TITLE —FOREIGN TAX PROVISIONS

[OPTION Y]

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Subtitle A—Reform of Taxation of Income Earned by Controlled Foreign Corporations

PART I—GENERAL PROVISIONS

Subpart A—Participation Exemption System for Taxation of Foreign Income

SEC. 01. DEDUCTION FOR DIVIDENDS RECEIVED BY DOMESTIC CORPORATIONS FROM CERTAIN FOREIGN CORPORATIONS.

(a) ALLOWANCE OF DEDUCTION.—Part VIII of subchapter B of chapter 1 is amended by inserting after section 245 the following new section:

“SEC. 245A. DIVIDENDS RECEIVED BY DOMESTIC CORPORATIONS FROM CERTAIN FOREIGN CORPORATIONS.

“(a) IN GENERAL.—In the case of any dividend received from a controlled foreign corporation by a domestic corporation which is a United States shareholder with respect to such controlled foreign corporation, there shall be allowed as a deduction an amount equal to 100 percent of the foreign-source portion of the dividend.

“(b) FOREIGN-SOURCE PORTION OF DIVIDENDS.—For purposes of this section—
'(1) IN GENERAL.—The foreign-source portion of any dividend is an amount which bears the same ratio to such dividend as—

    ‘‘(A) the undistributed foreign earnings, bears to

    ‘‘(B) the undistributed earnings.

    ‘‘(2) UNDISTRIBUTED EARNINGS.—The term ‘undistributed earnings’ has the meaning given such term by section 245(a)(4).

    ‘‘(3) UNDISTRIBUTED FOREIGN EARNINGS.—The term ‘undistributed foreign earnings’ means the portion of the undistributed earnings which is attributable to neither—

    ‘‘(A) income effectively connected with the conduct of a trade or business within the United States and subject to tax under this chapter, nor

    ‘‘(B) any dividend received directly or indirectly from a domestic corporation.

    ‘‘(c) DISALLOWANCE OF FOREIGN TAX CREDIT, ETC.—For disallowance of credit and deduction for foreign income taxes imposed with respect to income of a controlled foreign corporation not treated as subpart F income, see section 901(n).

    ‘‘(d) SPECIAL RULES FOR HYBRID DIVIDENDS.—
“(1) IN GENERAL.—Subsection (a) shall not apply to any dividend received by a United States shareholder from a controlled foreign corporation if the dividend is a hybrid dividend.

“(2) HYBRID DIVIDENDS OF TIERED CONTROLLED FOREIGN CORPORATIONS.—For treatment of hybrid dividends from one controlled foreign corporation to another controlled foreign corporation which is a member of the same expanded affiliated group (as defined in section 7874(c)(1)) as the corporation, see section 952(e)(2).

“(3) HYBRID DIVIDEND.—The term ‘hybrid dividend’ means an amount received from a controlled foreign corporation—

“(A) which is treated as a dividend for purposes of this title, and

“(B) for which a deduction (or similar tax benefit) is allowable to the controlled foreign corporation under the laws of any foreign country with respect to which the controlled foreign corporation is a resident for purposes of the country’s income tax laws.

“(e) DEFINITIONS.—For purposes of this section—
“(1) UNITED STATES SHAREHOLDER.—The term ‘United States shareholder’ has the meaning given such term in section 951(b).

“(2) CONTROLLED FOREIGN CORPORATION.—
The term ‘controlled foreign corporation’ has the meaning given such term in section 957(a).

“(f) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the provisions of this section.”.

(b) APPLICATION OF HOLDING PERIOD REQUIREMENT.—Subsection (c) of section 246 is amended by adding at the end the following new paragraph:

“(5) SPECIAL RULES FOR QUALIFIED FOREIGN-SOURCE PORTION OF DIVIDENDS RECEIVED FROM CONTROLLED FOREIGN CORPORATIONS.—

“(A) IN GENERAL.—No deduction shall be allowed under section 245A in respect of any dividend on any share of stock—

“(i) which is held by the taxpayer for 365 days or less during the 731-day period beginning on the date which is 365 days before the date on which such dividend is paid, or

“(ii) to the extent the taxpayer is under an obligation (whether pursuant to a
short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

“(B) Status must be maintained during holding period.—For purposes of section 245A, the holding period requirement of clause (i) of subparagraph (A) shall be treated as met only if, with respect to periods during which the controlled foreign corporation is in existence—

“(i) the controlled foreign corporation referred to in section 245A(a) is a controlled foreign corporation at all times during such period, and

“(ii) the taxpayer is a United States shareholder (as defined in section 245A(e)(1)) with respect to such controlled foreign corporation at all times during such period.”.

(c) Application of Rules Generally Applicable to Deductions for Dividends Received.—

(1) Treatment of dividends from tax-exempt corporations.—Paragraph (1) of section 246(a) is amended by striking “and 245” and inserting “245, and 245A”.
(2) Assets generating tax-exempt portion of dividend not taken into account in allocating and apportioning deductible expenses.—Paragraph (3) of section 864(e) is amended by striking “or 245(a)” and inserting “, 245(a), or 245A”.

(3) Coordination with section 1059.—Subparagraph (B) of section 1059(b)(2) is amended by striking “or 245” and inserting “245, or 245A”.

(d) Conforming Amendments.—

(1) Clause (vi) of section 56(g)(4)(C) is amended by inserting “245A or” before “965”.

(2) The table of sections for part VIII of subchapter B of chapter 1 is amended by inserting after the item relating to section 245 the following new item:

“Sec. 245A. Dividends received by domestic corporations from certain foreign corporations.”.

(e) Effective Date.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2014, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.
SEC. 02. APPLICATION OF DIVIDENDS RECEIVED DEDUCTION TO CERTAIN SALES AND EXCHANGES OF STOCK.

