

**THE U.S. INTERNATIONAL TAX RULES:
BACKGROUND, DATA, AND SELECTED ISSUES
RELATING TO THE COMPETITIVENESS OF
U.S.-BASED BUSINESS OPERATIONS**

Scheduled for a Public Hearing
Before the
SENATE COMMITTEE ON FINANCE
on July 8, 2003

Prepared by the Staff
of the
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JCX-67-03

D. Background Data Relating to Foreign Sales Corporations

Foreign sales corporations and U.S. exports

Data on the role of foreign sales corporations in U.S. trade is limited. Figure 31 details foreign sales corporation (“FSC”) and domestic international sales corporation (“DISC”) dividends as a percentage of the profits of all U.S. corporations. While trending upwards over the last several years, FSC profits constitute less than 1.5 percent of total corporate profits. While a relatively small part of the overall profits of U.S. corporations, sales of goods and services through FSCs may represent a substantial share of U.S. exports. Figure 32 below reports the “foreign trade gross receipts” of FSCs as a percentage of total U.S. exports of goods and services for 1987, 1992, and 1996. “Foreign trade gross receipts” represent the receipts from the sale of export property, the lease payments on qualifying export property, and payments for services related to qualifying sales and leases. In general, these data measure the receipts derived from qualified export sales.⁵⁵ Figure 32 reports that qualifying FSC exports comprised one third of U.S. merchandise and service exports in 1996. These data give a picture of the scope of FSCs in U.S. exports but should not be over emphasized. On one hand, these data may overstate somewhat the role of FSCs as foreign trade gross receipts include the value of marketing and sales service performed abroad which would not normally be included as an export. On the other hand, the Statistics of Income Division of the Internal Revenue Service report that not all FSC tax returns report foreign trade gross receipts⁵⁶ and the imputation of the missing data is likely to understate the value of foreign trade gross receipts. Another factor to consider is that approximately 90 percent of FSC returns represent FSCs related to manufacturing industries. The percentages reported in Figure 32 compare FSC sales to exports of goods and services. FSC sales of manufactured goods is likely to constitute a higher percentage of merchandise exports than the percentages reported in the figure.

⁵⁵ “Foreign trade gross receipts also include payments for engineering and architectural services on foreign construction projects. In the case of a commission FSC, the foreign trade gross receipts of the related supplier are included in these data. FSCs reported \$84.3 billion in foreign trade gross receipts in 1987, \$152.3 billion in 1992, and \$185.9 billion in 1996. Cynthia Belmonte, “Foreign Sales Corporations, 1996, *SOI Bulletin*, 19, Spring 2000, pp. 87-122.

⁵⁶ A foreign sales corporation need not report “foreign trade gross receipts” in order to determine its tax liability.

Figure 31

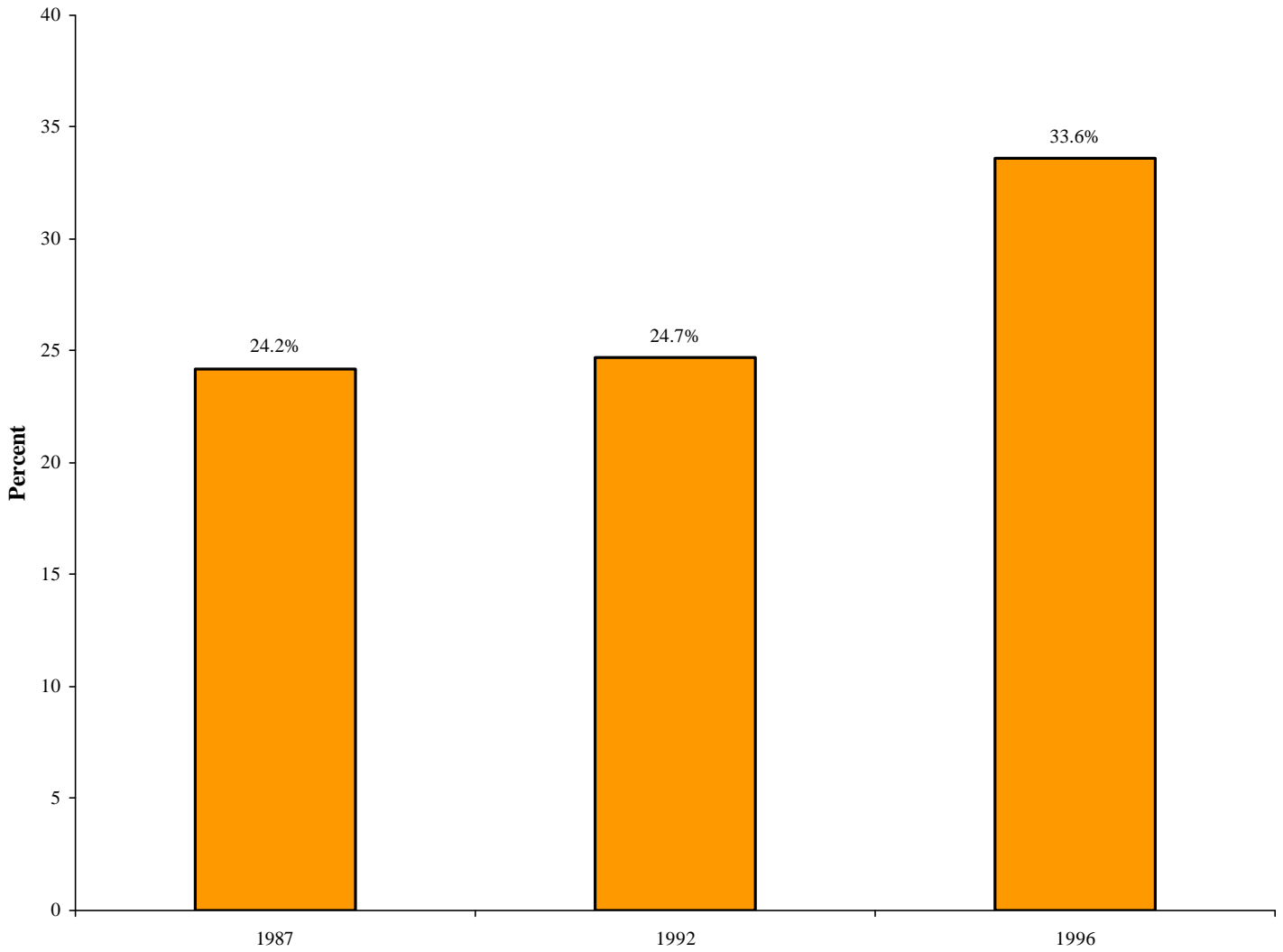
**FSC and DISC Dividends as a Percentage of Corporate Profits,
1983-1998**



Source: Statistics of Income, Internal Revenue Service and JCT staff calculations.

Figure 32

FSC Exports of Goods and Services as a Percentage of Total U.S. Exports of Goods and Services, 1987, 1992, and 1996



Source: Statistics of Income, Internal Revenue Service and JCT staff calculations.

