

Calendar No. 465107TH CONGRESS
2^D SESSION**S. 2119****[Report No. 107-188]**

To amend the Internal Revenue Code of 1986 to provide for the tax treatment of inverted corporate entities and of transactions with such entities, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 11, 2002

Mr. GRASSLEY (for himself, Mr. BAUCUS, Mr. DODD, Mr. LIEBERMAN, Mr. WELLSTONE, Mr. CARPER, and Mr. MCCAIN) introduced the following bill; which was read twice and referred to the Committee on Finance

JUNE 28, 2002

Reported by Mr. BAUCUS, with an amendment

[Strike out all after the enacting clause and insert the part printed in *italic*]

A BILL

To amend the Internal Revenue Code of 1986 to provide for the tax treatment of inverted corporate entities and of transactions with such entities, and for other purposes.

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

1 **SECTION 1. SHORT TITLE.**

2 This Act may be cited as the “Reversing the Expa-
3 triation of Profits Offshore Act”.

4 **SEC. 2. TAX TREATMENT OF INVERTED CORPORATE ENTI-
5 TIES.**

6 (a) IN GENERAL.—Subchapter C of chapter 80 of the
7 Internal Revenue Code of 1986 (relating to provisions af-
8 fecting more than one subtitle) is amended by adding at
9 the end the following new section:

10 **“SEC. 7874. RULES RELATING TO INVERTED CORPORATE
11 ENTITIES.**

12 **“(a) INVERTED CORPORATIONS TREATED AS DOMES-
13 TIC CORPORATIONS.—**

14 **“(1) IN GENERAL.—**If a foreign incorporated
15 entity is treated as an inverted domestic corporation,
16 then, notwithstanding section 7701(a)(4), such enti-
17 ty shall be treated for purposes of this title as a do-
18 mestic corporation.

19 **“(2) INVERTED DOMESTIC CORPORATION.—**For
20 purposes of this section, a foreign incorporated enti-
21 ty shall be treated as an inverted domestic corpora-
22 tion if, pursuant to a plan (or a series of related
23 transactions)—

24 **“(A) the entity completes after March 20,**
25 **2002,** the direct or indirect acquisition of sub-
26 **stantially all of the properties held directly or**

1 indirectly by a domestic corporation or substan-
2 tially all of the properties constituting a trade
3 or business of a domestic partnership;

4 “(B) after the acquisition at least 80 per-
5 cent of the stock (by vote or value) of the entity
6 is held—

7 “(i) in the case of an acquisition with
8 respect to a domestic corporation, by
9 former shareholders of the domestic cor-
10 poration by reason of holding stock in the
11 domestic corporation; or

12 “(ii) in the case of an acquisition with
13 respect to a domestic partnership, by
14 former partners of the domestic partner-
15 ship; and

16 “(C) the expanded affiliated group which
17 after the acquisition includes the entity does
18 not have substantial business activities in the
19 foreign country in which or under the law of
20 which the entity is created or organized when
21 compared to the total business activities of such
22 expanded affiliated group.

23 “(b) PRESERVATION OF DOMESTIC TAX BASE IN
24 CERTAIN INVERSION TRANSACTIONS TO WHICH SUB-
25 SECTION (a) DOES NOT APPLY.—

1 “(1) IN GENERAL.—If a foreign incorporated
2 entity would be treated as an inverted domestic cor-
3 poration with respect to an acquired entity if
4 either—

5 “(A) subsection (a)(2)(A) were applied by
6 substituting ‘on or before March 20, 2002’ for
7 ‘after March 20, 2002’ and subsection
8 (a)(2)(B) were applied by substituting ‘more
9 than 50 percent’ for ‘at least 80 percent’, or

10 “(B) subsection (a)(2)(B) were applied by
11 substituting ‘more than 50 percent’ for ‘at least
12 80 percent’,

13 then the rules of subsection (c) shall apply to any
14 inversion gain of the acquired entity during the ap-
15 plicable period and the rules of subsection (d) shall
16 apply to any related party transaction of the ac-
17 quired entity during the applicable period. This sub-
18 section shall not apply for any taxable year if sub-
19 section (a) applies to such foreign incorporated enti-
20 ty for such taxable year.

21 “(2) ACQUIRED ENTITY.—For purposes of this
22 section—

23 “(A) IN GENERAL.—The term ‘acquired
24 entity’ means the domestic corporation or part-
25 nership substantially all of the properties of

1 which are directly or indirectly acquired in an
2 acquisition described in subsection (a)(2)(A) to
3 which this subsection applies.

