

108TH CONGRESS
2D SESSION

S. 2155

To amend the Internal Revenue Code of 1986 to provide for a manufacturer's jobs credit, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 2, 2004

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

A BILL

To amend the Internal Revenue Code of 1986 to provide for a manufacturer's jobs credit, 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,*

3 **SECTION 1. SHORT TITLE; ETC.**

4 (a) **SHORT TITLE.**—This Act may be cited as the
5 “Growing Our Manufacturing Employment (GoME) Act”.

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

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

3 (c) TABLE OF CONTENTS.—The table of contents for
 4 this Act is as follows:

Sec. 1. Short title; etc.

TITLE I—GENERAL MANUFACTURING PROVISIONS

Sec. 101. Manufacturer’s jobs credit.

Sec. 102. Deduction relating to income attributable to United States production activities.

TITLE II—MANUFACTURING RELATING TO TIMBER

Sec. 201. Expensing of certain reforestation expenditures.

Sec. 202. Election to treat cutting of timber as a sale or exchange.

Sec. 203. Capital gain treatment under section 631(b) to apply to outright sales by landowners.

TITLE III—REVENUE PROVISIONS

Sec. 301. Clarification of economic substance doctrine.

Sec. 302. Tax treatment of inverted corporate entities.

5 TITLE I—GENERAL 6 MANUFACTURING PROVISIONS

7 SEC. 101. MANUFACTURER’S JOBS CREDIT.

8 (a) IN GENERAL.—Subpart D of part IV of sub-
 9 chapter A of chapter 1 of the Internal Revenue Code of
 10 1986 (relating to business-related credits) is amended by
 11 adding at the end the following:

12 “SEC. 45G. MANUFACTURER’S JOBS CREDIT.

13 “(a) GENERAL RULE.—For purposes of section 38,
 14 in the case of an eligible taxpayer, the manufacturer’s jobs
 15 credit determined under this section is an amount equal
 16 to the lesser of the following:

1 “(1) The excess of the W–2 wages paid by the
2 taxpayer during the taxable year over the W–2
3 wages paid by the taxpayer during the preceding
4 taxable year.

5 “(2) The W–2 wages paid by the taxpayer dur-
6 ing the taxable year to any employee who is an eligi-
7 ble TAA recipient (as defined in section 35(c)(2))
8 for any month during such taxable year.

9 “(3) 22.4 percent of the W–2 wages paid by the
10 taxpayer during the taxable year.

11 “(b) LIMITATION.—The amount of credit determined
12 under subsection (a) shall be reduced by an amount which
13 bears the same ratio to the amount of the credit (deter-
14 mined without regard to this subsection) as—

15 “(1) the excess of the W–2 wages paid by the
16 taxpayer to employees outside the United States
17 during the taxable year over such wages paid during
18 the most recent taxable year ending before the date
19 of the enactment of this section, bears to

20 “(2) the excess of the W–2 wages paid by the
21 taxpayer to employees within the United States dur-
22 ing the taxable year over such wages paid during
23 such most recent taxable year.

24 “(c) ELIGIBLE TAXPAYER.—For purposes of this sec-
25 tion, the term ‘eligible taxpayer’ means any taxpayer—

1 “(1) which has domestic production gross re-
2 ceipts for the taxable year and the preceding taxable
3 year, and

4 “(2) which is not treated at any time during
5 the taxable year as an inverted domestic corporation
6 under section 7874.

7 “(d) DEFINITIONS.—For purposes of this section,
8 W-2 wages and domestic production gross receipts shall
9 be determined in the same manner as under section 199.

10 “(e) CERTAIN RULES MADE APPLICABLE.—For pur-
11 poses of this section, rules similar to the rules of section
12 52 shall apply.

13 “(f) TERMINATION.—This section shall not apply to
14 any taxable year beginning after December 31, 2005.”.

15 (b) CREDIT TO BE PART OF GENERAL BUSINESS
16 CREDIT.—Section 38(b) (relating to current year business
17 credit) is amended by striking “plus” at the end of para-
18 graph (14), by striking the period at the end of paragraph
19 (15) and inserting “, plus”, and by adding at the end the
20 following:

21 “(16) the manufacturer’s jobs credit determined
22 under section 45G.”.

23 (c) CLERICAL AMENDMENT.—The table of sections
24 for subpart D of part IV of subchapter A of chapter 1
25 is amended by adding at the end the following:

“Sec. 45G. Manufacturer’s jobs credit.”.

1 (d) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to taxable years beginning after
3 December 31, 2003.

