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Comparison of the House and Senate ETI/Business Investment Bills (H.R. 4520 and S. 1637, 108th Congress)

Updated November 8, 2004

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Summary

In fall 2004, Congress is considering legislation that addresses both domestic and international business investment and the long-simmering controversy between the United States and the European Union (EU) over the U.S. tax code's extraterritorial income (ETI) tax benefit for exporting. Both the House and the Senate have passed bills that would repeal ETI and implement a range of tax benefits for business investment, in some cases restricted to domestic investment and in other cases applying to overseas investment. The bills are similar in this general thrust of repealing ETI while implementing a mix of domestic and overseas business tax cuts. The House and Senate bills are contained in separate versions of H.R. 4520. The Senate-passed version of H.R. 4520 contains the language of S. 1637, first passed by the Senate in May 2004, but with the addition of tobacco buyout provisions. On October 6, a conference committee approved a bill reconciling the House and Senate bills. The President signed the measure, and it became P.L. 108-357.

There were several prominent differences between the House and Senate bills. The House bill proposed a tax benefit limited to domestic production that would be in the form of a tax rate reduction; the Senate bill provided a domestic production tax cut similar in size but in the form of a tax deduction. The conference agreement provided a deduction. The House bill contained several tax cuts not in the Senate bill, including a rate reduction for lower levels of corporate income, an extension of the "expensing" benefit for equipment investment, liberalized depreciation for leaseholds, and an option for individual taxpayers to deduct state and local sales taxes rather than income taxes. Of these, the October conference agreement did not provide the rate-reduction, but included the other three of these items. In addition to taxes, the House bill proposed payments to tobacco farmers in compensation for the removal of the federal quota program. In passing its bill as an amended version of H.R. 4520, the Senate added its own tobacco buyout provisions, and the conference agreement likewise contains a buyout provision. The Senate bill contained a number of investment tax cuts not in the House bill, including tax incentives related to energy and an extension of the allowable carryback period for tax losses (net operating losses, or NOLs). These two items were not in the conference bill.

In addition to their tax cuts, the House and Senate bills contained various revenue-raising provisions that reduced the bills' net revenue loss. In terms of revenue impact, the House bill was projected to reduce revenue while the Senate bill was estimated to reduce revenue in its first years but increase revenue very slightly over the long run. Joint Tax Committee revenue estimates for the conference committee chairman's mark show a revenue loss of \$8.8 billion over five years and a gain of \$238 million (approximate revenue neutrality) over 10 years..

This report will not be updated.

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Comparison of the House and Senate ETI/Business Investment Bills (H.R. 4520 and S. 1637, 108th Congress)

A major focus of congressional tax policy deliberations in the first half of 2004 has been legislation that addresses the controversy between the European Union (EU) and the United States over the U.S. tax code's extraterritorial income (ETI) tax benefit for exporting. In recent years, the EU has complained that the U.S. ETI provisions contravene the World Trade Organization's (WTO) prohibition of export subsidies; in a series of panel rulings, the WTO has supported the EU's complaint and authorized the EU's imposition of retaliatory tariffs on U.S. goods. The EU began a phased-in imposition of the tariffs in March.

Both the House and the Senate passed versions of legislation addressing the ETI controversy, the Senate on May 11 (S. 1637), and the House on June 17 (H.R. 4520). On July 15, the Senate prepared the bill for conference by approving its own version of H.R. 4520 that contained the language of the bill it had approved in May, but with the addition of buyout provisions for tobacco quotas. (The House bill contains its own tobacco buyout provisions.) Both the House and Senate bills proposed to phase out ETI, but contain a wide range of additional tax cuts that, in contrast to ETI's repeal, would cut business taxes rather than increase them. In general, the tax cuts in both bills contained a mix of tax incentives primarily for domestic production and tax cuts for overseas investment. Both bills also contained a variety of revenue-raising items.

The Conference Agreement

While the bills overlapped in several areas, there were prominent differences among both the tax cuts and the revenue-raising items, and among both the bills' domestic and international provisions. On October 6, House and Senate conferees approved a version of H.R. 4520 reconciling the bills' differences; the House approved the agreement on October 7 and the Senate on October 11. The President signed the bill on October 22. It became Public Law, P.L. 108-357. According to Joint Tax Committee estimates, the bill agreement would reduce tax revenue by \$8.7 billion over five years and would be virtually revenue-neutral over 10 years, increasing revenue by \$1 million over fiscal years 2005-2014.