4 “(B) AGGREGATION RULES.—Any domes-
5 tic person bearing a relationship described in
6 section 267(b) or 707(b) to an acquired entity
7 shall be treated as an acquired entity with re-
8 spect to the acquisition described in subpara-
9 graph (A).

10 “(3) APPLICABLE PERIOD.—For purposes of
11 this section—

12 “(A) IN GENERAL.—The term ‘applicable
13 period’ means the period—

14 “(i) beginning on the first date prop-
15 erties are acquired as part of the acquisi-
16 tion described in subsection (a)(2)(A) to
17 which this subsection applies; and

18 “(ii) ending on the date which is 10
19 years after the last date properties are ac-
20 quired as part of such acquisition.

21 “(B) SPECIAL RULE FOR INVERSIONS OC-
22 CURRING BEFORE MARCH 21, 2002.—In the case
23 of any acquired entity to which paragraph
24 (1)(A) applies, the applicable period shall be the
25 10-year period beginning on January 1, 2002.

1 “(c) TAX ON INVERSION GAINS MAY NOT BE OFF-
2 SET.—If subsection (b) applies—

3 “(1) IN GENERAL.—The taxable income of an
4 acquired entity for any taxable year which includes
5 any portion of the applicable period shall in no event
6 be less than the inversion gain of the entity for the
7 taxable year.

8 “(2) CREDITS NOT ALLOWED AGAINST TAX ON
9 INVERSION GAIN.—Credits shall be allowed against
10 the tax imposed by chapter 1 on an acquired entity
11 for any taxable year described in paragraph (1) only
12 to the extent such tax exceeds the product of—

13 “(A) the amount of taxable income de-
14 scribed in paragraph (1) for the taxable year,
15 and

16 “(B) the highest rate of tax specified in
17 section 11(b)(1).

18 “(3) SPECIAL RULES FOR PARTNERSHIPS.—In
19 the case of an acquired entity which is a
20 partnership—

21 “(A) the limitations of this subsection shall
22 apply at the partner rather than the partner-
23 ship level,

24 “(B) the inversion gain of any partner for
25 any taxable year shall be equal to the sum of—

1 “(i) the partner’s distributive share of
2 inversion gain of the partnership for such
3 taxable year, plus

4 “(ii) gain required to be recognized
5 for the taxable year by the partner under
6 section 367(a), 741, or 1001, or under any
7 other provision of chapter 1, by reason of
8 the transfer during the applicable period of
9 any partnership interest of the partner in
10 such partnership to the foreign incor-
11 porated entity, and

12 “(C) the highest rate of tax specified in
13 the rate schedule applicable to the partner
14 under chapter 1 shall be substituted for the
15 rate of tax under paragraph (2)(B).

16 “(4) INVERSION GAIN.—For purposes of this
17 section, the term ‘inversion gain’ means the gain re-
18 quired to be recognized under section 304, 311(b),
19 367, 1001, or 1248, or under any other provision of
20 chapter 1, by reason of the transfer during the ap-
21 plicable period of stock or other properties by an ac-
22 quired entity—

23 “(A) as part of the acquisition described in
24 subsection (a)(2)(A) to which subsection (b) ap-
25 plies, or

1 “(B) after such acquisition to a foreign re-
2 lated person.

3 ~~“(5) COORDINATION WITH SECTION 172 AND~~
4 ~~MINIMUM TAX.—~~Rules similar to the rules of para-
5 graphs (3) and (4) of section 860E(a) shall apply
6 for purposes of this subsection.

7 ~~“(d) SPECIAL RULES APPLICABLE TO RELATED~~
8 ~~PARTY TRANSACTIONS.—~~

9 ~~“(1) ANNUAL PREAPPROVAL REQUIRED.—~~

10 ~~“(A) IN GENERAL.—~~An acquired entity to
11 which subsection (b) applies shall enter into an
12 annual preapproval agreement under subpara-
13 graph (C) with the Secretary for each taxable
14 year which includes a portion of the applicable
15 period.

16 ~~“(B) FAILURES TO ENTER AGREE-~~
17 ~~MENTS.—~~If an acquired entity fails to meet the
18 requirements of subparagraph (A) for any tax-
19 able year, then for such taxable year—

20 ~~“(i) there shall not be allowed any de-~~
21 ~~duction, or addition to basis or cost of~~
22 ~~goods sold, for amounts paid or incurred,~~
23 ~~or losses incurred, by reason of a trans-~~
24 ~~action between the acquired entity and a~~
25 ~~foreign related person,~~

1 “(ii) any transfer or license of intan-
2 gible property (as defined in section
3 936(h)(3)(B)) between the acquired entity
4 and a foreign related person shall be dis-
5 regarded; and

6 “(iii) any cost-sharing arrangement
7 between the acquired entity and a foreign
8 related person shall be disregarded.

