To provide for reconciliation pursuant to section 201 of the concurrent resolution on the budget for fiscal year 2004.

IN THE SENATE OF THE UNITED STATES

MAY 13, 2003

Mr. GRASSLEY, from the Committee on Finance, reported the following original bill; which was read twice and placed on the calendar

A BILL

To provide for reconciliation pursuant to section 201 of the concurrent resolution on the budget for fiscal year 2004.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; REFERENCES; TABLE OF CONTENTS.

(a) Short Title.—This Act may be cited as the “Jobs and Growth Tax Relief Reconciliation Act of 2003”.

(b) Amendment of 1986 Code.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment
to, or repeal of, a section or other provision, the reference
shall be considered to be made to a section or other provi-

(c) Table of Contents.—The table of contents of
this Act is as follows:

Sec. 1. Short title; references; table of contents.

TITLE I—ACCELERATION OF CERTAIN PREVIOUSLY ENACTED
TAX REDUCTIONS; INCREASED EXPENSING FOR SMALL BUSI-
NESSES

Sec. 101. Acceleration of 10-percent individual income tax rate bracket expan-
sion.
Sec. 102. Acceleration of reduction in individual income tax rates.
Sec. 103. Minimum tax relief to individuals.
Sec. 104. Acceleration of increase in standard deduction for married taxpayers
filing joint returns.
Sec. 105. Acceleration of 15-percent individual income tax rate bracket expan-
sion for married taxpayers filing joint returns.
Sec. 106. Acceleration of increase in, and refundability of, child tax credit.
Sec. 107. Increased expensing for small business.
Sec. 108. Application of EGTRRA sunset to this title.

TITLE II—PARTIAL EXCLUSION OF DIVIDENDS

Sec. 201. Partial exclusion of dividends received by individuals.

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 eco-
nomic 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 shel-
ters 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. Penalty on promoters of tax shelters.
Sec. 315. Statute of limitations for taxable years for which listed transactions not reported.
Sec. 316. Denial of deduction for interest on underpayments attributable to nondisclosed reportable and noneconomic substance transactions.

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. Modifications of certain rules relating to controlled foreign corporations.
Sec. 327. Controlled entities ineligible for REIT status.

Subtitle C—Other Corporate Governance Provisions

PART I—GENERAL PROVISIONS

Sec. 331. Affirmation of consolidated return regulation authority.
Sec. 332. Signing of corporate tax returns by chief executive officer.
Sec. 333. Denial of deduction for certain fines, penalties, and other amounts.
Sec. 334. Disallowance of deduction for punitive damages.

PART II—EXECUTIVE COMPENSATION REFORM

Sec. 335. Treatment of nonqualified deferred compensation funded with assets located outside the United States.
Sec. 336. Inclusion in gross income of funded deferred compensation of corporate insiders.
Sec. 337. Prohibition on deferral of gain from the exercise of stock options and restricted stock gains through deferred compensation arrangements.
Sec. 338. Increase in withholding from supplemental wage payments in excess of $1,000,000.

Subtitle D—International Provisions

PART I—PROVISIONS TO DISCOURAGE EXPATRIATION

Sec. 340. Revision of tax rules on expatriation.
Sec. 341. Tax treatment of inverted corporate entities.
Sec. 342. Excise tax on stock compensation of insiders in inverted corporations.
Sec. 343. Reinsurance of United States risks in foreign jurisdictions.

PART II—OTHER PROVISIONS

Sec. 344. Doubling of certain penalties, fines, and interest on underpayments related to certain offshore financial arrangement.
Sec. 345. Effectively connected income to include certain foreign source income.
Sec. 346. Determination of basis of amounts paid from foreign pension plans.
Sec. 347. Recapture of overall foreign losses on sale of controlled foreign corporation.
Sec. 348. Prevention of mismatching of interest and original issue discount deductions and income inclusions in transactions with related foreign persons.
Sec. 349. Sale of gasoline and diesel fuel at duty-free sales enterprises.
Sec. 350. Repeal of earned income exclusion of citizens or residents living abroad.

Subtitle E—Other Revenue Provisions

Sec. 351. Extension of Internal Revenue Service user fees.
Sec. 352. Addition of vaccines against hepatitis A to list of taxable vaccines.
Sec. 353. Disallowance of certain partnership loss transfers.
Sec. 354. Treatment of stripped interests in bond and preferred stock funds, etc.
Sec. 355. Reporting of taxable mergers and acquisitions.
Sec. 356. Minimum holding period for foreign tax credit on withholding taxes on income other than dividends.
Sec. 357. Qualified tax collection contracts.
Sec. 358. Extension of customs user fees.
Sec. 359. Clarification of exemption from tax for small property and casualty insurance companies.
Sec. 360. Partial payment of tax liability in installment agreements.
Sec. 361. Extension of amortization of intangibles to sports franchises.
Sec. 362. Deposits made to suspend running of interest on potential underpayments.
Sec. 363. Clarification of rules for payment of estimated tax for certain deemed asset sales.
Sec. 364. Limitation on deduction for charitable contributions of patents and similar property.
Sec. 365. Extension of provision permitting qualified transfers of excess pension assets to retiree health accounts.
Sec. 366. Proration rules for life insurance business of property and casualty insurance companies.
Sec. 367. Modification of treatment of transfers to creditors in divisive reorganizations.

Subtitle F—Other Provisions

Sec. 371. Temporary State Fiscal Relief Fund.
Sec. 372. Review of State agency blindness and disability determinations.
Sec. 373. Prohibition on use of SCHIP funds to provide coverage for childless adults.

TITLE IV—SMALL BUSINESS AND AGRICULTURAL PROVISIONS

Subtitle A—Small Business Provisions

Sec. 401. Exclusion of certain indebtedness of small business investment companies from acquisition indebtedness.
Sec. 402. Repeal of occupational taxes relating to distilled spirits, wine, and beer.
Sec. 403. Custom gunsmiths.
Sec. 404. Simplification of excise tax imposed on bows and arrows.

Subtitle B—Agricultural Provisions
Sec. 411. Capital gain treatment under section 631(b) to apply to outright sales by landowners.
Sec. 412. Special rules for livestock sold on account of weather-related conditions.
Sec. 413. Exclusion for loan payments under national health service corps loan repayment program.
Sec. 414. Payment of dividends on stock of cooperatives without reducing patronage dividends.

TITLE V—SIMPLIFICATION AND OTHER PROVISIONS

Subtitle A—Uniform Definition of Child

Sec. 501. Uniform definition of child, etc.
Sec. 502. Modifications of definition of head of household.
Sec. 503. Modifications of dependent care credit.
Sec. 504. Modifications of child tax credit.
Sec. 505. Modifications of earned income credit.
Sec. 506. Modifications of deduction for personal exemption for dependents.
Sec. 507. Technical and conforming amendments.
Sec. 508. Effective date.

Subtitle B—Simplification

Sec. 511. Consolidation of life and non-life insurance company returns.
Sec. 512. Special rules for taxation of life insurance companies.
Sec. 513. Modification of active business definition under section 355.

Subtitle C—Other Provisions

Sec. 521. Civil rights tax relief.
Sec. 522. Increase in section 382 limitation for companies emerging from bankruptcy.
Sec. 523. Increase in historic rehabilitation credit for certain low-income housing for the elderly.
Sec. 524. Modification of application of income forecast method of depreciation.
Sec. 525. Additional advance refundings of certain governmental bonds.
Sec. 526. Exclusion of income derived from certain wagers on horse races from gross income of nonresident alien individuals.
Sec. 527. Federal reimbursement of emergency health services furnished to undocumented aliens.
Sec. 528. Premiums for mortgage insurance.

TITLE VI—SUNSET

Sec. 601. Sunset.
TITLE I—ACCELERATION OF CERTAIN PREVIOUSLY ENACTED TAX REDUCTIONS; INCREASED EXPENSING FOR SMALL BUSINESSES

SEC. 101. ACCELERATION OF 10-PERCENT INDIVIDUAL INCOME TAX RATE BRACKET EXPANSION.

(a) In General.—Clause (i) of section 1(i)(1)(B) (relating to the initial bracket amount) is amended by striking “($12,000 in the case of taxable years beginning before January 1, 2008)”.

(b) Inflation Adjustment Beginning in 2004.—Subparagraph (C) of section 1(i)(1) (relating to inflation adjustment) is amended to read as follows:

“(C) Inflation Adjustment.—In prescribing the tables under subsection (f) which apply with respect to taxable years beginning in calendar years after 2003—

“(i) the cost-of-living adjustment used in making adjustments to the initial bracket amount shall be determined under subsection (f)(3) by substituting ‘2002’ for ‘1992’ in subparagraph (B) thereof, and
“(ii) such adjustment shall not apply to the amount referred to in subparagraph (B)(iii).

If any amount after adjustment under the preceding sentence is not a multiple of $50, such amount shall be rounded to the next lowest multiple of $50.”.

(c) Effective Dates.—

(1) Subsection (a).—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2002.

(2) Subsection (b).—The amendment made by subsection (b) shall apply to taxable years beginning after December 31, 2003.

(3) Tables for 2003.—The Secretary of the Treasury shall modify each table which has been prescribed for taxable years beginning in 2003 and which relates to the amendment made by subsection (a), section 102, or section 103 to reflect each such amendment.

SEC. 102. ACCELERATION OF REDUCTION IN INDIVIDUAL INCOME TAX RATES.

(a) In General.—The table in paragraph (2) of section 1(i) (relating to reductions in rates after June 30, 2001) is amended to read as follows:
In the case of taxable years beginning during calendar year:

<table>
<thead>
<tr>
<th>Year</th>
<th>The corresponding percentages shall be substituted for the following percentages:</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>27.5% 30.5% 35.5% 39.1%</td>
</tr>
<tr>
<td>2002</td>
<td>27.0% 30.0% 35.0% 38.6%</td>
</tr>
<tr>
<td>2003 and thereafter</td>
<td>25.0% 28.0% 33.0% 35.0%</td>
</tr>
</tbody>
</table>

(b) Effective Date.—The amendment made by this section shall apply to taxable years beginning after December 31, 2002.

4 SEC. 103. MINIMUM TAX RELIEF TO INDIVIDUALS.

(a) In General.—So much of paragraph (1) of section 55(d) (relating to exemption amount for taxpayers other than corporations) as precedes subparagraph (C) thereof is amended to read as follows:

“(1) Exemption amount for taxpayers other than corporations.—In the case of a taxpayer other than a corporation, the term ‘exemption amount’ means as follows:

“(A) Joint return and surviving spouse.—In the case of a joint return or a surviving spouse, the amount under the following table:

<table>
<thead>
<tr>
<th>In the case of taxable years beginning:</th>
<th>The exemption amount is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 2001</td>
<td>$45,000</td>
</tr>
<tr>
<td>In 2001 and 2002</td>
<td>$49,000</td>
</tr>
<tr>
<td>In 2003, 2004, and 2005</td>
<td>$61,000</td>
</tr>
<tr>
<td>After 2005</td>
<td>$45,000.</td>
</tr>
</tbody>
</table>

“(B) Individual not married and not a surviving spouse.—In the case of an individual who is not a married individual and is
not a surviving spouse, the amount under the following table:

```
<table>
<thead>
<tr>
<th>In the case of taxable years beginning:</th>
<th>The exemption amount is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 2001 ..................................................</td>
<td>$33,750</td>
</tr>
<tr>
<td>In 2001 and 2002 ........................................</td>
<td>$35,750</td>
</tr>
<tr>
<td>In 2003, 2004, and 2005 .....................</td>
<td>$41,750</td>
</tr>
<tr>
<td>After 2005 ...................................................</td>
<td>$33,750</td>
</tr>
</tbody>
</table>
```

(b) CONFORMING AMENDMENTS.—

(1) Section 55(d)(1)(C) is amended—

(A) by striking “, and” and inserting a period, and

(B) by striking “50 percent” and inserting “MARRIED INDIVIDUAL FILING A SEPARATE RETURN.—50 percent”.

(2) Section 55(d)(1)(D) is amended by striking “$22,500” and inserting “ESTATE AND TRUST.—$22,500”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.

SEC. 104. ACCELERATION OF INCREASE IN STANDARD DEDUCTION FOR MARRIED TAXPAYERS FILING JOINT RETURNS.

(a) IN GENERAL.—Paragraph (2) of section 63(c)

(relating to basic standard deduction) is amended to read as follows:
“(2) Basic standard deduction.—For purposes of paragraph (1), the basic standard deduction is—

“(A) 200 percent of the dollar amount in effect under subparagraph (C) for the taxable year in the case of—

“(i) a joint return, or

“(ii) a surviving spouse (as defined in section 2(a)),

“(B) $4,400 in the case of a head of household (as defined in section 2(b)), or

“(C) $3,000 in any other case.”.

(b) Conforming amendments.—

(1) Section 63(c)(4) is amended by striking “(2)(D)” each place it occurs and inserting “(2)(C)”.

(2) Section 63(c) is amended by striking paragraph (7).

(3) Section 301(d) of the Economic Growth and Tax Relief Reconciliation Act of 2001 is amended by striking “2004” and inserting “2002”.

(c) Effective date.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.
SEC. 105. ACCELERATION OF 15-PERCENT INDIVIDUAL INCOME TAX RATE BRACKET EXPANSION FOR MARRIED TAXPAYERS FILING JOINT RETURNS.

(a) In General.—Paragraph (8) of section 1(f) (relating to phaseout of marriage penalty in 15-percent bracket) is amended to read as follows:

“(8) Elimination of marriage penalty in 15-percent bracket.—With respect to taxable years beginning after December 31, 2002, in prescribing the tables under paragraph (1)—

“(A) the maximum taxable income in the 15 percent rate bracket in the table contained in subsection (a) (and the minimum taxable income in the next higher taxable income bracket in such table) shall be 200 percent of the maximum taxable income in the 15-percent rate bracket in the table contained in subsection (c) (after any other adjustment under this subsection), and

“(B) the comparable taxable income amounts in the table contained in subsection (d) shall be 1/2 of the amounts determined under subparagraph (A).”.

(b) Conforming Amendments.—
(1) The heading for subsection (f) of section 1 is amended by striking “PHASEOUT” and inserting “ELIMINATION”.

(2) Section 302(c) of the Economic Growth and Tax Relief Reconciliation Act of 2001 is amended by striking “2004” and inserting “2002”.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.

SEC. 106. ACCELERATION OF INCREASE IN, AND REFUNDABILITY OF, CHILD TAX CREDIT.

(a) ACCELERATION OF INCREASE IN CREDIT.—Subsection (a) of section 24 (relating to child tax credit) is amended to read as follows:

“(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year with respect to each qualifying child of the taxpayer an amount equal to $1,000.”.

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

(e) ADVANCE PAYMENT OF PORTION OF INCREASED CREDIT IN 2003.—
(1) In General.—Subchapter B of chapter 65 (relating to abatements, credits, and refunds) is amended by adding at the end the following new section:

"SEC. 6429. ADVANCE PAYMENT OF PORTION OF INCREASED CHILD CREDIT FOR 2003.

"(a) In General.—Each taxpayer who claimed a credit under section 24 on the return for the taxpayer’s first taxable year beginning in 2002 shall be treated as having made a payment against the tax imposed by chapter 1 for such taxable year in an amount equal to the child tax credit refund amount (if any) for such taxable year.

"(b) Child Tax Credit Refund Amount.—For purposes of this section, the child tax credit refund amount is the amount by which the aggregate credits allowed under part IV of subchapter A of chapter 1 for such first taxable year would have been increased if—

"(1) the per child amount under section 24(a)(2) for such year were $1,000,

"(2) only qualifying children (as defined in section 24(c)) of the taxpayer for such year who had not attained age 17 as of December 31, 2003, were taken into account, and

"(3) section 24(d)(1)(B)(ii) did not apply."
“(c) Timing of Payments.—In the case of any overpayment attributable to this section, the Secretary shall, subject to the provisions of this title, refund or credit such overpayment as rapidly as possible and, to the extent practicable, before October 1, 2003. No refund or credit shall be made or allowed under this section after December 31, 2003.

“(d) Coordination with Child Tax Credit.—

“(1) In General.—The amount of credit which would (but for this subsection and section 26) be allowed under section 24 for the taxpayer’s first taxable year beginning in 2003 shall be reduced (but not below zero) by the payments made to the taxpayer under this section. Any failure to so reduce the credit shall be treated as arising out of a mathematical or clerical error and assessed according to section 6213(b)(1).

“(2) Joint Returns.—In the case of a payment under this section with respect to a joint return, half of such payment shall be treated as having been made to each individual filing such return.

“(e) No Interest.—No interest shall be allowed on any overpayment attributable to this section.”.
(2) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 65 is amended by adding at the end the following new item:

“Sec. 6429. Advance payment of portion of increased child credit for 2003.”.

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2002.

(2) SUBSECTION (c).—The amendments made by subsection (c) shall take effect on the date of the enactment of this Act.

SEC. 107. INCREASED EXPENSING FOR SMALL BUSINESS.

(a) IN GENERAL.—Paragraph (1) of section 179(b) (relating to dollar limitation) is amended to read as follows:

“(1) DOLLAR LIMITATION.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed $75,000.”.

(b) INCREASE IN QUALIFYING INVESTMENT AT WHICH PHASEOUT BEGINS.—Paragraph (2) of section 179(b) (relating to reduction in limitation) is amended by striking “$200,000” and inserting “$325,000”.

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(c) Off-the-Shelf Computer Software.—Paragraph (1) of section 179(d) (defining section 179 property) is amended to read as follows:

“(1) SECTION 179 PROPERTY.—For purposes of this section, the term 'section 179 property' means property—

“(A) which is—

“(i) tangible property (to which section 168 applies), or

“(ii) computer software (as defined in section 197(e)(3)(B)) which is described in section 197(e)(3)(A)(i) and to which section 167 applies,

“(B) which is section 1245 property (as defined in section 1245(a)(3)), and

“(C) which is acquired by purchase for use in the active conduct of a trade or business.

Such term shall not include any property described in section 50(b) and shall not include air conditioning or heating units.”.

(d) Adjustment of Dollar Limit and Phaseout Threshold for Inflation.—Subsection (b) of section 179 (relating to limitations) is amended by adding at the end the following new paragraph:

“(5) INFLATION ADJUSTMENTS.—
“(A) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2003, the dollar amounts in paragraphs (1) and (2) shall each be increased by an amount equal to—

“(i) such dollar amount, multiplied by

“(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting ‘calendar year 2002’ for ‘calendar year 1992’ in subparagraph (B) thereof.

“(B) ROUNDING.—

“(i) DOLLAR LIMITATION.—If the amount in paragraph (1) as increased under subparagraph (A) is not a multiple of $1,000, such amount shall be rounded to the nearest multiple of $1,000.

“(ii) PHASEOUT AMOUNT.—If the amount in paragraph (2) as increased under subparagraph (A) is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000.”.
(c) Revocation of Election.—Paragraph (2) of section 179(c) (relating to election irrevocable) is amended to read as follows:

“(2) Revocation of election.—The taxpayer may revoke an election under paragraph (1), and any specification contained in any such election, with respect to any property. Such revocation, once made, shall be irrevocable.”.

(f) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.

SEC. 108. APPLICATION OF EGTRRA SUNSET TO THIS TITLE.

Each amendment made by this title (other than section 107) shall be subject to title IX of the Economic Growth and Tax Relief Reconciliation Act of 2001 to the same extent and in the same manner as the provision of such Act to which such amendment relates.

TITLE II—PARTIAL EXCLUSION OF DIVIDENDS

SEC. 201. PARTIAL EXCLUSION OF DIVIDENDS RECEIVED BY INDIVIDUALS.

(a) General Rule.—Part III of subchapter B of chapter 1 is amended by inserting after section 115 the following new section:
SEC. 116. PARTIAL EXCLUSION OF DIVIDENDS RECEIVED
BY INDIVIDUALS.

“(a) Exclusion From Gross Income.—

“(1) In general.—Gross income does not in-
clude qualified dividend income received during the
taxable year by an individual.

“(2) Limitation.—Paragraph (1) shall apply
to qualified dividend income of a taxpayer only to
the extent such income does not exceed the sum of—

“(A) $500 ($250 in the case of a married
individual filing a separate return), plus

“(B) 10 percent (20 percent in the case of
taxable years beginning after 2007) of such in-
come in excess of the amount applicable under
subparagraph (A).

“(b) Qualified Dividend Income.—For purposes
of this subsection—

“(1) In general.—The term ‘qualified divi-
dend income’ means dividends received with respect
to any share of stock of—

“(A) any domestic corporation, or

“(B) any foreign corporation but only if
such share of stock is readily tradable on an es-
tablished securities market.

“(2) Certain dividends excluded.—Such

term shall not include—
“(A) any dividend from a corporation which for the taxable year of the corporation in which the distribution is made, or the preceding taxable year, is a corporation exempt from tax under section 501 or 521,

“(B) any amount allowed as a deduction under section 591 (relating to deduction for dividends paid by mutual savings banks, etc.), and

“(C) any dividend described in section 404(k).

“(3) EXCLUSION OF DIVIDENDS OF CERTAIN FOREIGN CORPORATIONS.—Such term shall not include any dividend from a foreign corporation which for the taxable year of the corporation in which the distribution was made, or the preceding taxable year, is a foreign personal holding company (as defined in section 552), a foreign investment company (as defined in section 1246(b)), or a passive foreign investment company (as defined in section 1297).

“(4) COORDINATION WITH SECTION 246(C).—Such term shall not include any dividend on any share of stock—
“(A) with respect to which the holding period requirements of section 246(e) are not met, or

“(B) to the extent that the taxpayer is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

“(e) Special Rules.—

“(1) Amounts taken into account as investment income.—Qualified dividend income shall not include any amount which the taxpayer takes into account as investment income under section 163(d)(4)(B).

“(2) Coordination with foreign tax credit and deduction.—No credit shall be allowed under section 901, and no deduction shall be allowed under this chapter, for any taxes paid or accrued with respect to any income excludable under this section.

“(3) Extraordinary dividends.—If an individual receives, with respect to any share of stock, qualified dividend income from 1 or more dividends which are extraordinary dividends (within the meaning of section 1059(c)), any loss on the sale or ex-
change of such share shall, to the extent of such dividends, be treated as long-term capital loss.

“(4) Certain nonresident aliens ineligible for exclusion.—In the case of a nonresident alien individual, subsection (a) shall apply only in determining the tax imposed for the taxable year by sections 871(b)(1) and 877(b).

“(5) Exclusion disregarded in determining income for certain purposes.—Subsection (a) shall not apply for purposes of determining amounts of income under sections 32(i), 86(b), 135(b), 137(b), 219(g), 221(b), 222(b), 408A(c)(3), 469(i), and 530(c), or subpart A of part IV of subchapter A.

“(6) Treatment of dividends from regulated investment companies and real estate investment trusts.—A dividend from a regulated investment company or real estate investment trust shall be subject to the limitations prescribed in sections 854 and 857.”.

(b) Exclusion of dividends from investment income.—Subparagraph (B) of section 163(d)(4) (defining net investment income) is amended by adding at the end the following flush sentence:
“Such term shall include qualified dividend income (as defined in section 116(b)) only to the extent the taxpayer elects to treat such income as investment income for purposes of this subsection.”.

(c) Treatment of Dividends From Regulated Investment Companies.—

(1) Subsection (a) of section 854 (relating to dividends received from regulated investment companies) is amended by inserting “section 116 (relating to partial exclusion of dividends received by individuals) and” after “For purposes of”.

(2) Paragraph (1) of section 854(b) (relating to other dividends) is amended by redesignating subparagraph (B) as subparagraph (C) and by inserting after subparagraph (A) the following new subparagraph:

“(B) Exclusion under section 116.—

“(i) In general.—If the aggregate dividends received by a regulated investment company during any taxable year are less than 95 percent of its gross income, then, in computing the exclusion under section 116, rules similar to the rules of subparagraph (A) shall apply.
“(ii) Gross income.—For purposes of clause (i), in the case of 1 or more sales or other dispositions of stock or securities, the term ‘gross income’ includes only the excess of—

“(I) the net short-term capital gain from such sales or dispositions, over

“(II) the net long-term capital loss from such sales or dispositions.”.

(3) Subparagraph (C) of section 854(b)(1), as redesignated by paragraph (2), is amended by striking “subparagraph (A)” and inserting “subparagraph (A) or (B)”.

(4) Paragraph (2) of section 854(b) is amended by inserting “the exclusion under section 116 and” after “for purposes of”.

(5) Subsection (b) of section 854 is amended by adding at the end the following new paragraph:

“(5) Coordination with section 116.—For purposes of paragraph (1)(B), an amount shall be treated as a dividend only if the amount is qualified dividend income (within the meaning of section 116(b)).”.
(d) Treatment of Dividends Received From Real Estate Investment Trusts.—Section 857(c) (relating to restrictions applicable to dividends received from real estate investment trusts) is amended to read as follows:

“(c) Restrictions Applicable to Dividends Received From Real Estate Investment Trusts.—

“(1) Section 243.—For purposes of section 243 (relating to deductions for dividends received by corporations), a dividend received from a real estate investment trust which meets the requirements of this part shall not be considered a dividend.

“(2) Section 116.—For purposes of section 116 (relating to exclusion of dividends), rules similar to the rules of section 854(b)(1)(B) shall apply to dividends received from a real estate trust which meets the requirements of this part.”.

(e) Conforming Amendments.—

(1) Subsection (f) of section 301 is amended adding at the end the following new paragraph:

“(4) For partial exclusion from gross income of dividends received by individuals, see section 116.”.

(2) Paragraph (1) of section 306(a) is amended by adding at the end the following new subparagraph:
“(D) Treatment as dividend.—For purposes of section 116, any amount treated as ordinary income under this paragraph shall be treated as a dividend received from the corporation.”.

(3)(A) Subpart C of part II of subchapter C of chapter 1 (relating to collapsible corporations) is repealed.

(B)(i) Section 338(h) is amended by striking paragraph (14).

(ii) Sections 467(c)(5)(C), 1255(b)(2), and 1257(d) are each amended by striking “,, 341(e)(12),”.

(iii) The table of subparts for part II of subchapter C of chapter 1 is amended by striking the item related to subpart C.

(4) Section 531(a) is amended by inserting “90 percent (80 percent in the case of taxable years beginning after 2007) of” after “equal to”.

(5) Section 541(a) is amended by inserting “90 percent (80 percent in the case of taxable years beginning after 2007) of” after “equal to”.

(6) Section 584(e) is amended by adding at the end the following new flush sentence:
“The proportionate share of each participant in the
amount of dividends received by the common trust fund
and to which section 116 applies shall be considered for
purposes of such paragraph as having been received by
such participant.”.

(7) Section 643(a) is amended by redesignating
paragraph (7) as paragraph (8) and by inserting
after paragraph (6) the following new paragraph:

“(7) EXCLUDED DIVIDENDS.—There shall be
included the amount of any dividends excluded from
gross income under section 116 (relating to partial
exclusion of dividends).”.

(8) Paragraph (5) of section 702(a) is amended
to read as follows:

“(5) dividends with respect to which section
116 or part VII of subchapter B applies,”.

(f) EFFECTIVE DATE.—The amendments made by
this section shall apply to taxable years beginning after
TITLE III—REVENUE
PROVISIONS
Subtitle A—Provisions Designed To
Curtail Tax Shelters

SEC. 301. CLARIFICATION OF ECONOMIC SUBSTANCE DOCTRINE.

(a) In General.—Section 7701 is amended by redesignating subsection (n) as subsection (o) and by inserting after subsection (m) the following new subsection:

“(n) Clarification of Economic Substance Doctrine; Etc.—

“(1) General rules.—

“(A) In general.—In applying the economic substance doctrine, the determination of whether a transaction has economic substance shall be made as provided in this paragraph.

“(B) Definition of economic substance.—For purposes of subparagraph (A)—

“(i) In general.—A transaction has economic substance only if—

“(I) the transaction changes in a meaningful way (apart from Federal tax effects) the taxpayer’s economic position, and
“(II) the taxpayer has a substantial nontax purpose for entering into such transaction and the transaction is a reasonable means of accomplishing such purpose.

In applying subclause (II), a purpose of achieving a financial accounting benefit shall not be taken into account in determining whether a transaction has a substantial nontax purpose if the origin of such financial accounting benefit is a reduction of income tax.

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

“(I) the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected, and
“(II) the reasonably expected pre-tax profit from the transaction exceeds a risk-free rate of return.

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

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

“(A) SPECIAL RULES FOR FINANCING TRANSACTIONS.—The form of a transaction which is in substance the borrowing of money or the acquisition of financial capital directly or indirectly from a tax-indifferent party shall not be respected if the present value of the deductions to be claimed with respect to the transaction is substantially in excess of the present value of the anticipated economic returns of the person lending the money or providing the financial capital. A public offering shall be treated as a borrowing, or an acquisition of financial capital, from a tax-indifferent party if it is reasonably expected that at least 50 percent of the
offering will be placed with tax-indifferent parties.