Distribution of FSC Dividends Across Corporations

Among the 4.9 million corporate returns filed in 1999, 1,886 corporations (0.04 percent of corporations) reported a FSC dividend. Table 6 ranks FSC beneficiaries by decile according to the size of their FSC benefit for 1999. That is, Table 6 divides those corporations that reported FSC dividends into ten equal groups of 188 corporations, from the 188 corporations that reported the least FSC dividends to the 188 corporations that reported the most FSC dividends. Table 6 reports that among the 1,886 corporations reporting a FSC dividend in 1999, 10 percent accounted for 87 percent of the total dollar value of claimed FSC benefits. Table 6 also shows, by decile, how the average size of the FSC dividend correlates with average taxable income, average assets, and average sales.

Table 7 groups all corporate tax returns for 1999 by industry classification and shows, for each category, the number of returns on which FSC dividends were not claimed, the number of returns on which FSC dividends were claimed, and the average and total amounts of FSC dividends for each category. Table 7 shows that the manufacturing sector accounts for the bulk of the overall FSC benefit (76 percent of the number of corporations reporting FSC dividends and 89 percent of the dollar value of dividends reported in 1999). It is important to note that Table 7 is based on the industry classifications reported by the corporations themselves, using the North American Industrial Classification System (“NAICS Code”) system. These self-reported classifications are not audited or verified in any way. In addition, consolidated groups report a single classification for these purposes, which may provide a distorted view of some companies -- e.g., a large conglomerate may have lines of business in several different categories, but it would report only a single category for the entire consolidated group.

**Table 6.—All Corporations Reporting a FSC Dividend in 1999, By Decile
(188 Firms Per Decile)**

Decile by Size of FSC Dividend	Average FSC Dividend <i>(thousands)</i>	Percentage of Total FSC Dividend <i>(percent)</i>	Average Taxable Income <i>(thousands)</i>	Average Assets <i>(thousands)</i>	Average Sales <i>(thousands)</i>
lowest 10 percent	\$25	0.03%	\$4,297	\$154,861	\$65,336
11 - 20th percentile	\$66	0.09%	\$2,258	\$1,000,279	\$64,793
21 - 30 th percentile	\$124	0.17%	\$5,388	\$91,434	\$107,238
31 - 40 th percentile	\$231	0.32%	\$13,755	\$204,210	\$267,977
41 - 50 th percentile	\$361	0.49%	\$9,564	\$163,106	\$167,581
51 - 60 th percentile	\$545	0.75%	\$21,155	\$587,752	\$270,579
61 - 70 th percentile	\$980	1.34%	\$81,294	\$1,495,840	\$904,679
71 - 80 th percentile	\$1,980	2.72%	\$97,506	\$7,344,215	\$1,254,670
81 - 90 th percentile	\$5,035	6.94%	\$171,370	\$4,143,671	\$2,130,158
largest 10 percent	\$63,564	87.14%	\$716,194	\$31,133,400	\$9,274,154

Source: JCT staff calculations from IRS data.

Table 7.—Returns of Corporations Reporting FSC Dividends by Industry, 1999

Industry	Number of Corporations Not Claiming FSC Dividends	Percentage of Firms Not Claiming FSC Dividends	Number of Corp. Claiming FSC Dividends	Percentage of Firms Claiming FSC Dividends	Average FSC Dividend (\$ Millions)	Total Industry FSC Dividends (\$ Millions)	Percentage of Total FSC Dividends
Manufacturing	296,288	6.0%	1,426	75.6%	\$8.52	\$12,156.15	88.6%
Information	107,573	2.2%	55	2.9%	\$13.58	\$746.81	5.4%
Professional, Scientific, and Technical Services	657,099	13.3%	54	2.9%	\$3.32	\$179.17	1.3%
Mining	30,829	0.6%	20	1.1%	\$7.46	\$149.18	1.1%
Wholesale Trade	349,684	7.1%	190	10.1%	\$0.71	\$135.66	1.0%
Retail Trade	596,339	12.1%	19	1.0%	\$5.87	\$111.47	0.8%
Holding Companies	43,223	0.9%	23	1.2%	\$3.16	\$72.62	0.5%
Finance and Insurance	217,766	4.4%	14	0.7%	\$4.92	\$68.92	0.5%
Agriculture, Forestry, Fishing and Hunting	141,645	2.9%	33	1.7%	\$0.91	\$30.13	0.2%
Construction	580,278	11.8%	24	1.3%	\$0.25	\$5.93	0.0%
Transportation and Warehousing	160,189	3.2%	(1)	(1)	(1)	(1)	(1)
Utilities	7,038	0.1%	(1)	(1)	(1)	(1)	(1)
Real Estate and Rental and Leasing	521,442	10.6%	(1)	(1)	(1)	(1)	(1)
Accommodation and Food Services	252,111	5.1%	(1)	(1)	(1)	(1)	(1)
Health Care and Social Services	303,498	6.2%	(1)	(1)	(1)	(1)	(1)
Other Services	305,723	6.2%	(1)	(1)	(1)	(1)	(1)
Arts, Entertainment, and Recreation	93,920	1.9%	(1)	(1)	(1)	(1)	(1)
Administrative and Support and Waste Management and Remediation Services	205,009	4.2%	(1)	(1)	(1)	(1)	(1)
Educational Services	35,195	0.7%	(1)	(1)	(1)	(1)	(1)
Wholesale and Retail Trade not Allocable	2,139	0.0%	0	0.0%	-	\$0	0.0%
Not Allocable	27,031	0.5%	0	0.0%	-	\$0	0.0%
TOTAL	4,934,018	100.0%	1,886	100.0%	\$7.27	\$13,713.70	100.0%

(1) – Data not disclosed to protect taxpayer confidentiality.

Industry classification self-reported on a consolidated return basis.

Note: Totals may not add due to rounding.

Source: JCT staff calculations from IRS data.

Because of the predominance of the manufacturing sector among those corporations reporting FSC dividends, Table 8 and Table 9 present the same information as Table 6 and Table 7 for the manufacturing sector only. Among 296,000 manufacturing corporations, 1,427 (0.48 percent) reported FSC dividends in 1999. Table 8 reports that among the 1,427 manufacturing corporations reporting a FSC dividend in 1999, 10 percent accounted for 88 percent of the total dollar value of claimed FSC benefits. Table 9 reports that three industries accounted for more than 70 percent of FSC benefits: transportation equipment (32.2 percent); computer and electronic products (25.7 percent); and chemicals (14.0 percent).

**Table 8.—All Manufacturing Corporations Reporting a FSC Dividend in 1999,
By Decile
(143 Firms Per Decile)**

Decile by Size of FSC Dividend	Average FSC Dividend <i>(thousands)</i>	Percentage of Total FSC Dividend <i>(percent)</i>	Average Taxable Income <i>(thousands)</i>	Average Assets <i>(thousands)</i>	Average Sales <i>(thousands)</i>
lowest 10 percent	\$29	0.04%	\$4,192	\$51,640	\$64,461
11 - 20th percentile	\$76	0.08%	\$2,522	\$82,747	\$78,378
21 - 30th percentile	\$151	0.18%	\$6,206	\$109,784	\$114,843
31 - 40th percentile	\$270	0.32%	\$6,234	\$105,024	\$120,099
41 - 50th percentile	\$390	0.46%	\$8,311	\$146,073	\$143,072
51 - 60th percentile	\$616	0.72%	\$12,680	\$374,127	\$250,463
61 - 70th percentile	\$1,089	1.28%	\$60,325	\$762,213	\$647,588
71 - 80th percentile	\$2,247	2.63%	\$57,707	\$1,751,720	\$1,123,782
81 - 90th percentile	\$5,540	6.52%	\$165,002	\$2,811,985	\$1,726,259
largest 10 percent	\$75,160	87.78%	\$687,862	\$21,892,107	\$10,191,067

Source: JCT staff calculations from IRS data.

