

PERMANENT ACTIVE FINANCING EXCEPTION ACT OF
2015

OCTOBER 23, 2015.—Committed to the Committee of the Whole House on the State
of the Union and ordered to be printed

Mr. RYAN of Wisconsin, from the Committee on Ways and Means,
submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 961]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 961) to amend the Internal Revenue Code of 1986 to permanently extend the subpart F exemption for active financing income, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the “Permanent Active Financing Exception Act of 2015”.

SEC. 2. PERMANENT SUBPART F EXEMPTION FOR ACTIVE FINANCING INCOME.

(a) **BANKING, FINANCING, OR SIMILAR BUSINESSES.**—Section 954(h) of the Internal Revenue Code of 1986 (relating to special rule for income derived in the active conduct of banking, financing, or similar businesses) is amended by striking paragraph (9).

(b) **INSURANCE BUSINESSES.**—Section 953(e) of such Code (relating to exempt insurance income) is amended by striking paragraph (10) and by redesignating paragraph (11) as paragraph (10).

(c) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years of a foreign corporation beginning after December 31, 2014, and to taxable years of United States shareholders with or within which such taxable years of such foreign corporation end.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

H.R. 961, reported by the Committee on Ways and Means, provides a permanent exception from subpart F for active financing income. Under current law, that exception expired for taxable years beginning after December 31, 2014.

B. BACKGROUND AND NEED FOR LEGISLATION

While the Committee continues actively to pursue comprehensive tax reform as a critical means of promoting economic growth and job creation, the Committee also believes that it is important to provide permanent, immediate tax relief to worldwide American companies to help encourage economic growth and job creation here in the United States. By providing deferral of U.S. tax on their active financing income, H.R. 961 would deliver certainty and stability to these companies, allowing U.S. businesses to compete against foreign multinational corporations that are not subject to an onerous worldwide tax system.

C. LEGISLATIVE HISTORY

Background

H.R. 961 was introduced on February 12, 2015, and was referred to the Committee on Ways and Means.

Committee action

The Committee on Ways and Means marked up H.R. 961, the “Permanent Active Financing Exception Act of 2015,” on September

17, 2015, and ordered the bill, as amended, favorably reported (with a quorum being present).

Committee hearings

The need for a permanent extension of the active financing exception was discussed at no fewer than six hearings during the 112th, 113th and 114th Congresses:

- Full Committee hearing on Fundamental Tax Reform (January 20, 2011);
- Full Committee hearing on the Need for Comprehensive Tax Reform to Help American Companies Compete in the Global Market and Create Jobs for American Workers (May 12, 2011);
- Select Revenue Measures Subcommittee hearing on Ways and Means International Tax Reform Discussion Draft (November 17, 2011);
- Full Committee hearing on Tax Havens, Base Erosion and Profit-Shifting (June 13, 2013);
- Full Committee hearing on the Benefits of Permanent Tax Policy for America’s Job Creators (April 8, 2014); and
- Select Revenue Measures Subcommittee Hearing on Repatriation of Foreign Earnings as a Source of Funding for the Highway Trust Fund (June 24, 2015).

II. EXPLANATION OF THE BILL

A. EXCEPTIONS FOR ACTIVE FINANCING INCOME (SECS. 953 AND 954 OF THE CODE)

PRESENT LAW

Under the subpart F rules,¹ 10-percent-or-greater U.S. shareholders of a controlled foreign corporation (“CFC”) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, insurance income and foreign base company income. Foreign base company income includes, among other things, foreign personal holding company income and foreign base company services income (*i.e.*, income derived from services performed for or on behalf of a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents, and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and real estate mortgage investment conduits (“REMICs”); (3) net gains from commodities transactions; (4) net gains from certain foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; (7) payments in lieu of dividends; and (8) amounts received under personal service contracts.

¹ Secs. 951–964.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income.²

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the conduct of an insurance business (so-called "active financing income").

With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the active financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met. Additional exceptions from foreign personal holding company income apply for certain income derived by a securities dealer within the meaning of section 475 and for gain from the sale of active financing assets.

In the case of a securities dealer, the temporary exception from foreign personal holding company income applies to certain income. The income covered by the exception is any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of section 475. In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that this exception generally takes precedence over the exception for income of a banking, financing or similar business, in the case of a securities dealer.

In the case of insurance, a temporary exception from foreign personal holding company income applies for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. In the case of insurance,

²Prop. Treas. Reg. sec. 1.953-1(a).

temporary exceptions from insurance income and from foreign personal holding company income also apply for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Further, additional temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions are met. In the case of a life insurance or annuity contract, reserves for such contracts are determined under rules specific to the temporary exceptions. Present law also permits a taxpayer in certain circumstances, subject to approval by the Internal Revenue Service (“IRS”) through the ruling process or in published guidance, to establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

The temporary exceptions for active financing income expire for taxable years of foreign corporations beginning after December 31, 2014 (and taxable years of U.S. shareholders ending with or within those taxable years).

REASONS FOR CHANGE

The Committee believes that it is appropriate to make permanent the temporary provisions to provide certainty and to facilitate business planning.

EXPLANATION OF PROVISION

The provision makes permanent the temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the conduct of an insurance business.

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means in its consideration of H.R. 961, the “Permanent Active Financing Exception Act of 2015,” on September 17, 2015.

The Chairman's amendment in the nature of a substitute was adopted by a voice vote (with a quorum being present).

The bill, H.R. 961, was ordered favorably reported as amended to the House of Representatives by a roll call vote of 22 yeas to 11 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Ryan	X	.....	.....	Mr. Levin .....	.....	X	.....
Mr. Johnson	X	.....	.....	Mr. Rangel .....	.....	X	.....
Mr. Brady	X	.....	.....	Mr. McDermott .....	.....	X	.....
Mr. Nunes	X	.....	.....	Mr. Lewis .....	.....	X	.....
Mr. Tiberi	X	.....	.....	Mr. Neal .....	.....	X	.....
Mr. Reichert	X	.....	.....	Mr. Becerra .....	.....	.....	.....
Mr. Boustany	X	.....	.....	Mr. Doggett .....	.....	X	.....
Mr. Roskam	X	.....	.....	Mr. Thompson .....	.....	.....	.....
Mr. Price	X	.....	.....	Mr. Larson .....	.....	.....	.....
Mr. Buchanan	X	.....	.....	Mr. Blumenauer .....	.....	X	.....
Mr. Smith (NE)	X	.....	.....	Mr. Kind .....	.....	X	.....
Ms. Jenkins	X	.....	.....	Mr. Pascrell .....	.....	X	.....
Mr. Paulsen	X	.....	.....	Mr. Crowley .....	.....	X	.....
Mr. Marchant .....	.....	.....	.....	Mr. Davis .....	.....	X	.....
Ms. Black	X	.....	.....	Ms. Sanchez .....	.....	.....	.....
Mr. Reed	X	.....	.....		
Mr. Young	X	.....	.....		
Mr. Kelly	X	.....	.....		
Mr. Renacci	X	.....	.....		
Mr. Meehan .....	.....	.....	.....	
Ms. Noem	X	.....	.....		
Mr. Holding	X	.....	.....		
Mr. Smith (MO)	X	.....	.....		
Mr. Dold	X	.....	.....		

IV. BUDGET EFFECTS OF THE BILL

A. COMMITTEE ESTIMATE OF BUDGETARY EFFECTS

In compliance with clause 3(d) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the bill, H.R. 961, as reported.

The bill, as reported, is estimated to have the following effect on Federal budget receipts for fiscal years 2016–2025:

Fiscal Years												
[Millions of Dollars]												
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016-25	
	-9,975	-7,050	-7,097	-7,150	-7,247	-7,347	-7,698	-8,036	-8,151	-8,254	-38,519	-78,005

Pursuant to clause 8 of rule XIII of the Rules of the House of Representatives, the following statement is made by the Joint Committee on Taxation with respect to the provisions of the bill amending the Internal Revenue Code of 1986: The gross budgetary effect (before incorporating macroeconomic effects) in any fiscal year is less than 0.25 percent of the current projected gross domestic product of the United States for that fiscal year; therefore, the bill is not “major legislation” for purposes of requiring that the estimate include the budgetary effects of changes in economic output, employment, capital stock and other macroeconomic variables.

B. STATEMENT REGARDING NEW BUDGET AUTHORITY AND TAX
EXPENDITURES BUDGET AUTHORITY

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue-reducing tax provisions involve increased tax expenditures. (See amounts in table in Part IV.A., above.)

C. COST ESTIMATE PREPARED BY THE CONGRESSIONAL BUDGET
OFFICE

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE
Washington, DC, September 22, 2015.

Hon. PAUL RYAN,
*Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 961, the Permanent Active Financing Exception Act of 2015.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Peter Huether.

Sincerely,

KEITH HALL.

Enclosure.

H.R. 961—Permanent Active Financing Exception Act of 2015

H.R. 961 would amend the Internal Revenue Code to permanently allow the deferral of tax on certain income earned in foreign companies when calculating taxable income. Under Subpart F rules in the Internal Revenue Code, U.S. shareholders that hold 10 percent or more of a controlled foreign corporation are subject to U.S. tax annually on certain income earned by that corporation, whether or not that income is distributed to shareholders. H.R. 961 would make permanent the temporary exceptions from Subpart F tax treatment for income from active banking, financing, insurance, or similar business that generally expired after December 31, 2014.

The staff of the Joint Committee on Taxation (JCT) estimates that enacting H.R. 961 would reduce revenues, thus increasing fed-

eral budget deficits, by about \$78 billion over the 2016–2025 period.

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending and revenues. Enacting H.R. 961 would result in revenue losses in each year beginning in 2016. The estimated increases in the deficit are shown in the following table.

JCT has determined that the bill contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act.

The CBO staff contact for this estimate is Peter Huether. The estimate was approved by David Weiner, Assistant Director for Tax Analysis.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR H.R. 961, AS ORDERED REPORTED BY THE
HOUSE COMMITTEE ON WAYS AND MEANS ON SEPTEMBER 17, 2015

	By fiscal year, in millions of dollars												
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2016– 2020	2016– 2025	
NET INCREASE IN THE DEFICIT													
Statutory Pay-As-You-Go													
Effects	9,975	7,050	7,097	7,150	7,247	7,347	7,698	8,036	8,151	8,254	38,519	78,005	

Source: Staff of the Joint Committee on Taxation.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. COMMITTEE OVERSIGHT FINDINGS AND RECOMMENDATIONS

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was as a result of the Committee’s review of the provisions of H.R. 961 that the Committee concluded that it is appropriate to report the bill, as amended, favorably to the House of Representatives with the recommendation that the bill do pass.

B. STATEMENT OF GENERAL PERFORMANCE GOALS AND OBJECTIVES

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. INFORMATION RELATING TO UNFUNDED MANDATES

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104–4).

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

D. APPLICABILITY OF HOUSE RULE XXI 5(B)

Rule XXI 5(b) of the Rules of the House of Representatives provides, in part, that “A bill or joint resolution, amendment, or con-

ference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present.” The Committee has carefully reviewed the bill, and states that the bill does not involve any Federal income tax rate increases within the meaning of the rule.

E. TAX COMPLEXITY ANALYSIS

Section 4022(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (“IRS Reform Act”) requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code and has widespread applicability to individuals or small businesses.

Pursuant to clause 3(h)(1) of rule XIII of the Rules of the House of Representatives, the staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Internal Revenue Code and that have “widespread applicability” to individuals or small businesses, within the meaning of the rule.

F. CONGRESSIONAL EARMARKS, LIMITED TAX BENEFITS, AND LIMITED TARIFF BENEFITS

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

G. DUPLICATION OF FEDERAL PROGRAMS

In compliance with Sec. 3(g)(2) of H. Res. 5 (114th Congress), the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program, (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Public Law 95–220, as amended by Public Law 98–169).

H. DISCLOSURE OF DIRECTED RULE MAKINGS

In compliance with Sec. 3(i) of H. Res. 5 (114th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires no directed rule makings within the meaning of such section.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

A. TEXT OF EXISTING LAW AMENDED OR REPEALED BY THE BILL, AS REPORTED

In compliance with clause 3(e)(1)(A) of rule XIII of the Rules of the House of Representatives, the text of each section proposed to be amended or repealed by the bill, as reported, is shown below:

TEXT OF EXISTING LAW AMENDED OR REPEALED BY THE BILL, AS REPORTED

In compliance with clause 3(e)(1)(A) of rule XIII of the Rules of the House of Representatives, the text of each section proposed to be amended or repealed by the bill, as reported, is shown below:

INTERNAL REVENUE CODE OF 1986

* * * * *

Subtitle A—Income Taxes

* * * * *

CHAPTER 1—NORMAL TAXES AND SURTAXES

* * * * *

Subchapter N—Tax Based on Income From Sources Within or Without the United States

* * * * *

PART III—INCOME FROM SOURCES WITHOUT THE UNITED STATES

* * * * *

Subpart F—Controlled Foreign Corporations

* * * * *

SEC. 953. INSURANCE INCOME.