4 **SEC. 102. DEDUCTION RELATING TO INCOME ATTRIB-**
5 **UTABLE TO UNITED STATES PRODUCTION**
6 **ACTIVITIES.**

7 (a) IN GENERAL.—Part VI of subchapter B of chap-
8 ter 1 (relating to itemized deductions for individuals and
9 corporations) is amended by adding at the end the fol-
10 lowing new section:

11 **“SEC. 199. INCOME ATTRIBUTABLE TO DOMESTIC PRODUC-**
12 **TION ACTIVITIES.**

13 “(a) ALLOWANCE OF DEDUCTION.—There shall be
14 allowed as a deduction an amount equal to 9 percent of
15 the qualified production activities income of the taxpayer
16 for the taxable year.

17 “(b) DEDUCTION LIMITED TO WAGES PAID.—

18 “(1) IN GENERAL.—The amount of the deduc-
19 tion allowable under subsection (a) for any taxable
20 year shall not exceed 50 percent of the W-2 wages
21 of the employer for the taxable year.

22 “(2) W-2 WAGES.—For purposes of paragraph
23 (1), the term ‘W-2 wages’ means the sum of the ag-
24 gregate amounts the taxpayer is required to include
25 on statements under paragraphs (3) and (8) of sec-

1 tion 6051(a) with respect to employment of employ-
2 ees of the taxpayer during the taxpayer's taxable
3 year.

4 “(3) SPECIAL RULES.—

5 “(A) PASS-THRU ENTITIES.—In the case
6 of an S corporation, partnership, estate or
7 trust, or other pass-thru entity, the limitation
8 under this subsection shall apply at the entity
9 level.

10 “(B) ACQUISITIONS AND DISPOSITIONS.—
11 The Secretary shall provide for the application
12 of this subsection in cases where the taxpayer
13 acquires, or disposes of, the major portion of a
14 trade or business or the major portion of a sep-
15 arate unit of a trade or business during the tax-
16 able year.

17 “(c) QUALIFIED PRODUCTION ACTIVITIES IN-
18 COME.—For purposes of this section—

19 “(1) IN GENERAL.—The term ‘qualified produc-
20 tion activities income’ means an amount equal to the
21 portion of the modified taxable income of the tax-
22 payer which is attributable to domestic production
23 activities.

24 “(2) REDUCTION FOR TAXABLE YEARS BEGIN-
25 NING BEFORE 2013.—The amount otherwise deter-

1 mined under paragraph (1) (the ‘unreduced
2 amount’) shall not exceed the product of the unre-
3 duced amount and the domestic/worldwide fraction.

4 “(d) DETERMINATION OF INCOME ATTRIBUTABLE
5 TO DOMESTIC PRODUCTION ACTIVITIES.—For purposes
6 of this section—

7 “(1) IN GENERAL.—The portion of the modified
8 taxable income which is attributable to domestic pro-
9 duction activities is so much of the modified taxable
10 income for the taxable year as does not exceed—

11 “(A) the taxpayer’s domestic production
12 gross receipts for such taxable year, reduced by

13 “(B) the sum of—

14 “(i) the costs of goods sold that are
15 allocable to such receipts,

16 “(ii) other deductions, expenses, or
17 losses directly allocable to such receipts,
18 and

19 “(iii) a proper share of other deduc-
20 tions, expenses, and losses that are not di-
21 rectly allocable to such receipts or another
22 class of income.

23 “(2) ALLOCATION METHOD.—The Secretary
24 shall prescribe rules for the proper allocation of
25 items of income, deduction, expense, and loss for

1 purposes of determining income attributable to do-
2 mestic production activities.

3 “(3) SPECIAL RULES FOR DETERMINING
4 COSTS.—

5 “(A) IN GENERAL.—For purposes of deter-
6 mining costs under clause (i) of paragraph
7 (1)(B), any item or service brought into the
8 United States shall be treated as acquired by
9 purchase, and its cost shall be treated as not
10 less than its fair market value immediately
11 after it entered the United States. A similar
12 rule shall apply in determining the adjusted
13 basis of leased or rented property where the
14 lease or rental gives rise to domestic production
15 gross receipts.

16 “(B) EXPORTS FOR FURTHER MANUFAC-
17 TURE.—In the case of any property described
18 in subparagraph (A) that had been exported by
19 the taxpayer for further manufacture, the in-
20 crease in cost or adjusted basis under subpara-
21 graph (A) shall not exceed the difference be-
22 tween the value of the property when exported
23 and the value of the property when brought
24 back into the United States after the further
25 manufacture.