9 “(C) PREAPPROVAL AGREEMENT.—For
10 purposes of subparagraph (A), the term
11 ‘preapproval agreement’ means a prefilling, ad-
12 vance pricing, or other agreement specified by
13 the Secretary which—

14 “(i) is entered into at such time as
15 may be specified by the Secretary; and

16 “(ii) contains such provisions as the
17 Secretary determines necessary to ensure
18 that the requirements of sections 163(j),
19 267(a)(3), 482, and 845, and any other
20 provision of this title applicable to trans-
21 actions between related persons and speci-
22 fied by the Secretary, are met.

23 “(2) MODIFICATIONS OF LIMITATION ON INTER-
24 EST DEDUCTION.—In the case of an acquired entity

1 to which subsection (b) applies, section 163(j) shall
2 be applied—

3 “(A) without regard to paragraph
4 (2)(A)(ii) thereof, and

5 “(B) by substituting ‘25 percent’ for ‘50
6 percent’ each place it appears in paragraph
7 (2)(B) thereof.

8 “(e) OTHER DEFINITIONS AND SPECIAL RULES.—
9 For purposes of this section—

10 “(1) RULES FOR APPLICATION OF SUBSECTION
11 (a)(2).—In applying subsection (a)(2) for purposes of
12 subsections (a) and (b), the following rules shall
13 apply:

14 “(A) CERTAIN STOCK DISREGARDED.—
15 There shall not be taken into account in deter-
16 mining ownership for purposes of subsection
17 (a)(2)(B)—

18 “(i) stock held by members of the ex-
19 panded affiliated group which includes the
20 foreign incorporated entity, or

21 “(ii) stock of such entity which is sold
22 in a public offering related to the acquisi-
23 tion described in subsection (a)(2)(A).

24 “(B) PLAN DEEMED IN CERTAIN CASES.—

25 If a foreign incorporated entity acquires directly

1 or indirectly substantially all of the properties
2 of a domestic corporation or partnership during
3 the 4-year period beginning on the date which
4 is 2 years before the ownership requirements of
5 subsection (a)(2)(B) are met, such actions shall
6 be treated as pursuant to a plan.

7 “(C) CERTAIN TRANSFERS DIS-
8 REGARDED.—The transfer of properties or li-
9 abilities (including by contribution or distribu-
10 tion) shall be disregarded if such transfers are
11 part of a plan a principal purpose of which is
12 to avoid the purposes of this section.

13 “(D) SPECIAL RULE FOR RELATED PART-
14 NERSHIPS.—For purposes of applying sub-
15 section (a)(2) to the acquisition of a domestic
16 partnership, except as provided in regulations,
17 all partnerships which are under common con-
18 trol (within the meaning of section 482) shall
19 be treated as 1 partnership.

20 “(2) EXPANDED AFFILIATED GROUP.—The
21 term ‘expanded affiliated group’ means an affiliated
22 group as defined in section 1504(a) but without re-
23 gard to section 1504(b), except that section 1504(a)
24 shall be applied by substituting ‘more than 50 per-
25 cent’ for ‘at least 80 percent’ each place it appears.

1 “(3) FOREIGN INCORPORATED ENTITY.—The
2 term ‘foreign incorporated entity’ means any entity
3 which is, or but for subsection (a)(1) would be,
4 treated as a foreign corporation for purposes of this
5 title.

6 “(4) FOREIGN RELATED PERSON.—The term
7 ‘foreign related person’ means, with respect to any
8 acquired entity, a foreign person which—

9 “(A) bears a relationship to such entity de-
10 scribed in section 267(b) or 707(b), or

11 “(B) is under the same common control
12 (within the meaning of section 482) as such en-
13 tity.

14 “(f) REGULATIONS.—The Secretary shall provide
15 such regulations as are necessary to carry out this section,
16 including regulations providing for such adjustments to
17 the application of this section as are necessary to prevent
18 the avoidance of the purposes of this section, including the
19 avoidance of such purposes through—

20 “(1) the use of related persons, pass-through or
21 other noncorporate entities, or other intermediaries,
22 or

23 “(2) transactions designed to have persons
24 cease to be (or not become) members of expanded
25 affiliated groups or related persons.”.