(a) **INSURANCE INCOME.**—

(1) **IN GENERAL.**—For purposes of section 952(a)(1), the term “insurance income” means any income which—

(A) is attributable to the issuing (or reinsuring) of an insurance or annuity contract, and

(B) would (subject to the modifications provided by subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance company.

(2) **EXCEPTION.**—Such term shall not include any exempt insurance income (as defined in subsection (e)).

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

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

(A) The small life insurance company deduction.

- (B) Section 805(a)(5) (relating to operations loss deduction).
- (C) Section 832(c)(5) (relating to certain capital losses).
- (2) The items referred to in—
- (A) section 803(a)(1) (relating to gross amount of premiums and other considerations),
- (B) section 803(a)(2) (relating to net decrease in reserves),
- (C) section 805(a)(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 subsection (a)(1).
- (3) Reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i).
- (4) All items of income, expenses, losses, and deductions shall be properly allocated or apportioned under regulations prescribed by the Secretary.
- (c) SPECIAL RULE FOR CERTAIN CAPTIVE INSURANCE COMPANIES.—
- (1) IN GENERAL.—For purposes only of taking into account related person insurance income—
- (A) the term “United States shareholder” means, with respect to any foreign corporation, a United States person (as defined in section 957(c)) who owns (within the meaning of section 958(a)) any stock of the foreign corporation,
- (B) the term “controlled foreign corporation” has the meaning given to such term by section 957(a) determined by substituting “25 percent or more” for “more than 50 percent”, and
- (C) the pro rata share referred to in section 951(a)(1)(A)(i) shall be determined under paragraph (5) of this subsection.
- (2) RELATED PERSON INSURANCE INCOME.—For purposes of this subsection, the term “related person insurance income” means any insurance income (within the meaning of subsection (a)) attributable to a policy of insurance or reinsurance with respect to which the person (directly or indirectly) insured is a United States shareholder in the foreign corporation or a related person to such a shareholder.
- (3) EXCEPTIONS.—
- (A) CORPORATIONS NOT HELD BY INSURED.—Paragraph (1) shall not apply to any foreign corporation if at all times during the taxable year of such foreign corporation—
- (i) less than 20 percent of the total combined voting power of all classes of stock of such corporation entitled to vote, and
- (ii) less than 20 percent of the total value of such corporation,
- is owned (directly or indirectly under the principles of section 883(c)(4)) by persons who are (directly or indirectly) insured under any policy of insurance or reinsurance

issued by such corporation or who are related persons to any such person.

(B) DE MINIMIS EXCEPTION.—Paragraph (1) shall not apply to any foreign corporation for a taxable year of such corporation if the related person insurance income (determined on a gross basis) of such corporation for such taxable year is less than 20 percent of its insurance income (as so determined) for such taxable year determined without regard to those provisions of subsection (a)(1) which limit insurance income to income from countries other than the country in which the corporation was created or organized.

(C) ELECTION TO TREAT INCOME AS EFFECTIVELY CONNECTED.—Paragraph (1) shall not apply to any foreign corporation for any taxable year if—

(i) such corporation elects (at such time and in such manner as the Secretary may prescribe)—

(I) to treat its related person insurance income for such taxable year as income effectively connected with the conduct of a trade or business in the United States, and

(II) to waive all benefits (other than with respect to section 884) with respect to related person insurance income granted by the United States under any treaty between the United States and any foreign country, and

(ii) such corporation meets such requirements as the Secretary shall prescribe to ensure that the tax imposed by this chapter on such income is paid.

An election under this subparagraph made for any taxable year shall not be effective if the corporation (or any predecessor thereof) was a disqualified corporation for the taxable year for which the election was made or for any prior taxable year beginning after 1986.

(D) Special rules for subparagraph (C)

(i) PERIOD DURING WHICH ELECTION IN EFFECT.—

(I) IN GENERAL.—Except as provided in subclause (II), any election under subparagraph (C) shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(II) TERMINATION.—If a foreign corporation which made an election under subparagraph (C) for any taxable year is a disqualified corporation for any subsequent taxable year, such election shall not apply to any taxable year beginning after such subsequent taxable year.

(ii) EXEMPTION FROM TAX IMPOSED BY SECTION 4371.—The tax imposed by section 4371 shall not apply with respect to any related person insurance income treated as effectively connected with the conduct of a trade or business within the United States under subparagraph (C).

(E) DISQUALIFIED CORPORATION.—For purposes of this paragraph the term “disqualified corporation” means, with

respect to any taxable year, any foreign corporation which is a controlled foreign corporation for an uninterrupted period of 30 days or more during such taxable year (determined without regard to this subsection) but only if a United States shareholder (determined without regard to this subsection) owns (within the meaning of section 958(a)) stock in such corporation at some time during such taxable year.

(4) TREATMENT OF MUTUAL INSURANCE COMPANIES.—In the case of a mutual insurance company—

(A) this subsection shall apply,

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

(C) appropriate adjustments in the application of this subpart shall be made under regulations prescribed by the Secretary.

(5) DETERMINATION OF PRO RATA SHARE.—

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

(i) the amount which would be determined under paragraph (2) of section 951(a) if—

(I) only related person insurance income were taken into account,

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

(III) only distributions received by United States shareholders were taken into account under subparagraph (B) of such paragraph (2), or

(ii) the amount which would be determined under paragraph (2) of section 951(a) if the entire earnings and profits of the foreign corporation for the taxable year were subpart F income.

(B) COORDINATION WITH OTHER PROVISIONS.—The Secretary shall prescribe regulations providing for such modifications to the provisions of this subpart as may be necessary or appropriate by reason of subparagraph (A).

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

(A) IN GENERAL.—Except as provided in subparagraph (B), the term “related person” has the meaning given such term by section 954(d)(3).

(B) TREATMENT OF CERTAIN LIABILITY INSURANCE POLICIES.—In the case of any policy of insurance covering liability arising from services performed as a director, officer, or employee of a corporation or as a partner or employee of a partnership, the person performing such services and the entity for which such services are performed shall be treated as related persons.

(7) COORDINATION WITH SECTION 1248.—For purposes of section 1248, if any person is (or would be but for paragraph (3)) treated under paragraph (1) as a United States shareholder with respect to any foreign corporation which would be taxed under subchapter L if it were a domestic corporation and

which is (or would be but for paragraph (3)) treated under paragraph (1) as a controlled foreign corporation—

(A) such person shall be treated as meeting the stock ownership requirements of section 1248(a)(2) with respect to such foreign corporation, and

(B) such foreign corporation shall be treated as a controlled foreign corporation.

(8) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including—

(A) regulations preventing the avoidance of this subsection through cross insurance arrangements or otherwise, and

(B) regulations which may provide that a person will not be treated as a United States shareholder under paragraph (1) with respect to any foreign corporation if neither such person (nor any related person to such person) is (directly or indirectly) insured under any policy of insurance or reinsurance issued by such foreign corporation.

(d) ELECTION BY FOREIGN INSURANCE COMPANY TO BE TREATED AS DOMESTIC CORPORATION.—

(1) IN GENERAL.—If—

(A) a foreign corporation is a controlled foreign corporation (as defined in section 957(a) by substituting “25 percent or more” for “more than 50 percent” and by using the definition of United States shareholder under 953(c)(1)(A)),

(B) such foreign corporation would qualify under part I or II of subchapter L for the taxable year if it were a domestic corporation,

(C) such foreign corporation meets such requirements as the Secretary shall prescribe to ensure that the taxes imposed by this chapter on such foreign corporation are paid, and

(D) such foreign corporation makes an election to have this paragraph apply and waives all benefits to such corporation granted by the United States under any treaty, for purposes of this title, such corporation shall be treated as a domestic corporation.

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

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

(B) TERMINATION.—If a corporation which made an election under paragraph (1) for any taxable year fails to meet the requirements of subparagraphs (A), (B), and (C), of paragraph (1) for any subsequent taxable year, such election shall not apply to any taxable year beginning after such subsequent taxable year.

(3) TREATMENT OF LOSSES.—If any corporation treated as a domestic corporation under this subsection is treated as a member of an affiliated group for purposes of chapter 6 (relating to consolidated returns), any loss of such corporation shall be treated as a dual consolidated loss for purposes of section 1503(d) without regard to paragraph (2)(B) thereof.

(4) EFFECT OF ELECTION.—

(A) IN GENERAL.—For purposes of section 367, any foreign corporation making an election under paragraph (1) shall be treated as transferring (as of the 1st day of the 1st taxable year to which such election applies) all of its assets to a domestic corporation in connection with an exchange to which section 354 applies.

(B) EXCEPTION FOR PRE-1988 EARNINGS AND PROFIT.—

(i) IN GENERAL.—Earnings and profits of the foreign corporation accumulated in taxable years beginning before January 1, 1988, shall not be included in the gross income of the persons holding stock in such corporation by reason of subparagraph (A).

(ii) TREATMENT OF DISTRIBUTIONS.—For purposes of this title, any distribution made by a corporation to which an election under paragraph (1) applies out of earnings and profits accumulated in taxable years beginning before January 1, 1988, shall be treated as a distribution made by a foreign corporation.

(iii) CERTAIN RULES TO CONTINUE TO APPLY TO PRE-1988 EARNINGS.—The provisions specified in clause (iv) shall be applied without regard to paragraph (1), except that, in the case of a corporation to which an election under paragraph (1) applies, only earnings and profits accumulated in taxable years beginning before January 1, 1988, shall be taken into account.

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

(I) Section 1248 (relating to gain from certain sales or exchanges of stock in certain foreign corporations).

(II) Subpart F of part III of subchapter N to the extent such subpart relates to earnings invested in United States property or amounts referred to in clause (ii) or (iii) of section 951(a)(1)(A).

(III) Section 884 to the extent the foreign corporation reinvested 1987 earnings and profits in United States assets.

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

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

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

such corporation shall be treated as a domestic corporation transferring (as of the 1st day of such subsequent taxable year) all of its property to a foreign corporation in connection with an exchange to which section 354 applies.

(6) ADDITIONAL TAX ON CORPORATION MAKING ELECTION.—

(A) IN GENERAL.—If a corporation makes an election under paragraph (1), the amount of tax imposed by this chapter for the 1st taxable year to which such election applies shall be increased by the amount determined under subparagraph (B).

- (B) AMOUNT OF TAX.—The amount of tax determined under this paragraph shall be equal to the lesser of—
- (i) 3/4 of 1 percent of the aggregate amount of capital and accumulated surplus of the corporation as of December 31, 1987, or
 - (ii) \$1,500,000.
- (e) EXEMPT INSURANCE INCOME.—For purposes of this section—
- (1) EXEMPT INSURANCE INCOME DEFINED.—
 - (A) IN GENERAL.—The term “exempt insurance income” means income derived by a qualifying insurance company which—
 - (i) is attributable to the issuing (or reinsuring) of an exempt contract by such company or a qualifying insurance company branch of such company, and
 - (ii) is treated as earned by such company or branch in its home country for purposes of such country’s tax laws.
 - (B) EXCEPTION FOR CERTAIN ARRANGEMENTS.—Such term shall not include income attributable to the issuing (or reinsuring) of an exempt contract as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of issuing (or reinsuring) a contract which is not an exempt contract.
 - (C) DETERMINATIONS MADE SEPARATELY.—For purposes of this subsection and section 954(i), the exempt insurance income and exempt contracts of a qualifying insurance company or any qualifying insurance company branch of such company shall be determined separately for such company and each such branch by taking into account—
 - (i) in the case of the qualifying insurance company, only items of income, deduction, gain, or loss, and activities of such company not properly allocable or attributable to any qualifying insurance company branch of such company, and
 - (ii) in the case of a qualifying insurance company branch, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such branch.
 - (2) EXEMPT CONTRACT.—
 - (A) IN GENERAL.—The term “exempt contract” means an insurance or annuity contract issued or reinsured by a qualifying insurance company or qualifying insurance company branch in connection with property in, liability arising out of activity in, or the lives or health of residents of, a country other than the United States.
 - (B) MINIMUM HOME COUNTRY INCOME REQUIRED.—
 - (i) IN GENERAL.—No contract of a qualifying insurance company or of a qualifying insurance company branch shall be treated as an exempt contract unless such company or branch derives more than 30 percent of its net written premiums from exempt contracts (determined without regard to this subparagraph)—
 - (I) which cover applicable home country risks,
 - and

(II) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)).

(ii) APPLICABLE HOME COUNTRY RISKS.—The term “applicable home country risks” means risks in connection with property in, liability arising out of activity in, or the lives or health of residents of, the home country of the qualifying insurance company or qualifying insurance company branch, as the case may be, issuing or reinsuring the contract covering the risks.

