

[COMMITTEE PRINT]

TAX REFORM BILL OF 1974

Press Release Descriptions of Tentative Decisions  
Corresponding to Sections of Draft Bill

TITLE III—CHANGES IN TREATMENT  
OF FOREIGN INCOME

PREPARED FOR THE USE OF  
THE COMMITTEE ON WAYS AND MEANS  
U.S. HOUSE OF REPRESENTATIVES

BY

THE STAFF

OF THE

JOINT COMMITTEE ON INTERNAL  
REVENUE TAXATION



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### **TITLE III—CHANGES IN TREATMENT OF FOREIGN INCOME**

#### **Part I—Amendments Primarily Affecting Individuals**

**Sec. 311. Repeal of exclusion for income earned abroad by United States citizens living or residing abroad.**

The exclusion from income under present law of \$20,000 (or, in some cases, \$25,000) for income earned abroad by U.S. citizens living or residing abroad is to be repealed.

**Sec. 312. Foreign trusts having one or more United States beneficiaries to be taxed currently to grantor.**

Income of foreign trusts established by a U.S. grantor which has one or more U.S. beneficiaries is to be taxed currently to the grantor under the existing so-called grantor trust rules of the Code.

**Sec. 313. Interest charge on accumulation distributions from foreign trusts.**

In the case of accumulated income of foreign trusts which is not taxed on a current basis, an interest charge is to be added to the tax paid by U.S. beneficiaries when they receive accumulated income distributions.

**Sec. 314. Excise tax on transfers of property to foreign persons to avoid Federal income tax.**

The 27½ percent excise tax which, under present law, applies to transfers of appreciated stocks or securities to a foreign trust or a foreign corporation or partnership, is to be increased to 35 percent and apply to transfers of all types of appreciated property.

#### **Part II—Amendments Affecting Tax Treatment of Controlled Foreign Corporations and Their Shareholders**

**Sec. 321. Repeal of minimum distributions exception to requirement of current taxation of subpart F income.**

The exception in present law which permits deferral of income earned through so-called tax haven operations by foreign subsidiaries of U.S. corporations in cases where the foreign corporation (or various combinations of related foreign corporations) distribute certain minimum dividends to their U.S. shareholders is to be repealed. The effect of repealing this exception is to tax currently all income of foreign subsidiaries of U.S. corporations which is deemed to be tax haven income under the existing so-called subpart F rules of the Code.

**Sec. 322. Repeal of exception to requirement of current taxation of subpart F income for reinvestment in less developed countries.**

The provisions in present law ending deferral for certain tax-haven income (so-called Subpart F income) are to be modified to end the exception which presently applies where the dividends are reinvested in less-developed countries.

**Sec. 323. Amendment of provision relating to investment in United States property by controlled foreign corporations.**

The provision in present law under which U.S. shareholders of a controlled foreign corporation are deemed to have received dividends from that corporation if it reinvests its profits in the United States is to be limited to cases where the foreign corporation engages in a leasing arrangement or lends money to a related U.S. person.

**Sec. 324. Repeal of exclusion for earnings of less developed country corporations for purposes of section 1248.**

Third, The provisions of present law providing for ordinary income taxation to U.S. shareholders on gains from the sale of stock in foreign corporations (to the extent of the shareholder's pro rata share of the earnings and profits of that corporation) are to be applied in the same manner to less-developed country corporations as they apply to other foreign corporations.

**Sec. 325. Shipping profits of controlled foreign corporation to be taxed currently except to extent reinvested in shipping operations.**

The rule under present law which permits deferral of U.S. tax for shipping income received by a foreign subsidiary of a U.S. corporation is continued, but is to be limited to the extent that the profits of these corporations are reinvested in shipping operations.

**Part III—Amendments Affecting DISC**

**Sec. 331. Denial of DISC benefits with respect to certain items.**

The committee agreed to make the DISC provisions inapplicable to agricultural and natural resource products and to goods subject to export control.

**Sec. 332. Termination of application of DISC provisions in connection with trade agreement to reduce barriers to international trade.**

The committee agreed to give the President's Special Representative for Trade Negotiations authority to negotiate the elimination of DISC benefits as part of multilateral agreements on trade.

**Part IV—Amendments Affecting Treatment of Foreign Taxes**

**Sec. 341. Requirement that foreign tax credit be determined on overall basis.**

The per-country limitation on the foreign tax credit is to be repealed for all industries. This extends and is consistent with the com-

mittee's earlier action in the Oil and Gas Energy Tax Act, which repeals this limitation in the case of oil and gas companies. The repeal would be effective as of January 1, 1975.