**Table 9.—Returns of Manufacturing Corporations Reporting FSC Dividends
Dividends by Type of Manufacturing, 1999**

Type of Manufacturing	Number of Corporations not Claiming FSC Dividends	Percentage of Firms not Claiming FSC Dividends	Number of Corporations Claiming FSC Dividends	Percentage of Firms Claiming FSC Dividends	Average FSC Dividends (\$ Millions)	Total Industry FSC Dividends (\$ Millions)	Percentage of Total FSC Dividends
Transportation Equipment	10,708	3.6%	81	5.7%	\$48.30	\$3,912.47	32.2%
Computer & Electronic Products	15,437	5.2%	288	20.2%	\$10.87	\$3,129.52	25.7%
Chemicals	10,380	3.5%	130	9.1%	\$13.08	\$1,699.80	14.0%
Machinery	25,936	8.8%	196	13.7%	\$5.20	\$1,018.24	8.4%
Electrical Equipment, Appliance, and Components	9,624	3.2%	104	7.3%	\$3.90	\$405.11	3.3%
Beverage & Tobacco	2,341	0.8%	14	1.0%	\$13.08	\$364.27	3.0%
Misc. Manufacturing	37,842	12.8%	136	9.5%	\$2.61	\$354.42	2.9%
Food	16,636	5.6%	61	4.3%	\$4.46	\$272.03	2.2%
Fabricated Metal Products	57,044	19.3%	132	9.3%	\$1.94	\$255.93	2.1%
Paper	3,089	1.0%	33	2.3%	\$7.11	\$234.47	1.9%
Primary Metals	5,191	1.8%	35	2.5%	\$3.71	\$129.92	1.1%
Plastics & Rubber Products	13,043	4.4%	60	4.2%	\$1.49	\$89.41	0.7%
Nonmetallic Mineral Products	8,627	2.9%	18	1.3%	\$4.27	\$76.82	0.6%
Textile Mills & Textile Mills Products	5,788	2.0%	38	2.7%	\$1.19	\$45.20	0.4%
Furniture & Related Products	10,966	3.7%	19	1.3%	\$1.29	\$24.60	0.2%
Wood Products	13,345	4.5%	52	3.6%	\$0.37	\$19.27	0.2%
Printing & Related Support	32,814	11.1%	10	0.7%	\$0.74	\$7.40	0.1%
Petroleum & Coal Products	1,390	0.5%	(1)	(1)	(1)	(1)	(1)
Leather & Allied Products	1,695	0.6%	(1)	(1)	(1)	(1)	(1)
Apparel	14,393	4.9%	(1)	(1)	(1)	(1)	(1)
TOTAL	296,287	100.0%	1,427	100.0%	\$8.52	\$12,158.11	100.0%

(1) – Data not disclosed to protect taxpayer confidentiality.

Industry classification self-reported on a consolidated return basis.

Note: Totals may not add due to rounding

Source: JCT staff calculations from IRS data

Characterization of FSC beneficiaries

In general

It is not really possible to describe a “generic” corporation that has utilized the FSC (or ETI) benefits of the Code. As detailed above, fewer than 200 corporations claimed most of the FSC benefits in 1999. These corporations generally were large when measured by assets, sales, or income. Moreover, in general, these corporations apply substantial amounts of physical (*i.e.*, plant and equipment) and intangible capital (*e.g.*, patents, trademarks, proprietary information and processes, and goodwill) in their business and also have substantial amounts of non-FSC foreign income. Yet there are numerous exceptions to this generalization of FSC beneficiaries. It also is the case that there are a number of large corporations that apply substantial amounts of physical and intangible capital in their business and also have substantial amounts of non-FSC foreign income that did not claim FSC benefits in 1999.

It is difficult to bring data to bear to characterize those corporations that claimed FSC benefits in 1999 as capital intensive or not capital intensive, to assess the extent to which such businesses earn returns from intangible capital, or to measure the extent to which FSC beneficiaries have non-FSC foreign source earnings. The source of data reported in the following tables is tax return data. These data are not perfectly suited to the task of characterizing those businesses that claim FSC benefits because items reported on the tax return may only offer crude approximations for the information necessary to describe the corporation’s business activity. For example, tax return information does not report the value of patents or copyrights that a taxpayer may be employing to earn income. Likewise tax return information does not report the value of a taxpayer’s investment in plant and equipment outside of the United States. The tables below report data drawn from the sample of corporate returns for 1999 prepared by the Internal Revenue Service’s Statistics of Income Division.

FSC beneficiaries and investments in physical capital

Table 10 and Table 11 sort all corporations (Table 10) that reported a FSC dividend in 1999 and all manufacturing corporations (Table 11) that reported a FSC dividend in 1999 by the size of the FSC dividend reported. These tables display the average assets and average depreciation reported by decile, from those ten percent of firms reporting the smallest FSC dividends to the ten percent of firms reporting the largest FSC dividends.

**Table 10.—The Average FSC Dividend, Average Assets, and Average Depreciation
Reported by All Corporations Reporting a FSC Dividend in 1999,
by Decile Based on the Size of the FSC Dividend
(188 firms per decile)**

FSC Decile	Average FSC Dividend (\$ thousands)	Average Assets (\$ thousands)	Average Depreciation (\$ thousands)
Smallest to 10 th percentile	\$25	\$154,861	\$4,505
11 th to 20 th percentile	66	1,000,279	3,648
21 st to 30 th percentile	124	91,434	3,704
31 st to 40 th percentile	231	204,210	7,227
41 st to 50 th percentile	361	163,106	4,270
51 st to 60 th percentile	545	587,572	13,172
61 st to 70 th percentile	980	1,495,840	44,758
71 st to 80 th percentile	1,980	7,344,215	44,697
81 st to 90 th percentile	5,035	4,143,671	74,333
Largest 10 percent of FSC dividends reported	63,564	31,133,400	639,211

Note: JCT staff tabulations of IRS Statistics of Income data.

