

108TH CONGRESS  
1ST SESSION

# H. R. 2286

To amend the Internal Revenue Code of 1986 to increase partial refundability of the child tax credit, to provide that pay received by members of the Armed Forces while serving in Iraq or other combat zones will be taken into account in determining eligibility for partial refundability of the child tax credit, to accelerate marriage penalty relief in the earned income tax credit, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

JUNE 2, 2003

Mr. RANGEL (for himself, Ms. DELAURO, Mr. MICHAUD, Mr. HOYER, Mr. DAVIS of Alabama, Mr. MORAN of Virginia, and Mr. STRICKLAND) introduced the following bill; which was referred to the Committee on Ways and Means

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## A BILL

To amend the Internal Revenue Code of 1986 to increase partial refundability of the child tax credit, to provide that pay received by members of the Armed Forces while serving in Iraq or other combat zones will be taken into account in determining eligibility for partial refundability of the child tax credit, to accelerate marriage penalty relief in the earned income tax credit, and for other purposes.

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

1 **SECTION 1. SHORT TITLE; REFERENCE.**

2 (a) SHORT TITLE.—This Act may be cited as the  
3 “Working Families Tax Credit Act of 2003”.

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

10 **TITLE I—FAMILY TAX CREDITS.**

11 **SEC. 101. PARTIAL REFUNDABILITY OF FAMILY CREDIT.**

12 (a) IN GENERAL.—Clause (i) of section 24(d)(1)(B)  
13 to read as follows:

14 “(i) 15 percent of such much of the  
15 taxpayer’s earned income (within the  
16 meaning of section 32) which is taken into  
17 account in computing taxable income for  
18 the taxable year as exceeds \$7,500, or”.

19 (b) COMBAT PAY TAKEN INTO ACCOUNT.—Para-  
20 graph (1) of section 24(d) is amended by adding at the  
21 end the following flush sentence: “For purposes of clause  
22 (i) of subparagraph (B), amounts excluded from gross in-  
23 come under section 112 (relating to combat pay) shall be  
24 treated as earned income that is taken into account in  
25 computing taxable income.”.

1 (c) CONFORMING AMENDMENT.—Section 24(d)(3) is  
2 amended—

3 (1) by striking “after 2001” and inserting  
4 “after 2003”,

5 (2) by striking “\$10,000” and inserting  
6 “\$7,500”, and

7 (3) by striking “2000” and inserting “2002”.

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

11 **SEC. 102. MARRIAGE PENALTY IN THE EARNED INCOME**  
12 **CREDIT.**

13 (a) IN GENERAL.—Subparagraph (B) of section  
14 32(b)(2) is amended to read as follows:

15 “(B) JOINT RETURNS.—In the case of a  
16 joint return filed by an eligible individual and  
17 such individual’s spouse, the phaseout amount  
18 determined under subparagraph (A) shall be in-  
19 creased by \$3,000.”.

20 (b) CONFORMING AMENDMENT.—Section  
21 32(j)(1)(B)(ii) is amended—

22 (1) by striking “subsection (b)(2)(B)(iii)” and  
23 inserting “subsection (b)(2)(B)”, and

24 (2) by striking “2007” and inserting “2002”.

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

4 **TITLE II—ELIMINATION OF**  
5 **ABUSIVE TAX STRATEGIES**

6 **SEC. 201. FINDINGS AND PURPOSE.**

7 (a) FINDINGS.—The Congress hereby finds that:

8 (1) Many corporate tax shelter transactions are  
9 complicated ways of accomplishing nothing aside  
10 from claimed tax benefits, and the legal opinions  
11 justifying those transactions take an inappropriately  
12 narrow and restrictive view of well-developed court  
13 doctrines under which—

14 (A) the taxation of a transaction is deter-  
15 mined in accordance with its substance and not  
16 merely its form,

17 (B) transactions which have no significant  
18 effect on the taxpayer's economic or beneficial  
19 interests except for tax benefits are treated as  
20 sham transactions and disregarded,

21 (C) transactions involving multiple steps  
22 are collapsed when those steps have no substan-  
23 tial economic meaning and are merely designed  
24 to create tax benefits,

1 (D) transactions with no business purpose  
2 are not given effect, and

3 (E) in the absence of a specific congress-  
4 sional authorization, it is presumed that Con-  
5 gress did not intend a transaction to result in  
6 a negative tax where the taxpayer's economic  
7 position or rate of return is better after tax  
8 than before tax.

9 (2) Permitting aggressive and abusive tax shel-  
10 ters not only results in large revenue losses but also  
11 undermines voluntary compliance with the Internal  
12 Revenue Code of 1986.

13 (b) PURPOSE.—The purpose of this title is to elimi-  
14 nate abusive tax shelters by denying tax attributes claimed  
15 to arise from transactions that do not meet a heightened  
16 economic substance requirement and by repealing the pro-  
17 vision that permits legal opinions to be used to avoid pen-  
18 alties on tax underpayments resulting from transactions  
19 without significant economic substance or business pur-  
20 pose.

1                   **Subtitle A—Tax Shelters**  
2                   **Part I—Provisions Designed To**  
3                   **Curtail Tax Shelters**

4 **SEC. 211. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**  
5                   **TRINE.**

6           (a) IN GENERAL.—Section 7701 is amended by re-  
7 designating subsection (m) as subsection (n) and by in-  
8 serting after subsection (l) the following new subsection:

9           “(m) CLARIFICATION OF ECONOMIC SUBSTANCE  
10 DOCTRINE; ETC.—

11                   “(1) GENERAL RULES.—

12                           “(A) IN GENERAL.—In applying the eco-  
13 nomic substance doctrine, the determination of  
14 whether a transaction has economic substance  
15 shall be made as provided in this paragraph.

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

18                                   “(i) IN GENERAL.—A transaction has  
19 economic substance only if—

20   “(I) the transaction changes in a  
21 meaningful way (apart from Federal  
22 tax effects and, if there is any Federal  
23 tax effects, also apart from any for-  
24 eign, State, or local tax effects) the  
25 taxpayer’s economic position, and

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

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

11           “(I) the present value of the rea-  
12          sonably expected pre-tax profit from  
13          the transaction is substantial in rela-  
14          tion to the present value of the ex-  
15          pected net tax benefits that would be  
16          allowed if the transaction were re-  
17          spected, and

18           “(II) the reasonably expected  
19          pre-tax profit from the transaction ex-  
20          ceeds a risk-free rate of return.