Like the House and Senate bills, the conference agreement is quite broad in scope and focuses on business taxes; it contains a broad range of both tax cuts and tax increases. And like the House and Senate bills, the centerpiece of the conference agreement is repeal of the ETI export tax benefit on the one hand, and provision a tax benefit for domestic production on the other, along with a number of tax cuts for

firms with overseas production. The conference agreement follows the Senate's version of a domestic production benefit, providing a deduction rather than a tax-rate cut for domestic production. (After a phase-in, the deduction would be 9% of taxable income.) As with both the House and Senate bills, the largest tax reduction for multinational firms is an alteration of the rules for allocating interest expense in connection with the foreign tax credit limitation.

Other prominent differences between the House and Senate bills included a number of items included in the House bill, but not the Senate legislation. These included a number of tax cuts, including a rate reduction for lower levels of corporate income, an extension of the "expensing" benefit for equipment investment, liberalized depreciation for leaseholds, and an option for individual taxpayers to deduct state and local sales taxes rather than income taxes. Of these, the October conference agreement did not provide the rate-reduction, but included the other three of these items. Likewise, the Senate bill contained a number of investment tax cuts not in the House bill, including tax incentives related to energy and an extension of the allowable carryback period for tax losses (net operating losses, or NOLs). These two items were not in the conference bill.

For a more detailed list of the conference agreement's provisions, see: CRS Report RL32652, *The 2004 Corporate Tax and FSC/ETI Bill: The American Jobs Creation Act of 2004*.

Impact on Tax Revenues

According to estimates by the Joint Committee on Taxation (JCT), the House bill would reduce tax revenue by \$32.4 billion over a period generally spanning its first five years (FY2005-FY2009) and by \$35.7 billion over its first 10 years (FY2005-FY2014). The Senate bill would reduce revenue by \$10.2 billion over its first five years and increase revenue by \$847 million over its first 10 years.¹ These are net amounts, comprised of the impact of revenue losing items minus revenue raising items; the scope of the changes that would be implemented by the bills is thus not fully reflected by the net estimates. The difference in the expected direction of the bills' impact over the longer estimating period — that is, the House bill's projected revenue loss and the Senate measure's expected small revenue gain — is chiefly due to larger revenue-raising provisions in the Senate bill, particularly in the areas of tax shelters, expatriation, and energy. The bills' revenue-losing provisions would reduce revenue by roughly comparable amounts.

JCT revenue estimates for the conference committee chairman's mark indicate the conference agreement would reduce revenue by \$8.766 billion over five years (FY2005-FY2009) and would increase revenue by \$238 million over ten years

¹ U.S. Congress, Joint Committee on Taxation, *Comparison of the Estimated Budget Effects of H.R. 4520, the "American Jobs Creation Act of 2004," as Passed by the House of Representatives, and H.R. 4520, the "Jumpstart our Business Strength (JOBS) Act," as Amended by the Senate*, JCX-53-04, July 23, 2004.

(FY2005-FY2014). Estimates for the final version of the conference agreement may differ slightly from these totals.

A side-by-side comparison of the House and Senate bills follows.

Extraterritorial Income (ETI) Benefit for Exports

Both bills address the ETI controversy by phasing out the provision. The bills differ, however in the particulars of the phaseout.

Senate	House
Phases out the ETI benefit over 2004-2006, with full repeal applicable in 2007.	Phases out the ETI benefit over 2005 and 2006, with full repeal applicable in 2007.
During the phase-out period, During 2004-2006, a firm's ETI benefit would equal a specified percentage of their average benefit in 2000-2001.	During 2005-2006, a firm's ETI benefit would equal a specified percentage of the full ETI benefit that would otherwise apply for that year.

Tax Benefits Restricted to Domestic Production

By definition, exports are produced in the domestic economy rather than abroad; a tax benefit for exports such as ETI therefore necessarily poses a tax incentive that favors domestic over overseas investment. Both bills contain new tax incentives that are explicitly limited to domestic rather than foreign investment, although — in view of WTO rulings against export subsidies such as ETI — the new benefits apply to domestic production in general and are not restricted to the export sector.