**Table 11.—The Average FSC Dividend, Average Assets, and Average Depreciation
Reported by Manufacturing Corporations Reporting a FSC Dividend in 1999,
by Decile Based on the Size of the FSC Dividend
(143 firms per decile)**

FSC Decile	Average FSC Dividend (\$ thousands)	Average Assets (\$ thousands)	Average Depreciation (\$ thousands)
Smallest to 10 th percentile	\$29	\$51,640	\$2,151
11 th to 20 th percentile	76	82,747	3,588
21 st to 30 th percentile	151	109,784	4,659
31 st to 40 th percentile	270	105,024	4,049
41 st to 50 th percentile	390	146,073	4,131
51 st to 60 th percentile	616	374,127	8,750
61 st to 70 th percentile	1,089	762,213	27,788
71 st to 80 th percentile	2,247	1,751,720	44,935
81 st to 90 th percentile	5,540	2,811,985	74,192
Largest 10 percent of FSC dividends reported	75,160	21,892,107	607,354

Note: JCT staff tabulations of IRS Statistics of Income data.

As reported above, manufacturing firms comprise the vast majority of FSC beneficiaries. However, obviously, not all manufacturing firms utilized an FSC. Table 12 displays, by firm size as measured by firm assets, the average depreciation reported by manufacturing firms that did not report any FSC dividends in 1999 and also displays the average depreciation reported by those manufacturing firms that did report a FSC dividend in 1999. Table 12 also reports the average FSC dividend reported by those manufacturing firms that reported a FSC dividend in 1999.

For manufacturing corporations with less than \$1 billion in assets, the average depreciation claimed in 1999 by FSC beneficiaries and by manufacturing corporations that claimed no FSC benefits was comparable. Among the largest manufacturing corporations (those with assets of \$1 billion or more), FSC beneficiaries reported nearly three times as much depreciation expense as did non-FSC beneficiaries.

Table 12.—Number of Manufacturing Firms Not Reporting a FSC Dividend, Number of Manufacturing Firms Reporting a FSC Dividend, Average Depreciation Claimed by Manufacturing Firms Not Reporting a FSC Dividend, Average Depreciation Claimed by Manufacturing Firms Reporting a FSC Dividend, and Average FSC Dividend Reported, by Asset Size of Firm

Size of Firm by Total Assets	Number of Firms		Average Depreciation (\$ thousands)		Average FSC Dividend (\$ thousands)
	No FSC Dividend Reported	FSC Dividend Reported	No FSC Dividend Reported	FSC Dividend Reported	
Zero or missing.....	11,665	n.d.	\$263	n.d.	n.d.
\$1 to \$999,999.....	213,029	n.d.	16	n.d.	n.d.
\$1 million to less than \$10 million.....	57,941	195	168	\$265	\$179
\$10 million to less than \$50 million.....	9,881	349	996	1,113	288
\$50 million to less than \$250 million.....	2,721	323	4,591	5,292	926
\$250 million to less than \$1 billion.....	710	234	19,811	19,007	2,619
\$1 billion or more.....	341	287	137,571	363,819	38,592
All firms.....	296,288	1,426	336	77,899	8,526

n.d. – not disclosed to protect confidentiality.

FSC beneficiaries and investments in intangible capital

As noted above, it is difficult to assess the extent to which a corporation employs intangible capital in its business activities. Two potential items reported on the corporation's tax return that are related to intangible capital are research credits claimed and royalty income earned. Table 13 and Table 14 are similar to Table 10 and Table 11 except that, instead of reporting assets and depreciation by FSC dividend decile, they report average research credit amount claimed and the average royalty income reported by FSC beneficiaries.

Table 13.—The Average FSC Dividend, Average Research Credit Claimed, and Average Royalty Income Reported by All Corporations Reporting a FSC Dividend in 1999, by Decile Based on the Size of the FSC Dividend (188 firms per decile)

FSC Decile	Average FSC Dividend (\$ thousands)	Average Research Credit Claimed (\$ thousands)	Average Royalty Income Reported (\$ thousands)
Smallest to 10 th percentile	\$25	\$49	\$397
11 th to 20 th percentile	66	75	125
21 st to 30 th percentile	124	62	229
31 st to 40 th percentile	231	95	2,698
41 st to 50 th percentile	361	78	936
51 st to 60 th percentile	545	161	4,081
61 st to 70 th percentile	980	393	10,579
71 st to 80 th percentile	1,980	780	16,454
81 st to 90 th percentile	5,035	1,112	19,583
Largest 10 percent of FSC dividends reported	63,564	10,505	191,518

Note: JCT staff tabulations of IRS Statistics of Income data.

Table 14.–The Average FSC Dividend, Average Research Credit Claimed, and Average Royalty Income Reported by Manufacturing Corporations Reporting a FSC Dividend in 1999, by Decile Based on the Size of the FSC Dividend (143 firms per decile)

FSC Decile	Average FSC Dividend (\$ thousands)	Average Research Credit Claimed (\$ thousands)	Average Royalty Income Reported (\$ thousands)
Smallest to 10 th percentile	\$29	\$75	\$604
11 th to 20 th percentile	76	35	51
21 st to 30 th percentile	151	72	372
31 st to 40 th percentile	270	67	363
41 st to 50 th percentile	390	54	763
51 st to 60 th percentile	616	121	1,950
61 st to 70 th percentile	1,089	435	10,697
71 st to 80 th percentile	2,247	814	18,831
81 st to 90 th percentile	5,540	1,269	18,838
Largest 10 percent of FSC dividends reported	75,160	12,718	214,173

Note: JCT staff tabulations of IRS Statistics of Income data.

Table 15 and Table 16 restrict the presentation to corporations that report themselves as predominantly engaged in manufacturing. Table 15 sorts manufacturing firms that did not report any FSC dividends and those that did report FSC dividends by asset size and for each size class reports the average research credit claimed in 1999. Table 16 sorts manufacturing firms that did not report any FSC dividends and those that did report FSC dividends by asset size and for each size class reports the average royalty income reported in 1999. On average, for each asset size classification, manufacturing corporations that claimed FSC benefits in 1999 claimed twice as much research credit as did manufacturing corporations that did not claim FSC benefits. Likewise, on average, for each asset size classification, manufacturing corporations that claimed FSC benefits in 1999 reported at least 50 percent more royalty income than did manufacturing corporations that did not claim FSC benefits. As reported in Table 9, three industries accounted for more than 70 percent of FSC benefits: transportation equipment; computer and electronic products; and chemicals. Given the technical nature of these industries, the indication of potentially greater reliance on intangible capital by FSC beneficiaries reported in Table 15 and Table 16 may be expected.

Table 15.—Number of Manufacturing Firms Not Reporting a FSC Dividend, Number of Manufacturing Firms Reporting a FSC Dividend, Average Research Credit Claimed by Manufacturing Firms Not Reporting a FSC Dividend, Average Research Credit Claimed by Manufacturing Firms Reporting a FSC Dividend, and Average FSC Dividend Reported, by Asset Size of Firm

Size of Firm by Total Assets	Number of Firms		Average Research Credit Claimed (\$ thousands)		Average FSC Dividend (\$ thousands)
	No FSC Dividend Reported	FSC Dividend Reported	No FSC Dividend Reported	FSC Dividend Reported	
Zero or missing.....	11,665	n.d.	\$4	n.d.	n.d.
\$1 to \$999,999.....	213,029	n.d.	0	n.d.	n.d.
\$1 million to less than \$10 million.....	57,941	195	2	\$12	\$179
\$10 million to less than \$50 million.....	9,881	349	15	30	288
\$50 million to less than \$250 million.....	2,721	323	64	129	926
\$250 million to less than \$1 billion.....	710	234	285	408	2,619
\$1 billion or more.....	341	287	3,057	7,220	38,592
All firms.....	296,288	1,426	6	1,561	8,526

n.d. – not disclosed to protect confidentiality.