(a) SALES BY UNITED STATES PERSONS OF STOCK IN CFC.—Section 1248 is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

“(j) COORDINATION WITH DIVIDENDS RECEIVED DEDUCTION.—

“(1) IN GENERAL.—In the case of the sale or exchange by a domestic corporation of stock in a foreign corporation held for 1 year or more, any amount received by the domestic corporation which is treated as a dividend by reason of this section shall be treated as a dividend for purposes of applying section 245A.

“(2) LOSSES DISALLOWED.—If a domestic corporation—

“(A) sells or exchanges stock in a foreign corporation and such sale or exchange is in a taxable year of the domestic corporation with or within which a taxable year of the foreign corporation beginning after December 31, 2014, ends, and
“(B) met, immediately before such sale or exchange, the ownership requirements of subsection (a)(2) with respect to such stock, no deduction shall be allowed to the domestic corporation with respect to any loss from the sale or exchange.”.

(b) Sale by a CFC of a Lower Tier CFC.—Section 964(e) is amended by adding at the end the following new paragraph:

“(4) Effect of Loss on Earnings and Profits.—For purposes of this title, if, for any taxable year of a controlled foreign corporation beginning after December 31, 2014—

“(A) there is a sale or exchange by such controlled foreign corporation of stock in another foreign corporation, and

“(B) section 1248(j)(2) would apply if such controlled foreign corporation were a United States shareholder,

then the earnings and profits of the selling controlled foreign corporation shall not be reduced by reason of any loss from such sale or exchange.”.

(e) Effective Date.—

(1) In general.—Except as provided in paragraph (2), the amendments made by this section
shall apply to sales and exchanges after December 31, 2014.

(2) Transition Rule.—The amendments made by this section shall not apply to the sale or exchange of stock of a foreign corporation in existence on December 31, 2014, if such sale or exchange is before the beginning of the first taxable year of such foreign corporation beginning after December 31, 2014.

Subpart B—Reform of Subpart F Inclusion

SEC. 03. INCLUSION OF UNITED STATES RELATED INCOME IN SUBPART F INCOME.

(a) In General.—Section 952(a) is amended by redesignating paragraphs (3), (4), and (5) as paragraphs (4), (5), and (6), respectively, and by inserting after paragraph (2) the following new paragraph:

“(3) United States related income (as defined in section 955),”.

(b) United States Related Income.—Section 955 is amended to read as follows:

“SEC. 955. UNITED STATES RELATED INCOME.

“(a) United States Related Income.—

“(1) In general.—For purposes of section 952(a)(3), the term ‘United States related income’ means, with respect to any controlled foreign cor-
poration for any taxable year, the sum of the cor-
poration’s—

“(A) imported property income, and

“(B) United States services income.

“(2) EXCEPTION.—Such term shall not include
any income which is income of the corporation taken
into account under paragraphs (1), (2), (4), (5), or
(6) of section 952(a).

“(b) IMPORTED PROPERTY INCOME.—

“(1) IN GENERAL.—For purposes of this sec-
tion, the term ‘imported property income’ means in-
come (whether in the form of profits, commissions,
fees, or otherwise) derived in connection with—

“(A) manufacturing, producing, growing,
or extracting imported property,

“(B) the sale, exchange, or other disposi-
tion of imported property, or

“(C) the lease, rental, or licensing of im-
ported property.

“(2) IMPORTED PROPERTY.—For purposes of
this subsection—

“(A) IN GENERAL.—Except as otherwise
provided in this paragraph, the term ‘imported
property’ means property which is imported
into the United States by the controlled foreign
corporation or a related person.

“(B) IMPORTED PROPERTY INCLUDES CERTAIN PROPERTY IMPORTED BY OTHER PERSONS.—The term ‘imported property’ includes any property sold, exchanged, or otherwise disposed of to any person if, when such property was sold, exchanged or otherwise disposed of to such person, it was reasonable for the controlled foreign corporation or a related person to expect that—

“(i) such property would be imported into the United States, or

“(ii) such property would be used in the manufacture or production of, or as a component part in, other property which would be imported into the United States.

“(C) CHAIN OF RELATED PERSONS.—If—

“(i) property is ultimately imported into the United States, and

“(ii) all sales, exchanges, or dispositions of such property (or of the other property described in subparagraph (B)(ii)) before the sale for use, consump-
tion, or disposition in the United States are between related persons,

then, for purposes of subparagraph (B), there shall be deemed to have been a reasonable expectation that the property (or the other property described in subparagraph (B)(ii)) would be imported into the United States.

“(D) EXCEPTION FOR PROPERTY SUBSEQUENTLY EXPORTED.—The term ‘imported property’ does not include any property which is imported into the United States and which—

“(i) before substantial use in the United States, is sold, leased, rented, or licensed by the controlled foreign corporation or a related person for direct use, consumption, or disposition outside the United States, or

“(ii) is used by the controlled foreign corporation or a related person as a component in other property which is so sold, leased, rented, or licensed.

“(3) DEFINITION OF IMPORTED.—For purposes of this subsection, the term ‘imported’ means the bringing of property into the United States for consumption or use within the United States. Such
term includes any grant of the right to use intangible property (as defined in section 936(h)(3)(B)), tangible property, or real property in the United States.

“(4) RELATED PERSON.—For purposes of this subsection, the term ‘related person’ has the meaning given such term in section 954(b).

“(c) UNITED STATES SERVICES INCOME.—For purposes of this section—

“(1) IN GENERAL.—The term ‘United States services income’ means income which is derived in connection with services (including income derived in connection with insurance, reinsurance, annuity contracts, banking, financing, or a similar business) provided with respect to persons or property located within the United States (or, in the case of insurance or reinsurance services, with respect to United States risks).

“(2) EXCLUSION.—Such term does not include income which is imported property income.”.

(c) CONFORMING AMENDMENTS.—

(1) Section 964(b) is amended by striking “sections 952, 955, and 956” and inserting “sections 952 and 956”.
(2)(A) Part III of subchapter N of chapter 1 is amended by striking subpart G.

(B) Section 865(e)(2)(A) is amended by striking the last sentence.

(C) The table of subparts for part III of subchapter N of chapter 1 is amended by striking the item relating to subpart G.