“(B) ARTIFICIAL INCOME SHIFTING AND BASIS ADJUSTMENTS.—The form of a transaction with a tax-indifferent party shall not be respected if—

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

“(ii) it results in a basis adjustment or shifting of basis on account of overstating the income or gain of the tax-indifferent party.

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

“(A) ECONOMIC SUBSTANCE DOCTRINE.—The term ‘economic substance doctrine’ means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

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

“(C) Exception for personal transactions of individuals.—In the case of an individual, this subsection shall apply only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income.

“(D) Treatment of lessors.—A lessor of tangible property subject to a lease shall be treated as satisfying the requirements of paragraph (1)(B)(ii) with respect to the leased property if such lease satisfies such requirements as provided by the Secretary.

“(4) Other common law doctrines not affected.—Except as specifically provided in this subsection, the provisions of this subsection shall not be construed as altering or supplanting any other rule of law, and the requirements of this subsection shall be construed as being in addition to any such other rule of law.
“(5) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection. Such regulations may include exemptions from the application of this subsection.”.

(b) Effective Date.—The amendments made by this section shall apply to transactions entered into on or after May 8, 2003.

SEC. 302. PENALTY FOR FAILING TO DISCLOSE REPORTABLE TRANSACTION.

(a) In General.—Part I of subchapter B of chapter 68 (relating to assessable penalties) is amended by inserting after section 6707 the following new section: "SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE REPORTABLE TRANSACTION INFORMATION WITH RETURN OR STATEMENT.

“(a) Imposition of Penalty.—Any person who fails to include on any return or statement any information with respect to a reportable transaction which is required under section 6011 to be included with such return or statement shall pay a penalty in the amount determined under subsection (b).

“(b) Amount of Penalty.—
“(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the amount of the penalty under subsection (a) shall be $50,000.

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

“(3) INCREASE IN PENALTY FOR LARGE ENTITIES AND HIGH NET WORTH INDIVIDUALS.—

“(A) IN GENERAL.—In the case of a failure under subsection (a) by—

“(i) a large entity, or

“(ii) a high net worth individual,

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

“(B) LARGE ENTITY.—For purposes of subparagraph (A), the term ‘large entity’ means, with respect to any taxable year, a person (other than a natural person) with gross receipts in excess of $10,000,000 for the taxable year in which the reportable transaction occurs or the preceding taxable year. Rules similar to the rules of paragraph (2) and subparagraphs (B), (C), and (D) of paragraph (3) of section
448(c) shall apply for purposes of this subpar-

agraph.

“(C) High net worth individual.—For

purposes of subparagraph (A), the term ‘high

net worth individual’ means, with respect to a

reportable transaction, a natural person whose

net worth exceeds $2,000,000 immediately be-

fore the transaction.

“(e) Definitions.—For purposes of this section—

“(1) Reportable transaction.—The term

‘reportable transaction’ means any transaction with

respect to which information is required to be in-

cluded with a return or statement because, as deter-

mined under regulations prescribed under section

6011, such transaction is of a type which the Sec-

retary determines as having a potential for tax

avoidance or evasion.

“(2) Listed transaction.—Except as pro-

vided in regulations, the term ‘listed transaction’

means a reportable transaction which is the same as,

or substantially similar to, a transaction specifically

identified by the Secretary as a tax avoidance trans-

action for purposes of section 6011.

“(d) Authority to rescind penalty.—
“(1) IN GENERAL.—The Commissioner of Internal Revenue may rescind all or any portion of any penalty imposed by this section with respect to any violation if—

“(A) the violation is with respect to a reportable transaction other than a listed transaction,

“(B) the person on whom the penalty is imposed has a history of complying with the requirements of this title,

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

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

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

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

“(3) No appeal.—Notwithstanding any other provision of law, any determination under this subsection may not be reviewed in any administrative or judicial proceeding.

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

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

“(B) the reasons for the rescission, and

“(C) the amount of the penalty rescinded.

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

“(A) a summary of the total number and aggregate amount of penalties imposed, and re-
“(B) a description of each penalty rescinded under this subsection and the reasons therefor.

“(c) Penalty Reported to SEC.—In the case of a person—

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

“(2) which—

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

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

“(C) is required to pay a penalty under section 6662B with respect to any noneconomic substance transaction,

the requirement to pay such penalty shall be disclosed in such reports filed by such person for such periods as the Secretary shall specify. Failure to make a disclosure in accordance with the preceding sentence shall be treated
as a failure to which the penalty under subsection (b)(2) applies.

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

(b) CONFORMING AMENDMENT.—The table of sections for part I of subchapter B of chapter 68 is amended by inserting after the item relating to section 6707 the following:

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

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

SEC. 303. ACCURACY-RELATED PENALTY FOR LISTED TRANSACTIONS AND OTHER REPORTABLE TRANSACTIONS HAVING A SIGNIFICANT TAX AVOIDANCE PURPOSE.

(a) IN GENERAL.—Subchapter A of chapter 68 is amended by inserting after section 6662 the following new section:
"SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PENALTY ON UNDERSTATEMENTS WITH RESPECT TO REPORTABLE TRANSACTIONS.

"(a) Imposition of Penalty.—If a taxpayer has a reportable transaction understatement for any taxable year, there shall be added to the tax an amount equal to 20 percent of the amount of such understatement.

"(b) Reportable Transaction Understatement.—For purposes of this section—

"(1) In general.—The term ‘reportable transaction understatement’ means the sum of—

"(A) the product of—

"(i) the amount of the increase (if any) in taxable income which results from a difference between the proper tax treatment of an item to which this section applies and the taxpayer’s treatment of such item (as shown on the taxpayer’s return of tax), and

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

"(B) the amount of the decrease (if any) in the aggregate amount of credits determined under subtitle A which results from a difference between the taxpayer’s treatment of an item to
which this section applies (as shown on the taxpayer’s return of tax) and the proper tax treatment of such item.

For purposes of subparagraph (A), any reduction of the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income.

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

“(A) any listed transaction, and

“(B) any reportable transaction (other than a listed transaction) if a significant purpose of such transaction is the avoidance or evasion of Federal income tax.

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

“(1) IN GENERAL.—Subsection (a) shall be applied by substituting ‘30 percent’ for ‘20 percent’ with respect to the portion of any reportable transaction understatement with respect to which the requirement of section 6664(d)(2)(A) is not met.
“(2) Rules applicable to compromise of penalty.—

“(A) In general.—If the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals has been sent with respect to a penalty to which paragraph (1) applies, only the Commissioner of Internal Revenue may compromise all or any portion of such penalty.

“(B) Applicable rules.—The rules of paragraphs (2), (3), (4), and (5) of section 6707A(d) shall apply for purposes of subparagraph (A).

“(d) Definitions of reportable and listed transactions.—For purposes of this section, the terms ‘reportable transaction’ and ‘listed transaction’ have the respective meanings given to such terms by section 6707A(e).

“(e) Special rules.—

“(1) Coordination with penalties, etc., on other understatements.—In the case of an understatement (as defined in section 6662(d)(2))—

“(A) the amount of such understatement (determined without regard to this paragraph)
shall be increased by the aggregate amount of reportable transaction understatements and noneconomic substance transaction understatements for purposes of determining whether such understatement is a substantial understatement under section 6662(d)(1), and

“(B) the addition to tax under section 6662(a) shall apply only to the excess of the amount of the substantial understatement (if any) after the application of subparagraph (A) over the aggregate amount of reportable transaction understatements and noneconomic substance transaction understatements.

“(2) COORDINATION WITH OTHER PENALTIES.—

“(A) APPLICATION OF FRAUD PENALTY.— References to an underpayment in section 6663 shall be treated as including references to a reportable transaction understatement and a noneconomic substance transaction understatement.

“(B) NO DOUBLE PENALTY.—This section shall not apply to any portion of an understatement on which a penalty is imposed under section 6662B or 6663.
“(3) Special rule for amended returns.—Except as provided in regulations, in no event shall any tax treatment included with an amendment or supplement to a return of tax be taken into account in determining the amount of any reportable transaction understatement or noneconomic substance transaction understatement if the amendment or supplement is filed after the earlier of the date the taxpayer is first contacted by the Secretary regarding the examination of the return or such other date as is specified by the Secretary.

“(4) Noneconomic substance transaction understatement.—For purposes of this subsection, the term ‘noneconomic substance transaction understatement’ has the meaning given such term by section 6662B(c).

“(5) Cross reference.—

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

(b) Determination of other understatements.—Subparagraph (A) of section 6662(d)(2) is amended by adding at the end the following flush sentence:

“The excess under the preceding sentence shall be determined without regard to items to which section 6662A applies and without regard to
items with respect to which a penalty is imposed by section 6662B.”.

(c) Reasonable Cause Exception.—

(1) In general.—Section 6664 is amended by adding at the end the following new subsection:

“(d) Reasonable Cause Exception for Reportable Transaction Understatements.—

“(1) In general.—No penalty shall be imposed under section 6662A with respect to any portion of a reportable transaction understatement if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

“(2) Special rules.—Paragraph (1) shall not apply to any reportable transaction understatement unless—

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

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

“(C) the taxpayer reasonably believed that such treatment was more likely than not the proper treatment.
A taxpayer failing to adequately disclose in accordance with section 6011 shall be treated as meeting the requirements of subparagraph (A) if the penalty for such failure was rescinded under section 6707A(d).

“(3) Rules relating to reasonable belief.—For purposes of paragraph (2)(C)—

“(A) In general.—A taxpayer shall be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief—

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

“(ii) relates solely to the taxpayer’s chances of success on the merits of such treatment and does not take into account the possibility that a return will not be audited, such treatment will not be raised on audit, or such treatment will be resolved through settlement if it is raised.

“(B) Certain opinions may not be relied upon.—

“(i) In general.—An opinion of a tax advisor may not be relied upon to es-
establish the reasonable belief of a taxpayer if—

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

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

“(ii) DISQUALIFIED TAX ADVISORS.—

A tax advisor is described in this clause if the tax advisor—

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

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

“(III) has a fee arrangement with respect to the transaction which is contingent on all or part of the intended tax benefits from the transaction being sustained, or
“(IV) as determined under regulations prescribed by the Secretary, has a continuing financial interest with respect to the transaction.

“(iii) DISQUALIFIED OPINIONS.—For purposes of clause (i), an opinion is disqualified if the opinion—

“(I) is based on unreasonable factual or legal assumptions (including assumptions as to future events),

“(II) unreasonably relies on representations, statements, findings, or agreements of the taxpayer or any other person,

“(III) does not identify and consider all relevant facts, or

“(IV) fails to meet any other requirement as the Secretary may prescribe.”.

(2) CONFORMING AMENDMENT.—The heading for subsection (e) of section 6664 is amended by inserting “FOR UNDERPAYMENTS” after “EXCEPTION”.

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

(2) Paragraph (3) of section 1274(b) is amended—

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

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

“(C) TAX SHELTER.—For purposes of subparagraph (B), the term ‘tax shelter’ means—

“(i) a partnership or other entity,

“(ii) any investment plan or arrangement, or

“(iii) any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.”.

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

(4) Section 6664(c)(1) is amended by striking “this part” and inserting “section 6662 or 6663”.
(5) Subsection (b) of section 7525 is amended by striking “section 6662(d)(2)(C)(iii)” and inserting “section 1274(b)(3)(C)”.

(6)(A) The heading for section 6662 is amended to read as follows:

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

(B) The table of sections for part II of subchapter A of chapter 68 is amended by striking the item relating to section 6662 and inserting the following new items:

“Sec. 6662. Imposition of accuracy-related penalty on underpayments.
“Sec. 6662A. Imposition of accuracy-related penalty on understatements with respect to reportable transactions.”.

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

SEC. 304. PENALTY FOR UNDERSTATEMENTS ATTRIBUTABLE TO TRANSACTIONS LACKING ECONOMIC SUBSTANCE, ETC.

(a) IN GENERAL.—Subchapter A of chapter 68 is amended by inserting after section 6662A the following new section:
SEC. 6662B. PENALTY FOR UNDERSTATEMENTS ATTRIBUTABLE TO TRANSACTIONS LACKING ECONOMIC SUBSTANCE, ETC.

(a) Imposition of Penalty.—If a taxpayer has an noneconomic substance transaction understatement for any taxable year, there shall be added to the tax an amount equal to 40 percent of the amount of such understatement.

(b) Reduction of Penalty for Disclosed Transactions.—Subsection (a) shall be applied by substituting ‘20 percent’ for ‘40 percent’ with respect to the portion of any noneconomic substance transaction understatement with respect to which the relevant facts affecting the tax treatment of the item are adequately disclosed in the return or a statement attached to the return.

(c) Noneconomic Substance Transaction Understatement.—For purposes of this section—

(1) In general.—The term ‘noneconomic substance transaction understatement’ means any amount which would be an understatement under section 6662A(b)(1) if section 6662A were applied by taking into account items attributable to noneconomic substance transactions rather than items to which section 6662A would apply without regard to this paragraph.
“(2) Noneconomic substance transaction.—The term ‘noneconomic substance transaction’ means any transaction if—

“(A) there is a lack of economic substance (within the meaning of section 7701(n)(1)) for the transaction giving rise to the claimed benefit or the transaction was not respected under section 7701(n)(2), or

“(B) the transaction fails to meet the requirements of any similar rule of law.

“(d) Rules applicable to compromise of penalty.—

“(1) In general.—If the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals has been sent with respect to a penalty to which this section applies, only the Commissioner of Internal Revenue may compromise all or any portion of such penalty.

“(2) Applicable rules.—The rules of paragraphs (2), (3), (4), and (5) of section 6707A(d) shall apply for purposes of paragraph (1).

“(e) Coordination with other penalties.—Except as otherwise provided in this part, the penalty im-
posed by this section shall be in addition to any other pen-
alty imposed by this title.

“(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).”.

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

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

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transactions entered into on or after May 8, 2003.

SEC. 305. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-
MENT PENALTY FOR NONREPORTABLE
TRANSACTIONS.

(a) SUBSTANTIAL UNDERSTATEMENT OF CORPO-
RATIONS.—Section 6662(d)(1)(B) (relating to special rule for corporations) is amended to read as follows:

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

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

“(ii) $10,000,000.”.

(b) Reduction for Understatement of Taxpayer Due to Position of Taxpayer or Disclosed Item.—

(1) In General.—Section 6662(d)(2)(B)(i) (relating to substantial authority) is amended to read as follows:

“(i) the tax treatment of any item by the taxpayer if the taxpayer had reasonable belief that the tax treatment was more likely than not the proper treatment, or”.

(2) Conforming Amendment.—Section 6662(d) is amended by adding at the end the following new paragraph:

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

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

SEC. 306. TAX SHELTER EXCEPTION TO CONFIDENTIALITY PRIVILEGES RELATING TO TAXPAYER COMMUNICATIONS.

(a) IN GENERAL.—Section 7525(b) (relating to section not to apply to communications regarding corporate tax shelters) is amended to read as follows:

“(b) SECTION NOT TO APPLY TO COMMUNICATIONS REGARDING TAX SHELTERS.—The privilege under subsection (a) shall not apply to any written communication which is—

“(1) between a federally authorized tax practitioner and—

“(A) any person,

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

“(C) any other person holding a capital or profits interest in the person, and
“(2) in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in section 1274(b)(3)(C)).”.

(b) Effective Date.—The amendment made by this section shall apply to communications made on or after the date of the enactment of this Act.

SEC. 307. DISCLOSURE OF REPORTABLE TRANSACTIONS.

(a) In General.—Section 6111 (relating to registration of tax shelters) is amended to read as follows:

“SEC. 6111. DISCLOSURE OF REPORTABLE TRANSACTIONS.

“(a) In General.—Each material advisor with respect to any reportable transaction shall make a return (in such form as the Secretary may prescribe) setting forth—

“(1) information identifying and describing the transaction,

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

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

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

“(b) Definitions.—For purposes of this section—

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

“(i) who provides any material aid, assistance, or advice with respect to organizing, promoting, selling, implementing, or carrying out any reportable transaction, and

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

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

“(i) $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons, and

“(ii) $250,000 in any other case.

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

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

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

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

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

(b) CONFORMING AMENDMENTS.—

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

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

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

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

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

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

“(2) containing such other information as the
Secretary may by regulations require.
This section shall apply without regard to whether a material advisor is required to file a return under section 6111 with respect to such transaction.”.

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

(C) Section 6112(b), as redesignated by subparagraph (B), is amended—

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

(ii) by striking “shall prescribe” in paragraph (2) and inserting “may prescribe”.

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

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

(3)(A) The heading for section 6708 is amended to read as follows:

“SEC. 6708. FAILURE TO MAINTAIN LISTS OF ADVISEES WITH RESPECT TO REPORTABLE TRANSACTIONS.”.

(B) The item relating to section 6708 in the table of sections for part I of subchapter B of chapter 68 is amended to read as follows:

“Sec. 6708. Failure to maintain lists of advisees with respect to reportable transactions.”.
(c) **Effective Date.**—The amendments made by this section shall apply to transactions with respect to which material aid, assistance, or advice referred to in section 6111(b)(1)(A)(i) of the Internal Revenue Code of 1986 (as added by this section) is provided after the date of the enactment of this Act.

**Sec. 308. Modifications to Penalty for Failure to Register Tax Shelters.**

(a) **In General.**—Section 6707 (relating to failure to furnish information regarding tax shelters) is amended to read as follows:

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“Sec. 6707. Failure to Furnish Information Regarding Reportable Transactions.

“(a) In General.—If a person who is required to file a return under section 6111(a) with respect to any reportable transaction—

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

“(2) files false or incomplete information with the Secretary with respect to such transaction,

such person shall pay a penalty with respect to such return in the amount determined under subsection (b).

“(b) Amount of Penalty.—
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“(1) IN GENERAL.—Except as provided in paragraph (2), the penalty imposed under subsection (a) with respect to any failure shall be $50,000.

“(2) LISTED TRANSACTIONS.—The penalty imposed under subsection (a) with respect to any listed transaction shall be an amount equal to the greater of—

“(A) $200,000, or

“(B) 50 percent of the gross income derived by such person with respect to aid, assistance, or advice which is provided with respect to the listed transaction before the date the return including the transaction is filed under section 6111.

Subparagraph (B) shall be applied by substituting ‘75 percent’ for ‘50 percent’ in the case of an intentional failure or act described in subsection (a).

“(c) RESCISSION AUTHORITY.—The provisions of section 6707A(d) (relating to authority of Commissioner to rescind penalty) shall apply to any penalty imposed under this section.

“(d) REPORTABLE AND LISTED TRANSACTIONS.—The terms ‘reportable transaction’ and ‘listed transaction’ have the respective meanings given to such terms by section 6707A(e).”.
(b) CLERICAL AMENDMENT.—The item relating to section 6707 in the table of sections for part I of subchapter B of chapter 68 is amended by striking “tax shelters” and inserting “reportable transactions”.

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

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

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

“(a) IMPOSITION OF PENALTY.—

“(1) IN GENERAL.—If any person who is required to maintain a list under section 6112(a) fails to make such list available upon written request to the Secretary in accordance with section 6112(b)(1)(A) within 20 business days after the date of the Secretary’s request, such person shall pay a penalty of $10,000 for each day of such failure after such 20th day.

“(2) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed by paragraph (1) with respect to the failure on any day if such failure is due to reasonable cause.”.
(b) **Effective Date.**—The amendment made by this section shall apply to requests made after the date of the enactment of this Act.

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

(a) **In General.**—Section 7408 (relating to action to enjoin promoters of abusive tax shelters, etc.) is amended by redesignating subsection (c) as subsection (d) and by striking subsections (a) and (b) and inserting the following new subsections:

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“(a) **Authority To Seek Injunction.**—A civil action in the name of the United States to enjoin any person from further engaging in specified conduct may be commenced at the request of the Secretary. Any action under this section shall be brought in the district court of the United States for the district in which such person resides, has his principal place of business, or has engaged in specified conduct. The court may exercise its jurisdiction over such action (as provided in section 7402(a)) separate and apart from any other action brought by the United States against such person.

“(b) **Adjudication and Decree.**—In any action under subsection (a), if the court finds—
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“(1) that the person has engaged in any specified conduct, and

“(2) that injunctive relief is appropriate to prevent recurrence of such conduct,

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

“(c) SPECIFIED CONDUCT.—For purposes of this section, the term ‘specified conduct’ means any action, or failure to take action, subject to penalty under section 6700, 6701, 6707, or 6708.”.

(b) CONFORMING AMENDMENTS.—

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

“SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RELATED TO TAX SHELTERS AND REPORTABLE TRANSACTIONS.”.

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

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

(e) EFFECTIVE DATE.—The amendment made by this section shall take effect on the day after the date of the enactment of this Act.
SEC. 311. UNDERSTATEMENT OF TAXPAYER'S LIABILITY BY INCOME TAX RETURN PREPARER.

(a) Standards Conformed to Taxpayer Standards.—Section 6694(a) (relating to understatements due to unrealistic positions) is amended—

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

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

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

(b) Amount of Penalty.—Section 6694 is amended—

(1) by striking “$250” in subsection (a) and inserting “$1,000”, and

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

(c) Effective Date.—The amendments made by this section shall apply to documents prepared after the date of the enactment of this Act.
SEC. 312. PENALTY ON FAILURE TO REPORT INTERESTS IN FOREIGN FINANCIAL ACCOUNTS.

(a) In General.—Section 5321(a)(5) of title 31, United States Code, is amended to read as follows:

“(5) FOREIGN FINANCIAL AGENCY TRANSACTION VIOLATION.—

“(A) PENALTY AUTHORIZED.—The Secretary of the Treasury may impose a civil money penalty on any person who violates, or causes any violation of, any provision of section 5314.

“(B) AMOUNT OF PENALTY.—

“(i) IN GENERAL.—Except as provided in subparagraph (C), the amount of any civil penalty imposed under subparagraph (A) shall not exceed $5,000.

“(ii) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under subparagraph (A) with respect to any violation if—

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

“(II) the amount of the transaction or the balance in the account at the time of the transaction was properly reported.
“(C) WILLFUL VIOLATIONS.—In the case of any person willfully violating, or willfully causing any violation of, any provision of section 5314—

“(i) the maximum penalty under subparagraph (B)(i) shall be increased to the greater of—

“(I) $25,000, or

“(II) the amount (not exceeding $100,000) determined under subparagraph (D), and

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

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

“(i) in the case of a violation involving a transaction, the amount of the transaction, or

“(ii) in the case of a violation involving a failure to report the existence of an account or any identifying information required to be provided with respect to an account, the balance in the account at the time of the violation.”.
(b) Effective Date.—The amendment made by this section shall apply to violations occurring after the date of the enactment of this Act.

SEC. 313. FRIVOLOUS TAX SUBMISSIONS.

(a) Civil Penalties.—Section 6702 is amended to read as follows:

"SEC. 6702. FRIVOLOUS TAX SUBMISSIONS."

"(a) Civil Penalty for Frivolous Tax Returns.—A person shall pay a penalty of $5,000 if—"

"(1) such person files what purports to be a return of a tax imposed by this title but which—"

"(A) does not contain information on which the substantial correctness of the self-assessment may be judged, or"

"(B) contains information that on its face indicates that the self-assessment is substantially incorrect; and"

"(2) the conduct referred to in paragraph (1)—"

"(A) is based on a position which the Secretary has identified as frivolous under subsection (c), or"

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

"(b) Civil Penalty for Specified Frivolous Submissions.—"
“(1) IMPOSITION OF PENALTY.—Except as provided in paragraph (3), any person who submits a specified frivolous submission shall pay a penalty of $5,000.

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

“(A) SPECIFIED FRIVOLOUS SUBMISSION.—The term ‘specified frivolous submission’ means a specified submission if any portion of such submission—

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

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

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

“(i) a request for a hearing under—

“(I) section 6320 (relating to notice and opportunity for hearing upon filing of notice of lien), or

“(II) section 6330 (relating to notice and opportunity for hearing before levy), and
“(ii) an application under—

“(I) section 6159 (relating to agreements for payment of tax liability in installments),

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

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

“(3) Opportunity to withdraw submission.—If the Secretary provides a person with notice that a submission is a specified frivolous submission and such person withdraws such submission within 30 days after such notice, the penalty imposed under paragraph (1) shall not apply with respect to such submission.

“(e) Listing of frivolous positions.—The Secretary shall prescribe (and periodically revise) a list of positions which the Secretary has identified as being frivolous for purposes of this subsection. The Secretary shall not include in such list any position that the Secretary determines meets the requirement of section 6662(d)(2)(B)(ii)(II).

“(d) Reduction of penalty.—The Secretary may reduce the amount of any penalty imposed under this section if the Secretary determines that such reduction would
promote compliance with and administration of the Federal tax laws.

“(e) Penalties in Addition to Other Penalties.—The penalties imposed by this section shall be in addition to any other penalty provided by law.”.

(b) Treatment of Frivolous Requests for Hearings Before Levy.—

(1) Frivolous requests disregarded.—

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

“(g) Frivolous Requests for Hearing, Etc.— Notwithstanding any other provision of this section, if the Secretary determines that any portion of a request for a hearing under this section or section 6320 meets the requirement of clause (i) or (ii) of section 6702(b)(2)(A), then the Secretary may treat such portion as if it were never submitted and such portion shall not be subject to any further administrative or judicial review.”.

(2) Preclusion from raising frivolous issues at hearing.—Section 6330(c)(4) is amended—

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

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

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

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

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

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

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

(1) in subsection (b)(1), by striking “under subsection (a)(3)(B)” and inserting “in writing under subsection (a)(3)(B) and states the grounds for the requested hearing”, and

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

(d) TREATMENT OF FRIVOLOUS APPLICATIONS FOR OFFERS-IN-COMpromise AND INSTALLMENT AGREEMENTS.—Section 7122 is amended by adding at the end the following new subsection:
“(e) Frivolous Submissions, Etc.—Notwithstanding any other provision of this section, if the Secretary determines that any portion of an application for an offer-in-compromise or installment agreement submitted under this section or section 6159 meets the requirement of clause (i) or (ii) of section 6702(b)(2)(A), then the Secretary may treat such portion as if it were never submitted and such portion shall not be subject to any further administrative or judicial review.”.

(c) Clerical Amendment.—The table of sections for part I of subchapter B of chapter 68 is amended by striking the item relating to section 6702 and inserting the following new item:

“Sec. 6702. Frivolous tax submissions.”.

(f) Effective Date.—The amendments made by this section shall apply to submissions made and issues raised after the date on which the Secretary first prescribes a list under section 6702(c) of the Internal Revenue Code of 1986, as amended by subsection (a).

SEC. 314. PENALTY ON PROMOTERS OF TAX SHELTERS.

(a) Penalty on Promoting Abusive Tax Shelters.—Section 6700(a) is amended by adding at the end the following new sentence: “Notwithstanding the first sentence, if an activity with respect to which a penalty imposed under this subsection involves a statement described in paragraph (2)(A), the amount of the penalty
shall be equal to 50 percent of the gross income derived (or to be derived) from such activity by the person on which the penalty is imposed.”.

(b) Effective Date.—The amendment made by this section shall apply to activities after the date of the enactment of this Act.

SEC. 315. STATUTE OF LIMITATIONS FOR TAXABLE YEARS FOR WHICH LISTED TRANSACTIONS NOT REPORTED.

(a) In General.—Section 6501(e)(1) (relating to substantial omission of items for income taxes) is amended by adding at the end the following new subparagraph:

“(C) Listed Transactions.—If a taxpayer fails to include on any return or statement for any taxable year any information with respect to a listed transaction (as defined in section 6707A(c)(2)) which is required under section 6011 to be included with such return or statement, the tax for such taxable year may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time within 6 years after the time the return is filed. This subparagraph shall not apply to any taxable year if the time for assessment or beginning the proceeding in court has

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expired before the time a transaction is treated
as a listed transaction under section 6011.”.

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

SEC. 316. DENIAL OF DEDUCTION FOR INTEREST ON UN-
DERPAYMENTS ATTRIBUTABLE TO NONDIS-
CLOSED REPORTABLE AND NONECONOMIC
SUBSTANCE TRANSACTIONS.

(a) IN GENERAL.—Section 163 (relating to deduction
for interest) is amended by redesignating subsection (m)
as subsection (n) and by inserting after subsection (l) the
following new subsection:

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

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

“(2) any noneconomic substance transaction
understatement (as defined in section 6662B(e)).”.
(b) Effective Date.—The amendments made by this section shall apply to transactions in taxable years beginning after the date of the enactment of this Act.

Subtitle B—Enron-Related Tax Shelter Provisions

Sec. 321. Limitation on transfer or importation of built-in losses.