Senate	House
Phases in a 9% tax deduction for domestic production that initially would decline in proportion to the extent of a firm's foreign operations. The deduction would be limited to 50% of wages paid. For a firm receiving the full deduction and subject to the top corporate tax rate, the benefit would have an effect similar to reducing the tax rate to 31.85%.	Phases in a reduction in the top corporate tax rate to 32% from current law's 35%. The deduction would not be diminished by foreign operations or subject to a wage cap.

Tax Reductions for Foreign-Source Income: Foreign Tax Credit

U.S. citizens and firms are generally permitted to credit foreign taxes they pay against U.S. tax they would otherwise owe on foreign-source income. In general, the

bills each provide more generous rules relating to the foreign tax credit and associated calculations. The tax code provides that foreign taxes can offset only the portion of a firm's U.S. tax liability that applies to foreign (and not domestic) income. Many of the changes in the two bills apply to the rules firms must follow in calculating this limitation. While there are some differences between the two bills, there is substantial overlap. The bills' provisions for allocating interest expense — probably the most prominent foreign tax credit in either bill — are essentially the same.

Senate	House
Revises rules for allocating interest expense when calculating foreign tax credit limitation.	Revises rules for allocating interest expense when calculating foreign tax credit limitation.
Provides more generous treatment of domestic losses in calculating foreign tax credit limitation.	Provides more generous treatment of domestic losses in calculating foreign tax credit limitation.
Repeals limit on use of foreign tax credits to offset alternative minimum tax (AMT).	Repeals limit on use of foreign tax credits to offset alternative minimum tax (AMT).
Shortens the “carryback” period for foreign tax credits to one year from current law’s two years; lengthens the carryforward period to 20 years from current law’s five years.	No carryback or carryforward provisions.
Does not provide for the consolidation of foreign tax credit limitations.	Reduces the number of income categories for which a separate foreign tax credit limitation must be calculated, providing for two separate limits (“baskets”) compared to current law’s nine.

Tax Reductions for Foreign-Source Income: Deferral and Subpart F

Under current law, U.S. firms can indefinitely postpone (defer) U.S. tax on foreign income as long as the income is earned through a foreign subsidiary corporation chartered abroad and the income is reinvested overseas rather than repatriated to the U.S. parent as dividends or other income. This deferral benefit, however, is restricted in some cases by the tax code's Subpart F. Subpart F provides that certain types of income — principally income from passive investment, such as interest, rents, royalties, and dividends — are subject to U.S. tax even if earned through a foreign subsidiary and not repatriated. In general, the bills would expand the scope of the deferral benefit incrementally by relaxing certain Subpart F rules and making other changes. As with the bills' foreign tax credit provisions, the bills' deferral and subpart F provisions contain considerable overlap but some difference. For example, the bills contain a similar (but not identical) tax cut for earnings repatriated from foreign subsidiaries.

Senate	House
Provides a temporary (one year) reduced tax rate for dividends repatriated to U.S. corporations from their foreign subsidiaries. The reduced tax rate would be 5.25%.	Provides a temporary (six month) 85% tax deduction for certain dividends repatriated to U.S. corporations from foreign subsidiaries. For a firm paying the top corporate tax rate of 35%, the deduction has an effect similar to a reduction in the tax rate to 5.25%.
Provides less restrictive “look through” rules under Subpart F for payments among related foreign subsidiaries.	Provides less restrictive “look through” rules under Subpart F for payments among related foreign subsidiaries.
Provides more generous treatment of transportation income under Subpart F.	Provides more generous treatment of transportation income under Subpart F, but with differences from the Senate bill.
Provides a less restrictive <i>de minimis</i> rule under Subpart F.	Does not alter Subpart F’s <i>de minimis</i> rule.

Other Tax Cuts

In addition to the tax cuts aimed explicitly at domestic production and those that apply to international or foreign-source income, both bills contain a wide variety of additional tax cuts. The list of these assorted provisions is substantially different between the bills. Prominent provisions that are in the House, but not the Senate bill are: a reduction of the tax rates that apply to lower levels of corporate income, and a provision allowing individual taxpayers the alternative of deducting state and local sales taxes rather than income taxes. The House bill also contains a non-tax provision providing compensation to tobacco farmers for the cessation of tobacco quotas. The Senate, in agreeing to a conference on the bill, in mid-July added tobacco provisions that differ somewhat from those in the House. In addition, the Senate bill contains a number of energy-related tax benefits that are not in the House bill as well as more generous treatment of tax losses. The bills are similar, however, in extending a set of temporary targeted tax benefits (the “extenders”), although the particulars of the bills’ extensions differ.