(C) SUBSTANTIAL ACTIVITY REQUIREMENTS FOR CROSS BORDER RISKS.—A contract issued by a qualifying insurance company or qualifying insurance company branch which covers risks other than applicable home country risks (as defined in subparagraph (B)(ii)) shall not be treated as an exempt contract unless such company or branch, as the case may be—

(i) conducts substantial activity with respect to an insurance business in its home country, and

(ii) performs in its home country substantially all of the activities necessary to give rise to the income generated by such contract.

(3) QUALIFYING INSURANCE COMPANY.—The term “qualifying insurance company” means any controlled foreign corporation which—

(A) is subject to regulation as an insurance (or reinsurance) company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country,

(B) derives more than 50 percent of its aggregate net written premiums from the issuance or reinsurance by such controlled foreign corporation and each of its qualifying insurance company branches of contracts—

(i) covering applicable home country risks (as defined in paragraph (2)) of such corporation or branch, as the case may be, and

(ii) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)),

except that in the case of a branch, such premiums shall only be taken into account to the extent such premiums are treated as earned by such branch in its home country for purposes of such country’s tax laws, and

(C) is engaged in the insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

(4) QUALIFYING INSURANCE COMPANY BRANCH.—The term “qualifying insurance company branch” means a qualified business unit (within the meaning of section 989(a)) of a controlled foreign corporation if—

(A) such unit is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country

to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country, and

(B) such controlled foreign corporation is a qualifying insurance company, determined under paragraph (3) as if such unit were a qualifying insurance company branch.

(5) LIFE INSURANCE OR ANNUITY CONTRACT.—For purposes of this section and section 954, the determination of whether a contract issued by a controlled foreign corporation or a qualified business unit (within the meaning of section 989(a)) is a life insurance contract or an annuity contract shall be made without regard to sections 72(s), 101(f), 817(h), and 7702 if—

(A) such contract is regulated as a life insurance or annuity contract by the corporation's or unit's home country, and

(B) no policyholder, insured, annuitant, or beneficiary with respect to the contract is a United States person.

(6) HOME COUNTRY.—For purposes of this subsection, except as provided in regulations—

(A) CONTROLLED FOREIGN CORPORATION.—The term “home country” means, with respect to a controlled foreign corporation, the country in which such corporation is created or organized.

(B) QUALIFIED BUSINESS UNIT.—The term “home country” means, with respect to a qualified business unit (as defined in section 989(a)), the country in which the principal office of such unit is located and in which such unit is licensed, authorized, or regulated by the applicable insurance regulatory body to sell insurance, reinsurance, or annuity contracts to persons other than related persons (as defined in section 954(d)(3)) in such country.

(7) ANTI-ABUSE RULES.—For purposes of applying this subsection and section 954(i)—

(A) the rules of section 954(h)(7) (other than subparagraph (B) thereof) shall apply,

(B) there shall be disregarded any item of income, gain, loss, or deduction of, or derived from, an entity which is not engaged in regular and continuous transactions with persons which are not related persons,

(C) there shall be disregarded any change in the method of computing reserves a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of this subsection or section 954(i),

(D) a contract of insurance or reinsurance shall not be treated as an exempt contract (and premiums from such contract shall not be taken into account for purposes of paragraph (2)(B) or (3)) if—

(i) any policyholder, insured, annuitant, or beneficiary is a resident of the United States and such contract was marketed to such resident and was written to cover a risk outside the United States, or

(ii) the contract covers risks located within and without the United States and the qualifying insurance company or qualifying insurance company branch does not maintain such contemporaneous records, and

file such reports, with respect to such contract as the Secretary may require,

(E) the Secretary may prescribe rules for the allocation of contracts (and income from contracts) among 2 or more qualifying insurance company branches of a qualifying insurance company in order to clearly reflect the income of such branches, and

(F) premiums from a contract shall not be taken into account for purposes of paragraph (2)(B) or (3) if such contract reinsures a contract issued or reinsured by a related person (as defined in section 954(d)(3)). For purposes of subparagraph (D), the determination of where risks are located shall be made under the principles of section 953.

(8) COORDINATION WITH SUBSECTION (C).—In determining insurance income for purposes of subsection (c), exempt insurance income shall not include income derived from exempt contracts which cover risks other than applicable home country risks.

(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and section 954(i).

(10) APPLICATION.—This subsection and section 954(i) shall apply only to taxable years of a foreign corporation beginning after December 31, 1998, and before January 1, 2015, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends. If this subsection does not apply to a taxable year of a foreign corporation beginning after December 31, 2014 (and taxable years of United States shareholders ending with or within such taxable year), then, notwithstanding the preceding sentence, subsection (a) shall be applied to such taxable years in the same manner as it would if the taxable year of the foreign corporation began in 1998.

(11) CROSS REFERENCE.—For income exempt from foreign personal holding company income, see section 954(i).

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)),

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

(5) the foreign base company oil related income for the taxable year (determined under subsection (g) and reduced as provided in subsection (b)(5)).

(b) EXCLUSION AND SPECIAL RULES.—

(3) DE MINIMIS, ETC., RULES.—For purposes of subsection (a) and section 953—

(A) DE MINIMIS RULE.—If the sum of foreign base company income (determined without regard to paragraph (5)) and the gross insurance income for the taxable year is less than the lesser of—

- (i) 5 percent of gross income, or
- (ii) \$1,000,000, no part of the gross income for the taxable year shall be treated as foreign base company income or insurance income.

(B) FOREIGN BASE COMPANY INCOME AND INSURANCE INCOME IN EXCESS OF 70 PERCENT OF GROSS INCOME.—If the sum of the foreign base company income (determined without regard to paragraph (5)) and the gross insurance income for the taxable year exceeds 70 percent of gross income, the entire gross income for the taxable year shall, subject to the provisions of paragraphs (4) and (5), be treated as foreign base company income or insurance income (whichever is appropriate).

(C) GROSS INSURANCE INCOME.—For purposes of subparagraphs (A) and (B), the term “gross insurance income” means any item of gross income taken into account in determining insurance income under section 953.

(4) EXCEPTION FOR CERTAIN INCOME SUBJECT TO HIGH FOREIGN TAXES.—For purposes of subsection (a) and section 953, foreign base company income and insurance income shall not include any item of income received by a controlled foreign corporation if the taxpayer establishes to the satisfaction of the Secretary that such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in section 11. The preceding sentence shall not apply to foreign base company oil-related income described in subsection (a)(5).

(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 the foreign base company oil related income shall be reduced, under regulations prescribed by the Secretary so as to take into account deductions (including taxes) properly allocable to such income. Except to the extent provided in regulations prescribed by the Secretary, any interest which is paid or accrued by the controlled foreign corporation to any United States shareholder in such corporation (or any controlled foreign corporation related to such a shareholder) shall be allocated first to foreign personal holding company income which is passive income (within the meaning of section 904(d)(2)) of such corporation to the extent thereof. The Secretary may, by regulations, provide that the preceding sentence shall apply also to interest paid or accrued to other persons.

(6) FOREIGN BASE COMPANY OIL RELATED INCOME NOT TREATED AS ANOTHER KIND OF BASE COMPANY INCOME.—Income of a corporation which is foreign base company oil related income shall not be considered foreign base company income of such corporation under paragraph (2), or (3) of subsection (a).

(c) FOREIGN PERSONAL HOLDING COMPANY INCOME.—

(1) IN GENERAL.—For purposes of subsection (a)(1), the term “foreign personal holding company income” means the portion of the gross income which consists of:

(A) DIVIDENDS, ETC.—Dividends, interest, royalties, rents, and annuities.

(B) CERTAIN PROPERTY TRANSACTIONS.—The excess of gains over losses from the sale or exchange of property—

(i) which gives rise to income described in subparagraph (A) (after application of paragraph (2)(A)) other than property which gives rise to income not treated as foreign personal holding company income by reason of subsection (h) or (i) for the taxable year,

(ii) which is an interest in a trust, partnership, or REMIC, or

(iii) which does not give rise to any income.

Gains and losses from the sale or exchange of any property which, in the hands of the controlled foreign corporation, is property described in section 1221(a)(1) shall not be taken into account under this subparagraph.

(C) COMMODITIES TRANSACTIONS.—The excess of gains over losses from transactions (including futures, forward, and similar transactions) in any commodities. This subparagraph shall not apply to gains or losses which—

(i) arise out of commodity hedging transactions (as defined in paragraph (5)(A)),

(ii) are active business gains or losses from the sale of commodities, but only if substantially all of the controlled foreign corporation’s commodities are property described in paragraph (1), (2), or (8) of section 1221(a), or

(iii) are foreign currency gains or losses (as defined in section 988(b)) attributable to any section 988 transactions.

(D) FOREIGN CURRENCY GAINS.—The excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to any section 988 transactions. This subparagraph shall not apply in the case of any transaction directly related to the business needs of the controlled foreign corporation.

(E) INCOME EQUIVALENT TO INTEREST.—Any income equivalent to interest, including income from commitment fees (or similar amounts) for loans actually made.

(F) INCOME FROM NOTIONAL PRINCIPAL CONTRACTS.—

(i) IN GENERAL.—Net income from notional principal contracts.

(ii) COORDINATION WITH OTHER CATEGORIES OF FOREIGN PERSONAL HOLDING COMPANY INCOME.—Any item of income, gain, deduction, or loss from a notional principal contract entered into for purposes of hedging any item described in any preceding subparagraph shall not be taken into account for purposes of this subparagraph but shall be taken into account under such other subparagraph.

(G) PAYMENTS IN LIEU OF DIVIDENDS.—Payments in lieu of dividends which are made pursuant to an agreement to which section 1058 applies.

(H) PERSONAL SERVICE CONTRACTS.—

(i) Amounts received under a contract under which the corporation is to furnish personal services if—

(I) some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or

(II) the individual who is to perform the services is designated (by name or by description) in the contract, and

(ii) amounts received from the sale or other disposition of such a contract.

This subparagraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(2) EXCEPTION FOR CERTAIN AMOUNTS.—

(A) RENTS AND ROYALTIES DERIVED IN ACTIVE BUSINESS.—Foreign personal holding company income shall not include rents and royalties which are derived in the active conduct of a trade or business and which are received from a person other than a related person (within the meaning of subsection (d)(3)). For purposes of the preceding sentence, rents derived from leasing an aircraft or vessel in foreign commerce shall not fail to be treated as derived in the active conduct of a trade or business if, as determined under regulations prescribed by the Secretary, the active leasing expenses are not less than 10 percent of the profit on the lease.

(B) CERTAIN EXPORT FINANCING.—Foreign personal holding company income shall not include any interest which is derived in the conduct of a banking business and which is export financing interest (as defined in section 904(d)(2)(G)).

(C) EXCEPTION FOR DEALERS.—Except as provided by regulations, in the case of a regular dealer in property which is property described in paragraph (1)(B), forward contracts, option contracts, or similar financial instruments (including notional principal contracts and all instruments referenced to commodities), there shall not be taken into account in computing foreign personal holding company income—

(i) any item of income, gain, deduction, or loss (other than any item described in subparagraph (A), (E), or (G) of paragraph (1)) from any transaction (including hedging transactions and transactions involving physical settlement) entered into in the ordinary course of such dealer's trade or business as such a dealer, and

(ii) if such dealer is a dealer in securities (within the meaning of section 475), any interest or dividend or

equivalent amount described in subparagraph (E) or (G) of paragraph (1) from any transaction (including any hedging transaction or transaction described in section 956(c)(2)(I)) entered into in the ordinary course of such dealer's trade or business as such a dealer in securities, but only if the income from the transaction is attributable to activities of the dealer in the country under the laws of which the dealer is created or organized (or in the case of a qualified business unit described in section 989(a), is attributable to activities of the unit in the country in which the unit both maintains its principal office and conducts substantial business activity).

(3) CERTAIN INCOME RECEIVED FROM RELATED PERSONS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term “foreign personal holding company income” does not include—

(i) dividends and interest received from a related person which (I) is a corporation created or 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, and

(ii) rents and royalties received from a corporation which is 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.

To the extent provided in regulations, payments made by a partnership with 1 or more corporate partners shall be treated as made by such corporate partners in proportion to their respective interests in the partnership.

(B) EXCEPTION NOT TO APPLY TO ITEMS WHICH REDUCE SUBPART F INCOME.—Subparagraph (A) shall not apply in the case of any interest, rent, or royalty to the extent such interest, rent, or royalty reduces the payor's subpart F income or creates (or increases) a deficit which under section 952(c) may reduce the subpart F income of the payor or another controlled foreign corporation.

(C) EXCEPTION FOR CERTAIN DIVIDENDS.—Subparagraph (A)(i) shall not apply to any dividend with respect to any stock which is attributable to earnings and profits of the distributing corporation accumulated during any period during which the person receiving such dividend did not hold such stock either directly, or indirectly through a chain of one or more subsidiaries each of which meets the requirements of subparagraph (A)(i).