(a) In General.—Section 362 (relating to basis to corporations) is amended by adding at the end the following new subsection:

"(e) Limitations on Built-In Losses.—

"(1) Limitation on importation of built-in losses.—

"(A) In general.—If in any transaction described in subsection (a) or (b) there would (but for this subsection) be an importation of a net built-in loss, the basis of each property described in subparagraph (B) which is acquired in such transaction shall (notwithstanding subsections (a) and (b)) be its fair market value immediately after such transaction.

"(B) Property described.—For purposes of subparagraph (A), property is described in this subparagraph if—
“(i) gain or loss with respect to such property is not subject to tax under this subtitle in the hands of the transferor immediately before the transfer, and

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

In any case in which the transferor is a partnership, the preceding sentence shall be applied by treating each partner in such partnership as holding such partner’s proportionate share of the property of such partnership.

“(C) Importation of Net Built-In Loss.—For purposes of subparagraph (A), there is an importation of a net built-in loss in a transaction if the transferee’s aggregate adjusted bases of property described in subparagraph (B) which is transferred in such transaction would (but for this paragraph) exceed the fair market value of such property immediately after such transaction.”.

“(2) Limitation on Transfer of Built-In Losses in Section 351 Transactions.—

“(A) In General.—If—
“(i) property is transferred by a
transferor in any transaction which is de-
scribed in subsection (a) and which is not
described in paragraph (1) of this sub-
section, and

“(ii) the transferee’s aggregate ad-
justed bases of such property so trans-
ferred would (but for this paragraph) ex-
ceed the fair market value of such property
immediately after such transaction,
then, notwithstanding subsection (a), the trans-
feree’s aggregate adjusted bases of the property
so transferred shall not exceed the fair market
value of such property immediately after such
transaction.

“(B) Allocation of Basis Reduc-
tion.—The aggregate reduction in basis by
reason of subparagraph (A) shall be allocated
among the property so transferred in proportion
to their respective built-in losses immediately
before the transaction.

“(C) Exception for Transfers Within
Affiliated Group.—Subparagraph (A) shall
not apply to any transaction if the transferor
owns stock in the transferee meeting the re-
quirements of section 1504(a)(2). In the case of property to which subparagraph (A) does not apply by reason of the preceding sentence, the transferor’s basis in the stock received for such property shall not exceed its fair market value immediately after the transfer.”.

(b) COMPARABLE TREATMENT WHERE LIQUIDATION.—Paragraph (1) of section 334(b) (relating to liquidation of subsidiary) is amended to read as follows:

“(1) IN GENERAL.—If property is received by a corporate distributee in a distribution in a complete liquidation to which section 332 applies (or in a transfer described in section 337(b)(1)), the basis of such property in the hands of such distributee shall be the same as it would be in the hands of the transferor; except that the basis of such property in the hands of such distributee shall be the fair market value of the property at the time of the distribution—

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

“(B) in any case in which the liquidating corporation is a foreign corporation, the corporate distributee is a domestic corporation,
and the corporate distributee’s aggregate ad-
justed bases of property described in section
362(e)(1)(B) which is distributed in such liq-
uidation would (but for this subparagraph) ex-
ceed the fair market value of such property im-
mediately after such liquidation.”

(ec) EFFECTIVE DATE.—The amendments made by
this section shall apply to transactions after February 13,
2003.

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

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

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

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

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“(2) any amount not allocable to stock by reason of paragraph (1) shall be allocated under subsection (a) to other partnership property.

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

(b) Effective Date.—The amendment made by this section shall apply to distributions after February 13, 2003.

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

(a) In General.—Part V of subchapter M of chapter 1 (relating to financial asset securitization investment trusts) is hereby repealed.

(b) Conforming Amendments.—

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

(2) Clause (ii) of section 382(l)(4)(B) is amended by striking “a REMIC to which part IV of subchapter M applies, or a FASIT to which part V of subchapter M applies,” and inserting “or a REMIC to which part IV of subchapter M applies,”. 
(3) Paragraph (1) of section 582(c) is amended by striking “, and any regular interest in a FASIT,”.

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

(5) Paragraph (5) of section 860G(a) is amended by adding “and” at the end of subparagraph (B), by striking “, and” at the end of subparagraph (C) and inserting a period, and by striking subparagraph (D).

(6) Subparagraph (C) of section 1202(e)(4) is amended by striking “REMIC, or FASIT” and inserting “or REMIC”.

(7) Subparagraph (C) of section 7701(a)(19) is amended by adding “and” at the end of clause (ix), by striking “, and” at the end of clause (x) and inserting a period, and by striking clause (xi).

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

(c) Effective Date.—

(1) In General.—Except as provided in paragraph (2), the amendments made by this section shall take effect on February 14, 2003.

(2) Exception for Existing FASITS.—
(A) IN GENERAL.—Paragraph (1) shall not apply to any FASIT in existence on the date of the enactment of this Act to the extent that regular interests issued by the FASIT before such date continue to remain outstanding in accordance with the original terms of issuance.

(B) TRANSFER OF ADDITIONAL ASSETS NOT PERMITTED.—Except as provided in regulations prescribed by the Secretary of the Treasury or the Secretary’s delegate, subparagraph (A) shall cease to apply as of the earliest date after the date of the enactment of this Act that any property is transferred to the FASIT.

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

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

(b) EXCEPTION FOR CERTAIN INSTRUMENTS ISSUED BY DEALERS IN SECURITIES.—Section 163(l) is amended by redesignating paragraphs (4) and (5) as paragraphs (5) and (6) and by inserting after paragraph (3) the following new paragraph:
“(4) Exception for certain instruments issued by dealers in securities.—For purposes of this subsection, the term ‘disqualified debt instrument’ does not include indebtedness issued by a dealer in securities (or a related party) which is payable in, or by reference to, equity (other than equity of the issuer or a related party) held by such dealer in its capacity as a dealer in securities. For purposes of this paragraph, the term ‘dealer in securities’ has the meaning given such term by section 475.”.

(c) Conforming Amendment.—Paragraph (3) of section 163(l) is amended by striking “or a related party” in the material preceding subparagraph (A) and inserting “or any other person”.

(d) Effective Date.—The amendments made by this section shall apply to debt instruments issued after February 13, 2003.

SEC. 325. Expanded Authority to Disallow Tax Benefits Under Section 269.

(a) In General.—Subsection (a) of section 269 (relating to acquisitions made to evade or avoid income tax) is amended to read as follows:

“(a) In General.—If—

“(1)(A) any person acquires stock in a corporation, or
“(B) any corporation acquires, directly or indirectly, property of another corporation and the basis of such property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and

“(2) the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance,

then the Secretary may disallow such deduction, credit, or other allowance.”.

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

SEC. 326. MODIFICATIONS OF CERTAIN RULES RELATING TO CONTROLLED FOREIGN CORPORATIONS.

(a) LIMITATION ON EXCEPTION FROM PFIC RULES FOR UNITED STATES SHAREHOLDERS OF CONTROLLED FOREIGN CORPORATIONS.—Paragraph (2) of section 1297(e) (relating to passive investment company) is amended by adding at the end the following flush sentence:

“Such term shall not include any period if there is only a remote likelihood of an inclusion in gross in-
come under section 951(a)(1)(A)(i) of subpart F income of such corporation for such period.’’.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years on controlled foreign corporation beginning after February 13, 2003, and to taxable years of United States shareholder in which or with which such taxable years of controlled foreign corporations end.

SEC. 327. CONTROLLED ENTITIES INELIGIBLE FOR REIT STATUS.

(a) IN GENERAL.—Subsection (a) of section 856 (relating to definition of real estate investment trust) is amended by striking “and” at the end of paragraph (6), by redesignating paragraph (7) as paragraph (8), and by inserting after paragraph (6) the following new paragraph:

“(7) which is not a controlled entity (as defined in subsection (l)); and’’.

(b) CONTROLLED ENTITY.—Section 856 is amended by adding at the end the following new subsection:

“(l) CONTROLLED ENTITY.—

“(1) IN GENERAL.—For purposes of subsection (a)(7), an entity is a controlled entity if, at any time during the taxable year, one person (other than a qualified entity)—
“(A) in the case of a corporation, owns stock—

“(i) possessing at least 50 percent of the total voting power of the stock of such corporation, or

“(ii) having a value equal to at least 50 percent of the total value of the stock of such corporation, or

“(B) in the case of a trust, owns beneficial interests in the trust which would meet the requirements of subparagraph (A) if such interests were stock.

“(2) QUALIFIED ENTITY.—For purposes of paragraph (1), the term ‘qualified entity’ means—

“(A) any real estate investment trust, and

“(B) any partnership in which one real estate investment trust owns at least 50 percent of the capital and profits interests in the partnership.

“(3) Attribution rules.—For purposes of this paragraphs (1) and (2)—

“(A) In general.—Rules similar to the rules of subsections (d)(5) and (h)(3) shall apply; except that section 318(a)(3)(C) shall not be applied under such rules to treat stock
owned by a qualified entity as being owned by a person which is not a qualified entity.

“(B) Stapled entities.—A group of entities which are stapled entities (as defined in section 269B(c)(2)) shall be treated as one person.

“(4) Exception for certain new REITs.—

“(A) In general.—The term ‘controlled entity’ shall not include an incubator REIT.

“(B) Incubator REIT.—A corporation shall be treated as an incubator REIT for any taxable year during the eligibility period if it meets all the following requirements for such year:

“(i) The corporation elects to be treated as an incubator REIT.

“(ii) The corporation has only voting common stock outstanding.

“(iii) Not more than 50 percent of the corporation’s real estate assets consist of mortgages.

“(iv) From not later than the beginning of the last half of the second taxable year, at least 10 percent of the corporation’s capital is provided by lenders or eq-
uity investors who are unrelated to the corporation’s largest shareholder.

“(v) The corporation annually increases the value of its real estate assets by at least 10 percent.

“(vi) The directors of the corporation adopt a resolution setting forth an intent to engage in a going public transaction.

No election may be made with respect to any REIT if an election under this subsection was in effect for any predecessor of such REIT.

“(C) ELIGIBILITY PERIOD.—

“(i) IN GENERAL.—The eligibility period (for which an incubator REIT election can be made) begins with the REIT’s second taxable year and ends at the close of the REIT’s third taxable year, except that the REIT may, subject to clauses (ii), (iii), and (iv), elect to extend such period for an additional 2 taxable years.

“(ii) GOING PUBLIC TRANSACTION.—

A REIT may not elect to extend the eligibility period under clause (i) unless it enters into an agreement with the Secretary that if it does not engage in a going public
transaction by the end of the extended eligibility period, it shall pay Federal income taxes for the 2 years of the extended eligibility period as if it had not made an incubator REIT election and had ceased to qualify as a REIT for those 2 taxable years.

“(iii) Returns, Interest, and Notice.—

“(I) Returns.—In the event the corporation ceases to be treated as a REIT by operation of clause (ii), the corporation shall file any appropriate amended returns reflecting the change in status within 3 months of the close of the extended eligibility period.

“(II) Interest.—Interest shall be payable on any tax imposed by reason of clause (ii) for any taxable year but, unless there was a finding under subparagraph (D), no substantial underpayment penalties shall be imposed.

“(III) Notice.—The corporation shall, at the same time it files its re-
turns under subclause (I), notify its shareholders and any other persons whose tax position is, or may reasonably be expected to be, affected by the change in status so they also may file any appropriate amended returns to conform their tax treatment consistent with the corporation’s loss of REIT status.

“(IV) REGULATIONS.—The Secretary shall provide appropriate regulations setting forth transferee liability and other provisions to ensure collection of tax and the proper administration of this provision.

“(iv) Clauses (ii) and (iii) shall not apply if the corporation allows its incubator REIT status to lapse at the end of the initial 2-year eligibility period without engaging in a going public transaction if the corporation is not a controlled entity as of the beginning of its fourth taxable year. In such a case, the corporation’s directors may still be liable for the penalties de-
scribed in subparagraph (D) during the eligibility period.

“(D) SPECIAL PENALTIES.—If the Secretary determines that an incubator REIT election was filed for a principal purpose other than as part of a reasonable plan to undertake a going public transaction, an excise tax of $20,000 shall be imposed on each of the corporation’s directors for each taxable year for which an election was in effect.

“(E) GOING PUBLIC TRANSACTION.—For purposes of this paragraph, a going public transaction means—

“(i) a public offering of shares of the stock of the incubator REIT;

“(ii) a transaction, or series of transactions, that results in the stock of the incubator REIT being regularly traded on an established securities market and that results in at least 50 percent of such stock being held by shareholders who are unrelated to persons who held such stock before it began to be so regularly traded; or

“(iii) any transaction resulting in ownership of the REIT by 200 or more
persons (excluding the largest single share-
holder) who in the aggregate own at least
50 percent of the stock of the REIT.

For the purposes of this subparagraph, the
rules of paragraph (3) shall apply in deter-
mining the ownership of stock.

“(F) DEFINITIONS.—The term ‘established
securities market’ shall have the meaning set
forth in the regulations under section 897.”.

(c) CONFORMING AMENDMENT.—Paragraph (2) of
section 856(h) is amended by striking “and (6)” each
place it appears and inserting “, (6), and (7)”.

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by
this section shall apply to taxable years ending after

(2) EXCEPTION FOR EXISTING CONTROLLED
ENTITIES.—The amendments made by this section
shall not apply to any entity which is a controlled
entity (as defined in section 856(l) of the Internal
Revenue Code of 1986, as added by this section) as
of May 8, 2003, which is a real estate investment
trust for the taxable year which includes such date,
and which has significant business assets or activi-
ties as of such date. For purposes of the preceding
sentence, an entity shall be treated as such a con-
trolled entity on May 8, 2003, if it becomes such an
entity after such date in a transaction—

(A) made pursuant to a written agreement
which was binding on such date and at all times
thereafter, or

(B) described on or before such date in a
filing with the Securities and Exchange Com-
mission required solely by reason of the trans-
action.

Subtitle C—Other Corporate
Governance Provisions

PART I—GENERAL PROVISIONS

SEC. 331. AFFIRMATION OF CONSOLIDATED RETURN REGU-
LATION AUTHORITY.

(a) IN GENERAL.—Section 1502 (relating to consoli-
dated return regulations) is amended by adding at the end
the following new sentence: “In prescribing such regula-
tions, the Secretary may prescribe rules applicable to cor-
porations filing consolidated returns under section 1501
that are different from other provisions of this title that
would apply if such corporations filed separate returns.”.

(b) RESULT NOT OVERTURNED.—Notwithstanding
subsection (a), the Internal Revenue Code of 1986 shall
be construed by treating Treasury regulation § 1.1502–
20(c)(1)(iii) (as in effect on January 1, 2001) as being inapplicable to the type of factual situation in 255 F.3d 1357 (Fed. Cir. 2001).

(c) EFFECTIVE DATE.—The provisions of this section shall apply to taxable years beginning before, on, or after the date of the enactment of this Act.

SEC. 332. SIGNING OF CORPORATE TAX RETURNS BY CHIEF EXECUTIVE OFFICER.

(a) IN GENERAL.—Section 6062 (relating to signing of corporation returns) is amended by striking the first sentence and inserting the following new sentence: “The return of a corporation with respect to income shall be signed by the chief executive officer of such corporation (or other such officer of the corporation as the Secretary may designate if the corporation does not have a chief executive officer). The preceding sentence shall not apply to any return of a regulated investment company (within the meaning of section 851).”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to returns filed after the date of the enactment of this Act.
SEC. 333. DENIAL OF DEDUCTION FOR CERTAIN FINES, PENALTIES, AND OTHER AMOUNTS.

(a) In General.—Subsection (f) of section 162 (relating to trade or business expenses) is amended to read as follows:

“(f) FINES, PENALTIES, AND OTHER AMOUNTS.—

“(1) IN GENERAL.—Except as provided in paragraph (2), no deduction otherwise allowable shall be allowed under this chapter for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or entity described in paragraph (3) in relation to the violation of any law or the investigation or inquiry into the potential violation of any law.

“(2) EXCEPTION FOR AMOUNTS CONSTITUTING RESTITUTION.—Paragraph (1) shall not apply to any amount which the taxpayer establishes constitutes restitution for damage or harm caused by the violation of any law or the potential violation of any law. This paragraph shall not apply to any amount paid or incurred as reimbursement to the government or entity for the costs of any investigation or litigation.

“(3) CERTAIN NONGOVERNMENTAL REGULATORY ENTITIES.—An entity is described in this paragraph if it is—
“(A) a nongovernmental entity which exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange (as defined in section 1256(g)(7)), or

“(B) to the extent provided in regulations, a nongovernmental entity which exercises self-regulatory powers (including imposing sanctions) as part of performing an essential governmental function.”.

(b) Effective Date.—The amendment made by this section shall apply to amounts paid or incurred after April 27, 2003, except that such amendment shall not apply to amounts paid or incurred under any binding order or agreement entered into on or before April 27, 2003. Such exception shall not apply to an order or agreement requiring court approval unless the approval was obtained on or before April 27, 2003.

SEC. 334. DISALLOWANCE OF DEDUCTION FOR PUNITIVE DAMAGES.

(a) Disallowance of Deduction.—

(1) In General.—Section 162(g) (relating to treble damage payments under the antitrust laws) is amended by adding at the end the following new paragraph:
“(2) PUNITIVE DAMAGES.—No deduction shall be allowed under this chapter for any amount paid or incurred for punitive damages in connection with any judgment in, or settlement of, any action. This paragraph shall not apply to punitive damages described in section 104(e).”.

(2) CONFORMING AMENDMENTS.—

(A) Section 162(g) is amended—

(i) by striking “If” and inserting:

“(1) TREBLE DAMAGES.—If”, and

(ii) by redesignating paragraphs (1) and (2) as subparagraphs (A) and (B), respectively.

(B) The heading for section 162(g) is amended by inserting “OR PUNITIVE DAMAGES” after “LAWS”.

(b) INCLUSION IN INCOME OF PUNITIVE DAMAGES PAID BY INSURER OR OTHERWISE.—

(1) IN GENERAL.—Part II of subchapter B of chapter 1 (relating to items specifically included in gross income) is amended by adding at the end the following new section:
“SEC. 91. PUNITIVE DAMAGES COMPENSATED BY INSURANCE OR OTHERWISE.

“Gross income shall include any amount paid to or on behalf of a taxpayer as insurance or otherwise by reason of the taxpayer’s liability (or agreement) to pay punitive damages.”.

(2) REPORTING REQUIREMENTS.—Section 6041 (relating to information at source) is amended by adding at the end the following new subsection:

“(f) SECTION TO APPLY TO PUNITIVE DAMAGES COMPENSATION.—This section shall apply to payments by a person to or on behalf of another person as insurance or otherwise by reason of the other person’s liability (or agreement) to pay punitive damages.”.

(3) CONFORMING AMENDMENT.—The table of sections for part II of subchapter B of chapter 1 is amended by adding at the end the following new item:

“Sec. 91. Punitive damages compensated by insurance or otherwise.”.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to damages paid or incurred on or after the date of the enactment of this Act.
PART II—EXECUTIVE COMPENSATION REFORM

SEC. 335. TREATMENT OF NONQUALIFIED DEFERRED COMPENSATION FUNDED WITH ASSETS LOCATED OUTSIDE THE UNITED STATES.

(a) In General.—Section 83(c) (relating to special rules for property transferred in connection with performance of services) is amended by adding at the end the following new paragraph:

“(4) Foreign assets funding nonqualified deferred compensation arrangements.—

“(A) In general.—In determining whether there is a transfer of property for purposes of subsection (a), if assets are—

“(i) designated or otherwise available for the payment of nonqualified deferred compensation, and

“(ii) located outside the United States,

such assets shall not be treated as subject to the claims of creditors.

“(B) Compensation for services performed in foreign jurisdiction.—Subparagraph (A) shall not apply to assets located in a foreign jurisdiction if substantially all of the services to which the nonqualified deferred com-
pensation relates are performed in such jurisdic-

“(C) REGULATIONS.—The Secretary shall

prescribe such regulations as are necessary to
carry out the provisions of this paragraph, in-
cluding regulations to exempt arrangements
from the application of this paragraph if—

“(i) the arrangement will not result in
an improper deferral of United States tax,
and

“(ii) the assets involved in the ar-
rangement will be readily accessible in any
insolvency or bankruptcy proceeding.”.

(b) EFFECTIVE DATE.—The amendments made by
this section shall apply to amounts deferred in taxable

SEC. 336. INCLUSION IN GROSS INCOME OF FUNDED DE-
FERRED COMPENSATION OF CORPORATE IN-
SIDERS.

(a) IN GENERAL.—Subpart A of part I of subchapter
D of chapter 1 is amended by adding at the end the fol-
lowing new section:
"SEC. 409A. INCLUSION IN GROSS INCOME OF FUNDED DEFERRED COMPENSATION OF CORPORATE INSIDERS.

“(a) In General.—If an employer maintains a funded deferred compensation plan—

“(1) compensation of any disqualified individual which is deferred under such funded deferred compensation plan shall be included in the gross income of the disqualified individual or beneficiary for the 1st taxable year in which there is no substantial risk of forfeiture of the rights to such compensation, and

“(2) the tax treatment of any amount made available under the plan to a disqualified individual or beneficiary shall be determined under section 72 (relating to annuities, etc.).

“(b) Funded Deferred Compensation Plan.—

For purposes of this section—

“(1) In General.—The term ‘funded deferred compensation plan’ means any plan providing for the deferral of compensation unless—

“(A) the employee’s rights to the compensation deferred under the plan are no greater than the rights of a general creditor of the employer, and

“(B) all amounts set aside (directly or indirectly) for purposes of paying the deferred
compensation, and all income attributable to such amounts, remain (until made available to the participant or other beneficiary) solely the property of the employer (without being restricted to the provision of benefits under the plan),

“(C) the amounts referred to in subparagraph (B) are available to satisfy the claims of the employer’s general creditors at all times (not merely after bankruptcy or insolvency), and

“(D) the investment options which a participant may elect under the plan are the same as the investment options which a participant may elect under the qualified employer plan of the employer which has the fewest investment options.

Such term shall not include a qualified employer plan.

“(2) SPECIAL RULES.—

“(A) EMPLOYEE’S RIGHTS.—A plan shall be treated as failing to meet the requirements of paragraph (1)(A) unless—

“(i) the compensation deferred under the plan is payable only upon separation
from service, death, disability (within the meaning of section 1614(a)(3) of the Social Security Act (42 U.S.C. 1382c(a)(3))), or at a specified time (or pursuant to a fixed schedule), and

“(ii) the plan does not permit the acceleration of the time such deferred compensation is payable by reason of any event.

If the employer and employee agree to a modification of the plan that accelerates the time for payment of any deferred compensation, then all compensation previously deferred under the plan shall be includible in gross income for the taxable year during which such modification takes effect and the taxpayer shall pay interest at the underpayment rate on the underpayments that would have occurred had the deferred compensation been includible in gross income on the earliest date that there is no substantial risk of forfeiture of the rights to such compensation.

“(B) CREDITOR’S RIGHTS.—A plan shall be treated as failing to meet the requirements
of paragraph (1)(B) with respect to amounts
set aside in a trust unless—

“(i) the employee has no beneficial in-
terest in the trust,

“(ii) assets in the trust are available
to satisfy claims of general creditors at all
times (not merely after bankruptcy or in-
solvency), and

“(iii) there is no factor that would
make it more difficult for general creditors
to reach the assets in the trust than it
would be if the trust assets were held di-
rectly by the employer in the United
States.

Except as provided in regulations prescribed by
the Secretary, such a factor shall include the lo-
cation of the trust outside the United States
unless substantially all of the services to which
the nonqualified deferred compensation relates
are performed outside the United States. Such
regulations may exempt any such trust if the
trust will not result in an improper deferral of
United States tax, and the assets involved in
the trust will be readily accessible in any insol-
veny or bankruptcy proceeding.
“(c) **DISQUALIFIED INDIVIDUAL.**—For purposes of this section, the term ‘disqualified individual’ means, with respect to a corporation, any individual—

“(1) who is subject to the requirements of section 16(a) of the Securities Exchange Act of 1934 with respect to such corporation, or

“(2) who would be subject to such requirements if such corporation were an issuer of equity securities referred to in such section.

“(d) **OTHER DEFINITIONS AND SPECIAL RULES.**—

For purposes of this section—

“(1) **QUALIFIED EMPLOYER PLAN.**—The term ‘qualified employer plan’ means—

“(A) any plan, contract, pension, account, or trust described in subparagraph (A) or (B) of section 219(g)(5), and

“(B) any other plan of an organization exempt from tax under subtitle A.

“(2) **PLAN INCLUDES ARRANGEMENTS, ETC.**—The term ‘plan’ includes any agreement or arrangement.

“(3) **SUBSTANTIAL RISK OF FORFEITURE.**—The rights of a person to compensation are subject to a substantial risk of forfeiture if such person’s rights to such compensation are conditioned upon the fu-
ture performance of substantial services by any individual.

“(4) Treatment of Earnings.—References to deferred compensation shall be treated as including references to income attributable to such compensation or such income.”.

(b) Clerical Amendment.—The table of sections for such subpart A is amended by adding at the end the following new item:

“Sec. 409A. Inclusion in gross income of funded deferred compensation of corporate insiders.”.

(e) Effective Date.—The amendments made by this section shall apply to amounts deferred in taxable years beginning after December 31, 2003.

SEC. 337. PROHIBITION ON DEFERRAL OF GAIN FROM THE EXERCISE OF STOCK OPTIONS AND RESTRICTED STOCK GAINS THROUGH DEFERRED COMPENSATION ARRANGEMENTS.

(a) In General.—Section 83 (relating to property transferred in connection with performance of services) is amending by adding at the end the following new subsection:

“(i) Prohibition on Additional Deferral Through Deferred Compensation Arrangements.—If a taxpayer elects to exchange an option to purchase employer securities—
“(1) to which subsection (a) applies, or
“(2) which is described in subsection (e)(3),
or any other compensation based on employer securities, for a right to receive future payments, then, notwithstanding any other provision of this title, there shall be included in gross income for the taxable year of the exchange an amount equal to the present value of such right (or such other amount as the Secretary may by regulations specify). For purposes of this subsection, the term ‘employer securities’ has the meaning given such term by section 409(l)’.

(b) Effective Date.—The amendment made by this section shall apply to any exchange after December 31, 2003.

SEC. 338. INCREASE IN WITHHOLDING FROM SUPPLEMENTAL WAGE PAYMENTS IN EXCESS OF $1,000,000.

(a) In General.—If an employer elects under Treasury Regulation 31.3402(g)–1 to determine the amount to be deducted and withheld from any supplemental wage payment by using a flat percentage rate, the rate to be used in determining the amount to be so deducted and withheld shall not be less than 28 percent (or the corresponding rate in effect under section 1(i)(2) of the Internal Revenue Code of 1986 for taxable years be-
ginning in the calendar year in which the payment is
made).

(b) Special Rule for Large Payments.—

(1) In General.—Notwithstanding subsection
(a), if the supplemental wage payment, when added
to all such payments previously made by the em-
ployer to the employee during the calendar year, ex-
ceeds $1,000,000, the rate used with respect to such
excess shall be equal to the maximum rate of tax in
effect under section 1 of such Code for taxable years
beginning in such calendar year.

(2) Aggregation.—All persons treated as a
single employer under subsection (a) or (b) of sec-
tion 52 of the Internal Revenue Code of 1986 shall
be treated as a single employer for purposes of this
subsection.

(c) Conforming Amendment.—Section 13273 of
the Revenue Reconciliation Act of 1993 (Public Law 103–
66) is repealed.

(d) Effective Date.—The provisions of, and the
amendment made by, this section shall apply to payments
Subtitle D—International
Provisions

PART I—PROVISIONS TO DISCOURAGE
EXPATRIATION

SEC. 340. REVISION OF TAX RULES ON EXPATRIATION.

(a) In General.—Subpart A of part II of subchapter N of chapter 1 is amended by inserting after section 877 the following new section:

“SEC. 877A. TAX RESPONSIBILITIES OF EXPATRIATION.

“(a) General Rules.—For purposes of this subtitle—

“(1) MARK TO MARKET.—Except as provided in subsections (d) and (f), all property of a covered expatriate to whom this section applies shall be treated as sold on the day before the expatriation date for its fair market value.

“(2) RECOGNITION OF GAIN OR LOSS.—In the case of any sale under paragraph (1)—

“(A) notwithstanding any other provision of this title, any gain arising from such sale shall be taken into account for the taxable year of the sale, and

“(B) any loss arising from such sale shall be taken into account for the taxable year of the sale to the extent otherwise provided by this
title, except that section 1091 shall not apply to any such loss.

Proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account under the preceding sentence.

“(3) EXCLUSION FOR CERTAIN GAIN.—

“(A) IN GENERAL.—The amount which, but for this paragraph, would be includible in the gross income of any individual by reason of this section shall be reduced (but not below zero) by $600,000. For purposes of this paragraph, allocable expatriation gain taken into account under subsection (f)(2) shall be treated in the same manner as an amount required to be includible in gross income.

