

108TH CONGRESS
2D SESSION

H. R. 4997

To amend the Internal Revenue Code of 1986 to provide tax relief for middle income taxpayers, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JULY 22, 2004

Mr. STENHOLM (for himself, Mr. ALEXANDER, Mr. BACA, Mr. BERRY, Mr. BISHOP of Georgia, Mr. BOSWELL, Mr. BOYD, Mr. CARDOZA, Mr. CASE, Mr. CHANDLER, Mr. COOPER, Mr. CRAMER, Mr. DAVIS of Tennessee, Ms. HARMAN, Ms. HERSETH, Mr. HILL, Mr. HOLDEN, Mr. LUCAS of Kentucky, Mr. MICHAUD, Mr. MOORE, Mr. PETERSON of Minnesota, Mr. POMEROY, Mr. ROSS, Mr. SANDLIN, Mr. SCHIFF, Mr. SCOTT of Georgia, Mr. TANNER, Mrs. TAUSCHER, Mr. TAYLOR of Mississippi, Mr. THOMPSON of California, Mr. TURNER of Texas, Ms. LORETTA SANCHEZ of California, Mr. ISRAEL, Mr. FORD, and Mr. MCINTYRE) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to provide tax relief for middle income taxpayers, and for other purposes.

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. SHORT TITLE; ETC.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “Fiscally Responsible Family Tax Relief Act of 2004”.

1 (b) AMENDMENT OF 1986 CODE.—Except as other-
 2 wise expressly provided, whenever in this Act an amend-
 3 ment or repeal is expressed in terms of an amendment
 4 to, or repeal of, a section or other provision, the reference
 5 shall be considered to be made to a section or other provi-
 6 sion of the Internal Revenue Code of 1986.

7 (c) TABLE OF CONTENTS.—The table of contents for
 8 this Act is as follows:

Sec. 1. Short title; etc.

TITLE I—EXTENSION OF CERTAIN EXPIRING PROVISIONS

Sec. 101. Extension of family tax provisions through 2005.

Sec. 102. Acceleration of increase in refundability of the child tax credit.

Sec. 103. Application of EGTRRA sunset to this title.

TITLE II—UNIFORM DEFINITION OF CHILD

Sec. 201. Uniform definition of child, etc.

Sec. 202. Modifications of definition of head of household.

Sec. 203. Modifications of dependent care credit.

Sec. 204. Modifications of child tax credit.

Sec. 205. Modifications of earned income credit.

Sec. 206. Modifications of deduction for personal exemption for dependents.

Sec. 207. Technical and conforming amendments.

Sec. 208. Effective date.

TITLE III—REVENUE PROVISIONS

Subtitle A—Provisions Designed To Curtail Tax Shelters

Sec. 301. Clarification of economic substance doctrine.

Sec. 302. Penalty for failing to disclose reportable transaction.

Sec. 303. Accuracy-related penalty for listed transactions and other reportable transactions having a significant tax avoidance purpose.

Sec. 304. Penalty for understatements attributable to transactions lacking economic substance, etc.

Sec. 305. Modifications of substantial understatement penalty for nonreportable transactions.

Sec. 306. Tax shelter exception to confidentiality privileges relating to taxpayer communications.

Sec. 307. Disclosure of reportable transactions.

Sec. 308. Modifications to penalty for failure to register tax shelters.

Sec. 309. Modification of penalty for failure to maintain lists of investors.

Sec. 310. Modification of actions to enjoin certain conduct related to tax shelters and reportable transactions.

Sec. 311. Understatement of taxpayer's liability by income tax return preparer.

- Sec. 312. Penalty on failure to report interests in foreign financial accounts.
 Sec. 313. Frivolous tax submissions.
 Sec. 314. Regulation of individuals practicing before the Department of Treasury.
 Sec. 315. Penalty for promoting abusive tax shelters.
 Sec. 316. Statute of limitations for taxable years for which required listed transactions not reported.
 Sec. 317. Denial of deduction for interest on underpayments attributable to nondisclosed reportable and noneconomic substance transactions.
 Sec. 318. Authorization of appropriations for tax law enforcement.
 Sec. 319. Penalty for aiding and abetting the understatement of tax liability.

Subtitle B—Enron-Related Tax Shelter Provisions

- Sec. 321. Limitation on transfer or importation of built-in losses.
 Sec. 322. No reduction of basis under section 734 in stock held by partnership in corporate partner.
 Sec. 323. Repeal of special rules for FASITs.
 Sec. 324. Expanded disallowance of deduction for interest on convertible debt.
 Sec. 325. Expanded authority to disallow tax benefits under section 269.
 Sec. 326. Modification of interaction between subpart F and passive foreign investment company rules.

Subtitle C—Extension of Customs User Fees

- Sec. 331. Extension of customs user fees.

1 **TITLE I—EXTENSION OF**
 2 **CERTAIN EXPIRING PROVISIONS**
 3 **SEC. 101. EXTENSION OF FAMILY TAX PROVISIONS**
 4 **THROUGH 2005.**

- 5 (a) CHILD CREDIT.—The table contained in section
 6 24(a)(2) (relating to per child amount) is amended—
 7 (1) by striking “2005,” in the second item, and
 8 (2) by striking “or 2004” in the first item and
 9 inserting “, 2004, or 2005”.
 10 (b) MARRIAGE PENALTY RELIEF IN STANDARD DE-
 11 DUCTION.—Paragraph (7) of section 63(c) (relating to ap-
 12 plicable percentage) is amended by striking “174” and in-
 13 serting “200”.

1 (c) MARRIAGE PENALTY RELIEF IN 15-PERCENT IN-
2 COME TAX BRACKET.—Subparagraph (B) of section
3 1(f)(8) (relating to applicable percentage) is amended by
4 striking “180” and inserting “200”.

5 (d) 10-PERCENT RATE BRACKET.—Paragraph (1) of
6 section 1(i) (relating to rate reductions after 2000) is
7 amended—

8 (1) by striking “2004” in subparagraph (B)(i)
9 and inserting “2005”, and

10 (2) by inserting “and 2005” after “2004” in
11 subparagraph (C)(ii).

12 (e) EFFECTIVE DATE.—The amendments made by
13 this section shall apply to taxable years beginning after
14 December 31, 2004.

15 **SEC. 102. ACCELERATION OF INCREASE IN REFUNDABILITY**
16 **OF THE CHILD TAX CREDIT.**

17 (a) ACCELERATION OF REFUNDABILITY.—Section
18 24(d)(1)(B)(i) (relating to portion of credit refundable) is
19 amended by striking “(10 percent in the case of taxable
20 years beginning before January 1, 2005)”.

21 (b) EARNED INCOME INCLUDES COMBAT PAY.—Sec-
22 tion 24(d)(1) is amended by adding at the end the fol-
23 lowing new sentence: “For purposes of subparagraph (B),
24 any amount excluded from gross income by reason of sec-
25 tion 112 shall be treated as earned income which is taken

1 into account in computing taxable income for the taxable
2 year.”.

3 (c) EFFECTIVE DATE.—The amendments made by
4 this section shall apply to taxable years beginning after
5 December 31, 2003.

6 **SEC. 103. APPLICATION OF EGTRRA SUNSET TO THIS TITLE.**

7 Each amendment made by this title shall be subject
8 to title IX of the Economic Growth and Tax Relief Rec-
9 onciliation Act of 2001 to the same extent and in the same
10 manner as the provision of such Act to which such amend-
11 ment relates.

12 **TITLE II—UNIFORM DEFINITION**
13 **OF CHILD**

14 **SEC. 201. UNIFORM DEFINITION OF CHILD, ETC.**

15 Section 152 is amended to read as follows:

16 **“SEC. 152. DEPENDENT DEFINED.**

17 “(a) IN GENERAL.—For purposes of this subtitle, the
18 term ‘dependent’ means—

19 “(1) a qualifying child, or

20 “(2) a qualifying relative.

21 “(b) EXCEPTIONS.—For purposes of this section—

22 “(1) DEPENDENTS INELIGIBLE.—If an indi-
23 vidual is a dependent of a taxpayer for any taxable
24 year of such taxpayer beginning in a calendar year,
25 such individual shall be treated as having no depend-

1 ents for any taxable year of such individual beginning
2 in such calendar year.

3 “(2) MARRIED DEPENDENTS.—An individual
4 shall not be treated as a dependent of a taxpayer
5 under subsection (a) if such individual has made a
6 joint return with the individual’s spouse under sec-
7 tion 6013 for the taxable year beginning in the cal-
8 endar year in which the taxable year of the taxpayer
9 begins.

10 “(3) CITIZENS OR NATIONALS OF OTHER COUN-
11 TRIES.—

12 “(A) IN GENERAL.—The term ‘dependent’
13 does not include an individual who is not a cit-
14 izen or national of the United States unless
15 such individual is a resident of the United
16 States or a country contiguous to the United
17 States.

18 “(B) EXCEPTION FOR ADOPTED CHILD.—
19 Subparagraph (A) shall not exclude any child of
20 a taxpayer (within the meaning of subsection
21 (f)(1)(B)) from the definition of ‘dependent’
22 if—

23 “(i) for the taxable year of the tax-
24 payer, the child has the same principal

1 place of abode as the taxpayer and is a
2 member of the taxpayer's household, and

3 “(ii) the taxpayer is a citizen or na-
4 tional of the United States.

5 “(c) QUALIFYING CHILD.—For purposes of this sec-
6 tion—

7 “(1) IN GENERAL.—The term ‘qualifying child’
8 means, with respect to any taxpayer for any taxable
9 year, an individual—

10 “(A) who bears a relationship to the tax-
11 payer described in paragraph (2),

12 “(B) who has the same principal place of
13 abode as the taxpayer for more than one-half of
14 such taxable year,

15 “(C) who meets the age requirements of
16 paragraph (3), and

17 “(D) who has not provided over one-half of
18 such individual's own support for the calendar
19 year in which the taxable year of the taxpayer
20 begins.

21 “(2) RELATIONSHIP.—For purposes of para-
22 graph (1)(A), an individual bears a relationship to
23 the taxpayer described in this paragraph if such in-
24 dividual is—

1 “(A) a child of the taxpayer or a descend-
2 ant of such a child, or

3 “(B) a brother, sister, stepbrother, or step-
4 sister of the taxpayer or a descendant of any
5 such relative.

6 “(3) AGE REQUIREMENTS.—

7 “(A) IN GENERAL.—For purposes of para-
8 graph (1)(C), an individual meets the require-
9 ments of this paragraph if such individual—

10 “(i) has not attained the age of 19 as
11 of the close of the calendar year in which
12 the taxable year of the taxpayer begins, or

13 “(ii) is a student who has not attained
14 the age of 24 as of the close of such cal-
15 endar year.

16 “(B) SPECIAL RULE FOR DISABLED.—In
17 the case of an individual who is permanently
18 and totally disabled (as defined in section
19 22(e)(3)) at any time during such calendar
20 year, the requirements of subparagraph (A)
21 shall be treated as met with respect to such in-
22 dividual.

23 “(4) SPECIAL RULE RELATING TO 2 OR MORE
24 CLAIMING QUALIFYING CHILD.—

1 “(A) IN GENERAL.—Except as provided in
2 subparagraph (B) and subsection (e), if (but for
3 this paragraph) an individual may be and is
4 claimed as a qualifying child by 2 or more tax-
5 payers for a taxable year beginning in the same
6 calendar year, such individual shall be treated
7 as the qualifying child of the taxpayer who is—

8 “(i) a parent of the individual, or

9 “(ii) if clause (i) does not apply, the
10 taxpayer with the highest adjusted gross
11 income for such taxable year.

12 “(B) MORE THAN 1 PARENT CLAIMING
13 QUALIFYING CHILD.—If the parents claiming
14 any qualifying child do not file a joint return
15 together, such child shall be treated as the
16 qualifying child of—

17 “(i) the parent with whom the child
18 resided for the longest period of time dur-
19 ing the taxable year, or

20 “(ii) if the child resides with both par-
21 ents for the same amount of time during
22 such taxable year, the parent with the
23 highest adjusted gross income.

24 “(d) QUALIFYING RELATIVE.—For purposes of this
25 section—

1 “(1) IN GENERAL.—The term ‘qualifying rel-
2 ative’ means, with respect to any taxpayer for any
3 taxable year, an individual—

4 “(A) who bears a relationship to the tax-
5 payer described in paragraph (2),

6 “(B) whose gross income for the calendar
7 year in which such taxable year begins is less
8 than the exemption amount (as defined in sec-
9 tion 151(d)),

10 “(C) with respect to whom the taxpayer
11 provides over one-half of the individual’s sup-
12 port for the calendar year in which such taxable
13 year begins, and

14 “(D) who is not a qualifying child of such
15 taxpayer or of any other taxpayer for any tax-
16 able year beginning in the calendar year in
17 which such taxable year begins.

18 “(2) RELATIONSHIP.—For purposes of para-
19 graph (1)(A), an individual bears a relationship to
20 the taxpayer described in this paragraph if the indi-
21 vidual is any of the following with respect to the tax-
22 payer:

23 “(A) A child or a descendant of a child.

24 “(B) A brother, sister, stepbrother, or
25 stepsister.

1 “(C) The father or mother, or an ancestor
2 of either.

3 “(D) A stepfather or stepmother.

4 “(E) A son or daughter of a brother or sis-
5 ter of the taxpayer.

6 “(F) A brother or sister of the father or
7 mother of the taxpayer.

8 “(G) A son-in-law, daughter-in-law, father-
9 in-law, mother-in-law, brother-in-law, or sister-
10 in-law.

11 “(H) An individual (other than an indi-
12 vidual who at any time during the taxable year
13 was the spouse, determined without regard to
14 section 7703, of the taxpayer) who, for the tax-
15 able year of the taxpayer, has the same prin-
16 cipal place of abode as the taxpayer and is a
17 member of the taxpayer’s household.