1 (b) TREATMENT OF AGREEMENTS.—

2 (1) CONFIDENTIALITY.—

3 (A) TREATMENT AS RETURN INFORMA-
 4 TION.—Section 6103(b)(2) of the Internal Rev-
 5 enue Code of 1986 (relating to return informa-
 6 tion) is amended by striking “and” at the end
 7 of subparagraph (C); by inserting “and” at the
 8 end of subparagraph (D); and by inserting after
 9 subparagraph (D) the following new subpara-
 10 graph:

11 “(E) any preapproval agreement under
 12 section 7874(d)(1) to which any preceding sub-
 13 paragraph does not apply and any background
 14 information related to the agreement or any ap-
 15 plication for the agreement.”.

16 (B) EXCEPTION FROM PUBLIC INSPECTION
 17 AS WRITTEN DETERMINATION.—Section
 18 6110(b)(1)(B) of such Code is amended by
 19 striking “or (D)” and inserting “, (D), or (E)”.

20 (2) REPORTING.—The Secretary of the Treas-
 21 ury shall include with any report on advance pricing
 22 agreements required to be submitted after the date
 23 of the enactment of this Act under section 521(b) of
 24 the Ticket to Work and Work Incentives Improve-
 25 ment Act of 1999 (Public Law 106–170) a report

1 regarding preapproval agreements under section
 2 7874(d)(1) of the Internal Revenue Code of 1986.
 3 Such report shall include information similar to the
 4 information required with respect to advance pricing
 5 agreements and shall be treated for confidentiality
 6 purposes in the same manner as the reports on ad-
 7 vance pricing agreements are treated under section
 8 521(b)(3) of such Act.

9 (c) CONFORMING AMENDMENTS.—The table of sec-
 10 tions for subchapter C of chapter 80 of the Internal Rev-
 11 enue Code of 1986 is amended by adding at the end the
 12 following new item:

“Sec. 7874. Rules relating to inverted corporate entities.”

13 **SEC. 3. REINSURANCE OF UNITED STATES RISKS IN FOR-**
 14 **EIGN JURISDICTIONS.**

15 (a) IN GENERAL.—Section 845(a) of the Internal
 16 Revenue Code of 1986 (relating to allocation in case of
 17 reinsurance agreement involving tax avoidance or evasion)
 18 is amended by striking “source and character” and insert-
 19 ing “amount, source, or character”.

20 (b) EFFECTIVE DATE.—The amendments made by
 21 this section shall apply to any risk reinsured after April
 22 11, 2002.

23 **SECTION 1. SHORT TITLE.**

24 *This Act may be cited as the “Reversing the Expatria-*
 25 *tion of Profits Offshore Act”.*

1 **SEC. 2. TAX TREATMENT OF INVERTED CORPORATE ENTI-**
 2 **TIES.**

3 (a) *IN GENERAL.*—Subchapter C of chapter 80 of the
 4 Internal Revenue Code of 1986 (relating to provisions af-
 5 fecting more than one subtitle) is amended by adding at
 6 the end the following new section:

7 **“SEC. 7874. RULES RELATING TO INVERTED CORPORATE**
 8 **ENTITIES.**

9 “(a) *INVERTED CORPORATIONS TREATED AS DOMES-*
 10 *TIC CORPORATIONS.*—

11 “(1) *IN GENERAL.*—If a foreign incorporated en-
 12 tity is treated as an inverted domestic corporation,
 13 then, notwithstanding section 7701(a)(4), such entity
 14 shall be treated for purposes of this title as a domestic
 15 corporation.

16 “(2) *INVERTED DOMESTIC CORPORATION.*—For
 17 purposes of this section, a foreign incorporated entity
 18 shall be treated as an inverted domestic corporation
 19 if, pursuant to a plan (or a series of related trans-
 20 actions)—

21 “(A) the entity completes after March 20,
 22 2002, the direct or indirect acquisition of sub-
 23 stantially all of the properties held directly or
 24 indirectly by a domestic corporation or substan-
 25 tially all of the properties constituting a trade or
 26 business of a domestic partnership,

1 “(B) after the acquisition at least 80 per-
2 cent of the stock (by vote or value) of the entity
3 is held—

4 “(i) in the case of an acquisition with
5 respect to a domestic corporation, by former
6 shareholders of the domestic corporation by
7 reason of holding stock in the domestic cor-
8 poration, or

9 “(ii) in the case of an acquisition with
10 respect to a domestic partnership, by former
11 partners of the domestic partnership by rea-
12 son of holding a capital or profits interest
13 in the domestic partnership, and

14 “(C) the expanded affiliated group which
15 after the acquisition includes the entity does not
16 have substantial business activities in the foreign
17 country in which or under the law of which the
18 entity is created or organized when compared to
19 the total business activities of such expanded af-
20 filiated group.