Table 16.–Number of Manufacturing Firms Not Reporting a FSC Dividend, Number of Manufacturing Firms Reporting a FSC Dividend, Average Royalty Income Reported by Manufacturing Firms Not Reporting a FSC Dividend, Average Royalty Income Reported by Manufacturing Firms Reporting a FSC Dividend, and Average FSC Dividend Reported, by Asset Size of Firm

Size of Firm by Total Assets	Number of Firms		Average Royalty Income Claimed (\$ thousands)		Average FSC Dividend (\$ thousands)
	No FSC Dividend Reported	FSC Dividend Reported	No FSC Dividend Reported	FSC Dividend Reported	
Zero or missing.....	11,665	n.d.	\$64	n.d.	n.d.
\$1 to \$999,999.....	213,029	n.d.	0	n.d.	n.d.
\$1 million to less than \$10 million.....	57,941	195	1	\$2	\$179
\$10 million to less than \$50 million.....	9,881	349	23	47	288
\$50 million to less than \$250 million.....	2,721	323	301	557	926
\$250 million to less than \$1 billion.....	710	234	1,904	2,819	2,619
\$1 billion or more.....	341	287	88,858	129,051	38,592
All firms.....	296,288	1,426	6	26,576	8,526

n.d. – not disclosed to protect confidentiality.

FSC beneficiaries and other foreign operations

Corporations that claimed FSC benefits in 1999 generally were large enterprises. Many large U.S. corporations have established subsidiaries or branches overseas to increase their sales and income. Table 17 and Table 18 are similar to Table 10 and Table 11 and Table 13 and Table 14 except that they report, by decile, the average foreign tax credit claimed in 1999 and the average non-FSC foreign dividends reported in 1999 by FSC beneficiaries. These two variables reported on the corporation's tax return may serve as an indicator of the extent to which the corporation has a presence outside of the United States. As before, Table 17 presents data for all 1,885 FSC beneficiaries and Table 17 presents data for the 1,426 manufacturing firms who were FSC beneficiaries in 1999. Across all deciles of FSC beneficiaries, on average, the corporation's non-FSC foreign dividends exceed the FSC dividend reported in 1999.

Table 17.—The Average FSC Dividend, Average Foreign Tax Credit Claimed, and Average non-FSC Foreign Dividends Reported by All Corporations Reporting a FSC Dividend in 1999, by Decile Based on the Size of the FSC Dividend (188 firms per decile)

FSC Dividend Decile	Average FSC Dividend (\$ thousands)	Average Foreign Tax Credit Claimed (\$ thousands)	Average Non-FSC Foreign Dividends Reported (\$ thousands)
Smallest to 10 th percentile	\$25	\$48	\$33
11 th to 20 th percentile	66	231	4,519
21 st to 30 th percentile	124	125	185
31 st to 40 th percentile	231	124	278
41 st to 50 th percentile	361	160	138
51 st to 60 th percentile	545	1,912	1,616
61 st to 70 th percentile	980	5,620	12,005
71 st to 80 th percentile	1,980	10,307	6,209
81 st to 90 th percentile	5,035	12,567	32,993
Largest 10 percent of FSC dividends reported	63,564	83,609	70,226

Note: JCT staff tabulations of IRS Statistics of Income data.

Table 18.—The Average FSC Dividend, Average Foreign Tax Credit Claimed, and Average non-FSC Foreign Dividends Reported by Manufacturing Corporations Reporting a FSC Dividend in 1999, by Decile Based on the Size of the FSC Dividend (143 firms per decile)

FSC Dividend Decile	Average FSC Dividend (\$ thousands)	Average Foreign Tax Credit Claimed (\$ thousands)	Average Non-FSC Foreign Dividends Reported (\$ thousands)
Smallest to 10 th percentile	\$29	\$26	\$19
11 th to 20 th percentile	76	45	199
21 st to 30 th percentile	151	223	321
31 st to 40 th percentile	270	38	91
41 st to 50 th percentile	390	110	153
51 st to 60 th percentile	616	1,78	418
61 st to 70 th percentile	1,089	6,878	14,825
71 st to 80 th percentile	2,247	4,881	5,385
81 st to 90 th percentile	5,540	13,851	39,911
Largest 10 percent of FSC dividends reported	75,160	92,390	85,778

Note: JCT staff tabulations of IRS Statistics of Income data.

Table 19 and Table 20 restrict the presentation to corporations that report themselves as predominantly engaged in manufacturing. Table 19 sorts manufacturing firms that did not report any FSC dividends and those that did report FSC dividends by asset size and for each size class reports the average foreign tax credit claimed. Table 20 sorts manufacturing firms that did not report any FSC dividends and those that did report FSC dividends by asset size and for each size class reports the average non-FSC foreign dividends reported in 1999.

For manufacturing corporations with less than \$1 billion in assets, the average FSC dividend claimed in 1999 exceeded the average non-FSC foreign dividend reported by FSC beneficiaries. Among the largest manufacturing corporations (those with assets of \$1 billion or more), FSC beneficiaries reported non-FSC foreign dividends nearly twice as large as FSC dividends on average.

Table 19.—Number of Manufacturing Firms Not Reporting a FSC Dividend, Number of Manufacturing Firms Reporting a FSC Dividend, Average Foreign Tax Credit Claimed by Manufacturing Firms Not Reporting a FSC Dividend, Average Foreign Tax Credit Claimed by Manufacturing Firms Reporting a FSC Dividend, and Average FSC Dividend Reported, by Asset Size of Firm

Size of Firm by Total Assets	Number of Firms		Average Foreign Tax Credit Claimed (\$ thousands)		Average FSC Dividend (\$ thousands)
	No FSC Dividend Reported	FSC Dividend Reported	No FSC Dividend Reported	FSC Dividend Reported	
Zero or missing.....	11,665	n.d.	\$99	n.d.	n.d.
\$1 to \$999,999.....	213,029	n.d.	0	n.d.	n.d.
\$1 million to less than \$10 million.....	57,941	195	0	\$0	\$179
\$10 million to less than \$50 million.....	9,881	349	4	12	288
\$50 million to less than \$250 million.....	2,721	323	60	205	926
\$250 million to less than \$1 billion.....	710	234	522	1,340	2,619
\$1 billion or more.....	341	287	21,697	57,404	38,592
All firms.....	296,288	1,426	31	11,826	8,526

n.d. – not disclosed to protect confidentiality.