18 “(3) SPECIAL RULE RELATING TO MULTIPLE
19 SUPPORT AGREEMENTS.—For purposes of paragraph
20 (1)(C), over one-half of the support of an individual
21 for a calendar year shall be treated as received from
22 the taxpayer if—

23 “(A) no one person contributed over one-
24 half of such support,

1 “(B) over one-half of such support was re-
2 ceived from 2 or more persons each of whom,
3 but for the fact that any such person alone did
4 not contribute over one-half of such support,
5 would have been entitled to claim such indi-
6 vidual as a dependent for a taxable year begin-
7 ning in such calendar year,

8 “(C) the taxpayer contributed over 10 per-
9 cent of such support, and

10 “(D) each person described in subpara-
11 graph (B) (other than the taxpayer) who con-
12 tributed over 10 percent of such support files a
13 written declaration (in such manner and form
14 as the Secretary may by regulations prescribe)
15 that such person will not claim such individual
16 as a dependent for any taxable year beginning
17 in such calendar year.

18 “(4) SPECIAL RULE RELATING TO INCOME OF
19 HANDICAPPED DEPENDENTS.—

20 “(A) IN GENERAL.—For purposes of para-
21 graph (1)(B), the gross income of an individual
22 who is permanently and totally disabled (as de-
23 fined in section 22(e)(3)) at any time during
24 the taxable year shall not include income attrib-

1 utable to services performed by the individual
2 at a sheltered workshop if—

3 “(i) the availability of medical care at
4 such workshop is the principal reason for
5 the individual’s presence there, and

6 “(ii) the income arises solely from ac-
7 tivities at such workshop which are inci-
8 dent to such medical care.

9 “(B) SHELTERED WORKSHOP DEFINED.—
10 For purposes of subparagraph (A), the term
11 ‘sheltered workshop’ means a school—

12 “(i) which provides special instruction
13 or training designed to alleviate the dis-
14 ability of the individual, and

15 “(ii) which is operated by an organi-
16 zation described in section 501(c)(3) and
17 exempt from tax under section 501(a), or
18 by a State, a possession of the United
19 States, any political subdivision of any of
20 the foregoing, the United States, or the
21 District of Columbia.

22 “(5) SPECIAL RULES FOR SUPPORT.—For pur-
23 poses of this subsection—

24 “(A) payments to a spouse which are in-
25 cludible in the gross income of such spouse

1 under section 71 or 682 shall not be treated as
2 a payment by the payor spouse for the support
3 of any dependent, and

4 “(B) in the case of the remarriage of a
5 parent, support of a child received from the
6 parent’s spouse shall be treated as received
7 from the parent.

8 “(e) SPECIAL RULE FOR DIVORCED PARENTS.—

9 “(1) IN GENERAL.—Notwithstanding subsection
10 (c)(4) or (d)(1)(C), if—

11 “(A) a child receives over one-half of the
12 child’s support during the calendar year from
13 the child’s parents—

14 “(i) who are divorced or legally sepa-
15 rated under a decree of divorce or separate
16 maintenance,

17 “(ii) who are separated under a writ-
18 ten separation agreement, or

19 “(iii) who live apart at all times dur-
20 ing the last 6 months of the calendar year,
21 and

22 “(B) such child is in the custody of 1 or
23 both of the child’s parents for more than one-
24 half of the calendar year,

1 such child shall be treated as being the qualifying
2 child or qualifying relative of the noncustodial par-
3 ent for a calendar year if the requirements described
4 in paragraph (2) are met.

5 “(2) REQUIREMENTS.—For purposes of para-
6 graph (1), the requirements described in this para-
7 graph are met if—

8 “(A) a decree of divorce or separate main-
9 tenance or written separation agreement be-
10 tween the parents applicable to the taxable year
11 beginning in such calendar year provides that—

12 “(i) the noncustodial parent shall be
13 entitled to any deduction allowable under
14 section 151 for such child, or

15 “(ii) the custodial parent will sign a
16 written declaration (in such manner and
17 form as the Secretary may prescribe) that
18 such parent will not claim such child as a
19 dependent for such taxable year, or

20 “(B) in the case of such an agreement exe-
21 cuted before January 1, 1985, the noncustodial
22 parent provides at least \$600 for the support of
23 such child during such calendar year.

24 For purposes of subparagraph (B), amounts ex-
25 pended for the support of a child or children shall

1 be treated as received from the noncustodial parent
2 to the extent that such parent provided amounts for
3 such support.

4 “(3) CUSTODIAL PARENT AND NONCUSTODIAL
5 PARENT.—For purposes of this subsection—

6 “(A) CUSTODIAL PARENT.—The term ‘cus-
7 todial parent’ means the parent with whom a
8 child shared the same principal place of abode
9 for the greater portion of the calendar year.

10 “(B) NONCUSTODIAL PARENT.—The term
11 ‘noncustodial parent’ means the parent who is
12 not the custodial parent.

13 “(4) EXCEPTION FOR MULTIPLE-SUPPORT
14 AGREEMENTS.—This subsection shall not apply in
15 any case where over one-half of the support of the
16 child is treated as having been received from a tax-
17 payer under the provision of subsection (d)(3).

18 “(f) OTHER DEFINITIONS AND RULES.—For pur-
19 poses of this section—

20 “(1) CHILD DEFINED.—

21 “(A) IN GENERAL.—The term ‘child’
22 means an individual who is—

23 “(i) a son, daughter, stepson, or step-
24 daughter of the taxpayer, or

1 “(ii) an eligible foster child of the tax-
2 payer.

3 “(B) ADOPTED CHILD.—In determining
4 whether any of the relationships specified in
5 subparagraph (A)(i) or paragraph (4) exists, a
6 legally adopted individual of the taxpayer, or an
7 individual who is lawfully placed with the tax-
8 payer for legal adoption by the taxpayer, shall
9 be treated as a child of such individual by
10 blood.

11 “(C) ELIGIBLE FOSTER CHILD.—For pur-
12 poses of subparagraph (A)(ii), the term ‘eligible
13 foster child’ means an individual who is placed
14 with the taxpayer by an authorized placement
15 agency or by judgment, decree, or other order
16 of any court of competent jurisdiction.

17 “(2) STUDENT DEFINED.—The term ‘student’
18 means an individual who during each of 5 calendar
19 months during the calendar year in which the tax-
20 able year of the taxpayer begins—

21 “(A) is a full-time student at an edu-
22 cational organization described in section
23 170(b)(1)(A)(ii), or

24 “(B) is pursuing a full-time course of insti-
25 tutional on-farm training under the supervision

1 of an accredited agent of an educational organi-
2 zation described in section 170(b)(1)(A)(ii) or
3 of a State or political subdivision of a State.

4 “(3) DETERMINATION OF HOUSEHOLD STA-
5 TUS.—An individual shall not be treated as a mem-
6 ber of the taxpayer’s household if at any time during
7 the taxable year of the taxpayer the relationship be-
8 tween such individual and the taxpayer is in viola-
9 tion of local law.

10 “(4) BROTHER AND SISTER.—The terms
11 ‘brother’ and ‘sister’ include a brother or sister by
12 the half blood.

13 “(5) SPECIAL SUPPORT TEST IN CASE OF STU-
14 DENTS.—For purposes of subsections (e)(1)(D) and
15 (d)(1)(C), in the case of an individual who is—

16 “(A) a child of the taxpayer, and

17 “(B) a student,

18 amounts received as scholarships for study at an
19 educational organization described in section
20 170(b)(1)(A)(ii) shall not be taken into account.

21 “(6) TREATMENT OF MISSING CHILDREN.—

22 “(A) IN GENERAL.—Solely for the pur-
23 poses referred to in subparagraph (B), a child
24 of the taxpayer—

1 “(i) who is presumed by law enforce-
2 ment authorities to have been kidnapped
3 by someone who is not a member of the
4 family of such child or the taxpayer, and

5 “(ii) who had, for the taxable year in
6 which the kidnapping occurred, the same
7 principal place of abode as the taxpayer for
8 more than one-half of the portion of such
9 year before the date of the kidnapping,

10 shall be treated as meeting the requirement of
11 subsection (c)(1)(B) with respect to a taxpayer
12 for all taxable years ending during the period
13 that the child is kidnapped.

14 “(B) PURPOSES.—Subparagraph (A) shall
15 apply solely for purposes of determining—

16 “(i) the deduction under section
17 151(e),

18 “(ii) the credit under section 24 (re-
19 lating to child tax credit),

20 “(iii) whether an individual is a sur-
21 viving spouse or a head of a household (as
22 such terms are defined in section 2), and

23 “(iv) the earned income credit under
24 section 32.

1 “(C) COMPARABLE TREATMENT OF CER-
2 TAIN QUALIFYING RELATIVES.—For purposes
3 of this section, a child of the taxpayer—

4 “(i) who is presumed by law enforce-
5 ment authorities to have been kidnapped
6 by someone who is not a member of the
7 family of such child or the taxpayer, and

8 “(ii) who was (without regard to this
9 paragraph) a qualifying relative of the tax-
10 payer for the portion of the taxable year
11 before the date of the kidnapping,

12 shall be treated as a qualifying relative of the
13 taxpayer for all taxable years ending during the
14 period that the child is kidnapped.

15 “(D) TERMINATION OF TREATMENT.—
16 Subparagraphs (A) and (C) shall cease to apply
17 as of the first taxable year of the taxpayer be-
18 ginning after the calendar year in which there
19 is a determination that the child is dead (or, if
20 earlier, in which the child would have attained
21 age 18).

1 “(7) CROSS REFERENCES.—

“For provision treating child as dependent of both
parents for purposes of certain provisions, see sec-
tions 105(b), 132(h)(2)(B), and 213(d)(5).”.

2 **SEC. 202. MODIFICATIONS OF DEFINITION OF HEAD OF**
3 **HOUSEHOLD.**

4 (a) HEAD OF HOUSEHOLD.—Clause (i) of section
5 2(b)(1)(A) is amended to read as follows:

6 “(i) a qualifying child of the indi-
7 vidual (as defined in section 152(c), deter-
8 mined without regard to section 152(e)),
9 but not if such child—

10 “(I) is married at the close of the
11 taxpayer’s taxable year, and

12 “(II) is not a dependent of such
13 individual by reason of section
14 152(b)(2) or 152(b)(3), or both, or”.

15 (b) CONFORMING AMENDMENTS.—

16 (1) Section 2(b)(2) is amended by striking sub-
17 paragraph (A) and by redesignating subparagraphs
18 (B), (C), and (D) as subparagraphs (A), (B), and
19 (C), respectively.

20 (2) Clauses (i) and (ii) of section 2(b)(3)(B) are
21 amended to read as follows:

22 “(i) subparagraph (H) of section
23 152(d)(2), or

1 “(ii) paragraph (3) of section
2 152(d).”.

3 **SEC. 203. MODIFICATIONS OF DEPENDENT CARE CREDIT.**

4 (a) IN GENERAL.—Section 21(a)(1) is amended by
5 striking “In the case of an individual who maintains a
6 household which includes as a member one or more quali-
7 fying individuals (as defined in subsection (b)(1))” and in-
8 serting “In the case of an individual for which there are
9 1 or more qualifying individuals (as defined in subsection
10 (b)(1)) with respect to such individual”.

11 (b) QUALIFYING INDIVIDUAL.—Paragraph (1) of sec-
12 tion 21(b) is amended to read as follows:

13 “(1) QUALIFYING INDIVIDUAL.—The term
14 ‘qualifying individual’ means—

15 “(A) a dependent of the taxpayer (as de-
16 fined in section 152(a)(1)) who has not attained
17 age 13,

18 “(B) a dependent of the taxpayer who is
19 physically or mentally incapable of caring for
20 himself or herself and who has the same prin-
21 cipal place of abode as the taxpayer for more
22 than one-half of such taxable year, or

23 “(C) the spouse of the taxpayer, if the
24 spouse is physically or mentally incapable of
25 caring for himself or herself and who has the

1 same principal place of abode as the taxpayer
2 for more than one-half of such taxable year.”.

3 (c) CONFORMING AMENDMENT.—Paragraph (1) of
4 section 21(e) is amended to read as follows:

5 “(1) PLACE OF ABODE.—An individual shall
6 not be treated as having the same principal place of
7 abode of the taxpayer if at any time during the tax-
8 able year of the taxpayer the relationship between
9 the individual and the taxpayer is in violation of
10 local law.”.

11 **SEC. 204. MODIFICATIONS OF CHILD TAX CREDIT.**

12 (a) IN GENERAL.—Paragraph (1) of section 24(c) is
13 amended to read as follows:

14 “(1) IN GENERAL.—The term ‘qualifying child’
15 means a qualifying child of the taxpayer (as defined
16 in section 152(c)) who has not attained age 17.”.

17 (b) CONFORMING AMENDMENT.—Section 24(c)(2) is
18 amended by striking “the first sentence of section
19 152(b)(3)” and inserting “subparagraph (A) of section
20 152(b)(3)”.

21 **SEC. 205. MODIFICATIONS OF EARNED INCOME CREDIT.**

22 (a) QUALIFYING CHILD.—Paragraph (3) of section
23 32(c) is amended to read as follows:

24 “(3) QUALIFYING CHILD.—

1 “(A) IN GENERAL.—The term ‘qualifying
2 child’ means a qualifying child of the taxpayer
3 (as defined in section 152(c), determined with-
4 out regard to paragraph (1)(D) thereof and sec-
5 tion 152(e)).

6 “(B) MARRIED INDIVIDUAL.—The term
7 ‘qualifying child’ shall not include an individual
8 who is married as of the close of the taxpayer’s
9 taxable year unless the taxpayer is entitled to
10 a deduction under section 151 for such taxable
11 year with respect to such individual (or would
12 be so entitled but for section 152(e)).

13 “(C) PLACE OF ABODE.—For purposes of
14 subparagraph (A), the requirements of section
15 152(c)(1)(B) shall be met only if the principal
16 place of abode is in the United States.

17 “(D) IDENTIFICATION REQUIREMENTS.—

18 “(i) IN GENERAL.—A qualifying child
19 shall not be taken into account under sub-
20 section (b) unless the taxpayer includes the
21 name, age, and TIN of the qualifying child
22 on the return of tax for the taxable year.

23 “(ii) OTHER METHODS.—The Sec-
24 retary may prescribe other methods for

1 providing the information described in
2 clause (i).”.