21 “(b) PRESERVATION OF DOMESTIC TAX BASE IN CER-
22 TAIN INVERSION TRANSACTIONS TO WHICH SUBSECTION
23 (a) DOES NOT APPLY.—

1 “(1) *IN GENERAL.*—*If a foreign incorporated en-*
2 *tity would be treated as an inverted domestic corpora-*
3 *tion with respect to an acquired entity if either—*

4 “(A) *subsection (a)(2)(A) were applied by*
5 *substituting ‘after December 31, 1996, and on or*
6 *before March 20, 2002’ for ‘after March 20, 2002’*
7 *and subsection (a)(2)(B) were applied by sub-*
8 *stituting ‘more than 50 percent’ for ‘at least 80*
9 *percent’, or*

10 “(B) *subsection (a)(2)(B) were applied by*
11 *substituting ‘more than 50 percent’ for ‘at least*
12 *80 percent’,*

13 *then the rules of subsection (c) shall apply to any in-*
14 *version gain of the acquired entity during the appli-*
15 *cable period and the rules of subsection (d) shall*
16 *apply to any related party transaction of the ac-*
17 *quired entity during the applicable period. This sub-*
18 *section shall not apply for any taxable year if sub-*
19 *section (a) applies to such foreign incorporated entity*
20 *for such taxable year.*

21 “(2) *ACQUIRED ENTITY.*—*For purposes of this*
22 *section—*

23 “(A) *IN GENERAL.*—*The term ‘acquired en-*
24 *tity’ means the domestic corporation or partner-*
25 *ship substantially all of the properties of which*

1 *are directly or indirectly acquired in an acquisi-*
2 *tion described in subsection (a)(2)(A) to which*
3 *this subsection applies.*

4 “(B) *AGGREGATION RULES.*—*Any domestic*
5 *person bearing a relationship described in sec-*
6 *tion 267(b) or 707(b) to an acquired entity shall*
7 *be treated as an acquired entity with respect to*
8 *the acquisition described in subparagraph (A).*

9 “(3) *APPLICABLE PERIOD.*—*For purposes of this*
10 *section—*

11 “(A) *IN GENERAL.*—*The term ‘applicable*
12 *period’ means the period—*

13 “(i) *beginning on the first date prop-*
14 *erties are acquired as part of the acquisi-*
15 *tion described in subsection (a)(2)(A) to*
16 *which this subsection applies, and*

17 “(ii) *ending on the date which is 10*
18 *years after the last date properties are ac-*
19 *quired as part of such acquisition.*

20 “(B) *SPECIAL RULE FOR INVERSIONS OC-*
21 *CURRING BEFORE MARCH 21, 2002.*—*In the case*
22 *of any acquired entity to which paragraph*
23 *(1)(A) applies, the applicable period shall be the*
24 *10-year period beginning on January 1, 2002.*

1 “(c) *TAX ON INVERSION GAINS MAY NOT BE OFF-*
2 *SET.—If subsection (b) applies—*

3 “(1) *IN GENERAL.—The taxable income of an ac-*
4 *quired entity (or any expanded affiliated group which*
5 *includes such entity) for any taxable year which in-*
6 *cludes any portion of the applicable period shall in*
7 *no event be less than the inversion gain of the entity*
8 *for the taxable year.*

9 “(2) *CREDITS NOT ALLOWED AGAINST TAX ON IN-*
10 *VERSION GAIN.—Credits shall be allowed against the*
11 *tax imposed by this chapter on an acquired entity for*
12 *any taxable year described in paragraph (1) only to*
13 *the extent such tax exceeds the product of—*

14 “(A) *the amount of the inversion gain for*
15 *the taxable year, and*

16 “(B) *the highest rate of tax specified in sec-*
17 *tion 11(b)(1).*

18 *The credit allowed by section 901 may be taken into*
19 *account under the preceding sentence only to the ex-*
20 *tent of the product of such highest rate and the*
21 *amount of taxable income from sources without the*
22 *United States that is not inversion gain.*

23 “(3) *SPECIAL RULES FOR PARTNERSHIPS.—In*
24 *the case of an acquired entity which is a*
25 *partnership—*

1 “(A) the limitations of this subsection shall
2 apply at the partner rather than the partnership
3 level,

4 “(B) the inversion gain of any partner for
5 any taxable year shall be equal to the sum of—

6 “(i) the partner’s distributive share of
7 inversion gain of the partnership for such
8 taxable year, plus

9 “(ii) income or gain required to be rec-
10 ognized for the taxable year by the partner
11 under section 367(a), 741, or 1001, or
12 under any other provision of chapter 1, by
13 reason of the transfer during the applicable
14 period of any partnership interest of the
15 partner in such partnership to the foreign
16 incorporated entity, and

17 “(C) the highest rate of tax specified in the
18 rate schedule applicable to the partner under
19 chapter 1 shall be substituted for the rate of tax
20 under paragraph (2)(B).