1 “(4) MODIFIED TAXABLE INCOME.—The term
2 ‘modified taxable income’ means taxable income
3 computed without regard to the deduction allowable
4 under this section.

5 “(e) DOMESTIC PRODUCTION GROSS RECEIPTS.—
6 For purposes of this section—

7 “(1) IN GENERAL.—The term ‘domestic produc-
8 tion gross receipts’ means the gross receipts of the
9 taxpayer which are derived from—

10 “(A) any sale, exchange, or other disposi-
11 tion of, or

12 “(B) any lease, rental, or license of,
13 qualifying production property which was manufac-
14 tured, produced, grown, or extracted in whole or in
15 significant part by the taxpayer within the United
16 States.

17 “(2) SPECIAL RULES FOR CERTAIN PROP-
18 ERTY.—In the case of any qualifying production
19 property described in subsection (f)(1)(C)—

20 “(A) such property shall be treated for
21 purposes of paragraph (1) as produced in sig-
22 nificant part by the taxpayer within the United
23 States if more than 50 percent of the aggregate
24 development and production costs are incurred
25 by the taxpayer within the United States, and

1 “(B) if a taxpayer acquires such property
2 before such property begins to generate sub-
3 stantial gross receipts, any development or pro-
4 duction costs incurred before the acquisition
5 shall be treated as incurred by the taxpayer for
6 purposes of subparagraph (A) and paragraph
7 (1).

8 “(f) QUALIFYING PRODUCTION PROPERTY.—For
9 purposes of this section—

10 “(1) IN GENERAL.—Except as otherwise pro-
11 vided in this paragraph, the term ‘qualifying produc-
12 tion property’ means—

13 “(A) any tangible personal property,

14 “(B) any computer software, and

15 “(C) any property described in section
16 168(f) (3) or (4), including any underlying
17 copyright or trademark.

18 “(2) EXCLUSIONS FROM QUALIFYING PRODUC-
19 TION PROPERTY.—The term ‘qualifying production
20 property’ shall not include—

21 “(A) consumable property that is sold,
22 leased, or licensed by the taxpayer as an inte-
23 gral part of the provision of services,

24 “(B) oil or gas,

25 “(C) electricity,

1 “(D) water supplied by pipeline to the con-
2 sumer,

3 “(E) utility services, or

4 “(F) any film, tape, recording, book, mag-
5 azine, newspaper, or similar property the mar-
6 ket for which is primarily topical or otherwise
7 essentially transitory in nature.

8 “(g) DOMESTIC/WORLDWIDE FRACTION.—For pur-
9 poses of this section—

10 “(1) IN GENERAL.—The term ‘domestic/world-
11 wide fraction’ means a fraction (not greater than
12 1)—

13 “(A) the numerator of which is the value
14 of the domestic production of the taxpayer, and

15 “(B) the denominator of which is the value
16 of the worldwide production of the taxpayer.

17 “(2) VALUE OF DOMESTIC PRODUCTION.—The
18 value of domestic production is the excess (if any)
19 of—

20 “(A) the domestic production gross re-
21 ceipts, over

22 “(B) the cost of purchased inputs allocable
23 to such receipts that are deductible under this
24 chapter for the taxable year.

25 “(3) PURCHASED INPUTS.—

1 “(A) IN GENERAL.—Purchased inputs are
2 any of the following items acquired by pur-
3 chase:

4 “(i) Services (other than services of
5 employees) used in manufacture, produc-
6 tion, growth, or extraction activities.

7 “(ii) Items consumed in connection
8 with such activities.

9 “(iii) Items incorporated as part of
10 the property being manufactured, pro-
11 duced, grown, or extracted.

12 “(B) SPECIAL RULE.—Rules similar to the
13 rules of subsection (d)(3) shall apply for pur-
14 poses of this subsection.

15 “(4) VALUE OF WORLDWIDE PRODUCTION.—

16 “(A) IN GENERAL.—The value of world-
17 wide production shall be determined under the
18 principles of paragraph (2), except that—

19 “(i) worldwide production gross re-
20 ceipts shall be taken into account, and

21 “(ii) paragraph (3)(B) shall not apply.

22 “(B) WORLDWIDE PRODUCTION GROSS RE-
23 CEIPTS.—The worldwide production gross re-
24 ceipts is the amount that would be determined
25 under subsection (e) if such subsection were ap-

1 plied without any reference to the United
2 States.

