TITLE ___—FOREIGN TAX PROVISIONS

[OPTION Z]

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

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

PART I—GENERAL PROVISIONS

SEC. __01. MODIFICATIONS TO SUBPART F INCOME.

(a) IN GENERAL.—Subpart F of part III of sub-
chapter N of chapter 1 of the Internal Revenue Code of
1986 is amended by striking sections 952 through 956
and inserting the following:
SEC. 952. SUBPART F INCOME DEFINED.

(a) In General.—For purposes of this subpart, the term ‘subpart F income’ means, with respect to any controlled foreign corporation, the sum of—

(1) [60 percent] of the corporation’s modified active income, plus

(2) 100 percent of the corporation’s modified nonactive income.

(b) Modified Active Income.—

(1) In General.—The term ‘modified active income’ means, with respect to any controlled foreign corporation, the excess (if any) of—

(A) the corporation’s active foreign market income, over

(B) the amount of the reduction under subsection (e) for deductions properly allocable to such income.

(2) Reduction for Certain Losses.—

(A) In General.—The modified active income determined under paragraph (1) for any taxable year shall be reduced (but not below zero)—

(i) first by any active foreign market loss for any prior taxable year, and

(ii) then by any qualified loss for such taxable year (or for any prior taxable
year to the extent provided in subsection (c)(3)(B)).

“(B) LIMITATION.—An active foreign market loss or qualified loss for any prior taxable year shall only be taken into account under subparagraph (A)—

“(i) if the prior taxable year is a taxable year which begins after December 31, 2014, and for which the controlled foreign corporation was a controlled foreign corporation, and

“(ii) to the extent such loss has not been previously taken into account under this subsection.

“(3) ACTIVE FOREIGN MARKET LOSS.—The term ‘active foreign market loss’ means, with respect to any taxable year, the amount by which the amount determined under paragraph (1)(B) exceeds the amount determined under paragraph (1)(A).

“(e) MODIFIED NONACTIVE INCOME.—

“(1) IN GENERAL.—The term ‘modified non-active income’ means, with respect to any controlled foreign corporation, the excess (if any) of—
“(A) the corporation’s gross income determined without regard to active foreign market income, over

“(B) the amount of the reduction under subsection (e) for deductions properly allocable to such gross income.

“(2) REDUCTION FOR QUALIFIED LOSSES.—The amount determined under paragraph (1) for any taxable year shall be reduced (but not below zero) by any qualified loss for any prior taxable year beginning after December 31, 2014, for which the controlled foreign corporation was a controlled foreign corporation, but only to the extent such loss has not been previously taken into account under subsection (b)(2) or this subsection.

“(3) QUALIFIED LOSS.—For purposes of this section—

“(A) IN GENERAL.—The term ‘qualified loss’ means, with respect to any taxable year, the amount by which the amount determined under paragraph (1)(B) exceeds the amount determined under paragraph (1)(A).

“(B) ORDERING RULE FOR LOSSES CARRIED FROM PRIOR TAXABLE YEARS.—In the case of any qualified losses carried to a taxable
year from 1 or more prior taxable years, such losses shall be taken into account—

“(i) first under paragraph (2), and

“(ii) then under subsection (b)(2)(B) to the extent such losses exceed the amount determined under paragraph (1).

“(d) EXCLUSION OF UNITED STATES INCOME.—For purposes of this subpart, any item of income of the controlled foreign corporation which is effectively connected with the conduct by such corporation of a trade or business within the United States shall not be taken into account in computing the subpart F income of such corporation unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States. For purposes of this subsection, any exemption (or reductions) with respect to the tax imposed by section 884 shall not be taken into account.

“(e) DEDUCTIONS.—For purposes of subsections (b)(1)(B) and (c)(1)(B), the active foreign market income, and gross income other than active foreign market income, of a controlled foreign corporation shall each be reduced, under regulations prescribed by the Secretary, by any deductions (including taxes) of such corporation properly allocable to items of income taken into account in computing such income.
“SEC. 953. ACTIVE FOREIGN MARKET INCOME.

“(a) Active Foreign Market Income Defined.—For purposes of this subpart, the term ‘active foreign market income’ means, with respect to any controlled foreign corporation, the aggregate of all items of income which are—

“(1) attributable to economically significant activities with respect to a qualified trade or business, and

“(2) derived in connection with—

“(A) property which is sold, exchanged, or otherwise disposed of for use, consumption, or disposition outside of the United States, or

“(B) services which are provided outside of the United States with respect to persons or property located outside of the United States.