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

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

3           “(A) SPECIAL RULES FOR FINANCING  
4 TRANSACTIONS.—The form of a transaction  
5 which is in substance the borrowing of money  
6 or the acquisition of financial capital directly or  
7 indirectly from a tax-indifferent party shall not  
8 be respected if the present value of the deduc-  
9 tions to be claimed with respect to the trans-  
10 action is substantially in excess of the present  
11 value of the anticipated economic returns of the  
12 person lending the money or providing the fi-  
13 nancial capital. A public offering shall be treat-  
14 ed as a borrowing, or an acquisition of financial  
15 capital, from a tax-indifferent party if it is rea-  
16 sonably expected that at least 50 percent of the  
17 offering will be placed with tax-indifferent par-  
18 ties.

19           “(B) ARTIFICIAL INCOME SHIFTING AND  
20 BASIS ADJUSTMENTS.—The form of a trans-  
21 action with a tax-indifferent party shall not be  
22 respected if—

23                   “(i) it results in an allocation of in-  
24 come or gain to the tax-indifferent party in

1 excess of such party's economic income or  
2 gain, or

3 “(ii) it results in a basis adjustment  
4 or shifting of basis on account of over-  
5 stating the income or gain of the tax-indif-  
6 ferent party.

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

9 “(A) ECONOMIC SUBSTANCE DOCTRINE.—  
10 The term ‘economic substance doctrine’ means  
11 the common law doctrine under which tax bene-  
12 fits under subtitle A with respect to a trans-  
13 action are not allowable if the transaction does  
14 not have economic substance or lacks a business  
15 purpose.

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

24 “(C) SUBSTANTIAL NONTAX PURPOSE.—In  
25 applying subclause (II) of paragraph (1)(B)(i),

1 a purpose of achieving a financial accounting  
2 benefit shall not be taken into account in deter-  
3 mining whether a transaction has a substantial  
4 nontax purpose if the origin of such financial  
5 accounting benefit is a reduction of income tax.

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

12 “(E) TREATMENT OF LESSORS.—In apply-  
13 ing subclause (I) of paragraph (1)(B)(ii) to the  
14 lessor of tangible property subject to a lease,  
15 the expected net tax benefits shall not include  
16 the benefits of depreciation, or any tax credit,  
17 with respect to the leased property and sub-  
18 clause (II) of paragraph (1)(B)(ii) shall be dis-  
19 regarded in determining whether any of such  
20 benefits are allowable.

21 “(4) OTHER COMMON LAW DOCTRINES NOT AF-  
22 FECTED.—Except as specifically provided in this  
23 subsection, the provisions of this subsection shall not  
24 be construed as altering or supplanting any other  
25 rule of law, and the requirements of this subsection

1 shall be construed as being in addition to any such  
2 other rule of law.

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

8 (b) EFFECTIVE DATE.—The amendments made by  
9 this section shall apply to transactions entered into after  
10 February 13, 2003.

11 **SEC. 212. PENALTY FOR FAILING TO DISCLOSE REPORT-**  
12 **ABLE TRANSACTION.**

13 (a) IN GENERAL.—Part I of subchapter B of chapter  
14 68 (relating to assessable penalties) is amended by insert-  
15 ing after section 6707 the following new section:

16 **“SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE REPORT-**  
17 **ABLE TRANSACTION INFORMATION WITH RE-**  
18 **TURN OR STATEMENT.**

19 “(a) IMPOSITION OF PENALTY.—Any person who  
20 fails to include on any return or statement any informa-  
21 tion with respect to a reportable transaction which is re-  
22 quired under section 6011 to be included with such return  
23 or statement shall pay a penalty in the amount determined  
24 under subsection (b).

25 “(b) AMOUNT OF PENALTY.—

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

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

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

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

11                   “(i) a large entity, or

12                   “(ii) a high net worth individual,

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

16          “(B) LARGE ENTITY.—For purposes of  
17          subparagraph (A), the term ‘large entity’  
18          means, with respect to any taxable year, a per-  
19          son (other than a natural person) with gross re-  
20          ceipts in excess of \$10,000,000 for the taxable  
21          year in which the reportable transaction occurs  
22          or the preceding taxable year. Rules similar to  
23          the rules of paragraph (2) and subparagraphs  
24          (B), (C), and (D) of paragraph (3) of section

1           448(c) shall apply for purposes of this subpara-  
2           graph.

3           “(C) HIGH NET WORTH INDIVIDUAL.—For  
4           purposes of subparagraph (A), the term ‘high  
5           net worth individual’ means, with respect to a  
6           reportable transaction, a natural person whose  
7           net worth exceeds \$2,000,000 immediately be-  
8           fore the transaction.

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

10           “(1) REPORTABLE TRANSACTION.—The term  
11           ‘reportable transaction’ means any transaction with  
12           respect to which information is required to be in-  
13           cluded with a return or statement because, as deter-  
14           mined under regulations prescribed under section  
15           6011, such transaction is of a type which the Sec-  
16           retary determines as having a potential for tax  
17           avoidance or evasion.

18           “(2) LISTED TRANSACTION.—Except as pro-  
19           vided in regulations, the term ‘listed transaction’  
20           means a reportable transaction which is the same as,  
21           or substantially similar to, a transaction specifically  
22           identified by the Secretary as a tax avoidance trans-  
23           action for purposes of section 6011.

24           “(d) AUTHORITY TO RESCIND PENALTY.—

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

5                   “(A) the violation is with respect to a re-  
6                   portable transaction other than a listed trans-  
7                   action,

8                   “(B) the person on whom the penalty is  
9                   imposed has a history of complying with the re-  
10                  quirements of this title,

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

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

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

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

1 of such Office for a determination under paragraph  
2 (1).

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

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

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

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

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

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

21 “(A) a summary of the total number and  
22 aggregate amount of penalties imposed, and re-  
23 scinded, under this section, and

1           “(B) a description of each penalty re-  
2           scinded under this subsection and the reasons  
3           therefor.