(3) The table of sections for subpart F of part III of subchapter N is amended by striking the item relating to section 955 and inserting the following:

"Sec. 955. United States related income."

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

SEC. _04. LOW-TAXED INCOME TREATED AS SUBPART F INCOME.

(a) TREATMENT AS SUBPART F INCOME.—

(1) IN GENERAL.—Subsection (a) of section 952, as amended by section _03, is amended by redesignating paragraphs (4), (5), and (6) as paragraphs (5), (6), and (7), respectively, and by inserting after paragraph (3) the following new paragraph:
“(4) low-taxed income (as defined in section 956),”.

(2) LOW-TAXED INCOME.—Section 956 is amended to read as follows:

“SEC. 956. LOW-TAXED INCOME.

“(a) IN GENERAL.—For purposes of this subpart, the term ‘low-taxed income’ means, with respect to any taxable year of a controlled foreign corporation, any item of income (other than any item of income which is otherwise taken into account under paragraph (1), (2), (3), (5), (6), or (7) of section 952(a)) which is subject to an effective rate of foreign income tax (as defined in section 960(d)) of less than [80] percent of the maximum rate specified in section 11(b).

“(b) RULES RELATED TO DETERMINATION OF EFFECTIVE RATE OF FOREIGN INCOME TAX.—For purposes of subsection (a)—

“(1) IN GENERAL.—Except as provided in this subsection, in determining the effective rate of foreign income tax with respect to any item of income—

“(A) such effective rate shall be determined under United States tax principles, and
“(B) only taxes and other deductions related to such item of income shall be taken into account.

“(2) Special rule for treatment of losses.—For purposes of determining the effective rate of foreign income tax imposed with respect to any item of income for any taxable year, the principles of section 172 shall apply except that any net operating loss carryback to such taxable year shall not be taken into account.”.

(3) Conforming amendments.—

(A) Section 864(d)(8) is amended by striking “or section 956(b)(3)”.

(B) Section 955, as amended by section _03, is amended by striking “paragraphs (1), (2), (4), (5), or (6) of section 952(a)” and inserting “paragraphs (1), (2), (5), (6), or (7) of section 952(a)”.

(C) Section 958(b) is amended—

(i) by striking “956(c)(2),” before “and 957”,

(ii) by striking “to treat the stock of a domestic corporation as owned by a United States shareholder of the controlled
foreign corporation for purposes of section 956(c)(2),” and

(iii) by striking the last sentence.

(D) Section 964(b), as amended by section 103, is amended by striking “sections 952 and 956” and inserting “section 952”.

(E) The table of sections for subpart F of part III of subchapter N is amended by striking the item relating to section 956 and inserting the following:

“Sec. 956. Low-taxed income.”.

(b) Partial Deduction for Low-Taxed Income.—

(1) In General.—Part VI of subchapter B of chapter 1 is amended by adding at the end the following new section:

“SEC. 200. PORTION OF LOW-TAXED INCOME.

“(a) In General.—In the case of any taxpayer who is a United States shareholder of a controlled foreign corporation, there shall be allowed as a deduction for the taxable year an amount equal to 20 percent of the amounts which—

“(1) are included in gross income for such taxable year under section 951(a) or section 78, and

“(2) are attributable to low-taxed income (as defined in section 956).
“(b) DEFINITIONS.—For purposes of this section—

“(1) UNITED STATES SHAREHOLDER.—The term ‘United States shareholder’ has the meaning given such term in section 951(b).

“(2) CONTROLLED FOREIGN CORPORATION.—The term ‘controlled foreign corporation’ has the meaning given such term in section 957(a).”.

(2) DEDUCTION TREATED AS ABOVE THE LINE.—Section 62(a) is amended by inserting after paragraph (21) the following new paragraph:

“(22) LOW-TAXED INCOME.—The deduction allowed by section 200.”.

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

“Sec. 200. Portion of low-taxed income.”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2014, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.
SEC. 05. REPEAL OF FOREIGN BASE COMPANY SALES, SERVICES, AND OIL RELATED INCOME; MODIFICATION OF FOREIGN PERSONAL HOLDING COMPANY INCOME.

(a) In General.—Paragraph (2) of section 952(a) is amended to read as follows:

“(2) the foreign personal holding company income (as determined under section 954),”.

(b) Foreign Personal Holding Income.—Section 954 is amended to read as follows:

“SEC. 954. FOREIGN PERSONAL HOLDING COMPANY INCOME.

“(a) Foreign Personal Holding Company Income.—

“(1) In General.—For purposes of section 952(a)(2), the term ‘foreign personal holding 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 prop-
erty which gives rise to income not treated as foreign personal holding company income by reason of subsection (c) or (d) 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)) attrib-
utable to any section 988 transactions.

“(D) FOREIGN CURRENCY GAINS.—The ex-
cess of foreign currency gains over foreign cur-
currency losses (as defined in section 988(b)) at-
tributable to any section 988 transactions. This
subparagraph shall not apply in the case of any
transaction, other than a borrowing, directly re-
lated to the business needs of the controlled for-
eign corporation.

“(E) INCOME EQUIVALENT TO INTER-
est.—Any income equivalent to interest, in-
cluding income from commitment fees (or simi-
lar 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 no-
tional 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. 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) 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 any item of income, gain, deduction, or loss 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.

“(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 which is a resident for purposes of the income tax laws of the same foreign country with respect to which the con-
trolled foreign corporation is a resident for such purposes, 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 a resident for purposes of the country’s income tax laws.

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 sub-
part 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, gain or loss on such sale shall be treated as being described in paragraph (1)(B)(ii) in the amount which bears the same ratio to the amount of such gain or loss as the controlled foreign corporation’s distributable share of subpart F income (determined without regard to the allocation of any deductions under section 952(f)) al-
located from the partnership over the 3 taxable years preceding the year of the sale bears to the controlled foreign corporation’s distributable share of gross income from the partnership over such period. The Secretary shall prescribe such regulations as may be appropriate to prevent abuse of the purposes of this paragraph, including regulations providing for the 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)(B) 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 persons.