3 “(h) DEFINITIONS AND SPECIAL RULES.—

4 “(1) APPLICATION OF SECTION TO PASS-THRU
5 ENTITIES.—In the case of an S corporation, partner-
6 ship, estate or trust, or other pass-thru entity—

7 “(A) subject to the provisions of paragraph
8 (2) and subsection (b)(3)(A), this section shall
9 be applied at the shareholder, partner, or simi-
10 lar level, and

11 “(B) the Secretary shall prescribe rules for
12 the application of this section, including rules
13 relating to—

14 “(i) restrictions on the allocation of
15 the deduction to taxpayers at the partner
16 or similar level, and

17 “(ii) additional reporting require-
18 ments.

19 “(2) EXCLUSION FOR PATRONS OF AGRICUL-
20 TURAL AND HORTICULTURAL COOPERATIVES.—

21 “(A) IN GENERAL.—If any amount de-
22 scribed in paragraph (1) or (3) of section 1385
23 (a)—

24 “(i) is received by a person from an
25 organization to which part I of subchapter

1 T applies which is engaged in the mar-
2 keting of agricultural or horticultural prod-
3 ucts, and

4 “(ii) is allocable to the portion of the
5 qualified production activities income of
6 the organization which is deductible under
7 subsection (a) and designated as such by
8 the organization in a written notice mailed
9 to its patrons during the payment period
10 described in section 1382(d),

11 then such person shall be allowed an exclusion
12 from gross income with respect to such amount.
13 The taxable income of the organization shall
14 not be reduced under section 1382 by the por-
15 tion of any such amount with respect to which
16 an exclusion is allowable to a person by reason
17 of this paragraph.

18 “(B) SPECIAL RULES.—For purposes of
19 applying subparagraph (A), in determining the
20 qualified production activities income of the or-
21 ganization under this section—

22 “(i) there shall not be taken into ac-
23 count in computing the organization’s
24 modified taxable income any deduction al-
25 lowable under subsection (b) or (c) of sec-

1 tion 1382 (relating to patronage dividends,
2 per-unit retain allocations, and nonpatron-
3 age distributions), and

4 “(ii) the organization shall be treated
5 as having manufactured, produced, grown,
6 or extracted in whole or significant part
7 any qualifying production property mar-
8 keted by the organization which its patrons
9 have so manufactured, produced, grown, or
10 extracted.

11 “(3) SPECIAL RULE FOR AFFILIATED
12 GROUPS.—

13 “(A) IN GENERAL.—All members of an ex-
14 panded affiliated group shall be treated as a
15 single corporation for purposes of this section.

16 “(B) EXPANDED AFFILIATED GROUP.—
17 The term ‘expanded affiliated group’ means an
18 affiliated group as defined in section 1504(a),
19 determined—

20 “(i) by substituting ‘50 percent’ for
21 ‘80 percent’ each place it appears, and

22 “(ii) without regard to paragraphs (2)
23 and (4) of section 1504(b).

24 For purposes of determining the domestic/
25 worldwide fraction under subsection (g), clause

1 (ii) shall be applied by also disregarding para-
2 graphs (3) and (8) of section 1504(b).

3 “(4) COORDINATION WITH MINIMUM TAX.—The
4 deduction under this section shall be allowed for
5 purposes of the tax imposed by section 55; except
6 that for purposes of section 55, alternative minimum
7 taxable income shall be taken into account in deter-
8 mining the deduction under this section.

9 “(5) ORDERING RULE.—The amount of any
10 other deduction allowable under this chapter shall be
11 determined as if this section had not been enacted.

12 “(6) TRADE OR BUSINESS REQUIREMENT.—
13 This section shall be applied by only taking into ac-
14 count items which are attributable to the actual con-
15 duct of a trade or business.

16 “(7) POSSESSIONS, ETC.—

17 “(A) IN GENERAL.—For purposes of sub-
18 sections (d) and (e), the term ‘United States’
19 includes the Commonwealth of Puerto Rico,
20 Guam, American Samoa, the Commonwealth of
21 the Northern Mariana Islands, and the Virgin
22 Islands of the United States.

23 “(B) SPECIAL RULES FOR APPLYING WAGE
24 LIMITATION.—For purposes of applying the

1 limitation under subsection (b) for any taxable
2 year—

3 “(i) the determination of W-2 wages
4 of a taxpayer shall be made without regard
5 to any exclusion under section 3401(a)(8)
6 for remuneration paid for services per-
7 formed in a jurisdiction described in sub-
8 paragraph (A), and

9 “(ii) in determining the amount of
10 any credit allowable under section 30A or
11 936 for the taxable year, there shall not be
12 taken into account any wages which are
13 taken into account in applying such limita-
14 tion.