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

6           “(1) which is required to file periodic reports  
7           under section 13 or 15(d) of the Securities Ex-  
8           change Act of 1934 or is required to be consolidated  
9           with another person for purposes of such reports,  
10          and

11          “(2) which—

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

14                  “(B) is required to pay a penalty under  
15                  section 6662A with respect to any reportable  
16                  transaction at a rate prescribed under section  
17                  6662A(c), or

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

21 the requirement to pay such penalty shall be disclosed in  
22 such reports filed by such person for such periods as the  
23 Secretary shall specify. Failure to make a disclosure in  
24 accordance with the preceding sentence shall be treated

1 as a failure to which the penalty under subsection (b)(2)  
2 applies.

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

6 (b) CONFORMING AMENDMENT.—The table of sec-  
7 tions for part I of subchapter B of chapter 68 is amended  
8 by inserting after the item relating to section 6707 the  
9 following:

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

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

14 **SEC. 213. ACCURACY-RELATED PENALTY FOR LISTED**  
15 **TRANSACTIONS AND OTHER REPORTABLE**  
16 **TRANSACTIONS HAVING A SIGNIFICANT TAX**  
17 **AVOIDANCE PURPOSE.**

18 (a) IN GENERAL.—Subchapter A of chapter 68 is  
19 amended by inserting after section 6662 the following new  
20 section:

1 **“SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PEN-**  
2 **ALTY ON UNDERSTATEMENTS WITH RESPECT**  
3 **TO REPORTABLE TRANSACTIONS.**

4 “(a) IMPOSITION OF PENALTY.—If a taxpayer has a  
5 reportable transaction understatement for any taxable  
6 year, there shall be added to the tax an amount equal to  
7 20 percent of the amount of such understatement.

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

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

12 “(A) the product of—

13 “(i) the amount of the increase (if  
14 any) in taxable income which results from  
15 a difference between the proper tax treat-  
16 ment of an item to which this section ap-  
17 plies and the taxpayer’s treatment of such  
18 item (as shown on the taxpayer’s return of  
19 tax), and

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

23 “(B) the amount of the decrease (if any)  
24 in the aggregate amount of credits determined  
25 under subtitle A which results from a difference  
26 between the taxpayer’s treatment of an item to

1           which this section applies (as shown on the tax-  
2           payer’s return of tax) and the proper tax treat-  
3           ment of such item.

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

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

13                   “(A) any listed transaction, and

14                   “(B) any reportable transaction (other  
15                   than a listed transaction) if a significant pur-  
16                   pose of such transaction is the avoidance or  
17                   evasion of Federal income tax.

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

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

1           “(2) RULES APPLICABLE TO COMPROMISE OF  
2 PENALTY.—

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

11           “(B) APPLICABLE RULES.—The rules of  
12 paragraphs (3), (4), and (5) of section  
13 6707A(d) shall apply for purposes of subpara-  
14 graph (A).

15           “(d) DEFINITIONS OF REPORTABLE AND LISTED  
16 TRANSACTIONS.—For purposes of this section, the terms  
17 ‘reportable transaction’ and ‘listed transaction’ have the  
18 respective meanings given to such terms by section  
19 6707A(c).

20           “(e) SPECIAL RULES.—

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

24           “(A) the amount of such understatement  
25 (determined without regard to this paragraph)

1 shall be increased by the aggregate amount of  
2 reportable transaction understatements and  
3 noneconomic substance transaction understate-  
4 ments for purposes of determining whether  
5 such understatement is a substantial under-  
6 statement under section 6662(d)(1), and

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

14 “(2) COORDINATION WITH OTHER PEN-  
15 ALTIES.—

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

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

1           “(3) SPECIAL RULE FOR AMENDED RE-  
2           TURNS.—Except as provided in regulations, in no  
3           event shall any tax treatment included with an  
4           amendment or supplement to a return of tax be  
5           taken into account in determining the amount of any  
6           reportable transaction understatement or non-  
7           economic substance transaction understatement if  
8           the amendment or supplement is filed after the ear-  
9           lier of the date the taxpayer is first contacted by the  
10          Secretary regarding the examination of the return or  
11          such other date as is specified by the Secretary.

12           “(4) NONECONOMIC SUBSTANCE TRANSACTION  
13          UNDERSTATEMENT.—For purposes of this sub-  
14          section, the term ‘noneconomic substance trans-  
15          action understatement’ has the meaning given such  
16          term by section 6662B(c).

17           “(5) CROSS REFERENCE.—

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

18          (b) DETERMINATION OF OTHER UNDERSTATE-  
19          MENTS.—Subparagraph (A) of section 6662(d)(2) is  
20          amended by adding at the end the following flush sen-  
21          tence:

22           “The excess under the preceding sentence shall  
23           be determined without regard to items to which  
24           section 6662A applies and without regard to

1 items with respect to which a penalty is im-  
2 posed by section 6662B.”.

3 (c) REASONABLE CAUSE EXCEPTION.—

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

6 “(d) REASONABLE CAUSE EXCEPTION FOR REPORT-  
7 ABLE TRANSACTION UNDERSTATEMENTS.—

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

14 “(2) SPECIAL RULES.—Paragraph (1) shall not  
15 apply to any reportable transaction understatement  
16 unless—

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

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

23 “(C) the taxpayer reasonably believed that  
24 such treatment was more likely than not the  
25 proper treatment.

1 A taxpayer failing to adequately disclose in accord-  
2 ance with section 6011 shall be treated as meeting  
3 the requirements of subparagraph (A) if the penalty  
4 for such failure was rescinded under section  
5 6707A(d).

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

8 “(A) IN GENERAL.—A taxpayer shall be  
9 treated as having a reasonable belief with re-  
10 spect to the tax treatment of an item only if  
11 such belief—

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

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

22 “(B) CERTAIN OPINIONS MAY NOT BE RE-  
23 LIED UPON.—

24 “(i) IN GENERAL.—An opinion of a  
25 tax advisor may not be relied upon to es-

1           tablish the reasonable belief of a taxpayer  
2           if—

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

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

7                   “(ii) DISQUALIFIED TAX ADVISORS.—  
8           A tax advisor is described in this clause if  
9           the tax advisor—

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

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

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

1 “(IV) as determined under regu-  
2 lations prescribed by the Secretary,  
3 has a continuing financial interest  
4 with respect to the transaction.

