

104TH CONGRESS  
1ST SESSION

# S. 701

To amend the Internal Revenue Code of 1986 to limit the interest deduction allowed corporations and to allow a deduction for dividends paid by corporations.

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IN THE SENATE OF THE UNITED STATES

APRIL 6 (legislative day, APRIL 5), 1995

Mr. SIMON introduced the following bill; which was read twice and referred to the Committee on Finance

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## A BILL

To amend the Internal Revenue Code of 1986 to limit the interest deduction allowed corporations and to allow a deduction for dividends paid by corporations.

1       *Be it enacted by the Senate and House of Representa-  
2       tives of the United States of America in Congress assembled,*

3       **SECTION 1. LIMITATION ON INTEREST DEDUCTION AL-  
4       LOWED CORPORATIONS.**

5       (a) IN GENERAL.—Section 163 of the Internal Reve-  
6       nue Code of 1986 (relating to deduction for interest) is  
7       amended by redesignating subsection (k) as subsection (l)  
8       and by inserting after subsection (j) the following new sub-  
9       section:

1       “(k) LIMITATION ON CORPORATE INTEREST PAY-  
2   MENTS.—

3           “(1) IN GENERAL.—Except as provided in para-  
4   graph (2), in the case of a corporation, the amount  
5   otherwise allowed as a deduction under this chapter  
6   for interest paid or accrued during the taxable year  
7   by such corporation shall be reduced by 20 percent.

8           “(2) EXCEPTION FOR CERTAIN CORPORA-  
9   TIONS.—

10           “(A) IN GENERAL.—Paragraph (1) shall  
11   not apply for any taxable year to any corpora-  
12   tion the earnings and profits of which for such  
13   taxable year (computed as of the close of the  
14   taxable year without diminution by reason of  
15   any dividend distributions made during such  
16   taxable year) do not exceed the lesser of—

17            “(i) the corporation’s tax liability  
18   under this chapter for such taxable year  
19   (determined after the application of para-  
20   graph (1)), or

21            “(ii) \$100,000.

22           “(B) CONTROLLED GROUP.—For purposes  
23   of subparagraph (A), all component members of  
24   a controlled group (as defined in section  
25   179(d)(7)) shall be treated as 1 corporation.

1               “(3) EXCEPTION FOR FARMING BUSINESSES.—  
2               Paragraph (1) shall not apply to any corporation  
3               substantially all of the assets of which are used in  
4               the active conduct of a farming business (as defined  
5               in section 448(d)(1)).”

6               (b) EFFECTIVE DATE.—The amendment made by  
7               subsection (a) shall apply to taxable years beginning after  
8               December 31, 1995.

9               **SEC. 2. DIVIDEND PAID DEDUCTION.**

10               (a) GENERAL RULE.—Part VIII of subchapter B of  
11               chapter 1 of the Internal Revenue Code of 1986 (relating  
12               to special deductions for corporations) is amended by  
13               striking the table of sections and section 241 and inserting  
14               the following:

“Subpart A. Dividend paid deduction.  
“Subpart B. Dividend received deduction.  
“Subpart C. Miscellaneous provisions.

15               **SEC. 230. ALLOWANCE OF SPECIAL DEDUCTIONS.**

16               “In addition to the deductions provided in part VI  
17               (section 161 and following), there shall be allowed as de-  
18               ductions in computing taxable income the items specified  
19               in this part.

20               **“Subpart A—Dividend Paid Deduction**

“Sec. 231. Dividend paid deduction.  
“Sec. 232. Qualified dividend account.  
“Sec. 233. Ineligible corporations.  
“Sec. 234. Special rules.

1   **“SEC. 231. DIVIDEND PAID DEDUCTION.**

2       “(a) ALLOWANCE OF DEDUCTION.—In the case of a  
3 corporation, there shall be allowed as a deduction an  
4 amount equal to 50 percent of the dividends paid by such  
5 corporation during the taxable year.