Table 20.—Number of Manufacturing Firms Not Reporting a FSC Dividend, Number of Manufacturing Firms Reporting a FSC Dividend, Average non-FSC Foreign Dividend Reported by Manufacturing Firms Not Reporting a FSC Dividend, Average non-FSC Foreign Dividend Reported by Manufacturing Firms Reporting a FSC Dividend, and Average FSC Dividend Reported, by Asset Size of Firm

Size of Firm by Total Assets	Number of Firms		Average Non-FSC Foreign Dividend Reported (\$ thousands)		Average FSC Dividend (\$ thousands)
	No FSC Dividend Reported	FSC Dividend Reported	No FSC Dividend Reported	FSC Dividend Reported	
Zero or missing.....	11,665	n.d.	\$59	n.d.	n.d.
\$1 to \$999,999.....	213,029	n.d.	0	n.d.	n.d.
\$1 million to less than \$10 million.....	57,941	195	0	\$0	\$179
\$10 million to less than \$50 million.....	9,881	349	12	20	288
\$50 million to less than \$250 million.....	2,721	323	106	359	926
\$250 million to less than \$1 billion.....	710	234	1,029	1,490	2,619
\$1 billion or more.....	341	287	25,311	68,308	38,592
All firms.....	296,288	1,426	35	14,686	8,526

n.d. – not disclosed to protect confidentiality.

III. SELECTED ISSUES

A. The FSC-ETI Dispute

Overview

Like many other countries, the United States has long provided export-related benefits under its tax law. In the United States, for most of the last two decades, these benefits were provided under the FSC regime. In 2000, the European Union (“EU”) succeeded in having the FSC regime declared a prohibited export subsidy by the WTO. In response to this WTO ruling, the United States repealed the FSC rules and enacted the ETI regime under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (the “ETI Act”). The EU immediately challenged the ETI regime in the WTO, and in January of 2002 a WTO Appellate Body held that the ETI regime also constituted a prohibited export subsidy under the relevant trade agreements.

In August 2002, a WTO arbitration panel ruled that the EU could impose trade sanctions of \$4.04 billion against U.S. exports to the EU as a countermeasure to the prohibited export subsidy provided through the ETI Act. In September 2002, the European Commission published an initial list of approximately \$12 billion worth of potentially targeted U.S. exports to EU member states. EU companies were given a 60-day consultation period to appeal the inclusion of items on the sanctions list (e.g., if they relied on a particular item as an input to production). In March 2003, EU member states approved a shortened list of U.S. exports to the EU that matched the \$4 billion retaliation amount authorized by the WTO.⁵⁷ The list includes more than 1,600 products listed by their eight-digit codes under the EU customs classification system.

Early statements by European Commission officials indicated that the EU would refrain from imposing sanctions against the United States as long as it was evident that progress was being made toward complying with the WTO rulings. In May 2003, EU Trade Commissioner Pascal Lamy indicated that the European Commission will review the situation this fall, and if there is no sign that compliance is forthcoming at that time, the European Commission will begin the legislative procedure for the adoption of countermeasures by January 1, 2004.

Background and History of the Trade Dispute Over the FSC and ETI Regimes

The “DISC” dispute and enactment of the FSC regime

Prior to the enactment of the FSC regime, the United States provided a different system of export-related tax benefits, which applied to certain export-intensive corporations known as “domestic international sales corporations” (“DISCs”).⁵⁸ Under this regime, DISCs were

⁵⁷ *European Commission Proposed Retaliatory Duties List in World Trade Organization Dispute Over U.S. Tax Treatment for Foreign Sales Corporations*, available in BNA Daily Tax Report, April 28, 2003, G-7.

⁵⁸ Another export incentive in turn preceded the DISC regime -- under provisions enacted in 1962, controlled foreign corporations that qualified as “export trade corporations” were permitted to reduce their subpart F income by the amount of certain export trade income.

incorporated as domestic corporations, but DISC income was exempt from corporate income tax, and the shareholder-level tax on that income was in part deferred. Shortly after the DISC regime's enactment in 1971, certain signatories to the General Agreement on Tariffs and Trade ("GATT") challenged the regime as a prohibited export subsidy. In 1976, a GATT panel sustained these challenges, as well as U.S. challenges to certain export tax incentives provided by France, Belgium, and the Netherlands. These rulings of the panel proved controversial and remained unadopted by the relevant signatory countries for a number of years.

In 1981, without conceding that the DISC regime violated the GATT, the United States agreed to adopt the general findings of the GATT panel, subject to a 1981 GATT Council Decision (the "1981 Understanding"), which was understood to qualify those findings. The 1981 Understanding had three main components: (1) GATT signatories are not required to tax export income that is attributable to economic processes occurring outside their territorial limits; (2) "arm's length" transfer pricing principles should be observed in transactions between exporting enterprises and related foreign buyers; and (3) the GATT does not prohibit the adoption of measures to avoid the double taxation of foreign-source income.

A debate subsequently ensued as to whether the DISC regime violated the GATT, as interpreted in light of the 1981 Understanding. The European Communities ("EC") argued that the DISC regime constituted an illegal export subsidy because it provided tax benefits for export income earned within the United States. The United States defended the regime on the grounds that, as applied to exports, it merely approximated the effect of a territorial tax system of the kind commonly used by European countries, which in turn was considered acceptable under the 1981 Understanding. A majority of GATT Council members sided with the EC and urged the United States to bring the DISC regime into compliance with the GATT. In addition, the EC took steps toward seeking approval for the imposition of trade sanctions against the United States, and other signatories indicated that they would seek compensation from the United States. In late 1982, the United States made a commitment to the GATT Council to develop legislation that would address these concerns, and in early 1983, the President set forth a proposal to replace the DISC regime with a new system that was thought to be GATT-compliant (without conceding that the DISC regime was not GATT-compliant).

In 1984, the Congress enacted legislation along the general lines proposed by the President, creating the FSC regime. Unlike the DISC regime, the FSC regime provided tax benefits for export-related income earned by foreign corporations that were required to have a foreign presence and to perform export-related activities outside the United States. Transfer pricing principles were also set forth for the measurement of FSC income. In light of these features, which caused the FSC regime to emulate more closely certain aspects of an exemption-method territorial tax system, the FSC regime was thought to fall directly within the terms of the 1981 Understanding.

The FSC regime had been in existence for approximately 14 years when the EU brought a case against it in the WTO in mid-1998.

The FSC dispute and enactment of the ETI regime

In 1999, a WTO panel agreed with the EU that the FSC regime constituted a prohibited export subsidy under the relevant WTO agreements, and in early 2000 a WTO Appellate Body upheld that finding. The rulings held that the FSC rules constituted a subsidy because under those rules the government refrained from collecting revenue that was “otherwise due”; the rulings held that this subsidy was prohibited because it was export-contingent. The EU also expressed additional objections to the FSC regime that were not addressed by the WTO -- specifically, that the FSC transfer pricing rules were not “arm’s length,” and that the FSC regime encouraged the use of tax havens.

In an effort to comply with these rulings (and to address the additional concerns raised by the EU), in late 2000 the United States repealed the FSC regime and enacted the ETI regime.