(4) LOOK-THRU RULE FOR CERTAIN PARTNERSHIP SALES.—

(A) IN GENERAL.—In the case of any sale by a controlled foreign corporation of an interest in a partnership with respect to which such corporation is a 25-percent owner, such corporation shall be treated for purposes of this subsection as selling the proportionate share of the assets of the partnership attributable to such interest. The Sec-

retary shall prescribe such regulations as may be appropriate to prevent abuse of the purposes of this paragraph, including regulations providing for coordination of this paragraph with the provisions of subchapter K.

(B) 25-PERCENT OWNER.—For purposes of this paragraph, the term “25-percent owner” means a controlled foreign corporation which owns directly 25 percent or more of the capital or profits interest in a partnership. For purposes of the preceding sentence, if a controlled foreign corporation is a shareholder or partner of a corporation or partnership, the controlled foreign corporation shall be treated as owning directly its proportionate share of any such capital or profits interest held directly or indirectly by such corporation or partnership. If a controlled foreign corporation is treated as owning a capital or profits interest in a partnership under constructive ownership rules similar to the rules of section 958(b), the controlled foreign corporation shall be treated as owning such interest directly for purposes of this subparagraph.

(5) DEFINITION AND SPECIAL RULES RELATING TO COMMODITY TRANSACTIONS.—

(A) COMMODITY HEDGING TRANSACTIONS.—For purposes of paragraph (1)(C)(i), the term “commodity hedging transaction” means any transaction with respect to a commodity if such transaction—

(i) is a hedging transaction as defined in section 1221(b)(2), determined—

(I) without regard to subparagraph (A)(ii) thereof,

(II) by applying subparagraph (A)(i) thereof by substituting “ordinary property or property described in section 1231(b)” for “ordinary property”, and

(III) by substituting “controlled foreign corporation” for “taxpayer” each place it appears, and

(ii) is clearly identified as such in accordance with section 1221(a)(7).

(B) TREATMENT OF DEALER ACTIVITIES UNDER PARAGRAPH (1)(C).—Commodities with respect to which gains and losses are not taken into account under paragraph (2)(C) in computing a controlled foreign corporation’s foreign personal holding company income shall not be taken into account in applying the substantially all test under paragraph (1)(C)(ii) to such corporation.

(C) REGULATIONS.—The Secretary shall prescribe such regulations as are appropriate to carry out the purposes of paragraph (1)(C) in the case of transactions involving related parties.

(6) LOOK-THRU RULE FOR RELATED CONTROLLED FOREIGN CORPORATIONS.—

(A) IN GENERAL.—For purposes of this subsection, dividends, interest, rents, and royalties received or accrued from a controlled foreign corporation which is a related person shall not be treated as foreign personal holding company income to the extent attributable or properly allo-

cable (determined under rules similar to the rules of subparagraphs (C) and (D) of section 904(d)(3)) to income of the related person which is neither subpart F income nor income treated as effectively connected with the conduct of a trade or business in the United States. For purposes of this subparagraph, interest shall include factoring income which is treated as income equivalent to interest for purposes of paragraph (1)(E). The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this paragraph, including such regulations as may be necessary or appropriate to prevent the abuse of the purposes of this paragraph.

(B) EXCEPTION.—Subparagraph (A) shall not apply in the case of any interest, rent, or royalty to the extent such interest, rent, or royalty creates (or increases) a deficit which under section 952(c) may reduce the subpart F income of the payor or another controlled foreign corporation.

(C) APPLICATION.—Subparagraph (A) shall apply to taxable years of foreign corporations beginning after December 31, 2005, and before January 1, 2015, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

(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.

For purposes of this subsection, personal property does not include agricultural commodities which are not grown in the United States in commercially marketable quantities.

(2) CERTAIN BRANCH INCOME.—For purposes of determining foreign base company sales income 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, under regulations prescribed by the Secretary 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, corporation, partnership, trust, or estate which controls, or is controlled by, the controlled foreign corporation, or

(B) such person is a corporation, partnership, trust, or estate which is controlled by the same person or persons which control the controlled foreign corporation.

For purposes of the preceding sentence, control means, with respect to a corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total voting power of all classes of stock entitled to vote or of the total value of stock of such corporation. In the case of a partnership, trust, or estate, control means the ownership, directly or indirectly, of more than 50 percent (by value) of the beneficial interests in such partnership, trust, or estate. For purposes of this paragraph, rules similar to the rules of section 958 shall apply.

(4) SPECIAL RULE FOR CERTAIN TIMBER PRODUCTS.—For purposes of subsection (a)(2), the term “foreign base company sales income” includes any income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with—

(A) the sale of any unprocessed timber referred to in section 865(b), or

(B) the milling of any such timber outside the United States.

Subpart G shall not apply to any amount treated as subpart F income by reason of this paragraph.

(e) FOREIGN BASE COMPANY SERVICES INCOME.—

(1) IN GENERAL.—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 technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which—

(A) are performed for or on behalf of any related person (within the meaning of subsection (d)(3)), and

(B) are performed outside the country under the laws of which the controlled foreign corporation is created or organized.

(2) EXCEPTION.—Paragraph (1) shall not apply to income derived in connection with the performance of services which are directly related to—

(A) the sale or exchange by the controlled foreign corporation of property manufactured, produced, grown, or extracted by it and which are performed before the time of the sale or exchange, or

(B) an offer or effort to sell or exchange such property.

Paragraph (1) shall also not apply to income which is exempt insurance income (as defined in section 953(e)) or which is not

treated as foreign personal holding income by reason of subsection (c)(2)(C)(ii), (h), or (i).

(g) FOREIGN BASE COMPANY OIL RELATED INCOME.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the term “foreign base company oil related income” means foreign oil related income (within the meaning of paragraphs (2) and (3) of section 907(c)) other than income derived from a source within a foreign country in connection with—

(A) oil or gas which was extracted from an oil or gas well located in such foreign country, or

(B) oil, gas, or a primary product of oil or gas which is sold by the foreign corporation or a related person for use or consumption within such country or is loaded in such country on a vessel or aircraft as fuel for such vessel or aircraft.

Such term shall not include any foreign personal holding company income (as defined in subsection (c)).

(2) PARAGRAPH (1) APPLIES ONLY WHERE CORPORATION HAS PRODUCED 1,000 BARRELS PER DAY OR MORE.—

(A) IN GENERAL.—The term “foreign base company oil related income” shall not include any income of a foreign corporation if such corporation is not a large oil producer for the taxable year.

(B) LARGE OIL PRODUCER.—For purposes of subparagraph (A), the term “large oil producer” means any corporation if, for the taxable year or for the preceding taxable year, the average daily production of foreign crude oil and natural gas of the related group which includes such corporation equaled or exceeded 1,000 barrels.

(C) RELATED GROUP.—The term “related group” means a group consisting of the foreign corporation and any other person who is a related person with respect to such corporation.

(D) AVERAGE DAILY PRODUCTION OF FOREIGN CRUDE OIL AND NATURAL GAS.—For purposes of this paragraph, the average daily production of foreign crude oil or natural gas of any related group for any taxable year (and the conversion of cubic feet of natural gas into barrels) shall be determined under rules similar to the rules of section 613A except that only crude oil or natural gas from a well located outside the United States shall be taken into account.

(h) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF BANKING, FINANCING, OR SIMILAR BUSINESSES.—

(1) IN GENERAL.—For purposes of subsection (c)(1), foreign personal holding company income shall not include qualified banking or financing income of an eligible controlled foreign corporation.

(2) ELIGIBLE CONTROLLED FOREIGN CORPORATION.—For purposes of this subsection—

(A) IN GENERAL.—The term “eligible controlled foreign corporation” means a controlled foreign corporation which—

(i) is predominantly engaged in the active conduct of a banking, financing, or similar business, and

(ii) conducts substantial activity with respect to such business.

(B) PREDOMINANTLY ENGAGED.—A controlled foreign corporation shall be treated as predominantly engaged in the active conduct of a banking, financing, or similar business if—

(i) more than 70 percent of the gross income of the controlled foreign corporation is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons,

(ii) it is engaged in the active conduct of a banking business and is an institution licensed to do business as a bank in the United States (or is any other corporation not so licensed which is specified by the Secretary in regulations), or

(iii) it is engaged in the active conduct of a securities business and is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934 or is registered as a Government securities broker or dealer under section 15C(a) of such Act (or is any other corporation not so registered which is specified by the Secretary in regulations).

(3) QUALIFIED BANKING OR FINANCING INCOME.—For purposes of this subsection—

(A) IN GENERAL.—The term “qualified banking or financing income” means income of an eligible controlled foreign corporation which—

(i) is derived in the active conduct of a banking, financing, or similar business by—

(I) such eligible controlled foreign corporation,

or

(II) a qualified business unit of such eligible controlled foreign corporation,

(ii) is derived from one or more transactions—

(I) with customers located in a country other than the United States, and

(II) substantially all of the activities in connection with which are conducted directly by the corporation or unit in its home country, and

(iii) is treated as earned by such corporation or unit in its home country for purposes of such country’s tax laws.

(B) LIMITATION ON NONBANKING AND NONSECURITIES BUSINESSES.—No income of an eligible controlled foreign corporation not described in clause (ii) or (iii) of paragraph (2)(B) (or of a qualified business unit of such corporation) shall be treated as qualified banking or financing income unless more than 30 percent of such corporation’s or unit’s gross income is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons and which are located within such corporation’s or unit’s home country.

(C) SUBSTANTIAL ACTIVITY REQUIREMENT FOR CROSS BORDER INCOME.—The term “qualified banking or financing income” shall not include income derived from 1 or more transactions with customers located in a country other than the home country of the eligible controlled foreign corporation or a qualified business unit of such corporation unless such corporation or unit conducts substantial activity with respect to a banking, financing, or similar business in its home country.

(D) DETERMINATIONS MADE SEPARATELY.—For purposes of this paragraph, the qualified banking or financing income of an eligible controlled foreign corporation and each qualified business unit of such corporation shall be determined separately for such corporation and each such unit by taking into account—

(i) in the case of the eligible controlled foreign corporation, only items of income, deduction, gain, or loss and activities of such corporation not properly allocable or attributable to any qualified business unit of such corporation, and

(ii) in the case of a qualified business unit, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such unit.

(E) DIRECT CONDUCT OF ACTIVITIES.—For purposes of subparagraph (A)(ii)(II), an activity shall be treated as conducted directly by an eligible controlled foreign corporation or qualified business unit in its home country if the activity is performed by employees of a related person and—

(i) the related person is an eligible controlled foreign corporation the home country of which is the same as the home country of the corporation or unit to which subparagraph (A)(ii)(II) is being applied,

(ii) the activity is performed in the home country of the related person, and

(iii) the related person is compensated on an arm’s-length basis for the performance of the activity by its employees and such compensation is treated as earned by such person in its home country for purposes of the home country’s tax laws.

(4) LENDING OR FINANCE BUSINESS.—For purposes of this subsection, the term “lending or finance business” means the business of—

(A) making loans,

(B) purchasing or discounting accounts receivable, notes, or installment obligations,

(C) engaging in leasing (including entering into leases and purchasing, servicing, and disposing of leases and leased assets),

(D) issuing letters of credit or providing guarantees,

(E) providing charge and credit card services, or

(F) rendering services or making facilities available in connection with activities described in subparagraphs (A) through (E) carried on by—

(i) the corporation (or qualified business unit) rendering services or making facilities available, or

- (ii) another corporation (or qualified business unit of a corporation) which is a member of the same affiliated group (as defined in section 1504, but determined without regard to section 1504(b)(3)).
- (5) OTHER DEFINITIONS.—For purposes of this subsection—
- (A) CUSTOMER.—The term “customer” means, with respect to any controlled foreign corporation or qualified business unit, any person which has a customer relationship with such corporation or unit and which is acting in its capacity as such.
 - (B) HOME COUNTRY.—Except as provided in regulations—
 - (i) CONTROLLED FOREIGN CORPORATION.—The term “home country” means, with respect to any controlled foreign corporation, the country under the laws of which the corporation was created or organized.
 - (ii) QUALIFIED BUSINESS UNIT.—The term “home country” means, with respect to any qualified business unit, the country in which such unit maintains its principal office.
 - (C) LOCATED.—The determination of where a customer is located shall be made under rules prescribed by the Secretary.
 - (D) QUALIFIED BUSINESS UNIT.—The term “qualified business unit” has the meaning given such term by section 989(a).
 - (E) RELATED PERSON.—The term “related person” has the meaning given such term by subsection (d)(3).
- (6) COORDINATION WITH EXCEPTION FOR DEALERS.—Paragraph (1) shall not apply to income described in subsection (c)(2)(C)(ii) of a dealer in securities (within the meaning of section 475) which is an eligible controlled foreign corporation described in paragraph (2)(B)(iii).
- (7) ANTI-ABUSE RULES.—For purposes of applying this subsection and subsection (c)(2)(C)(i)—
- (A) there shall be disregarded any item of income, gain, loss, or deduction with respect to any transaction or series of transactions one of the principal purposes of which is qualifying income or gain for the exclusion under this section, including any transaction or series of transactions a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of such exclusion through the application of this subsection,
 - (B) there shall be disregarded any item of income, gain, loss, or deduction of an entity which is not engaged in regular and continuous transactions with customers which are not related persons,
 - (C) there shall be disregarded any item of income, gain, loss, or deduction with respect to any transaction or series of transactions utilizing, or doing business with—
 - (i) one or more entities in order to satisfy any home country requirement under this subsection, or
 - (ii) a special purpose entity or arrangement, including a securitization, financing, or similar entity or arrangement,

if one of the principal purposes of such transaction or series of transactions is qualifying income or gain for the exclusion under this subsection, and

(D) a related person, an officer, a director, or an employee with respect to any controlled foreign corporation (or qualified business unit) which would otherwise be treated as a customer of such corporation or unit with respect to any transaction shall not be so treated if a principal purpose of such transaction is to satisfy any requirement of this subsection.