“(b) Related Person Defined.—For purposes of this section, a person is a related person with respect to a controlled foreign corporation, if—

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

“(2) 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 subsection, rules
similar to the rules of section 958 shall apply.

“(c) Special Rule for Income Derived in the
Active Conduct of Banking, Financing, or Similar
Businesses.—

“(1) In general.—For purposes of subsection
(a)(1), foreign personal holding company income
shall not include qualified banking or financing in-
come of an eligible controlled foreign corporation.

“(2) Eligible Controlled Foreign Cor-
poration.—For purposes of this subsection, the
term ‘eligible controlled foreign corporation’ means
any controlled foreign corporation if—

“(A) more than 80 percent of the gross in-
come of the controlled foreign corporation is de-
derived directly from the active and regular con-
duct of a lending, finance, or financial services
business from transactions with customers which are located outside the United States and are not related persons, or

“(B) it is a regulated financial institution.

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

“(B) Income derived from customers to include certain investment income.—For purposes of subparagraph (A), in the case of a regulated financial institution, income derived from customers includes income derived from—

“(i) reserves that are required to be held pursuant to banking regulations,

“(ii) deposits placed with the central bank (or equivalent thereof) in the corporation’s home country, and

“(iii) investments in debt instruments issued by the 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 unless such corporation conducts substantial activity with re-
spect to a banking, financing, or similar business in its home country.

“(D) 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 in its home country if the activity is performed by employees of a related person and—

“(i) the related person is a resident subject to tax under the laws of the home country of the corporation to which subparagraph (A)(ii)(II) is being applied,

“(ii) the activity is performed in such home country, 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 such home country for purposes of the home country’s tax laws.

“(4) LENDING, FINANCE, OR FINANCIAL SERVICES BUSINESS.—For purposes of this subsection, except as provided in regulations, the term ‘lending,
finance, or financial services business’ means the business of—

“(A) making loans,

“(B) purchasing, selling, discounting, or negotiating on a regular basis 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,

“(F) performing trust services, including as a fiduciary, agent, or custodian, other than trust services provided by a broker or dealer in stock, securities, or other financial instruments,

“(G) arranging interest rate or currency futures, forwards, options, or notional principal contracts for, or entering into such transactions with, customers,

“(H) providing traveler’s check and money order services for customers,

“(I) providing correspondent bank services for customers,
“(J) engaging in hedging activities directly related to an activity described in any other subparagraph of this paragraph,

“(K) underwriting issues of stock, debt, or other securities for customers,

“(L) providing financial, investment advisory, or investment management services,

“(M) purchasing or selling stock, debt instruments, interest rate or currency futures, or other securities or derivative financial products (including notional principal contracts) from or to customers and holding such stock, debt instruments, futures, or other securities or products as inventory for sale to customers, unless such stock, debt instruments, futures, or other securities or products are not held in a dealer capacity,

“(N) effecting transactions in securities for customers as a securities broker, or

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

“(i) the corporation rendering services or making facilities available, or
“(ii) another 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, any person which has a customer relationship with such corporation and which is acting in its capacity as such.

“(B) HOME COUNTRY.—Except as provided in regulations, the term ‘home country’ means, with respect to any entity, the country with respect to which the entity is a resident for purposes of the country’s income tax laws.

“(C) LOCATED.—Except as provided in regulations, for purposes of paragraph (3)(A)—

“(i) if a customer is a natural person, the customer is considered to be located in the country in which the customer is physically located when entering into the transaction, and

“(ii) if a customer is not a natural person, the customer is considered to be lo-
located in the country from which the customer enters into the transaction.

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

“(E) REGULATED FINANCIAL INSTITUTION.—Except as provided in regulations, the term ‘regulated financial institution’ means a controlled foreign corporation which—

“(i) 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

“(ii) satisfies each of the following conditions:

“(I) The corporation is directly or indirectly wholly owned by a domestic corporation that is a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1))).
“(II) The corporation is subject to bank regulatory supervision in a jurisdiction the central bank of which (or equivalent thereof) is a member of the Basel Committee on Banking Supervision.

“(III) The corporation is licensed and regulated in such jurisdiction as a bank.

“(6) SEPARATE APPLICATION TO QUALIFIED BUSINESS UNITS.—

“(A) IN GENERAL.—If a controlled foreign corporation has 1 or more qualified business units—

“(i) this subsection shall be applied separately to each such unit in the same manner as if it were a controlled foreign corporation, and

“(ii) if any such unit is treated as an eligible controlled foreign corporation after application of clause (i), the qualified banking or financing income of such unit shall be treated as qualified banking or financing income of the controlled foreign corporation of which such unit is a part.
“(B) Determinations Made Separately.—For purposes of the separate application of this subsection to a controlled foreign corporation and its qualified business units—

“(i) in the case of the controlled foreign corporation, only activities and 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 shall be taken into account, and

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

“(C) Home Country.—For purposes of this subsection, except as provided in regulations, notwithstanding paragraph (5)(B), the home country with respect to any qualified business unit treated as a controlled foreign corporation under subparagraph (A) shall be the country in which such unit maintains its principal office.
“(7) ANTI-ABUSE RULES.—For purposes of applying this subsection—

“(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 which would otherwise be treated as a customer of such corporation 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 and subsection (a)(1)(B)(i).

“(d) Special Rule for Income Derived in the Active Conduct of Insurance Business.—

“(1) In general.—For purposes of subsection (a)(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 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 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 re-
serves described in subparagraph (A) for such contracts.

“(3) Principles for determining qualified 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 section, any term used in this subsection which is also used in section 953(e) shall have the meaning given such term under section 953(e).”.