“(b) Treatment of Passive Income.—

“(1) In General.—Except as otherwise provided in this subsection, the term ‘active foreign market income’ shall not include the passive income (as defined in section 954) of a controlled foreign corporation.

“(2) Active Foreign Market Income Includes Certain Income.—The term ‘active foreign market income’ shall include—
“(A) if the controlled foreign corporation or a qualified business unit of the corporation is an eligible controlled foreign corporation (as defined in section 954(c)), any item of income of the corporation or unit which is qualified banking or financing income (as so defined),

“(B) if the controlled foreign corporation or a qualified business unit of the corporation is a qualifying insurance company (as defined in section 954(d)) or a qualifying insurance company branch (as so defined), any item of income of the corporation or unit which is qualified insurance income (as so defined),

“(C) any item of income which is rents or royalties derived from the ownership and operation (including leasing) of real or personal property which is not treated as passive income under section 954(a)(2)(A), and

“(D) in the case of a regular dealer in property which is property described in section 954(a)(1)(B), forward contracts, option contracts, or similar financial instruments (including notional principal contracts and all instruments referenced to commodities), any item of income 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) GAIN OR LOSS FROM SALES OF STOCK IN
OTHER CFCS.—If a controlled foreign corporation
sells, exchanges, or otherwise disposes of stock in
another controlled foreign corporation which is a re-
lated person to the selling corporation—

“(A) gain from such sale, exchange, or dis-
position shall be treated as active foreign mar-
et income to the extent that such gain would
have been excluded from gross income under
section 1203 if the selling corporation were a
United States shareholder in the other con-
trolled foreign corporation, and

“(B) loss from such sale, exchange, or dis-
position shall not be allowed to the extent such
loss would have been disallowed under section
1213 if the selling corporation were a United
States shareholder in the other controlled for-
eign corporation.

“(4) GAIN OR LOSS FROM SALES OF INTERESTS
IN 25-PERCENT OWNED PARTNERSHIPS.—

“(A) IN GENERAL.—
“(i) Portion treated as active foreign market income.—In the case of any sale or exchange 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 taken into account in determining active foreign market income 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 the active foreign market income from the partnership over the applicable period 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 coordination of this paragraph with the provisions of subchapter K.

“(ii) Applicable period.—For purposes of this subparagraph, the term ‘applicable period’ means, with respect to any
interest in a partnership, the shorter of the 3-taxed year period immediately preceding the taxable year of the sale or exchange or the controlled foreign corporation’s holding period in the interest. In no event shall the applicable period include any portion of any taxable year beginning before January 1, 2015.

“(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 a partnership, the controlled foreign corporation shall be treated as owning directly its proportionate share of any capital or profits interest in any partnership 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.

“(c) TREATMENT OF INSURANCE INCOME.—

“(1) IN GENERAL.—Except as otherwise pro-

vided in this subsection, the term ‘active foreign

market income’ shall not include the insurance in-

come (as defined in section 955(a)) of a controlled

foreign corporation.

“(2) ACTIVE FOREIGN MARKET INCOME IN-

CLUDES EXEMPT INSURANCE INCOME.—The term

‘active foreign market income’ shall include exempt

insurance income (as defined in section 955(c)) shall

be treated as active foreign market income.

“(d) TREATMENT OF INCOME FROM PROPERTY

USED, CONSUMED, OR DISPOSED OF IN THE UNITED

STATES.—For purposes of subsection (a)(2)(A)—

“(1) IN GENERAL.—The term ‘active foreign

market income’ shall not include income derived in

connection with property which is sold, exchanged,

or otherwise disposed of to any person if it was rea-

sonable for the controlled foreign corporation (or a

related person) to expect that—

“(A) such property would be used, con-

sumed, or disposed of in the United States, or
“(B) such property would be used in the manufacture or production of, or as a component part in, other property which would be used, consumed, or disposed of in the United States.