Senate	House
<p>Extends or makes permanent various temporary targeted tax benefits and tax-reducing provisions (the “extenders”). The extensions are for various periods, but are generally one or two years. A partial list of extenders in the bill includes the research and experimentation tax credit, the welfare to work and work opportunities tax credits, and expanded treatment of non-refundable personal tax credits under the minimum tax.</p> <p>Temporarily extends the carryback back period for tax losses (net operating losses, or NOLs) to three years from current law’s two; the extension would apply to losses arising in 2003. Suspends the limitation on the use of NOLs against the minimum tax for the same period.</p> <p>Provides or extends various tax benefits generally designed to promote energy production or conservation.</p> <p>Provides a tax credit to employers of National Guard personnel on active duty and for small business or self-employed employers of replacement employees for National Guard employees.</p> <p>No general reduction in corporate tax rates (excepting the domestic production deduction described above).</p> <p>Extends a scaled-back version of the temporarily increased “expensing” benefit for small business equipment investment.</p> <p>No depreciation provisions for leasehold improvement.</p> <p>No state and local tax provisions.</p> <p>No tobacco quota provision.</p>	<p>Extends or makes permanent various temporary targeted tax benefits and tax-reducing provisions (the “extenders”). The extensions are for various periods, but are generally for two years. A partial list of extenders in the bill includes the research and experimentation tax credit, the welfare to work and work opportunities tax credits, and expanded treatment of non-refundable personal tax credits under the minimum tax.</p> <p>No NOL provisions.</p> <p>Contains limited energy provisions.</p> <p>No provision.</p> <p>Provides a phased-in reduction in the statutory tax rates applicable to lower ranges of corporate income.</p> <p>Extends a temporary increase in the expensing benefit for small business investment (not scaled-back, as in the Senate bill).</p> <p>Provides more generous depreciation rules for leasehold improvements.</p> <p>Provides individual taxpayers the alternative of deducting state and local sales taxes rather than income taxes.</p> <p>Provides tobacco farmers compensation for terminated tobacco quotas.</p>

Revenue-Raising Provisions

Both bills contain a variety of revenue raising provisions, although the total amount of revenue projected to be raised by the Senate bill is larger than that of the House bill. The broad areas to which the revenue-raisers apply overlap to some extent, though in some areas where they do — for example, tax shelters, leasing, and corporate expatriation — the Senate provisions tend to be more stringent.

Senate	House
<p>Applies more stringent tax treatment to corporations that shift their country of incorporation abroad (corporate “inversions” or “expatriation”). Under certain circumstances, restrictions include taxing an inverted corporation as a domestic corporation (thus nullifying the tax advantages from inversion). Other restrictions include more stringent tax treatment of assets transferred to inverted corporations and an excise tax that would in some cases apply to stock options of inverted firms’ officers.</p>	<p>Applies more stringent tax treatment to corporations that shift their country of incorporation abroad (corporate “inversions” or “expatriation”); unlike the Senate bill, H.R. 4520 would not tax inverted corporations like U.S. corporations. Does place other restrictions on inverted firms and their owners, including more stringent treatment of assets transferred to inverted firms and application of an excise tax to the stock options of inverted firms’ officers.</p>
<p>Places limits on corporate use of tax shelters, including “clarification and enhancement” the judicial doctrine that limits the use of tax benefits associated with transactions that lack economic substance. Provides new provisions related to reporting and penalties.</p>	<p>Provides new tax shelter provisions related to reporting and penalties; does not contain provisions related to the economic substance doctrine.</p>
<p>Places new limits on tax savings available from leasing arrangements between taxpayers and tax-exempt (or tax “indifferent”) entities.</p>	<p>Places new limits on tax savings available from leasing arrangements between taxpayers and tax-exempt (or tax “indifferent”) entities. The limits are in some respects less stringent than those of the Senate bill.</p>
<p>Contains provisions designed to limit evasion of excise tax on fuels.</p>	<p>Contains provisions designed to limit evasion of excise tax on fuels.</p>
<p>Extends certain customs user-fees that are scheduled to expire under current law.</p>	<p>Extends certain customs user-fees that are scheduled to expire under current law.</p>