(e) EXCLUSION OF DIVIDENDS FROM CONTROLLED FOREIGN CORPORATIONS FROM THE DEFINITION OF PERSONAL HOLDING COMPANY INCOME FOR PURPOSES OF THE PERSONAL HOLDING COMPANY RULES.—Paragraph (1) of section 543(a) is amended by redesignating subparagraphs (C) and (D) as subparagraphs (D) and (E), respectively, and by inserting after subparagraph (B) the following new subparagraph:

“(C) dividends received by a United States shareholder (as defined in section 951(b)) from a controlled foreign corporation (as defined in section 957(a)).”.

(d) CONFORMING AMENDMENTS.—

(1) Section 355(g)(2)(B)(ii)(I) is amended by striking “section 954(h)(4)” and inserting “section 954(c)(4)”.

(2) Section 864(d)(5)(A) is amended—

(A) by striking clause (iii) and redesignating clause (iv) as clause (iii), and
(B) by striking “954(c)(3)(A)” in clause (iii) (as redesignated by subparagraph (A)) and inserting “954(a)(3)(A)”.

(3) Section 864(d)(7)(B) is amended by striking “foreign base company income (as defined in section 954(a), determined without regard to section 954(b)(3)(A))” and inserting “foreign personal holding company income (as defined in section 954(a))”.

(4) Section 881(c)(5)(A)(iii) is amended by striking “954(c)(3)(A)” and inserting “954(a)(3)(A)”.

(5) Section 936(h)(5) is amended—

(A) by inserting “(as in effect on the day before the enactment of the _________ Act of 2013)” after “section 954” in the last sentence of subparagraph (B)(ii), and

(B) in subparagraph (F)(iv)(II)—

(i) by inserting “(as in effect on the day before the enactment of the _________ Act of 2013)” after “section 954”, and

(ii) by inserting “(as so in effect)” after “section 954(a)”. 
(6) Paragraph (3) of section 953(b) is amended by striking “954(i)” each place it appears and inserting “954(d)”.

(7) Section 964(e)(2) is amended by striking “954(c)(3)(A)” and inserting “954(a)(3)(A)”.

(8) Section 1296(f)(2) is amended by striking “section 954(e)(1)(A)” in subparagraph (A) and inserting “section 954(a)(1)(C)”.

(9) Section 1297(b) is amended to read as follows:

“(b) PASSIVE INCOME.—The term ‘passive income’ means, with respect to any foreign corporation, any income which would be foreign personal holding company income as defined in section 954 if the foreign corporation were a controlled foreign corporation.”.

(10) Section 2057(e)(2)(D)(ii) is amended by striking “section 954(e)(1)” and inserting “section 954(a)(1)”.

(11) The following sections are amended by striking “954(d)(3)” each place it appears and inserting “954(b)”:

(A) Section 861(e)(2)(B).
(B) Section 953(c)(6)(A).
(C) Section 958(b).
(D) Section 988(a)(3)(C).
(E) Subsections (d)(3)(A) and (e)(2)(B)(i) of section 1298.

(F) Section 1471(e)(2).

(G) Section 3121(z)(2).

(12) The table of sections for subpart F of part III of subchapter N is amended by striking the item relating to section 954 and inserting the following:

“Sec. 954. Foreign personal holding company income.”

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

SEC. 06. MODIFICATION OF RULES RELATING TO INSURANCE INCOME.

(a) EXEMPT INSURANCE INCOME.—Subsection (e) of section 953 is amended to read as follows:

“(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(d), 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 NON-RELATED INCOME REQUIRED.—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) with respect to
which no policyholder, insured, annuitant, or
beneficiary is a related person (as defined in
section 954(b)).

“(C) SUBSTANTIAL ACTIVITY REQUIRE-
MENTS.—A contract issued by a qualifying in-
surance company or qualifying insurance com-
pany branch 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.—

“(A) IN GENERAL.—The term ‘qualifying
insurance company’ means any controlled for-
eign corporation—

“(i) which—

“(I) is subject to regulation as an
insurance (or reinsurance) company
by its home country, and is licensed,
authorized, or regulated by the appli-
cable 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(b)) in such home country, and

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

“(ii) which 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 with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(b)), 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,
“(iii) more than 50 percent of the gross receipts of which for the taxable year—

“(I) consist of premiums for insurance or reinsurance in connection with property, liability, or the lives or health of individuals, and

“(II) are treated as earned by such controlled foreign corporation in its home country for purposes of such country’s tax laws, and

“(iv) the applicable insurance liabilities of which constitute more than 35 percent of its total assets as reported on the company’s applicable financial statement for the year with which or in which the taxable year ends.

“(B) APPLICABLE INSURANCE LIABILITIES.—For purposes of subparagraph (A)(iv), the term ‘applicable insurance liabilities’ means—

“(i) loss and loss adjustment expenses,

“(ii) unearned premiums, and
“(iii) reserves (other than any catastrophe, deficiency, equalization, or similar reserves) for life and health insurance risks and life and health insurance claims with respect to contracts providing coverage for mortality or morbidity risks (not to exceed the amount of such reserve that is required to be reported to the home country insurance regulatory body).

“(C) APPLICABLE FINANCIAL STATEMENT.—For purposes of subparagraph (A)(iv), the term ‘applicable financial statement’ means a statement for financial reporting purposes which—

“(i) is made on the basis of generally accepted accounting principles,

“(ii) is made on the basis of international financial reporting standards, but only if there is no statement that meets the requirement of clause (i), or

“(iii) except as otherwise provided by the Secretary in regulations, is the annual statement which is required to be filed with the home country insurance regulatory body, but only if there is no state-
ment which meets the requirements of clause (i) or (ii).

“(D) REGULATIONS.—The Secretary shall prescribe such regulations as necessary to carry out the purposes of this paragraph.

“(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(b)) 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 qualifying insurance company branch is a life insurance con-
tract 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 ins-
surance or annuity contract by the corpora-
tion’s or branch’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 CORPORA-
tion.—The term ‘home country’ means, with
respect to a controlled foreign corporation, the
country in which such corporation is created or
organized.