6       “(b) LIMITATION BASED ON AMOUNT IN QUALIFIED  
7 DIVIDEND ACCOUNT.—The amount of the dividends paid  
8 during any taxable year which may be taken into account  
9 under subsection (a) shall not exceed the amount in the  
10 corporation’s qualified dividend account as of the close of  
11 such taxable year determined after the application of sec-  
12 tion 232(b)(1) for the taxable year but before the applica-  
13 tion of section 232(b)(2) for such taxable year.

14   **“SEC. 232. QUALIFIED DIVIDEND ACCOUNT.**

15       “(a) ESTABLISHMENT OF ACCOUNT.—Each corpora-  
16 tion shall establish a qualified dividend account. The open-  
17 ing balance of such account shall be zero.

18       “(b) ADJUSTMENTS TO ACCOUNTS.—As of the close  
19 of each taxable year beginning after January 1, 1995, the  
20 qualified dividend account—

21           “(1) shall be increased by the adjusted taxable  
22 income of the corporation for the taxable year, and  
23           “(2) shall be reduced by the amount of the divi-  
24           dends paid by the corporation during the taxable  
25           year to the extent the amount so paid does not ex-  
26           ceed the limitation of section 231(b).

1       “(c) ADJUSTED TAXABLE INCOME.—For purposes of  
2 this section—

3           “(1) IN GENERAL.—The term ‘adjusted taxable  
4 income’ means taxable income adjusted as provided  
5 in this subsection.

6           “(2) ADJUSTMENT FOR CERTAIN QUALIFYING  
7 DIVIDENDS.—Taxable income shall be increased by  
8 the deduction allowed under section 243 with respect  
9 to that portion of any qualifying dividend (as defined  
10 in section 243(b)(1)) for which such deduction is de-  
11 termined at a rate of less than 100 percent. Similar  
12 rules shall apply in the case of dividends for which  
13 deductions are allowable under section 245(b).

14           “(3) ADJUSTMENT FOR TAX CREDITS.—

15           “(A) IN GENERAL.—Taxable income shall  
16 be reduced by the deduction equivalent of the  
17 tentative nonrefundable credits for the taxable  
18 year.

19           “(B) DEDUCTION EQUIVALENT.—For pur-  
20 poses of subparagraph (A), the deduction equiv-  
21 alent of the tentative nonrefundable credits for  
22 any taxable year is the amount which (if al-  
23 lowed as a deduction for the taxable year)  
24 would reduce the tax liability (as defined in sec-

11                   “(4) ADJUSTMENT FOR CORPORATE MINIMUM  
12                   TAX.—If tax is imposed by section 55 on the cor-  
13                   poration for any taxable year, taxable income for the  
14                   succeeding taxable year shall be increased by an  
15                   amount equal to  $\frac{35}{100}$  of the amount of tax so im-  
16                   posed.

17               “(5) DIVIDEND PAID DEDUCTION NOT TAKEN  
18       INTO ACCOUNT.—Taxable income shall be deter-  
19       mined without regard to the deduction allowed under  
20       section 231.

## 21 "SEC. 233. INELIGIBLE CORPORATIONS.

22        "(a) GENERAL RULE.—No deduction shall be allowed  
23 under section 231 with respect to any dividend paid by—

24                   “(1) a regulated investment company.

25                   “(2) a real estate investment trust.

1           “(3) an S corporation,

2           “(4) any organization taxable under subchapter  
3           T of this chapter (relating to cooperative organiza-  
4           tions), or

5           “(5) a FSC or DISC.

6        “(b) FOREIGN CORPORATIONS.—In the case of a for-  
7        eign corporation—

8           “(1) no deduction shall be allowed under section  
9           231 for dividends paid by such corporation during  
10          any taxable year unless the corporation meets the  
11          requirements of section 245(a) for such taxable year,

12           “(2) only adjusted taxable income effectively  
13          connected with the conduct of a trade or business in  
14          the United States and attributable to the uninter-  
15          rupted period referred to in section 245(a) shall be  
16          added to the qualified dividend account, and

17           “(3) any distribution shall be treated as made  
18          ratably out of income effectively connected with the  
19          conduct of a trade or business in the United States  
20          and other income.