“(2) Chain of related persons.—If—

“(A) property is ultimately used, consumed, or disposed of as described in subparagraph (A) or (B) of paragraph (1), and

“(B) all sales, exchanges, or dispositions of such property (or of the other property described in paragraph (1)(B)) before the sale for use, consumption, or disposition in the United States are between related persons,

then, for purposes of paragraph (1), there shall be deemed to have been a reasonable expectation that the property (or the other property described in paragraph (1)(B)) would be used, consumed, or disposed of in the United States.

“(3) Exception for property subsequently exported.—Paragraphs (1) and (2) shall not apply with respect to property which, after entry into the United States is—

“(A) sold, leased, rented, or licensed by the controlled foreign corporation or a related per-
son for direct use, consumption, or disposition outside the United States, or

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

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

“(e) ECONOMICALLY SIGNIFICANT ACTIVITIES.—For purposes of this section, the term ‘economically significant activities’ means, with respect to any item of income, activities—

“(1) performed outside the United States,

“(2) performed by officers or employees of the controlled foreign corporation which are part of the management and operational functions of the corporation, and

“(3) which make a substantial contribution to the production of such item of income.

“(f) QUALIFIED TRADE OR BUSINESS.—For purposes of this section—
“(1) IN GENERAL.—The term ‘qualified trade or business’ means any trade or business which consists of—

“(A) manufacturing, producing, growing, or extracting property outside of the United States, or

“(B) providing services outside of the United States.

“(2) SPECIAL RULE FOR SUBSTANTIAL CONTRIBUTIONS TO MANUFACTURING AND SERVICES.—If a trade or business consists of making a substantial contribution through the activities of the officers and employees of the controlled foreign corporation to a qualified trade or business which is described in subparagraph (A) or (B) of paragraph (1) of another person, then the trade or business shall be treated as a qualified trade or business described in subparagraph (A) or (B) of paragraph (1), whichever is applicable.

“SEC. 954. DEFINITION OF PASSIVE INCOME.

“(a) PASSIVE INCOME.—

“(1) IN GENERAL.—For purposes of this part, the term ‘passive 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 passive 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)) 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, other than a borrowing, 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 passive 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 indi-
vidual who is to perform the services,

or

“(II) the individual who is to per-
form the services is designated (by
name or by description) in the con-
tract, 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 out-
standing stock of the corporation is owned, di-
rectly or indirectly, by or for the individual who
has performed, is to perform, or may be des-
ignated (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.—Passive 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 passive 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) LOOK-THRU RULE FOR CERTAIN PARTNERSHIP SALES.—

“(A) IN GENERAL.—In the case of any sale or exchange by a controlled foreign corporation of an interest in a partnership with re-
spect 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 passive income from the partnership over the applicable period (as defined in section 953(b)(4)(A)(ii)) 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’ has the meaning given such term under section 953(b)(4)(B).

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

“(A) COMMODITY HEDGING TRANSACTIONS.—For purposes of paragraph (1)(C)(i), the term ‘commodity hedging trans-
action’ 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 passive 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), passive 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, the term ‘eligible controlled foreign corporation’ means any controlled foreign corporation if—

“(A) more than 80 percent of the gross income of the controlled foreign corporation is derived directly from the active and regular conduct 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 corpora-
tion,

“(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 ac-
tivities in connection with which are
conducted directly by the corporation
in its home country, and

“(iii) is treated as earned by such cor-
poration 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 de-
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 respect 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 com-
pensated on an arm’s-length basis for the
performance of the activity by its employ-
ees and such compensation is treated as
earned by such person in such home coun-
try for purposes of the home country’s tax
laws.

“(4) LENDING, FINANCE, OR FINANCIAL SERV-
ICES 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 receiv-
able, notes, or installment obligations,

“(C) engaging in leasing (including enter-
ing 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 prod-
ucts 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 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 trans-
action 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), passive income shall not include qualified insurance income of a qualifying insurance company.

“(2) Qualified insurance income.—For purposes of this subsection, 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 reserves 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 deter-
mining 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 955(c) shall have the meaning given such term under section 955(c).

“SEC. 955. DEFINITION OF INSURANCE INCOME.

“(a) INSURANCE INCOME.—
“(1) IN GENERAL.—For purposes of section 953(c), the term ‘insurance income’ means the gross income which—

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

“(B) is of a kind that would be subject to tax 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 (c)).