21 “(4) INVERSION GAIN.—For purposes of this sec-
22 tion, the term ‘inversion gain’ means any income or
23 gain required to be recognized under section 304,
24 311(b), 367, 1001, or 1248, or under any other provi-
25 sion of chapter 1, by reason of the transfer during the

1 applicable period of stock or other properties by an
2 acquired entity—

3 “(A) as part of the acquisition described in
4 subsection (a)(2)(A) to which subsection (b) ap-
5 plies, or

6 “(B) after such acquisition to a foreign re-
7 lated person.

8 The Secretary may provide that income or gain from
9 the sale of inventories or other transactions in the or-
10 dinary course of a trade or business shall not be treat-
11 ed as inversion gain under subparagraph (B) to the
12 extent the Secretary determines such treatment would
13 not be inconsistent with the purposes of this section.

14 “(5) COORDINATION WITH SECTION 172 AND MIN-
15 IMUM TAX.—Rules similar to the rules of paragraphs
16 (3) and (4) of section 860E(a) shall apply for pur-
17 poses of this section.

18 “(6) STATUTE OF LIMITATIONS.—

19 “(A) IN GENERAL.—The statutory period
20 for the assessment of any deficiency attributable
21 to the inversion gain of any taxpayer for any
22 pre-inversion year shall not expire before the ex-
23 piration of 3 years from the date the Secretary
24 is notified by the taxpayer (in such manner as
25 the Secretary may prescribe) of the acquisition

1 described in subsection (a)(2)(A) to which such
2 gain relates and such deficiency may be assessed
3 before the expiration of such 3-year period not-
4 withstanding the provisions of any other law or
5 rule of law which would otherwise prevent such
6 assessment.

7 “(B) *PRE-INVERSION YEAR.*—For purposes
8 of subparagraph (A), the term ‘pre-inversion
9 year’ means any taxable year if—

10 “(i) any portion of the applicable pe-
11 riod is included in such taxable year, and

12 “(ii) such year ends before the taxable
13 year in which the acquisition described in
14 subsection (a)(2)(A) is completed.

15 “(d) *SPECIAL RULES APPLICABLE TO RELATED*
16 *PARTY TRANSACTIONS.*—

17 “(1) *ANNUAL APPLICATION FOR AGREEMENTS ON*
18 *RETURN POSITIONS.*—

19 “(A) *IN GENERAL.*—Each acquired entity to
20 which subsection (b) applies shall file with the
21 Secretary an application for an approval agree-
22 ment under subparagraph (D) for each taxable
23 year which includes a portion of the applicable
24 period. Such application shall be filed at such

1 *time and manner, and shall contain such infor-*
2 *mation, as the Secretary may prescribe.*

3 “(B) *SECRETARIAL ACTION.*—*Within 90*
4 *days of receipt of an application under subpara-*
5 *graph (A) (or such longer period as the Secretary*
6 *and entity may agree upon), the Secretary*
7 *shall—*

8 “(i) *enter into an agreement described*
9 *in subparagraph (D) for the taxable year*
10 *covered by the application,*

11 “(ii) *notify the entity that the Sec-*
12 *retary has determined that the application*
13 *was filed in good faith and substantially*
14 *complies with the requirements for the ap-*
15 *plication under subparagraph (A), or*

16 “(iii) *notify the entity that the Sec-*
17 *retary has determined that the application*
18 *was not filed in good faith or does not sub-*
19 *stantially comply with such requirements.*

20 *If the Secretary fails to act within the time pre-*
21 *scribed under the preceding sentence, the entity*
22 *shall be treated for purposes of this paragraph as*
23 *having received notice under clause (ii).*

24 “(C) *FAILURES TO COMPLY.*—*If an ac-*
25 *quired entity fails to file an application under*

1 subparagraph (A), or the acquired entity receives
2 a notice under subparagraph (B)(iii), for any
3 taxable year, then for such taxable year—

4 “(i) there shall not be allowed any de-
5 duction, or addition to basis or cost of goods
6 sold, for amounts paid or incurred, or losses
7 incurred, by reason of a transaction between
8 the acquired entity and a foreign related
9 person,

10 “(ii) any transfer or license of intan-
11 gible property (as defined in section
12 936(h)(3)(B)) between the acquired entity
13 and a foreign related person shall be dis-
14 regarded, and

15 “(iii) any cost-sharing arrangement
16 between the acquired entity and a foreign
17 related person shall be disregarded.