5 “(iii) DISQUALIFIED OPINIONS.—For  
6 purposes of clause (i), an opinion is dis-  
7 qualified if the opinion—

8 “(I) is based on unreasonable  
9 factual or legal assumptions (includ-  
10 ing assumptions as to future events),

11 “(II) unreasonably relies on rep-  
12 resentations, statements, findings, or  
13 agreements of the taxpayer or any  
14 other person,

15 “(III) does not identify and con-  
16 sider all relevant facts, or

17 “(IV) fails to meet any other re-  
18 quirement as the Secretary may pre-  
19 scribe.”.

20 (2) CONFORMING AMENDMENT.—The heading  
21 for subsection (c) of section 6664 is amended by in-  
22 serting “FOR UNDERPAYMENTS” after “EXCEP-  
23 TION”.

24 (d) CONFORMING AMENDMENTS.—

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

4           (2) Paragraph (3) of section 1274(b) is amend-  
5 ed—

6           (A) by striking “(as defined in section  
7 6662(d)(2)(C)(iii))” in subparagraph (B)(i),  
8 and

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

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

13           “(i) a partnership or other entity,

14           “(ii) any investment plan or arrange-  
15 ment, or

16           “(iii) any other plan or arrangement,  
17 if a significant purpose of such partnership, en-  
18 tity, plan, or arrangement is the avoidance or  
19 evasion of Federal income tax.”.

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

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



1 **“SEC. 6662B. PENALTY FOR UNDERSTATEMENTS ATTRIB-**  
2 **UTABLE TO TRANSACTIONS LACKING ECO-**  
3 **NOMIC SUBSTANCE, ETC.**

4 “(a) IMPOSITION OF PENALTY.—If a taxpayer has an  
5 noneconomic substance transaction understatement for  
6 any taxable year, there shall be added to the tax an  
7 amount equal to 40 percent of the amount of such under-  
8 statement.

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

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

18 “(1) IN GENERAL.—The term ‘noneconomic  
19 substance transaction understatement’ means any  
20 amount which would be an understatement under  
21 section 6662A(b)(1) if section 6662A were applied  
22 by taking into account items attributable to non-  
23 economic substance transactions rather than items  
24 to which section 6662A would apply without regard  
25 to this paragraph.

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

4           “(A) there is a lack of economic substance  
5 (within the meaning of section 7701(m)(1)) for  
6 the transaction giving rise to the claimed tax  
7 benefit or the transaction was not respected  
8 under section 7701(m)(2), or

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

11       “(d) RULES APPLICABLE TO COMPROMISE OF PEN-  
12 ALTY.—

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

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

23       “(e) COORDINATION WITH OTHER PENALTIES.—Ex-  
24 cept as otherwise provided in this part, the penalty im-

1 posed by this section shall be in addition to any other pen-  
 2 alty imposed by this title.

3 “(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).**”.

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

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

8 (c) EFFECTIVE DATE.—The amendments made by  
 9 this section shall apply to transactions entered into after  
 10 February 13, 2003.

11 **SEC. 215. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-**  
 12 **MENT PENALTY FOR NONREPORTABLE**  
 13 **TRANSACTIONS.**

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

17 “(B) SPECIAL RULE FOR CORPORA-  
 18 TIONS.—In the case of a corporation other than  
 19 an S corporation or a personal holding company  
 20 (as defined in section 542), there is a substan-  
 21 tial understatement of income tax for any tax-

1           able year if the amount of the understatement  
2           for the taxable year exceeds the lesser of—

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

6                   “(ii) \$10,000,000.”.

7           (b) REDUCTION FOR UNDERSTATEMENT OF TAX-  
8 PAYER DUE TO POSITION OF TAXPAYER OR DISCLOSED  
9 ITEM.—

10           (1) IN GENERAL.—Section 6662(d)(2)(B)(i)  
11           (relating to substantial authority) is amended to  
12           read as follows:

13                   “(i) the tax treatment of any item by  
14                   the taxpayer if the taxpayer had reason-  
15                   able belief that the tax treatment was more  
16                   likely than not the proper treatment, or”.

17           (2) CONFORMING AMENDMENT.—Section  
18           6662(d) is amended by adding at the end the fol-  
19           lowing new paragraph:

20                   “(3) SECRETARIAL LIST.—For purposes of this  
21                   subsection, section 6664(d)(2), and section  
22                   6694(a)(1), the Secretary may prescribe a list of po-  
23                   sitions for which the Secretary believes there is not  
24                   substantial authority or there is no reasonable belief  
25                   that the tax treatment is more likely than not the

1 proper tax treatment. Such list (and any revisions  
2 thereof) shall be published in the Federal Register  
3 or the Internal Revenue Bulletin.”

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

7 **SEC. 216. TAX SHELTER EXCEPTION TO CONFIDENTIALITY**  
8 **PRIVILEGES RELATING TO TAXPAYER COM-**  
9 **MUNICATIONS.**

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

13 “(b) SECTION NOT TO APPLY TO COMMUNICATIONS  
14 REGARDING TAX SHELTERS.—The privilege under sub-  
15 section (a) shall not apply to any written communication  
16 which is—

17 “(1) between a federally authorized tax practi-  
18 tioner and—

19 “(A) any person,

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

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

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

4           (b) EFFECTIVE DATE.—The amendment made by  
5           this section shall apply to communications made on or  
6           after the date of the enactment of this Act.

7           **SEC. 217. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

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

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

11          “(a) IN GENERAL.—Each material advisor with re-  
12          spect to any reportable transaction shall make a return  
13          (in such form as the Secretary may prescribe) setting  
14          forth—

15                 “(1) information identifying and describing the  
16          transaction,

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

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

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

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

24                 “(1) MATERIAL ADVISOR.—

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

3                   “(i) who provides any material aid,  
4                   assistance, or advice with respect to orga-  
5                   nizing, promoting, selling, implementing,  
6                   or carrying out any reportable transaction,  
7                   and

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

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

13                   “(i) \$50,000 in the case of a report-  
14                   able transaction substantially all of the tax  
15                   benefits from which are provided to nat-  
16                   ural persons, and

17                   “(ii) \$250,000 in any other case.

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

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

23                   “(1) that only 1 person shall be required to  
24                   meet the requirements of subsection (a) in cases in

1 which 2 or more persons would otherwise be re-  
2 quired to meet such requirements,

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

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

7 (b) CONFORMING AMENDMENTS.—

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

17 **“SEC. 6708. FAILURE TO MAINTAIN LISTS OF ADVISEES**  
18 **WITH RESPECT TO REPORTABLE TRANS-**  
19 **ACTIONS.”.**

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

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

1 (c) EFFECTIVE DATE.—The amendments made by  
2 this section shall apply to transactions with respect to  
3 which material aid, assistance, or advice referred to in sec-  
4 tion 6111(b)(1)(A)(i) of the Internal Revenue Code of  
5 1986 (as added by this section) is provided after the date  
6 of the enactment of this Act.