“(b) SPECIAL RULES FOR DETERMINATION OF GROSS INCOME AND ALLOCABLE DEDUCTIONS.—For purposes of determining gross income under subsection (a) and deductions allocable to insurance income under section 952(e), the following rules shall apply:

“(1) CERTAIN DEDUCTIONS NOT ALLOWED.—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) SPECIAL RULES FOR AMOUNTS INCLUDED
IN INCOME.—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 de-
crease in reserves),

“(C) section 805(a)(2) (relating to net in-
crease in reserves), and

“(D) section 832(b)(4) (relating to pre-
miums 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 sub-
section (a)(1).

“(3) TREATMENT OF RESERVES.—Reserves for
any insurance or annuity contract shall be deter-
mined in the same manner as under section 954(d).

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

“(1) EXEMPT INSURANCE INCOME DEFINED.—

“(A) IN GENERAL.—The term ‘exempt in-
surance 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 requirements.—A contract issued by a qualifying insurance company or qualifying insurance company 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 foreign 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 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

“(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 pre-
miums 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 regu-
latory 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, re-
insurance, 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 CON-
TRACT.—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-
tact 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 in-
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 CORPO-
RATION.—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 ap-
plying 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 reinsur-
ance 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, annu-
itant, 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(b)).

“(8) COORDINATION WITH SECTION 956(a).—

“(A) IN GENERAL.—In determining insurance income for purposes of section 956(a), 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 treatment of certain investment income derived by qualifying insurance companies, see section 954(d).

“SEC. 956. SPECIAL RULE FOR CERTAIN CAPTIVE INSURANCE COMPANIES.

“(a) Treatment as Controlled Foreign Corporations and United States Shareholders.—

“(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) 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 section 955(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.
“(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 ‘disquali-
fied corporation’ means, with respect to any taxable year, any foreign corporation which is a controlled foreign corporation at any time 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 reg-
ulations 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(b).

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

“(7) REGULATIONS.—The Secretary shall pre-
scribe 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 ar-
rangements 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 per-
son (nor any related person to such person) is
(directly or indirectly) insured under any policy
of insurance or reinsurance issued by such for-
eign corporation.

“(b) 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 defini-
tion of United States shareholder under sub-
section (a)(1)(B)),

“(B) such foreign corporation would qual-
ify 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) 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 profits.—

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

“(4) 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.

“(5) 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.”.

(b) Treatment of Certain Excluded Subpart F Income as Previously Taxed Income.—Section 959(g), as added by section 1031, is amended to read as follows:

“(g) Special Rules for Nontaxed Portion of Certain Income.—For purposes of this section—

“(1) In General.—A United States shareholder’s pro rata share of the excludable portion of the controlled foreign corporation’s subpart F income shall be treated as an amount which has been included in gross income under section 951(a).

“(2) Ordering Rule.—Notwithstanding subsection (c), for purposes of subsections (a) and (b), section 316(a) shall be applied by applying paragraph (2) thereof and then paragraph (1) thereof—

“(A) first to the deductible portion (as defined in section 965(c)(3)) of the increase in subpart F income described in section 965(a)(1) included in the gross income of United States shareholders under section
65

951(a)(1) (after application of section 965(a)(2)(A)),

“(B) second to the excludable portion of the controlled foreign corporation’s subpart F income, and

“(C) then to the amounts described in paragraphs (1), (2), or (3) of subsection (e) in accordance with the provisions of subsection (e).

“(3) DEFINITIONS.—For purposes of this subsection—

“(A) DEDUCTIBLE PORTION.—The term ‘deductible portion’ has the meaning given such term by section 965(c)(3).

“(B) EXCLUDABLE PORTION.—For purposes of this subsection, the term ‘excludable portion’ means, with respect to the subpart F income of a controlled foreign corporation, the \( [40\] \) percent of the modified active income not taken into account in computing subpart F income by reason of section 952(a)(1).”.

(c) GAINS AND LOSSES FROM THE SALE OF CFC STOCK.—

(1) GAINS.—
(A) IN GENERAL.—Part I of subchapter P of chapter 1 is amended by adding at the end the following new section:

"SEC. 1203. GAINS FROM SALES OR EXCHANGES OF STOCK IN CONTROLLED FOREIGN CORPORATIONS.

“(a) IN GENERAL.—In the case of a United States shareholder (as defined in section 951), there shall be excluded from gross income an amount equal to the applicable portion of the amount of any gain recognized from the sale or exchange of stock in a controlled foreign corporation.