“(B) COST-OF-LIVING ADJUSTMENT.—

“(i) IN GENERAL.—In the case of an expatriation date occurring in any calendar year after 2003, the $600,000 amount under subparagraph (A) shall be increased by an amount equal to—

“(I) such dollar amount, multi-plied by
“(II) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, determined by substituting ‘calendar year 2002’ for ‘calendar year 1992’ in subparagraph (B) thereof.

“(ii) Rounding rules.—If any amount after adjustment under clause (i) is not a multiple of $1,000, such amount shall be rounded to the next lower multiple of $1,000.

“(4) Election to continue to be taxed as United States citizen.—

“(A) In general.—If a covered expatriate elects the application of this paragraph—

“(i) this section (other than this paragraph and subsection (i)) shall not apply to the expatriate, but

“(ii) in the case of property to which this section would apply but for such election, the expatriate shall be subject to tax under this title in the same manner as if the individual were a United States citizen.
“(B) REQUIREMENTS.—Subparagraph (A) shall not apply to an individual unless the individual—

“(i) provides security for payment of tax in such form and manner, and in such amount, as the Secretary may require,

“(ii) consents to the waiver of any right of the individual under any treaty of the United States which would preclude assessment or collection of any tax which may be imposed by reason of this paragraph, and

“(iii) complies with such other requirements as the Secretary may prescribe.

“(C) ELECTION.—An election under subparagraph (A) shall apply to all property to which this section would apply but for the election and, once made, shall be irrevocable. Such election shall also apply to property the basis of which is determined in whole or in part by reference to the property with respect to which the election was made.

“(b) ELECTION TO DEFER TAX.—

“(1) IN GENERAL.—If the taxpayer elects the application of this subsection with respect to any
property treated as sold by reason of subsection (a),
the payment of the additional tax attributable to
such property shall be postponed until the due date
of the return for the taxable year in which such
property is disposed of (or, in the case of property
disposed of in a transaction in which gain is not rec-
ognized in whole or in part, until such other date as
the Secretary may prescribe).

“(2) Determination of tax with respect
to property.—For purposes of paragraph (1), the
additional tax attributable to any property is an
amount which bears the same ratio to the additional
tax imposed by this chapter for the taxable year
solely by reason of subsection (a) as the gain taken
into account under subsection (a) with respect to
such property bears to the total gain taken into ac-
count under subsection (a) with respect to all prop-
erty to which subsection (a) applies.

“(3) Termination of postponement.—No
tax may be postponed under this subsection later
than the due date for the return of tax imposed by
this chapter for the taxable year which includes the
date of death of the expatriate (or, if earlier, the
time that the security provided with respect to the
property fails to meet the requirements of paragraph
(4), unless the taxpayer corrects such failure within the time specified by the Secretary).

“(4) Security.—

“(A) In general.—No election may be made under paragraph (1) with respect to any property unless adequate security is provided to the Secretary with respect to such property.

“(B) Adequate security.—For purposes of subparagraph (A), security with respect to any property shall be treated as adequate security if—

“(i) it is a bond in an amount equal to the deferred tax amount under paragraph (2) for the property, or

“(ii) the taxpayer otherwise establishes to the satisfaction of the Secretary that the security is adequate.

“(5) Waiver of certain rights.—No election may be made under paragraph (1) unless the taxpayer consents to the waiver of any right under any treaty of the United States which would preclude assessment or collection of any tax imposed by reason of this section.

“(6) Elections.—An election under paragraph (1) shall only apply to property described in the elec-
tion and, once made, is irrevocable. An election may be made under paragraph (1) with respect to an interest in a trust with respect to which gain is required to be recognized under subsection (f)(1).

“(7) **INTEREST.**—For purposes of section 6601—

“(A) the last date for the payment of tax shall be determined without regard to the election under this subsection, and

“(B) section 6621(a)(2) shall be applied by substituting ‘5 percentage points’ for ‘3 percentage points’ in subparagraph (B) thereof.

“(c) **COVERED EXPATRIATE.**—For purposes of this section—

“(1) **IN GENERAL.**—Except as provided in paragraph (2), the term ‘covered expatriate’ means an expatriate.

“(2) **EXCEPTIONS.**—An individual shall not be treated as a covered expatriate if—

“(A) the individual—

“(i) became at birth a citizen of the United States and a citizen of another country and, as of the expatriation date, continues to be a citizen of, and is taxed as a resident of, such other country, and
“(ii) has not been a resident of the United States (as defined in section 7701(b)(1)(A)(ii)) during the 5 taxable years ending with the taxable year during which the expatriation date occurs, or
“(B)(i) the individual’s relinquishment of United States citizenship occurs before such individual attains age 18 1⁄2, and
“(ii) the individual has been a resident of the United States (as so defined) for not more than 5 taxable years before the date of relinquishment.
“(d) EXEMPT PROPERTY; SPECIAL RULES FOR PENSION PLANS.—
“(1) EXEMPT PROPERTY.—This section shall not apply to the following:
“(A) UNITED STATES REAL PROPERTY INTERESTS.—Any United States real property interest (as defined in section 897(e)(1)), other than stock of a United States real property holding corporation which does not, on the day before the expatriation date, meet the requirements of section 897(e)(2).
“(B) SPECIFIED PROPERTY.—Any property or interest in property not described in
subparagraph (A) which the Secretary specifies in regulations.

“(2) Special rules for certain retirement plans.—

“(A) In general.—If a covered expatriate holds on the day before the expatriation date any interest in a retirement plan to which this paragraph applies—

“(i) such interest shall not be treated as sold for purposes of subsection (a)(1), but

“(ii) an amount equal to the present value of the expatriate’s nonforfeitable accrued benefit shall be treated as having been received by such individual on such date as a distribution under the plan.

“(B) Treatment of subsequent distributions.—In the case of any distribution on or after the expatriation date to or on behalf of the covered expatriate from a plan from which the expatriate was treated as receiving a distribution under subparagraph (A), the amount otherwise includible in gross income by reason of the subsequent distribution shall be reduced by the excess of the amount includible
in gross income under subparagraph (A) over
any portion of such amount to which this sub-
paragraph previously applied.

“(C) Treatment of subsequent dis-
tributions by plan.—For purposes of this
title, a retirement plan to which this paragraph
applies, and any person acting on the plan’s be-
half, shall treat any subsequent distribution de-
scribed in subparagraph (B) in the same man-
ner as such distribution would be treated with-
out regard to this paragraph.

“(D) Applicable plans.—This para-
graph shall apply to—

“(i) any qualified retirement plan (as
defined in section 4974(e)),

“(ii) an eligible deferred compensation
plan (as defined in section 457(b)) of an
eligible employer described in section
457(e)(1)(A), and

“(iii) to the extent provided in regula-
tions, any foreign pension plan or similar
retirement arrangements or programs.

“(e) Definitions.—For purposes of this section—

“(1) Expatriate.—The term ‘expatriate’
means—
“(A) any United States citizen who relinquishes citizenship, and

“(B) any long-term resident of the United States who—

“(i) ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)), or

“(ii) commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country and who does not waive the benefits of such treaty applicable to residents of the foreign country.

“(2) EXPATRIATION DATE.—The term ‘expatriation date’ means—

“(A) the date an individual relinquishes United States citizenship, or

“(B) in the case of a long-term resident of the United States, the date of the event described in clause (i) or (ii) of paragraph (1)(B).

“(3) RELINQUISHEMENT OF CITIZENSHIP.—A citizen shall be treated as relinquishing United States citizenship on the earliest of—
“(A) the date the individual renounces such individual’s United States nationality before a diplomatic or consular officer of the United States pursuant to paragraph (5) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(5)),

“(B) the date the individual furnishes to the United States Department of State a signed statement of voluntary relinquishment of United States nationality confirming the performance of an act of expatriation specified in paragraph (1), (2), (3), or (4) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(1)–(4)),

“(C) the date the United States Department of State issues to the individual a certificate of loss of nationality, or

“(D) the date a court of the United States cancels a naturalized citizen’s certificate of naturalization.

Subparagraph (A) or (B) shall not apply to any individual unless the renunciation or voluntary relinquishment is subsequently approved by the issuance to the individual of a certificate of loss of nationality by the United States Department of State.
“(4) Long-term resident.—The term ‘long-term resident’ has the meaning given to such term by section 877(e)(2).

“(f) Special Rules Applicable to Beneficiaries’ Interests in Trust.—

“(1) In general.—Except as provided in paragraph (2), if an individual is determined under paragraph (3) to hold an interest in a trust on the day before the expatriation date—

“(A) the individual shall not be treated as having sold such interest,

“(B) such interest shall be treated as a separate share in the trust, and

“(C)(i) such separate share shall be treated as a separate trust consisting of the assets allocable to such share,

“(ii) the separate trust shall be treated as having sold its assets on the day before the expatriation date for their fair market value and as having distributed all of its assets to the individual as of such time, and

“(iii) the individual shall be treated as having recontributed the assets to the separate trust.
Subsection (a)(2) shall apply to any income, gain, or loss of the individual arising from a distribution described in subparagraph (C)(ii). In determining the amount of such distribution, proper adjustments shall be made for liabilities of the trust allocable to an individual’s share in the trust.

“(2) SPECIAL RULES FOR INTERESTS IN QUALIFIED TRUSTS.—

“(A) IN GENERAL.—If the trust interest described in paragraph (1) is an interest in a qualified trust—

“(i) paragraph (1) and subsection (a) shall not apply, and

“(ii) in addition to any other tax imposed by this title, there is hereby imposed on each distribution with respect to such interest a tax in the amount determined under subparagraph (B).

“(B) AMOUNT OF TAX.—The amount of tax under subparagraph (A)(ii) shall be equal to the lesser of—

“(i) the highest rate of tax imposed by section 1(e) for the taxable year which includes the day before the expatriation date,
multiplied by the amount of the distribution, or

“(ii) the balance in the deferred tax account immediately before the distribution determined without regard to any increases under subparagraph (C)(ii) after the 30th day preceding the distribution.

“(C) DEFERRED TAX ACCOUNT.—For purposes of subparagraph (B)(ii)—

“(i) OPENING BALANCE.—The opening balance in a deferred tax account with respect to any trust interest is an amount equal to the tax which would have been imposed on the allocable expatriation gain with respect to the trust interest if such gain had been included in gross income under subsection (a).

“(ii) INCREASE FOR INTEREST.—The balance in the deferred tax account shall be increased by the amount of interest determined (on the balance in the account at the time the interest accrues), for periods after the 90th day after the expatriation date, by using the rates and method applicable under section 6621 for underpay-
ments of tax for such periods, except that section 6621(a)(2) shall be applied by substituting ‘5 percentage points’ for ‘3 percentage points’ in subparagraph (B) thereof.

“(iii) Decrease for taxes previously paid.—The balance in the tax deferred account shall be reduced—

“(I) by the amount of taxes imposed by subparagraph (A) on any distribution to the person holding the trust interest, and

“(II) in the case of a person holding a nonvested interest, to the extent provided in regulations, by the amount of taxes imposed by subparagraph (A) on distributions from the trust with respect to nonvested interests not held by such person.

“(D) Allocable expatriation gain.—

For purposes of this paragraph, the allocable expatriation gain with respect to any beneficiary’s interest in a trust is the amount of gain which would be allocable to such beneficiary’s vested and nonvested interests in the
trust if the beneficiary held directly all assets allocable to such interests.

“(E) TAX DEDUCTED AND WITHHELD.—

“(i) IN GENERAL.—The tax imposed by subparagraph (A)(ii) shall be deducted and withheld by the trustees from the distribution to which it relates.

“(ii) EXCEPTION WHERE FAILURE TO WAIVE TREATY RIGHTS.—If an amount may not be deducted and withheld under clause (i) by reason of the distributee failing to waive any treaty right with respect to such distribution——

“(I) the tax imposed by subparagraph (A)(ii) shall be imposed on the trust and each trustee shall be personally liable for the amount of such tax, and

“(II) any other beneficiary of the trust shall be entitled to recover from the distributee the amount of such tax imposed on the other beneficiary.

“(F) DISPOSITION.—If a trust ceases to be a qualified trust at any time, a covered expatriate disposes of an interest in a qualified
trust, or a covered expatriate holding an interest in a qualified trust dies, then, in lieu of the tax imposed by subparagraph (A)(ii), there is hereby imposed a tax equal to the lesser of—

“(i) the tax determined under paragraph (1) as if the day before the expatriation date were the date of such cessation, disposition, or death, whichever is applicable, or

“(ii) the balance in the tax deferred account immediately before such date.

Such tax shall be imposed on the trust and each trustee shall be personally liable for the amount of such tax and any other beneficiary of the trust shall be entitled to recover from the covered expatriate or the estate the amount of such tax imposed on the other beneficiary.

“(G) Definitions and special rules.—

For purposes of this paragraph—

“(i) Qualified trust.—The term ‘qualified trust’ means a trust which is described in section 7701(a)(30)(E).

“(ii) Vested interest.—The term ‘vested interest’ means any interest which,
as of the day before the expatriation date, is vested in the beneficiary.

“(iii) NONVESTED INTEREST.—The term ‘nonvested interest’ means, with respect to any beneficiary, any interest in a trust which is not a vested interest. Such interest shall be determined by assuming the maximum exercise of discretion in favor of the beneficiary and the occurrence of all contingencies in favor of the beneficiary.

“(iv) ADJUSTMENTS.—The Secretary may provide for such adjustments to the bases of assets in a trust or a deferred tax account, and the timing of such adjustments, in order to ensure that gain is taxed only once.

“(v) COORDINATION WITH RETIREMENT PLAN RULES.—This subsection shall not apply to an interest in a trust which is part of a retirement plan to which subsection (d)(2) applies.

“(3) DETERMINATION OF BENEFICIARIES’ INTEREST IN TRUST.—
“(A) Determinations under paragraph (1).—For purposes of paragraph (1), a beneficiary’s interest in a trust shall be based upon all relevant facts and circumstances, including the terms of the trust instrument and any letter of wishes or similar document, historical patterns of trust distributions, and the existence of and functions performed by a trust protector or any similar adviser.

“(B) Other determinations.—For purposes of this section—

“(i) Constructive ownership.—If a beneficiary of a trust is a corporation, partnership, trust, or estate, the shareholders, partners, or beneficiaries shall be deemed to be the trust beneficiaries for purposes of this section.

“(ii) Taxpayer return position.—A taxpayer shall clearly indicate on its income tax return—

“(I) the methodology used to determine that taxpayer’s trust interest under this section, and

“(II) if the taxpayer knows (or has reason to know) that any other
beneficiary of such trust is using a different methodology to determine such beneficiary’s trust interest under this section.

“(g) Termination of Deferrals, etc.—In the case of any covered expatriate, notwithstanding any other provision of this title—

“(1) any period during which recognition of income or gain is deferred shall terminate on the day before the expatriation date, and

“(2) any extension of time for payment of tax shall cease to apply on the day before the expatriation date and the unpaid portion of such tax shall be due and payable at the time and in the manner prescribed by the Secretary.

“(h) Imposition of Tentative Tax.—

“(1) In general.—If an individual is required to include any amount in gross income under subsection (a) for any taxable year, there is hereby imposed, immediately before the expatriation date, a tax in an amount equal to the amount of tax which would be imposed if the taxable year were a short taxable year ending on the expatriation date.
“(2) Due date.—The due date for any tax imposed by paragraph (1) shall be the 90th day after the expatriation date.

“(3) Treatment of tax.—Any tax paid under paragraph (1) shall be treated as a payment of the tax imposed by this chapter for the taxable year to which subsection (a) applies.

“(4) Deferral of tax.—The provisions of subsection (b) shall apply to the tax imposed by this subsection to the extent attributable to gain includible in gross income by reason of this section.

“(i) Special Liens for Deferred Tax Amounts.—

“(1) Imposition of lien.—

“(A) In general.—If a covered expatriate makes an election under subsection (a)(4) or (b) which results in the deferral of any tax imposed by reason of subsection (a), the deferred amount (including any interest, additional amount, addition to tax, assessable penalty, and costs attributable to the deferred amount) shall be a lien in favor of the United States on all property of the expatriate located in the United States (without regard to whether this section applies to the property).
“(B) DEFERRED AMOUNT.—For purposes of this subsection, the deferred amount is the amount of the increase in the covered expatriate’s income tax which, but for the election under subsection (a)(4) or (b), would have occurred by reason of this section for the taxable year including the expatriation date.

“(2) PERIOD OF LIEN.—The lien imposed by this subsection shall arise on the expatriation date and continue until—

“(A) the liability for tax by reason of this section is satisfied or has become unenforceable by reason of lapse of time, or

“(B) it is established to the satisfaction of the Secretary that no further tax liability may arise by reason of this section.

“(3) CERTAIN RULES APPLY.—The rules set forth in paragraphs (1), (3), and (4) of section 6324A(d) shall apply with respect to the lien imposed by this subsection as if it were a lien imposed by section 6324A.

“(j) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.”.
(b) **INCLUSION IN INCOME OF GIFTS AND BEQUESTS RECEIVED BY UNITED STATES CITIZENS AND RESIDENTS FROM EXPATRIATES.**—Section 102 (relating to gifts, etc. not included in gross income) is amended by adding at the end the following new subsection:

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(d) GIFTS AND INHERITANCES FROM COVERED EXPATRIATES.—

(1) IN GENERAL.—Subsection (a) shall not exclude from gross income the value of any property acquired by gift, bequest, devise, or inheritance from a covered expatriate after the expatriation date. For purposes of this subsection, any term used in this subsection which is also used in section 877A shall have the same meaning as when used in section 877A.

(2) EXCEPTIONS FOR TRANSFERS OTHERWISE SUBJECT TO ESTATE OR GIFT TAX.—Paragraph (1) shall not apply to any property if either—

(A) the gift, bequest, devise, or inheritance is—

(i) shown on a timely filed return of tax imposed by chapter 12 as a taxable gift by the covered expatriate, or

(ii) included in the gross estate of the covered expatriate for purposes of
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chapter 11 and shown on a timely filed return of tax imposed by chapter 11 of the estate of the covered expatriate, or

“(B) no such return was timely filed but no such return would have been required to be filed even if the covered expatriate were a citizen or long-term resident of the United States.”.

(e) Definition of Termination of United States Citizenship.—Section 7701(a) is amended by adding at the end the following new paragraph:

“(48) Termination of United States citizenship.—

“(A) In general.—An individual shall not cease to be treated as a United States citizen before the date on which the individual’s citizenship is treated as relinquished under section 877A(e)(3).

“(B) Dual citizens.—Under regulations prescribed by the Secretary, subparagraph (A) shall not apply to an individual who became at birth a citizen of the United States and a citizen of another country.”.

(d) Ineligibility for Visa or Admission to United States.—
(1) IN GENERAL.—Section 212(a)(10)(E) of the Immigration and Nationality Act (8 U.S.C. 1182(a)(10)(E)) is amended to read as follows:

“(E) Former Citizens not in Compliance with Expatriation Revenue Provisions.—Any alien who is a former citizen of the United States who relinquishes United States citizenship (within the meaning of section 877A(e)(3) of the Internal Revenue Code of 1986) and who is not in compliance with section 877A of such Code (relating to expatriation).”.

(2) Availability of Information.—

(A) In General.—Section 6103(l) (relating to disclosure of returns and return information for purposes other than tax administration) is amended by adding at the end the following new paragraph:

“(19) Disclosure to Deny Visa or Admission to Certain Expatriates.—Upon written request of the Attorney General or the Attorney General’s delegate, the Secretary shall disclose whether an individual is in compliance with section 877A (and if not in compliance, any items of noncompliance) to officers and employees of the Federal agen-
cy responsible for administering section 212(a)(10)(E) of the Immigration and Nationality Act solely for the purpose of, and to the extent necessary in, administering such section 212(a)(10)(E).”.

(B) SAFEGUARDS.—

(i) TECHNICAL AMENDMENTS.—Paragraph (4) of section 6103(p) of the Internal Revenue Code of 1986, as amended by section 202(b)(2)(B) of the Trade Act of 2002 (Public Law 107–210; 116 Stat. 961), is amended by striking “or (17)” after “any other person described in subsection (l)(16)” each place it appears and inserting “or (18)”.

(ii) CONFORMING AMENDMENTS.—Section 6103(p)(4) (relating to safeguards), as amended by clause (i), is amended by striking “or (18)” after “any other person described in subsection (l)(16)” each place it appears and inserting “(18), or (19)”.

(3) EFFECTIVE DATES.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by
this subsection shall apply to individuals who
relinquish United States citizenship on or after
the date of the enactment of this Act.

(B) TECHNICAL AMENDMENTS.—The
amendments made by paragraph (2)(B)(i) shall
take effect as if included in the amendments
made by section 202(b)(2)(B) of the Trade Act

(e) CONFORMING AMENDMENTS.—

(1) Section 877 is amended by adding at the
end the following new subsection:

“(g) APPLICATION.—This section shall not apply to
an expatriate (as defined in section 877A(e)) whose expa-
triation date (as so defined) occurs on or after February
5, 2003.”.

(2) Section 2107 is amended by adding at the
end the following new subsection:

“(f) APPLICATION.—This section shall not apply to
any expatriate subject to section 877A.”.

(3) Section 2501(a)(3) is amended by adding at
the end the following new subparagraph:

“(F) APPLICATION.—This paragraph shall
not apply to any expatriate subject to section
877A.”.
(4)(A) Paragraph (1) of section 6039G(d) is amended by inserting “or 877A” after “section 877”.

(B) The second sentence of section 6039G(e) is amended by inserting “or who relinquishes United States citizenship (within the meaning of section 877A(e)(3))” after “877(a))”.

(C) Section 6039G(f) is amended by inserting “or 877A(e)(2)(B)” after “877(e)(1)”.

(f) CLERICAL AMENDMENT.—The table of sections for subpart A of part II of subchapter N of chapter 1 is amended by inserting after the item relating to section 877 the following new item:

“Sec. 877A. Tax responsibilities of expatriation.”.

(g) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to expatriates (within the meaning of section 877A(e) of the Internal Revenue Code of 1986, as added by this section) whose expatriation date (as so defined) occurs on or after February 5, 2003.

(2) GIFTS AND BEQUESTS.—Section 102(d) of the Internal Revenue Code of 1986 (as added by subsection (b)) shall apply to gifts and bequests received on or after February 5, 2003, from an indi-
vidual or the estate of an individual whose expatriation date (as so defined) occurs after such date.

(3) DUE DATE FOR TENTATIVE TAX.—The due date under section 877A(h)(2) of the Internal Revenue Code of 1986, as added by this section, shall in no event occur before the 90th day after the date of the enactment of this Act.

SEC. 341. TAX TREATMENT OF INVERTED CORPORATE ENTITIES.

(a) In General.—Subchapter C of chapter 80 (relating to provisions affecting more than one subtitle) is amended by adding at the end the following new section:

"SEC. 7874. RULES RELATING TO INVERTED CORPORATE ENTITIES.

"(a) Inverted Corporations Treated as Domestic Corporations.—

"(1) In General.—If a foreign incorporated entity is treated as an inverted domestic corporation, then, notwithstanding section 7701(a)(4), such entity shall be treated for purposes of this title as a domestic corporation.

"(2) Inverted Domestic Corporation.—For purposes of this section, a foreign incorporated entity shall be treated as an inverted domestic corpora-
tion if, pursuant to a plan (or a series of related transactions)—

“(A) the entity completes after March 20, 2002, the direct or indirect acquisition of sub-
stantially all of the properties held directly or indirectly by a domestic corporation or substan-
tially all of the properties constituting a trade or business of a domestic partnership,

“(B) after the acquisition at least 80 per-
cent of the stock (by vote or value) of the entity is held—

“(i) in the case of an acquisition with respect to a domestic corporation, by former shareholders of the domestic cor-
poration by reason of holding stock in the domestic corporation, or

“(ii) in the case of an acquisition with respect to a domestic partnership, by former partners of the domestic partner-
ship by reason of holding a capital or prof-
its interest in the domestic partnership, and

“(C) the expanded affiliated group which after the acquisition includes the entity does not have substantial business activities in the
foreign country in which or under the law of
which the entity is created or organized when
compared to the total business activities of such
expanded affiliated group.

Except as provided in regulations, an acquisition of
properties of a domestic corporation shall not be
treated as described in subparagraph (A) if none of
the corporation’s stock was readily tradeable on an
established securities market at any time during the
4-year period ending on the date of the acquisition.

“(b) Preservation of Domestic Tax Base In
Certain Inversion Transactions To Which Sub-
section (a) Does Not Apply.—

“(1) In general.—If a foreign incorporated
entity would be treated as an inverted domestic cor-
poration with respect to an acquired entity if ei-
ther—

“(A) subsection (a)(2)(A) were applied by
substituting ‘after December 31, 1996, and on
or before March 20, 2002’ for ‘after March 20,
2002’ and subsection (a)(2)(B) were applied by
substituting ‘more than 50 percent’ for ‘at least
80 percent’, or
“(B) subsection (a)(2)(B) were applied by substituting ‘more than 50 percent’ for ‘at least 80 percent’,
then the rules of subsection (c) shall apply to any inversion gain of the acquired entity during the applicable period and the rules of subsection (d) shall apply to any related party transaction of the acquired entity during the applicable period. This subsection shall not apply for any taxable year if subsection (a) applies to such foreign incorporated entity for such taxable year.

“(2) ACQUIRED ENTITY.—For purposes of this section—

“(A) IN GENERAL.—The term ‘acquired entity’ means the domestic corporation or partnership substantially all of the properties of which are directly or indirectly acquired in an acquisition described in subsection (a)(2)(A) to which this subsection applies.

“(B) AGGREGATION RULES.—Any domestic person bearing a relationship described in section 267(b) or 707(b) to an acquired entity shall be treated as an acquired entity with respect to the acquisition described in subpara-


“(3) Applicable period.—For purposes of this section—

“(A) In general.—The term ‘applicable period’ means the period—

“(i) beginning on the first date properties are acquired as part of the acquisition described in subsection (a)(2)(A) to which this subsection applies, and

“(ii) ending on the date which is 10 years after the last date properties are acquired as part of such acquisition.

“(B) Special rule for inversions occurring before March 21, 2002.—In the case of any acquired entity to which paragraph (1)(A) applies, the applicable period shall be the 10-year period beginning on January 1, 2003.

“(c) Tax on inversion gains may not be offset.—If subsection (b) applies—

“(1) In general.—The taxable income of an acquired entity (or any expanded affiliated group which includes such entity) for any taxable year which includes any portion of the applicable period shall in no event be less than the inversion gain of the entity for the taxable year.
“(2) Credits not allowed against tax on inversion gain.—Credits shall be allowed against the tax imposed by this chapter on an acquired entity for any taxable year described in paragraph (1) only to the extent such tax exceeds the product of—

“(A) the amount of the inversion gain for the taxable year, and

“(B) the highest rate of tax specified in section 11(b)(1).

For purposes of determining the credit allowed by section 901 inversion gain shall be treated as from sources within the United States.

“(3) Special rules for partnerships.—In the case of an acquired entity which is a partnership—

“(A) the limitations of this subsection shall apply at the partner rather than the partnership level,

“(B) the inversion gain of any partner for any taxable year shall be equal to the sum of—

“(i) the partner’s distributive share of inversion gain of the partnership for such taxable year, plus

“(ii) income or gain required to be recognized for the taxable year by the part-
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ner under section 367(a), 741, or 1001, or
2 under any other provision of chapter 1, by
3 reason of the transfer during the applica-
4 ble period of any partnership interest of
5 the partner in such partnership to the for-
6 eign incorporated entity, and

“(C) the highest rate of tax specified in
7 the rate schedule applicable to the partner
8 under chapter 1 shall be substituted for the
9 rate of tax under paragraph (2)(B).

“(4) INVERSION GAIN.—For purposes of this
11 section, the term ‘inversion gain’ means any income
12 or gain required to be recognized under section 304,
13 311(b), 367, 1001, or 1248, or under any other pro-
14 vision of chapter 1, by reason of the transfer during
15 the applicable period of stock or other properties by
16 an acquired entity—

“(A) as part of the acquisition described in
18 subsection (a)(2)(A) to which subsection (b) ap-
19 plies, or

“(B) after such acquisition to a foreign re-
21 lated person.

The Secretary may provide that income or gain from
23 the sale of inventories or other transactions in the
24 ordinary course of a trade or business shall not be
treated as inversion gain under subparagraph (B) to
the extent the Secretary determines such treatment
would not be inconsistent with the purposes of this
section.

“(5) Coordination with section 172 and
minimum tax.—Rules similar to the rules of para-
graphs (3) and (4) of section 860E(a) shall apply
for purposes of this section.