(8) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, subsection (c)(1)(B)(i), subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2).

(9) APPLICATION.—This subsection, subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2) shall apply only to taxable years of a foreign corporation beginning after December 31, 1998, and before January 1, 2015, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends.

(i) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF INSURANCE BUSINESS.—

(1) IN GENERAL.—For purposes of subsection (c)(1), foreign personal holding company income shall not include qualified insurance income of a qualifying insurance company.

(2) QUALIFIED INSURANCE INCOME.—The term “qualified insurance income” means income of a qualifying insurance company which is—

(A) received from a person other than a related person (within the meaning of subsection (d)(3)) and derived from the investments made by a qualifying insurance company or a qualifying insurance company branch of its reserves allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in the manner prescribed under paragraph (4)), or

(B) received from a person other than a related person (within the meaning of subsection (d)(3)) and derived from investments made by a qualifying insurance company or a qualifying insurance company branch of an amount of its assets allocable to exempt contracts equal to—

(i) in the case of property, casualty, or health insurance contracts, one-third of its premiums earned on such insurance contracts during the taxable year (as defined in section 832(b)(4)), and

(ii) in the case of life insurance or annuity contracts, 10 percent of the reserves described in subparagraph (A) for such contracts.

(3) PRINCIPLES FOR DETERMINING INSURANCE INCOME.—Except as provided by the Secretary, for purposes of subparagraphs (A) and (B) of paragraph (2)—

(A) in the case of any contract which is a separate account-type contract (including any variable contract not meeting the requirements of section 817), income credited

under such contract shall be allocable only to such contract, and

(B) income not allocable under subparagraph (A) shall be allocated ratably among contracts not described in subparagraph (A).

(4) METHODS FOR DETERMINING UNEARNED PREMIUMS AND RESERVES.—For purposes of paragraph (2)(A)—

(A) PROPERTY AND CASUALTY CONTRACTS.—The unearned premiums and reserves of a qualifying insurance company or a qualifying insurance company branch with respect to property, casualty, or health insurance contracts shall be determined using the same methods and interest rates which would be used if such company or branch were subject to tax under subchapter L, except that—

(i) the interest rate determined for the functional currency of the company or branch, and which, except as provided by the Secretary, is calculated in the same manner as the Federal mid-term rate under section 1274(d), shall be substituted for the applicable Federal interest rate, and

(ii) such company or branch shall use the appropriate foreign loss payment pattern.

(B) LIFE INSURANCE AND ANNUITY CONTRACTS.—

(i) IN GENERAL.—Except as provided in clause (ii), the amount of the reserve of a qualifying insurance company or qualifying insurance company branch for any life insurance or annuity contract shall be equal to the greater of—

(I) the net surrender value of such contract (as defined in section 807(e)(1)(A)), or

(II) the reserve determined under paragraph (5).

(ii) RULING REQUEST, ETC.—The amount of the reserve under clause (i) shall be the foreign statement reserve for the contract (less any catastrophe, deficiency, equalization, or similar reserves), if, pursuant to a ruling request submitted by the taxpayer or as provided in published guidance, the Secretary determines that the factors taken into account in determining the foreign statement reserve provide an appropriate means of measuring income.

(C) LIMITATION ON RESERVES.—In no event shall the reserve determined under this paragraph for any contract as of any time exceed the amount which would be taken into account with respect to such contract as of such time in determining foreign statement reserves (less any catastrophe, deficiency, equalization, or similar reserves).

(5) AMOUNT OF RESERVE.—The amount of the reserve determined under this paragraph with respect to any contract shall be determined in the same manner as it would be determined if the qualifying insurance company or qualifying insurance company branch were subject to tax under subchapter L, except that in applying such subchapter—

(A) the interest rate determined for the functional currency of the company or branch, and which, except as provided by the Secretary, is calculated in the same manner

as the Federal mid-term rate under section 1274(d), shall be substituted for the applicable Federal interest rate,

(B) the highest assumed interest rate permitted to be used in determining foreign statement reserves shall be substituted for the prevailing State assumed interest rate, and

(C) tables for mortality and morbidity which reasonably reflect the current mortality and morbidity risks in the company's or branch's home country shall be substituted for the mortality and morbidity tables otherwise used for such subchapter.

The Secretary may provide that the interest rate and mortality and morbidity tables of a qualifying insurance company may be used for 1 or more of its qualifying insurance company branches when appropriate.

(6) DEFINITIONS.—For purposes of this subsection, any term used in this subsection which is also used in section 953(e) shall have the meaning given such term by section 953.

* * * * *

B. CHANGES IN EXISTING LAW PROPOSED BY THE BILL, AS REPORTED

In compliance with clause 3(e)(1)(A) of rule XIII of the Rules of the House of Representatives, the text of each section proposed to be amended or repealed by the bill, as reported, is shown below:

CHANGES IN EXISTING LAW PROPOSED BY THE BILL, AS REPORTED

In compliance with clause 3(e)(1)(B) of rule XIII of the Rules of the House of Representatives, changes in existing law proposed by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

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Subtitle A—Income Taxes

* * * * *

CHAPTER 1—NORMAL TAXES AND SURTAXES

* * * * *

Subchapter N—Tax Based on Income From Sources Within or Without the United States

* * * * *

PART III—INCOME FROM SOURCES WITHOUT THE UNITED STATES

* * * * *

Subpart F—Controlled Foreign Corporations

* * * * *

SEC. 953. INSURANCE INCOME.

(a) **INSURANCE INCOME.**—

(1) **IN GENERAL.**—For purposes of section 952(a)(1), the term “insurance income” means any income which—

(A) is attributable to the issuing (or reinsuring) of an insurance or annuity contract, and

(B) would (subject to the modifications provided by subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance company.

(2) **EXCEPTION.**—Such term shall not include any exempt insurance income (as defined in subsection (e)).

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

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

(A) The small life insurance company deduction.

(B) Section 805(a)(5) (relating to operations loss deduction).

(C) Section 832(c)(5) (relating to certain capital losses).

(2) The items referred to in—

(A) section 803(a)(1) (relating to gross amount of premiums and other considerations),

(B) section 803(a)(2) (relating to net decrease in reserves),

(C) section 805(a)(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 subsection (a)(1).

(3) Reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i).

(4) All items of income, expenses, losses, and deductions shall be properly allocated or apportioned under regulations prescribed by the Secretary.

(c) **SPECIAL RULE FOR CERTAIN CAPTIVE INSURANCE COMPANIES.**—

(1) **IN GENERAL.**—For purposes only of taking into account related person insurance income—

(A) the term “United States shareholder” means, with respect to any foreign corporation, a United States person (as defined in section 957(c)) who owns (within the meaning of section 958(a)) any stock of the foreign corporation,

(B) the term “controlled foreign corporation” has the meaning given to such term by section 957(a) determined by substituting “25 percent or more” for “more than 50 percent”, and

(C) the pro rata share referred to in section 951(a)(1)(A)(i) shall be determined under paragraph (5) of this subsection.

(2) **RELATED PERSON INSURANCE INCOME.**—For purposes of this subsection, the term “related person insurance income”

means any insurance income (within the meaning of subsection (a)) attributable to a policy of insurance or reinsurance with respect to which the person (directly or indirectly) insured is a United States shareholder in the foreign corporation or a related person to such a shareholder.

(3) EXCEPTIONS.—

(A) CORPORATIONS NOT HELD BY INSURED.—Paragraph (1) shall not apply to any foreign corporation if at all times during the taxable year of such foreign corporation—

(i) less than 20 percent of the total combined voting power of all classes of stock of such corporation entitled to vote, and

(ii) less than 20 percent of the total value of such corporation,

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

(B) DE MINIMIS EXCEPTION.—Paragraph (1) shall not apply to any foreign corporation for a taxable year of such corporation if the related person insurance income (determined on a gross basis) of such corporation for such taxable year is less than 20 percent of its insurance income (as so determined) for such taxable year determined without regard to those provisions of subsection (a)(1) which limit insurance income to income from countries other than the country in which the corporation was created or organized.

(C) ELECTION TO TREAT INCOME AS EFFECTIVELY CONNECTED.—Paragraph (1) shall not apply to any foreign corporation for any taxable year if—

(i) such corporation elects (at such time and in such manner as the Secretary may prescribe)—

(I) to treat its related person insurance income for such taxable year as income effectively connected with the conduct of a trade or business in the United States, and

(II) to waive all benefits (other than with respect to section 884) with respect to related person insurance income granted by the United States under any treaty between the United States and any foreign country, and

(ii) such corporation meets such requirements as the Secretary shall prescribe to ensure that the tax imposed by this chapter on such income is paid.

An election under this subparagraph made for any taxable year shall not be effective if the corporation (or any predecessor thereof) was a disqualified corporation for the taxable year for which the election was made or for any prior taxable year beginning after 1986.

(D) Special rules for subparagraph (C)

(i) PERIOD DURING WHICH ELECTION IN EFFECT.—

(I) IN GENERAL.—Except as provided in subclause (II), any election under subparagraph (C)

shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(II) TERMINATION.—If a foreign corporation which made an election under subparagraph (C) for any taxable year is a disqualified corporation for any subsequent taxable year, such election shall not apply to any taxable year beginning after such subsequent taxable year.

(ii) EXEMPTION FROM TAX IMPOSED BY SECTION 4371.—The tax imposed by section 4371 shall not apply with respect to any related person insurance income treated as effectively connected with the conduct of a trade or business within the United States under subparagraph (C).

(E) DISQUALIFIED CORPORATION.—For purposes of this paragraph the term “disqualified corporation” means, with respect to any taxable year, any foreign corporation which is a controlled foreign corporation for an uninterrupted period of 30 days or more during such taxable year (determined without regard to this subsection) but only if a United States shareholder (determined without regard to this subsection) owns (within the meaning of section 958(a)) stock in such corporation at some time during such taxable year.

(4) TREATMENT OF MUTUAL INSURANCE COMPANIES.—In the case of a mutual insurance company—

(A) this subsection shall apply,

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

(C) appropriate adjustments in the application of this subpart shall be made under regulations prescribed by the Secretary.

(5) DETERMINATION OF PRO RATA SHARE.—

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

(i) the amount which would be determined under paragraph (2) of section 951(a) if—

(I) only related person insurance income were taken into account,

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

(III) only distributions received by United States shareholders were taken into account under subparagraph (B) of such paragraph (2), or

(ii) the amount which would be determined under paragraph (2) of section 951(a) if the entire earnings and profits of the foreign corporation for the taxable year were subpart F income.

(B) COORDINATION WITH OTHER PROVISIONS.—The Secretary shall prescribe regulations providing for such modi-

fications to the provisions of this subpart as may be necessary or appropriate by reason of subparagraph (A).

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

(A) IN GENERAL.—Except as provided in subparagraph (B), the term “related person” has the meaning given such term by section 954(d)(3).

(B) TREATMENT OF CERTAIN LIABILITY INSURANCE POLICIES.—In the case of any policy of insurance covering liability arising from services performed as a director, officer, or employee of a corporation or as a partner or employee of a partnership, the person performing such services and the entity for which such services are performed shall be treated as related persons.

(7) COORDINATION WITH SECTION 1248.—For purposes of section 1248, if any person is (or would be but for paragraph (3)) treated under paragraph (1) as a United States shareholder with respect to any foreign corporation which would be taxed under subchapter L if it were a domestic corporation and which is (or would be but for paragraph (3)) treated under paragraph (1) as a controlled foreign corporation—

(A) such person shall be treated as meeting the stock ownership requirements of section 1248(a)(2) with respect to such foreign corporation, and

(B) such foreign corporation shall be treated as a controlled foreign corporation.

(8) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including—

(A) regulations preventing the avoidance of this subsection through cross insurance arrangements or otherwise, and

(B) regulations which may provide that a person will not be treated as a United States shareholder under paragraph (1) with respect to any foreign corporation if neither such person (nor any related person to such person) is (directly or indirectly) insured under any policy of insurance or reinsurance issued by such foreign corporation.