Under the ETI regime, an exclusion from gross income applies with respect to “extraterritorial income,” which is a taxpayer’s gross income attributable to “foreign trading gross receipts.” This income is eligible for the exclusion to the extent that it is “qualifying foreign trade income.” Qualifying foreign trade income is the amount of gross income that, if excluded, would result in a reduction of taxable income by the greatest of: (1) 1.2 percent of the foreign trading gross receipts derived by the taxpayer from the transaction; (2) 15 percent of the “foreign trade income” derived by the taxpayer from the transaction;⁵⁹ or (3) 30 percent of the “foreign sale and leasing income” derived by the taxpayer from the transaction.⁶⁰

Foreign trading gross receipts are gross receipts derived from certain activities in connection with “qualifying foreign trade property” with respect to which certain economic processes take place outside of the United States. Specifically, the gross receipts must be: (1) from the sale, exchange, or other disposition of qualifying foreign trade property; (2) from the lease or rental of qualifying foreign trade property for use by the lessee outside the United States; (3) for services which are related and subsidiary to the sale, exchange, disposition, lease, or rental of qualifying foreign trade property (as described above); (4) for engineering or architectural services for construction projects located outside the United States; or (5) for the performance of certain managerial services for unrelated persons. A taxpayer may elect to treat gross receipts from a transaction as not foreign trading gross receipts. As a result of such an election, a taxpayer may use any related foreign tax credits in lieu of the exclusion.

⁵⁹ “Foreign trade income” is the taxable income of the taxpayer (determined without regard to the exclusion of qualifying foreign trade income) attributable to foreign trading gross receipts.

⁶⁰ “Foreign sale and leasing income” is the amount of the taxpayer's foreign trade income (with respect to a transaction) that is properly allocable to activities that constitute foreign economic processes. Foreign sale and leasing income also includes foreign trade income derived by the taxpayer in connection with the lease or rental of qualifying foreign trade property for use by the lessee outside the United States.

Qualifying foreign trade property generally is property manufactured, produced, grown, or extracted within or outside the United States that is held primarily for sale, lease, or rental in the ordinary course of a trade or business for direct use, consumption, or disposition outside the United States. No more than 50 percent of the fair market value of such property can be attributable to the sum of: (1) the fair market value of articles manufactured outside the United States; and (2) the direct costs of labor performed outside the United States. With respect to property that is manufactured outside the United States, certain rules are provided to ensure consistent U.S. tax treatment with respect to manufacturers.

Even before Congress enacted the ETI regime, the EU informed the United States that it intended to challenge the regime before the WTO.

The Appellate Body decision in the ETI dispute

In general

Two days after the President signed the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 into law, the EU brought its case against the ETI regime in the WTO. In August of 2001, a WTO panel (the “Panel”) held that the ETI regime constituted a prohibited export subsidy under the relevant WTO agreements,⁶¹ and a WTO Appellate Body (the “Appellate Body”) later affirmed the Panel’s findings (but modified the Panel’s reasoning in part).⁶²

The Appellate Body reviewed and upheld several findings of the Panel, including the findings that the ETI legislation: (1) involves the forgoing of revenue which is otherwise due and thus gives rise to a “financial contribution” (i.e., a subsidy); (2) includes subsidies contingent on export performance; (3) does not qualify for the exception from treatment as a prohibited export subsidy as a measure to avoid double taxation of foreign-source income; (4) is inconsistent with other U.S. trade obligations because it accords less favorable treatment to imported products as compared with like products of U.S. origin; and (5) did not fully withdraw the FSC rules that were previously found to constitute a prohibited export subsidy.⁶³

⁶¹ United States -- Tax Treatment for “Foreign Sales Corporations” -- Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/RW, Report of the Panel, August 20, 2001.

⁶² United States -- Tax Treatment for “Foreign Sales Corporations” -- Recourse to Article 21.5 of the DSU by the European Communities, WT/DS108/RW, Report of the Panel, as modified by the Appellate Body, January 14, 2002, adopted January 29, 2002 (the “Appellate Body Decision”).

⁶³ The Appellate Body also reviewed and upheld other findings of the Panel, including a finding that the ETI rules involve prohibited export subsidies under the Agreement on Agriculture.

Subsidy

The Panel found that the ETI rules constitute a subsidy under the Agreement on Subsidies and Countermeasures (the “SCM Agreement”). Under that agreement, a subsidy is deemed to exist if there is a financial contribution by a government, and a benefit is thereby conferred. A financial contribution by a government exists where government revenue that is otherwise due is forgone or not collected.

The Appellate Body reviewed the Panel’s finding that the ETI rules involve the forgoing of revenue that is otherwise due and thus give rise to a financial contribution. The Appellate Body stated that the term “otherwise due” implies a comparison with a “defined, normative benchmark,” to distinguish situations where revenue forgone is “otherwise due” and situations where such revenue is not “otherwise due.” The Appellate Body further stated that the normative benchmark for the ETI rules consists of the other rules of taxation applicable to the foreign-source income of U.S. citizens and residents earned through the sale or lease of property, or through the performance of related services.

The Appellate Body stated that the United States taxes U.S. citizens and residents, in principle, on all foreign-source income, subject to permissible deductions and allowable foreign tax credits. The Appellate Body further stated that, under the ETI rules, certain extraterritorial income (i.e., “qualifying foreign trade income”) is excluded from U.S. taxation, and that taxpayers may elect to apply this exclusion or be subject to tax under the other rules applicable to such income. The Appellate Body further stated that where a taxpayer elects to apply the ETI rules, “the amount of tax paid by the taxpayer will very likely be less than the tax which the taxpayer would have paid, on that income, under the rules ‘otherwise’ applicable to foreign-source income, if the taxpayer did not elect to use the ETI measure.”⁶⁴ The Appellate Body concluded that “the definitive exclusion from tax of [qualifying foreign trade income], compared with the taxation of other foreign-source income, and coupled with the right of election for taxpayers to use the rules of taxation most favourable to them, means that, under the contested measure, the United States foregoes revenue on [qualifying foreign trade income] which is otherwise due.”⁶⁵

Export contingency

The Appellate Body upheld the Panel’s finding that the ETI rules include subsidies contingent on export performance. The SCM Agreement prohibits “subsidies contingent, in law or in fact, whether solely or as one of several conditions, upon export performance.” The Panel found that the ETI rules involve subsidies contingent in law upon exports in relation to property produced in the United States.

The Appellate Body concluded that the ETI rules grant a tax exemption as to certain transactions involving two different types of property: (1) property that is produced within the United States and held for use outside the United States, and (2) property that is produced

⁶⁴ Appellate Body Report at 32.

⁶⁵ Id.

outside the United States and held for use outside the United States. The Appellate Body reasoned that the division of the ETI rules into these two separate circumstances is supported by provisions in the ETI rules themselves, each addressing a particular factual situation: specifically, certain foreign-source limitation rules that apply only to property produced in the United States and certain consistency rules that apply only to property produced outside the United States. The Appellate Body concluded that the portion of the ETI rules that provides a tax exemption for property produced in the United States and held for use outside the United States is export-contingent.⁶⁶

Exception for measures to avoid double taxation

Under the SCM Agreement, even a subsidy that is contingent on exports is not prohibited if it is found to be a measure designed to avoid the double taxation of foreign-source income (often referred to as the “Footnote 59” exception, after its location in the SCM Agreement). The Appellate Body rejected the U.S. argument that the ETI regime qualified for the Footnote 59 exception, because it found that the regime applied not only to foreign-source income that could potentially be subjected to double taxation, but also to a broad class of U.S.-source income that faced no such threat of double taxation (e.g., income attributable to manufacturing activities in the United States).