“(B) QUALIFYING INSURANCE COMPANY
BRANCH.—The term ‘home country’ means,
with respect to a qualifying insurance company
branch, the country in which the principal office
of such branch is located and in which such
branch 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(b)) in such country.

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

“(A) the rules of section 954(c)(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(d),

“(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 mar-
keted 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(b)).

“(8) COORDINATION WITH SUBSECTION (c).—

“(A) IN GENERAL.—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.

“(B) Applicable home country risks.—For purposes of subparagraph (A), 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.

“(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(d).

“(10) Cross reference.—For income exempt from foreign personal holding company income, see section 954(d).”.

(b) Captive Insurance Companies.—

(1) Modification of de minimis exception.—Section 953(c)(3)(B) is amended by striking “determined without regard to those provisions of subsection (a)(1) which limit insurance income to in-
come from countries other than the county in which
the corporation was created or organized”.

(2) CONFORMING AMENDMENT RELATING TO
SECTION __36.—Section 953(c)(3)(E) is amended by
striking by striking “for an uninterrupted period of
30 days or more” and inserting “at any time”.

(e) EFFECTIVE DATE.—The amendments made by
this section shall apply to taxable years of foreign corpora-
tions beginning after December 31, 2014, and to taxable
years of United States shareholders with or within which
such taxable years of foreign corporations end.

SEC. __07. EXCLUSION OF DIVIDENDS FROM RELATED
CFCS.

(a) IN GENERAL.—Section 952 is amended by adding
at the end the following new subsection:

“(e) EXCLUSION OF DIVIDENDS FROM RELATED
CFC.—

“(1) IN GENERAL.—In the case of a controlled
foreign corporation, subpart F income does not in-
clude any item of income which consists of a divi-
dend received or accrued from another controlled
foreign corporation which is a member of the same
expanded affiliated group (as defined in section
7874(c)(1)) as the corporation.
“(2) SPECIAL RULES FOR HYBRID DIVIDENDS.—Paragraph (1) shall not apply to any dividend if the dividend is a hybrid dividend.

“(3) HYBRID DIVIDEND.—The term ‘hybrid dividend’ has the meaning given such term under section 245A(d)(3).”.

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

SEC. __08. OTHER CONFORMING MODIFICATIONS TO DEFINITION OF SUBPART F INCOME.

(a) DEDUCTIONS TAKEN INTO ACCOUNT.—

(1) IN GENERAL.—Section 952, as amended by section __07, is amended by adding at the end the following new subsection:

“(f) DEDUCTIONS TO BE TAKEN INTO ACCOUNT.—

For purposes of subsection (a), the foreign personal holding company income, the United States related income, and the low-taxed 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 con-
trolled foreign corporation related to such a shareholder)
shall be allocated first to foreign personal holding com-
pany 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.”.

(2) CONFORMING AMENDMENTS.—
(A) Section 864(d)(5)(A), as amended by
section _05(c), is amended by striking clause
(ii) and by redesignating clause (iii) as clause
(ii).

(B) Section 864(d)(7)(B) is amended—
(i) by striking “foreign base company
income” and inserting “foreign personal
holding company income”, and
(ii) by striking “, determined without
regard to section 954(b)(3)”.

(C) Section 881(c)(5)(A), as amended by
section _05(c), is amended to read as follows:
“(A) IN GENERAL.—In the case of any
portfolio interest received by a controlled for-
eign corporation, clause (i) of section 954(a)(3)(A) shall not apply.”.

(b) Modifications to Earnings and Profits Limitation.—Clause (iii) of section 952(c)(1)(B) is amended to read as follows:

“(iii) QUALIFIED ACTIVITY.—For purposes of this paragraph, the term ‘qualified activity’ means any activity giving rise to—

“(I) United States related income, or

“(II) low-taxed income.”.

c) Coordination With Amounts Included in Gross Income of United States Shareholders.—

(1) In general.—Paragraph (1) of section 951(a) is amended by striking “such taxable year of the corporation ends—” and all that follows through the end period and inserting: “such taxable year of the corporation ends, the shareholder’s pro rata share (determined under paragraph (2)) of the corporation’s subpart F income for such taxable year.”.

(2) Conforming Amendments.—

(A) Section 951(a) is amended—
(i) by striking “paragraph (1)(A)(i)” in paragraph (2) and inserting “paragraph (1)”, and
(ii) by striking paragraph (3).

(B) Subparagraph (A) of section 512(b)(17) is amended by striking “951(a)(1)(A)” and inserting “951(a)(1)”.

(C) Section 851(b) is amended by striking “951(a)(1)(A)(i)” in the first sentence following paragraph (3) and inserting “951(a)(1)”.

(D) Section 904(d)(3) is amended—
(i) by striking “951(a)(1)(A)” in subparagraph (B) and inserting “951(a)(1)”.
(ii) by striking the first sentence of subparagraph (G), and
(iii) by striking “951(a)(1)(A)” each place it appears in subparagraph (G) (as amended by clause (ii)) and inserting “951(a)(1)”.

(E) Section 952(c)(1)(B)(i) is amended by striking “951(a)(1)(A)(i)” and inserting “951(a)(1)”. 

(F) Section 953 is amended—
(i) by striking “951(a)(1)(A)(i)” in subsection (e)(1)(C) and inserting “951(a)(1)”,

(ii) by striking paragraph (3) of subsection (d), and

(iii) in clause (iv) of subsection (d)(4)(B), by inserting “(as in effect on the day before the date of the enactment of the _______ Act of 2013)” after “section 951(a)(1)(A)”.

(G) Section 959(a) is amended—

   (i) by striking “shall not, when” and all that follows through “such shareholder” and inserting “shall not, when actually distributed to such shareholder”, and

   (ii) by striking “and the rules of subsection (f) shall apply for purposes of paragraph (2) of this subsection”.

(H) Section 959(c) is amended by adding at the end the following: “References in this subsection and subsection (f) to section 951(a)(1)(B) shall be treated as references to such provisions as in effect on the day before the enactment of the _______ Act of 2013.”.
(I) Section 959(e) is amended by striking “951(a)(1)(A)” and inserting “951(a)(1)”.