“(b) APPLICABLE PORTION.—For purposes of this section—

“(1) IN GENERAL.—The term ‘applicable portion’ means the amount which bears the same ratio to the gain recognized from such sale or exchange as—

“(A) the shareholder’s pro rata share (determined under section 951(a)(2)) of the excludable portion of the aggregate subpart F income of the controlled foreign corporation for the applicable period, bears to

“(B) the sum of the amount determined under subparagraph (A) plus the shareholder’s pro rata share (determined under section
951(a)(2)) of the aggregate subpart F income
of the controlled foreign corporation for the ap-
plicable period.

“(2) EXCLUDABLE PORTION.—For purposes of
this section, the term ‘excludable portion’ has the
meaning given such term by section 959(g)(3)(B).

“(3) APPLICABLE PERIOD.—The term ‘applica-
ble period’ means, with respect to any stock, the
shorter of the 3-taxable year period immediately pre-
ceeding the taxable year of the sale or exchange or
the shareholder’s holding period in the stock. In no
event shall the applicable period include any portion
of any taxable year beginning before January 1,
2015.”.

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

“Sec. 1203. Gains from sales or exchanges of stock in controlled foreign cor-
porations.”.

(2) LOSSES.—

(A) IN GENERAL.—Part II of subchapter P
of chapter 1 is amended by adding at the end
the following new section:
“SEC. 1213. LOSSES FROM SALES OR EXCHANGES OF STOCK IN CONTROLLED FOREIGN CORPORATIONS.

“(a) In General.—In the case of a United States shareholder (as defined in section 951), any loss from the sale or exchange of stock in a controlled foreign corporation shall be reduced (but not below zero) by an amount equal to the shareholder’s aggregate pro rata share (determined under section 951(a)(2)) of the excludable portion of the subpart F income of the controlled foreign corporation during the shareholder’s holding period in the stock.

“(b) Excludable Portion.—For purposes of this section, the term ‘excludable portion’ has the meaning given such term by section 959(g)(3)(B).”.

(B) Clerical Amendment.—The table of sections for part I of subchapter P of chapter 1 is amended by adding at the end the following new item:

“Sec. 1213. Losses from sales or exchanges of stock in controlled foreign corporations.”.

(d) Repeal of Ordinary Income Treatment for Gains From the Sale of Stock in Certain Foreign Corporations.—

(1) In General.—Part IV of subchapter P of chapter 1 is amended by striking section 1248.

(2) Conforming Amendments.—
A) Section (a) is amended by striking paragraph (11).

B) Section 338(h) is amended—
   (i) in paragraph (6)(B)(ii), by striking “or described in section 1248(e)”", and
   (ii) in paragraph (16), by striking the second sentence.

C) Section 751 is amended—
   (i) in subsection (e), by striking “stock in certain foreign corporations (as described in section 1248),”", and
   (ii) by striking subsection (e) and redesignating subsection (f) as subsection (e).

D) Section 865(k) is amended to read as follows:
   “(k) CROSS REFERENCE.—For sourcing of income from certain foreign currency transactions, see section 988.”.

E) Section 904(h)(7) is amended by striking “or as a dividend under section 1248”.

F) Section 951(a)(2) is amended by striking the last sentence thereof.

G) Section 964 is amended by striking subsection (e).
(H) Section 989(b) is amended by striking paragraph (2) and by redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively.

(e) 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 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”.

(E) Section 959(e) 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.”.

(F) Section 959(e) is amended by striking “951(a)(1)(A)” and inserting “951(a)(1)”.

(G) Section 989(b)(3) is amended by striking “951(a)(1)(A)” and inserting “951(a)(1)”.

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

(f) Application of Anti-Loss Importation Rules.—Section 362(e)(1)(B) is amended by adding at the end the following new sentence: “For purposes of clause (i), except as provided under regulations, a con-
trolled foreign corporation shall be considered to be sub-
ject to tax under this subtitle.”.

(g) Other Conforming Amendments.—

(1) Sections 163(e)(3)(B)(i) and
267(a)(3)(B)(i) are each amended by striking “and
qualified deficits under section 952(c)(1)(B)” and
inserting “and loss carryforwards under sections
952(d) and 953(b)”.

(2) Section 304(b)(5)(B)(ii) is amended by
striking “953(e)” and inserting “956(a)”.