15 “(i) TERMINATION.—This section shall not apply to
16 any taxable year beginning after December 31, 2005.”.

17 (b) MINIMUM TAX.—Section 56(g)(4)(C) (relating to
18 disallowance of items not deductible in computing earnings
19 and profits) is amended by adding at the end the following
20 new clause:

21 “(v) DEDUCTION FOR DOMESTIC PRO-
22 DUCTION.—Clause (i) shall not apply to
23 any amount allowable as a deduction under
24 section 199.”.

1 (c) CLERICAL AMENDMENT.—The table of sections
 2 for part VI of subchapter B of chapter 1 is amended by
 3 adding at the end the following new item:

“Sec. 199. Income attributable to domestic production activities.”.

4 (d) EFFECTIVE DATE.—

5 (1) IN GENERAL.—The amendments made by
 6 this section shall apply to taxable years beginning
 7 after December 31, 2003.

8 (2) APPLICATION OF SECTION 15.—Section 15
 9 of the Internal Revenue Code of 1986 shall apply to
 10 the amendments made by this section as if they were
 11 changes in a rate of tax.

12 **TITLE II—MANUFACTURING** 13 **RELATING TO TIMBER**

14 **SEC. 201. EXPENSING OF CERTAIN REFORESTATION EX-** 15 **PENDITURES.**

16 (a) IN GENERAL.—So much of subsection (b) of sec-
 17 tion 194 (relating to amortization of reforestation expendi-
 18 tures) as precedes paragraph (2) is amended to read as
 19 follows:

20 “(b) TREATMENT AS EXPENSES.—

21 “(1) ELECTION TO TREAT CERTAIN REFOREST-
 22 ATION EXPENDITURES AS EXPENSES.—

23 “(A) IN GENERAL.—In the case of any
 24 qualified timber property with respect to which

1 the taxpayer has made (in accordance with reg-
2 ulations prescribed by the Secretary) an election
3 under this subsection, the taxpayer shall treat
4 reforestation expenditures which are paid or in-
5 curred during the taxable year with respect to
6 such property as an expense which is not
7 chargeable to capital account. The reforestation
8 expenditures so treated shall be allowed as a de-
9 duction.

10 “(B) DOLLAR LIMITATION.—The aggre-
11 gate amount of reforestation expenditures which
12 may be taken into account under subparagraph
13 (A) with respect to each qualified timber prop-
14 erty for any taxable year shall not exceed
15 \$10,000 (\$5,000 in the case of a separate re-
16 turn by a married individual (as defined in sec-
17 tion 7703)).”.

18 (b) NET AMORTIZABLE BASIS.—Section 194(c)(2)
19 (defining amortizable basis) is amended by inserting
20 “which have not been taken into account under subsection
21 (b)” after “expenditures”.

22 (c) CONFORMING AMENDMENTS.—

23 (1) Section 194(b) is amended by striking para-
24 graphs (3) and (4).

1 (2) Section 194(b)(2) is amended by striking
2 “paragraph (1)” both places it appears and inserting
3 “paragraph (1)(B)”.

4 (3) Section 194(e) is amended by striking para-
5 graph (4) and inserting the following new para-
6 graphs:

7 “(4) TREATMENT OF TRUSTS AND ESTATES.—

8 “(A) IN GENERAL.—Except as provided in
9 subparagraph (B), this section shall not apply
10 to trusts and estates.

11 “(B) AMORTIZATION DEDUCTION AL-
12 LOWED TO ESTATES.—The benefit of the de-
13 duction for amortization provided by subsection
14 (a) shall be allowed to estates in the same man-
15 ner as in the case of an individual. The allow-
16 able deduction shall be apportioned between the
17 income beneficiary and the fiduciary under reg-
18 ulations prescribed by the Secretary. Any
19 amount so apportioned to a beneficiary shall be
20 taken into account for purposes of determining
21 the amount allowable as a deduction under sub-
22 section (a) to such beneficiary.

23 “(5) APPLICATION WITH OTHER DEDUC-
24 TIONS.—No deduction shall be allowed under any
25 other provision of this chapter with respect to any

1 expenditure with respect to which a deduction is al-
 2 lowed or allowable under this section to the
 3 taxpayer.”.

4 (4) The heading for section 194 is amended by
 5 striking “**AMORTIZATION**” and inserting “**TREAT-**
 6 **MENT**”.

7 (5) The item relating to section 194 in the table
 8 of sections for part VI of subchapter B of chapter
 9 1 is amended by striking “Amortization” and insert-
 10 ing “Treatment”.