“(6) Statute of limitations.—

“(A) In general.—The statutory period
for the assessment of any deficiency attrib-
utable to the inversion gain of any taxpayer for
any pre-inversion year shall not expire before
the expiration of 3 years from the date the Sec-
retary is notified by the taxpayer (in such man-
ner as the Secretary may prescribe) of the ac-
quision described in subsection (a)(2)(A) to
which such gain relates and such deficiency
may be assessed before the expiration of such
3-year period notwithstanding the provisions of
any other law or rule of law which would other-
wise prevent such assessment.

“(B) Pre-inversion year.—For purposes
of subparagraph (A), the term ‘pre-inversion
year’ means any taxable year if—
“(i) any portion of the applicable period is included in such taxable year, and
“(ii) such year ends before the taxable year in which the acquisition described in subsection (a)(2)(A) is completed.

“(d) Special Rules Applicable to Related Party Transactions.—

“(1) Annual Application for Agreements on Return Positions.—

“(A) In general.—Each acquired entity to which subsection (b) applies shall file with the Secretary an application for an approval agreement under subparagraph (D) for each taxable year which includes a portion of the applicable period. Such application shall be filed at such time and manner, and shall contain such information, as the Secretary may prescribe.

“(B) Secretarial Action.—Within 90 days of receipt of an application under subparagraph (A) (or such longer period as the Secretary and entity may agree upon), the Secretary shall—
“(i) enter into an agreement described in subparagraph (D) for the taxable year covered by the application,

“(ii) notify the entity that the Secretary has determined that the application was filed in good faith and substantially complies with the requirements for the application under subparagraph (A), or

“(iii) notify the entity that the Secretary has determined that the application was not filed in good faith or does not substantially comply with such requirements.

If the Secretary fails to act within the time prescribed under the preceding sentence, the entity shall be treated for purposes of this paragraph as having received notice under clause (ii).

“(C) FAILURES TO COMPLY.—If an acquired entity fails to file an application under subparagraph (A), or the acquired entity receives a notice under subparagraph (B)(iii), for any taxable year, then for such taxable year—

“(i) there shall not be allowed any deduction, or addition to basis or cost of goods sold, for amounts paid or incurred, or losses incurred, by reason of a trans-
action between the acquired entity and a foreign related person,

“(ii) any transfer or license of intangible property (as defined in section 936(h)(3)(B)) between the acquired entity and a foreign related person shall be disregarded, and

“(iii) any cost-sharing arrangement between the acquired entity and a foreign related person shall be disregarded.

“(D) APPROVAL AGREEMENT.—For purposes of subparagraph (A), the term ‘approval agreement’ means a prefiling, advance pricing, or other agreement specified by the Secretary which contains such provisions as the Secretary determines necessary to ensure that the requirements of sections 163(j), 267(a)(3), 482, and 845, and any other provision of this title applicable to transactions between related persons and specified by the Secretary, are met.

“(E) TAX COURT REVIEW.—

“(i) IN GENERAL.—The Tax Court shall have jurisdiction over any action brought by an acquired entity receiving a notice under subparagraph (B)(iii) to de-
termine whether the issuance of the notice was an abuse of discretion, but only if the action is brought within 30 days after the date of the mailing (determined under rules similar to section 6213) of the notice.

“(ii) COURT ACTION.—The Tax Court shall issue its decision within 30 days after the filing of the action under clause (i) and may order the Secretary to issue a notice described in subparagraph (B)(ii).

“(iii) REVIEW.—An order of the Tax Court under this subparagraph shall be reviewable in the same manner as any other decision of the Tax Court.

“(2) MODIFICATIONS OF LIMITATION ON INTEREST DEDUCTION.—In the case of an acquired entity to which subsection (b) applies, section 163(j) shall be applied—

“(A) without regard to paragraph (2)(A)(ii) thereof, and

“(B) by substituting ‘25 percent’ for ‘50 percent’ each place it appears in paragraph (2)(B) thereof.

“(e) OTHER DEFINITIONS AND SPECIAL RULES.—

For purposes of this section—
“(1) Rules for application of subsection (a)(2).—In applying subsection (a)(2) for purposes of subsections (a) and (b), the following rules shall apply:

“(A) Certain stock disregarded.— There shall not be taken into account in determining ownership for purposes of subsection (a)(2)(B)—

“(i) stock held by members of the expanded affiliated group which includes the foreign incorporated entity, or

“(ii) stock of such entity which is sold in a public offering or private placement related to the acquisition described in subsection (a)(2)(A).

“(B) Plan deemed in certain cases.— If a foreign incorporated entity acquires directly or indirectly substantially all of the properties of a domestic corporation or partnership during the 4-year period beginning on the date which is 2 years before the ownership requirements of subsection (a)(2)(B) are met with respect to such domestic corporation or partnership, such actions shall be treated as pursuant to a plan.
“(C) Certain transfers disregarded.—The transfer of properties or liabilities (including by contribution or distribution) shall be disregarded if such transfers are part of a plan a principal purpose of which is to avoid the purposes of this section.

“(D) Special rule for related partnerships.—For purposes of applying subsection (a)(2) to the acquisition of a domestic partnership, except as provided in regulations, all partnerships which are under common control (within the meaning of section 482) shall be treated as 1 partnership.

“(E) Treatment of certain rights.—The Secretary shall prescribe such regulations as may be necessary—

“(i) to treat warrants, options, contracts to acquire stock, convertible debt instruments, and other similar interests as stock, and

“(ii) to treat stock as not stock.

“(2) Expanded affiliated group.—The term ‘expanded affiliated group’ means an affiliated group as defined in section 1504(a) but without regard to section 1504(b)(3), except that section
1504(a) shall be applied by substituting ‘more than 50 percent’ for ‘at least 80 percent’ each place it appears.

“(3) FOREIGN INCORPORATED ENTITY.—The term ‘foreign incorporated entity’ means any entity which is, or but for subsection (a)(1) would be, treated as a foreign corporation for purposes of this title.

“(4) FOREIGN RELATED PERSON.—The term ‘foreign related person’ means, with respect to any acquired entity, a foreign person which—

“(A) bears a relationship to such entity described in section 267(b) or 707(b), or

“(B) is under the same common control (within the meaning of section 482) as such entity.

“(5) SUBSEQUENT ACQUISITIONS BY UNRELATED DOMESTIC CORPORATIONS.—

“(A) IN GENERAL.—Subject to such conditions, limitations, and exceptions as the Secretary may prescribe, if, after an acquisition described in subsection (a)(2)(A) to which subsection (b) applies, a domestic corporation stock of which is traded on an established securities market acquires directly or indirectly any prop-
erties of one or more acquired entities in a transaction with respect to which the requirements of subparagraph (B) are met, this section shall cease to apply to any such acquired entity with respect to which such requirements are met.

“(B) REQUIREMENTS.—The requirements of the subparagraph are met with respect to a transaction involving any acquisition described in subparagraph (A) if—

“(i) before such transaction the domestic corporation did not have a relationship described in section 267(b) or 707(b), and was not under common control (within the meaning of section 482), with the acquired entity, or any member of an expanded affiliated group including such entity, and

“(ii) after such transaction, such acquired entity—

“(I) is a member of the same expanded affiliated group which includes the domestic corporation or has such a relationship or is under such com-
mon control with any member of such group, and

“(II) is not a member of, and does not have such a relationship and is not under such common control with any member of, the expanded affiliated group which before such acquisition included such entity.

“(f) REGULATIONS.—The Secretary shall provide such regulations as are necessary to carry out this section, including regulations providing for such adjustments to the application of this section as are necessary to prevent the avoidance of the purposes of this section, including the avoidance of such purposes through—

“(1) the use of related persons, pass-through or other noncorporate entities, or other intermediaries, or

“(2) transactions designed to have persons cease to be (or not become) members of expanded affiliated groups or related persons.”.

(b) TREATMENT OF AGREEMENTS.—

(1) CONFIDENTIALITY.—

(A) TREATMENT AS RETURN INFORMATION.—Section 6103(b)(2) (relating to return information) is amended by striking “and” at
the end of subparagraph (C), by inserting
“and” at the end of subparagraph (D), and by
inserting after subparagraph (D) the following
new subparagraph:

“(E) any approval agreement under section
7874(d)(1) to which any preceding subpara-
graph does not apply and any background in-
formation related to the agreement or any ap-
plication for the agreement.”.

(B) Exception from public inspection
as written determination.—Section
6110(b)(1)(B) is amended by striking “or (D)”
and inserting “, (D), or (E)”.

(2) Reporting.—The Secretary of the Treas-
ury shall include with any report on advance pricing
agreements required to be submitted after the date
of the enactment of this Act under section 521(b) of
the Ticket to Work and Work Incentives Improve-
ment Act of 1999 (Public Law 106–170) a report
regarding approval agreements under section
Such report shall include information similar to the
information required with respect to advance pricing
agreements and shall be treated for confidentiality
purposes in the same manner as the reports on ad-
vance pricing agreements are treated under section 521(b)(3) of such Act.

(c) INFORMATION REPORTING.—The Secretary of the Treasury shall exercise the Secretary’s authority under the Internal Revenue Code of 1986 to require entities involved in transactions to which section 7874 of such Code (as added by subsection (a)) applies to report to the Secretary, shareholders, partners, and such other persons as the Secretary may prescribe such information as is necessary to ensure the proper tax treatment of such transactions.

(d) CONFORMING AMENDMENT.—The table of sections for subchapter C of chapter 80 is amended by adding at the end the following new item:

“Sec. 7874. Rules relating to inverted corporate entities.”

(e) TRANSITION RULE FOR CERTAIN REGULATED INVESTMENT COMPANIES AND UNIT INVESTMENT TRUSTS.—Notwithstanding section 7874 of the Internal Revenue Code of 1986 (as added by subsection (a)), a regulated investment company, or other pooled fund or trust specified by the Secretary of the Treasury, may elect to recognize gain by reason of section 367(a) of such Code with respect to a transaction under which a foreign incorporated entity is treated as an inverted domestic corporation under section 7874(a) of such Code by reason of an acquisition completed after March 20, 2002, and before January 1, 2004.
SEC. 342. EXCISE TAX ON STOCK COMPENSATION OF INSITERS IN INVERTED CORPORATIONS.

(a) In General.—Subtitle D is amended by adding at the end the following new chapter:

“CHAPTER 48—STOCK COMPENSATION OF INSITERS IN INVERTED CORPORATIONS

“Sec. 5000A. Stock compensation of insiders in inverted corporations entities.

“SEC. 5000A. STOCK COMPENSATION OF INSITERS IN INVERTED CORPORATIONS.

“(a) Imposition of Tax.—In the case of an individual who is a disqualified individual with respect to any inverted corporation, there is hereby imposed on such person a tax equal to 20 percent of the value (determined under subsection (b)) of the specified stock compensation held (directly or indirectly) by or for the benefit of such individual or a member of such individual’s family (as defined in section 267) at any time during the 12-month period beginning on the date which is 6 months before the inversion date.

“(b) Value.—For purposes of subsection (a)—

“(1) In General.—The value of specified stock compensation shall be—

“(A) in the case of a stock option (or other similar right) or any stock appreciation right, the fair value of such option or right, and
“(B) in any other case, the fair market value of such compensation.

“(2) DATE FOR DETERMINING VALUE.—The determination of value shall be made—

“(A) in the case of specified stock compensation held on the inversion date, on such date,

“(B) in the case of such compensation which is canceled during the 6 months before the inversion date, on the day before such cancellation, and

“(C) in the case of such compensation which is granted after the inversion date, on the date such compensation is granted.

“(c) TAX TO APPLY ONLY IF SHAREHOLDER GAIN RECOGNIZED.—Subsection (a) shall apply to any disqualified individual with respect to an inverted corporation only if gain (if any) on any stock in such corporation is recognized in whole or part by any shareholder by reason of the acquisition referred to in section 7874(a)(2)(A) (determined by substituting ‘July 10, 2002’ for ‘March 20, 2002’) with respect to such corporation.

“(d) EXCEPTION WHERE GAIN RECOGNIZED ON COMPENSATION.—Subsection (a) shall not apply to—
“(1) any stock option which is exercised on the inversion date or during the 6-month period before such date and to the stock acquired in such exercise, and

“(2) any specified stock compensation which is sold, exchanged, or distributed during such period in a transaction in which gain or loss is recognized in full.

“(e) Definitions.—For purposes of this section—

“(1) Disqualified individual.—The term ‘disqualified individual’ means, with respect to a corporation, any individual who, at any time during the 12-month period beginning on the date which is 6 months before the inversion date—

“(A) is subject to the requirements of section 16(a) of the Securities Exchange Act of 1934 with respect to such corporation or any member of the expanded affiliated group which includes such corporation, or

“(B) would be subject to such requirements if such corporation or member were an issuer of equity securities referred to in such section.

“(2) Inverted corporation; inversion date.—
“(A) INVERTED CORPORATION.—The term ‘inverted corporation’ means any corporation to which subsection (a) or (b) of section 7874 applies determined—

“(i) by substituting ‘July 10, 2002’ for ‘March 20, 2002’ in section 7874(a)(2)(A), and

“(ii) without regard to subsection (b)(1)(A).

Such term includes any predecessor or successor of such a corporation.

“(B) INVERSION DATE.—The term ‘inversion date’ means, with respect to a corporation, the date on which the corporation first becomes an inverted corporation.

“(3) SPECIFIED STOCK COMPENSATION.—

“(A) IN GENERAL.—The term ‘specified stock compensation’ means payment (or right to payment) granted by the inverted corporation (or by any member of the expanded affiliated group which includes such corporation) to any person in connection with the performance of services by a disqualified individual for such corporation or member if the value of such payment or right is based on (or determined by ref-
erence to) the value (or change in value) of stock in such corporation (or any such member).

“(B) EXCEPTIONS.—Such term shall not include—

“(i) any option to which part II of subchapter D of chapter 1 applies, or

“(ii) any payment or right to payment from a plan referred to in section 280G(b)(6).

“(4) EXPANDED AFFILIATED GROUP.—The term ‘expanded affiliated group’ means an affiliated group (as defined in section 1504(a) without regard to section 1504(b)(3)); except that section 1504(a) shall be applied by substituting ‘more than 50 percent’ for ‘at least 80 percent’ each place it appears.

“(f) SPECIAL RULES.—For purposes of this section—

“(1) CANCELLATION OF RESTRICTION.—The cancellation of a restriction which by its terms will never lapse shall be treated as a grant.

“(2) PAYMENT OR REIMBURSEMENT OF TAX BY CORPORATION TREATED AS SPECIFIED STOCK COMPENSATION.—Any payment of the tax imposed by this section directly or indirectly by the inverted cor-
poration or by any member of the expanded affiliated group which includes such corporation—

“(A) shall be treated as specified stock compensation, and

“(B) shall not be allowed as a deduction under any provision of chapter 1.

“(3) Certain restrictions ignored.— Whether there is specified stock compensation, and the value thereof, shall be determined without regard to any restriction other than a restriction which by its terms will never lapse.

“(4) Property transfers.—Any transfer of property shall be treated as a payment and any right to a transfer of property shall be treated as a right to a payment.

“(5) Other administrative provisions.— For purposes of subtitle F, any tax imposed by this section shall be treated as a tax imposed by subtitle A.

“(g) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.”.

(b) Denial of deduction.—

(1) In general.—Paragraph (6) of section 275(a) is amended by inserting “48,” after “46,”.
(2) $1,000,000 LIMIT ON DEDUCTIBLE COMPENSATION REDUCED BY PAYMENT OF EXCISE TAX ON SPECIFIED STOCK COMPENSATION.—Paragraph (4) of section 162(m) is amended by adding at the end the following new subparagraph:

“(G) COORDINATION WITH EXCISE TAX ON SPECIFIED STOCK COMPENSATION.—The dollar limitation contained in paragraph (1) with respect to any covered employee shall be reduced (but not below zero) by the amount of any payment (with respect to such employee) of the tax imposed by section 5000A directly or indirectly by the inverted corporation (as defined in such section) or by any member of the expanded affiliated group (as defined in such section) which includes such corporation.”.

(c) CONFORMING AMENDMENTS.—

(1) The last sentence of section 3121(v)(2)(A) is amended by inserting before the period “or to any specified stock compensation (as defined in section 5000A) on which tax is imposed by section 5000A”.

(2) The table of chapters for subtitle D is amended by adding at the end the following new item:

“Chapter 48. Stock compensation of insiders in inverted corporations.”.
(d) **Effective Date.**—The amendments made by this section shall take effect on July 11, 2002; except that periods before such date shall not be taken into account in applying the periods in subsections (a) and (e)(1) of section 5000A of the Internal Revenue Code of 1986, as added by this section.

**SEC. 343. REINSURANCE OF UNITED STATES RISKS IN FOREIGN JURISDICTIONS.**

(a) **In General.**—Section 845(a) (relating to allocation in case of reinsurance agreement involving tax avoidance or evasion) is amended by striking “source and character” and inserting “amount, source, or character”.

(b) **Effective Date.**—The amendments made by this section shall apply to any risk reinsured after April 11, 2002.

**PART II—OTHER PROVISIONS**

**SEC. 344. DOUBLING OF CERTAIN PENALTIES, FINES, AND INTEREST ON UNDERPAYMENTS RELATED TO CERTAIN OFFSHORE FINANCIAL ARRANGEMENT.**

(a) **General Rule.**—If—

(1) a taxpayer eligible to participate in the Department of the Treasury’s Offshore Voluntary Compliance Initiative did not participate in such initiative, and
(2) any interest or applicable penalty is imposed with respect to any arrangement to which such initiative applied or to any underpayment of Federal income tax attributable to items arising in connection with such arrangement,
then, notwithstanding any other provision of law, the amount of such interest or penalty shall be equal to twice that determined without regard to this section.

(b) DEFINITIONS AND RULES.—For purposes of this section—

(1) APPLICABLE PENALTY.—The term “applicable penalty” means any penalty, addition to tax, or fine imposed under chapter 68 of the Internal Revenue Code of 1986.

(2) VOLUNTARY OFFSHORE COMPLIANCE INITIATIVE.—The term “Voluntary Offshore Compliance Initiative” means the program established by the Department of the Treasury in January of 2003 under which any taxpayer was eligible to voluntarily disclose previously undisclosed income on assets placed in offshore accounts and accessed through credit card and other financial arrangements.

(3) PARTICIPATION.—A taxpayer shall be treated as having participated in the Voluntary Offshore Compliance Initiative if the taxpayer submitted the
request in a timely manner and all information re-
quested by the Secretary of the Treasury or his dele-
gate within a reasonable period of time following the
request.

(c) EFFECTIVE DATE.—The provisions of this section
shall apply to interest penalties, additions to tax, and fines
with respect to any taxable year if as of May 8, 2003,
the assessment of any tax, penalty, or interest with respect
to such taxable year is not prevented by the operation of
any law or rule of law.

SEC. 345. EFFECTIVELY CONNECTED INCOME TO INCLUDE
CERTAIN FOREIGN SOURCE INCOME.

(a) IN GENERAL.—Section 864(c)(4)(B) (relating to
treatment of income from sources without the United
States as effectively connected income) is amended by add-
ing at the end the following new flush sentence:

“Any income or gain which is equivalent to any
item of income or gain described in clause (i),
(ii), or (iii) shall be treated in the same manner
as such item for purposes of this subpara-
graph.”.

(b) EFFECTIVE DATE.—The amendment made by
this section shall apply to taxable years beginning after
the date of the enactment of this Act.
SEC. 346. DETERMINATION OF BASIS OF AMOUNTS PAID FROM FOREIGN PENSION PLANS.

(a) In General.—Section 72 (relating to annuities and certain proceeds of endowment and life insurance contracts) is amended by redesignating subsection (w) as subsection (x) by inserting subsection (v) the following new subsection:

“(w) DETERMINATION OF BASIS OF FOREIGN PENSION PLANS.—Notwithstanding any other provision of this section, for purposes of determining the portion of any distribution from a foreign pension plan which is includible in gross income of the distributee, the investment in the contract with respect to the plan shall not include employer or employee contributions to the plan (or any earnings on such contributions) unless such contributions or earnings were subject to taxation by the United States or any foreign government.”.

(b) Effective Date.—The amendments made by this section shall apply to distributions on or after the date of the enactment of this Act.

SEC. 347. RECAPTURE OF OVERALL FOREIGN LOSSES ON SALE OF CONTROLLED FOREIGN CORPORATION.

(a) In General.—Section 904(f)(3) (relating to dispositions) is amending by adding at the end the following new subparagraph:
“(D) Application to dispositions of stock in controlled foreign corporations.—In the case of any disposition by a taxpayer of any share of stock in a controlled foreign corporation (as defined in section 957), this paragraph shall apply to such disposition in the same manner as if it were a disposition of property described in subparagraph (A), except that the exception contained in subparagraph (C)(i) shall not apply.”.

(b) Effective Date.—The amendment made by this section shall apply to dispositions after the date of the enactment of this Act.

SEC. 348. PREVENTION OF MISMATCHING OF INTEREST AND ORIGINAL ISSUE DISCOUNT DEDUCTIONS AND INCOME INCLUSIONS IN TRANSACTIONS WITH RELATED FOREIGN PERSONS.

(a) Original Issue Discount.—Section 163(e)(3) (relating to special rule for original issue discount on obligation held by related foreign person) is amended by redesignating subparagraph (B) as subparagraph (C) and by inserting after subparagraph (A) the following new subparagraph:

“(B) Special rule for certain foreign entities.—Notwithstanding subpara-
graph (A) (and any regulations thereunder), in
the case of any debt instrument having original
issue discount which is held by a related foreign
person which is a foreign personal holding com-
pany (as defined in section 552), a controlled
foreign corporation (as defined in section 957),
or a passive foreign investment company (as de-
defined in section 1297), a deduction shall be al-
lowable to the issuer with respect to such origi-
nal issue discount for any taxable year only to
the extent such original issue discount is in-
cluded during such taxable year in the gross in-
come of a United States person who owns
(within the meaning of section 958(a)) stock in
such corporation. For purposes of this subpara-
graph, the determination as to the proper allo-
cation of the original issue discount to share-
holders shall be made in such manner as the
Secretary may prescribe.”.

(b) INTEREST AND OTHER DEDUCTIBLE
AMOUNTS.—Section 267(a)(3) is amended—

(1) by striking “The Secretary” and inserting:
“(A) IN GENERAL.—The Secretary”, and

(2) by adding at the end the following new sub-
paragraph:
“(B) SPECIAL RULE FOR CERTAIN FOREIGN ENTITIES.—Notwithstanding any regulations issued under subparagraph (A), in the case of any amount payable to a foreign personal holding company (as defined in section 552), a controlled foreign corporation (as defined in section 957), or a passive foreign investment company (as defined in section 1297), a deduction shall be allowable to the payor with respect to such amount for any taxable year only to the extent such amount is included during such taxable year in the gross income of a United States person who owns (within the meaning of section 958(a)) stock in such corporation. For purposes of this subparagraph, the determination as to the proper allocation of such amount to shareholders shall be made in such manner as the Secretary may prescribe.”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to payments accrued on or after May 8, 2003.

SEC. 349. SALE OF GASOLINE AND DIESEL FUEL AT DUTY-FREE SALES ENTERPRISES.

(a) PROHIBITION.—Section 555(b) of the Tariff Act of 1930 (19 U.S.C. 1555(b)) is amended—
(1) by redesignating paragraphs (6) through (8) as paragraphs (7) through (9), respectively; and

(2) by inserting after paragraph (5) the following:

“(6) Any gasoline or diesel fuel sold at a duty-free sales enterprise shall be considered to be entered for consumption into the customs territory of the United States.”.

(b) CONSTRUCTION.—The amendments made by this section shall not be construed to create any inference with respect to the interpretation of any provision of law as such provision was in effect on the day before the date of enactment of this Act.

(e) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of enactment of this Act.

SEC. 350. REPEAL OF EARNED INCOME EXCLUSION OF CITIZENS OR RESIDENTS LIVING ABROAD.

(a) REPEAL.—Section 911 (relating to citizens or residents living abroad) is amended by adding at the end the following new subsection:

“(g) TERMINATION.—This section shall not apply to any taxable year beginning after December 31, 2003.”.
(b) EFFECTIVE DATE.—The amendments made by
this section shall apply to taxable years beginning after

Subtitle E—Other Revenue
Provisions

SEC. 351. EXTENSION OF INTERNAL REVENUE SERVICE
USER FEES.

(a) IN GENERAL.—Chapter 77 (relating to miscella-
neous provisions) is amended by adding at the end the
following new section:

"SEC. 7528. INTERNAL REVENUE SERVICE USER FEES.

"(a) GENERAL RULE.—The Secretary shall establish
a program requiring the payment of user fees for—

"(1) requests to the Internal Revenue Service
for ruling letters, opinion letters, and determination
letters, and

"(2) other similar requests.

"(b) PROGRAM CRITERIA.—

"(1) IN GENERAL.—The fees charged under the
program required by subsection (a)—

"(A) shall vary according to categories (or
subcategories) established by the Secretary,

"(B) shall be determined after taking into
account the average time for (and difficulty of)
complying with requests in each category (and subcategory), and

“(C) shall be payable in advance.

“(2) EXEMPTIONS, ETC.—

“(A) IN GENERAL.—The Secretary shall provide for such exemptions (and reduced fees) under such program as the Secretary determines to be appropriate.

“(B) EXEMPTION FOR CERTAIN REQUESTS REGARDING PENSION PLANS.—The Secretary shall not require payment of user fees under such program for requests for determination letters with respect to the qualified status of a pension benefit plan maintained solely by 1 or more eligible employers or any trust which is part of the plan. The preceding sentence shall not apply to any request—

“(i) made after the later of—

“(I) the fifth plan year the pension benefit plan is in existence, or

“(II) the end of any remedial amendment period with respect to the plan beginning within the first 5 plan years, or
“(ii) made by the sponsor of any prototype or similar plan which the sponsor intends to market to participating employers.

“(C) Definitions and special rules.—

For purposes of subparagraph (B)—

“(i) Pension benefit plan.—The term ‘pension benefit plan’ means a pension, profit-sharing, stock bonus, annuity, or employee stock ownership plan.

“(ii) Eligible employer.—The term ‘eligible employer’ means an eligible employer (as defined in section 408(p)(2)(C)(i)(I)) which has at least 1 employee who is not a highly compensated employee (as defined in section 414(q)) and is participating in the plan. The determination of whether an employer is an eligible employer under subparagraph (B) shall be made as of the date of the request described in such subparagraph.

“(iii) Determination of average fees charged.—For purposes of any determination of average fees charged, any
request to which subparagraph (B) applies shall not be taken into account.

“(3) AVERAGE FEE REQUIREMENT.—The average fee charged under the program required by subsection (a) shall not be less than the amount determined under the following table:

<table>
<thead>
<tr>
<th>Category</th>
<th>Average Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee plan ruling and opinion</td>
<td>$250</td>
</tr>
<tr>
<td>Exempt organization ruling</td>
<td>$350</td>
</tr>
<tr>
<td>Employee plan determination</td>
<td>$300</td>
</tr>
<tr>
<td>Exempt organization determination</td>
<td>$275</td>
</tr>
<tr>
<td>Chief counsel ruling</td>
<td>$200</td>
</tr>
</tbody>
</table>

“(c) TERMINATION.—No fee shall be imposed under this section with respect to requests made after September 30, 2013.”.

(b) CONFORMING AMENDMENTS.—

(1) The table of sections for chapter 77 is amended by adding at the end the following new item:

“Sec. 7528. Internal Revenue Service user fees.”.

(2) Section 10511 of the Revenue Act of 1987 is repealed.

(3) Section 620 of the Economic Growth and Tax Relief Reconciliation Act of 2001 is repealed.

(e) LIMITATIONS.—Notwithstanding any other provision of law, any fees collected pursuant to section 7528 of the Internal Revenue Code of 1986, as added by sub-
section (a), shall not be expended by the Internal Revenue
Service unless provided by an appropriations Act.

(d) Effective Date.—The amendments made by
this section shall apply to requests made after the date
of the enactment of this Act.

SEC. 352. ADDITION OF VACCINES AGAINST HEPATITIS A
TO LIST OF TAXABLE VACCINES.

(a) In General.—Section 4132(a)(1) (defining tax-
able vaccine) is amended by redesignating subparagraphs
(I), (J), (K), and (L) as subparagraphs (J), (K), (L), and
(M), respectively, and by inserting after subparagraph (H)
the following new subparagraph:

“(I) Any vaccine against hepatitis A.”.

(b) Conforming Amendment.—Section
9510(c)(1)(A) is amended by striking “October 18, 2000”
and inserting “May 8, 2003”.

(c) Effective Date.—

(1) Sales, Etc.—The amendments made by
this section shall apply to sales and uses on or after
the first day of the first month which begins more
than 4 weeks after the date of the enactment of this
Act.