(J) Section 989(b) is amended—

(i) by striking “951(a)(1)(A)” in paragraph (3) and inserting “951(a)(1)”, and

(ii) by striking the last sentence.

(K) Section 1298(b) is amended by striking paragraph (8).

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

PART II—FOREIGN TAX CREDIT LIMITATIONS

SEC. 11. REFORM OF FOREIGN TAX CREDIT LIMITATION.

(a) IN GENERAL.—Subsection (d) of section 904 is amended to read as follows:

“(d) SEPARATE APPLICATION OF SECTION WITH RESPECT TO CERTAIN CATEGORIES OF INCOME.—

“(1) IN GENERAL.—The provisions of subsections (a), (b), and (c) and sections 907 and 960 shall be applied separately with respect to—

“(A) passive income,
“(B) amounts included under section 951(a) which are attributable to insurance income (as defined in section 953),

“(C) amounts included under section 951(a) which are attributable to United States related income (as defined in section 955),

“(D) amounts included under section 951(a) which are attributable to low-taxed income (as defined in section 956),

“(E) foreign branch income, and

“(F) income other than income described in any of the preceding subparagraphs.

“(2) DEFINITIONS AND SPECIAL RULES.—

“(A) PASSIVE INCOME.—

“(i) IN GENERAL.—The term ‘passive income’ means—

“(I) income received or accrued by the taxpayer which is of a kind that would be foreign personal holding company income (as defined under section 954(a)) if such taxpayer were a controlled foreign corporation, and

“(II) income which is included in gross income of the taxpayer under section 951(a)(1) to the extent such
income is attributable to foreign personal holding income.

“(ii) EXCEPTION FOR HIGH-TAXED INCOME.—Passive income shall not include any high-taxed income.

“(iii) HIGH-TAXED INCOME.—For purposes of clause (ii), the term ‘high-taxed income’ means any income which (but for this clause) would be passive income if the sum of—

“(I) the foreign income taxes paid or accrued by the taxpayer with respect to such income, and

“(II) the foreign income taxes deemed paid by the taxpayer with respect to such income under section 960,

exceeds the highest rate of tax specified in section 1 or 11 (whichever applies) multiplied by the amount of such income (determined with regard to section 78). For purposes of the preceding sentence, the term ‘foreign income taxes’ means any income, war profits, or excess profits tax imposed
by any foreign country or possession of the United States.

“(iv) Clarification of application of section 864(d)(6).—In determining whether any income is passive income, the rules of section 864(d)(6) shall apply only in the case of income of a controlled foreign corporation.

“(B) Foreign branch income.—The term ‘foreign branch income’ means the business profits of such United States person which are attributable to 1 or more qualified business units (as defined in section 989(a)) in 1 or more foreign countries. For purposes of the preceding sentence, the amount of business profits attributable to a qualified business unit shall be determined—

“(i) in the case of a qualified business unit in a foreign country with which the United States has an income tax treaty in force, in accordance with the terms of such treaty, and

“(ii) in any other case, under rules established by the Secretary.
Such term shall not include any income which is passive income.

“(C) TREATMENT OF INCOME TAX BASE DIFFERENCES.—

“(i) IN GENERAL.—In the case of taxable years beginning after December 31, 2014, tax imposed under the law of a foreign country or possession of the United States on an amount which does not constitute income under United States tax principles shall be treated as imposed on income described in paragraph (1)(F).

“(ii) SPECIAL RULES FOR YEARS AFTER 2006 AND BEFORE 2015.—In the case of taxable years beginning after December 31, 2006, and before January 1, 2015, tax imposed under the law of a foreign country or possession of the United States on an amount which does not constitute income under United States tax principles shall be treated as imposed on income described in paragraph (1)(B) (as in effect for taxable years beginning in 2014).
“(iii) Special rule for years before 2007.—

“(I) In general.—In the case of taxes paid or accrued in taxable years beginning after December 31, 2004, and before January 1, 2007, a taxpayer may elect to treat tax imposed under the law of a foreign country or possession of the United States on an amount which does not constitute income under United States tax principles as tax imposed on income described in subparagraph (C) or (I) of paragraph (1) (as in effect for taxable years beginning in 2006).

“(II) Revocation.—Any such election shall apply to the taxable year for which made and all subsequent taxable years described in subclause (I) unless revoked with the consent of the Secretary.

“(D) Transition rules for certain carryforwards and carrybacks.—For purposes of paragraph (1)—
“(i) in the case of any taxes carried from any taxable year beginning before January 1, 2015, to any taxable year beginning on or after such date—

“(I) if such taxes were treated as attributable to income described in paragraph (1)(A) (as in effect for taxable years beginning in 2014), such taxes shall be treated as attributable to income described in paragraph (1)(A), and

“(II) if such taxes were treated as attributable to income described in paragraph (1)(B) (as in effect for taxable years beginning in 2014), such taxes shall be treated as attributable to income described in paragraph (1)(F), and

“(ii) the Secretary may by regulations provide for the allocation of any carryback of taxes with respect to income from a taxable year beginning on or after January 1, 2015, to a taxable year beginning before such date for purposes of allocating such
income among the separate categories in effect for the taxable year to which carried.

“(3) Controlled foreign corporation; United States shareholder.—For purposes of this subsection—

“(A) Controlled foreign corporation.—The term ‘controlled foreign corporation’ has the meaning given such term by section 957 (taking into account section 953(c)).

“(B) United States shareholder.—The term ‘United States shareholder’ has the meaning given such term by section 951(b) (taking into account section 953(c)).

“(4) Separate application to items resourced under treaties.—

“(A) In general.—If—

“(i) without regard to any treaty obligation of the United States, any item of income would be treated as derived from sources within the United States,

“(ii) under a treaty obligation of the United States, such item would be treated as arising from sources outside the United States, and
“(iii) the taxpayer chooses the benefits of such treaty obligation,

subsections (a), (b), and (c) of this section and sections 907 and 960 shall be applied separately with respect to each such item.