18 “(D) APPROVAL AGREEMENT.—For pur-
19 poses of subparagraph (A), the term ‘approval
20 agreement’ means a prefiling, advance pricing,
21 or other agreement specified by the Secretary
22 which contains such provisions as the Secretary
23 determines necessary to ensure that the require-
24 ments of sections 163(j), 267(a)(3), 482, and 845,
25 and any other provision of this title applicable

1 to transactions between related persons and spec-
2 ified by the Secretary, are met.

3 “(2) *MODIFICATIONS OF LIMITATION ON INTER-*
4 *EST DEDUCTION.*—*In the case of an acquired entity*
5 *to which subsection (b) applies, section 163(j) shall be*
6 *applied—*

7 “(A) *without regard to paragraph (2)(A)(ii)*
8 *thereof, and*

9 “(B) *by substituting ‘25 percent’ for ‘50*
10 *percent’ each place it appears in paragraph*
11 *(2)(B) thereof.*

12 “(e) *OTHER DEFINITIONS AND SPECIAL RULES.*—*For*
13 *purposes of this section—*

14 “(1) *RULES FOR APPLICATION OF SUBSECTION*
15 *(a)(2).*—*In applying subsection (a)(2) for purposes of*
16 *subsections (a) and (b), the following rules shall*
17 *apply:*

18 “(A) *CERTAIN STOCK DISREGARDED.*—
19 *There shall not be taken into account in deter-*
20 *mining ownership for purposes of subsection*
21 *(a)(2)(B)—*

22 “(i) *stock held by members of the ex-*
23 *panded affiliated group which includes the*
24 *foreign incorporated entity, or*

1 “(ii) stock of such entity which is sold
2 in a public offering related to the acquisi-
3 tion described in subsection (a)(2)(A).

4 “(B) *PLAN DEEMED IN CERTAIN CASES.*—If
5 a foreign incorporated entity acquires directly or
6 indirectly substantially all of the properties of a
7 domestic corporation or partnership during the
8 4-year period beginning on the date which is 2
9 years before the ownership requirements of sub-
10 section (a)(2)(B) are met, such actions shall be
11 treated as pursuant to a plan.

12 “(C) *CERTAIN TRANSFERS DISREGARDED.*—
13 The transfer of properties or liabilities (includ-
14 ing by contribution or distribution) shall be dis-
15 regarded if such transfers are part of a plan a
16 principal purpose of which is to avoid the pur-
17 poses of this section.

18 “(D) *SPECIAL RULE FOR RELATED PART-*
19 *NERSHIPS.*—For purposes of applying subsection
20 (a)(2) to the acquisition of a domestic partner-
21 ship, except as provided in regulations, all part-
22 nerships which are under common control (with-
23 in the meaning of section 482) shall be treated
24 as 1 partnership.

1 “(E) *TREATMENT OF CERTAIN RIGHTS.*—
2 *The Secretary shall prescribe such regulations as*
3 *may be necessary—*

4 “(i) *to treat warrants, options, con-*
5 *tracts to acquire stock, convertible debt in-*
6 *struments, and other similar interests as*
7 *stock, and*

8 “(ii) *to treat stock as not stock.*

9 “(2) *EXPANDED AFFILIATED GROUP.*—*The term*
10 *‘expanded affiliated group’ means an affiliated group*
11 *as defined in section 1504(a) but without regard to*
12 *section 1504(b), except that section 1504(a) shall be*
13 *applied by substituting ‘more than 50 percent’ for ‘at*
14 *least 80 percent’ each place it appears.*

15 “(3) *FOREIGN INCORPORATED ENTITY.*—*The*
16 *term ‘foreign incorporated entity’ means any entity*
17 *which is, or but for subsection (a)(1) would be, treated*
18 *as a foreign corporation for purposes of this title.*

19 “(4) *FOREIGN RELATED PERSON.*—*The term ‘for-*
20 *foreign related person’ means, with respect to any ac-*
21 *quired entity, a foreign person which—*

22 “(A) *bears a relationship to such entity de-*
23 *scribed in section 267(b) or 707(b), or*

1 “(B) is under the same common control
2 *(within the meaning of section 482) as such enti-*
3 *ty.*

4 “(5) *SUBSEQUENT ACQUISITIONS BY UNRELATED*
5 *DOMESTIC CORPORATIONS.*—*Subject to such condi-*
6 *tions, limitations, and exceptions as the Secretary*
7 *may prescribe, if, after an acquisition described in*
8 *subsection (a)(2)(A) to which subsection (b) applies—*

9 “(A) *a domestic corporation stock of which*
10 *is traded on an established securities market ac-*
11 *quires directly or indirectly substantially all of*
12 *the properties of an acquired entity,*