(d) ELECTION BY FOREIGN INSURANCE COMPANY TO BE TREATED AS DOMESTIC CORPORATION.—

(1) IN GENERAL.—If—

(A) a foreign corporation is a controlled foreign corporation (as defined in section 957(a) by substituting “25 percent or more” for “more than 50 percent” and by using the definition of United States shareholder under 953(c)(1)(A)),

(B) such foreign corporation would qualify under part I or II of subchapter L for the taxable year if it were a domestic corporation,

(C) such foreign corporation meets such requirements as the Secretary shall prescribe to ensure that the taxes imposed by this chapter on such foreign corporation are paid, and

(D) such foreign corporation makes an election to have this paragraph apply and waives all benefits to such corporation granted by the United States under any treaty,

for purposes of this title, such corporation shall be treated as a domestic corporation.

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

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

(B) TERMINATION.—If a corporation which made an election under paragraph (1) for any taxable year fails to meet the requirements of subparagraphs (A), (B), and (C), of paragraph (1) for any subsequent taxable year, such election shall not apply to any taxable year beginning after such subsequent taxable year.

(3) TREATMENT OF LOSSES.—If any corporation treated as a domestic corporation under this subsection is treated as a member of an affiliated group for purposes of chapter 6 (relating to consolidated returns), any loss of such corporation shall be treated as a dual consolidated loss for purposes of section 1503(d) without regard to paragraph (2)(B) thereof.

(4) EFFECT OF ELECTION.—

(A) IN GENERAL.—For purposes of section 367, any foreign corporation making an election under paragraph (1) shall be treated as transferring (as of the 1st day of the 1st taxable year to which such election applies) all of its assets to a domestic corporation in connection with an exchange to which section 354 applies.

(B) EXCEPTION FOR PRE-1988 EARNINGS AND PROFIT.—

(i) IN GENERAL.—Earnings and profits of the foreign corporation accumulated in taxable years beginning before January 1, 1988, shall not be included in the gross income of the persons holding stock in such corporation by reason of subparagraph (A).

(ii) TREATMENT OF DISTRIBUTIONS.—For purposes of this title, any distribution made by a corporation to which an election under paragraph (1) applies out of earnings and profits accumulated in taxable years beginning before January 1, 1988, shall be treated as a distribution made by a foreign corporation.

(iii) CERTAIN RULES TO CONTINUE TO APPLY TO PRE-1988 EARNINGS.—The provisions specified in clause (iv) shall be applied without regard to paragraph (1), except that, in the case of a corporation to which an election under paragraph (1) applies, only earnings and profits accumulated in taxable years beginning before January 1, 1988, shall be taken into account.

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

(I) Section 1248 (relating to gain from certain sales or exchanges of stock in certain foreign corporations).

(II) Subpart F of part III of subchapter N to the extent such subpart relates to earnings invested in United States property or amounts referred to in clause (ii) or (iii) of section 951(a)(1)(A).

(III) Section 884 to the extent the foreign corporation reinvested 1987 earnings and profits in United States assets.

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

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

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

such corporation shall be treated as a domestic corporation transferring (as of the 1st day of such subsequent taxable year) all of its property to a foreign corporation in connection with an exchange to which section 354 applies.

(6) ADDITIONAL TAX ON CORPORATION MAKING ELECTION.—

(A) IN GENERAL.—If a corporation makes an election under paragraph (1), the amount of tax imposed by this chapter for the 1st taxable year to which such election applies shall be increased by the amount determined under subparagraph (B).

(B) AMOUNT OF TAX.—The amount of tax determined under this paragraph shall be equal to the lesser of—

(i) $\frac{3}{4}$ of 1 percent of the aggregate amount of capital and accumulated surplus of the corporation as of December 31, 1987, or

(ii) \$1,500,000.

(e) EXEMPT INSURANCE INCOME.—For purposes of this section—

(1) EXEMPT INSURANCE INCOME DEFINED.—

(A) IN GENERAL.—The term “exempt insurance income” means income derived by a qualifying insurance company which—

(i) is attributable to the issuing (or reinsuring) of an exempt contract by such company or a qualifying insurance company branch of such company, and

(ii) is treated as earned by such company or branch in its home country for purposes of such country’s tax laws.

(B) EXCEPTION FOR CERTAIN ARRANGEMENTS.—Such term shall not include income attributable to the issuing (or reinsuring) of an exempt contract as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of issuing (or reinsuring) a contract which is not an exempt contract.

(C) DETERMINATIONS MADE SEPARATELY.—For purposes of this subsection and section 954(i), the exempt insurance income and exempt contracts of a qualifying insurance company or any qualifying insurance company branch of such company shall be determined separately for such company and each such branch by taking into account—

(i) in the case of the qualifying insurance company, only items of income, deduction, gain, or loss, and activities of such company not properly allocable or attributable to any qualifying insurance company branch of such company, and

(ii) in the case of a qualifying insurance company branch, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such branch.

(2) EXEMPT CONTRACT.—

(A) IN GENERAL.—The term “exempt contract” means an insurance or annuity contract issued or reinsured by a qualifying insurance company or qualifying insurance company branch in connection with property in, liability arising out of activity in, or the lives or health of residents of, a country other than the United States.

(B) MINIMUM HOME COUNTRY INCOME REQUIRED.—

(i) IN GENERAL.—No contract of a qualifying insurance company or of a qualifying insurance company branch shall be treated as an exempt contract unless such company or branch derives more than 30 percent of its net written premiums from exempt contracts (determined without regard to this subparagraph)—

(I) which cover applicable home country risks, and

(II) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)).

(ii) APPLICABLE HOME COUNTRY RISKS.—The term “applicable home country risks” means risks in connection with property in, liability arising out of activity in, or the lives or health of residents of, the home country of the qualifying insurance company or qualifying insurance company branch, as the case may be, issuing or reinsuring the contract covering the risks.

(C) SUBSTANTIAL ACTIVITY REQUIREMENTS FOR CROSS BORDER RISKS.—A contract issued by a qualifying insurance company or qualifying insurance company branch which covers risks other than applicable home country risks (as defined in subparagraph (B)(ii)) shall not be treated as an exempt contract unless such company or branch, as the case may be—

(i) conducts substantial activity with respect to an insurance business in its home country, and

(ii) performs in its home country substantially all of the activities necessary to give rise to the income generated by such contract.

(3) QUALIFYING INSURANCE COMPANY.—The term “qualifying insurance company” means any controlled foreign corporation which—

(A) is subject to regulation as an insurance (or reinsurance) company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country,

(B) derives more than 50 percent of its aggregate net written premiums from the issuance or reinsurance by

such controlled foreign corporation and each of its qualifying insurance company branches of contracts—

(i) covering applicable home country risks (as defined in paragraph (2)) of such corporation or branch, as the case may be, and

(ii) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)),

except that in the case of a branch, such premiums shall only be taken into account to the extent such premiums are treated as earned by such branch in its home country for purposes of such country's tax laws, and

(C) is engaged in the insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

(4) **QUALIFYING INSURANCE COMPANY BRANCH.**—The term “qualifying insurance company branch” means a qualified business unit (within the meaning of section 989(a)) of a controlled foreign corporation if—

(A) such unit is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country, and

(B) such controlled foreign corporation is a qualifying insurance company, determined under paragraph (3) as if such unit were a qualifying insurance company branch.

(5) **LIFE INSURANCE OR ANNUITY CONTRACT.**—For purposes of this section and section 954, the determination of whether a contract issued by a controlled foreign corporation or a qualified business unit (within the meaning of section 989(a)) is a life insurance contract or an annuity contract shall be made without regard to sections 72(s), 101(f), 817(h), and 7702 if—

(A) such contract is regulated as a life insurance or annuity contract by the corporation's or unit's home country, and

(B) no policyholder, insured, annuitant, or beneficiary with respect to the contract is a United States person.

(6) **HOME COUNTRY.**—For purposes of this subsection, except as provided in regulations—

(A) **CONTROLLED FOREIGN CORPORATION.**—The term “home country” means, with respect to a controlled foreign corporation, the country in which such corporation is created or organized.

(B) **QUALIFIED BUSINESS UNIT.**—The term “home country” means, with respect to a qualified business unit (as defined in section 989(a)), the country in which the principal office of such unit is located and in which such unit is licensed, authorized, or regulated by the applicable insurance regulatory body to sell insurance, reinsurance, or annuity contracts to persons other than related persons (as defined in section 954(d)(3)) in such country.

(7) **ANTI-ABUSE RULES.**—For purposes of applying this subsection and section 954(i)—

(A) the rules of section 954(h)(7) (other than subparagraph (B) thereof) shall apply,

(B) there shall be disregarded any item of income, gain, loss, or deduction of, or derived from, an entity which is not engaged in regular and continuous transactions with persons which are not related persons,

(C) there shall be disregarded any change in the method of computing reserves a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of this subsection or section 954(i),

(D) a contract of insurance or reinsurance shall not be treated as an exempt contract (and premiums from such contract shall not be taken into account for purposes of paragraph (2)(B) or (3)) if—

(i) any policyholder, insured, annuitant, or beneficiary is a resident of the United States and such contract was marketed to such resident and was written to cover a risk outside the United States, or

(ii) the contract covers risks located within and without the United States and the qualifying insurance company or qualifying insurance company branch does not maintain such contemporaneous records, and file such reports, with respect to such contract as the Secretary may require,

(E) the Secretary may prescribe rules for the allocation of contracts (and income from contracts) among 2 or more qualifying insurance company branches of a qualifying insurance company in order to clearly reflect the income of such branches, and

(F) premiums from a contract shall not be taken into account for purposes of paragraph (2)(B) or (3) if such contract reinsures a contract issued or reinsured by a related person (as defined in section 954(d)(3)). For purposes of subparagraph (D), the determination of where risks are located shall be made under the principles of section 953.

(8) COORDINATION WITH SUBSECTION (C).—In determining insurance income for purposes of subsection (c), exempt insurance income shall not include income derived from exempt contracts which cover risks other than applicable home country risks.

(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and section 954(i).

[(10) APPLICATION.—This subsection and section 954(i) shall apply only to taxable years of a foreign corporation beginning after December 31, 1998, and before January 1, 2015, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends. If this subsection does not apply to a taxable year of a foreign corporation beginning after December 31, 2014 (and taxable years of United States shareholders ending with or within such taxable year), then, notwithstanding the preceding sentence, subsection (a) shall be applied to such taxable years in the same manner as it would if the taxable year of the foreign corporation began in 1998.]

[(11)] (10) CROSS REFERENCE.—For income exempt from foreign personal holding company income, see section 954(i).

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)),

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

(5) the foreign base company oil related income for the taxable year (determined under subsection (g) and reduced as provided in subsection (b)(5)).

(b) EXCLUSION AND SPECIAL RULES.—

(3) DE MINIMIS, ETC., RULES.—For purposes of subsection (a) and section 953—

(A) DE MINIMIS RULE.—If the sum of foreign base company income (determined without regard to paragraph (5)) and the gross insurance income for the taxable year is less than the lesser of—

(i) 5 percent of gross income, or

(ii) \$1,000,000, no part of the gross income for the taxable year shall be treated as foreign base company income or insurance income.

(B) FOREIGN BASE COMPANY INCOME AND INSURANCE INCOME IN EXCESS OF 70 PERCENT OF GROSS INCOME.—If the sum of the foreign base company income (determined without regard to paragraph (5)) and the gross insurance income for the taxable year exceeds 70 percent of gross income, the entire gross income for the taxable year shall, subject to the provisions of paragraphs (4) and (5), be treated as foreign base company income or insurance income (whichever is appropriate).

(C) GROSS INSURANCE INCOME.—For purposes of subparagraphs (A) and (B), the term “gross insurance income” means any item of gross income taken into account in determining insurance income under section 953.

(4) EXCEPTION FOR CERTAIN INCOME SUBJECT TO HIGH FOREIGN TAXES.—For purposes of subsection (a) and section 953, foreign base company income and insurance income shall not include any item of income received by a controlled foreign corporation if the taxpayer establishes to the satisfaction of the Secretary that such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in section 11. The preceding sentence shall not apply to foreign base company oil-related income described in subsection (a)(5).

(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 the foreign base company oil related income shall be reduced, under regulations prescribed by the Secretary so as to take into account deductions (including taxes) properly allocable to such income. Except to the extent provided in regulations prescribed by the Secretary, any interest which is paid or accrued by the controlled foreign corporation to any United States shareholder in such corporation (or any controlled foreign corporation related to such a shareholder) shall be allocated first to foreign personal holding company income which is passive income (within the meaning of section 904(d)(2)) of such corporation to the extent thereof. The Secretary may, by regulations, provide that the preceding sentence shall apply also to interest paid or accrued to other persons.

(6) FOREIGN BASE COMPANY OIL RELATED INCOME NOT TREATED AS ANOTHER KIND OF BASE COMPANY INCOME.—Income of a corporation which is foreign base company oil related income shall not be considered foreign base company income of such corporation under paragraph (2), or (3) of subsection (a).