“(B) COORDINATION WITH OTHER PROVISIONS.—This paragraph shall not apply to any item of income to which subsection (h)(10) or section 865(h) applies.

“(C) REGULATIONS.—The Secretary may issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations or other guidance which provides that related items of income may be aggregated for purposes of this paragraph.

“(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate for the purposes of this subsection, including preventing the manipulation of the character of income the effect of which is to avoid the purposes of this subsection.”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2014.
SEC. 12. DENIAL OF CREDIT AND DEDUCTION FOR FOREIGN TAXES WITH RESPECT TO INCOME NOT TREATED AS SUBPART F INCOME.

(a) In General.—Section 901 is amended by redesignating subsection (n) as subsection (o) and by inserting after subsection (m) the following:

“(n) Denial of foreign tax credit and deduction on income not treated as Subpart F income.—

“(1) In general.—No credit shall be allowed under subsection (a) for any income, war profits, or excess profits taxes paid or accrued by the taxpayer—

“(A) with respect to income of a controlled foreign corporation which is not included in the gross income of a United States shareholder under section 951(a)(1), or

“(B) with respect to any dividend for which a deduction is allowed under section 245A.

“(2) Denial of deduction.—No deduction shall be allowed to a taxpayer under this chapter for any tax for which credit is not allowable under section 901 by reason of paragraph (1).”.

(b) Effective Date.—The amendments made by this section shall apply to taxable years of foreign corpora-
tions beginning after December 31, 2014, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

PART III—EXPENSE DISALLOWANCE

SEC. 21. DISALLOWANCE OF DEDUCTION FOR INTEREST EXPENSE ALLOCABLE TO EXEMPT INCOME OF A CONTROLLED FOREIGN CORPORATION.

(a) In General.—Part IX of subchapter B of chapter 1 is amended by adding at the end the following:

"SEC. 265A. INTEREST EXPENSE ALLOCABLE TO EXEMPT INCOME OF A CONTROLLED FOREIGN CORPORATION.

"(a) In General.—In the case of a domestic corporation which is a United States shareholder of a controlled foreign corporation for any taxable year, no deduction shall be allowed under this chapter for the disallowed portion of any allocable CFC interest.

"(b) Disallowed Portion.—For purposes of this section—

"(1) In General.—The term 'disallowed portion' means, with respect to any allocable CFC interest in connection with a controlled foreign corporation, the amount which bears the same ratio to the amount of such interest as—
“(A) the amount of the excess for the applicable taxable year of the corporation of—

“(i) the corporation’s current earnings and profits, over

“(ii) the sum of—

“(I) the corporation’s subpart F income, reduced, under regulations provided by the Secretary, to take into account the deduction allowed under section 200, plus

“(II) the amount of effectively connected income excluded from the corporation’s subpart F income by reason of section 952(b), reduced, in accordance with regulations prescribed by the Secretary, so as to take into account deductions (including taxes) for expenses of the controlled foreign corporation properly allocable to such income, bears to

“(B) the corporation’s current earnings and profits.

“(2) CURRENT EARNINGS AND PROFITS.—For purposes of this subsection, the term ‘current earnings and profits’ means the earnings and profits of
the controlled foreign corporation for the applicable taxable year computed in the same manner as for purposes of section 952(c), except that such earnings and profits shall be reduced by dividends received by the controlled foreign corporation from another controlled foreign corporation which are not taken into account in computing the subpart F income of the recipient controlled foreign corporation by reason of section 952(e).

“(c) Definitions and Special Rules.—For purposes of this section—

“(1) Allocable CFC interest.—The term ‘allocable CFC interest’ means any interest expense paid or accrued during the taxable year by a domestic corporation which is a United States shareholder of a controlled foreign corporation which under section 861, and subsection (e) or (f) of section 864 (whichever is applicable), is apportioned to income of the controlled foreign corporation. For purposes of the preceding sentence, in applying section 864(e)(3), any reference to section 245A shall be disregarded.

“(2) Applicable taxable year.—The term ‘applicable taxable year’ means, with respect to any controlled foreign corporation, the taxable year of
such corporation which ends with or within the taxable year of the United States shareholder described in subsection (a).

“(3) United States shareholder; controlled foreign corporation.—The term ‘United States shareholder’ has the meaning given such term by section 951(b) and the term ‘controlled foreign corporation’ shall have the meaning given such term by section 957(a).

“(4) Special rule for members of an affiliated group.—If a United States shareholder to which subsection (a) applies is a member of a group all members of which are treated as a single corporation under subsection (e) or (f) of section 864, whichever is applicable, all domestic corporations which are members of such group shall be treated as a single corporation for purposes of this section.

“(5) Special rules.—

“(A) Coordination with other provisions.—Except as provided in regulations, this section shall be applied before any other provision of this chapter limiting the deductibility of any allocable CFC interest.
“(B) SEPARATE APPLICATION TO INCOME
IN SEPARATE BASKETS.—This section shall be
applied separately with respect to the categories
of income under section 904(d)(1).

“(d) REGULATIONS.—The Secretary shall prescribe
such regulations as may be necessary to carry out the pur-
poses of this section, including regulations providing—

“(1) for the sharing of information between
shareholders if necessary to carry out the provisions
of this section,

“(2) for directly associating interest expenses
disallowed under this section with income of a con-
trolled foreign corporation and for coordinating this
section with other provisions of this chapter limiting
the deductibility of interest or other expenses, and

“(3) for the proper application of this section
with respect to the taxpayer’s share of net operating
losses or deficits in earnings and profits of a con-
trolled foreign corporation.”.

(b) CONFORMING AMENDMENT.—The table of sec-
tions for part IX of subchapter B of chapter 1 is amended
by inserting after the item relating to section 265 the fol-
lowing:

“Sec. 265A. Interest expense allocable to exempt income of a controlled foreign
corporation.”.
(c) **Effective Date.**—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2014, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.