



Joint Committee on Taxation
April 2, 2003
JCX-34-03

**DESCRIPTION OF CHAIRMAN'S AMENDMENT
IN THE NATURE OF A SUBSTITUTE
TO H.R. 1531,
THE "ENERGY TAX POLICY ACT OF 2003"**

The Chairman's amendment in the nature of a substitute to H.R. 1531 would add the following five modifications and two new provisions.

A. Modifications

1. Modification to provision relating to section 45

The Chairman's substitute provides that for wind energy facilities placed in service after the date of enactment the taxpayer may claim the section 45 credit against both the regular tax and alternative minimum tax for the first four years of production beginning after the date the facility is placed in service.

2. Modification to provision for clean-fuel vehicles

In addition, to the provisions relating to sec. 179A and sec. 30, the Chairman's substitute provides a credit for the purchase of a new qualified fuel cell motor vehicle and a new advanced lean burn technology motor vehicle. In general the proposal provides that the buyer claims the credit, unless the buyer is a tax-exempt entity in which case the seller or lessor of the vehicle may claim the credit. The proposal permits unused credits to be carried forward for up to 20 years. Qualified advanced lean burn technology motor vehicles are vehicles placed in service before 2007. Qualified fuel cell motor vehicles are vehicles placed in service before 2013.

Fuel cell vehicles

A qualifying fuel cell vehicle is a motor vehicle that is propelled by power derived from one or more cells which convert chemical energy directly into electricity by combining oxygen with hydrogen fuel which is stored on board the vehicle and may or may not require reformation prior to use. The amount of credit for the purchase of a fuel cell vehicle is determined by a base credit amount that depends upon the weight class of the vehicle and in the case of automobiles or light trucks and additional credit amount that depends upon the rated fuel economy of the vehicle compared to a base fuel economy. For these purposes the base fuel economy is the 2000 model

year city fuel economy rating for vehicles of various weight classes (see below). Table 1 below, shows the proposed base credit amounts.

Table 1.–Base Credit Amount for Fuel Cell Vehicles

Vehicle Gross Weight Rating in Pounds	Credit Amount
vehicle ≤ 8,500.....	\$4,000
8,500 < vehicle ≤ 14,000.....	\$10,000
14,000 < vehicle ≤ 26,000.....	\$20,000
26,000 < vehicle.....	\$40,000

Table 2, below, shows the proposed additional credits for automobiles or light trucks.

Table 2.–Credit for Qualifying Fuel Cell Vehicles

Credit	If Fuel Economy of the Fuel Cell Vehicle Is:	
	at least	But less than
\$1,000	150% of base fuel economy	175% of base fuel economy
\$1,500	175% of base fuel economy	200% of base fuel economy
\$2,000	200% of base fuel economy	225% of base fuel economy
\$2,500	225% of base fuel economy	250% of base fuel economy
\$3,000	250% of base fuel economy	275% of base fuel economy
\$3,500	275% of base fuel economy	300% of base fuel economy
\$4,000	300% of base fuel economy	

Advanced lean burn technology motor vehicle

A qualifying advanced lean burn technology motor vehicle must meet the Environmental Protection Agency's Tier II bin 8 emissions standards. Table 3, below, shows the proposed credits for the purchase of an advanced lean burn technology motor vehicle.

Table 3.—Credit for Qualifying Advanced Lean Burn Technology Motor Vehicles

Credit	If Fuel Economy of the Vehicle Is:	
	at least	but less than
\$500	125% of base fuel economy	150% of base fuel economy
\$1,000	150% of base fuel economy	175% of base fuel economy
\$1,500	175% of base fuel economy	200% of base fuel economy
\$2,000	200% of base fuel economy	225% of base fuel economy
\$2,500	225% of base fuel economy	250% of base fuel economy
\$3,000	250% of base fuel economy	

In addition to the credit amount shown in Table 3, an advanced lean burn technology automobile or light truck may be eligible for an additional credit of \$250 if the vehicle achieves an estimated lifetime fuel savings of at least 1,500 gallons of fuel and a further additional credit of \$500 if the vehicle achieves an estimated lifetime fuel savings of at least 2,500 gallons compared to a like conventional vehicle (using the 2000 model year city fuel economy rating for the like vehicle and assuming 120,000 miles driven).

Base fuel economy

The base fuel economy is the 2000 model year city fuel economy for vehicles by inertia weight class by vehicle type. The "vehicle inertia weight class" is that defined in regulations prescribed by the Environmental Protection Agency for purposes of Title II of the Clean Air Act. Table 4, below, shows the 2000 model year city fuel economy for vehicles by type and by inertia weight class.