(c) FOREIGN PERSONAL HOLDING COMPANY INCOME.—

(1) IN GENERAL.—For purposes of subsection (a)(1), the term “foreign personal holding company income” means the portion of the gross income which consists of:

(A) DIVIDENDS, ETC.—Dividends, interest, royalties, rents, and annuities.

(B) CERTAIN PROPERTY TRANSACTIONS.—The excess of gains over losses from the sale or exchange of property—

(i) which gives rise to income described in subparagraph (A) (after application of paragraph (2)(A)) other than property which gives rise to income not treated as foreign personal holding company income by reason of subsection (h) or (i) for the taxable year,

(ii) which is an interest in a trust, partnership, or REMIC, or

(iii) which does not give rise to any income.

Gains and losses from the sale or exchange of any property which, in the hands of the controlled foreign corporation, is property described in section 1221(a)(1) shall not be taken into account under this subparagraph.

(C) COMMODITIES TRANSACTIONS.—The excess of gains over losses from transactions (including futures, forward, and similar transactions) in any commodities. This subparagraph shall not apply to gains or losses which—

(i) arise out of commodity hedging transactions (as defined in paragraph (5)(A)),

(ii) are active business gains or losses from the sale of commodities, but only if substantially all of the controlled foreign corporation’s commodities are property described in paragraph (1), (2), or (8) of section 1221(a), or

(iii) are foreign currency gains or losses (as defined in section 988(b)) attributable to any section 988 transactions.

(D) FOREIGN CURRENCY GAINS.—The excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to any section 988 transactions. This subparagraph shall not apply in the case of any transaction directly related to the business needs of the controlled foreign corporation.

(E) INCOME EQUIVALENT TO INTEREST.—Any income equivalent to interest, including income from commitment fees (or similar amounts) for loans actually made.

(F) INCOME FROM NOTIONAL PRINCIPAL CONTRACTS.—

(i) IN GENERAL.—Net income from notional principal contracts.

(ii) COORDINATION WITH OTHER CATEGORIES OF FOREIGN PERSONAL HOLDING COMPANY INCOME.—Any item of income, gain, deduction, or loss from a notional principal contract entered into for purposes of hedging any item described in any preceding subparagraph shall not be taken into account for purposes of this subparagraph but shall be taken into account under such other subparagraph.

(G) PAYMENTS IN LIEU OF DIVIDENDS.—Payments in lieu of dividends which are made pursuant to an agreement to which section 1058 applies.

(H) PERSONAL SERVICE CONTRACTS.—

(i) Amounts received under a contract under which the corporation is to furnish personal services if—

(I) some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or

(II) the individual who is to perform the services is designated (by name or by description) in the contract, and

(ii) amounts received from the sale or other disposition of such a contract.

This subparagraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(2) EXCEPTION FOR CERTAIN AMOUNTS.—

(A) RENTS AND ROYALTIES DERIVED IN ACTIVE BUSINESS.—Foreign personal holding company income shall not include rents and royalties which are derived in the active conduct of a trade or business and which are received from a person other than a related person (within the meaning of subsection (d)(3)). For purposes of the preceding sentence, rents derived from leasing an aircraft or vessel in foreign commerce shall not fail to be treated as derived in the active conduct of a trade or business if, as determined under regulations prescribed by the Secretary, the active

leasing expenses are not less than 10 percent of the profit on the lease.

(B) CERTAIN EXPORT FINANCING.—Foreign personal holding company income shall not include any interest which is derived in the conduct of a banking business and which is export financing interest (as defined in section 904(d)(2)(G)).

(C) EXCEPTION FOR DEALERS.—Except as provided by regulations, in the case of a regular dealer in property which is property described in paragraph (1)(B), forward contracts, option contracts, or similar financial instruments (including notional principal contracts and all instruments referenced to commodities), there shall not be taken into account in computing foreign personal holding company income—

(i) any item of income, gain, deduction, or loss (other than any item described in subparagraph (A), (E), or (G) of paragraph (1)) from any transaction (including hedging transactions and transactions involving physical settlement) entered into in the ordinary course of such dealer's trade or business as such a dealer, and

(ii) if such dealer is a dealer in securities (within the meaning of section 475), any interest or dividend or equivalent amount described in subparagraph (E) or (G) of paragraph (1) from any transaction (including any hedging transaction or transaction described in section 956(c)(2)(I)) entered into in the ordinary course of such dealer's trade or business as such a dealer in securities, but only if the income from the transaction is attributable to activities of the dealer in the country under the laws of which the dealer is created or organized (or in the case of a qualified business unit described in section 989(a), is attributable to activities of the unit in the country in which the unit both maintains its principal office and conducts substantial business activity).

(3) CERTAIN INCOME RECEIVED FROM RELATED PERSONS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term “foreign personal holding company income” does not include—

(i) dividends and interest received from a related person which (I) is a corporation created or 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, and

(ii) rents and royalties received from a corporation which is 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.

To the extent provided in regulations, payments made by a partnership with 1 or more corporate partners shall be

treated as made by such corporate partners in proportion to their respective interests in the partnership.

(B) EXCEPTION NOT TO APPLY TO ITEMS WHICH REDUCE SUBPART F INCOME.—Subparagraph (A) shall not apply in the case of any interest, rent, or royalty to the extent such interest, rent, or royalty reduces the payor's subpart F income or creates (or increases) a deficit which under section 952(c) may reduce the subpart F income of the payor or another controlled foreign corporation.

(C) EXCEPTION FOR CERTAIN DIVIDENDS.—Subparagraph (A)(i) shall not apply to any dividend with respect to any stock which is attributable to earnings and profits of the distributing corporation accumulated during any period during which the person receiving such dividend did not hold such stock either directly, or indirectly through a chain of one or more subsidiaries each of which meets the requirements of subparagraph (A)(i).

(4) LOOK-THRU RULE FOR CERTAIN PARTNERSHIP SALES.—

(A) IN GENERAL.—In the case of any sale by a controlled foreign corporation of an interest in a partnership with respect to which such corporation is a 25-percent owner, such corporation shall be treated for purposes of this subsection as selling the proportionate share of the assets of the partnership attributable to such interest. The Secretary shall prescribe such regulations as may be appropriate to prevent abuse of the purposes of this paragraph, including regulations providing for coordination of this paragraph with the provisions of subchapter K.

(B) 25-PERCENT OWNER.—For purposes of this paragraph, the term “25-percent owner” means a controlled foreign corporation which owns directly 25 percent or more of the capital or profits interest in a partnership. For purposes of the preceding sentence, if a controlled foreign corporation is a shareholder or partner of a corporation or partnership, the controlled foreign corporation shall be treated as owning directly its proportionate share of any such capital or profits interest held directly or indirectly by such corporation or partnership. If a controlled foreign corporation is treated as owning a capital or profits interest in a partnership under constructive ownership rules similar to the rules of section 958(b), the controlled foreign corporation shall be treated as owning such interest directly for purposes of this subparagraph.

(5) DEFINITION AND SPECIAL RULES RELATING TO COMMODITY TRANSACTIONS.—

(A) COMMODITY HEDGING TRANSACTIONS.—For purposes of paragraph (1)(C)(i), the term “commodity hedging transaction” means any transaction with respect to a commodity if such transaction—

(i) is a hedging transaction as defined in section 1221(b)(2), determined—

(I) without regard to subparagraph (A)(ii) thereof,

(II) by applying subparagraph (A)(i) thereof by substituting “ordinary property or property de-

scribed in section 1231(b)” for “ordinary property”, and

(III) by substituting “controlled foreign corporation” for “taxpayer” each place it appears, and

(ii) is clearly identified as such in accordance with section 1221(a)(7).

(B) TREATMENT OF DEALER ACTIVITIES UNDER PARAGRAPH (1)(C).—Commodities with respect to which gains and losses are not taken into account under paragraph (2)(C) in computing a controlled foreign corporation’s foreign personal holding company income shall not be taken into account in applying the substantially all test under paragraph (1)(C)(ii) to such corporation.

(C) REGULATIONS.—The Secretary shall prescribe such regulations as are appropriate to carry out the purposes of paragraph (1)(C) in the case of transactions involving related parties.

(6) LOOK-THRU RULE FOR RELATED CONTROLLED FOREIGN CORPORATIONS.—

(A) IN GENERAL.—For purposes of this subsection, dividends, interest, rents, and royalties received or accrued from a controlled foreign corporation which is a related person shall not be treated as foreign personal holding company income to the extent attributable or properly allocable (determined under rules similar to the rules of subparagraphs (C) and (D) of section 904(d)(3)) to income of the related person which is neither subpart F income nor income treated as effectively connected with the conduct of a trade or business in the United States. For purposes of this subparagraph, interest shall include factoring income which is treated as income equivalent to interest for purposes of paragraph (1)(E). The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this paragraph, including such regulations as may be necessary or appropriate to prevent the abuse of the purposes of this paragraph.

(B) EXCEPTION.—Subparagraph (A) shall not apply in the case of any interest, rent, or royalty to the extent such interest, rent, or royalty creates (or increases) a deficit which under section 952(c) may reduce the subpart F income of the payor or another controlled foreign corporation.

(C) APPLICATION.—Subparagraph (A) shall apply to taxable years of foreign corporations beginning after December 31, 2005, and before January 1, 2015, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

(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.

For purposes of this subsection, personal property does not include agricultural commodities which are not grown in the United States in commercially marketable quantities.

(2) CERTAIN BRANCH INCOME.—For purposes of determining foreign base company sales income 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, under regulations prescribed by the Secretary 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, corporation, partnership, trust, or estate which controls, or is controlled by, the controlled foreign corporation, or

(B) such person is a corporation, partnership, trust, or estate which is controlled by the same person or persons which control the controlled foreign corporation.

For purposes of the preceding sentence, control means, with respect to a corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total voting power of all classes of stock entitled to vote or of the total value of stock of such corporation. In the case of a partnership, trust, or estate, control means the ownership, directly or indirectly, of more than 50 percent (by value) of the beneficial interests in such partnership, trust, or estate. For purposes of this paragraph, rules similar to the rules of section 958 shall apply.

(4) SPECIAL RULE FOR CERTAIN TIMBER PRODUCTS.—For purposes of subsection (a)(2), the term “foreign base company sales income” includes any income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with—

(A) the sale of any unprocessed timber referred to in section 865(b), or

(B) the milling of any such timber outside the United States.

Subpart G shall not apply to any amount treated as subpart F income by reason of this paragraph.

(e) FOREIGN BASE COMPANY SERVICES INCOME.—

(1) IN GENERAL.—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 technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which—

(A) are performed for or on behalf of any related person (within the meaning of subsection (d)(3)), and

(B) are performed outside the country under the laws of which the controlled foreign corporation is created or organized.

(2) EXCEPTION.—Paragraph (1) shall not apply to income derived in connection with the performance of services which are directly related to—

(A) the sale or exchange by the controlled foreign corporation of property manufactured, produced, grown, or extracted by it and which are performed before the time of the sale or exchange, or

(B) an offer or effort to sell or exchange such property. Paragraph (1) shall also not apply to income which is exempt insurance income (as defined in section 953(e)) or which is not treated as foreign personal holding income by reason of subsection (c)(2)(C)(ii), (h), or (i).

(g) FOREIGN BASE COMPANY OIL RELATED INCOME.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the term “foreign base company oil related income” means foreign oil related income (within the meaning of paragraphs (2) and (3) of section 907(c)) other than income derived from a source within a foreign country in connection with—

(A) oil or gas which was extracted from an oil or gas well located in such foreign country, or

(B) oil, gas, or a primary product of oil or gas which is sold by the foreign corporation or a related person for use or consumption within such country or is loaded in such country on a vessel or aircraft as fuel for such vessel or aircraft.

Such term shall not include any foreign personal holding company income (as defined in subsection (c)).

(2) PARAGRAPH (1) APPLIES ONLY WHERE CORPORATION HAS PRODUCED 1,000 BARRELS PER DAY OR MORE.—

(A) IN GENERAL.—The term “foreign base company oil related income” shall not include any income of a foreign corporation if such corporation is not a large oil producer for the taxable year.

(B) LARGE OIL PRODUCER.—For purposes of subparagraph (A), the term “large oil producer” means any corporation if, for the taxable year or for the preceding taxable year, the average daily production of foreign crude oil and natural gas of the related group which includes such corporation equaled or exceeded 1,000 barrels.

(C) RELATED GROUP.—The term “related group” means a group consisting of the foreign corporation and any other person who is a related person with respect to such corporation.

(D) AVERAGE DAILY PRODUCTION OF FOREIGN CRUDE OIL AND NATURAL GAS.—For purposes of this paragraph, the average daily production of foreign crude oil or natural gas of any related group for any taxable year (and the conversion of cubic feet of natural gas into barrels) shall be determined under rules similar to the rules of section 613A except that only crude oil or natural gas from a well located outside the United States shall be taken into account.