11 (d) REPEAL OF REFORESTATION CREDIT.—

12 (1) IN GENERAL.—Section 46 (relating to
 13 amount of credit) is amended—

14 (A) by adding “and” at the end of para-
 15 graph (1),

16 (B) by striking “, and ” at the end of
 17 paragraph (2) and inserting a period, and

18 (C) by striking paragraph (3).

19 (2) CONFORMING AMENDMENTS.—

20 (A) Section 48 is amended—

21 (i) by striking subsection (b),

22 (ii) by striking “this subsection” in
 23 paragraph (5) of subsection (a) and insert-
 24 ing “subsection (a)”, and

1 (iii) by redesignating such paragraph
2 (5) as subsection (b).

3 (B) The heading for section 48 is amended
4 by striking “; **REFORESTATION CREDIT**”.

5 (C) The item relating to section 48 in the
6 table of sections for subpart E of part IV of
7 subchapter A of chapter 1 is amended by strik-
8 ing “, reforestation credit”.

9 (D) Section 50(c)(3) is amended by strik-
10 ing “or reforestation credit”.

11 (e) **EFFECTIVE DATE.**—The amendments made by
12 this section shall apply with respect to expenditures paid
13 or incurred after the date of the enactment of this Act.

14 **SEC. 202. ELECTION TO TREAT CUTTING OF TIMBER AS A**
15 **SALE OR EXCHANGE.**

16 Any election under section 631(a) of the Internal
17 Revenue Code of 1986 made for a taxable year ending on
18 or before the date of the enactment of this Act may be
19 revoked by the taxpayer for any taxable year ending after
20 such date. For purposes of determining whether the tax-
21 payer may make a further election under such section,
22 such election (and any revocation under this section) shall
23 not be taken into account.

1 **SEC. 203. CAPITAL GAIN TREATMENT UNDER SECTION**
2 **631(b) TO APPLY TO OUTRIGHT SALES BY**
3 **LANDOWNERS.**

4 (a) **IN GENERAL.**—The first sentence of section
5 631(b) (relating to disposal of timber with a retained eco-
6 nomic interest) is amended by striking “retains an eco-
7 nomic interest in such timber” and inserting “either re-
8 tains an economic interest in such timber or makes an
9 outright sale of such timber”.

10 (b) **CONFORMING AMENDMENTS.**—

11 (1) The third sentence of section 631(b) is
12 amended by striking “The date of disposal” and in-
13 sserting “In the case of disposal of timber with a re-
14 tained economic interest, the date of disposal”.

15 (2) The heading for section 631(b) is amended
16 by striking “WITH A RETAINED ECONOMIC INTER-
17 EST”.

18 (c) **EFFECTIVE DATE.**—The amendments made by
19 this section shall apply to sales after the date of the enact-
20 ment of this Act.

1 **TITLE III—REVENUE**
2 **PROVISIONS**

3 **SEC. 301. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**
4 **TRINE.**

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

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

10 “(1) GENERAL RULES.—

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

19 “(I) depreciation,

20 “(II) any tax credit, or

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

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

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

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

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

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

18 **SEC. 302. TAX TREATMENT OF INVERTED CORPORATE EN-**
19 **TITIES**

20 (a) IN GENERAL.—Subchapter C of chapter 80 (re-
21 lating to provisions affecting more than one subtitle) is
22 amended by adding at the end the following new section:

1 **“SEC. 7874. RULES RELATING TO INVERTED CORPORATE**
2 **ENTITIES**

3 “(a) INVERTED CORPORATIONS TREATED AS DOMES-
4 TIC CORPORATIONS.—

5 “(1) IN GENERAL.—If a foreign incorporated
6 entity is treated as an inverted domestic corporation,
7 then, notwithstanding section 7701(a)(4), such enti-
8 ty shall be treated for purposes of this title as a do-
9 mestic corporation.

10 “(2) INVERTED DOMESTIC CORPORATION.—For
11 purposes of this section, a foreign incorporated enti-
12 ty shall be treated as an inverted domestic corpora-
13 tion if, pursuant to a plan (or a series of related
14 transactions)—

15 “(A) the entity completes after March 20,
16 2002, the direct or indirect acquisition of sub-
17 stantially all of the properties held directly or
18 indirectly by a domestic corporation or substan-
19 tially all of the properties constituting a trade
20 or business of a domestic partnership,

21 “(B) after the acquisition at least 80 per-
22 cent of the stock (by vote or value) of the entity
23 is held—

24 “(i) in the case of an acquisition with
25 respect to a domestic corporation, by
26 former shareholders of the domestic cor-

1 poration by reason of holding stock in the
2 domestic corporation, or

3 “(ii) in the case of an acquisition with
4 respect to a domestic partnership, by
5 former partners of the domestic partner-
6 ship by reason of holding a capital or prof-
7 its interest in the domestic partnership,
8 and

9 “(C) the expanded affiliated group which
10 after the acquisition includes the entity does
11 not have substantial business activities in the
12 foreign country in which or under the law of
13 which the entity is created or organized when
14 compared to the total business activities of such
15 expanded affiliated group.