7 **SEC. 218. MODIFICATIONS TO PENALTY FOR FAILURE TO**  
8 **REGISTER TAX SHELTERS.**

9 (a) IN GENERAL.—Section 6707 (relating to failure  
10 to furnish information regarding tax shelters) is amended  
11 to read as follows:

12 **“SEC. 6707. FAILURE TO FURNISH INFORMATION REGARD-**  
13 **ING REPORTABLE TRANSACTIONS.**

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

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

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

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

23 “(b) AMOUNT OF PENALTY.—

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

4           “(2) LISTED TRANSACTIONS.—The penalty im-  
5           posed under subsection (a) with respect to any listed  
6           transaction shall be an amount equal to the greater  
7           of—

8                   “(A) \$200,000, or

9                   “(B) 50 percent of the gross income de-  
10                  rived by such person with respect to aid, assist-  
11                  ance, or advice which is provided with respect  
12                  to the reportable transaction before the date the  
13                  return including the transaction is filed under  
14                  section 6111.

15           Subparagraph (B) shall be applied by substituting  
16           ‘75 percent’ for ‘50 percent’ in the case of an inten-  
17           tional failure or act described in subsection (a).

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

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

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

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

8 **SEC. 219. MODIFICATION OF PENALTY FOR FAILURE TO**  
9 **MAINTAIN LISTS OF INVESTORS.**

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

12 “(a) IMPOSITION OF PENALTY.—

13 “(1) IN GENERAL.—If any person who is re-  
14 quired to maintain a list under section 6112(a) fails  
15 to make such list available upon written request to  
16 the Secretary in accordance with section  
17 6112(b)(1)(A) within 20 business days after the  
18 date of the Secretary’s request, such person shall  
19 pay a penalty of \$10,000 for each day of such fail-  
20 ure after such 20th day.

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

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

4 **SEC. 220. MODIFICATION OF ACTIONS TO ENJOIN CERTAIN**  
5 **CONDUCT RELATED TO TAX SHELTERS AND**  
6 **REPORTABLE TRANSACTIONS.**

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

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

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

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

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

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

8           “(c) SPECIFIED CONDUCT.—For purposes of this  
9 section, the term ‘specified conduct’ means any action, or  
10 failure to take action, subject to penalty under section  
11 6700, 6701, 6707, or 6708.”.

12           (b) CONFORMING AMENDMENTS.—

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

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

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

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

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

1 **SEC. 221. UNDERSTATEMENT OF TAXPAYER'S LIABILITY BY**  
2 **INCOME TAX RETURN PREPARER.**

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

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

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

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

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

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

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

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

1 **SEC. 222. PENALTY ON FAILURE TO REPORT INTERESTS IN**  
2 **FOREIGN FINANCIAL ACCOUNTS.**

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

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

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

12 “(B) AMOUNT OF PENALTY.—

13 “(i) IN GENERAL.—Except as pro-  
14 vided in subparagraph (C), the amount of  
15 any civil penalty imposed under subpara-  
16 graph (A) shall not exceed \$5,000.

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

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

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

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

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

8           “(I) \$25,000, or

9           “(II) the amount (not exceeding  
10 \$100,000) determined under subpara-  
11 graph (D), and

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

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

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

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

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

4 **SEC. 223. FRIVOLOUS TAX SUBMISSIONS.**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 “(ii) an application under—

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

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

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

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

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

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

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

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

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

8 (1) FRIVOLOUS REQUESTS DISREGARDED.—  
9 Section 6330 (relating to notice and opportunity for  
10 hearing before levy) is amended by adding at the  
11 end the following new subsection:

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

20 (2) PRECLUSION FROM RAISING FRIVOLOUS  
21 ISSUES AT HEARING.—Section 6330(c)(4) is amend-  
22 ed—

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

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

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

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

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

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

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

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

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

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

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

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

“Sec. 6702. Frivolous tax submissions.”.

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

19 **SEC. 224. REGULATION OF INDIVIDUALS PRACTICING BE-**  
 20 **FORE THE DEPARTMENT OF TREASURY.**

21       (a) CENSURE; IMPOSITION OF PENALTY.—

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

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

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

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

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

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

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

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

3 **SEC. 225. PENALTY ON PROMOTERS OF TAX SHELTERS.**

4 (a) PENALTY ON PROMOTING ABUSIVE TAX SHEL-  
5 TERS.—Section 6700(a) is amended by adding at the end  
6 the following new sentence: “Notwithstanding the first  
7 sentence, if an activity with respect to which a penalty  
8 imposed under this subsection involves a statement de-  
9 scribed in paragraph (2)(A), the amount of the penalty  
10 shall be equal to 50 percent of the gross income derived  
11 (or to be derived) from such activity by the person on  
12 which the penalty is imposed.”.

13 (b) EFFECTIVE DATE.—The amendment made by  
14 this section shall apply to activities after the date of the  
15 enactment of this Act.

16 **SEC. 226. STATUTE OF LIMITATIONS FOR TAXABLE YEARS**  
17 **FOR WHICH LISTED TRANSACTIONS NOT RE-**  
18 **PORTED.**

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

22 “(C) LISTED TRANSACTIONS.—If a tax-  
23 payer fails to include on any return or state-  
24 ment for any taxable year any information with  
25 respect to a listed transaction (as defined in

1 section 6707A(c)(2)) which is required under  
2 section 6011 to be included with such return or  
3 statement, the tax for such taxable year may be  
4 assessed, or a proceeding in court for collection  
5 of such tax may be begun without assessment,  
6 at any time within 6 years after the time the  
7 return is filed. This subparagraph shall not  
8 apply to any taxable year if the time for assess-  
9 ment or beginning the proceeding in court has  
10 expired before the time a transaction is treated  
11 as a listed transaction under section 6011.”.

12 (b) EFFECTIVE DATE.—The amendment made by  
13 this section shall apply to transactions after the date of  
14 the enactment of this Act in taxable years ending after  
15 such date.