While the Appellate Body acknowledged that countries must be given latitude to develop their own definitions of foreign-source income, it held that, at a minimum, such income must have some functional connection to a foreign country sufficient to create some possibility of taxation in that foreign country. While the ETI regime’s foreign economic processes requirement ensures that transactions qualifying for benefits under the ETI regime involve some link to activities conducted abroad, the Appellate Body held that that requirement was insufficient to ensure that all of the income generated in those transactions (and benefited by the ETI regime) possessed such a link. In particular, the Appellate Body examined the three main methods for calculating “qualifying foreign trade income” under the ETI regime and noted that, of the three methods, only the one applicable to “foreign sale and leasing income” includes any allocation rule to distinguish income connected with foreign activities from income connected with domestic activities. The other two methods employ formulas based on flat percentages (1.2 percent of “foreign trading gross receipts” or 15 percent of “foreign trade income”) and thus, in the Appellate Body’s view, do not sufficiently distinguish between foreign-source and domestic-source income in providing the ETI benefit. In addition, the foreign economic processes requirement does not apply at all to “small” taxpayers (i.e., those with \$5 million or less of “foreign trading gross receipts”), and thus, according to the Appellate Body, no effort at all is made to distinguish foreign-source and domestic-source income with respect to these taxpayers.

The Appellate Body further noted that the ETI regime is elective, and that taxpayers are allowed to choose between the ETI regime and the foreign tax credit regime generally provided under U.S. law to mitigate double taxation, making it difficult in the Appellate Body’s view to

⁶⁶ The Appellate Body did not opine on the issue of whether the portion of the ETI rules that applies to property produced outside the United States and held for use outside the United States is export-contingent.

maintain that the United States designed and enacted the ETI regime with a view toward avoiding double taxation.

Limitation on foreign content

The Appellate Body upheld the Panel's finding that the ETI rules accord less favorable treatment to imported products as compared with like products of U.S. origin and thus violate the GATT 1994, which broadly prohibits discrimination against imports. The ETI rules require that not more than 50 percent of the fair market value of qualifying foreign trade property may be attributable to articles produced or direct labor performed outside the United States. In the Appellate Body's view, this foreign-content limitation on the ETI tax benefit constitutes discrimination against imports in violation of the GATT 1994, because taxpayers seeking ETI benefits have an incentive to use U.S. inputs instead of foreign inputs in order to ensure that they comply with the foreign-content limitation.

Withdrawal of FSC rules

The Appellate Body upheld the Panel's finding that the United States has not fully withdrawn the FSC rules previously found to be prohibited export subsidies. In the FSC dispute, the WTO panel recommended that the United States withdraw the FSC subsidies by October 1, 2000; the WTO Dispute Settlement Body acceded to a U.S. request to modify the time period in that dispute to expire on November 1, 2000. Although the FSC rules have been largely repealed, transition rules apply to certain existing FSCs and to certain pre-existing binding contractual arrangements involving FSCs. The Appellate Body concluded that the FSC rules were required to be fully withdrawn without delay, and that there was no basis to extend the time period for the United States to fully withdraw the FSC rules.

Arbitration proceedings on trade sanctions

WTO rules allow complaining countries to impose countermeasures against countries that are found to violate their WTO obligations. In this dispute, the EU requested authorization from a WTO arbitration panel to impose trade sanctions in the amount of \$4.04 billion per year against U.S. exports. The EU based this figure on estimates of the total cost to the United States of providing the subsidy, not on any estimate of actual trade harm to the EU itself. The United States argued in its submission to the arbitration panel that the EU figure was disproportionate to any possible harm to the EU itself and is therefore inappropriate, and that the maximum level of permissible sanctions in this case is \$956 million per year.

The parties filed their initial submissions on the sanctions issue in early February of 2002. In August 2002, a WTO arbitration panel ruled that the EU could impose trade sanctions of \$4.04 billion against U.S. exports to the EU as a countermeasure to the prohibited export subsidies provided by the United States through the ETI Act. In September 2002, the European Commission published an initial list of approximately \$12 billion worth of potentially targeted U.S. exports to the EU member states. EU companies were given a 60-day consultation period to appeal the inclusion of items on the sanctions list (e.g., if they relied on a particular item as an input to production). In March 2003, EU member states approved a shortened list of U.S.

exports to the EU that matched the \$4 billion retaliation amount authorized by the WTO.⁶⁷ The list includes more than 1,600 products listed by their eight-digit codes under the EU customs classification system.

Authorization of trade sanctions

In May 2003, the WTO Dispute Settlement Body granted final authorization to the EU to impose sanctions against the United States. The legislative procedure for adopting countermeasures against the United States would require an agreement of the 15 EU member states, voting by a qualified majority in the EU Council, upon recommendation by the European Commission to impose sanctions.

Proposed alternatives to FSC-ETI

H.R. 5095 (107th Congress)

H.R. 5095, the “American Competitiveness and Corporate Accountability Act of 2002,” was introduced by Chairman William Thomas of the House Ways and Means Committee on July 11, 2002. The bill would repeal the ETI regime and replace it with international competitiveness provisions relating to income from foreign business operations and investment. The bill includes several proposals relating to subpart F (e.g., repeal of the foreign base company sales and services income rules, look-through treatment of certain payments between related controlled foreign corporations under the foreign personal holding company rules) and the foreign tax credit (e.g., allocation of interest expense using a worldwide fungibility approach, recharacterization of overall domestic losses, reduction to three foreign tax credit baskets, extension of carryforward period for foreign tax credits).⁶⁸ The bill also includes provisions relating to corporate tax shelters and inversion transactions.

H.R. 1769

H.R. 1769, the “Job Protection Act of 2003,” was introduced by Representatives Philip Crane and Charles Rangel, the House Ways and Means Trade Subcommittee chairman and the committee’s ranking member, respectively, on April 11, 2003. The bill would repeal the ETI regime and replace it with a percentage deduction for domestic manufacturing income. The bill generally allows a corporation a deduction equal to 10 percent of its taxable income related to domestic production activities for the taxable year. However, the amount of this deduction is reduced for taxpayers with foreign production activities, in proportion to the relative value of such activities. The bill also provides transition relief to current FSC/ETI beneficiaries. The bill allows current FSC/ETI benefits to remain in effect for transactions between unrelated parties pursuant to a binding contract and allows a deduction equal to a percentage of the taxpayer’s

⁶⁷ *European Commission Proposed Retaliatory Duties List in World Trade Organization Dispute Over U.S. Tax Treatment for Foreign Sales Corporations*, available in BNA Daily Tax Report, April 28, 2003, G-7.

⁶⁸ For a more detailed analysis of the provisions contained in H.R. 5095, see Joint Committee on Taxation, *Technical Explanation of H.R. 5095*, (JCX-78-02), July 2002.

FSC/ETI benefit accrued in 2001 (indexed for inflation). The deduction is phased out over a period of five years and does not apply to the extent that the binding contract transition relief applies to the taxpayer.