(2) Deliveries.—For purposes of paragraph
(1) and section 4131 of the Internal Revenue Code
of 1986, in the case of sales on or before the effec-
tive date described in such paragraph for which de-
livery is made after such date, the delivery date shall
be considered the sale date.

SEC. 353. DISALLOWANCE OF CERTAIN PARTNERSHIP LOSS
TRANSFERS.

(a) Treatment of Contributed Property With
Built-In Loss.—Paragraph (1) of section 704(c) is
amended by striking “and” at the end of subparagraph
(A), by striking the period at the end of subparagraph
(B) and inserting “, and”, and by adding at the end the
following:

“(C) if any property so contributed has a
built-in loss—

“(i) such built-in loss shall be taken
into account only in determining the
amount of items allocated to the contrib-
uting partner, and

“(ii) except as provided in regulations,
in determining the amount of items allo-
cated to other partners, the basis of the
contributed property in the hands of the
partnership shall be treated as being equal
to its fair market value immediately after
the contribution.
For purposes of subparagraph (C), the term ‘built-in loss’ means the excess of the adjusted basis of the property (determined without regard to subparagraph (C)(ii)) over its fair market value immediately after the contribution.”.

(b) ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY ON TRANSFER OF PARTNERSHIP INTEREST IF THERE IS SUBSTANTIAL BUILT-IN LOSS.—

(1) ADJUSTMENT REQUIRED.—Subsection (a) of section 743 (relating to optional adjustment to basis of partnership property) is amended by inserting before the period “or unless the partnership has a substantial built-in loss immediately after such transfer”.

(2) ADJUSTMENT.—Subsection (b) of section 743 is amended by inserting “or with respect to which there is a substantial built-in loss immediately after such transfer” after “section 754 is in effect”.

(3) SUBSTANTIAL BUILT-IN LOSS.—Section 743 is amended by adding at the end the following new subsection:

“(d) SUBSTANTIAL BUILT-IN LOSS.—

“(1) IN GENERAL.—For purposes of this section, a partnership has a substantial built-in loss with respect to a transfer of an interest in a part-
nership if the transferee partner’s proportionate share of the adjusted basis of the partnership property exceeds by more than $250,000 the basis of such partner’s interest in the partnership.

“(2) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of paragraph (1) and section 734(d), including regulations aggregating related partnerships and disregarding property acquired by the partnership in an attempt to avoid such purposes.”.

(4) CLERICAL AMENDMENTS.—

(A) The section heading for section 743 is amended to read as follows:

“SEC. 743. ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY WHERE SECTION 754 ELECTION OR SUBSTANTIAL BUILT-IN LOSS.”.

(B) The table of sections for subpart C of part II of subchapter K of chapter 1 is amended by striking the item relating to section 743 and inserting the following new item:

“Sec. 743. Adjustment to basis of partnership property where section 754 election or substantial built-in loss.”.

(c) ADJUSTMENT TO BASIS OF UNDISTRIBUTED PARTNERSHIP PROPERTY IF THERE IS SUBSTANTIAL BASIS REDUCTION.—
(1) Adjustment Required.—Subsection (a) of section 734 (relating to optional adjustment to basis of undistributed partnership property) is amended by inserting before the period “or unless there is a substantial basis reduction”.

(2) Adjustment.—Subsection (b) of section 734 is amended by inserting “or unless there is a substantial basis reduction” after “section 754 is in effect”.

(3) Substantial Basis Reduction.—Section 734 is amended by adding at the end the following new subsection:

“(d) Substantial Basis Reduction.—

“(1) In General.—For purposes of this section, there is a substantial basis reduction with respect to a distribution if the sum of the amounts described in subparagraphs (A) and (B) of subsection (b)(2) exceeds $250,000.

“(2) Regulations.—

“For regulations to carry out this subsection, see section 743(d)(2).”.

(4) Clerical Amendments.—

(A) The section heading for section 734 is amended to read as follows:
“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED PARTNERSHIP PROPERTY WHERE SECTION 754 ELECTION OR SUBSTANTIAL BASIS REDUCTION.”.

(B) The table of sections for subpart B of part II of subchapter K of chapter 1 is amended by striking the item relating to section 734 and inserting the following new item:

“Sec. 734. Adjustment to basis of undistributed partnership property where section 754 election or substantial basis reduction.”.

(d) Effective Dates.—

(1) Subsection (a).—The amendment made by subsection (a) shall apply to contributions made after the date of the enactment of this Act.

(2) Subsection (b).—The amendments made by subsection (b) shall apply to transfers after the date of the enactment of this Act.

(3) Subsection (c).—The amendments made by subsection (c) shall apply to distributions after the date of the enactment of this Act.

SEC. 354. TREATMENT OF STRIPPED INTERESTS IN BOND AND PREFERRED STOCK FUNDS, ETC.

(a) In General.—Section 1286 (relating to tax treatment of stripped bonds) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (c) the following new subsection:
“(f) Treatment of Stripped Interests in Bond and Preferred Stock Funds, Etc.—In the case of an account or entity substantially all of the assets of which consist of bonds, preferred stock, or a combination thereof, the Secretary may by regulations provide that rules similar to the rules of this section and 305(e), as appropriate, shall apply to interests in such account or entity to which (but for this subsection) this section or section 305(e), as the case may be, would not apply.”.

(b) Cross Reference.—Subsection (e) of section 305 is amended by adding at the end the following new paragraph:

“(7) Cross reference.—

“For treatment of stripped interests in certain accounts or entities holding preferred stock, see section 1286(f).”.

(c) Effective Date.—The amendments made by this section shall apply to purchases and dispositions after the date of the enactment of this Act.

SEC. 355. Reporting of Taxable Mergers and Acquisitions.

(a) In General.—Subpart B of part III of subchapter A of chapter 61 is amended by inserting after section 6043 the following new section:

“SEC. 6043A. Taxable Mergers and Acquisitions.

“(a) In General.—The acquiring corporation in any taxable acquisition shall make a return (according to the
forms or regulations prescribed by the Secretary) setting forth—

“(1) a description of the acquisition,

“(2) the name and address of each shareholder of the acquired corporation who is required to recognize gain (if any) as a result of the acquisition,

“(3) the amount of money and the fair market value of other property transferred to each such shareholder as part of such acquisition, and

“(4) such other information as the Secretary may prescribe.

To the extent provided by the Secretary, the requirements of this section applicable to the acquiring corporation shall be applicable to the acquired corporation and not to the acquiring corporation.

“(b) NOMINEE REPORTING.—Any person who holds stock as a nominee for another person shall furnish in the manner prescribed by the Secretary to such other person the information provided by the corporation under subsection (d).

“(c) TAXABLE ACQUISITION.—For purposes of this section, the term ‘taxable acquisition’ means any acquisition by a corporation of stock in or property of another corporation if any shareholder of the acquired corporation
is required to recognize gain (if any) as a result of such
acquisition.

“(d) Statements to Be Furnished to Share-
holders.—Every person required to make a return under
subsection (a) shall furnish to each shareholder whose
name is required to be set forth in such return a written
statement showing—

“(1) the name, address, and phone number of
the information contact of the person required to
make such return,

“(2) the information required to be shown on
such return with respect to such shareholder, and

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

The written statement required under the preceding sen-
tence shall be furnished to the shareholder on or before
January 31 of the year following the calendar year during
which the taxable acquisition occurred.”.

(b) Assessable Penalties.—

(1) Subparagraph (B) of section 6724(d)(1)
(relating to definitions) is amended by redesignating
clauses (ii) through (xvii) as clauses (iii) through
(xviii), respectively, and by inserting after clause (i)
the following new clause:
“(ii) section 6043A(a) (relating to returns relating to taxable mergers and acquisitions),”.

(2) Paragraph (2) of section 6724(d) is amended by redesignating subparagraphs (F) through (AA) as subparagraphs (G) through (BB), respectively, and by inserting after subparagraph (E) the following new subparagraph:

“(F) subsections (b) and (d) of section 6043A (relating to returns relating to taxable mergers and acquisitions).”.

(c) Clerical Amendment.—The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by inserting after the item relating to section 6043 the following new item:

“Sec. 6043A. Returns relating to taxable mergers and acquisitions.”.

(d) Effective Date.—The amendments made by this section shall apply to acquisitions after the date of the enactment of this Act.

SEC. 356. MINIMUM HOLDING PERIOD FOR FOREIGN TAX CREDIT ON WITHHOLDING TAXES ON INCOME OTHER THAN DIVIDENDS.

(a) In General.—Section 901 is amended by redesignating subsection (l) as subsection (m) and by inserting after subsection (k) the following new subsection:
“(l) Minimum Holding Period for Withholding Taxes on Gain and Income Other than Dividends Etc.—

“(1) In general.—In no event shall a credit be allowed under subsection (a) for any withholding tax (as defined in subsection (k)) on any item of income or gain with respect to any property if—

“(A) such property is held by the recipient of the item for 15 days or less during the 30-day period beginning on the date which is 15 days before the date on which the right to receive payment of such item arises, or

“(B) to the extent that the recipient of the item is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

This paragraph shall not apply to any dividend to which subsection (k) applies.

“(2) Exception for taxes paid by dealers.—

“(A) In general.—Paragraph (1) shall not apply to any qualified tax with respect to any property held in the active conduct in a for-
eign country of a business as a dealer in such property.

“(B) QUALIFIED TAX.—For purposes of subparagraph (A), the term ‘qualified tax’ means a tax paid to a foreign country (other than the foreign country referred to in subparagraph (A)) if—

“(i) the item to which such tax is attributable is subject to taxation on a net basis by the country referred to in subparagraph (A), and

“(ii) such country allows a credit against its net basis tax for the full amount of the tax paid to such other foreign country.

“(C) DEALER.—For purposes of subparagraph (A), the term ‘dealer’ means—

“(i) with respect to a security, any person to whom paragraphs (1) and (2) of subsection (k) would not apply by reason of paragraph (4) thereof if such security were stock, and

“(ii) with respect to any other property, any person with respect to whom
such property is described in section 1221(a)(1).

“(D) Regulations.—The Secretary may prescribe such regulations as may be appropriate to carry out this paragraph, including regulations to prevent the abuse of the exception provided by this paragraph and to treat other taxes as qualified taxes.

“(3) Exceptions.—The Secretary may by regulation provide that paragraph (1) shall not apply to property where the Secretary determines that the application of paragraph (1) to such property is not necessary to carry out the purposes of this subsection.

“(4) Certain rules to apply.—Rules similar to the rules of paragraphs (5), (6), and (7) of subsection (k) shall apply for purposes of this subsection.

“(5) Determination of holding period.—Holding periods shall be determined for purposes of this subsection without regard to section 1235 or any similar rule.”.

(b) Conforming Amendment.—The heading of subsection (k) of section 901 is amended by inserting “On Dividends” after “Taxes”.

•S 1054 PCS
(c) **Effective Date.**—The amendments made by this section shall apply to amounts paid or accrued more than 30 days after the date of the enactment of this Act.

**SEC. 357. QUALIFIED TAX COLLECTION CONTRACTS.**

(a) **Contract Requirements.**—

(1) **In General.**—Subchapter A of chapter 64 (relating to collection) is amended by adding at the end the following new section:

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"SEC. 6306. QUALIFIED TAX COLLECTION CONTRACTS.

"(a) In General.—Nothing in any provision of law shall be construed to prevent the Secretary from entering into a qualified tax collection contract.

"(b) Qualified Tax Collection Contract.—For purposes of this section, the term ‘qualified tax collection contract’ means any contract which—

"(1) is for the services of any person (other than an officer or employee of the Treasury Department) to locate and contact any taxpayer specified by the Secretary, to request payment from such taxpayer of an amount of Federal tax specified by the Secretary, and to obtain financial information specified by the Secretary with respect to such taxpayer, and

"(2) prohibits each person providing such services under such contract from committing any act or
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omission which employees of the Internal Revenue Service are prohibited from committing in the performance of similar services.

“(c) Fees.—The Secretary may retain and use an amount not in excess of 25 percent of the amount collected under any qualified tax collection contract for the costs of services performed under such contract. The Secretary shall keep adequate records regarding amounts so retained and used. The amount credited as paid by any taxpayer shall be determined without regard to this subsection.

“(d) No Federal Liability.—The United States shall not be liable for any act or omission of any person performing services under a qualified tax collection contract.


“(f) Cross References.—

“(1) For damages for certain unauthorized collection actions by persons performing services under a qualified tax collection contract, see section 7433A.
“(2) For application of Taxpayer Assistance Orders to persons performing services under a qualified tax collection contract, see section 7811(a)(4).”.

(2) CONFORMING AMENDMENTS.—

(A) Section 7809(a) is amended by inserting “6306,” before “7651”.

(B) The table of sections for subchapter A of chapter 64 is amended by adding at the end the following new item:

“Sec. 6306. Qualified Tax Collection Contracts.”.

(b) CIVIL DAMAGES FOR CERTAIN UNAUTHORIZED COLLECTION ACTIONS BY PERSONS PERFORMING SERVICES UNDER QUALIFIED TAX COLLECTION CONTRACTS.—

(1) IN GENERAL.—Subchapter B of chapter 76 (relating to proceedings by taxpayers and third parties) is amended by inserting after section 7433 the following new section:

“SEC. 7433A. CIVIL DAMAGES FOR CERTAIN UNAUTHORIZED COLLECTION ACTIONS BY PERSONS PERFORMING SERVICES UNDER QUALIFIED TAX COLLECTION CONTRACTS.

“(a) IN GENERAL.—Subject to the modifications provided by subsection (b), section 7433 shall apply to the acts and omissions of any person performing services under a qualified tax collection contract (as defined in sec-
tion 6306(b)) to the same extent and in the same manner as if such person were an employee of the Internal Revenue Service.

“(b) Modifications.—For purposes of subsection (a)—

“(1) Any civil action brought under section 7433 by reason of this section shall be brought against the person who entered into the qualified tax collection contract with the Secretary and shall not be brought against the United States.

“(2) Such person and not the United States shall be liable for any damages and costs determined in such civil action.

“(3) Such civil action shall not be an exclusive remedy with respect to such person.

“(4) Subsections (c) and (d)(1) of section 7433 shall not apply.”.

(2) Clerical Amendment.—The table of sections for subchapter B of chapter 76 is amended by inserting after the item relating to section 7433 the following new item:

“Sec. 7433A. Civil damages for certain unauthorized collection actions by persons performing services under a qualified tax collection contract.”.

(c) Application of Taxpayer Assistance Orders to Persons Performing Services Under a Qualified Tax Collection Contract.—Section 7811
(relating to taxpayer assistance orders) is amended by adding at the end the following new subsection:

“(g) Application to Persons Performing Services Under a Qualified Tax Collection Contract.—Any order issued or action taken by the National Taxpayer Advocate pursuant to this section shall apply to persons performing services under a qualified tax collection contract (as defined in section 6306(b)) to the same extent and in the same manner as such order or action applies to the Secretary.”.

(d) Ineligibility of Individuals Who Commit Misconduct to Perform Under Contract.—Section 1203 of the Internal Revenue Service Restructuring Act of 1998 (relating to termination of employment for misconduct) is amended by adding at the end the following new subsection:

“(e) Individuals Performing Services Under a Qualified Tax Collection Contract.—An individual shall cease to be permitted to perform any services under any qualified tax collection contract (as defined in section 6306(b) of the Internal Revenue Code of 1986) if there is a final determination by the Secretary of the Treasury under such contract that such individual committed any act or omission described under subsection (b) in connection with the performance of such services.”.
(c) Effective Date.—The amendments made to this section shall take effect on the date of the enactment of this Act.

SEC. 358. EXTENSION OF CUSTOMS USER FEES.


SEC. 359. CLARIFICATION OF EXEMPTION FROM TAX FOR SMALL PROPERTY AND CASUALTY INSURANCE COMPANIES.

(a) In General.—Section 501(c)(15)(A) is amended to read as follows:

“(A) Insurance companies or associations other than life (including interinsurers and reciprocal underwriters) if—

“(i) the gross receipts for the taxable year do not exceed $600,000, and

“(ii) more than 50 percent of such gross receipts consist of premiums.”.

(b) Controlled Group Rule.—Section 501(c)(15)(C) is amended by inserting “, except that in applying section 1563 for purposes of section 831(b)(2)(B)(ii), subparagraphs (B) and (C) of section
1563(b)(2) shall be disregarded” before the period at the end.

(c) CONFORMING AMENDMENT.—Clause (i) of section 831(b)(2)(A) is amended by striking “exceed $350,000 but”.

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

SEC. 360. PARTIAL PAYMENT OF TAX LIABILITY IN INSTALLMENT AGREEMENTS.

(a) IN GENERAL.—

(1) Section 6159(a) (relating to authorization of agreements) is amended—

(A) by striking “satisfy liability for payment of” and inserting “make payment on”,

and

(B) by inserting “full or partial” after “facilitate”.

(2) Section 6159(c) (relating to Secretary required to enter into installment agreements in certain cases) is amended in the matter preceding paragraph (1) by inserting “full” before “payment”.

(b) REQUIREMENT TO REVIEW PARTIAL PAYMENT AGREEMENTS EVERY TWO YEARS.—Section 6159 is amended by redesignating subsections (d) and (e) as sub-
sections (e) and (f), respectively, and inserting after subsection (e) the following new subsection:

“(d) Secretary Required To Review Installment Agreements for Partial Collection Every Two Years.—In the case of an agreement entered into by the Secretary under subsection (a) for partial collection of a tax liability, the Secretary shall review the agreement at least once every 2 years.”.

(e) Effective Date.—The amendments made by this section shall apply to agreements entered into on or after the date of the enactment of this Act.

SEC. 361. EXTENSION OF AMORTIZATION OF INTANGIBLES TO SPORTS FRANCHISES.

(a) In General.—Section 197(e) (relating to exceptions to definition of section 197 intangible) is amended by striking paragraph (6) and by redesignating paragraphs (7) and (8) as paragraphs (6) and (7), respectively.

(b) Conforming Amendments.—

(1)(A) Section 1056 (relating to basis limitation for player contracts transferred in connection with the sale of a franchise) is repealed.

(B) The table of sections for part IV of subchapter O of chapter 1 is amended by striking the item relating to section 1056.
(2) Section 1253 (relating to transfers of franchises, trademarks, and trade names) is amended by striking subsection (e).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property acquired after the date of the enactment of this Act.

SEC. 362. DEPOSITS MADE TO SUSPEND RUNNING OF INTEREST ON POTENTIAL UNDERPAYMENTS.

(a) IN GENERAL.—Subchapter A of chapter 67 (relating to interest on underpayments) is amended by adding at the end the following new section:

"SEC. 6603. DEPOSITS MADE TO SUSPEND RUNNING OF INTEREST ON POTENTIAL UNDERPAYMENTS, ETC.

"(a) Authority To Make Deposits Other Than As Payment Of Tax.—A taxpayer may make a cash deposit with the Secretary which may be used by the Secretary to pay any tax imposed under subtitle A or B or chapter 41, 42, 43, or 44 which has not been assessed at the time of the deposit. Such a deposit shall be made in such manner as the Secretary shall prescribe.

"(b) No Interest Imposed.—To the extent that such deposit is used by the Secretary to pay tax, for purposes of section 6601 (relating to interest on underpay-
ments), the tax shall be treated as paid when the deposit is made.

"(c) Return of Deposit.—Except in a case where the Secretary determines that collection of tax is in jeopardy, the Secretary shall return to the taxpayer any amount of the deposit (to the extent not used for a payment of tax) which the taxpayer requests in writing.

"(d) Payment of Interest.—

"(1) In general.—For purposes of section 6611 (relating to interest on overpayments), a deposit which is returned to a taxpayer shall be treated as a payment of tax for any period to the extent (and only to the extent) attributable to a disputable tax for such period. Under regulations prescribed by the Secretary, rules similar to the rules of section 6611(b)(2) shall apply.

"(2) Disputable Tax.—

"(A) In general.—For purposes of this section, the term ‘disputable tax’ means the amount of tax specified at the time of the deposit as the taxpayer’s reasonable estimate of the maximum amount of any tax attributable to disputable items.

"(B) Safe Harbor Based on 30-Day Letter.—In the case of a taxpayer who has
been issued a 30-day letter, the maximum amount of tax under subparagraph (A) shall not be less than the amount of the proposed deficiency specified in such letter.

“(3) OTHER DEFINITIONS.—For purposes of paragraph (2)—

“(A) DISPUTABLE ITEM.—The term ‘disputable item’ means any item of income, gain, loss, deduction, or credit if the taxpayer—

“(i) has a reasonable basis for its treatment of such item, and

“(ii) reasonably believes that the Secretary also has a reasonable basis for disallowing the taxpayer’s treatment of such item.

“(B) 30-DAY LETTER.—The term ‘30-day letter’ means the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

“(4) RATE OF INTEREST.—The rate of interest allowable under this subsection shall be the Federal short-term rate determined under section 6621(b), compounded daily.

“(e) USE OF DEPOSITS.—
“(1) PAYMENT OF TAX.—Except as otherwise provided by the taxpayer, deposits shall be treated as used for the payment of tax in the order deposited.

“(2) RETURNS OF DEPOSITS.—Deposits shall be treated as returned to the taxpayer on a last-in, first-out basis.”.

(b) CLERICAL AMENDMENT.—The table of sections for subchapter A of chapter 67 is amended by adding at the end the following new item:

“Sec. 6603. Deposits made to suspend running of interest on potential underpayments, etc.”.

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to deposits made after the date of the enactment of this Act.

(2) COORDINATION WITH DEPOSITS MADE UNDER REVENUE PROCEDURE 84–58.—In the case of an amount held by the Secretary of the Treasury or his delegate on the date of the enactment of this Act as a deposit in the nature of a cash bond deposit pursuant to Revenue Procedure 84–58, the date that the taxpayer identifies such amount as a deposit made pursuant to section 6603 of the Internal Revenue Code (as added by this Act) shall be treated as
the date such amount is deposited for purposes of
such section 6603.

SEC. 363. CLARIFICATION OF RULES FOR PAYMENT OF ESTIMATED TAX FOR CERTAIN DEEMED ASSET SALES.

(a) IN GENERAL.—Paragraph (13) of section 338(h) (relating to tax on deemed sale not taken into account for estimated tax purposes) is amended by adding at the end the following: “The preceding sentence shall not apply with respect to a qualified stock purchase for which an election is made under paragraph (10).”.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to transactions occurring after the date of the enactment of this Act.

SEC. 364. LIMITATION OF DEDUCTION FOR CHARITABLE CONTRIBUTIONS OF PATENTS AND SIMILAR PROPERTY.

(a) IN GENERAL.—Section 170(e)(1)(B) (relating to certain contributions of ordinary income and capital gain property) is amended by striking “or” at the end of clause (i), by adding “or” at the end of clause (ii), and by inserting after clause (ii) the following new clause:

“(iii) of any patent, copyright, trade-mark, trade name, trade secret, know-how,
software, or similar property, or applications or registrations of such property,”.

(b) Anti-Abuse Rules.—The Secretary of the Treasury may prescribe such regulations or other administrative guidance as may be necessary or appropriate to prevent the avoidance of the purposes of section 170(e)(1)(B)(iii) of the Internal Revenue Code of 1986 (as added by subsection (a)), including preventing—

(1) the circumvention of the reduction of the charitable deduction by embedding or bundling the patent or similar property as part of a charitable contribution of property that includes the patent or similar property,

(2) the manipulation of the basis of the property to increase the amount of the charitable deduction through the use of related persons, pass-thru entities, or other intermediaries, or through the use of any provision of law or regulation (including the consolidated return regulations), and

(3) a donor from changing the form of the patent or similar property to property of a form for which different deduction rules would apply.

(e) Effective Date.—The amendments made by this section shall apply to contributions made after May 7, 2003.
SEC. 365. EXTENSION OF TRANSFERS OF EXCESS PENSION ASSETS TO RETIREE HEALTH ACCOUNTS.

(a) Amendment of Internal Revenue Code of 1986.—Paragraph (5) of section 420(b) (relating to expiration) is amended by striking “December 31, 2005” and inserting “December 31, 2013”.

(b) Amendments of ERISA.—


(2) Section 403(c)(1) of such Act (29 U.S.C. 1103(c)(1)) is amended by striking “Tax Relief Extension Act of 1999” and inserting “Jobs and Growth Tax Relief Reconciliation Act of 2003”.

(3) Paragraph (13) of section 408(b) of such Act (29 U.S.C. 1108(b)(3)) is amended—

(A) by striking “January 1, 2006” and inserting “January 1, 2014”, and

(B) by striking “Tax Relief Extension Act of 1999” and inserting “Jobs and Growth Tax Relief Reconciliation Act of 2003”.

•S 1054 PCS
SEC. 366. PRORATION RULES FOR LIFE INSURANCE BUSINESS OF PROPERTY AND CASUALTY INSURANCE COMPANIES.

(a) In General.—Section 832(b)(4) (defining premiums earned) is amended—

(1) by inserting “, except that any deduction attributable to such reserves shall be reduced in the same manner as the deductions provided by sections 243, 244, and 245 for a life insurance company are reduced under section 805(a)(4)” before the period at the end of the first sentence following subparagraph (C), and

(2) by adding at the end the following new sentence: “In applying section 812(d) for purposes of the reduction under the third preceding sentence, only gross investment income attributable to the reserves described in such sentence shall be taken into account.”.

(b) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 2003.

SEC. 367. MODIFICATION OF TREATMENT OF TRANSFERS TO CREDITORS IN DIVISIVE REORGANIZATIONS.

(a) In General.—Section 361(b)(3) (relating to treatment of transfers to creditors) is amended by adding
at the end the following new sentence: “In the case of a reorganization described in section 368(a)(1)(D) with respect to which stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 355, this paragraph shall apply only to the extent that the money or other property transferred to such creditors does not exceed the adjusted bases of such assets transferred.”.

(b) Liabilities in Excess of Basis.—Section 357(c)(1)(B) is amended by inserting “with respect to which stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 355” after “section 368(a)(1)(D)”.

(c) Effective Date.—The amendments made by this section shall apply to transfers of money or other property, or liabilities assumed, in connection with a reorganization occurring on or after the date of the enactment of this Act.

Subtitle F—Other Provisions

SEC. 371. TEMPORARY STATE FISCAL RELIEF FUND.

(a) Authority To Make Payments To States.—

(1) In general.—Not later than 45 days after the date of enactment of this Act, the Secretary of the Treasury (in this section referred to as the “Sec-
(2) REQUIREMENT.—In making payments to States under this section, the Secretary shall ensure that not more than 50 percent of the aggregate amount made available for payments under this section (after the application of section 1903(x)(3) of the Social Security Act) is paid to States in fiscal year 2003.

(b) USE OF PAYMENT.—

(1) IN GENERAL.—Subject to paragraph (2), a State shall use the funds provided under a payment made under this section to carry out 1 or more of the following activities:

(A) Improving education or job training.

(B) Improving health care services.

(C) Improving transportation or other infrastructure.
(D) Improving law enforcement or public safety.

(E) Maintaining essential government services.

(2) LIMITATION.—A State may only use funds provided under a payment made under this section for types of expenditures permitted under the most recently approved budget for the State.

(e) CERTIFICATIONS.—In order to receive a payment under this section, the State shall provide the Secretary with certifications that—

(1) the State’s proposed uses of the funds are consistent with subsection (b); and

(2) the State will allocate 50 percent of the funds directly to units of general local government based on the relative local population proportion for the State (as defined in subsection (d)(5)).

(d) AMOUNT OF PAYMENT.—

(1) IN GENERAL.—The amount of payment made to a State under this section shall be the minimum payment amount described in paragraph (2) plus the relative population proportion amount described in paragraph (3).
(2) MINIMUM PAYMENT AMOUNT.—The minimum payment amount described in this paragraph is—

(A) in the case of any of the several States or the District of Columbia, one-half of 1 percent of the aggregate amount made available for payments under this section (after the application of section 1903(x)(3) of the Social Security Act); and

(B) in the case of the Commonwealth of Puerto Rico, the United States Virgin Islands, Guam, the Commonwealth of the Northern Mariana Islands, or American Samoa, one-tenth of 1 percent of such aggregate amount (after the application of section 1903(x)(3) of the Social Security Act).

(3) RELATIVE POPULATION PROPORTION AMOUNT.—The relative population proportion amount described in this paragraph is the product of—

(A) the aggregate amount made available for payments under this section (after the application of section 1903(x)(3) of the Social Security Act) minus the total of all of the min-
imum payment amounts determined under paragraph (2); and

(B) the relative State population proportion (as defined in paragraph (4)).

(4) RELATIVE STATE POPULATION PROPORTION DEFINED.—In this section, the term “relative State population proportion” means, with respect to a State, the amount equal to the quotient of—

(A) the population of the State (as reported in the most recent decennial census); and

(B) the total population of all States (as reported in the most recent decennial census).