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

(4) Section 512(b)(17) is amended by striking
“953” and inserting “section 955”.

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

(6) 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)”.

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

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

(9) Section 884(d)(2)(D) is amended by strik-
ing “953(c)(3)(C)” and inserting “956(a)(3)(C)”.

(10) Section 898(b)(3) is amended—

(A) by striking “953(c)(2)” and inserting
“956(a)(2)”, and

(B) by striking “953(c)(1)” and inserting
“956(a)(1)”.

(11) 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)”.
(12) Section 957(b) is amended—

(A) by striking “income described in section 953(a)” and inserting “income described in section 955(a)”, and

(B) by striking “contracts described in section 953(a)(1)” and inserting “contracts described in section 955(a)(1)”.

(13) Section 958(b) is amended—

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

(B) 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

(C) by striking the last sentence.

(14) Section 964(b) is amended by striking “sections 952, 955, and 956” and inserting “section 952”.

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

(16)(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.

(17) Section 999(c) is amended—

(A) by striking “, 952(a)(3)” in paragraph (1), and

(B) by striking “, the addition to subpart F income under section 952(a)(3),” in paragraph (2).

(18) Section 1296(f)(2) is amended—

(A) by striking “foreign personal holding company income described in section 954(c)(1)(A)” in subparagraph (A) and inserting “passive income (as defined in section 954(a))”, and

(B) by striking “foreign personal holding company income so described” and inserting “such passive income”.

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

“(b) PASSIVE INCOME.—

“(1) IN GENERAL.—Except as provided in paragraph (2), the term ‘passive income’ means any income received or accrued by any foreign corporation which is of a kind which would be passive income as
defined in section 954 if the foreign corporation were a controlled foreign corporation.

“(2) Exception.—Except as provided in regulations, the term ‘passive income’ does not include any income which is interest, a dividend, or a rent or royalty, which is received or accrued from a related person (within the meaning of section 954(b)) to the extent that such amount is properly allocable (under regulations prescribed by the Secretary) to income of such related person which is not passive income.”.

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

(21) 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 958(b).

(C) Section 988(a)(3)(C).

(D) Subsections (d)(3)(A) and (e)(2)(B)(i) of section 1298.

(E) Section 1471(e)(2).

(F) Section 3121(z)(2).
(22) The table of sections for subpart F of part III of subchapter 1 is amended by striking the items relating to sections 952 through 956 and inserting the following:

"Sec. 952. Subpart F income defined.
"Sec. 953. Active foreign market income.
"Sec. 954. Definition of passive income.
"Sec. 955. Definition of insurance income.
"Sec. 956. Special rule for certain captive insurance companies."

(h) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), 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.

(2) GAINS AND LOSSES FROM THE SALE OF CFC STOCK; REPEAL OF SECTION 1248.—The amendments made by subsections (c) and (d) shall apply to sales or exchanges after December 31, 2014.

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 section 907 and 960 shall be applied separately with respect to—

“(A) amounts included under section 951(a) which are attributable to active foreign market income (as defined in section 953),

“(B) passive category income, and

“(C) income other than income described in either of the preceding subparagraphs.

“(2) DEFINITIONS AND SPECIAL RULES.—

“(A) PASSIVE CATEGORY INCOME.—

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

“(I) United States taxpayer passive income described in subparagraph (B), 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 passive income (as defined in section 954(a)).

“(ii) EXCEPTION FOR HIGH-TAXED INCOME.—Passive category income shall not include any high-taxed income.
“(iii) Clarification of application of section 864(d)(6).—In determining whether any income is passive category income, the rules of section 864(d)(6) shall apply only in the case of income of a controlled foreign corporation.

“(B) United States taxpayer passive income.—United States taxpayer passive income described in this subparagraph is income received or accrued by the taxpayer which is of a kind that would be passive income as defined under section 954(a) if such taxpayer were a controlled foreign corporation.

“(C) Treatment of financial services income and companies.—

“(i) In general.—Financial services income which is not active foreign market category income shall be treated as income described in paragraph (1)(C) in the case of—

“(I) a member of a financial services group, and

“(II) any other person if such person is predominantly engaged in
the active conduct of a banking, insurance, financing, or similar business.