16 Except as provided in regulations, an acquisition of
17 properties of a domestic corporation shall not be
18 treated as described in subparagraph (A) if none of
19 the corporation’s stock was readily tradeable on an
20 established securities market at any time during the
21 4-year period ending on the date of the acquisition.

22 “(b) PRESERVATION OF DOMESTIC TAX BASE IN
23 CERTAIN INVERSION TRANSACTIONS TO WHICH SUB-
24 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 ei-
4 ther—

5 “(A) subsection (a)(2)(A) were applied by
6 substituting ‘after December 31, 1996, and on
7 or before March 20, 2002’ for ‘after March 20,
8 2002’ and subsection (a)(2)(B) were applied by
9 substituting ‘more than 50 percent’ for ‘at least
10 80 percent’, or

11 “(B) subsection (a)(2)(B) were applied by
12 substituting ‘more than 50 percent’ for ‘at least
13 80 percent’,

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

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

24 “(A) IN GENERAL.—The term ‘acquired
25 entity’ means the domestic corporation or part-

1 nership substantially all of the properties of
2 which are directly or indirectly acquired in an
3 acquisition described in subsection (a)(2)(A) to
4 which this subsection applies.

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

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

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

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

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

22 “(B) SPECIAL RULE FOR INVERSIONS OC-
23 CURRING BEFORE MARCH 21, 2002.—In the case
24 of any acquired entity to which paragraph

1 (1)(A) applies, the applicable period shall be the
2 10-year period beginning on January 1, 2003.

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

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

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

16 “(A) the amount of the inversion gain for
17 the taxable year, and

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

20 For purposes of determining the credit allowed by
21 section 901 inversion gain shall be treated as from
22 sources within the United States.

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

1 “(A) the limitations of this subsection shall
2 apply at the partner rather than the partner-
3 ship 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
10 recognized for the taxable year by the part-
11 ner under section 367(a), 741, or 1001, or
12 under any other provision of chapter 1, by
13 reason of the transfer during the applica-
14 ble period of any partnership interest of
15 the partner in such partnership to the for-
16 eign incorporated entity, and

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

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

1 the applicable period of stock or other properties by
2 an 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
10 ordinary course of a trade or business shall not be
11 treated as inversion gain under subparagraph (B) to
12 the extent the Secretary determines such treatment
13 would not be inconsistent with the purposes of this
14 section.

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

19 “(6) STATUTE OF LIMITATIONS.—

20 “(A) IN GENERAL.—The statutory period
21 for the assessment of any deficiency attrib-
22 utable to the inversion gain of any taxpayer for
23 any pre-inversion year shall not expire before
24 the expiration of 3 years from the date the Sec-
25 retary is notified by the taxpayer (in such man-

1 ner as the Secretary may prescribe) of the ac-
2 quisition described in subsection (a)(2)(A) to
3 which such gain relates and such deficiency
4 may be assessed before the expiration of such
5 3-year period notwithstanding the provisions of
6 any other law or rule of law which would other-
7 wise prevent such assessment.

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

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

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

16 “(d) SPECIAL RULES APPLICABLE TO ACQUIRED EN-
17 TITIES TO WHICH SUBSECTION (b) APPLIES.—

18 “(1) INCREASES IN ACCURACY-RELATED PEN-
19 ALTIES.—In the case of any underpayment of tax of
20 an acquired entity to which subsection (b) applies—

21 “(A) section 6662(a) shall be applied with
22 respect to such underpayment by substituting
23 ‘30 percent’ for ‘20 percent’, and

24 “(B) if such underpayment is attributable
25 to one or more gross valuation understate-

1 ments, the increase in the rate of penalty under
2 section 6662(h) shall be to 50 percent rather
3 than 40 percent.

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

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

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

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

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

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

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

1 “(ii) stock of such entity which is sold
2 in a public offering or private placement
3 related to the acquisition described in sub-
4 section (a)(2)(A).