3 (b) CONFORMING AMENDMENTS.—

4 (1) Section 32(c)(1) is amended by striking
5 subparagraph (C) and by redesignating subpara-
6 graphs (D), (E), (F), and (G) as subparagraphs (C),
7 (D), (E), and (F), respectively.

8 (2) Section 32(c)(4) is amended by striking
9 “(3)(E)” and inserting “(3)(C)”.

10 (3) Section 32(m) is amended by striking “sub-
11 sections (c)(1)(F)” and inserting “subsections
12 (c)(1)(E)”.

13 **SEC. 206. MODIFICATIONS OF DEDUCTION FOR PERSONAL**
14 **EXEMPTION FOR DEPENDENTS.**

15 Subsection (c) of section 151 is amended to read as
16 follows:

17 “(c) ADDITIONAL EXEMPTION FOR DEPENDENTS.—
18 An exemption of the exemption amount for each individual
19 who is a dependent (as defined in section 152) of the tax-
20 payer for the taxable year.”.

21 **SEC. 207. TECHNICAL AND CONFORMING AMENDMENTS.**

22 (1) Section 2(a)(1)(B)(i) is amended by insert-
23 ing “, determined without regard to subsections
24 (b)(1), (b)(2), and (d)(1)(B) thereof” after “section
25 152”.

1 (2) Section 21(e)(5) is amended—

2 (A) by striking “paragraph (2) or (4) of”
3 in subparagraph (A), and

4 (B) by striking “within the meaning of sec-
5 tion 152(e)(1)” and inserting “as defined in
6 section 152(e)(3)(A)”.

7 (3) Section 21(e)(6)(B) is amended by striking
8 “section 151(c)(3)” and inserting “section
9 152(f)(1)”.

10 (4) Section 25B(c)(2)(B) is amended by strik-
11 ing “151(c)(4)” and inserting “152(f)(2)”.

12 (5)(A) Subparagraphs (A) and (B) of section
13 51(i)(1) are each amended by striking “paragraphs
14 (1) through (8) of section 152(a)” both places it ap-
15 pears and inserting “subparagraphs (A) through (G)
16 of section 152(d)(2)”.

17 (B) Section 51(i)(1)(C) is amended by striking
18 “152(a)(9)” and inserting “152(d)(2)(H)”.

19 (6) Section 72(t)(2)(D)(i)(III) is amended by
20 inserting “, determined without regard to sub-
21 sections (b)(1), (b)(2), and (d)(1)(B) thereof” after
22 “section 152”.

23 (7) Section 72(t)(7)(A)(iii) is amended by strik-
24 ing “151(c)(3)” and inserting “152(f)(1)”.

1 (8) Section 42(i)(3)(D)(ii)(I) is amended by in-
2 serting “, determined without regard to subsections
3 (b)(1), (b)(2), and (d)(1)(B) thereof” after “section
4 152”.

5 (9) Subsections (b) and (c)(1) of section 105
6 are amended by inserting “, determined without re-
7 gard to subsections (b)(1), (b)(2), and (d)(1)(B)
8 thereof” after “section 152”.

9 (10) Section 120(d)(4) is amended by inserting
10 “(determined without regard to subsections (b)(1),
11 (b)(2), and (d)(1)(B) thereof)” after “section 152”.

12 (11) Section 125(e)(1)(D) is amended by in-
13 serting “, determined without regard to subsections
14 (b)(1), (b)(2), and (d)(1)(B) thereof” after “section
15 152”.

16 (12) Section 129(c)(2) is amended by striking
17 “151(e)(3)” and inserting “152(f)(1)”.

18 (13) The first sentence of section 132(h)(2)(B)
19 is amended by striking “151(e)(3)” and inserting
20 “152(f)(1)”.

21 (14) Section 153 is amended by striking para-
22 graph (1) and by redesignating paragraphs (2), (3),
23 and (4) as paragraphs (1), (2), and (3), respectively.

1 (15) Section 170(g)(1) is amended by inserting
2 “(determined without regard to subsections (b)(1),
3 (b)(2), and (d)(1)(B) thereof)” after “section 152”.

4 (16) Section 170(g)(3) is amended by striking
5 “paragraphs (1) through (8) of section 152(a)” and
6 inserting “subparagraphs (A) through (G) of section
7 152(d)(2)”.

8 (17) Section 213(a) is amended by inserting “,
9 determined without regard to subsections (b)(1),
10 (b)(2), and (d)(1)(B) thereof” after “section 152”.

11 (18) The second sentence of section 213(d)(11)
12 is amended by striking “paragraphs (1) through (8)
13 of section 152(a)” and inserting “subparagraphs (A)
14 through (G) of section 152(d)(2)”.

15 (19) Section 220(d)(2)(A) is amended by in-
16 serting “, determined without regard to subsections
17 (b)(1), (b)(2), and (d)(1)(B) thereof” after “section
18 152”.

19 (20) Section 221(d)(4) is amended by inserting
20 “(determined without regard to subsections (b)(1),
21 (b)(2), and (d)(1)(B) thereof)” after “section 152”.

22 (21) Section 529(e)(2)(B) is amended by strik-
23 ing “paragraphs (1) through (8) of section 152(a)”
24 and inserting “subparagraphs (A) through (G) of
25 section 152(d)(2)”.

1 (22) Section 2032A(c)(7)(D) is amended by
2 striking “section 151(c)(4)” and inserting “section
3 152(f)(2)”.

4 (23) Section 2057(d)(2)(B) is amended by in-
5 serting “, determined without regard to subsections
6 (b)(1), (b)(2), and (d)(1)(B) thereof” after “section
7 152”.

8 (24) Section 7701(a)(17) is amended by strik-
9 ing “152(b)(4), 682,” and inserting “682”.

10 (25) Section 7702B(f)(2)(C)(iii) is amended by
11 striking “paragraphs (1) through (8) of section
12 152(a)” and inserting “subparagraphs (A) through
13 (G) of section 152(d)(2)”.

14 (26) Section 7703(b)(1) is amended—

15 (A) by striking “151(c)(3)” and inserting
16 “152(f)(1)”, and

17 (B) by striking “paragraph (2) or (4) of”.

18 **SEC. 208. EFFECTIVE DATE.**

19 The amendments made by this title shall apply to tax-
20 able years beginning after December 31, 2004.

1 **TITLE III—REVENUE**
2 **PROVISIONS**
3 **Subtitle A—Provisions Designed To**
4 **Curtail Tax Shelters**

5 **SEC. 301. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**
6 **TRINE.**

7 (a) IN GENERAL.—Section 7701 is amended by re-
8 designating subsection (n) as subsection (o) and by insert-
9 ing after subsection (m) the following new subsection:

10 “(n) CLARIFICATION OF ECONOMIC SUBSTANCE
11 DOCTRINE; ETC.—

12 “(1) GENERAL RULES.—

13 “(A) IN GENERAL.—In any case in which
14 a court determines that the economic substance
15 doctrine is relevant for purposes of this title to
16 a transaction (or series of transactions), such
17 transaction (or series of transactions) shall have
18 economic substance only if the requirements of
19 this paragraph are met.

20 “(B) DEFINITION OF ECONOMIC SUB-
21 STANCE.—For purposes of subparagraph (A)—

22 “(i) IN GENERAL.—A transaction has
23 economic substance only if—

24 “(I) the transaction changes in a
25 meaningful way (apart from Federal

1 tax effects) the taxpayer's economic
2 position, and

3 “(II) the taxpayer has a substan-
4 tial nontax purpose for entering into
5 such transaction and the transaction
6 is a reasonable means of accom-
7 plishing such purpose.

8 In applying subclause (II), a purpose of
9 achieving a financial accounting benefit
10 shall not be taken into account in deter-
11 mining whether a transaction has a sub-
12 stantial nontax purpose if the origin of
13 such financial accounting benefit is a re-
14 duction of income tax.

15 “(ii) SPECIAL RULE WHERE TAX-
16 PAYER RELIES ON PROFIT POTENTIAL.—A
17 transaction shall not be treated as having
18 economic substance by reason of having a
19 potential for profit unless—

20 “(I) the present value of the rea-
21 sonably expected pre-tax profit from
22 the transaction is substantial in rela-
23 tion to the present value of the ex-
24 pected net tax benefits that would be

1 allowed if the transaction were re-
2 spected, and

3 “(II) the reasonably expected
4 pre-tax profit from the transaction ex-
5 ceeds a risk-free rate of return.

6 “(C) TREATMENT OF FEES AND FOREIGN
7 TAXES.—Fees and other transaction expenses
8 and foreign taxes shall be taken into account as
9 expenses in determining pre-tax profit under
10 subparagraph (B)(ii).

11 “(2) SPECIAL RULES FOR TRANSACTIONS WITH
12 TAX-INDIFFERENT PARTIES.—

13 “(A) SPECIAL RULES FOR FINANCING
14 TRANSACTIONS.—The form of a transaction
15 which is in substance the borrowing of money
16 or the acquisition of financial capital directly or
17 indirectly from a tax-indifferent party shall not
18 be respected if the present value of the deduc-
19 tions to be claimed with respect to the trans-
20 action is substantially in excess of the present
21 value of the anticipated economic returns of the
22 person lending the money or providing the fi-
23 nancial capital. A public offering shall be treat-
24 ed as a borrowing, or an acquisition of financial
25 capital, from a tax-indifferent party if it is rea-

1 sonably expected that at least 50 percent of the
2 offering will be placed with tax-indifferent par-
3 ties.

4 “(B) ARTIFICIAL INCOME SHIFTING AND
5 BASIS ADJUSTMENTS.—The form of a trans-
6 action with a tax-indifferent party shall not be
7 respected if—

8 “(i) it results in an allocation of in-
9 come or gain to the tax-indifferent party in
10 excess of such party’s economic income or
11 gain, or

12 “(ii) it results in a basis adjustment
13 or shifting of basis on account of over-
14 stating the income or gain of the tax-indif-
15 ferent party.

16 “(3) DEFINITIONS AND SPECIAL RULES.—For
17 purposes of this subsection—

18 “(A) ECONOMIC SUBSTANCE DOCTRINE.—
19 The term ‘economic substance doctrine’ means
20 the common law doctrine under which tax bene-
21 fits under subtitle A with respect to a trans-
22 action are not allowable if the transaction does
23 not have economic substance or lacks a business
24 purpose.

1 “(B) TAX-INDIFFERENT PARTY.—The
2 term ‘tax-indifferent party’ means any person
3 or entity not subject to tax imposed by subtitle
4 A. A person shall be treated as a tax-indifferent
5 party with respect to a transaction if the items
6 taken into account with respect to the trans-
7 action have no substantial impact on such per-
8 son’s liability under subtitle A.

9 “(C) EXCEPTION FOR PERSONAL TRANS-
10 ACTIONS OF INDIVIDUALS.—In the case of an
11 individual, this subsection shall apply only to
12 transactions entered into in connection with a
13 trade or business or an activity engaged in for
14 the production of income.

15 “(D) TREATMENT OF LESSORS.—In apply-
16 ing paragraph (1)(B)(ii) to the lessor of tan-
17 gible property subject to a lease—

18 “(i) the expected net tax benefits with
19 respect to the leased property shall not in-
20 clude the benefits of—

21 “(I) depreciation,

22 “(II) any tax credit, or

23 “(III) any other deduction as
24 provided in guidance by the Secretary,
25 and

1 “(ii) subclause (II) of paragraph
2 (1)(B)(ii) shall be disregarded in deter-
3 mining whether any of such benefits are al-
4 lowable.

5 “(4) OTHER COMMON LAW DOCTRINES NOT AF-
6 FECTED.—Except as specifically provided in this
7 subsection, the provisions of this subsection shall not
8 be construed as altering or supplanting any other
9 rule of law, and the requirements of this subsection
10 shall be construed as being in addition to any such
11 other rule of law.

12 “(5) REGULATIONS.—The Secretary shall pre-
13 scribe such regulations as may be necessary or ap-
14 propriate to carry out the purposes of this sub-
15 section. Such regulations may include exemptions
16 from the application of this subsection.”.

17 (b) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to transactions entered into after
19 the date of the enactment of this Act.

20 **SEC. 302. PENALTY FOR FAILING TO DISCLOSE REPORT-**
21 **ABLE TRANSACTION.**

22 (a) IN GENERAL.—Part I of subchapter B of chapter
23 68 (relating to assessable penalties) is amended by insert-
24 ing after section 6707 the following new section:

1 **“SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE REPORT-**
2 **ABLE TRANSACTION INFORMATION WITH RE-**
3 **TURN OR STATEMENT.**

4 “(a) IMPOSITION OF PENALTY.—Any person who
5 fails to include on any return or statement any informa-
6 tion with respect to a reportable transaction which is re-
7 quired under section 6011 to be included with such return
8 or statement shall pay a penalty in the amount determined
9 under subsection (b).

10 “(b) AMOUNT OF PENALTY.—

11 “(1) IN GENERAL.—Except as provided in para-
12 graphs (2) and (3), the amount of the penalty under
13 subsection (a) shall be \$50,000.

14 “(2) LISTED TRANSACTION.—The amount of
15 the penalty under subsection (a) with respect to a
16 listed transaction shall be \$100,000.

17 “(3) INCREASE IN PENALTY FOR LARGE ENTI-
18 TIES AND HIGH NET WORTH INDIVIDUALS.—

19 “(A) IN GENERAL.—In the case of a fail-
20 ure under subsection (a) by—

21 “(i) a large entity, or

22 “(ii) a high net worth individual,

23 the penalty under paragraph (1) or (2) shall be
24 twice the amount determined without regard to
25 this paragraph.

1 “(B) LARGE ENTITY.—For purposes of
2 subparagraph (A), the term ‘large entity’
3 means, with respect to any taxable year, a per-
4 son (other than a natural person) with gross re-
5 ceipts in excess of \$10,000,000 for the taxable
6 year in which the reportable transaction occurs
7 or the preceding taxable year. Rules similar to
8 the rules of paragraph (2) and subparagraphs
9 (B), (C), and (D) of paragraph (3) of section
10 448(c) shall apply for purposes of this subpara-
11 graph.