16 **SEC. 227. DENIAL OF DEDUCTION FOR INTEREST ON UN-**  
17 **DERPAYMENTS ATTRIBUTABLE TO NONDIS-**  
18 **CLOSED REPORTABLE AND NONECONOMIC**  
19 **SUBSTANCE TRANSACTIONS.**

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

24 “(m) INTEREST ON UNPAID TAXES ATTRIBUTABLE  
25 TO NONDISCLOSED REPORTABLE TRANSACTIONS AND

1 NONECONOMIC SUBSTANCE TRANSACTIONS.—No deduc-  
 2 tion shall be allowed under this chapter for any interest  
 3 paid or accrued under section 6601 on any underpayment  
 4 of tax which is attributable to—

5 “(1) the portion of any reportable transaction  
 6 understatement (as defined in section 6662A(b))  
 7 with respect to which the requirement of section  
 8 6664(d)(2)(A) is not met, or

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

11 (b) EFFECTIVE DATE.—The amendments made by  
 12 this section shall apply to transactions after the date of  
 13 the enactment of this Act in taxable years ending after  
 14 such date.

## 15 **Part II—Other Provisions**

### 16 **SEC. 231. LIMITATION ON TRANSFER OR IMPORTATION OF** 17 **BUILT-IN LOSSES.**

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

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

22 “(1) LIMITATION ON IMPORTATION OF BUILT-  
 23 IN LOSSES.—

24 “(A) IN GENERAL.—If in any transaction  
 25 described in subsection (a) or (b) there would

1 (but for this subsection) be an importation of a  
2 net built-in loss, the basis of each property de-  
3 scribed in subparagraph (B) which is acquired  
4 in such transaction shall (notwithstanding sub-  
5 sections (a) and (b)) be its fair market value  
6 immediately after such transaction.

7 “(B) PROPERTY DESCRIBED.—For pur-  
8 poses of subparagraph (A), property is de-  
9 scribed in this paragraph if—

10 “(i) gain or loss with respect to such  
11 property is not subject to tax under this  
12 subtitle in the hands of the transferor im-  
13 mediately before the transfer, and

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

18 In any case in which the transferor is a part-  
19 nership, the preceding sentence shall be applied  
20 by treating each partner in such partnership as  
21 holding such partner’s proportionate share of  
22 the property of such partnership.

23 “(C) IMPORTATION OF NET BUILT-IN  
24 LOSS.—For purposes of subparagraph (A),  
25 there is an importation of a net built-in loss in

1 a transaction if the transferee's aggregate ad-  
2 justed bases of property described in subpara-  
3 graph (B) which is transferred in such trans-  
4 action would (but for this paragraph) exceed  
5 the fair market value of such property imme-  
6 diately after such transaction.”.

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

9 “(A) IN GENERAL.—If—

10 “(i) property is transferred in any  
11 transaction which is described in sub-  
12 section (a) and which is not described in  
13 paragraph (1) of this subsection, and

14 “(ii) the transferee's aggregate ad-  
15 justed bases of the property so transferred  
16 would (but for this paragraph) exceed the  
17 fair market value of such property imme-  
18 diately after such transaction,

19 then, notwithstanding subsection (a), the trans-  
20 feree's aggregate adjusted bases of the property  
21 so transferred shall not exceed the fair market  
22 value of such property immediately after such  
23 transaction.

24 “(B) ALLOCATION OF BASIS REDUC-  
25 TION.—The aggregate reduction in basis by

1           reason of subparagraph (A) shall be allocated  
2           among the property so transferred in proportion  
3           to their respective built-in losses immediately  
4           before the transaction.

5                   “(C) EXCEPTION FOR TRANSFERS WITHIN  
6           AFFILIATED GROUP.—Subparagraph (A) shall  
7           not apply to any transaction if the transferor  
8           owns stock in the transferee meeting the re-  
9           quirements of section 1504(a)(2). In the case of  
10          property to which subparagraph (A) does not  
11          apply by reason of the preceding sentence, the  
12          transferor’s basis in the stock received for such  
13          property shall not exceed its fair market value  
14          immediately after the transfer.”.

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

18                   “(1) IN GENERAL.—If property is received by a  
19          corporate distributee in a distribution in a complete  
20          liquidation to which section 332 applies (or in a  
21          transfer described in section 337(b)(1)), the basis of  
22          such property in the hands of such distributee shall  
23          be the same as it would be in the hands of the trans-  
24          feror; except that the basis of such property in the  
25          hands of such distributee shall be the fair market

1 value of the property at the time of the distribu-  
2 tion—

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

6 “(B) in any case in which the liquidating  
7 corporation is a foreign corporation, the cor-  
8 porate distributee is a domestic corporation,  
9 and the corporate distributee’s aggregate ad-  
10 justed bases of property described in section  
11 362(e)(1)(B) which is distributed in such liq-  
12 uidation would (but for this subparagraph) ex-  
13 ceed the fair market value of such property im-  
14 mediately after such liquidation.”.

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

18 **SEC. 232. DISALLOWANCE OF CERTAIN PARTNERSHIP LOSS**

19 **TRANSFERS.**

20 (a) TREATMENT OF CONTRIBUTED PROPERTY WITH  
21 BUILT-IN LOSS.—Paragraph (1) of section 704(c) is  
22 amended by striking “and” at the end of subparagraph  
23 (A), by striking the period at the end of subparagraph  
24 (B) and inserting “, and”, and by adding at the end the  
25 following:

1           “(C) if any property so contributed has a  
2           built-in loss—

3                   “(i) such built-in loss shall be taken  
4                   into account only in determining the  
5                   amount of items allocated to the contrib-  
6                   uting partner, and

7                   “(ii) except as provided in regulations,  
8                   in determining the amount of items allo-  
9                   cated to other partners, the basis of the  
10                  contributed property in the hands of the  
11                  partnership shall be treated as being equal  
12                  to its fair market value immediately after  
13                  the contribution.

14           For purposes of subparagraph (C), the term ‘built-  
15           in loss’ means the excess of the adjusted basis of the  
16           property (determined without regard to subpara-  
17           graph (C)(ii)) over its fair market value immediately  
18           after the contribution.”.