(h) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF BANKING, FINANCING, OR SIMILAR BUSINESSES.—

(1) IN GENERAL.—For purposes of subsection (c)(1), foreign personal holding company income shall not include qualified banking or financing income of an eligible controlled foreign corporation.

(2) ELIGIBLE CONTROLLED FOREIGN CORPORATION.—For purposes of this subsection—

(A) IN GENERAL.—The term “eligible controlled foreign corporation” means a controlled foreign corporation which—

- (i) is predominantly engaged in the active conduct of a banking, financing, or similar business, and
- (ii) conducts substantial activity with respect to such business.

(B) PREDOMINANTLY ENGAGED.—A controlled foreign corporation shall be treated as predominantly engaged in the active conduct of a banking, financing, or similar business if—

- (i) more than 70 percent of the gross income of the controlled foreign corporation is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons,
- (ii) it is engaged in the active conduct of a banking business and is an institution licensed to do business as a bank in the United States (or is any other corporation not so licensed which is specified by the Secretary in regulations), or
- (iii) it is engaged in the active conduct of a securities business and is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934 or is registered as a Government securities broker or dealer under section 15C(a) of such Act (or is any other corporation not so registered which is specified by the Secretary in regulations).

(3) QUALIFIED BANKING OR FINANCING INCOME.—For purposes of this subsection—

(A) IN GENERAL.—The term “qualified banking or financing income” means income of an eligible controlled foreign corporation which—

- (i) is derived in the active conduct of a banking, financing, or similar business by—

- (I) such eligible controlled foreign corporation,
- or
- (II) a qualified business unit of such eligible controlled foreign corporation,

(ii) is derived from one or more transactions—

- (I) with customers located in a country other than the United States, and

- (II) substantially all of the activities in connection with which are conducted directly by the corporation or unit in its home country, and

(iii) is treated as earned by such corporation or unit in its home country for purposes of such country's tax laws.

(B) LIMITATION ON NONBANKING AND NONSECURITIES BUSINESSES.—No income of an eligible controlled foreign corporation not described in clause (ii) or (iii) of paragraph (2)(B) (or of a qualified business unit of such corporation) shall be treated as qualified banking or financing income unless more than 30 percent of such corporation's or unit's gross income is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons and which are located within such corporation's or unit's home country.

(C) SUBSTANTIAL ACTIVITY REQUIREMENT FOR CROSS BORDER INCOME.—The term “qualified banking or financing income” shall not include income derived from 1 or more transactions with customers located in a country other than the home country of the eligible controlled foreign corporation or a qualified business unit of such corporation unless such corporation or unit conducts substantial activity with respect to a banking, financing, or similar business in its home country.

(D) DETERMINATIONS MADE SEPARATELY.—For purposes of this paragraph, the qualified banking or financing income of an eligible controlled foreign corporation and each qualified business unit of such corporation shall be determined separately for such corporation and each such unit by taking into account—

- (i) in the case of the eligible controlled foreign corporation, only items of income, deduction, gain, or loss and activities of such corporation not properly allocable or attributable to any qualified business unit of such corporation, and

- (ii) in the case of a qualified business unit, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such unit.

(E) DIRECT CONDUCT OF ACTIVITIES.—For purposes of subparagraph (A)(ii)(II), an activity shall be treated as conducted directly by an eligible controlled foreign corporation or qualified business unit in its home country if the activity is performed by employees of a related person and—

- (i) the related person is an eligible controlled foreign corporation the home country of which is the same as

the home country of the corporation or unit to which subparagraph (A)(ii)(II) is being applied,

(ii) the activity is performed in the home country of the related person, and

(iii) the related person is compensated on an arm's-length basis for the performance of the activity by its employees and such compensation is treated as earned by such person in its home country for purposes of the home country's tax laws.

(4) LENDING OR FINANCE BUSINESS.—For purposes of this subsection, the term “lending or finance business” means the business of—

(A) making loans,

(B) purchasing or discounting accounts receivable, notes, or installment obligations,

(C) engaging in leasing (including entering into leases and purchasing, servicing, and disposing of leases and leased assets),

(D) issuing letters of credit or providing guarantees,

(E) providing charge and credit card services, or

(F) rendering services or making facilities available in connection with activities described in subparagraphs (A) through (E) carried on by—

(i) the corporation (or qualified business unit) rendering services or making facilities available, or

(ii) another corporation (or qualified business unit of a corporation) which is a member of the same affiliated group (as defined in section 1504, but determined without regard to section 1504(b)(3)).

(5) OTHER DEFINITIONS.—For purposes of this subsection—

(A) CUSTOMER.—The term “customer” means, with respect to any controlled foreign corporation or qualified business unit, any person which has a customer relationship with such corporation or unit and which is acting in its capacity as such.

(B) HOME COUNTRY.—Except as provided in regulations—

(i) CONTROLLED FOREIGN CORPORATION.—The term “home country” means, with respect to any controlled foreign corporation, the country under the laws of which the corporation was created or organized.

(ii) QUALIFIED BUSINESS UNIT.—The term “home country” means, with respect to any qualified business unit, the country in which such unit maintains its principal office.

(C) LOCATED.—The determination of where a customer is located shall be made under rules prescribed by the Secretary.

(D) QUALIFIED BUSINESS UNIT.—The term “qualified business unit” has the meaning given such term by section 989(a).

(E) RELATED PERSON.—The term “related person” has the meaning given such term by subsection (d)(3).

(6) COORDINATION WITH EXCEPTION FOR DEALERS.—Paragraph (1) shall not apply to income described in subsection

(c)(2)(C)(ii) of a dealer in securities (within the meaning of section 475) which is an eligible controlled foreign corporation described in paragraph (2)(B)(iii).

(7) ANTI-ABUSE RULES.—For purposes of applying this subsection and subsection (c)(2)(C)(i)—

(A) there shall be disregarded any item of income, gain, loss, or deduction with respect to any transaction or series of transactions one of the principal purposes of which is qualifying income or gain for the exclusion under this section, including any transaction or series of transactions a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of such exclusion through the application of this subsection,

(B) there shall be disregarded any item of income, gain, loss, or deduction of an entity which is not engaged in regular and continuous transactions with customers which are not related persons,

(C) there shall be disregarded any item of income, gain, loss, or deduction with respect to any transaction or series of transactions utilizing, or doing business with—

(i) one or more entities in order to satisfy any home country requirement under this subsection, or

(ii) a special purpose entity or arrangement, including a securitization, financing, or similar entity or arrangement,

if one of the principal purposes of such transaction or series of transactions is qualifying income or gain for the exclusion under this subsection, and

(D) a related person, an officer, a director, or an employee with respect to any controlled foreign corporation (or qualified business unit) which would otherwise be treated as a customer of such corporation or unit with respect to any transaction shall not be so treated if a principal purpose of such transaction is to satisfy any requirement of this subsection.

(8) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, subsection (c)(1)(B)(i), subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2).

[(9) APPLICATION.—This subsection, subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2) shall apply only to taxable years of a foreign corporation beginning after December 31, 1998, and before January 1, 2015, and to taxable years of United States shareholders with or within which any such taxable year of such foreign corporation ends.]

(i) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF INSURANCE BUSINESS.—

(1) IN GENERAL.—For purposes of subsection (c)(1), foreign personal holding company income shall not include qualified insurance income of a qualifying insurance company.

(2) QUALIFIED INSURANCE INCOME.—The term “qualified insurance income” means income of a qualifying insurance company which is—

(A) received from a person other than a related person (within the meaning of subsection (d)(3)) and derived from

the investments made by a qualifying insurance company or a qualifying insurance company branch of its reserves allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in the manner prescribed under paragraph (4)), or

(B) received from a person other than a related person (within the meaning of subsection (d)(3)) and derived from investments made by a qualifying insurance company or a qualifying insurance company branch of an amount of its assets allocable to exempt contracts equal to—

(i) in the case of property, casualty, or health insurance contracts, one-third of its premiums earned on such insurance contracts during the taxable year (as defined in section 832(b)(4)), and

(ii) in the case of life insurance or annuity contracts, 10 percent of the reserves described in subparagraph (A) for such contracts.

(3) PRINCIPLES FOR DETERMINING INSURANCE INCOME.—Except as provided by the Secretary, for purposes of subparagraphs (A) and (B) of paragraph (2)—

(A) in the case of any contract which is a separate account-type contract (including any variable contract not meeting the requirements of section 817), income credited under such contract shall be allocable only to such contract, and

(B) income not allocable under subparagraph (A) shall be allocated ratably among contracts not described in subparagraph (A).

(4) METHODS FOR DETERMINING UNEARNED PREMIUMS AND RESERVES.—For purposes of paragraph (2)(A)—

(A) PROPERTY AND CASUALTY CONTRACTS.—The unearned premiums and reserves of a qualifying insurance company or a qualifying insurance company branch with respect to property, casualty, or health insurance contracts shall be determined using the same methods and interest rates which would be used if such company or branch were subject to tax under subchapter L, except that—

(i) the interest rate determined for the functional currency of the company or branch, and which, except as provided by the Secretary, is calculated in the same manner as the Federal mid-term rate under section 1274(d), shall be substituted for the applicable Federal interest rate, and

(ii) such company or branch shall use the appropriate foreign loss payment pattern.

(B) LIFE INSURANCE AND ANNUITY CONTRACTS.—

(i) IN GENERAL.—Except as provided in clause (ii), the amount of the reserve of a qualifying insurance company or qualifying insurance company branch for any life insurance or annuity contract shall be equal to the greater of—

(I) the net surrender value of such contract (as defined in section 807(e)(1)(A)), or

(II) the reserve determined under paragraph (5).

(ii) RULING REQUEST, ETC.—The amount of the reserve under clause (i) shall be the foreign statement reserve for the contract (less any catastrophe, deficiency, equalization, or similar reserves), if, pursuant to a ruling request submitted by the taxpayer or as provided in published guidance, the Secretary determines that the factors taken into account in determining the foreign statement reserve provide an appropriate means of measuring income.

(C) LIMITATION ON RESERVES.—In no event shall the reserve determined under this paragraph for any contract as of any time exceed the amount which would be taken into account with respect to such contract as of such time in determining foreign statement reserves (less any catastrophe, deficiency, equalization, or similar reserves).

(5) AMOUNT OF RESERVE.—The amount of the reserve determined under this paragraph with respect to any contract shall be determined in the same manner as it would be determined if the qualifying insurance company or qualifying insurance company branch were subject to tax under subchapter L, except that in applying such subchapter—

(A) the interest rate determined for the functional currency of the company or branch, and which, except as provided by the Secretary, is calculated in the same manner as the Federal mid-term rate under section 1274(d), shall be substituted for the applicable Federal interest rate,

(B) the highest assumed interest rate permitted to be used in determining foreign statement reserves shall be substituted for the prevailing State assumed interest rate, and

(C) tables for mortality and morbidity which reasonably reflect the current mortality and morbidity risks in the company's or branch's home country shall be substituted for the mortality and morbidity tables otherwise used for such subchapter.

The Secretary may provide that the interest rate and mortality and morbidity tables of a qualifying insurance company may be used for 1 or more of its qualifying insurance company branches when appropriate.

(6) DEFINITIONS.—For purposes of this subsection, any term used in this subsection which is also used in section 953(e) shall have the meaning given such term by section 953.

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VII. DISSENTING VIEWS

The five permanent, unpaid-for tax extender bills approved by the Republicans at the markup would add more than \$411 billion to the deficit. Combined with the eleven tax bills that were approved by the Republicans in previous markups this Congress, these sixteen tax bills would add more than \$1 trillion to the deficit. In the 113th Congress, Ways and Means Committee Republicans selectively approved fourteen of the more than fifty expired tax provisions, totaling more than \$825 billion worth of deficit-financed, permanent tax cuts. This selective approach failed last Congress, with none of these permanent provisions being enacted into law or even considered by the Senate. The permanent, unpaid-for bills marked up by the Committee set us down a partisan path, when we should be working in a responsible, bipartisan manner on tax reform.

Even though a number of these bills were introduced individually with some bipartisan support, our opposition to these bills is based on the position that these tax provisions should not be made permanent without any revenue offset. The fiscally irresponsible approach that the Committee Republicans are taking with respect to this and other legislation undermines the bipartisan support that some of the provisions enjoy. The cost of making this provision permanent should be offset, and Republicans should stop playing games by passing these provisions outside of comprehensive tax reform. The American people expect a tax code that maintains and supports our shared priorities, and each time the Committee considers these bills in a piecemeal approach, it is taking a step in the wrong direction and away from comprehensive tax reform.

Expired provisions must be dealt with in a comprehensive manner. The Republicans did not take up other tax extenders that also are important to Democratic Committee Members. Left to an uncertain fate are provisions like the Work Opportunity Tax Credit, the New Markets Tax Credit, and the renewable energy tax credits, as well as the long-term status of the Earned Income Tax Credit, the Child Tax Credit, and the American Opportunity Tax Credit.

Sincerely,

SANDER M. LEVIN,
Ranking Member.

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