The American Jobs Creation Act of 2003

Summary of H.R. 2896 as passed by Committee

The proposed mark provides $140 billion of tax relief over ten years. However, the net cost of the proposed mark is $60 billion over ten years. Over two-thirds of the tax relief goes to domestic manufacturers. Less than one-third of the tax relief goes towards international tax relief for multinational companies even though multinationals currently receive over 90 percent of FSC-ETI benefits and employ over 50 percent of the United States' manufacturing workforce. The following summarizes the proposed mark highlights.

U.S. manufacturing and production tax rate cut *($61 billion.)* The corporate tax rate on U.S. manufacturing and production income is reduced by 3 percentage points (from 35% to 32%.) The tax rate cut applies to property that is manufactured, produced, grown or extracted, including tangible personal property, agriculture, softwood timber, processed food, construction, architectural, and engineering services for construction projects built in the United States, extracted items, software, movies, music, and oil and gas refining and production. The rate cut schedule is as follows:

- 2004-2006 34%
- 2007 & after 32%

Across the board tax rate cut *($16.4 billion.)* In addition to the manufacturing and production rate cut, the bill provides a new reduced 32 percent top corporate tax rate for all corporations with less than $20 million of taxable income. According to the Joint Committee on Taxation, over ***99.7 percent*** of corporations have taxable incomes of less than $20 million. The small business rate schedule is as follows:

- 2004-2006 33% (under $1 million of taxable income)
- 2007-2008 32% (under $1 million of taxable income)
- 2009-2011 32% (under $5 million of taxable income)
- 2012 & after 32% (under $20 million of taxable income)

Section 179 expensing *($2 billion.)* The Growth bill section 179 provision is extended for two years (through December 31, 2007.)

- The Growth bill's section 179 provision increases the amount of capital purchases that small and medium sized businesses can expense (immediately deduct) from $25,000 to $100,000 and increases the size of companies eligible for the provision by doubling the capital expenditure cap from $200,000 to $400,000. (Both amounts are indexed for inflation.)

Depreciation relief *($2.9 billion.)* The bill contains provisions that allow productive assets to be depreciated in a "real world" time frame.

- **Leasehold and restaurant improvements.** 39 year leasehold and restaurant depreciation lives are reduced to 15 years. The provisions sunset on December 31, 2005.

AMT relief *($8.7 billion.)* The National Association of Manufacturers calls AMT the "Anti-Manufacturing Tax." The bill contains several provisions that greatly reduce the "Anti-Manufacturing Tax."

- Expands the size of companies exempt from AMT from $7.5 million of gross receipts to $20 million of gross receipts. According to the Joint Committee on Taxation, a $20 million exemption takes ***97 percent*** of corporations out of the AMT.
- Eliminates the 90 percent limitation of the use of net operating losses (NOLs) against AMT.
- Eliminates the 90 percent limitation on the use of foreign tax credits against AMT.
- Coordinates farmer income averaging and the AMT.

S corporation reforms *($1.3 billion.)* The bill contains various provisions to simplify the taxation of S corporations and expand S corporation eligibility.

- Treat three generations of family members as one shareholder.
- Expand the maximum number of S corporation shareholders from 75 to 100.
- Includes all of the S corporation provisions in H.R. 2896 including, treating IRAs as eligible S corporation shareholders and modifying the treatment of qualifying director shares.

Repeal of the Extraterritorial Income Exclusion Act of 2000 (ETI) *(Transition $12.5 billion.)* In order to give those currently benefiting from ETI a "soft landing," ETI repeal includes the following transition relief.

- Under the bill, companies retain ETI benefits as follows:
  - 100 percent of their ETI benefits in 2003
  - 80 percent of their ETI benefits in 2004
  - 80 percent of their ETI benefits in 2005
  - 60 percent of their ETI benefits in 2006

- Binding contracts in effect prior to January 14, 2002 retain FSC and ETI benefits.

Competitive taxation of global earnings *($15.1 billion.)* The bill contains provisions that enable U.S. companies to compete under rules similar to their foreign competitors. Many countries do not tax income earned outside its borders. The United States taxes income wherever it is earned. Although not nearly as beneficial as the complete exemption from tax that many countries provide to their businesses, the United States allows its companies to defer current U.S. tax on active foreign income. However, the Tax Code contains several anti-deferral provisions that result in the immediate U.S. taxation of active income. This bill contains provision that ensure that active income retains its character as active income.

- **Treat EU as one country.** The bill modifies the current taxation of foreign sales and services income so that U.S. companies are not disadvantaged in the marketplace when competing against foreign companies in the EU. The provision allows U.S. companies to remove duplicative and uncompetitive structures and operate under rules similar to those enjoyed by EU companies. The provision specifically helps U.S. companies expand their U.S. manufacturing by lowering the cost of U.S. exports to Europe.
- **Repeals anti-deferral foreign shipping income rules.** Unlike other countries that don't tax shipping income, the United States imposes immediate U.S. taxation on foreign shipping

income earned by U.S. companies. This provision allows U.S. shippers to defer U.S. tax on their active foreign shipping income.