Table 4.—2000 Model Year City Fuel Economy

Vehicle Inertia Weight Class (pounds)	Passenger Automobile (miles per gallon)	Light Truck (miles per gallon)
1,500	43.7	37.6
1,750	43.7	37.6
2,000	38.3	33.7
2,250	34.1	30.6
2,500	30.7	28.0
2,750	27.9	25.9
3,000	25.6	24.1
3,500	22.0	21.3
4,000	19.3	19.0
4,500	17.2	17.3
5,000	15.5	15.8
5,500	14.1	14.6
6,000	12.9	13.6
6,500	11.9	12.8
7,000	11.1	12.0
8,500	11.1	12.0

3. Repeal certain excise taxes on rail diesel fuel and inland waterway barge fuels

The Chairman’s substitute changes the effective date of repeal to January 1, 2004.

4. Modifications to expensing of capital costs incurred in complying with Environmental Protection Agency sulfur regulations

The Chairman’s substitute provides that the taxpayer’s basis in property is reduced by any deduction claimed.

5. Modifications to provision relating to section 29

The Chairman’s substitute provides that section 29 is added to the list of general business credits. The Chairman’s substitute also changes the effective date to April 1, 2003.

B. Corporate Expatriation

1. Tax treatment of corporate expatriation

Present Law

Determination of corporate residence

The U.S. tax treatment of a multinational corporate group depends significantly on whether the top-tier parent corporation of the group is domestic or foreign. For purposes of U.S. tax law, a corporation is treated as domestic if it is incorporated under the law of the United States or of any State. All other corporations (i.e., those incorporated under the laws of foreign countries) are treated as foreign.

U.S. taxation of domestic corporations

The United States employs a “worldwide” tax system, under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. In order to mitigate the double taxation that may arise from taxing the foreign-source income of a domestic corporation, a foreign tax credit for income taxes paid to foreign countries is provided to reduce or eliminate the U.S. tax owed on such income, subject to certain limitations.

Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income is generally deferred. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F¹ and the passive foreign investment company rules.² A foreign tax credit is generally available to offset, in whole or in part, the U.S. tax owed on this foreign-source income, whether repatriated as an actual dividend or included under one of the anti-deferral regimes.

U.S. taxation of foreign corporations

The United States taxes foreign corporations only on income that has a sufficient nexus to the United States. Thus, a foreign corporation is generally subject to U.S. tax only on income that is “effectively connected” with the conduct of a trade or business in the United States. Such “effectively connected income” generally is taxed in the same manner and at the same rates as the income of a U.S. corporation. An applicable tax treaty may limit the imposition of U.S. tax

¹ Secs. 951-964.

² Secs. 1291-1298.

on business operations of a foreign corporation to cases in which the business is conducted through a “permanent establishment” in the United States.

In addition, foreign corporations generally are subject to a gross-basis U.S. tax at a flat 30-percent rate on the receipt of interest, dividends, rents, royalties, and certain similar types of income derived from U.S. sources, subject to certain exceptions. The tax generally is collected by means of withholding by the person making the payment. This tax may be reduced or eliminated under an applicable tax treaty.

U.S. tax treatment of inversion transactions

Under present law, U.S. corporations may reincorporate in low-tax foreign jurisdictions and thereby replace the U.S. parent corporation of a multinational corporate group with a foreign parent corporation. These transactions are commonly referred to as inversion transactions. Inversion transactions may take many different forms, including stock inversions, asset inversions, and various combinations of and variations on the two. Most of the known transactions to date have been stock inversions. In one example of a stock inversion, a U.S. corporation forms a foreign corporation, which in turn forms a domestic merger subsidiary. The domestic merger subsidiary then merges into the U.S. corporation, with the U.S. corporation surviving, now as a subsidiary of the new foreign corporation. The U.S. corporation’s shareholders receive shares of the foreign corporation and are treated as having exchanged their U.S. corporation shares for the foreign corporation shares. An asset inversion reaches a similar result, but through a direct merger of the top-tier U.S. corporation into a new foreign corporation, among other possible forms. An inversion transaction may be accompanied or followed by further restructuring of the corporate group. For example, in the case of a stock inversion, in order to remove income from foreign operations from the U.S. taxing jurisdiction, the U.S. corporation may transfer some or all of its foreign subsidiaries directly to the new foreign parent corporation or other related foreign corporations.

