the amount of foreign taxes to be taken into account under subsection (c)(1)(A), the limitation of such subparagraph shall not apply.

(b) CLERICAL AMENDMENT.—The table of sections for such part IV is amended by adding at the end thereof the following:

“Sec. 1248. Gain from certain sales or exchanges of stock in certain foreign corporations.”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to sales or exchanges occurring after December 31, 1962.

PART 4

Explanation and Draft of Amendments Recommended by Treasury Department to Section 20 of H.R. 10650

SECTION 20. INFORMATION WITH RESPECT TO CERTAIN FOREIGN ENTITIES

Amendment No. 1—[This amendment would restrict the application of the constructive ownership rules under section 6038 for purposes of determining whether 50-percent U.S. control exists. It would provide that (1) stock owned by corporations will not be attributed to the corporation's shareholders unless such shareholders are at least 10-percent owners, and (2) corporations will not be considered as owning stock owned by the shareholders of such corporations.]

In line 9 on page 235, strike the material after the semicolon and strike lines 10 and 11 and insert the following language:

except—

(A) in applying clause (i) of subparagraph (C) of section 318(a)(2), the phrase "10 percent" shall be substituted for the phrase "50 percent" used in subparagraph (C), and

(B) clause (ii) of subparagraph (C) of section 318(a)(2) shall not apply.

Amendment No. 2—[This amendment would liberalize the reporting requirements under section 6046 with respect to U.S. officers and directors. It would provide that such persons need not file any return unless the foreign corporation has a 5-percent U.S. shareholder and, further, when a return is required, U.S. officers and directors need only disclose the names and addresses of 5-percent U.S. shareholders.]

Page 236, line 9—Substitute the following for paragraph (1) of subsection (a) of section 6046:

(1) each United States citizen or resident who is at any time on or after January 1, 1963, an officer or director of a foreign corporation, 5 percent or more in value of the stock of which is owned at such time by a United States person,

At the end of line 8 on page 237, strike the period and insert a comma and the following clause:

except that in the case of persons described only in subsection (a)(1), the information required shall be limited to the names and addresses of persons described in subsection (a)(2).

Amendment No. 3—[This amendment would provide a limitation on the information required under section 6046 to the effect that such information must be required under regulations in effect prior to the date a person becomes liable to file a return.]

On page 237, line 22, redesignate subsection (e) as subsection (f) and insert the following new subsection (e):

(e) **LIMITATION.**—No information shall be required to be furnished under this section with respect to any foreign corporation unless such information was required to be furnished under regulations in effect prior to the date on which the United States citizen, resident, or person becomes liable to file a return required under subsection (a).

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