“(ii) **Financial Services Group.**—

The term ‘financial services group’ means any affiliated group (as defined in section 1504(a) without regard to paragraphs (2) and (3) of section 1504(b)) which is predominantly engaged in the active conduct of a banking, insurance, financing, or similar business. In determining whether such a group is so engaged, there shall be taken into account only the income of members of the group that are—

“(I) United States corporations,

or

“(II) controlled foreign corporations in which such United States corporations own, directly or indirectly, at least 80 percent of the total voting power and value of the stock.

“(iii) **Pass-Thru Entities.**—The Secretary shall by regulation specify for purposes of this subparagraph the treatment of financial services income received or accrued by partnerships and by other
pass-thru entities which are not members of a financial services group.

“(D) FINANCIAL SERVICES INCOME.—

“(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term ‘financial services income’ means any income which is received or accrued by any person predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, and which is—

“(I) described in clause (ii), or

“(II) United States taxpayer passive income (determined without regard to subparagraph (A)(ii)).

“(ii) GENERAL DESCRIPTION OF FINANCIAL SERVICES INCOME.—Income is described in this clause if such income is—

“(I) derived in the active conduct of a banking, financing, or similar business,

“(II) derived from the investment by an insurance company of its unearned premiums or reserves ordinary and necessary for the proper conduct of its insurance business, or
“(III) of a kind which would be insurance income as defined in section 955(a).

“(E) HIGH-TAXED INCOME.—The term ‘high-taxed income’ means any income which (but for this subparagraph) would be passive category 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.

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

“(i) IN GENERAL.—In the case of taxable years beginning after December 31,
2006, 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)(C).

“(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 im-
posed 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.

‘‘(G) 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)(B), 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)(C), 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 956(a)).
“(B) UNITED STATES SHAREHOLDER.—

The term ‘United States shareholder’ has the
meaning given such term by section 951(b)
taking into account section 956(a)).

“(4) SEPARATE APPLICATION TO ITEMS
RESＯURED UNDER TREATIES.—

“(A) IN GENERAL.—If—

“(i) without regard to any treaty obli-
gation 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 bene-
fits of such treaty obligation,

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

“(B) COORDINATION WITH OTHER PROVI-
SIONS.—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 as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations which provide 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 EXCLUDED 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 WITH RESPECT TO EXCLUDED SUBPART F INCOME.—
“(1) IN GENERAL.—Notwithstanding section 960(b), no credit shall be allowed under subsection (a) for any income, war profits, or excess profits taxes paid or accrued (or deemed paid or accrued under section 960) with respect to the excludable portion of subpart F income or any distribution received by a United States shareholder (as defined in section 951(b)) which is properly attributable to such excludable portion. No deduction shall be allowed to a taxpayer under this chapter for any tax for which a credit is not allowable by reason of the preceding sentence.

“(2) EXCLUDABLE PORTION.—The term ‘excludable portion’ has the meaning given such term by section 959(g)(3)(B).

“(3) COORDINATION WITH SECTION 78.—Section 78 shall not apply to any tax which is not allowable as a credit under this section by reason of this subsection.”.

(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.
PART III—EXPENSE DISALLOWANCE

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

“(a) In General.—In the case of a United States shareholder of a controlled foreign corporation for any taxable year, no deduction shall be allowed under this chapter for—

“(1) the disallowed portion of any allocable CFC interest, or

“(2) expenses directly allocable to the excludable portion of subpart F income (as defined in section 959(g)(3)(B)).

“(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, [40] percent of the amount which bears the same ratio to the amount of such interest as—
“(A) the corporation’s modified active income (as defined in section 952) for the applicable taxable year, bears to

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

“(2) CURRENT EARNINGS AND PROFITS.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘current earnings and profits’ means the earnings and profits of the controlled foreign corporation for the applicable taxable year, without diminution by reason of distributions made during the taxable year.

“(B) SPECIAL RULE FOR DETERMINING EARNINGS AND PROFITS.—Earnings and profits of any controlled foreign corporation shall be determined without regard to paragraphs (4), (5), and (6) of section 312(n). Under regulations, the preceding sentence shall not apply to the extent it would increase earnings and profits by an amount which was previously distributed by the controlled foreign corporation.

“(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 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.

“(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 domestic corporation which 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 purposes 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 or other expenses disallowed under this section with income of a controlled 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 of a controlled foreign corporation.”.

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

“Sec. 265A. 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.