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

14 “(C) CERTAIN TRANSFERS DIS-
15 REGARDED.—The transfer of properties or li-
16 abilities (including by contribution or distribu-
17 tion) shall be disregarded if such transfers are
18 part of a plan a principal purpose of which is
19 to avoid the purposes of this section.

20 “(D) SPECIAL RULE FOR RELATED PART-
21 NERSHIPS.—For purposes of applying sub-
22 section (a)(2) to the acquisition of a domestic
23 partnership, except as provided in regulations,
24 all partnerships which are under common con-

1 trol (within the meaning of section 482) shall
2 be treated as 1 partnership.

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

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

10 “(ii) to treat stock as not stock.

11 “(2) EXPANDED AFFILIATED GROUP.—The
12 term ‘expanded affiliated group’ means an affiliated
13 group as defined in section 1504(a) but without re-
14 gard to section 1504(b)(3), except that section
15 1504(a) shall be applied by substituting ‘more than
16 50 percent’ for ‘at least 80 percent’ each place it ap-
17 pears.

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

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

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

3 “(B) is under the same common control
4 (within the meaning of section 482) as such en-
5 tity.

6 “(5) SUBSEQUENT ACQUISITIONS BY UNRE-
7 LATED DOMESTIC CORPORATIONS.—

8 “(A) IN GENERAL.—Subject to such condi-
9 tions, limitations, and exceptions as the Sec-
10 retary may prescribe, if, after an acquisition de-
11 scribed in subsection (a)(2)(A) to which sub-
12 section (b) applies, a domestic corporation stock
13 of which is traded on an established securities
14 market acquires directly or indirectly any prop-
15 erties of one or more acquired entities in a
16 transaction with respect to which the require-
17 ments of subparagraph (B) are met, this sec-
18 tion shall cease to apply to any such acquired
19 entity with respect to which such requirements
20 are met.

21 “(B) REQUIREMENTS.—The requirements
22 of the subparagraph are met with respect to a
23 transaction involving any acquisition described
24 in subparagraph (A) if—

1 “(i) before such transaction the do-
2 mestic corporation did not have a relation-
3 ship described in section 267(b) or 707(b),
4 and was not under common control (within
5 the meaning of section 482), with the ac-
6 quired entity, or any member of an ex-
7 panded affiliated group including such en-
8 tity, and

9 “(ii) after such transaction, such ac-
10 quired entity—

11 “(I) is a member of the same ex-
12 panded affiliated group which includes
13 the domestic corporation or has such
14 a relationship or is under such com-
15 mon control with any member of such
16 group, and

17 “(II) is not a member of, and
18 does not have such a relationship and
19 is not under such common control
20 with any member of, the expanded af-
21 filiated group which before such ac-
22 quisition included such entity.

23 “(f) REGULATIONS.—The Secretary shall provide
24 such regulations as are necessary to carry out this section,
25 including regulations providing for such adjustments to

1 the application of this section as are necessary to prevent
 2 the avoidance of the purposes of this section, including the
 3 avoidance of such purposes through—

4 “(1) the use of related persons, pass-thru or
 5 other noncorporate entities, or other intermediaries,
 6 or

7 “(2) transactions designed to have persons
 8 cease to be (or not become) members of expanded
 9 affiliated groups or related persons.”.

10 (b) INFORMATION REPORTING.—The Secretary of
 11 the Treasury shall exercise the Secretary’s authority under
 12 the Internal Revenue Code of 1986 to require entities in-
 13 volved in transactions to which section 7874 of such Code
 14 (as added by subsection (a)) applies to report to the Sec-
 15 retary, shareholders, partners, and such other persons as
 16 the Secretary may prescribe such information as is nec-
 17 essary to ensure the proper tax treatment of such trans-
 18 actions.

19 (c) CONFORMING AMENDMENT.—The table of sec-
 20 tions for subchapter C of chapter 80 is amended by adding
 21 at the end the following new item:

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

22 (d) TRANSITION RULE FOR CERTAIN REGULATED
 23 INVESTMENT COMPANIES AND UNIT INVESTMENT
 24 TRUSTS.—Notwithstanding section 7874 of the Internal
 25 Revenue Code of 1986 (as added by subsection (a)), a reg-

1 ulated investment company, or other pooled fund or trust
2 specified by the Secretary of the Treasury, may elect to
3 recognize gain by reason of section 367(a) of such Code
4 with respect to a transaction under which a foreign incor-
5 porated entity is treated as an inverted domestic corpora-
6 tion under section 7874(a) of such Code by reason of an
7 acquisition completed after March 20, 2002, and before
8 January 1, 2004.

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