In addition to removing foreign operations from the U.S. taxing jurisdiction, the corporate group may derive further advantage from the inverted structure by reducing U.S. tax on U.S.-source income through various earnings stripping or other transactions. This may include earnings stripping through payment by a U.S. corporation of deductible amounts such as interest, royalties, rents, or management service fees to the new foreign parent or other foreign affiliates. In this respect, the post-inversion structure enables the group to employ the same tax-reduction strategies that are available to other multinational corporate groups with foreign parents and U.S. subsidiaries, subject to the same limitations.³

Inversion transactions may give rise to immediate U.S. tax consequences at the shareholder and/or the corporate level, depending on the type of inversion. In stock inversions, the U.S. shareholders generally recognize gain (but not loss) under section 367(a), based on the difference between the fair market value of the foreign corporation shares received and the adjusted basis of the domestic corporation stock exchanged. To the extent that a corporation’s share value has declined, and/or it has many foreign or tax-exempt shareholders, the impact of

³ See, e.g., secs. 163(j) and 482.

this section 367(a) “toll charge” is reduced. The transfer of foreign subsidiaries or other assets to the foreign parent corporation also may give rise to U.S. tax consequences at the corporate level (e.g., gain recognition and earnings and profits inclusions under sections 1001, 311(b), 304, 367, 1248 or other provisions). The tax on any income recognized as a result of these restructurings may be reduced or eliminated through the use of net operating losses, foreign tax credits, and other tax attributes.

In asset inversions, the U.S. corporation generally recognizes gain (but not loss) under section 367(a) as though it had sold all of its assets, but the shareholders generally do not recognize gain or loss, assuming the transaction meets the requirements of a reorganization under section 368.

Description of Proposal

The proposal denies the tax benefits of corporate inversion transactions completed after March 4, 2003 and before January 1, 2005, effectively imposing a moratorium on such transactions.

For purposes of the proposal, a corporate inversion transaction is a transaction in which, pursuant to a plan or a series of related transactions: (1) a U.S. corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity; (2) the former shareholders of the U.S. corporation hold (by reason of holding stock in the U.S. corporation) 80 percent or more (by vote or value) of the stock of the foreign-incorporated entity after the transaction; and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50 percent ownership (i.e., the “expanded affiliated group”), does not have substantial business activities in the entity’s country of incorporation, compared to the total worldwide business activities of the expanded affiliated group. The proposal denies the intended tax benefits of this type of inversion by deeming the top-tier foreign corporation to be a domestic corporation for purposes of the Code.

In determining whether a transaction meets the definition of an inversion under the proposal, stock held by members of the expanded affiliated group that includes the foreign incorporated entity is disregarded. For example, if the former top-tier U.S. corporation receives stock of the foreign incorporated entity (e.g., so-called “hook” stock), the stock would not be considered in determining whether the transaction meets the definition of an inversion. Similarly, if a U.S. parent corporation converts an existing wholly owned U.S. subsidiary into a wholly owned controlled foreign corporation, the stock of the new foreign corporation would be disregarded, and the definition would not be met. Stock sold in a public offering related to the transaction also is disregarded for these purposes.

Transfers of properties or liabilities as part of a plan a principal purpose of which is to avoid the purposes of the proposal are disregarded. In addition, the Treasury Secretary is granted authority to prevent the avoidance of the purposes of the proposal, including avoidance through the use of related persons, pass-through or other noncorporate entities, or other intermediaries, and through transactions designed to qualify or disqualify a person as a related person or a member of an expanded affiliated group. Similarly, the Treasury Secretary is granted authority

to treat certain non-stock instruments as stock, and certain stock as not stock, where necessary to carry out the purposes of the proposal.

The proposal also applies to partnership transactions in which a foreign-incorporated entity acquires substantially all of the properties constituting a trade or business of a domestic partnership, if after the acquisition at least 80 percent of the stock of the entity is held by former partners of the partnership (by reason of holding their partnership interests), and the “expanded affiliated group” that includes the foreign-incorporated entity does not have substantial business activities in the entity’s country of incorporation, compared to the total worldwide business activities of the expanded affiliated group. For purposes of applying this test, all partnerships that are under common control within the meaning of section 482 are treated as one partnership, except as provided otherwise in regulations.

The proposal explicitly provides that no treaty obligation shall prevent the application of the proposal.

Effective Date

The proposal is effective for taxable years ending after March 4, 2003. The proposal applies with respect to corporate inversion transactions completed after March 4, 2003 and before January 1, 2005.

2. Sense of the Congress that tax reform is needed to address the issue of corporate expatriation

Present Law

The United States employs a “worldwide” tax system, under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income is generally deferred. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States with respect to certain categories of passive or highly mobile income earned by its foreign subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F⁴ and the passive foreign investment company rules.⁵ A foreign tax credit is generally available to offset, in whole or in part, the U.S. tax owed on this foreign-source income, whether repatriated as an actual dividend or included under one of the anti-deferral regimes.

⁴ Secs. 951-964.

⁵ Secs. 1291-1298.

Description of Proposal

The proposal finds that the U.S. tax laws are overly complex and burdensome, placing domestically owned companies at a competitive disadvantage relative to foreign-owned companies, and thus creating an incentive for domestically owned companies to become foreign-owned, via inversion or otherwise. The proposal expresses the Sense of the Congress “that passage of legislation to fix the underlying problems with our tax laws is essential and should occur as soon as possible, so United States corporations will not face the current pressures to engage in inversion transactions.”

Effective Date

The proposal is effective on the date of enactment.