19           (b) ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-  
20           ERTY ON TRANSFER OF PARTNERSHIP INTEREST IF  
21           THERE IS SUBSTANTIAL BUILT-IN LOSS.—

22                   (1) ADJUSTMENT REQUIRED.—Subsection (a)  
23                   of section 743 (relating to optional adjustment to  
24                   basis of partnership property) is amended by insert-  
25                   ing before the period “or unless the partnership has

1 a substantial built-in loss immediately after such  
2 transfer”.

3 (2) ADJUSTMENT.—Subsection (b) of section  
4 743 is amended by inserting “or with respect to  
5 which there is a substantial built-in loss immediately  
6 after such transfer” after “section 754 is in effect”.

7 (3) SUBSTANTIAL BUILT-IN LOSS.—Section 743  
8 is amended by adding at the end the following new  
9 subsection:

10 “(d) SUBSTANTIAL BUILT-IN LOSS.—

11 “(1) IN GENERAL.—For purposes of this sec-  
12 tion, a partnership has a substantial built-in loss  
13 with respect to a transfer of an interest in a part-  
14 nership if the transferee partner’s proportionate  
15 share of the adjusted basis of the partnership prop-  
16 erty exceeds by more than \$250,000 the basis of  
17 such partner’s interest in the partnership.

18 “(2) REGULATIONS.—The Secretary shall pre-  
19 scribe such regulations as may be appropriate to  
20 carry out the purposes of paragraph (1) and section  
21 734(d), including regulations aggregating related  
22 partnerships and disregarding property acquired by  
23 the partnership in an attempt to avoid such pur-  
24 poses.”.

25 (4) CLERICAL AMENDMENTS.—

1 (A) The section heading for section 743 is  
2 amended to read as follows:

3 **“SEC. 743. ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-**  
4 **ERTY WHERE SECTION 754 ELECTION OR**  
5 **SUBSTANTIAL BUILT-IN LOSS.”.**

6 (B) The table of sections for subpart C of  
7 part II of subchapter K of chapter 1 is amend-  
8 ed by striking the item relating to section 743  
9 and inserting the following new item:

“Sec. 743. Adjustment to basis of partnership property where sec-  
tion 754 election or substantial built-in loss.”.

10 (c) **ADJUSTMENT TO BASIS OF UNDISTRIBUTED**  
11 **PARTNERSHIP PROPERTY IF THERE IS SUBSTANTIAL**  
12 **BASIS REDUCTION.—**

13 (1) **ADJUSTMENT REQUIRED.—**Subsection (a)  
14 of section 734 (relating to optional adjustment to  
15 basis of undistributed partnership property) is  
16 amended by inserting before the period “or unless  
17 there is a substantial basis reduction”.

18 (2) **ADJUSTMENT.—**Subsection (b) of section  
19 734 is amended by inserting “or unless there is a  
20 substantial basis reduction” after “section 754 is in  
21 effect”.

22 (3) **SUBSTANTIAL BASIS REDUCTION.—**Section  
23 734 is amended by adding at the end the following  
24 new subsection:

1 “(d) SUBSTANTIAL BASIS REDUCTION.—

2 “(1) IN GENERAL.—For purposes of this sec-  
3 tion, there is a substantial basis reduction with re-  
4 spect to a distribution if the sum of the amounts de-  
5 scribed in subparagraphs (A) and (B) of subsection  
6 (b)(2) exceeds \$250,000.

7 “(2) REGULATIONS.—

“For regulations to carry out this subsection, see  
section 743(d)(2).”.

8 (4) CLERICAL AMENDMENTS.—

9 (A) The section heading for section 734 is  
10 amended to read as follows:

11 **“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED**  
12 **PARTNERSHIP PROPERTY WHERE SECTION**  
13 **754 ELECTION OR SUBSTANTIAL BASIS RE-**  
14 **DUCTION.”.**

15 (B) The table of sections for subpart B of  
16 part II of subchapter K of chapter 1 is amend-  
17 ed by striking the item relating to section 734  
18 and inserting the following new item:

“Sec. 734. Adjustment to basis of undistributed partnership prop-  
erty where section 754 election or substantial basis  
reduction.”.

19 (d) EFFECTIVE DATES.—

20 (1) SUBSECTION (a).—The amendment made  
21 by subsection (a) shall apply to contributions made  
22 after the date of the enactment of this Act.

1           (2) SUBSECTION (b).—The amendments made  
2           by subsection (b) shall apply to transfers after the  
3           date of the enactment of this Act.

4           (3) SUBSECTION (c).—The amendments made  
5           by subsection (c) shall apply to distributions after  
6           the date of the enactment of this Act.

7 **SEC. 233. NO REDUCTION OF BASIS UNDER SECTION 734 IN**  
8                           **STOCK HELD BY PARTNERSHIP IN COR-**  
9                           **PORATE PARTNER.**

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

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

16                 “(1) no allocation may be made to stock in a  
17                 corporation which is a partner in the partnership,  
18                 and

19                 “(2) any amount not allocable to stock by rea-  
20                 son of paragraph (1) shall be allocated under sub-  
21                 section (a) to other partnership property.

22          Gain shall be recognized to the partnership to the extent  
23          that the amount required to be allocated under paragraph  
24          (2) to other partnership property exceeds the aggregate

1 adjusted basis of such other property immediately before  
2 the allocation required by paragraph (2).”.

3 (b) **EFFECTIVE DATE.**—The amendment made by  
4 this section shall apply to distributions after the date of  
5 the enactment of this Act.

6 **SEC. 234. REPEAL OF SPECIAL RULES FOR FASITS.**

7 (a) **IN GENERAL.**—Part V of subchapter M of chap-  
8 ter 1 (relating to financial asset securitization investment  
9 trusts) is hereby repealed.

10 (b) **CONFORMING AMENDMENTS.**—

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

14 (2) Clause (ii) of section 382(l)(4)(B) is amend-  
15 ed by striking “a REMIC to which part IV of sub-  
16 chapter M applies, or a FASIT to which part V of  
17 subchapter M applies,” and inserting “or a REMIC  
18 to which part IV of subchapter M applies,”.

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

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

24 (5) Paragraph (5) of section 860G(a) is amend-  
25 ed by adding “and” at the end of subparagraph (B),

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

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

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

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

14 (c) EFFECTIVE DATE.—

15 (1) IN GENERAL.—Except as provided in para-  
16 graph (2), the amendments made by this section  
17 shall apply to taxable years beginning after Decem-  
18 ber 31, 2003.