21        **“SEC. 234. SPECIAL RULES.**

22        “(a) CERTAIN DISTRIBUTIONS NOT TREATED AS  
23        DIVIDENDS.—For purposes of this subpart, the term ‘divi-  
24        dend’ does not include—

1           “(1) any distribution in redemption of stock, in  
2 liquidation, or in a reorganization (whether or not  
3 such distribution is treated as a distribution to  
4 which section 301 applies), and

5           “(2) any dividend described in section 244 (re-  
6 lating to dividends received on certain preferred  
7 stock).

8           “(b) DEDUCTION NOT TAKEN INTO ACCOUNT FOR  
9 PURPOSES OF CERTAIN LIMITATIONS BASED ON TAX-  
10 ABLE INCOME.—For purposes of sections 246(c), 613,  
11 613A, and 593, taxable income shall be determined with-  
12 out regard to the deduction allowed under section 231.

13           “(c) TREATMENT OF DIVIDENDS RECEIVED BY 5-  
14 PERCENT TAX-EXEMPT SHAREHOLDERS.—

15           “(1) IN GENERAL.—For purposes of part III of  
16 subchapter F (relating to taxation of unrelated busi-  
17 ness income of certain exempt organizations), any  
18 dividend received by a tax-exempt organization from  
19 a corporation in which such organization is a 5-per-  
20 cent shareholder shall be treated as unrelated busi-  
21 ness taxable income to the extent of the amount of  
22 the deduction allowable under section 231 to such  
23 corporation with respect to such dividend. Except as  
24 provided in regulations, the amount of such deduc-

1       tion shall be determined on the basis of the return  
2       filed by the corporation for the taxable year.

3           “(2) DEFINITIONS.—For purposes of this sub-  
4       section—

5               “(A) 5-PERCENT SHAREHOLDER.—The  
6       term ‘5-percent shareholder’ means any tax-ex-  
7       empt organization which owns (or is considered  
8       as owning within the meaning of section 318)—

9                   “(i) 5 percent or more (by value) of  
10      the outstanding stock of the corporation,  
11      or

12                   “(ii) stock possessing 5 percent or  
13      more of the total combined voting power of  
14      all stock of the corporation.

15           “(B) TAX-EXEMPT ORGANIZATION.—The  
16       term ‘tax-exempt organization’ means any orga-  
17       nization which is exempt from the tax imposed  
18       by this chapter.

19           “(C) RELATED ENTITIES.—A tax-exempt  
20      organization and 1 or more other tax-exempt  
21      organizations which have—

22                   “(i) significant common purposes and  
23      substantial common membership, or

24                   “(ii) directly or indirectly substantial  
25      common direction or control,

1           shall be treated as 1 tax-exempt organization  
2           for purposes of this paragraph.

3        “(d) TREATMENT OF SUBSEQUENT ADJUST-  
4 MENTS.—If there is any adjustment which affects the  
5 amount of the adjusted taxable income of a corporation  
6 for any taxable year (whether by reason of any carryback  
7 to such taxable year or otherwise) for purposes of this sub-  
8 part and subpart B, the amount of such adjustment shall  
9 be treated as made on the close of such taxable year.

10       “(e) ALLOCATION OF QUALIFIED DIVIDEND Ac-  
11 COUNT IN CORPORATE SEPARATIONS, REORGANIZATIONS,  
12 AND REDEMPTIONS.—Adjustments similar to the adjust-  
13 ments provided in subsection (h) or (n)(7) of section 312  
14 shall be made to the qualified dividend account in the case  
15 of a transaction described in either of such subsections.

16       “(f) MUTUAL LIFE INSURANCE COMPANIES.—

17        “(1) GENERAL RULE.—In the case of a mutual  
18 life insurance company, for purposes of this subpart,  
19 80 percent of the differential earnings amount (as  
20 defined in section 809(a)(3)) shall be treated as a  
21 dividend paid to a shareholder.