13 “(B) *before such acquisition such domestic*
14 *corporation did not have a relationship described*
15 *in section 267(b) or 707(b), and was not under*
16 *common control (within the meaning of section*
17 *482), with such entity, or any member of an ex-*
18 *expanded affiliated group including such entity,*
19 *and*

20 “(C) *after such acquisition such acquired*
21 *entity does not have such a relationship and was*
22 *not under such common control with any mem-*
23 *ber of the expanded affiliated group which before*
24 *such acquisition included such entity,*

25 *then this section shall cease to apply to such entity.*

1 “(f) *REGULATIONS.*—*The Secretary shall provide such*
 2 *regulations as are necessary to carry out this section, in-*
 3 *cluding regulations providing for such adjustments to the*
 4 *application of this section as are necessary to prevent the*
 5 *avoidance of the purposes of this section, including the*
 6 *avoidance of such purposes through—*

7 “(1) *the use of related persons, pass-through or*
 8 *other noncorporate entities, or other intermediaries,*
 9 *or*

10 “(2) *transactions designed to have persons cease*
 11 *to be (or not become) members of expanded affiliated*
 12 *groups or related persons.”*

13 “(b) *TREATMENT OF AGREEMENTS.*—

14 “(1) *CONFIDENTIALITY.*—

15 “(A) *TREATMENT AS RETURN INFORMA-*
 16 *TION.*—*Section 6103(b)(2) of the Internal Rev-*
 17 *enue Code of 1986 (relating to return informa-*
 18 *tion) is amended by striking “and” at the end*
 19 *of subparagraph (C), by inserting “and” at the*
 20 *end of subparagraph (D), and by inserting after*
 21 *subparagraph (D) the following new subpara-*
 22 *graph:*

23 “(E) *any approval agreement under section*
 24 *7874(d)(1) to which any preceding subparagraph*
 25 *does not apply and any background information*

1 *related to the agreement or any application for*
2 *the agreement.”.*

3 (B) *EXCEPTION FROM PUBLIC INSPECTION*
4 *AS WRITTEN DETERMINATION.—Section*
5 *6110(b)(1)(B) of such Code is amended by strik-*
6 *ing “or (D)” and inserting “, (D), or (E)”.*

7 (2) *REPORTING.—The Secretary of the Treasury*
8 *shall include with any report on advance pricing*
9 *agreements required to be submitted after the date of*
10 *the enactment of this Act under section 521(b) of the*
11 *Ticket to Work and Work Incentives Improvement Act*
12 *of 1999 (Public Law 106–170) a report regarding ap-*
13 *proval agreements under section 7874(d)(1) of the In-*
14 *ternal Revenue Code of 1986. Such report shall in-*
15 *clude information similar to the information required*
16 *with respect to advance pricing agreements and shall*
17 *be treated for confidentiality purposes in the same*
18 *manner as the reports on advance pricing agreements*
19 *are treated under section 521(b)(3) of such Act.*

20 (c) *INFORMATION REPORTING.—The Secretary of the*
21 *Treasury shall exercise the Secretary’s authority under the*
22 *Internal Revenue Code of 1986 to require entities involved*
23 *in transactions to which section 7874 of such Code (as*
24 *added by subsection (a)) applies to report to the Secretary,*
25 *shareholders, partners, and such other persons as the Sec-*

1 *retary may prescribe such information as is necessary to*
 2 *ensure the proper tax treatment of such transactions.*

3 (d) *CONFORMING AMENDMENT.—The table of sections*
 4 *for subchapter C of chapter 80 of the Internal Revenue Code*
 5 *of 1986 is amended by adding at the end the following new*
 6 *item:*

“Sec. 7874. Rules relating to inverted corporate entities.”

7 **SEC. 3. REINSURANCE OF UNITED STATES RISKS IN FOR-**
 8 **EIGN JURISDICTIONS.**

9 (a) *IN GENERAL.—Section 845(a) of the Internal Rev-*
 10 *enue Code of 1986 (relating to allocation in case of reinsur-*
 11 *ance agreement involving tax avoidance or evasion) is*
 12 *amended by striking “source and character” and inserting*
 13 *“amount, source, or character”.*

14 (b) *EFFECTIVE DATE.—The amendments made by this*
 15 *section shall apply to any risk reinsured after April 11,*
 16 *2002.*

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107TH CONGRESS
2D SESSION

S. 2119

[Report No. 107-188]

A BILL

To amend the Internal Revenue Code of 1986 to provide for the tax treatment of inverted corporate entities and of transactions with such entities, and for other purposes.

JUNE 28, 2002

Reported with an amendment