(5) RELATIVE LOCAL POPULATION PROPORTION DEFINED.—In this section, the term “relative local population proportion” means, with respect to a unit of general local government within a State, the amount equal to the quotient of—

(A) the population of such unit of general local government (as reported in the most recent decennial census); and

(B) the total population of the State (as reported in the most recent decennial census).

(e) APPROPRIATION.—There is authorized to be appropriated and is appropriated for making payments
under this section, $20,000,000,000 for fiscal year 2003. Amounts appropriated under this subsection shall remain available for expenditure through December 31, 2004.

(f) **INCREASED PAYMENTS TO STATES UNDER THE MEDICAID PROGRAM.**—Section 1903 of the Social Security Act (42 U.S.C. 1396b) is amended by adding at the end the following:

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“(x) TEMPORARY INCREASED PAYMENTS TO STATES.—

“(1) IN GENERAL.—From the amounts made available under paragraph (3), the Secretary shall increase payments to States under this section for the third and fourth calendar quarters of fiscal year 2003, each calendar quarter of fiscal year 2004, and the first calendar quarter of fiscal year 2005.

“(2) METHOD OF INCREASE.—The Secretary shall determine the appropriate method for increasing payments to States in accordance with this subsection.

“(3) FUNDING.—Notwithstanding section 371(e) of the Jobs and Growth Tax Relief Reconciliation Act of 2003, from the amounts appropriated in such section for fiscal year 2003, $499,999 of such amount is hereby transferred and made available for the purpose of increasing payments to
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States under this section in accordance with this subsection. Amounts transferred under this para-
graph shall remain available for expenditure through December 31, 2004.”.

(g) REPEAL.—Effective as of January 1, 2005, this section and the amendments made by this section are re-
pealed.

**SEC. 372. REVIEW OF STATE AGENCY BLINDNESS AND DIS-
ABILITY DETERMINATIONS.**

Section 1633 of the Social Security Act (42 U.S.C. 1383b) is amended by adding at the end the following:

“(e)(1) The Commissioner of Social Security shall re-
view determinations, made by State agencies pursuant to subsection (a) in connection with applications for benefits under this title on the basis of blindness or disability, that individuals who have attained 18 years of age are blind or disabled as of a specified onset date. The Commissioner of Social Security shall review such a determination before any action is taken to implement the determination.

“(2)(A) In carrying out paragraph (1), the Commiss-
ioner of Social Security shall review—

“(i) at least 25 percent of all determinations re-
ferred to in paragraph (1) that are made in fiscal year 2004; and
“(ii) at least 50 percent of all such determinations that are made in fiscal year 2005 or thereafter. “(B) In carrying out subparagraph (A), the Commissioner of Social Security shall, to the extent feasible, select for review the determinations which the Commissioner of Social Security identifies as being the most likely to be incorrect.”.

SEC. 373. PROHIBITION ON USE OF SCHIP FUNDS TO PROVIDE COVERAGE FOR CHILDLESS ADULTS.

(a) General Limitations on Payments.—Section 2105(c)(1) of the Social Security Act (42 U.S.C. 1397ee(c)(1)) is amended by inserting before the period the following: “and may not include coverage of a childless adult unless the childless adult is a pregnant woman. For purposes of the preceding sentence, a caretaker relative (as such term is defined for purposes of carrying out section 1931) shall not be considered a childless adult.”.

(b) Limitation on Waiver Authority.—Section 2107 of the Social Security Act (42 U.S.C. 1397gg) is amended by adding at the end the following:

“(f) Limitation of Waiver Authority.—Notwithstanding subsection (c)(2)(A) and section 1115(a), the Secretary may not approve a waiver, experimental, pilot, or demonstration project, or an amendment to such a project that has been approved as of the date of enactment
of this subsection, that would allow funds made available under this title to be used to provide child health assistance or other health benefits coverage to a childless adult, other than a childless adult who is a pregnant woman. For purposes of the preceding sentence, a caretaker relative (as such term is defined for purposes of carrying out section 1931) shall not be considered a childless adult.”.

(c) Effective Date.—The amendments made by this section take effect on the date of enactment of this Act and apply to proposals to conduct a waiver, experimental, pilot, or demonstration project affecting the State children’s health insurance program under title XXI of such Act, and to any proposals to amend such a project, that are approved or extended on or after such date of enactment.

(d) Rule of Construction.—Nothing in this section or the amendments made by this section shall be construed to—

(1) authorize the waiver of any provision of title XXI of the Social Security Act (42 U.S.C. 1397aa et seq.) that is not otherwise authorized to be waived under such title or under title XI of such Act (42 U.S.C. 1301 et seq.) as of the date of enactment of this Act; or
(2) imply congressional approval of any waiver, experimental, pilot, or demonstration project affecting the State children’s health insurance program under title XXI of such Act that has been approved as of such date of enactment.

TITLE IV—SMALL BUSINESS AND AGRICULTURAL PROVISIONS
Subtitle A—Small Business Provisions

SEC. 401. EXCLUSION OF CERTAIN INDEBTEDNESS OF SMALL BUSINESS INVESTMENT COMPANIES FROM ACQUISITION INDEBTEDNESS.

(a) In General.—Section 514(c) (relating to acquisition indebtedness) is amended by adding at the end the following new paragraph:

“(10) Certain indebtedness of small business investment companies.—For purposes of this section, the term ‘acquisition indebtedness’ does not include any indebtedness incurred by a small business investment company licensed under the Small Business Investment Act of 1958 which is evidenced by a debenture—

“(A) issued by such company under section 303(a) of such Act, or
“(B) held or guaranteed by the Small Business Administration.”.

(b) **Effective Date.**—The amendment made by this section shall apply to any indebtedness incurred after December 31, 2002, by a small business investment company described in section 514(c)(10) of the Internal Revenue Code of 1986 (as added by this section) with respect to property acquired by such company after such date.

**SEC. 402. REPEAL OF OCCUPATIONAL TAXES RELATING TO DISTILLED SPIRITS, WINE, AND BEER.**

(a) **Repeal of Occupational Taxes.**—

(1) **In General.**—The following provisions of part II of subchapter A of chapter 51 (relating to occupational taxes) are hereby repealed:

(A) Subpart A (relating to proprietors of distilled spirits plants, bonded wine cellars, etc.).

(B) Subpart B (relating to brewer).

(C) Subpart D (relating to wholesale dealers) (other than sections 5114 and 5116).

(D) Subpart E (relating to retail dealers) (other than section 5124).

(E) Subpart G (relating to general provisions) (other than sections 5142, 5143, 5145, and 5146).
(2) **Nonbeverage domestic drawback.**—

Section 5131 is amended by striking “on payment of a special tax per annum,”.

(3) **Industrial use of distilled spirits.**—

Section 5276 is hereby repealed.

(b) **Conforming amendments.**—

(1)(A) The heading for part II of subchapter A of chapter 51 and the table of subparts for such part are amended to read as follows:

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PART II—MISCELLANEOUS PROVISIONS
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“Subpart A. Manufacturers of stills.
“Subpart B. Nonbeverage domestic drawback claimants.
“Subpart C. Recordkeeping by dealers.
“Subpart D. Other provisions.”.

(B) The table of parts for such subchapter A is amended by striking the item relating to part II and inserting the following new item:

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Part II. Miscellaneous provisions.
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(2) Subpart C of part II of such subchapter (relating to manufacturers of stills) is redesignated as subpart A.

(3)(A) Subpart F of such part II (relating to nonbeverage domestic drawback claimants) is redesignated as subpart B and sections 5131 through 5134 are redesignated as sections 5111 through 5114, respectively.
(B) The table of sections for such subpart B, as so redesignated, is amended—

(i) by redesignating the items relating to sections 5131 through 5134 as relating to sections 5111 through 5114, respectively, and

(ii) by striking “and rate of tax” in the item relating to section 5111, as so redesignated.

(C) Section 5111, as redesignated by subparagraph (A), is amended—

(i) by striking “AND RATE OF TAX” in the section heading,

(ii) by striking the subsection heading for subsection (a), and

(iii) by striking subsection (b).

(4) Part II of subchapter A of chapter 51 is amended by adding after subpart B, as redesignated by paragraph (3), the following new subpart:

“Subpart C—Recordkeeping by Dealers

“Sec. 5121. Recordkeeping by wholesale dealers.
“Sec. 5122. Recordkeeping by retail dealers.
“Sec. 5123. Preservation and inspection of records, and entry of premises for inspection.”.

(5)(A) Section 5114 (relating to records) is moved to subpart C of such part II and inserted after the table of sections for such subpart.

(B) Section 5114 is amended—
(i) by striking the section heading and inserting the following new heading:

"SEC. 5121. RECORDKEEPING BY WHOLESALE DEALERS."

and

(ii) by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) WHOLESALE DEALERS.—For purposes of this part—

“(1) WHOLESALE DEALER IN LIQUORS.—The term ‘wholesale dealer in liquors’ means any dealer (other than a wholesale dealer in beer) who sells, or offers for sale, distilled spirits, wines, or beer, to another dealer.

“(2) WHOLESALE DEALER IN BEER.—The term ‘wholesale dealer in beer’ means any dealer who sells, or offers for sale, beer, but not distilled spirits or wines, to another dealer.

“(3) DEALER.—The term ‘dealer’ means any person who sells, or offers for sale, any distilled spirits, wines, or beer.

“(4) PRESUMPTION IN CASE OF SALE OF 20 WINE GALLONS OR MORE.—The sale, or offer for sale, of distilled spirits, wines, or beer, in quantities of 20 wine gallons or more to the same person at
the same time, shall be presumptive evidence that
the person making such sale, or offer for sale, is en-
gaged in or carrying on the business of a wholesale
dealer in liquors or a wholesale dealer in beer, as the
case may be. Such presumption may be overcome by
evidence satisfactorily showing that such sale, or
offer for sale, was made to a person other than a
dealer.”.

(C) Paragraph (3) of section 5121(d), as so re-
designated, is amended by striking “section 5146”
and inserting “section 5123”.

(6)(A) Section 5124 (relating to records) is
moved to subpart C of part II of subchapter A of
chapter 51 and inserted after section 5121.

(B) Section 5124 is amended—

(i) by striking the section heading and in-
serting the following new heading:

“SEC. 5122. RECORDKEEPING BY RETAIL DEALERS.”,

(ii) by striking “section 5146” in sub-
section (e) and inserting “section 5123”, and

(iii) by redesignating subsection (c) as sub-
section (d) and inserting after subsection (b)
the following new subsection:

“(c) RETAIL DEALERS.—For purposes of this sec-
tion—
“(1) Retail dealer in liquors.—The term ‘retail dealer in liquors’ means any dealer (other than a retail dealer in beer) who sells, or offers for sale, distilled spirits, wines, or beer, to any person other than a dealer.

“(2) Retail dealer in beer.—The term ‘retail dealer in beer’ means any dealer who sells, or offers for sale, beer, but not distilled spirits or wines, to any person other than a dealer.

“(3) Dealer.—The term ‘dealer’ has the meaning given such term by section 5121(c)(3).”.

(7) Section 5146 is moved to subpart C of part II of subchapter A of chapter 51, inserted after section 5122, and redesignated as section 5123.

(8) Part II of subchapter A of chapter 51 is amended by inserting after subpart C the following new subpart:

“Subpart D—Other Provisions

“Sec. 5131. Packaging distilled spirits for industrial uses.
“Sec. 5132. Prohibited purchases by dealers.”.

(9) Section 5116 is moved to subpart D of part II of subchapter A of chapter 51, inserted after the table of sections, redesignated as section 5131, and amended by inserting “(as defined in section 5121(e))” after “dealer” in subsection (a).
(10) Subpart D of part II of subchapter A of chapter 51 is amended by adding at the end thereof the following new section:

“SEC. 5132. PROHIBITED PURCHASES BY DEALERS.

“(a) IN GENERAL.—Except as provided in regulations prescribed by the Secretary, it shall be unlawful for a dealer to purchase distilled spirits for resale from any person other than a wholesale dealer in liquors who is required to keep the records prescribed by section 5121.

“(b) PENALTY AND FORFEITURE.—

“For penalty and forfeiture provisions applicable to violations of subsection (a), see sections 5687 and 7302.”

(11) Subsection (b) of section 5002 is amended—

(A) by striking “section 5112(a)” and inserting “section 5121(c)(3)”,

(B) by striking “section 5112” and inserting “section 5121(c)”,

(C) by striking “section 5122” and inserting “section 5122(e)”.

(12) Subparagraph (A) of section 5010(c)(2) is amended by striking “section 5134” and inserting “section 5114”.

(13) Subsection (d) of section 5052 is amended to read as follows:
“(d) BREWER.—For purposes of this chapter, the term ‘brewer’ means any person who brews beer or produces beer for sale. Such term shall not include any person who produces only beer exempt from tax under section 5053(e).”.

(14) The text of section 5182 is amended to read as follows:

“For provisions requiring recordkeeping by wholesale liquor dealers, see section 5121, and by retail liquor dealers, see section 5122.”.

(15) Subsection (b) of section 5402 is amended by striking “section 5092” and inserting “section 5052(d)”.

(16) Section 5671 is amended by striking “or 5091”.

(17)(A) Part V of subchapter J of chapter 51 is hereby repealed.

(B) The table of parts for such subchapter J is amended by striking the item relating to part V.

(18)(A) Sections 5142, 5143, and 5145 are moved to subchapter D of chapter 52, inserted after section 5731, redesignated as sections 5732, 5733, and 5734, respectively, and amended by striking “this part” each place it appears and inserting “this subchapter”.

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(B) Section 5732, as redesignated by subparagraph (A), is amended by striking“(except the tax imposed by section 5131)” each place it appears.

(C) Paragraph (2) of section 5733(c), as redesignated by subparagraph (A), is amended by striking “liquors” both places it appears and inserting “tobacco products and cigarette papers and tubes”.

(D) The table of sections for subchapter D of chapter 52 is amended by adding at the end thereof the following:

“Sec. 5732. Payment of tax.
“Sec. 5734. Application of State laws.”.

(E) Section 5731 is amended by striking subsection (c) and by redesignating subsection (d) as subsection (c).

(19) Subsection (c) of section 6071 is amended by striking “section 5142” and inserting “section 5732”.

(20) Paragraph (1) of section 7652(g) is amended—

(A) by striking “subpart F” and inserting “subpart B”, and

(B) by striking “section 5131(a)” and inserting “section 5111”.

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(c) **Effective Date.**—The amendments made by this section shall take effect on July 1, 2003, but shall not apply to taxes imposed for periods before such date.

**SEC. 403. CUSTOM GUNSMITHS.**

(a) **Small Manufacturers Exempt From Firearms Excise Tax.**—Section 4182 (relating to exemptions) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

“(c) **Small Manufacturers, Etc.—**

“(1) **In General.**—The tax imposed by section 4181 shall not apply to any article described in such section if manufactured, produced, or imported by a person who manufactures, produces, and imports less than 50 of such articles during the calendar year.

“(2) **Controlled Groups.**—All persons treated as a single employer for purposes of subsection (a) or (b) of section 52 shall be treated as one person for purposes of paragraph (1).”.

(b) **Effective Date.**—

(1) **In General.**—The amendments made by this section shall apply to articles sold by the manufacturer, producer, or importer on or after the date which is the first day of the month beginning at
least 2 weeks after the date of the enactment of this
Act.

(2) No inference.—Nothing in the amend-
ments made by this section shall be construed to
create any inference with respect to the proper tax
treatment of any sales before the effective date of
such amendments.

SEC. 404. SIMPLIFICATION OF EXCISE TAX IMPOSED ON
BOWS AND ARROWS.

(a) Bows.—Section 4161(b)(1) (relating to bows) is
amended to read as follows:

“(1) Bows.—

“(A) In general.—There is hereby im-
posed on the sale by the manufacturer, pro-
ducer, or importer of any bow which has a draw
weight of 30 pounds or more, a tax equal to 11
percent of the price for which so sold.

“(B) Archery equipment.—There is
hereby imposed on the sale by the manufac-
turer, producer, or importer—

“(i) of any part or accessory suitable
for inclusion in or attachment to a bow de-
scribed in subparagraph (A), and
“(ii) of any quiver or broadhead suitable for use with an arrow described in paragraph (3), a tax equal to 11 percent of the price for which so sold.”.

(b) ARROWS.—Section 4161(b) (relating to bows and arrows, etc.) is amended by redesignating paragraph (3) as paragraph (4) and inserting after paragraph (2) the following:

“(3) ARROWS.—

“(A) IN GENERAL.—There is hereby imposed on the sale by the manufacturer, producer, or importer of any arrow, a tax equal to 12 percent of the price for which so sold.

“(B) EXCEPTION.—The tax imposed by subparagraph (A) on an arrow shall not apply if the arrow contains an arrow shaft subject to the tax imposed by paragraph (2).

“(C) ARROW.—For purposes of this paragraph, the term ‘arrow’ means any shaft described in paragraph (2) to which additional components are attached.”.

(e) CONFORMING AMENDMENT.—The heading of section 4161(b)(2) (relating to arrows) is amended by strik-
(d) Effective Date.—The amendments made by this section shall apply to articles sold by the manufacturer, producer, or importer after the date of the enactment of this Act.

Subtitle B—Agricultural Provisions

SEC. 411. CAPITAL GAIN TREATMENT UNDER SECTION 631(b) TO APPLY TO OUTRIGHT SALES BY LANDOWNERS.

(a) In General.—The first sentence of section 631(b) (relating to disposal of timber with a retained economic interest) is amended by striking “retains an economic interest in such timber” and inserting “either retains an economic interest in such timber or makes an outright sale of such timber”.

(b) Conforming Amendment.—The third sentence of section 631(b) is amended by striking “The date of disposal” and inserting “In the case of disposal of timber with a retained economic interest, the date of disposal”.

(c) Effective Date.—The amendments made by this section shall apply to sales after the date of the enactment of this Act.
SEC. 412. SPECIAL RULES FOR LIVESTOCK SOLD ON ACCOUNT OF WEATHER-RELATED CONDITIONS.

(a) Rules for Replacement of Involuntarily Converted Livestock.—Subsection (e) of section 1033 (relating to involuntary conversions) is amended—

(1) by striking “CONDITIONS.—For purposes” and inserting “CONDITIONS.—

“(1) IN GENERAL.—For purposes”, and

(2) by adding at the end the following new paragraph:

“(2) EXTENSION OF REPLACEMENT PERIOD.—

“(A) IN GENERAL.—In the case of drought, flood, or other weather-related conditions described in paragraph (1) which result in the area being designated as eligible for assistance by the Federal Government, subsection (a)(2)(B) shall be applied with respect to any converted property by substituting ‘4 years’ for ‘2 years’.

“(B) FURTHER EXTENSION BY SECRETARY.—The Secretary may extend on a regional basis the period for replacement under this section (after the application of subparagraph (A)) for such additional time as the Secretary determines appropriate if the weather-re-
lated conditions which resulted in such applica-
tion continue for more than 3 years.”.

(b) INCOME INCLUSION RULES.—Section 451(e) (re-
ating to special rule for proceeds from livestock sold on
account of drought, flood, or other weather-related condi-
tions) is amended by adding at the end the following new
paragraph:

“(3) SPECIAL ELECTION RULES.—If section
1033(e)(2) applies to a sale or exchange of livestock
described in paragraph (1), the election under para-
graph (1) shall be deemed valid if made during the
replacement period described in such section.”.

(e) EFFECTIVE DATE.—The amendments made by
this section shall apply to any taxable year with respect
to which the due date of the return is after December 31,
2002.

SEC. 413. EXCLUSION FOR LOAN PAYMENTS UNDER NA-
TIONAL HEALTH SERVICE CORPS LOAN RE-
PAYMENT PROGRAM.

(a) IN GENERAL.—Section 108(f) (relating to stu-
dent loans) is amended by adding at the end the following
new paragraph:

“(4) LOAN PAYMENTS UNDER NATIONAL
HEALTH SERVICE CORPS LOAN REPAYMENT PRO-
GRAM.—In the case of an individual, gross income
shall not include any amount received under section 338B(g) of the Public Health Service Act.”.

(b) **Effective Date.**—The amendment made by subsection (a) shall apply to amounts received by an individual in taxable years beginning after December 31, 2002.

**SEC. 414. PAYMENT OF DIVIDENDS ON STOCK OF Cooperatives **

**Without Reducing Patronage Dividends.**

(a) **In General.**—Subsection (a) of section 1388 (relating to patronage dividend defined) is amended by adding at the end the following: “For purposes of paragraph (3), net earnings shall not be reduced by amounts paid during the year as dividends on capital stock or other proprietary capital interests of the organization to the extent that the articles of incorporation or bylaws of such organization or other contract with patrons provide that such dividends are in addition to amounts otherwise payable to patrons which are derived from business done with or for patrons during the taxable year.”.

(b) **Effective Date.**—The amendment made by this section shall apply to distributions in taxable years ending after the date of the enactment of this Act.
TITLE V—SIMPLIFICATION AND OTHER PROVISIONS

Subtitle A—Uniform Definition of Child

SEC. 501. UNIFORM DEFINITION OF CHILD, ETC.

Section 152 is amended to read as follows:

"SEC. 152. DEPENDENT DEFINED.

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

"(1) a qualifying child, or

"(2) a qualifying relative.

"(b) EXCEPTIONS.—For purposes of this section—

"(1) DEPENDENTS INELIGIBLE.—If an individual is a dependent of a taxpayer for any taxable year of such taxpayer beginning in a calendar year, such individual shall be treated as having no dependents for any taxable year of such individual beginning in such calendar year.

"(2) MARRIED DEPENDENTS.—An individual shall not be treated as a dependent of a taxpayer under subsection (a) if such individual has made a joint return with the individual’s spouse under section 6013 for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins."
“(3) Citizens or nationals of other countries.—

“(A) In general.—The term ‘dependent’ does not include an individual who is not a citizen or national of the United States unless such individual is a resident of the United States or a country contiguous to the United States.

“(B) Exception for adopted child.—Subparagraph (A) shall not exclude any child of a taxpayer (within the meaning of subsection (f)(1)(B)) from the definition of ‘dependent’ if—

“(i) for the taxable year of the taxpayer, the child’s principal place of abode is the home of the taxpayer, and

“(ii) the taxpayer is a citizen or national of the United States.

“(c) Qualifying child.—For purposes of this section—

“(1) In general.—The term ‘qualifying child’ means, with respect to any taxpayer for any taxable year, an individual—

“(A) who bears a relationship to the taxpayer described in paragraph (2),
“(B) who has the same principal place of
abode as the taxpayer for more than one-half of
such taxable year,

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

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

“(2) RELATIONSHIP TEST.—For purposes of
paragraph (1)(A), an individual bears a relationship
to the taxpayer described in this paragraph if such
individual is—

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

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

“(3) AGE REQUIREMENTS.—

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

“(i) has not attained the age of 19 as
of the close of the calendar year in which
the taxable year of the taxpayer begins, or
“(ii) is a student who has not attained the age of 24 as of the close of such calendar year.

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

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

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

“(i) a parent of the individual, or

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

“(B) MORE THAN 1 PARENT CLAIMING QUALIFYING CHILD.—If the parents claiming
any qualifying child do not file a joint return
together, such child shall be treated as the
qualifying child of—
“(i) the parent with whom the child
resided for the longest period of time dur-
ing the taxable year, or
“(ii) if the child resides with both par-
ents for the same amount of time during
such taxable year, the parent with the
highest adjusted gross income.
“(d) QUALIFYING RELATIVE.—For purposes of this
section—
“(1) IN GENERAL.—The term ‘qualifying rel-
ative’ means, with respect to any taxpayer for any
taxable year, an individual—
“(A) who bears a relationship to the tax-
payer described in paragraph (2),
“(B) whose gross income for the calendar
year in which such taxable year begins is less
than the exemption amount (as defined in sec-
tion 151(d)),
“(C) with respect to whom the taxpayer
provides over one-half of the individual’s sup-
port for the calendar year in which such taxable
year begins, and
“(D) who is not a qualifying child of such taxpayer or of any other taxpayer for any taxable year beginning in the calendar year in which such taxable year begins.

“(2) RELATIONSHIP.—For purposes of paragraph (1)(A), an individual bears a relationship to the taxpayer described in this paragraph if the individual is any of the following with respect to the taxpayer:

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

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

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

“(D) A stepfather or stepmother.

“(E) A son or daughter of a brother or sister of the taxpayer.

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


“(H) An individual (other than an individual who at any time during the taxable year was the spouse, determined without regard to
section 7703, of the taxpayer) who, for the taxable year of the taxpayer, has as such individual’s principal place of abode the home of the taxpayer and is a member of the taxpayer’s household.

“(3) Special rule relating to multiple support agreements.—For purposes of paragraph (1)(C), over one-half of the support of an individual for a calendar year shall be treated as received from the taxpayer if—

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

“(B) over one-half of such support was received from 2 or more persons each of whom, but for the fact that any such person alone did not contribute over one-half of such support, would have been entitled to claim such individual as a dependent for a taxable year beginning in such calendar year,

“(C) the taxpayer contributed over 10 percent of such support, and

“(D) each person described in subparagraph (B) (other than the taxpayer) who contributed over 10 percent of such support files a written declaration (in such manner and form
as the Secretary may by regulations prescribe) that such person will not claim such individual as a dependent for any taxable year beginning in such calendar year.

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

“(A) IN GENERAL.—For purposes of paragraph (1)(B), the gross income of an individual who is permanently and totally disabled (as defined in section 22(e)(3)) at any time during the taxable year shall not include income attributable to services performed by the individual at a sheltered workshop if—

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

“(ii) the income arises solely from activities at such workshop which are incident to such medical care.

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

“(i) which provides special instruction or training designed to alleviate the disability of the individual, and
“(ii) which is operated by an organization described in section 501(e)(3) and exempt from tax under section 501(a), or
by a State, a possession of the United States, any political subdivision of any of the foregoing, the United States, or the District of Columbia.

“(5) SPECIAL SUPPORT TEST IN CASE OF STUDENTS.—For purposes of paragraph (1)(C), in the case of an individual who is—

“(A) a child of the taxpayer, and
“(B) a student,
amounts received as scholarships for study at an educational organization described in section 170(b)(1)(A)(ii) shall not be taken into account in determining whether such individual received more than one-half of such individual’s support from the taxpayer.

“(6) SPECIAL RULES FOR SUPPORT.—For purposes of this subsection—
“(A) payments to a spouse which are includible in the gross income of such spouse under section 71 or 682 shall not be treated as a payment by the payor spouse for the support of any dependent,
“(B) amounts expended for the support of a child or children shall be treated as received from the noncustodial parent (as defined in subsection (e)(3)(B)) to the extent that such parent provided amounts for such support, and

“(C) in the case of the remarriage of a parent, support of a child received from the parent’s spouse shall be treated as received from the parent.

“(e) SPECIAL RULE FOR DIVORCED PARENTS.—

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

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

“(i) who are divorced or legally separated under a decree of divorce or separate maintenance,

“(ii) who are separated under a written separation agreement, or

“(iii) who live apart at all times during the last 6 months of the calendar year, and
“(B) such child is in the custody of 1 or both of the child’s parents for more than \( \frac{1}{2} \) of the calendar year,
such child shall be treated as being the qualifying child or qualifying relative of the noncustodial parent for a calendar year if the requirements described in paragraph (2) are met.

“(2) REQUIREMENTS.—For purposes of paragraph (1), the requirements described in this paragraph are met if—

“(A) a decree of divorce or separate maintenance or written agreement between the parents applicable to the taxable year beginning in such calendar year provides that—

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

“(ii) the custodial parent will sign a written declaration that such parent will not claim such child as a dependent for such taxable year, and

“(B) in the case of such an agreement executed before January 1, 1985, the nonecustodial parent provides at least $600 for the support of such child during such calendar year.
“(3) Custodial parent and noncustodial parent.—For purposes of this subsection—

“(A) Custodial parent.—The term ‘custodial parent’ means the parent with whom a child shared the same principal place of abode for the greater portion of the calendar year.

“(B) Noncustodial parent.—The term ‘noncustodial parent’ means the parent who is not the custodial parent.

“(4) Exception for multiple-support agreements.—This subsection shall not apply in any case where over one-half of the support of the child is treated as having been received from a taxpayer under the provision of subsection (d)(3).

“(f) Other definitions and rules.—For purposes of this section—

“(1) Child defined.—

“(A) In general.—The term ‘child’ means an individual who is—

“(i) a son, daughter, stepson, or stepdaughter of the taxpayer, or

“(ii) an eligible foster child of the taxpayer.

“(B) Adopted child.—In determining whether any of the relationships specified in
paragraph (A)(i) or paragraph (4) exists, a
legally adopted individual of the taxpayer, or an
individual who is placed with the taxpayer by
an authorized placement agency for adoption by
the taxpayer, shall be treated as a child of such
individual by blood.

