COMMITTEE ON
WAYS AND MEANS
CHAIRMAN PAUL RYAN

Section-by-Section Summary of the Innovation Promotion Act of 2015 Discussion Draft

Released by Rep. Charles Boustany (R-LA) and Rep. Richard Neal (D-MA)
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Section 1. Short Title; Etc.

This section provides that the short title for the bill is the "Innovation Promotion Act of 2015."

Section 2. Deduction for innovation box profits.

Current law: Current law does not provide a deduction or other preferential tax rules for income derived from intellectual property.

Provision: A corporation would be allowed to deduct 71 percent of its innovation box profits derived from qualifying intellectual property (IP) or 71 percent of the corporation's taxable income, if less. A 71-percent deduction would translate into an effective tax rate of 10.15 percent on all innovation box profits.

Innovation box profit would equal tentative innovation profit multiplied by the corporation's research and development (R&D) ratio. The R&D ratio would equal the corporation's domestic R&D expenditures over the preceding five years divided by the corporation's total costs over the preceding five years. Total costs would not include cost of goods sold, interest or taxes. Tentative innovation profit would equal qualified gross receipts reduced by cost of good sold and other expenses properly allocable to such gross receipts. Qualified gross receipts would consist of gross receipts derived from the sale, lease, license or other disposition of "qualified property" in the ordinary course of a U.S. trade or business. Qualified property would include patents, inventions, formulas, processes, knowhow, computer software, and other similar IP, as well as property produced using such IP.

The provision would be effective for tax years beginning after the date of enactment.

Section 3. Special rules for transfers of intangible property from controlled foreign corporations to United States shareholders.

Current law: When a company distributes appreciated property, including intangible property such as a patent, to one of its shareholders, the company recognizes gain equal to the excess of the property's fair market value (FMV) over the company's basis, and the company increases its earnings and profits (E&P) by the amount of the gain. The shareholder is treated as receiving a distribution equal to the FMV of the property, which is taxed as a dividend to the extent of the company's E&P. The company's E&P then goes down by the amount of the distribution. If the amount of the distribution exceeds the company's E&P, the excess reduces the shareholder's basis in its stock of the company, with any excess over the basis treated as a taxable gain. When the company is a controlled foreign corporation (CFC) of a U.S. parent, the gain recognized with respect to the distribution of the appreciated property may constitute subpart F income to the extent of the CFC's E&P, and such subpart F income is includible in the U.S. parent's income in the year the gain is recognized by the CFC.

Provision: If a CFC distributes qualifying intangible property to the U.S. parent, the distributed property would be treated as having a FMV of no more than the CFC's basis in the property. The U.S. parent would have the same basis in the property that it had in the hands of the CFC (i.e., "carryover basis"). The distribution would not result in subpart F income to the U.S. parent and would not increase the CFC's E&P. The distribution would be treated by the U.S. parent as a dividend to the extent of the CFC's E&P, and the U.S. parent would receive a 100-percent dividends received deduction (DRD). If the distribution exceeds the CFC's E&P, the excess would be treated as decreasing the parent's basis in the CFC, with any remaining excess decreasing the parent's basis in the property. To qualify, the distribution of the intangible property must be part of a plan that meets certain filing requirements. Intangible property qualifying for the DRD is the same as the intangible property that would qualify for the deduction for innovation box profits described in section 2.

The provision would be effective for distributions made after December 31, 2015.