12 “(C) HIGH NET WORTH INDIVIDUAL.—For
13 purposes of subparagraph (A), the term ‘high
14 net worth individual’ means, with respect to a
15 reportable transaction, a natural person whose
16 net worth exceeds \$2,000,000 immediately be-
17 fore the transaction.

18 “(c) DEFINITIONS.—For purposes of this section—

19 “(1) REPORTABLE TRANSACTION.—The term
20 ‘reportable transaction’ means any transaction with
21 respect to which information is required to be in-
22 cluded with a return or statement because, as deter-
23 mined under regulations prescribed under section
24 6011, such transaction is of a type which the Sec-

1 retary determines as having a potential for tax
2 avoidance or evasion.

3 “(2) LISTED TRANSACTION.—Except as pro-
4 vided in regulations, the term ‘listed transaction’
5 means a reportable transaction which is the same as,
6 or substantially similar to, a transaction specifically
7 identified by the Secretary as a tax avoidance trans-
8 action for purposes of section 6011.

9 “(d) AUTHORITY TO RESCIND PENALTY.—

10 “(1) IN GENERAL.—The Commissioner of In-
11 ternal Revenue may rescind all or any portion of any
12 penalty imposed by this section with respect to any
13 violation if—

14 “(A) the violation is with respect to a re-
15 portable transaction other than a listed trans-
16 action,

17 “(B) the person on whom the penalty is
18 imposed has a history of complying with the re-
19 quirements of this title,

20 “(C) it is shown that the violation is due
21 to an unintentional mistake of fact;

22 “(D) imposing the penalty would be
23 against equity and good conscience, and

1 “(E) rescinding the penalty would promote
2 compliance with the requirements of this title
3 and effective tax administration.

4 “(2) DISCRETION.—The exercise of authority
5 under paragraph (1) shall be at the sole discretion
6 of the Commissioner and may be delegated only to
7 the head of the Office of Tax Shelter Analysis. The
8 Commissioner, in the Commissioner’s sole discretion,
9 may establish a procedure to determine if a penalty
10 should be referred to the Commissioner or the head
11 of such Office for a determination under paragraph
12 (1).

13 “(3) NO APPEAL.—Notwithstanding any other
14 provision of law, any determination under this sub-
15 section may not be reviewed in any administrative or
16 judicial proceeding.

17 “(4) RECORDS.—If a penalty is rescinded under
18 paragraph (1), the Commissioner shall place in the
19 file in the Office of the Commissioner the opinion of
20 the Commissioner or the head of the Office of Tax
21 Shelter Analysis with respect to the determination,
22 including—

23 “(A) the facts and circumstances of the
24 transaction,

25 “(B) the reasons for the rescission, and

1 “(C) the amount of the penalty rescinded.

2 “(5) REPORT.—The Commissioner shall each
3 year report to the Committee on Ways and Means
4 of the House of Representatives and the Committee
5 on Finance of the Senate—

6 “(A) a summary of the total number and
7 aggregate amount of penalties imposed, and re-
8 scinded, under this section, and

9 “(B) a description of each penalty re-
10 scinded under this subsection and the reasons
11 therefor.

12 “(e) PENALTY REPORTED TO SEC.—In the case of
13 a person—

14 “(1) which is required to file periodic reports
15 under section 13 or 15(d) of the Securities Ex-
16 change Act of 1934 or is required to be consolidated
17 with another person for purposes of such reports,
18 and

19 “(2) which—

20 “(A) is required to pay a penalty under
21 this section with respect to a listed transaction,

22 “(B) is required to pay a penalty under
23 section 6662A with respect to any reportable
24 transaction at a rate prescribed under section
25 6662A(c), or

1 “(C) is required to pay a penalty under
2 section 6662B with respect to any noneconomic
3 substance transaction,
4 the requirement to pay such penalty shall be disclosed in
5 such reports filed by such person for such periods as the
6 Secretary shall specify. Failure to make a disclosure in
7 accordance with the preceding sentence shall be treated
8 as a failure to which the penalty under subsection (b)(2)
9 applies.

10 “(f) COORDINATION WITH OTHER PENALTIES.—The
11 penalty imposed by this section is in addition to any pen-
12 alty imposed under this title.”.

13 (b) DISCLOSURE BY SECRETARY.—

14 (1) IN GENERAL.—Section 6103 is amended by
15 redesignating subsection (q) as subsection (r) and by
16 inserting after subsection (p) the following new sub-
17 section:

18 “(q) DISCLOSURE RELATING TO PAYMENTS OF CER-
19 TAIN PENALTIES.—Notwithstanding any other provision
20 of this section, the Secretary shall make public the name
21 of any person required to pay a penalty described in sec-
22 tion 6707A(e)(2) and the amount of the penalty.”.

23 (2) RECORDS.—Section 6103(p)(3)(A) is
24 amended by striking “or (n)” and inserting “(n), or
25 (q)”.

1 (c) CONFORMING AMENDMENT.—The table of sec-
2 tions for part I of subchapter B of chapter 68 is amended
3 by inserting after the item relating to section 6707 the
4 following:

“Sec. 6707A. Penalty for failure to include reportable transaction
information with return or statement.”.

5 (d) EFFECTIVE DATE.—The amendments made by
6 this section shall apply to returns and statements the due
7 date for which is after the date of the enactment of this
8 Act.

9 **SEC. 303. ACCURACY-RELATED PENALTY FOR LISTED**
10 **TRANSACTIONS AND OTHER REPORTABLE**
11 **TRANSACTIONS HAVING A SIGNIFICANT TAX**
12 **AVOIDANCE PURPOSE.**

13 (a) IN GENERAL.—Subchapter A of chapter 68 is
14 amended by inserting after section 6662 the following new
15 section:

16 **“SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PEN-**
17 **ALTY ON UNDERSTATEMENTS WITH RESPECT**
18 **TO REPORTABLE TRANSACTIONS.**

19 “(a) IMPOSITION OF PENALTY.—If a taxpayer has a
20 reportable transaction understatement for any taxable
21 year, there shall be added to the tax an amount equal to
22 20 percent of the amount of such understatement.

23 “(b) REPORTABLE TRANSACTION UNDERSTATE-
24 MENT.—For purposes of this section—

1 “(1) IN GENERAL.—The term ‘reportable trans-
2 action understatement’ means the sum of—

3 “(A) the product of—

4 “(i) the amount of the increase (if
5 any) in taxable income which results from
6 a difference between the proper tax treat-
7 ment of an item to which this section ap-
8 plies and the taxpayer’s treatment of such
9 item (as shown on the taxpayer’s return of
10 tax), and

11 “(ii) the highest rate of tax imposed
12 by section 1 (section 11 in the case of a
13 taxpayer which is a corporation), and

14 “(B) the amount of the decrease (if any)
15 in the aggregate amount of credits determined
16 under subtitle A which results from a difference
17 between the taxpayer’s treatment of an item to
18 which this section applies (as shown on the tax-
19 payer’s return of tax) and the proper tax treat-
20 ment of such item.

21 For purposes of subparagraph (A), any reduction of
22 the excess of deductions allowed for the taxable year
23 over gross income for such year, and any reduction
24 in the amount of capital losses which would (without

1 regard to section 1211) be allowed for such year,
2 shall be treated as an increase in taxable income.

3 “(2) ITEMS TO WHICH SECTION APPLIES.—This
4 section shall apply to any item which is attributable
5 to—

6 “(A) any listed transaction, and

7 “(B) any reportable transaction (other
8 than a listed transaction) if a significant pur-
9 pose of such transaction is the avoidance or
10 evasion of Federal income tax.

11 “(c) HIGHER PENALTY FOR NONDISCLOSED LISTED
12 AND OTHER AVOIDANCE TRANSACTIONS.—

13 “(1) IN GENERAL.—Subsection (a) shall be ap-
14 plied by substituting ‘30 percent’ for ‘20 percent’
15 with respect to the portion of any reportable trans-
16 action understatement with respect to which the re-
17 quirement of section 6664(d)(2)(A) is not met.

18 “(2) RULES APPLICABLE TO ASSERTION AND
19 COMPROMISE OF PENALTY.—

20 “(A) IN GENERAL.—Only upon the ap-
21 proval by the Chief Counsel for the Internal
22 Revenue Service or the Chief Counsel’s delegate
23 at the national office of the Internal Revenue
24 Service may a penalty to which paragraph (1)
25 applies be included in a 1st letter of proposed

1 deficiency which allows the taxpayer an oppor-
2 tunity for administrative review in the Internal
3 Revenue Service Office of Appeals. If such a
4 letter is provided to the taxpayer, only the Com-
5 missioner of Internal Revenue may compromise
6 all or any portion of such penalty.

7 “(B) APPLICABLE RULES.—The rules of
8 paragraphs (2), (3), (4), and (5) of section
9 6707A(d) shall apply for purposes of subpara-
10 graph (A).

11 “(d) DEFINITIONS OF REPORTABLE AND LISTED
12 TRANSACTIONS.—For purposes of this section, the terms
13 ‘reportable transaction’ and ‘listed transaction’ have the
14 respective meanings given to such terms by section
15 6707A(e).

16 “(e) SPECIAL RULES.—

17 “(1) COORDINATION WITH PENALTIES, ETC.,
18 ON OTHER UNDERSTATEMENTS.—In the case of an
19 understatement (as defined in section 6662(d)(2))—

20 “(A) the amount of such understatement
21 (determined without regard to this paragraph)
22 shall be increased by the aggregate amount of
23 reportable transaction understatements and
24 noneconomic substance transaction understate-
25 ments for purposes of determining whether such

1 understatement is a substantial understatement
2 under section 6662(d)(1), and

3 “(B) the addition to tax under section
4 6662(a) shall apply only to the excess of the
5 amount of the substantial understatement (if
6 any) after the application of subparagraph (A)
7 over the aggregate amount of reportable trans-
8 action understatements and noneconomic sub-
9 stance transaction understatements.

10 “(2) COORDINATION WITH OTHER PEN-
11 ALTIES.—

12 “(A) APPLICATION OF FRAUD PENALTY.—
13 References to an underpayment in section 6663
14 shall be treated as including references to a re-
15 portable transaction understatement and a non-
16 economic substance transaction understatement.

17 “(B) NO DOUBLE PENALTY.—This section
18 shall not apply to any portion of an understate-
19 ment on which a penalty is imposed under sec-
20 tion 6662B or 6663.

21 “(3) SPECIAL RULE FOR AMENDED RE-
22 TURNS.—Except as provided in regulations, in no
23 event shall any tax treatment included with an
24 amendment or supplement to a return of tax be
25 taken into account in determining the amount of any

1 reportable transaction understatement or non-
2 economic substance transaction understatement if
3 the amendment or supplement is filed after the ear-
4 lier of the date the taxpayer is first contacted by the
5 Secretary regarding the examination of the return or
6 such other date as is specified by the Secretary.

7 “(4) NONECONOMIC SUBSTANCE TRANSACTION
8 UNDERSTATEMENT.—For purposes of this sub-
9 section, the term ‘noneconomic substance trans-
10 action understatement’ has the meaning given such
11 term by section 6662B(c).

12 “(5) CROSS REFERENCE.—

“**For reporting of section 6662A(c) penalty to the
Securities and Exchange Commission, see section
6707A(e).**”.

13 (b) DETERMINATION OF OTHER UNDERSTATE-
14 MENTS.—Subparagraph (A) of section 6662(d)(2) is
15 amended by adding at the end the following flush sen-
16 tence:

17 “The excess under the preceding sentence shall
18 be determined without regard to items to which
19 section 6662A applies and without regard to
20 items with respect to which a penalty is im-
21 posed by section 6662B.”.

22 (c) REASONABLE CAUSE EXCEPTION.—

23 (1) IN GENERAL.—Section 6664 is amended by
24 adding at the end the following new subsection:

1 “(d) REASONABLE CAUSE EXCEPTION FOR REPORT-
2 ABLE TRANSACTION UNDERSTATEMENTS.—

3 “(1) IN GENERAL.—No penalty shall be im-
4 posed under section 6662A with respect to any por-
5 tion of a reportable transaction understatement if it
6 is shown that there was a reasonable cause for such
7 portion and that the taxpayer acted in good faith
8 with respect to such portion.

9 “(2) SPECIAL RULES.—Paragraph (1) shall not
10 apply to any reportable transaction understatement
11 unless—

12 “(A) the relevant facts affecting the tax
13 treatment of the item are adequately disclosed
14 in accordance with the regulations prescribed
15 under section 6011,

16 “(B) there is or was substantial authority
17 for such treatment, and

18 “(C) the taxpayer reasonably believed that
19 such treatment was more likely than not the
20 proper treatment.

21 A taxpayer failing to adequately disclose in accord-
22 ance with section 6011 shall be treated as meeting
23 the requirements of subparagraph (A) if the penalty
24 for such failure was rescinded under section
25 6707A(d).

1 “(3) RULES RELATING TO REASONABLE BE-
2 LIEF.—For purposes of paragraph (2)(C)—

3 “(A) IN GENERAL.—A taxpayer shall be
4 treated as having a reasonable belief with re-
5 spect to the tax treatment of an item only if
6 such belief—

7 “(i) is based on the facts and law that
8 exist at the time the return of tax which
9 includes such tax treatment is filed, and

10 “(ii) relates solely to the taxpayer’s
11 chances of success on the merits of such
12 treatment and does not take into account
13 the possibility that a return will not be au-
14 dited, such treatment will not be raised on
15 audit, or such treatment will be resolved
16 through settlement if it is raised.

17 “(B) CERTAIN OPINIONS MAY NOT BE RE-
18 LIED UPON.—

19 “(i) IN GENERAL.—An opinion of a
20 tax advisor may not be relied upon to es-
21 tablish the reasonable belief of a taxpayer
22 if—

23 “(I) the tax advisor is described
24 in clause (ii), or

1 “(II) the opinion is described in
2 clause (iii).