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

“(2) Student defined.—The term ‘student’
means an individual who during each of 5 calendar
months during the calendar year in which the tax-
able year of the taxpayer begins—

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

“(B) is pursuing a full-time course of insti-
tutional on-farm training under the supervision
of an accredited agent of an educational organi-
ization described in section 170(b)(1)(A)(ii) or
of a State or political subdivision of a State.
“(3) PLACE OF ABODE.—An individual shall not be treated as having the same principal place of abode of the taxpayer if at any time during the taxable year of the taxpayer the relationship between the individual and the taxpayer is in violation of local law.

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

“(5) TREATMENT OF MISSING CHILDREN.—

“(A) IN GENERAL.—Solely for the purposes referred to in subparagraph (B), a child of the taxpayer—

“(i) who is presumed by law enforcement authorities to have been kidnapped by someone who is not a member of the family of such child or the taxpayer, and

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

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

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

“(i) the deduction under section
151(c),

“(ii) the credit under section 24 (re-
relating to child tax credit),

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

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

“(C) COMPARABLE TREATMENT OF cer-
tain qualifying relatives.—For purposes
of this section, a child of the taxpayer—

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

“(ii) who was (without regard to this
paragraph) a qualifying relative of the tax-
payer for the portion of the taxable year
before the date of the kidnapping,
shall be treated as a qualifying relative of the taxpayer for all taxable years ending during the period that the child is kidnapped.

“(D) Termination of Treatment.—

Subparagraphs (A) and (C) shall cease to apply as of the first taxable year of the taxpayer beginning after the calendar year in which there is a determination that the child is dead (or, if earlier, in which the child would have attained age 18).

“(6) Cross References.—

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

**SEC. 502. MODIFICATIONS OF DEFINITION OF HEAD OF HOUSEHOLD.**

(a) Head of Household.—Clause (i) of section 2(b)(1)(A) is amended to read as follows:

“(i) a qualifying child of the individual (as defined in section 152(c), determined without regard to section 152(e)), but not if such child—

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

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

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(b) CONFORMING AMENDMENTS.—

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

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

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

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

SEC. 503. MODIFICATIONS OF DEPENDENT CARE CREDIT.

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

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

“(1) QUALIFYING INDIVIDUAL.—The term
qualifying individual’ means—
“(A) a dependent of the taxpayer (as defined in section 152(a)(1)) who has not attained age 13,

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

“(C) the spouse of the taxpayer, if the spouse is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of such taxable year.”.

(c) Conforming Amendment.—Paragraph (1) of section 21(e) is amended to read as follows:

“(1) Place of Abode.—An individual shall not be treated as having the same principal place of abode of the taxpayer if at any time during the taxable year of the taxpayer the relationship between the individual and the taxpayer is in violation of local law.”.

SEC. 504. MODIFICATIONS OF CHILD TAX CREDIT.

(a) In General.—Paragraph (1) of section 24(e) is amended to read as follows:
“(1) IN GENERAL.—The term ‘qualifying child’ means a qualifying child of the taxpayer (as defined in section 152(c)) who has not attained age 17.”.

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

SEC. 505. MODIFICATIONS OF EARNED INCOME CREDIT.

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

“(3) QUALIFYING CHILD.—

“(A) IN GENERAL.—The term ‘qualifying child’ means a qualifying child of the taxpayer (as defined in section 152(e), determined without regard to paragraph (1)(D) thereof and section 152(e)).

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

“(C) PLACE OF ABODE.—For purposes of subparagraph (A), the requirements of section

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152(c)(1)(B) shall be met only if the principal
place of abode is in the United States.

“(D) IDENTIFICATION REQUIREMENTS.—

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

“(ii) OTHER METHODS.—The Sec-
retary may prescribe other methods for
providing the information described in
clause (i).”.

(b) CONFORMING AMENDMENTS.—

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

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

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

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SEC. 506. MODIFICATIONS OF DEDUCTION FOR PERSONAL EXEMPTION FOR DEPENDENTS.

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

“(c) ADDITIONAL EXEMPTION FOR DEPENDENTS.—An exemption of the exemption amount for each individual who is a dependent (as defined in section 152) of the taxpayer for the taxable year.”.

SEC. 507. TECHNICAL AND CONFORMING AMENDMENTS.

(1) Section 21(e)(5) is amended—

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

(B) by striking “within the meaning of section 152(e)(1)” and inserting “as defined in section 152(e)(3)(A)”.

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

(3) Section 25B(c)(2)(B) is amended by striking “151(c)(4)” and inserting “152(f)(2)”.

(4)(A) Subparagraphs (A) and (B) of section 51(i)(1) are each amended by striking “paragraphs (1) through (8) of section 152(a)” both places it appears and inserting “subparagraphs (A) through (G) of section 152(d)(2)”.

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

(5) Section 72(t)(7)(A)(iii) is amended by striking “151(c)(3)” and inserting “152(f)(1)”.

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

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

(8) Section 153 is amended by striking paragraph (1) and by redesignating paragraphs (2), (3), and (4) as paragraphs (1), (2), and (3), respectively.

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

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

(11) Section 529(e)(2)(B) is amended by striking “paragraphs (1) through (8) of section 152(a)” and inserting “subparagraphs (A) through (G) of section 152(d)(2)”.

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

(13) Section 7701(a)(17) is amended by striking “152(b)(4), 682,” and inserting “682”.

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

(15) Section 7703(b)(1) is amended—

(A) by striking “151(e)(3)” and inserting “152(f)(1)”, and

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

SEC. 508. EFFECTIVE DATE.

The amendments made by this subtitle shall apply to taxable years beginning after December 31, 2003.

Subtitle B—Simplification

SEC. 511. CONSOLIDATION OF LIFE AND NON-LIFE COMPANY RETURNS.

(a) In general.—Section 1504 (relating to definition of affiliated group) is amended by striking subsection (e) and by redesignating subsections (d), (e), and (f) as subsections (e), (d), and (e), respectively.

(b) Conforming Amendments.—
(1) Section 243(b)(2)(A) is amended by striking “, 1504(b)(4), and 1504(e)” and inserting “and 1504(b)(4)”.

(2) Section 818(e)(1) is amended by striking “If an election under section 1504(c)(2) is effect with respect to an affiliated group for the taxable year” and inserting “If an affiliated group includes members which are, and which are not, life insurance companies for any taxable year”.

(3) Section 1503(c)(1) is amended by striking “an election under section 1504(c)(2) is in effect for the taxable year”.

(c) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 2009.

(d) Waiver of 5-Year Waiting Period.—Under regulations prescribed by the Secretary of the Treasury or his delegate, an automatic waiver from the 5-year waiting period for reconsolidation provided in section 1504(a)(3) of the Internal Revenue Code of 1986 shall be granted to any corporation which was previously an includible corporation but was subsequently deemed a non-includible corporation as a result of becoming a subsidiary of a corporation which was not an includible corporation solely by operation of section 1504(e)(2) of such Code (as
in effect on the day before the date of the enactment of this Act).

(c) Nontermination of Group.—No affiliated group shall terminate solely as a result of the amendments made by this section.

SEC. 512. SPECIAL RULES FOR TAXATION OF LIFE INSURANCE COMPANIES.

(a) Reduction in Mutual Life Insurance Company Deductions Not To Apply.—

(1) In general.—Section 809 (relating to reduction in certain deductions of material life insurance companies) is amended by adding at the end the following:

“(j) Differential Earnings Rate Treated as Zero.—Notwithstanding subsection (c) or (f), the differential earnings rate shall be treated as zero for purposes of computing both the differential earnings amount and the recomputed differential earnings amount for any taxable year of a mutual life insurance company beginning after December 31, 2003, and before January 1, 2009.”.

(2) Effective date.—The amendment made by this section shall apply to taxable years beginning after December 31, 2003.

(b) Distributions To Shareholders From Pre-1984 Policyholders Surplus Account.—
(1) IN GENERAL.—Section 815 (relating to distributions to shareholders from pre-1984 policyholders surplus account) is amended by adding at the end the following:

“(g) SPECIAL RULES APPLICABLE DURING 2004 THROUGH 2008.—In the case of any taxable year of a stock life insurance company beginning after December 31, 2003, and before January 1, 2009—

“(1) the amount under subsection (a)(2) for such taxable year shall be treated as zero, and

“(2) notwithstanding subsection (b), in determining any subtractions from an account under subsections (c)(3) and (d)(3), any distribution to shareholders during such taxable year shall be treated as made first out of the policyholders surplus account, then out of the shareholders surplus account, and finally out of other accounts.”.

(2) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2003.

SEC. 513. MODIFICATION OF ACTIVE BUSINESS DEFINITION UNDER SECTION 355.

(a) IN GENERAL.—Section 355(b) (defining active conduct of a trade or business) is amended by adding at the end the following new paragraph:
“(3) Special rules relating to active business requirement.—

“(A) In general.—For purposes of determining whether a corporation meets the requirement of paragraph (2)(A), all members of such corporation’s separate affiliated group shall be treated as one corporation. For purposes of the preceding sentence, a corporation’s separate affiliated group is the affiliated group which would be determined under section 1504(a) if such corporation were the common parent and section 1504(b) did not apply.

“(B) Control.—For purposes of paragraph (2)(D), all distributee corporations which are members of the same affiliated group (as defined in section 1504(a) without regard to section 1504(b)) shall be treated as one distributee corporation.”.

(b) Conforming Amendments.—

(1) Subparagraph (A) of section 355(b)(2) is amended to read as follows:

“(A) it is engaged in the active conduct of a trade or business,”.

(2) Section 355(b)(2) is amended by striking the last sentence.
(c) **Effective Date.**—

(1) **In general.**—The amendments made by this section shall apply—

(A) to distributions after the date of the enactment of this Act, and

(B) for purposes of determining the continued qualification under section 355(b)(2)(A) of the Internal Revenue Code of 1986 (as amended by subsection (b)(1)) of distributions made before such date, as a result of an acquisition, disposition, or other restructuring after such date.

(2) **Transition rule.**—The amendments made by this section shall not apply to any distribution pursuant to a transaction which is—

(A) made pursuant to an agreement which was binding on such date of enactment and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission.
260  (3) Election to have amendments apply.—Paragraph (2) shall not apply if the distributing corporation elects not to have such paragraph apply to distributions of such corporation. Any such election, once made, shall be irrevocable.

Subtitle C—Other Provisions

SEC. 521. CIVIL RIGHTS TAX RELIEF.

(a) In general.—Part VII of subchapter B of chapter 1 of the Internal Revenue Code of 1986 (relating to additional itemized deductions for individuals) is amended by redesignating section 223 as section 224 and by inserting after section 222 the following new section:

“SEC. 223. ATTORNEY FEES AND COSTS IN CONNECTION WITH AMOUNTS RECEIVED ON ACCOUNT OF CERTAIN UNLAWFUL DISCRIMINATION OR CIVIL FRAUD AGAINST THE UNITED STATES.

“(a) In general.—There shall be allowed as a deduction for any taxable year an amount equal to the lesser of—

“(1) the attorney fees and court costs paid by, or on behalf of, the taxpayer for such taxable year in connection with any action involving a claim of unlawful discrimination or a claim of a violation of subchapter III of chapter 37 of title 31, United States Code, or
“(2) the amount includible in the taxpayer’s gross income for such taxable year on account of a judgment or settlement (whether by suit or agreement and whether as lump sums or periodic payments) resulting from such claim.

“(b) UNLAWFUL DISCRIMINATION DEFINED.—For purposes of this section, the term ‘unlawful discrimination’ means an act that is unlawful under any of the following:


“(2) Section 201, 202, 203, 204, 205, 206, or 207 of the Congressional Accountability Act of 1995 (2 U.S.C. 1311, 1312, 1313, 1314, 1315, 1316, or 1317).


“(7) Title IX of the Education Amendments of 1972 (29 U.S.C. 1681 et seq.).

“(9) The Worker Adjustment and Retraining Notification Act (29 U.S.C. 2102 et seq.).


“(11) Chapter 43 of title 38, United States Code (relating to employment and reemployment rights of members of the uniformed services).


“(14) Section 804, 805, 806, 808, or 818 of the Fair Housing Act (42 U.S.C. 3604, 3605, 3606, 3608, or 3617).

“(15) Section 102, 202, 302, or 503 of the Americans with Disabilities Act of 1990 (42 U.S.C. 12112, 12132, 12182, or 12203).


“(17) Any provision of Federal law (popularly known as whistleblower protection provisions) prohibiting the discharge of an employee, the discrimi-
nation against an employee, or any other form of retal-
iation or reprisal against an employee for assert-
ing rights or taking other actions permitted under
Federal law.

“(18) Any provision of State or local law, or
common law claims permitted under Federal, State,
or local law—

“(A) providing for the enforcement of civil
rights, or

“(B) regulating any aspect of the employ-
ment relationship, including prohibiting the dis-
charge of an employee, the discrimination
against an employee, or any other form of retal-
iation or reprisal against an employee for as-
serting rights or taking other actions permitted
by law.”.

(b) Deduction Allowed Whether or Not Tax-
payer Itemizes Other Deductions.—Subsection (a)
of section 62 (defining adjusted gross income) is amended
by inserting after paragraph (18) the following new item:

“(19) Costs involving discrimination
suits.—The deduction allowed by section 223.”.

(e) Clerical Amendment.—The table of sections
for part VII of subchapter B of chapter 1 is amended by
striking the last item and inserting the following new items:

“Sec. 223. Attorney fees and costs in connection with amounts received on account of certain unlawful discrimination or civil fraud against the United States.

“Sec. 224. Cross reference.”.

(d) Effective Date.—The amendments made by this section shall apply to fees and costs paid after the date of the enactment of this Act with respect to any judgment or settlement occurring after such date.

SEC. 522. INCREASE IN SECTION 382 LIMITATION FOR COMPANIES EMERGING FROM BANKRUPTCY.

(a) In General.—Section 382(b) (relating to section 382 limitation) is amended by adding at the end the following new paragraph:

“(4) Increase in Section 382 Limitation for Companies Emerging from Bankruptcy.—In the case of any new loss corporation which immediately before any ownership change was an old loss corporation under the jurisdiction of the court in a title 11 or similar case (as defined in subsection (l)(5)(G)), the section 382 limitation for any post-change year beginning in 2004 or 2005 shall be an amount equal to 200 percent of the amount otherwise determined under paragraph (1) for such year.”.
(b) **Effective Date.**—The amendment made by this section shall apply to ownership changes after December 31, 2002.

**SEC. 523. INCREASE IN HISTORIC REHABILITATION CREDIT FOR CERTAIN LOW-INCOME HOUSING FOR THE ELDERLY.**

(a) **In General.**—Section 47 (relating to rehabilitation credit) is amended by adding at the end the following new subsection:

“(e) **Special Rule Regarding Certain Historic Structures.**—In the case of any qualified rehabilitation expenditure with respect to any certified historic structure—

“(1) which is placed in service after the date of the enactment of this subsection,

“(2) which is part of a qualified low-income building with respect to which a credit under section 42 is allowed, and

“(3) substantially all of the residential rental units of which are used for tenants who have attained the age of 65,

subsection (a)(2) shall be applied by substituting ‘25 percent’ for ‘20 percent’.”.

(b) **Application of MACRS.**—The Internal Revenue Code of 1986 shall be applied and administered as
if paragraph (4)(X) of section 251(d) of the Tax Reform
Act of 1986 as applied to the amendments made by section
201 of such Act had not been enacted with respect to any
property described in such paragraph and placed in service
after the date of the enactment of this Act.

(c) Effective Date.—The amendment made by
subsection (a) shall apply to property placed in service
after the date of the enactment of this Act.

SEC. 524. MODIFICATION OF APPLICATION OF INCOME
FORECAST METHOD OF DEPRECIATION.

(a) In General.—Section 167(g) (relating to depre-
ciation under income forecast method) is amended by add-
ing at the end the following new paragraph:

“(7) Treatment of participations and re-
siduals.—

“(A) In general.—For purposes of deter-
mining the depreciation deduction allowable
with respect to a property under this sub-
section, the taxpayer may include participations
and residuals with respect to such property in
the adjusted basis of such property for the tax-
able year in which the property is placed in
service, but only to the extent that such partici-
pations and residuals relate to income estimated
(for purposes of this subsection) to be earned in
connection with the property before the close of
the 10th taxable year referred to in paragraph
(1)(A).

“(B) Participations and residuals.—
For purposes of this paragraph, the term ‘par-
ticipations and residuals’ means, with respect to
any property, costs the amount of which by con-
tract varies with the amount of income earned
in connection with such property.

“(C) Special rules relating to re-
computation years.—If the adjusted basis of
any property is determined under this para-
graph, paragraph (4) shall be applied by sub-
stituting ‘for each taxable year in such period’
for ‘for such period’.

“(D) Coordination with other
rules.—

“(i) Notwithstanding subparagraph
(A), the taxpayer may exclude participa-
tions and residuals from the adjusted basis
of such property and deduct such participa-
tions and residuals in the taxable year
that such participations and residuals are
paid.
“(ii) Deductions computed in accordance with this paragraph shall be allowable notwithstanding paragraph (1)(B) or sections 263, 263A, 404, 419, or 461(h).

“(E) Authority to make adjustments.—The Secretary shall prescribe appropriate adjustments to the basis of property and to the look-back method for the additional amounts allowable as a deduction solely by reason of this paragraph.”.

(b) Determination of Income.—Section 167(g)(5) (relating to special rules) is amended by redesignating subparagraphs (E) and (F) as subparagraphs (F) and (G), respectively, and inserting after subparagraph (D) the following new subparagraph:

“(E) Treatment of distribution costs.—For purposes of this subsection, the income with respect to any property shall be the taxpayer’s gross income from such property.”.

(c) Effective Date.—The amendments made by this section shall apply to property placed in service after the date of the enactment of this Act.
SEC. 525. ADDITIONAL ADVANCE REFUNDINGS OF CERTAIN GOVERNMENTAL BONDS.

(a) In General.—Section 149(d)(3)(A)(i) (relating to advance refundings of other bonds) is amended—

(1) by striking “or” at the end of subclause (I),

(2) by adding “or” at the end of subclause (II),

and

(3) by inserting after subclause (II) the following:

“(III) the 2nd advance refunding of the original bond if the original bond was issued after 1985 or the 3rd advance refunding of the original bond if the original bond was issued before 1986, if, in either case, the refunding bond is issued before the date which is 2 years after the date of the enactment of this subclause and the original bond was issued as part of an issue 90 percent or more of the net proceeds of which were used to finance a public elementary or secondary school in any State in which the State’s highest court ruled by opinion issued on November 21, 2002, that the State school funding system
violated the State constitution and was constitutionally inadequate.”.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to refunding bonds issued on or after the date of the enactment of this Act.

SEC. 526. EXCLUSION OF INCOME DERIVED FROM CERTAIN WAGERS ON HORSE RACES FROM GROSS INCOME OF NONRESIDENT ALIEN INDIVIDUALS.

(a) IN GENERAL.—Subsection (b) of section 872 (relating to exclusions) is amended by redesignating paragraphs (5), (6), and (7) as paragraphs (6), (7), and (8), respectively, and inserting after paragraph (4) the following new paragraph:

“(5) INCOME DERIVED FROM WAGERING TRANSACTIONS IN CERTAIN PARIMUTUEL POOLS.—Gross income derived by a nonresident alien individual from a legal wagering transaction initiated outside the United States in a parimutuel pool with respect to a live horse race in the United States.”.

(b) CONFORMING AMENDMENT.—Section 883(a)(4) is amended by striking “(5), (6), and (7)” and inserting “(6), (7), and (8)”.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to proceeds from wagering transactions after September 30, 2003.
SEC. 527. FEDERAL REIMBURSEMENT OF EMERGENCY HEALTH SERVICES FURNISHED TO UNDOCUMENTED ALIENS.

(a) Total Amount Available for Allotment.—There is appropriated, out of any funds in the Treasury not otherwise appropriated, $48,000,000 for fiscal year 2004, for the purpose of making allotments under this section to States described in paragraph (1) or (2) of subsection (b). Funds appropriated under the preceding sentence shall remain available until expended.

(b) State Allotments.—

(1) Based on Percentage of Undocumented Aliens.—

(A) In General.—Out of the amount appropriated under subsection (a) for fiscal year 2004, the Secretary shall use $32,000,000 of such amount to make allotments for such fiscal year in accordance with subparagraph (B).

(B) Formula.—The amount of the allotment for each State for fiscal year 2004 shall be equal to the product of—

(i) the total amount available for allotments under this paragraph for the fiscal year; and

(ii) the percentage of undocumented aliens residing in the State with respect to
the total number of such aliens residing in all States, as determined by the Statistics Division of the Immigration and Naturalization Service, as of January 2003, based on the 2000 decennial census.

(2) Based on number of undocumented alien apprehension states.—

(A) In general.—Out of the amount appropriated under subsection (a) for fiscal year 2004, the Secretary shall use $16,000,000 of such amount to make allotments for such fiscal year for each of the 6 States with the highest number of undocumented alien apprehensions for such fiscal year.

(B) Determination of allotments.—

The amount of the allotment for each State described in subparagraph (A) for fiscal year 2004 shall bear the same ratio to the total amount available for allotments under this paragraph for the fiscal year as the ratio of the number of undocumented alien apprehensions in the State in that fiscal year bears to the total of such numbers for all such States for such fiscal year.
(C) Data.—For purposes of this paragraph, the highest number of undocumented alien apprehensions for fiscal year 2004 shall be based on the 4 most recent quarterly apprehension rates for undocumented aliens in such States, as reported by the Immigration and Naturalization Service.

(3) Rule of Construction.—Nothing in this section shall be construed as prohibiting a State that is described in both of paragraphs (1) and (2) from receiving an allotment under both paragraphs for fiscal year 2004.

(c) Use of Funds.—

(1) Authority to Make Payments.—From the allotments made for a State under subsection (b) for fiscal year 2004, the Secretary shall pay directly to local governments, hospitals, or other providers located in the State (including providers of services received through an Indian Health Service facility whether operated by the Indian Health Service or by an Indian tribe or tribal organization) that provide uncompensated emergency health services furnished to undocumented aliens during that fiscal year, and to the State, such amounts (subject to the total amount available from such allotments) as the local
governments, hospitals, providers, or State demonstrate were incurred for the provision of such services during that fiscal year.

(2) LIMITATION ON STATE USE OF FUNDS.— Funds paid to a State from allotments made under subsection (b) for fiscal year 2004 may only be used for making payments to local governments, hospitals, or other providers for costs incurred in providing emergency health services to undocumented aliens or for State costs incurred with respect to the provision of emergency health services to such aliens.

(3) INCLUSION OF COSTS INCURRED WITH RESPECT TO CERTAIN ALIENS.—Uncompensated emergency health services furnished to aliens who have been allowed to enter the United States for the sole purpose of receiving emergency health services may be included in the determination of costs incurred by a State, local government, hospital, or other provider with respect to the provision of such services.

(d) APPLICATIONS; ADVANCE PAYMENTS.—

(1) DEADLINE FOR ESTABLISHMENT OF APPLICATION PROCESS.—

(A) IN GENERAL.—Not later than September 1, 2003, the Secretary shall establish a process under which States, local governments,
hospitals, or other providers located in the State may apply for payments from allotments made under subsection (b) for fiscal year 2004 for uncompensated emergency health services furnished to undocumented aliens during that fiscal year.

(B) INCLUSION OF MEASURES TO COMBAT FRAUD.—The Secretary shall include in the process established under subparagraph (A) measures to ensure that fraudulent payments are not made from the allotments determined under subsection (b).

(2) ADVANCE PAYMENT; RETROSPECTIVE ADJUSTMENT.—The process established under paragraph (1) shall allow for making payments under this section for each quarter of fiscal year 2004 on the basis of advance estimates of expenditures submitted by applicants for such payments and such other investigation as the Secretary may find necessary, and for making reductions or increases in the payments as necessary to adjust for any overpayment or underpayment for prior quarters of such fiscal year.

(c) DEFINITIONS.—In this section:
(1) Hospital.—The term “hospital” has the meaning given such term in section 1861(e) of the Social Security Act (42 U.S.C. 1395x(e)).

(2) Indian tribe; tribal organization.—The terms “Indian tribe” and “tribal organization” have the meanings given such terms in section 4 of the Indian Health Care Improvement Act (25 U.S.C. 1603).

(3) Provider.—The term “provider” includes a physician, any other health care professional licensed under State law, and any other entity that furnishes emergency health services, including ambulance services.

(4) Secretary.—The term “Secretary” means the Secretary of Health and Human Services.

(5) State.—The term “State” means the 50 States and the District of Columbia.

(f) Entitlement.—This section constitutes budget authority in advance of appropriations Acts and represents the obligation of the Federal Government to provide for the payment of amounts provided under this section.

SEC. 528. PREMIUMS FOR MORTGAGE INSURANCE.

(a) Mortgage insurance premiums treated as interest.—
(1) IN GENERAL.—Paragraph (3) of section 163(h) (relating to qualified residence interest) is amended by adding after subparagraph (D) the following new subparagraph:

“(E) MORTGAGE INSURANCE PREMIUMS TREATED AS INTEREST.—

“(i) IN GENERAL.—Premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness with respect to a qualified residence of the taxpayer shall be treated for purposes of this subsection as qualified residence interest.

“(ii) PHASEOUT.—The amount otherwise allowable as a deduction under clause (i) shall be reduced (but not below zero) by 10 percent of such amount for each $1,000 ($500 in the case of a married individual filing a separate return) (or fraction thereof) that the taxpayer’s adjusted gross income for the taxable year exceeds $100,000 ($50,000 in the case of a married individual filing a separate return).”.
(2) Definition and special rules.—Paragraph (4) of section 163(h) (relating to other definitions and special rules) is amended by adding at the end the following new subparagraphs:

“(E) Qualified mortgage insurance.—The term ‘qualified mortgage insurance’ means—

“(i) mortgage insurance provided by the Veterans Administration, the Federal Housing Administration, or the Rural Housing Administration, and

“(ii) private mortgage insurance (as defined by section 2 of the Homeowners Protection Act of 1998 (12 U.S.C. 4901), as in effect on the date of the enactment of this subparagraph).

“(F) Special rules for prepaid qualified mortgage insurance.—Any amount paid by the taxpayer for qualified mortgage insurance that is properly allocable to any mortgage the payment of which extends to periods that are after the close of the taxable year in which such amount is paid shall be chargeable to capital account and shall be treated as paid in such periods to which so allocated. No deduc-
tion shall be allowed for the unamortized bal-
ance of such account if such mortgage is satis-
fied before the end of its term. The preceding
sentences shall not apply to amounts paid for
qualified mortgage insurance provided by the
Veterans Administration or the Rural Housing
Administration.”.

(b) Information Returns Relating to Mort-
gage Insurance.—Section 6050H (relating to returns
relating to mortgage interest received in trade or business
from individuals) is amended by adding at the end the fol-
lowing new subsection:

“(h) Returns Relating to Mortgage Insurance
Premiums.—

“(1) In general.—The Secretary may pre-
scribe, by regulations, that any person who, in the
course of a trade or business, receives from any indi-
vidual premiums for mortgage insurance aggregating
$600 or more for any calendar year, shall make a
return with respect to each such individual. Such re-
turn shall be in such form, shall be made at such
time, and shall contain such information as the Sec-
retary may prescribe.

“(2) Statement to be furnished to indi-
viduals with respect to whom information is
REQUIRED.—Every person required to make a return under paragraph (1) shall furnish to each individual with respect to whom a return is made a written statement showing such information as the Secretary may prescribe. Such written statement shall be furnished on or before January 31 of the year following the calendar year for which the return under paragraph (1) was required to be made.

“(3) SPECIAL RULES.—For purposes of this subsection—

“(A) rules similar to the rules of subsection (c) shall apply, and

“(B) the term ‘mortgage insurance’ means—

“(i) mortgage insurance provided by the Veterans Administration, the Federal Housing Administration, or the Rural Housing Administration, and

“(ii) private mortgage insurance (as defined by section 2 of the Homeowners Protection Act of 1998 (12 U.S.C. 4901), as in effect on the date of the enactment of this subparagraph).”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or accrued after
the date of enactment of this section in taxable years ending after such date.

TITLE VI—SUNSET

SEC. 601. SUNSET.

(a) IN GENERAL.—Except as otherwise provided, the provisions of, and amendments made, by this Act shall not apply to taxable years beginning after December 31, 2012, and the Internal Revenue Code of 1986 shall be applied and administered to such years as if such amendments had never been enacted.

(b) EXCEPTIONS.—Subsection (a) shall not apply to the following provisions of, and amendments made by, this Act:

(1) Title I (other than section 107).

(2) Title III (other than section 362).
A BILL

To provide for reconciliation pursuant to section 201 of the concurrent resolution on the budget for fiscal year 2004.

MAY 13, 2003
Read twice and placed on the calendar