- **Look-through treatment.** Active income remains active when a controlled foreign corporation sells an interest in a partnership or makes a payment, such as a dividend, to another controlled foreign corporation.
- **Repeals the foreign personal holding company and foreign investment company rules.** Adopts the Joint Committee on Taxation's simplification recommendation to repeal these duplicative anti-deferral rules.
- **Treatment of commodities transactions in ordinary course of business.** The provision repeals the anti-deferral rule that imposes immediate U.S. tax when a controlled foreign corporation, in its normal course of business, enters into a commodities transaction to manage price changes or currency fluctuations.
- **Treatment of oil and gas pipeline transportation income.** The provision ensures that the active business of oil and gas pipeline transportation is treated as active income.
- **Partial exclusion of royalty payments paid to U.S. on certain domestic made films.**

Prevention of double taxation *($26.6 billion.)* The foreign tax credit provisions were intended to ensure that U.S. companies do not pay "double tax" on the same income. Due to 1986 revenue measures, the foreign tax credit rules do not work well and often result in U.S. companies paying double tax. The bill includes several provisions to reduce the double taxation of U.S. companies.

- **Reduces number of foreign tax credit baskets from 9 to 2.** Currently taxpayers must track, allocate and account for foreign tax credits in nine different tax baskets. This proposal greatly simplifies the tax code by reducing the number of baskets to two, an active and a passive basket.
- **Modifies the overall domestic loss rules.** The provision fixes an inequity in the law that artificially limits the ability of taxpayers to use their foreign tax credits.
- **Fixes interest allocation rules.** Both Republican and Democratic Administrations agree that the interest allocation rules need to be fixed. The United States is the only country to adopt these harsh and anti-competitive rules. The interest allocation rules increase double taxation and make the United States a less attractive place to invest. The bill fixes these costly and uncompetitive rules.
- **Facilitates the ability of U.S. mutual funds to attract foreign investors.**
- **Joint Committee on Taxation simplification recommendations.** Adopts Joint Committee on Taxation's simplification recommendations including, fixing the rules that limit the ability of company's to use foreign tax credits when it owns more than 10 percent but less than 50 percent of another company and repealing the complex secondary withholding tax that collects little or no revenue.
- **Other simplification provisions.** Treats the sale and lease of intangibles the same for purposes of the foreign tax credit, provides an election to allow the taxpayer to use actual versus average exchange rate for foreign tax payments, treats stock owned by partnerships as proportionally owned by its partners for purposes of the foreign tax credit, and provide equal treatment for interest paid by foreign partnerships and foreign corporations.

Provisions to prevent erosion of U.S. tax base *($3.4 billion raiser.)*

- The bill includes a **prospective** corporate inversion provision that requires inverting companies to pay the full U.S. tax on the transfer of U.S. assets to a foreign country. The provision does not disregard or unwind legal transactions.
- The bill equalizes the treatment of shareholders and corporate executives and insiders by imposing a 15% excise tax on stock options held by corporate executives and insiders when a company inverts. (Current law imposes a 15% capital gains tax on shareholder's stock when a company inverts.)
- The bill tightens current law to prevent companies from improperly eroding the U.S. tax base through excessive interest payments to foreign related parties. It does **not** include the controversial U.S. to worldwide leverage test contained in Treasury's 2002 Inversion Study.

Individual expatriation *($327 million raiser.)* This provision adopts the Joint Committee on Taxation's tax recommendations on individual expatriates. The provision provides an objective test (rather than current law's subject test) to determine if a taxpayer is subject to the U.S. expatriation rules.

Tax shelters *($1.5 billion raiser.)* The bill adopts the Administration's tax shelter recommendations that require increased disclosure of abusive transactions and increased penalties on those that promote and engage in abusive tax shelters. It does **not** codify the judicial economic substance doctrine. The provisions are contained in sections 3001 to 3012 of H.R. 2896.

Protecting employee benefits *($1.1 billion raiser.)*

- Creates rules to govern the tax treatment of nonqualified deferred compensation to ensure that tax is deferred only in situations where the compensation is truly at risk and the employee does not have access or control over the deferred amounts.
- Clarifies that statutory stock options are not subject to payroll tax when the option is exercised.
- Extends for five years the ability to transfer excess defined benefit pension assets to retiree health accounts.

Reforms and other provisions *($4.2 billion raiser.)*

- **Enron reforms.** The bill adopts a number of the Joint Committee on Taxation's Enron report recommendations including, provisions to prevent partnership losses from being taken more than once, repeal of special FASIT rules, and limitation on transfer of built-in losses on REMIC residuals. Sections 3024-3027 of H.R. 2896.
- **Other reforms.** Modifies treatment of stripped interest in bond and preferred stock funds, requires a minimum withholding period for foreign tax credit on withholding tax, clarifies what is a banking business for purposes of determining investment of earning in U.S. property, modifies exemption from tax for small property and casualty insurance companies, and prevents mismatching of deductions and income inclusions in transactions with related foreign persons.
- **Exclusion of like-kind exchange property from nonrecognition treatment on the sale or exchange of a principal residence.**
- **Internal Revenue Service user fees and other IRS provisions.** Extends the IRS users fees through 2013, authorizes the IRS to enter into installment agreements that provide for partial payment, modifies rules to allow deposits to stop running of interest on potential

underpayments, clarifies rules for payment of estimated tax for deemed asset sales, denies deduction for interest paid to the IRS on underpayments involving certain tax motivated transactions, and excludes from gross income interest on overpayments of income tax by individuals.

Extension of customs user fees *($16.3 billion raiser.)* The bill extends Customs User Fees until 2013. These fees will be more closely linked to the critical commercial services that Customs provides to importers such as the processing of merchandise, commercial inspections, and modernization of Customs' computer system.