3 “(ii) DISQUALIFIED TAX ADVISORS.—
4 A tax advisor is described in this clause if
5 the tax advisor—

6 “(I) is a material advisor (within
7 the meaning of section 6111(b)(1))
8 who participates in the organization,
9 management, promotion, or sale of
10 the transaction or who is related
11 (within the meaning of section 267(b)
12 or 707(b)(1)) to any person who so
13 participates,

14 “(II) is compensated directly or
15 indirectly by a material advisor with
16 respect to the transaction,

17 “(III) has a fee arrangement
18 with respect to the transaction which
19 is contingent on all or part of the in-
20 tended tax benefits from the trans-
21 action being sustained,

22 “(IV) has an arrangement with
23 respect to the transaction which pro-
24 vides that contractual disputes be-
25 tween the taxpayer and the advisor

1 are to be settled by arbitration or
2 which limits damages by reference to
3 fees paid to the advisor for such trans-
4 action, or

5 “(V) as determined under regula-
6 tions prescribed by the Secretary, has
7 a disqualifying financial interest with
8 respect to the transaction.

9 “(iii) DISQUALIFIED OPINIONS.—For
10 purposes of clause (i), an opinion is dis-
11 qualified if the opinion—

12 “(I) is based on unreasonable
13 factual or legal assumptions (includ-
14 ing assumptions as to future events),

15 “(II) unreasonably relies on rep-
16 resentations, statements, findings, or
17 agreements of the taxpayer or any
18 other person,

19 “(III) does not identify and con-
20 sider all relevant facts,

21 “(IV) is not signed by all individ-
22 uals who are principal authors of the
23 opinion, or

1 “(V) fails to meet any other re-
2 quirement as the Secretary may pre-
3 scribe.”.

4 (2) CONFORMING AMENDMENT.—The heading
5 for subsection (c) of section 6664 is amended by in-
6 serting “FOR UNDERPAYMENTS” after “EXCEP-
7 TION”.

8 (d) CONFORMING AMENDMENTS.—

9 (1) Subparagraph (C) of section 461(i)(3) is
10 amended by striking “section 6662(d)(2)(C)(iii)”
11 and inserting “section 1274(b)(3)(C)”.

12 (2) Paragraph (3) of section 1274(b) is amend-
13 ed—

14 (A) by striking “(as defined in section
15 6662(d)(2)(C)(iii))” in subparagraph (B)(i),
16 and

17 (B) by adding at the end the following new
18 subparagraph:

19 “(C) TAX SHELTER.—For purposes of sub-
20 paragraph (B), the term ‘tax shelter’ means—

21 “(i) a partnership or other entity,

22 “(ii) any investment plan or arrange-
23 ment, or

24 “(iii) any other plan or arrangement,

1 if a significant purpose of such partnership, en-
2 tity, plan, or arrangement is the avoidance or
3 evasion of Federal income tax.”.

4 (3) Section 6662(d)(2) is amended by striking
5 subparagraphs (C) and (D).

6 (4) Section 6664(c)(1) is amended by striking
7 “this part” and inserting “section 6662 or 6663”.

8 (5) Subsection (b) of section 7525 is amended
9 by striking “section 6662(d)(2)(C)(iii)” and insert-
10 ing “section 1274(b)(3)(C)”.

11 (6)(A) The heading for section 6662 is amend-
12 ed to read as follows:

13 **“SEC. 6662. IMPOSITION OF ACCURACY-RELATED PENALTY**
14 **ON UNDERPAYMENTS.”.**

15 (B) The table of sections for part II of sub-
16 chapter A of chapter 68 is amended by striking the
17 item relating to section 6662 and inserting the fol-
18 lowing new items:

“Sec. 6662. Imposition of accuracy-related penalty on underpay-
ments.

“Sec. 6662A. Imposition of accuracy-related penalty on under-
statements with respect to reportable trans-
actions.”.

19 (e) **EFFECTIVE DATE.**—The amendments made by
20 this section shall apply to taxable years ending after the
21 date of the enactment of this Act.

1 **SEC. 304. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
2 **UTABLE TO TRANSACTIONS LACKING ECO-**
3 **NOMIC SUBSTANCE, ETC.**

4 (a) IN GENERAL.—Subchapter A of chapter 68 is
5 amended by inserting after section 6662A the following
6 new section:

7 **“SEC. 6662B. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
8 **UTABLE TO TRANSACTIONS LACKING ECO-**
9 **NOMIC SUBSTANCE, ETC.**

10 “(a) IMPOSITION OF PENALTY.—If a taxpayer has an
11 noneconomic substance transaction understatement for
12 any taxable year, there shall be added to the tax an
13 amount equal to 40 percent of the amount of such under-
14 statement.

15 “(b) REDUCTION OF PENALTY FOR DISCLOSED
16 TRANSACTIONS.—Subsection (a) shall be applied by sub-
17 stituting ‘20 percent’ for ‘40 percent’ with respect to the
18 portion of any noneconomic substance transaction under-
19 statement with respect to which the relevant facts affect-
20 ing the tax treatment of the item are adequately disclosed
21 in the return or a statement attached to the return.

22 “(c) NONECONOMIC SUBSTANCE TRANSACTION UN-
23 DERSTATEMENT.—For purposes of this section—

24 “(1) IN GENERAL.—The term ‘noneconomic
25 substance transaction understatement’ means any
26 amount which would be an understatement under

1 section 6662A(b)(1) if section 6662A were applied
2 by taking into account items attributable to non-
3 economic substance transactions rather than items
4 to which section 6662A would apply without regard
5 to this paragraph.

6 “(2) NONECONOMIC SUBSTANCE TRANS-
7 ACTION.—The term ‘noneconomic substance trans-
8 action’ means any transaction if—

9 “(A) there is a lack of economic substance
10 (within the meaning of section 7701(n)(1)) for
11 the transaction giving rise to the claimed ben-
12 efit or the transaction was not respected under
13 section 7701(n)(2), or

14 “(B) the transaction fails to meet the re-
15 quirements of any similar rule of law.

16 “(d) RULES APPLICABLE TO COMPROMISE OF PEN-
17 ALTY.—

18 “(1) IN GENERAL.—If the 1st letter of pro-
19 posed deficiency which allows the taxpayer an oppor-
20 tunity for administrative review in the Internal Rev-
21 enue Service Office of Appeals has been sent with
22 respect to a penalty to which this section applies,
23 only the Commissioner of Internal Revenue may
24 compromise all or any portion of such penalty.

1 “(2) APPLICABLE RULES.—The rules of para-
2 graphs (2), (3), (4), and (5) of section 6707A(d)
3 shall apply for purposes of paragraph (1).

4 “(e) COORDINATION WITH OTHER PENALTIES.—Ex-
5 cept as otherwise provided in this part, the penalty im-
6 posed by this section shall be in addition to any other pen-
7 alty imposed by this title.

8 “(f) CROSS REFERENCES.—

**“(1) For coordination of penalty with understate-
ments under section 6662 and other special rules,
see section 6662A(e).**

**“(2) For reporting of penalty imposed under this
section to the Securities and Exchange Commission,
see section 6707A(e).”.**

9 (b) CLERICAL AMENDMENT.—The table of sections
10 for part II of subchapter A of chapter 68 is amended by
11 inserting after the item relating to section 6662A the fol-
12 lowing new item:

“Sec. 6662B. Penalty for understatements attributable to trans-
actions lacking economic substance, etc.”.

13 (c) EFFECTIVE DATE.—The amendments made by
14 this section shall apply to transactions entered into after
15 the date of the enactment of this Act.

16 **SEC. 305. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-**
17 **MENT PENALTY FOR NONREPORTABLE**
18 **TRANSACTIONS.**

19 (a) SUBSTANTIAL UNDERSTATEMENT OF CORPORA-
20 TIONS.—Section 6662(d)(1)(B) (relating to special rule
21 for corporations) is amended to read as follows:

1 “(B) SPECIAL RULE FOR CORPORA-
2 TIONS.—In the case of a corporation other than
3 an S corporation or a personal holding company
4 (as defined in section 542), there is a substan-
5 tial understatement of income tax for any tax-
6 able year if the amount of the understatement
7 for the taxable year exceeds the lesser of—

8 “(i) 10 percent of the tax required to
9 be shown on the return for the taxable
10 year (or, if greater, \$10,000), or

11 “(ii) \$10,000,000.”.

12 (b) REDUCTION FOR UNDERSTATEMENT OF TAX-
13 PAYER DUE TO POSITION OF TAXPAYER OR DISCLOSED
14 ITEM.—

15 (1) IN GENERAL.—Section 6662(d)(2)(B)(i)
16 (relating to substantial authority) is amended to
17 read as follows:

18 “(i) the tax treatment of any item by
19 the taxpayer if the taxpayer had reason-
20 able belief that the tax treatment was more
21 likely than not the proper treatment, or”.

22 (2) CONFORMING AMENDMENT.—Section
23 6662(d) is amended by adding at the end the fol-
24 lowing new paragraph:

1 “(3) SECRETARIAL LIST.—For purposes of this
2 subsection, section 6664(d)(2), and section
3 6694(a)(1), the Secretary may prescribe a list of po-
4 sitions for which the Secretary believes there is not
5 substantial authority or there is no reasonable belief
6 that the tax treatment is more likely than not the
7 proper tax treatment. Such list (and any revisions
8 thereof) shall be published in the Federal Register
9 or the Internal Revenue Bulletin.”.

10 (c) EFFECTIVE DATE.—The amendments made by
11 this section shall apply to taxable years beginning after
12 the date of the enactment of this Act.

13 **SEC. 306. TAX SHELTER EXCEPTION TO CONFIDENTIALITY**
14 **PRIVILEGES RELATING TO TAXPAYER COM-**
15 **MUNICATIONS.**

16 (a) IN GENERAL.—Section 7525(b) (relating to sec-
17 tion not to apply to communications regarding corporate
18 tax shelters) is amended to read as follows:

19 “(b) SECTION NOT TO APPLY TO COMMUNICATIONS
20 REGARDING TAX SHELTERS.—The privilege under sub-
21 section (a) shall not apply to any written communication
22 which is—

23 “(1) between a federally authorized tax practi-
24 tioner and—

25 “(A) any person,

1 “(B) any director, officer, employee, agent,
2 or representative of the person, or

3 “(C) any other person holding a capital or
4 profits interest in the person, and

5 “(2) in connection with the promotion of the di-
6 rect or indirect participation of the person in any
7 tax shelter (as defined in section 1274(b)(3)(C)).”.

8 (b) **EFFECTIVE DATE.**—The amendment made by
9 this section shall apply to communications made on or
10 after the date of the enactment of this Act.

11 **SEC. 307. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

12 (a) **IN GENERAL.**—Section 6111 (relating to registra-
13 tion of tax shelters) is amended to read as follows:

14 **“SEC. 6111. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

15 “(a) **IN GENERAL.**—Each material advisor with re-
16 spect to any reportable transaction shall make a return
17 (in such form as the Secretary may prescribe) setting
18 forth—

19 “(1) information identifying and describing the
20 transaction,

21 “(2) information describing any potential tax
22 benefits expected to result from the transaction, and

23 “(3) such other information as the Secretary
24 may prescribe.

1 Such return shall be filed not later than the date specified
2 by the Secretary.

3 “(b) DEFINITIONS.—For purposes of this section—

4 “(1) MATERIAL ADVISOR.—

5 “(A) IN GENERAL.—The term ‘material
6 advisor’ means any person—

7 “(i) who provides any material aid,
8 assistance, or advice with respect to orga-
9 nizing, managing, promoting, selling, im-
10 plementing, insuring, or carrying out any
11 reportable transaction, and

12 “(ii) who directly or indirectly derives
13 gross income in excess of the threshold
14 amount for such aid, assistance, or advice.

15 “(B) THRESHOLD AMOUNT.—For purposes
16 of subparagraph (A), the threshold amount is—

17 “(i) \$50,000 in the case of a report-
18 able transaction substantially all of the tax
19 benefits from which are provided to nat-
20 ural persons, and

21 “(ii) \$250,000 in any other case.

22 “(2) REPORTABLE TRANSACTION.—The term
23 ‘reportable transaction’ has the meaning given to
24 such term by section 6707A(c).

1 “(c) REGULATIONS.—The Secretary may prescribe
2 regulations which provide—

3 “(1) that only 1 person shall be required to
4 meet the requirements of subsection (a) in cases in
5 which 2 or more persons would otherwise be re-
6 quired to meet such requirements,

7 “(2) exemptions from the requirements of this
8 section, and

9 “(3) such rules as may be necessary or appro-
10 priate to carry out the purposes of this section.”.

11 (b) CONFORMING AMENDMENTS.—

12 (1) The item relating to section 6111 in the
13 table of sections for subchapter B of chapter 61 is
14 amended to read as follows:

 “Sec. 6111. Disclosure of reportable transactions.”.

15 (2)(A) So much of section 6112 as precedes
16 subsection (c) thereof is amended to read as follows:

17 **“SEC. 6112. MATERIAL ADVISORS OF REPORTABLE TRANS-**
18 **ACTIONS MUST KEEP LISTS OF ADVISEES.**

19 “(a) IN GENERAL.—Each material advisor (as de-
20 fined in section 6111) with respect to any reportable
21 transaction (as defined in section 6707A(e)) shall main-
22 tain, in such manner as the Secretary may by regulations
23 prescribe, a list—

1 “(1) identifying each person with respect to
2 whom such advisor acted as such a material advisor
3 with respect to such transaction, and

4 “(2) containing such other information as the
5 Secretary may by regulations require.

6 This section shall apply without regard to whether a mate-
7 rial advisor is required to file a return under section 6111
8 with respect to such transaction.”.

9 (B) Section 6112 is amended by redesignating
10 subsection (c) as subsection (b).

11 (C) Section 6112(b), as redesignated by sub-
12 paragraph (B), is amended—

13 (i) by inserting “written” before “request”
14 in paragraph (1)(A), and

15 (ii) by striking “shall prescribe” in para-
16 graph (2) and inserting “may prescribe”.

17 (D) The item relating to section 6112 in the
18 table of sections for subchapter B of chapter 61 is
19 amended to read as follows:

 “Sec. 6112. Material advisors of reportable transactions must
 keep lists of advisees.”.