22        “(2) REGULATIONS.—The Secretary may pre-  
23 scribe regulations applying rules consistent with this  
24 subpart to mutual life insurance companies. Such  
25 regulations may include rules treating an appro-

1 appropriate portion of the recomputed differential earn-  
2 ings amount (as defined in section 809(f)(3)) as an  
3 adjustment to the amount described in paragraph  
4 (1).

## 5       **“Subpart B—Dividend Received Deduction**

- “Sec. 243. Dividends received by corporations.
- “Sec. 244. Dividends received on certain preferred stock.
- “Sec. 245. Dividends received from certain foreign corporations.
- “Sec. 246. Rules applying to deductions for dividends received.
- “Sec. 246A. Dividends received deduction reduced where portfolio stock is debt financed.
- “Sec. 247. Dividends paid on certain preferred stock of public utilities.”.

6 (b) COMPENSATORY WITHHOLDING TAX ON DIVI-  
7 DENDS PAID TO NONRESIDENT ALIENS OR FOREIGN  
8 CORPORATIONS.—

15        "(a) GENERAL RULE.—In addition to any tax im-  
16 posed by section 871 or 881, there is hereby imposed a  
17 tax equal to 30.4 percent of the dividends received from  
18 sources within the United States by a nonresident alien  
19 individual or foreign corporation.

20       “(b) TAX NOT TO APPLY TO SHAREHOLDER’S EF-  
21 FECTIVELY CONNECTED ITEMS.—The tax imposed by this

1 section shall not apply to any dividend to the extent such  
2 dividend is effectively connected with the conduct of a  
3 trade or business by the shareholder within the United  
4 States.

5       “(c) CORRESPONDING INCREASE IN WITHHOLDING  
6 TAX.—In the case of any dividend subject to tax under  
7 subsection (a), the tax imposed by section 1441 or 1442  
8 (as the case may be) shall be increased by an amount  
9 equal to the applicable percentage of such dividend.

10       “(d) EXCEPTION FOR CERTAIN TREATY COUN-  
11 TRIES.—The tax imposed by subsection (a) shall not apply  
12 to any dividend paid to a resident or corporation of a for-  
13 eign country during any period—

14           “(1) in which an income tax treaty between  
15 such country and the United States is in effect, and  
16           “(2) during which there is in effect a certifi-  
17 cation by the Secretary that—

18           “(A) such income tax treaty has adequate  
19 provisions to prevent treaty shopping, and

20           “(B) if such foreign country imposes an in-  
21 come tax comparable to the tax imposed by this  
22 subtitle and grants relief from such tax to its  
23 residents, such country grants relief equivalent  
24 to that provided in section 231 with respect to  
25 dividends paid to United States persons.

1 The requirements of paragraph (2) shall not apply to divi-  
 2 dends paid before January 1, 1996.”.

3 (2) CLERICAL AMENDMENT.—The table of sec-  
 4 tions for subpart D of part II of subchapter N of  
 5 chapter 1 is amended by adding at the end thereof  
 6 the following new item:

“Sec. 899. Additional tax on dividends to reflect dividend paid de-  
 duction.”.

7 (c) SECTION 381 TO APPLY TO QUALIFIED DIVI-  
 8 DEND ACCOUNT.—Subsection (c) of section 381 (relating  
 9 to items of the distributor or transferor corporation) is  
 10 amended by adding at the end thereof the following new  
 11 paragraph:

12 “(27) QUALIFIED DIVIDEND ACCOUNT.—Under  
 13 regulations prescribed by the Secretary, the acquir-  
 14 ing corporation shall take into account (to the extent  
 15 proper to carry out the purposes of this section and  
 16 subpart A of part VIII of subchapter B of this chap-  
 17 ter) the qualified dividend account of the distributor  
 18 or transferor corporation.”.

19 (d) CLERICAL AMENDMENT.—Part VIII of sub-  
 20 chapter B of chapter 1 is amended by inserting after sec-  
 21 tion 247 the following:

22 **“Subpart C—Miscellaneous Provisions**

“Sec. 248. Organizational expenditures.

“Sec. 249. Limitation on deduction of bond premium on repur-  
 chase.”