**Sec. 342. Recapture of foreign losses.**

Consistent with earlier committee action in the Oil and Gas Energy Tax Act, the committee agreed to a provision to require that any foreign losses which offset U.S. income will be recaptured in future years when foreign income is earned.

**Sec. 343. Dividends from less developed country corporations to be grossed up for purposes of determining United States income and foreign tax credit against that income.**

Dividends received by U.S. shareholders from less-developed country corporations are to be "grossed-up" by the amount of taxes paid in the less-developed country both for purposes of computing U.S. income and for purposes of computing the U.S. foreign tax credit applicable to that income.

**Sec. 344. Treatment of capital gains for purposes of foreign tax credit.**

In cases where a U.S. taxpayer sells a capital asset in a foreign country, the amount of any income received from the sale is not to be included as foreign source income for purposes of computing the taxpayer's foreign tax credit limitation if no substantial foreign tax is paid upon the sale of the asset. In this case and in cases where U.S. source capital gains are realized, the foreign tax credit limitation is to be adjusted to the extent of the capital gains.

**Part V—Money or Other Property Moving Out of or Into the United States**

**Sec. 351. Portfolio investments in United States of nonresident aliens and foreign corporations.**

The 30 percent withholding tax on dividends and interest received from the United States by foreign persons is to be repealed except in the case of dividends and interest from investments that constitute a direct investment in U.S. securities rather than a portfolio investment. As part of this provision, the present exemption from the 30 percent withholding tax which applies to foreign deposits held in United States banks (which under present law would expire on December 31, 1975) is to be made permanent. In these cases where the withholding tax is not to apply, the stock and securities are to be exempt from U.S. estate tax.

**Sec. 352. Changes in ruling requirements under section 367; certain changes in section 1248.**

The committee tentatively agreed to eliminate the requirement in present law (section 367 of the Internal Revenue Code) that an advance Internal Revenue Service ruling must be obtained for tax-free exchanges involving a foreign corporation related to United States taxpayers. In addition, the Committee instructed the staff to set out rules under which no Internal Revenue Service rulings would be required.

**Sec. 353. Contiguous country branches of domestic mutual life insurance companies.**

The committee agreed to permit mutual life insurance companies maintaining separate life insurance operations in countries contiguous to the United States to treat these operations in a manner similar to foreign subsidiaries.

**Part VI—Possessions Corporations; Western Hemisphere Trade Corporations**

**Sec. 361. Tax treatment of corporations conducting trade or business in possessions of the United States.**

The committee agreed to a number of provisions modifying the treatment of possessions corporations (i.e., U.S. corporations conducting an active trade or business in a possession of the United States). These corporations are not subject to U.S. tax on income earned outside the United States when it is earned or when it is brought back to the United States. First, the Committee agreed to retain the provision in present law which allows possessions corporations to be liquidated by their shareholders without payment of U.S. taxes. Second, the dividends received deduction provided under present law for certain dividends from former possessions corporations would not be allowed if the dividends are attributable to earnings and profits received during years when the corporation was a possessions corporation. Third, corporations qualifying for possessions corporation status would be required to make an election in order to obtain the benefits of that status; such an election could not be revoked for at least 10 years. Fourth, the present requirement that a corporation obtain 50 percent of its gross income from the conduct of an active trade or business in a possession would be increased to require that 65 percent of gross income be so obtained. Fifth, the Committee agreed to retain the provision in present law which requires a possessions corporation to receive its income within the possession. Sixth, the Committee agreed to a new provision requiring that any income received by a possessions corporation from sources outside of the possession be currently taxed.

**Sec. 362. Western Hemisphere trade corporations.**

The committee agreed to phase out over a five-year period the provision in present law which provides a 14-percent lower tax rate for Western Hemisphere Trade Corporations. During the phaseout period, WHTC status will only be available for corporations presently qualifying as WHTC's and will not be available for corporations not presently in WHTC status. Also, during the transition period, WHTC's will be permitted to elect to reorganize as foreign corporations without obtaining a ruling under section 367 of the Code.

**Part VII—Other Amendments**

**Sec. 371. Repeal of percentage depletion for foreign minerals.**

Consistent with the committee's earlier action in the energy bill repealing foreign percentage depletion on oil and gas, the committee agreed to repeal the foreign percentage depletion allowance for other minerals as of January 1, 1974.