20 (3)(A) The heading for section 6708 is amend-
21 ed to read as follows:

1 **“SEC. 6708. FAILURE TO MAINTAIN LISTS OF ADVISEES**
2 **WITH RESPECT TO REPORTABLE TRANS-**
3 **ACTIONS.”.**

4 (B) The item relating to section 6708 in the
5 table of sections for part I of subchapter B of chap-
6 ter 68 is amended to read as follows:

“Sec. 6708. Failure to maintain lists of advisees with respect to
reportable transactions.”.

7 (c) **REQUIRED DISCLOSURE NOT SUBJECT TO CLAIM**
8 **OF CONFIDENTIALITY.**—Subparagraph (A) of section
9 6112(b)(1), as redesignated by subsection (b)(2)(B), is
10 amended by adding at the end the following new flush sen-
11 tence:

12 “For purposes of this section, the identity of any
13 person on such list shall not be privileged.”.

14 (d) **EFFECTIVE DATE.**—

15 (1) **IN GENERAL.**—Except as provided in para-
16 graph (2), the amendments made by this section
17 shall apply to transactions with respect to which ma-
18 terial aid, assistance, or advice referred to in section
19 6111(b)(1)(A)(i) of the Internal Revenue Code of
20 1986 (as added by this section) is provided after the
21 date of the enactment of this Act.

22 (2) **NO CLAIM OF CONFIDENTIALITY AGAINST**
23 **DISCLOSURE.**—The amendment made by subsection
24 (c) shall take effect as if included in the amend-

1 ments made by section 142 of the Deficit Reduction
2 Act of 1984.

3 **SEC. 308. MODIFICATIONS TO PENALTY FOR FAILURE TO**
4 **REGISTER TAX SHELTERS.**

5 (a) IN GENERAL.—Section 6707 (relating to failure
6 to furnish information regarding tax shelters) is amended
7 to read as follows:

8 **“SEC. 6707. FAILURE TO FURNISH INFORMATION REGARD-**
9 **ING REPORTABLE TRANSACTIONS.**

10 “(a) IN GENERAL.—If a person who is required to
11 file a return under section 6111(a) with respect to any
12 reportable transaction—

13 “(1) fails to file such return on or before the
14 date prescribed therefor, or

15 “(2) files false or incomplete information with
16 the Secretary with respect to such transaction,
17 such person shall pay a penalty with respect to such return
18 in the amount determined under subsection (b).

19 “(b) AMOUNT OF PENALTY.—

20 “(1) IN GENERAL.—Except as provided in para-
21 graph (2), the penalty imposed under subsection (a)
22 with respect to any failure shall be \$50,000.

23 “(2) LISTED TRANSACTIONS.—The penalty im-
24 posed under subsection (a) with respect to any listed

1 transaction shall be an amount equal to the greater
2 of—

3 “(A) \$200,000, or

4 “(B) 50 percent of the gross income de-
5 rived by such person with respect to aid, assist-
6 ance, or advice which is provided with respect
7 to the listed transaction before the date the re-
8 turn including the transaction is filed under
9 section 6111.

10 Subparagraph (B) shall be applied by substituting
11 ‘75 percent’ for ‘50 percent’ in the case of an inten-
12 tional failure or act described in subsection (a).

13 “(c) CERTAIN RULES TO APPLY.—The provisions of
14 section 6707A(d) shall apply to any penalty imposed under
15 this section.

16 “(d) REPORTABLE AND LISTED TRANSACTIONS.—
17 The terms ‘reportable transaction’ and ‘listed transaction’
18 have the respective meanings given to such terms by sec-
19 tion 6707A(c).”.

20 (b) CLERICAL AMENDMENT.—The item relating to
21 section 6707 in the table of sections for part I of sub-
22 chapter B of chapter 68 is amended by striking “tax shel-
23 ters” and inserting “reportable transactions”.

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to returns the due date for which
3 is after the date of the enactment of this Act.

4 **SEC. 309. MODIFICATION OF PENALTY FOR FAILURE TO**
5 **MAINTAIN LISTS OF INVESTORS.**

6 (a) IN GENERAL.—Subsection (a) of section 6708 is
7 amended to read as follows:

8 “(a) IMPOSITION OF PENALTY.—

9 “(1) IN GENERAL.—If any person who is re-
10 quired to maintain a list under section 6112(a) fails
11 to make such list available upon written request to
12 the Secretary in accordance with section
13 6112(b)(1)(A) within 20 business days after the
14 date of the Secretary’s request, such person shall
15 pay a penalty of \$10,000 for each day of such fail-
16 ure after such 20th day.

17 “(2) REASONABLE CAUSE EXCEPTION.—No
18 penalty shall be imposed by paragraph (1) with re-
19 spect to the failure on any day if such failure is due
20 to reasonable cause.”.

21 (b) EFFECTIVE DATE.—The amendment made by
22 this section shall apply to requests made after the date
23 of the enactment of this Act.

1 **SEC. 310. MODIFICATION OF ACTIONS TO ENJOIN CERTAIN**
2 **CONDUCT RELATED TO TAX SHELTERS AND**
3 **REPORTABLE TRANSACTIONS.**

4 (a) IN GENERAL.—Section 7408 (relating to action
5 to enjoin promoters of abusive tax shelters, etc.) is amend-
6 ed by redesignating subsection (c) as subsection (d) and
7 by striking subsections (a) and (b) and inserting the fol-
8 lowing new subsections:

9 “(a) AUTHORITY TO SEEK INJUNCTION.—A civil ac-
10 tion in the name of the United States to enjoin any person
11 from further engaging in specified conduct may be com-
12 menced at the request of the Secretary. Any action under
13 this section shall be brought in the district court of the
14 United States for the district in which such person resides,
15 has his principal place of business, or has engaged in spec-
16 ified conduct. The court may exercise its jurisdiction over
17 such action (as provided in section 7402(a)) separate and
18 apart from any other action brought by the United States
19 against such person.

20 “(b) ADJUDICATION AND DECREE.—In any action
21 under subsection (a), if the court finds—

22 “(1) that the person has engaged in any speci-
23 fied conduct, and

24 “(2) that injunctive relief is appropriate to pre-
25 vent recurrence of such conduct,

1 the court may enjoin such person from engaging in such
2 conduct or in any other activity subject to penalty under
3 this title.

4 “(c) SPECIFIED CONDUCT.—For purposes of this
5 section, the term ‘specified conduct’ means any action, or
6 failure to take action, which is—

7 “(1) subject to penalty under section 6700,
8 6701, 6707, or 6708, or

9 “(2) in violation of any requirement under reg-
10 ulations issued under section 320 of title 31, United
11 States Code.”.

12 (b) CONFORMING AMENDMENTS.—

13 (1) The heading for section 7408 is amended to
14 read as follows:

15 **“SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RE-**
16 **LATED TO TAX SHELTERS AND REPORTABLE**
17 **TRANSACTIONS.”.**

18 (2) The table of sections for subchapter A of
19 chapter 67 is amended by striking the item relating
20 to section 7408 and inserting the following new
21 item:

“Sec. 7408. Actions to enjoin specified conduct related to tax shelters and
reportable transactions.”.

22 (c) EFFECTIVE DATE.—The amendment made by
23 this section shall take effect on the day after the date of
24 the enactment of this Act.

1 **SEC. 311. UNDERSTATEMENT OF TAXPAYER'S LIABILITY BY**
2 **INCOME TAX RETURN PREPARER.**

3 (a) STANDARDS CONFORMED TO TAXPAYER STAND-
4 ARDS.—Section 6694(a) (relating to understatements due
5 to unrealistic positions) is amended—

6 (1) by striking “realistic possibility of being
7 sustained on its merits” in paragraph (1) and in-
8 serting “reasonable belief that the tax treatment in
9 such position was more likely than not the proper
10 treatment”,

11 (2) by striking “or was frivolous” in paragraph
12 (3) and inserting “or there was no reasonable basis
13 for the tax treatment of such position”, and

14 (3) by striking “UNREALISTIC” in the heading
15 and inserting “IMPROPER”.

16 (b) AMOUNT OF PENALTY.—Section 6694 is amend-
17 ed—

18 (1) by striking “\$250” in subsection (a) and in-
19 serting “\$1,000”, and

20 (2) by striking “\$1,000” in subsection (b) and
21 inserting “\$5,000”.

22 (c) EFFECTIVE DATE.—The amendments made by
23 this section shall apply to documents prepared after the
24 date of the enactment of this Act.

1 **SEC. 312. PENALTY ON FAILURE TO REPORT INTERESTS IN**
2 **FOREIGN FINANCIAL ACCOUNTS.**

3 (a) IN GENERAL.—Section 5321(a)(5) of title 31,
4 United States Code, is amended to read as follows:

5 “(5) FOREIGN FINANCIAL AGENCY TRANS-
6 ACTION VIOLATION.—

7 “(A) PENALTY AUTHORIZED.—The Sec-
8 retary of the Treasury may impose a civil
9 money penalty on any person who violates, or
10 causes any violation of, any provision of section
11 5314.

12 “(B) AMOUNT OF PENALTY.—

13 “(i) IN GENERAL.—Except as pro-
14 vided in subparagraph (C), the amount of
15 any civil penalty imposed under subpara-
16 graph (A) shall not exceed \$10,000.

17 “(ii) REASONABLE CAUSE EXCEP-
18 TION.—No penalty shall be imposed under
19 subparagraph (A) with respect to any vio-
20 lation if—

21 “(I) such violation was due to
22 reasonable cause, and

23 “(II) the amount of the trans-
24 action or the balance in the account
25 at the time of the transaction was
26 properly reported.

1 “(C) WILLFUL VIOLATIONS.—In the case
2 of any person willfully violating, or willfully
3 causing any violation of, any provision of sec-
4 tion 5314—

5 “(i) the maximum penalty under sub-
6 paragraph (B)(i) shall be increased to the
7 greater of—

8 “(I) \$100,000, or

9 “(II) 50 percent of the amount
10 determined under subparagraph (D),
11 and

12 “(ii) subparagraph (B)(ii) shall not
13 apply.

14 “(D) AMOUNT.—The amount determined
15 under this subparagraph is—

16 “(i) in the case of a violation involving
17 a transaction, the amount of the trans-
18 action, or

19 “(ii) in the case of a violation involv-
20 ing a failure to report the existence of an
21 account or any identifying information re-
22 quired to be provided with respect to an
23 account, the balance in the account at the
24 time of the violation.”.

1 (b) EFFECTIVE DATE.—The amendment made by
2 this section shall apply to violations occurring after the
3 date of the enactment of this Act.

4 **SEC. 313. FRIVOLOUS TAX SUBMISSIONS.**

5 (a) CIVIL PENALTIES.—Section 6702 is amended to
6 read as follows:

7 **“SEC. 6702. FRIVOLOUS TAX SUBMISSIONS.**

8 “(a) CIVIL PENALTY FOR FRIVOLOUS TAX RE-
9 TURNS.—A person shall pay a penalty of \$5,000 if—

10 “(1) such person files what purports to be a re-
11 turn of a tax imposed by this title but which—

12 “(A) does not contain information on
13 which the substantial correctness of the self-as-
14 sessment may be judged, or

15 “(B) contains information that on its face
16 indicates that the self-assessment is substan-
17 tially incorrect; and

18 “(2) the conduct referred to in paragraph (1)—

19 “(A) is based on a position which the Sec-
20 retary has identified as frivolous under sub-
21 section (c), or

22 “(B) reflects a desire to delay or impede
23 the administration of Federal tax laws.

24 “(b) CIVIL PENALTY FOR SPECIFIED FRIVOLOUS
25 SUBMISSIONS.—

1 “(1) IMPOSITION OF PENALTY.—Except as pro-
2 vided in paragraph (3), any person who submits a
3 specified frivolous submission shall pay a penalty of
4 \$5,000.

5 “(2) SPECIFIED FRIVOLOUS SUBMISSION.—For
6 purposes of this section—

7 “(A) SPECIFIED FRIVOLOUS SUBMIS-
8 SION.—The term ‘specified frivolous submis-
9 sion’ means a specified submission if any por-
10 tion of such submission—

11 “(i) is based on a position which the
12 Secretary has identified as frivolous under
13 subsection (c), or

14 “(ii) reflects a desire to delay or im-
15 pede the administration of Federal tax
16 laws.

17 “(B) SPECIFIED SUBMISSION.—The term
18 ‘specified submission’ means—

19 “(i) a request for a hearing under—

20 “(I) section 6320 (relating to no-
21 tice and opportunity for hearing upon
22 filing of notice of lien), or

23 “(II) section 6330 (relating to
24 notice and opportunity for hearing be-
25 fore levy), and

1 “(ii) an application under—

2 “(I) section 6159 (relating to
3 agreements for payment of tax liabil-
4 ity in installments),

5 “(II) section 7122 (relating to
6 compromises), or

7 “(III) section 7811 (relating to
8 taxpayer assistance orders).

9 “(3) OPPORTUNITY TO WITHDRAW SUBMIS-
10 SION.—If the Secretary provides a person with no-
11 tice that a submission is a specified frivolous sub-
12 mission and such person withdraws such submission
13 within 30 days after such notice, the penalty im-
14 posed under paragraph (1) shall not apply with re-
15 spect to such submission.

16 “(c) LISTING OF FRIVOLOUS POSITIONS.—The Sec-
17 retary shall prescribe (and periodically revise) a list of po-
18 sitions which the Secretary has identified as being frivo-
19 lous for purposes of this subsection. The Secretary shall
20 not include in such list any position that the Secretary
21 determines meets the requirement of section
22 6662(d)(2)(B)(ii)(II).

23 “(d) REDUCTION OF PENALTY.—The Secretary may
24 reduce the amount of any penalty imposed under this sec-
25 tion if the Secretary determines that such reduction would

1 promote compliance with and administration of the Fed-
2 eral tax laws.

3 “(e) PENALTIES IN ADDITION TO OTHER PEN-
4 ALTIES.—The penalties imposed by this section shall be
5 in addition to any other penalty provided by law.”.

6 (b) TREATMENT OF FRIVOLOUS REQUESTS FOR
7 HEARINGS BEFORE LEVY.—

8 (1) FRIVOLOUS REQUESTS DISREGARDED.—

9 Section 6330 (relating to notice and opportunity for
10 hearing before levy) is amended by adding at the
11 end the following new subsection:

12 “(g) FRIVOLOUS REQUESTS FOR HEARING, ETC.—

13 Notwithstanding any other provision of this section, if the
14 Secretary determines that any portion of a request for a
15 hearing under this section or section 6320 meets the re-
16 quirement of clause (i) or (ii) of section 6702(b)(2)(A),
17 then the Secretary may treat such portion as if it were
18 never submitted and such portion shall not be subject to
19 any further administrative or judicial review.”.

20 (2) PRECLUSION FROM RAISING FRIVOLOUS

21 ISSUES AT HEARING.—Section 6330(c)(4) is amend-
22 ed—

23 (A) by striking “(A)” and inserting
24 “(A)(i)”;

25 (B) by striking “(B)” and inserting “(ii)”;

1 (C) by striking the period at the end of the
2 first sentence and inserting “; or”; and

3 (D) by inserting after subparagraph (A)(ii)
4 (as so redesignated) the following:

5 “(B) the issue meets the requirement of
6 clause (i) or (ii) of section 6702(b)(2)(A).”.

7 (3) STATEMENT OF GROUNDS.—Section
8 6330(b)(1) is amended by striking “under sub-
9 section (a)(3)(B)” and inserting “in writing under
10 subsection (a)(3)(B) and states the grounds for the
11 requested hearing”.

12 (c) TREATMENT OF FRIVOLOUS REQUESTS FOR
13 HEARINGS UPON FILING OF NOTICE OF LIEN.—Section
14 6320 is amended—

15 (1) in subsection (b)(1), by striking “under sub-
16 section (a)(3)(B)” and inserting “in writing under
17 subsection (a)(3)(B) and states the grounds for the
18 requested hearing”, and

19 (2) in subsection (c), by striking “and (e)” and
20 inserting “(e), and (g)”.

21 (d) TREATMENT OF FRIVOLOUS APPLICATIONS FOR
22 OFFERS-IN-COMPROMISE AND INSTALLMENT AGREE-
23 MENTS.—Section 7122 is amended by adding at the end
24 the following new subsection:

1 “(e) FRIVOLOUS SUBMISSIONS, ETC.—Notwith-
 2 standing any other provision of this section, if the Sec-
 3 retary determines that any portion of an application for
 4 an offer-in-compromise or installment agreement sub-
 5 mitted under this section or section 6159 meets the re-
 6 quirement of clause (i) or (ii) of section 6702(b)(2)(A),
 7 then the Secretary may treat such portion as if it were
 8 never submitted and such portion shall not be subject to
 9 any further administrative or judicial review.”.

10 (e) CLERICAL AMENDMENT.—The table of sections
 11 for part I of subchapter B of chapter 68 is amended by
 12 striking the item relating to section 6702 and inserting
 13 the following new item:

“Sec. 6702. Frivolous tax submissions.”.

14 (f) EFFECTIVE DATE.—The amendments made by
 15 this section shall apply to submissions made and issues
 16 raised after the date on which the Secretary first pre-
 17 scribes a list under section 6702(e) of the Internal Rev-
 18 enue Code of 1986, as amended by subsection (a).

19 **SEC. 314. REGULATION OF INDIVIDUALS PRACTICING BE-**
 20 **FORE THE DEPARTMENT OF TREASURY.**

21 (a) CENSURE; IMPOSITION OF PENALTY.—

22 (1) IN GENERAL.—Section 330(b) of title 31,
 23 United States Code, is amended—

24 (A) by inserting “, or censure,” after “De-
 25 partment”, and

1 (B) by adding at the end the following new
2 flush sentence:

3 “The Secretary may impose a monetary penalty on any
4 representative described in the preceding sentence. If the
5 representative was acting on behalf of an employer or any
6 firm or other entity in connection with the conduct giving
7 rise to such penalty, the Secretary may impose a monetary
8 penalty on such employer, firm, or entity if it knew, or
9 reasonably should have known, of such conduct. Such pen-
10 alty shall not exceed the gross income derived (or to be
11 derived) from the conduct giving rise to the penalty and
12 may be in addition to, or in lieu of, any suspension, disbar-
13 ment, or censure of the representative.”.

14 (2) EFFECTIVE DATE.—The amendments made
15 by this subsection shall apply to actions taken after
16 the date of the enactment of this Act.

17 (b) TAX SHELTER OPINIONS, ETC.—Section 330 of
18 such title 31 is amended by adding at the end the fol-
19 lowing new subsection:

20 “(d) Nothing in this section or in any other provision
21 of law shall be construed to limit the authority of the Sec-
22 retary of the Treasury to impose standards applicable to
23 the rendering of written advice with respect to any entity,
24 transaction plan or arrangement, or other plan or arrange-

1 ment, which is of a type which the Secretary determines
2 as having a potential for tax avoidance or evasion.”.

3 **SEC. 315. PENALTY FOR PROMOTING ABUSIVE TAX SHEL-**
4 **TERS.**

5 (a) PENALTY FOR PROMOTING ABUSIVE TAX SHEL-
6 TERS.—Section 6700 (relating to promoting abusive tax
7 shelters, etc.) is amended—

8 (1) by redesignating subsections (b) and (c) as
9 subsections (d) and (e), respectively,

10 (2) by striking “a penalty” and all that follows
11 through the period in the first sentence of subsection
12 (a) and inserting “a penalty determined under sub-
13 section (b)”, and

14 (3) by inserting after subsection (a) the fol-
15 lowing new subsections:

16 “(b) AMOUNT OF PENALTY; CALCULATION OF PEN-
17 ALTY; LIABILITY FOR PENALTY.—

18 “(1) AMOUNT OF PENALTY.—The amount of
19 the penalty imposed by subsection (a) shall not ex-
20 ceed 100 percent of the gross income derived (or to
21 be derived) from such activity by the person or per-
22 sons subject to such penalty.

23 “(2) CALCULATION OF PENALTY.—The penalty
24 amount determined under paragraph (1) shall be
25 calculated with respect to each instance of an activ-

1 ity described in subsection (a), each instance in
2 which income was derived by the person or persons
3 subject to such penalty, and each person who par-
4 ticipated in such an activity.

5 “(3) LIABILITY FOR PENALTY.—If more than 1
6 person is liable under subsection (a) with respect to
7 such activity, all such persons shall be jointly and
8 severally liable for the penalty under such sub-
9 section.

10 “(c) PENALTY NOT DEDUCTIBLE.—The payment of
11 any penalty imposed under this section or the payment
12 of any amount to settle or avoid the imposition of such
13 penalty shall not be deductible by the person who is sub-
14 ject to such penalty or who makes such payment.”.

15 (b) EFFECTIVE DATE.—The amendments made by
16 this section shall apply to activities after the date of the
17 enactment of this Act.

18 **SEC. 316. STATUTE OF LIMITATIONS FOR TAXABLE YEARS**
19 **FOR WHICH REQUIRED LISTED TRANS-**
20 **ACTIONS NOT REPORTED.**

21 (a) IN GENERAL.—Section 6501(c) (relating to ex-
22 ceptions) is amended by adding at the end the following
23 new paragraph:

24 “(10) LISTED TRANSACTIONS.—If a taxpayer
25 fails to include on any return or statement for any

1 taxable year any information with respect to a listed
2 transaction (as defined in section 6707A(e)(2)) which
3 is required under section 6011 to be included with
4 such return or statement, the time for assessment of
5 any tax imposed by this title with respect to such
6 transaction shall not expire before the date which is
7 1 year after the earlier of—

8 “(A) the date on which the Secretary is
9 furnished the information so required; or

10 “(B) the date that a material advisor (as
11 defined in section 6111) meets the requirements
12 of section 6112 with respect to a request by the
13 Secretary under section 6112(b) relating to
14 such transaction with respect to such tax-
15 payer.”.

16 (b) EFFECTIVE DATE.—The amendment made by
17 this section shall apply to taxable years with respect to
18 which the period for assessing a deficiency did not expire
19 before the date of the enactment of this Act.

20 **SEC. 317. DENIAL OF DEDUCTION FOR INTEREST ON UN-**
21 **DERPAYMENTS ATTRIBUTABLE TO NONDIS-**
22 **CLOSED REPORTABLE AND NONECONOMIC**
23 **SUBSTANCE TRANSACTIONS.**

24 (a) IN GENERAL.—Section 163 (relating to deduction
25 for interest) is amended by redesignating subsection (m)

1 as subsection (n) and by inserting after subsection (l) the
2 following new subsection:

3 “(m) INTEREST ON UNPAID TAXES ATTRIBUTABLE
4 TO NONDISCLOSED REPORTABLE TRANSACTIONS AND
5 NONECONOMIC SUBSTANCE TRANSACTIONS.—No deduc-
6 tion shall be allowed under this chapter for any interest
7 paid or accrued under section 6601 on any underpayment
8 of tax which is attributable to—

9 “(1) the portion of any reportable transaction
10 understatement (as defined in section 6662A(b))
11 with respect to which the requirement of section
12 6664(d)(2)(A) is not met, or

13 “(2) any noneconomic substance transaction
14 understatement (as defined in section 6662B(c)).”.

15 (b) EFFECTIVE DATE.—The amendments made by
16 this section shall apply to transactions in taxable years
17 beginning after the date of the enactment of this Act.

18 **SEC. 318. AUTHORIZATION OF APPROPRIATIONS FOR TAX**

19 **LAW ENFORCEMENT.**

20 There is authorized to be appropriated \$300,000,000
21 for each fiscal year beginning after September 30, 2003,
22 for the purpose of carrying out tax law enforcement to
23 combat tax avoidance transactions and other tax shelters,
24 including the use of offshore financial accounts to conceal
25 taxable income.

1 **SEC. 319. PENALTY FOR AIDING AND ABETTING THE UN-**
2 **DERSTATEMENT OF TAX LIABILITY.**

3 (a) IN GENERAL.—Section 6701(a) (relating to impo-
4 sition of penalty) is amended—

5 (1) by inserting “the tax liability or” after “re-
6 spect to,” in paragraph (1),

7 (2) by inserting “aid, assistance, procurement,
8 or advice with respect to such” before “portion”
9 both places it appears in paragraphs (2) and (3),
10 and

11 (3) by inserting “instance of aid, assistance,
12 procurement, or advice or each such” before “docu-
13 ment” in the matter following paragraph (3).

14 (b) AMOUNT OF PENALTY.—Subsection (b) of section
15 6701 (relating to penalties for aiding and abetting under-
16 statement of tax liability) is amended to read as follows:

17 “(b) AMOUNT OF PENALTY; CALCULATION OF PEN-
18 ALTY; LIABILITY FOR PENALTY.—

19 “(1) AMOUNT OF PENALTY.—The amount of
20 the penalty imposed by subsection (a) shall not ex-
21 ceed 100 percent of the gross income derived (or to
22 be derived) from such aid, assistance, procurement,
23 or advice provided by the person or persons subject
24 to such penalty.

25 “(2) CALCULATION OF PENALTY.—The penalty
26 amount determined under paragraph (1) shall be

1 calculated with respect to each instance of aid, as-
2 sistance, procurement, or advice described in sub-
3 section (a), each instance in which income was de-
4 rived by the person or persons subject to such pen-
5 alty, and each person who made such an understatement
6 of the liability for tax.

7 “(3) LIABILITY FOR PENALTY.—If more than 1
8 person is liable under subsection (a) with respect to
9 providing such aid, assistance, procurement, or ad-
10 vice, all such persons shall be jointly and severally
11 liable for the penalty under such subsection.”.

12 (c) PENALTY NOT DEDUCTIBLE.—Section 6701 is
13 amended by adding at the end the following new sub-
14 section:

15 “(g) PENALTY NOT DEDUCTIBLE.—The payment of
16 any penalty imposed under this section or the payment
17 of any amount to settle or avoid the imposition of such
18 penalty shall not be deductible by the person who is sub-
19 ject to such penalty or who makes such payment.”.

20 (d) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to activities after the date of the
22 enactment of this Act.

1 **Subtitle B—Enron-Related Tax**
2 **Shelter Provisions**

3 **SEC. 321. LIMITATION ON TRANSFER OR IMPORTATION OF**
4 **BUILT-IN LOSSES.**

5 (a) IN GENERAL.—Section 362 (relating to basis to
6 corporations) is amended by adding at the end the fol-
7 lowing new subsection:

8 “(e) LIMITATIONS ON BUILT-IN LOSSES.—

9 “(1) LIMITATION ON IMPORTATION OF BUILT-
10 IN LOSSES.—

11 “(A) IN GENERAL.—If in any transaction
12 described in subsection (a) or (b) there would
13 (but for this subsection) be an importation of a
14 net built-in loss, the basis of each property de-
15 scribed in subparagraph (B) which is acquired
16 in such transaction shall (notwithstanding sub-
17 sections (a) and (b)) be its fair market value
18 immediately after such transaction.

19 “(B) PROPERTY DESCRIBED.—For pur-
20 poses of subparagraph (A), property is de-
21 scribed in this subparagraph if—

22 “(i) gain or loss with respect to such
23 property is not subject to tax under this
24 subtitle in the hands of the transferor im-
25 mediately before the transfer, and

1 “(ii) gain or loss with respect to such
2 property is subject to such tax in the
3 hands of the transferee immediately after
4 such transfer.

5 In any case in which the transferor is a part-
6 nership, the preceding sentence shall be applied
7 by treating each partner in such partnership as
8 holding such partner’s proportionate share of
9 the property of such partnership.

10 “(C) IMPORTATION OF NET BUILT-IN
11 LOSS.—For purposes of subparagraph (A),
12 there is an importation of a net built-in loss in
13 a transaction if the transferee’s aggregate ad-
14 justed bases of property described in subpara-
15 graph (B) which is transferred in such trans-
16 action would (but for this paragraph) exceed
17 the fair market value of such property imme-
18 diately after such transaction.

19 “(2) LIMITATION ON TRANSFER OF BUILT-IN
20 LOSSES IN SECTION 351 TRANSACTIONS.—

21 “(A) IN GENERAL.—If—

22 “(i) property is transferred by a
23 transferor in any transaction which is de-
24 scribed in subsection (a) and which is not

1 described in paragraph (1) of this sub-
2 section, and

3 “(ii) the transferee’s aggregate ad-
4 justed bases of such property so trans-
5 ferred would (but for this paragraph) ex-
6 ceed the fair market value of such property
7 immediately after such transaction,

8 then, notwithstanding subsection (a), the trans-
9 feree’s aggregate adjusted bases of the property
10 so transferred shall not exceed the fair market
11 value of such property immediately after such
12 transaction.

13 “(B) ALLOCATION OF BASIS REDUC-
14 TION.—The aggregate reduction in basis by
15 reason of subparagraph (A) shall be allocated
16 among the property so transferred in proportion
17 to their respective built-in losses immediately
18 before the transaction.

19 “(C) EXCEPTION FOR TRANSFERS WITHIN
20 AFFILIATED GROUP.—Subparagraph (A) shall
21 not apply to any transaction if the transferor
22 owns stock in the transferee meeting the re-
23 quirements of section 1504(a)(2). In the case of
24 property to which subparagraph (A) does not
25 apply by reason of the preceding sentence, the

1 transferor's basis in the stock received for such
2 property shall not exceed its fair market value
3 immediately after the transfer.”.

4 (b) COMPARABLE TREATMENT WHERE LIQUIDA-
5 TION.—Paragraph (1) of section 334(b) (relating to liq-
6 uidation of subsidiary) is amended to read as follows:

7 “(1) IN GENERAL.—If property is received by a
8 corporate distributee in a distribution in a complete
9 liquidation to which section 332 applies (or in a
10 transfer described in section 337(b)(1)), the basis of
11 such property in the hands of such distributee shall
12 be the same as it would be in the hands of the trans-
13 feror; except that the basis of such property in the
14 hands of such distributee shall be the fair market
15 value of the property at the time of the distribu-
16 tion—

17 “(A) in any case in which gain or loss is
18 recognized by the liquidating corporation with
19 respect to such property, or

20 “(B) in any case in which the liquidating
21 corporation is a foreign corporation, the cor-
22 porate distributee is a domestic corporation,
23 and the corporate distributee's aggregate ad-
24 justed bases of property described in section
25 362(e)(1)(B) which is distributed in such liq-

1 liquidation would (but for this subparagraph) ex-
2 ceed the fair market value of such property im-
3 mediately after such liquidation.”.

4 (c) EFFECTIVE DATES.—

5 (1) IN GENERAL.—The amendment made by
6 subsection (a) shall apply to transactions after De-
7 cember 31, 2003.

8 (2) LIQUIDATIONS.—The amendment made by
9 subsection (b) shall apply to liquidations after De-
10 cember 31, 2003.

11 **SEC. 322. NO REDUCTION OF BASIS UNDER SECTION 734 IN**
12 **STOCK HELD BY PARTNERSHIP IN COR-**
13 **PORATE PARTNER.**

14 (a) IN GENERAL.—Section 755 is amended by adding
15 at the end the following new subsection:

16 “(c) NO ALLOCATION OF BASIS DECREASE TO
17 STOCK OF CORPORATE PARTNER.—In making an alloca-
18 tion under subsection (a) of any decrease in the adjusted
19 basis of partnership property under section 734(b)—

20 “(1) no allocation may be made to stock in a
21 corporation (or any person which is related (within
22 the meaning of section 267(b) or 707(b)(1)) to such
23 corporation) which is a partner in the partnership,
24 and

1 “(2) any amount not allocable to stock by rea-
2 son of paragraph (1) shall be allocated under sub-
3 section (a) to other partnership property in such
4 manner as the Secretary may prescribe.

5 Gain shall be recognized to the partnership to the extent
6 that the amount required to be allocated under paragraph
7 (2) to other partnership property exceeds the aggregate
8 adjusted basis of such other property immediately before
9 the allocation required by paragraph (2).”.

10 (b) EFFECTIVE DATE.—The amendment made by
11 this section shall apply to distributions after February 13,
12 2003.

13 **SEC. 323. REPEAL OF SPECIAL RULES FOR FASITS.**

14 (a) IN GENERAL.—Part V of subchapter M of chap-
15 ter 1 (relating to financial asset securitization investment
16 trusts) is hereby repealed.

17 (b) CONFORMING AMENDMENTS.—

18 (1) Paragraph (6) of section 56(g) is amended
19 by striking “REMIC, or FASIT” and inserting “or
20 REMIC”.

21 (2) Clause (ii) of section 382(l)(4)(B) is amend-
22 ed by striking “a REMIC to which part IV of sub-
23 chapter M applies, or a FASIT to which part V of
24 subchapter M applies,” and inserting “or a REMIC
25 to which part IV of subchapter M applies,”.

1 (3) Paragraph (1) of section 582(c) is amended
2 by striking “, and any regular interest in a
3 FASIT,”.

4 (4) Subparagraph (E) of section 856(c)(5) is
5 amended by striking the last sentence.

6 (5)(A) Section 860G(a)(1) is amended by add-
7 ing at the end the following new sentence: “An inter-
8 est shall not fail to qualify as a regular interest sole-
9 ly because the specified principal amount of the reg-
10 ular interest (or the amount of interest accrued on
11 the regular interest) can be reduced as a result of
12 the nonoccurrence of 1 or more contingent payments
13 with respect to any reverse mortgage loan held by
14 the REMIC if, on the startup day for the REMIC,
15 the sponsor reasonably believes that all principal and
16 interest due under the regular interest will be paid
17 at or prior to the liquidation of the REMIC.”.

18 (B) The last sentence of section 860G(a)(3) is
19 amended by inserting “, and any reverse mortgage
20 loan (and each balance increase on such loan meet-
21 ing the requirements of subparagraph (A)(iii)) shall
22 be treated as an obligation secured by an interest in
23 real property” before the period at the end.

24 (6) Paragraph (3) of section 860G(a) is amend-
25 ed by adding “and” at the end of subparagraph (B),

1 by striking “, and” at the end of subparagraph (C)
2 and inserting a period, and by striking subparagraph
3 (D).

4 (7) Section 860G(a)(3), as amended by para-
5 graph (6), is amended by adding at the end the fol-
6 lowing new sentence: “For purposes of subparagraph
7 (A), if more than 50 percent of the obligations
8 transferred to, or purchased by, the REMIC are
9 originated by the United States or any State (or any
10 political subdivision, agency, or instrumentality of
11 the United States or any State) and are principally
12 secured by an interest in real property, then each
13 obligation transferred to, or purchased by, the
14 REMIC shall be treated as secured by an interest in
15 real property.”.

16 (8)(A) Section 860G(a)(3)(A) is amended by
17 striking “or” at the end of clause (i), by inserting
18 “or” at the end of clause (ii), and by inserting after
19 clause (ii) the following new clause:

20 “(iii) represents an increase in the
21 principal amount under the original terms
22 of an obligation described in clause (i) or
23 (ii) if such increase—

1 “(I) is attributable to an advance
2 made to the obligor pursuant to the
3 original terms of the obligation,

4 “(II) occurs after the startup
5 day, and

6 “(III) is purchased by the
7 REMIC pursuant to a fixed price con-
8 tract in effect on the startup day.”.

9 (B) Section 860G(a)(7)(B) is amended to read
10 as follows:

11 “(B) QUALIFIED RESERVE FUND.—For
12 purposes of subparagraph (A), the term ‘quali-
13 fied reserve fund’ means any reasonably re-
14 quired reserve to—

15 “(i) provide for full payment of ex-
16 penses of the REMIC or amounts due on
17 regular interests in the event of defaults on
18 qualified mortgages or lower than expected
19 returns on cash flow investments, or

20 “(ii) provide a source of funds for the
21 purchase of obligations described in clause
22 (ii) or (iii) of paragraph (3)(A).

23 The aggregate fair market value of the assets
24 held in any such reserve shall not exceed 50
25 percent of the aggregate fair market value of all

1 of the assets of the REMIC on the startup day,
2 and the amount of any such reserve shall be
3 promptly and appropriately reduced to the ex-
4 tent the amount held in such reserve is no
5 longer reasonably required for purposes speci-
6 fied in clause (i) or (ii) of this subparagraph.”.

7 (9) Subparagraph (C) of section 1202(e)(4) is
8 amended by striking “REMIC, or FASIT” and in-
9 serting “or REMIC”.

10 (10) Clause (xi) of section 7701(a)(19)(C) is
11 amended—

12 (A) by striking “and any regular interest
13 in a FASIT,” and

14 (B) by striking “or FASIT” each place it
15 appears.

16 (11) Subparagraph (A) of section 7701(i)(2) is
17 amended by striking “or a FASIT”.

18 (12) The table of parts for subchapter M of
19 chapter 1 is amended by striking the item relating
20 to part V.

21 (c) EFFECTIVE DATE.—

22 (1) IN GENERAL.—Except as provided in para-
23 graph (2), the amendments made by this section
24 shall take effect on February 14, 2003.

1 (2) EXCEPTION FOR EXISTING FASITS.—Para-
2 graph (1) shall not apply to any FASIT in existence
3 on the date of the enactment of this Act to the ex-
4 tent that regular interests issued by the FASIT be-
5 fore such date continue to remain outstanding in ac-
6 cordance with the original terms of issuance.

7 **SEC. 324. EXPANDED DISALLOWANCE OF DEDUCTION FOR**
8 **INTEREST ON CONVERTIBLE DEBT.**

9 (a) IN GENERAL.—Paragraph (2) of section 163(l)
10 is amended by inserting “or equity held by the issuer (or
11 any related party) in any other person” after “or a related
12 party”.

13 (b) CAPITALIZATION ALLOWED WITH RESPECT TO
14 EQUITY OF PERSONS OTHER THAN ISSUER AND RE-
15 LATED PARTIES.—Section 163(l) is amended by redesi-
16 gnating paragraphs (4) and (5) as paragraphs (5) and (6)
17 and by inserting after paragraph (3) the following new
18 paragraph:

19 “(4) CAPITALIZATION ALLOWED WITH RESPECT
20 TO EQUITY OF PERSONS OTHER THAN ISSUER AND
21 RELATED PARTIES.—If the disqualified debt instru-
22 ment of a corporation is payable in equity held by
23 the issuer (or any related party) in any other person
24 (other than a related party), the basis of such equity
25 shall be increased by the amount not allowed as a

1 deduction by reason of paragraph (1) with respect to
2 the instrument.”.

3 (c) EXCEPTION FOR CERTAIN INSTRUMENTS ISSUED
4 BY DEALERS IN SECURITIES.—Section 163(l), as amend-
5 ed by subsection (b), is amended by redesignating para-
6 graphs (5) and (6) as paragraphs (6) and (7) and by in-
7 serting after paragraph (4) the following new paragraph:

8 “(5) EXCEPTION FOR CERTAIN INSTRUMENTS
9 ISSUED BY DEALERS IN SECURITIES.—For purposes
10 of this subsection, the term ‘disqualified debt instru-
11 ment’ does not include indebtedness issued by a
12 dealer in securities (or a related party) which is pay-
13 able in, or by reference to, equity (other than equity
14 of the issuer or a related party) held by such dealer
15 in its capacity as a dealer in securities. For purposes
16 of this paragraph, the term ‘dealer in securities’ has
17 the meaning given such term by section 475.”.

18 (d) CONFORMING AMENDMENTS.—Paragraph (3) of
19 section 163(l) is amended—

20 (1) by striking “or a related party” in the ma-
21 terial preceding subparagraph (A) and inserting “or
22 any other person”, and

23 (2) by striking “or interest” each place it ap-
24 pears.

1 (e) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to debt instruments issued after
3 February 13, 2003.

4 **SEC. 325. EXPANDED AUTHORITY TO DISALLOW TAX BENE-**
5 **FITS UNDER SECTION 269.**

6 (a) IN GENERAL.—Subsection (a) of section 269 (re-
7 lating to acquisitions made to evade or avoid income tax)
8 is amended to read as follows:

9 “(a) IN GENERAL.—If—

10 “(1)(A) any person or persons acquire, directly
11 or indirectly, control of a corporation, or

12 “(B) any corporation acquires, directly or indi-
13 rectly, property of another corporation and the basis
14 of such property, in the hands of the acquiring cor-
15 poration, is determined by reference to the basis in
16 the hands of the transferor corporation, and

17 “(2) the principal purpose for which such acqui-
18 sition was made is evasion or avoidance of Federal
19 income tax,

20 then the Secretary may disallow such deduction, credit,
21 or other allowance. For purposes of paragraph (1)(A),
22 control means the ownership of stock possessing at least
23 50 percent of the total combined voting power of all class-
24 es of stock entitled to vote or at least 50 percent of the

1 total value of all shares of all classes of stock of the cor-
2 poration.”.

3 (b) EFFECTIVE DATE.—The amendment made by
4 this section shall apply to stock and property acquired
5 after February 13, 2003.

6 **SEC. 326. MODIFICATION OF INTERACTION BETWEEN SUB-**
7 **PART F AND PASSIVE FOREIGN INVESTMENT**
8 **COMPANY RULES.**

9 (a) LIMITATION ON EXCEPTION FROM PFIC RULES
10 FOR UNITED STATES SHAREHOLDERS OF CONTROLLED
11 FOREIGN CORPORATIONS.—Paragraph (2) of section
12 1297(e) (relating to passive foreign investment company)
13 is amended by adding at the end the following flush sen-
14 tence:

15 “Such term shall not include any period if the
16 earning of subpart F income by such corpora-
17 tion during such period would result in only a
18 remote likelihood of an inclusion in gross in-
19 come under section 951(a)(1)(A)(i).”.

20 (b) EFFECTIVE DATE.—The amendment made by
21 this section shall apply to taxable years of controlled for-
22 eign corporations beginning after February 13, 2003, and
23 to taxable years of United States shareholders with or
24 within which such taxable years of controlled foreign cor-
25 porations end.

1 **Subtitle C—Extension of Customs**
2 **User Fees**

3 **SEC. 331. EXTENSION OF CUSTOMS USER FEES.**

4 Section 13031(j)(3) of the Consolidated Omnibus
5 Budget Reconciliation Act of 1985 (19 U.S.C. 58c(j)(3))
6 is amended by striking “March 1, 2005” and inserting
7 “September 30, 2013”.

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