19 (2) EXCEPTION FOR EXISTING FASITS.—

20 (A) IN GENERAL.—Paragraph (1) shall not  
21 apply to any FASIT in existence on the date of  
22 the enactment of this Act.

23 (B) TRANSFER OF ADDITIONAL ASSETS  
24 NOT PERMITTED.—Except as provided in regu-  
25 lations prescribed by the Secretary of the

1 Treasury or the Secretary's delegate, subpara-  
2 graph (A) shall cease to apply as of the earliest  
3 date after the date of the enactment of this Act  
4 that any property is transferred to the FASIT.

5 **SEC. 235. EXPANDED DISALLOWANCE OF DEDUCTION FOR**  
6 **INTEREST ON CONVERTIBLE DEBT.**

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

11 (b) CONFORMING AMENDMENT.—Paragraph (3) of  
12 section 163(l) is amended by striking “or a related party”  
13 in the material preceding subparagraph (A) and inserting  
14 “or any other person”.

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

18 **SEC. 236. EXPANDED AUTHORITY TO DISALLOW TAX BENE-**  
19 **FITS UNDER SECTION 269.**

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

23 “(a) IN GENERAL.—If—

24 “(1)(A) any person acquires stock in a corpora-  
25 tion, or



1       come under section 951(a)(1)(A)(i) of subpart F in-  
2       come of such corporation for such period.”.

3       (b) DETERMINATION OF PRO RATA SHARE OF SUB-  
4 PART F INCOME.—Subsection (a) of section 951 (relating  
5 to amounts included in gross income of United States  
6 shareholders) is amended by adding at the end the fol-  
7 lowing new paragraph:

8               “(4) SPECIAL RULES FOR DETERMINING PRO  
9       RATA SHARE OF SUBPART F INCOME.—The pro rata  
10      share under paragraph (2) shall be determined by  
11      disregarding—

12              “(A) any rights lacking substantial eco-  
13              nomic effect, and

14              “(B) stock owned by a shareholder who is  
15              a tax-indifferent party (as defined in section  
16              7701(m)(3)) if the amount which would (but  
17              for this paragraph) be allocated to such share-  
18              holder does not reflect such shareholder’s eco-  
19              nomic share of the earnings and profits of the  
20              corporation.”.

21      (c) EFFECTIVE DATE.—The amendments made by  
22 this section shall apply to taxable years on controlled for-  
23 eign corporation beginning after February 13, 2003, and  
24 to taxable years of United States shareholder in which or

1 with which such taxable years of controlled foreign cor-  
2 porations end.

3 **SEC. 238. BASIS FOR DETERMINING LOSS ALWAYS RE-**  
4 **DUCED BY NONTAXED PORTION OF DIVI-**  
5 **DENDS.**

6       (a) IN GENERAL.—Section 1059 (relating to cor-  
7 porate shareholder’s basis in stock reduced by nontaxed  
8 portion of extraordinary dividends) is amended by redesi-  
9 gnating subsection (g) as subsection (h) and by inserting  
10 after subsection (f) the following new subsection:

11       “(g) BASIS FOR DETERMINING LOSS ALWAYS RE-  
12 DUCED BY NONTAXED PORTION OF DIVIDENDS.—The  
13 basis of stock in a corporation (for purposes of deter-  
14 mining loss) shall be reduced by the nontaxed portion of  
15 any dividend received with respect to such stock if this  
16 section does not otherwise apply to such dividend.”.

17       (b) EFFECTIVE DATE.—The amendment made by  
18 this section shall apply to dividends received after the date  
19 of the enactment of this Act.

20 **SEC. 239. AFFIRMATION OF CONSOLIDATED RETURN REGU-**  
21 **LATION AUTHORITY.**

22       (a) IN GENERAL.—Section 1502 (relating to consoli-  
23 dated return regulations) is amended by adding at the end  
24 the following new sentence: “In prescribing such regula-  
25 tions, the Secretary may prescribe rules applicable to cor-

1 porations filing consolidated returns under section 1501  
2 that are different from other provisions of this title that  
3 would apply if such corporations filed separate returns.”.

4 (b) RESULT NOT OVERTURNED.—Notwithstanding  
5 subsection (a), the Internal Revenue Code of 1986 shall  
6 be construed by treating Treasury regulation § 1.1502–  
7 20(c)(1)(iii) (as in effect on January 1, 2001) as being  
8 inapplicable to the type of factual situation in 255 F.3d  
9 1357 (Fed. Cir. 2001).

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

13 **Subtitle B—PREVENTION OF**  
14 **CORPORATE EXPATRIATION**  
15 **TO AVOID UNITED STATES IN-**  
16 **COME TAX**

17 **SEC. 251. PREVENTION OF CORPORATE EXPATRIATION TO**  
18 **AVOID UNITED STATES INCOME TAX.**

19 (a) IN GENERAL.—Paragraph (4) of section 7701(a)  
20 (defining domestic) is amended to read as follows:

21 “(4) DOMESTIC.—

22 “(A) IN GENERAL.—Except as provided in  
23 subparagraph (B), the term ‘domestic’ when ap-  
24 plied to a corporation or partnership means cre-  
25 ated or organized in the United States or under

1 the law of the United States or of any State  
2 unless, in the case of a partnership, the Sec-  
3 retary provides otherwise by regulations.

4 “(B) CERTAIN CORPORATIONS TREATED  
5 AS DOMESTIC.—

6 “(i) IN GENERAL.—The acquiring cor-  
7 poration in a corporate expatriation trans-  
8 action shall be treated as a domestic cor-  
9 poration.

10 “(ii) CORPORATE EXPATRIATION  
11 TRANSACTION.—For purposes of this sub-  
12 paragraph, the term ‘corporate expatria-  
13 tion transaction’ means any transaction  
14 if—

15 “(I) a nominally foreign corpora-  
16 tion (referred to in this subparagraph  
17 as the ‘acquiring corporation’) ac-  
18 quires, as a result of such transaction,  
19 directly or indirectly substantially all  
20 of the properties held directly or indi-  
21 rectly by a domestic corporation, and

22 “(II) immediately after the trans-  
23 action, more than 80 percent of the  
24 stock (by vote or value) of the acquir-  
25 ing corporation is held by former

1 shareholders of the domestic corpora-  
2 tion by reason of holding stock in the  
3 domestic corporation.

4 “(iii) LOWER STOCK OWNERSHIP RE-  
5 QUIREMENT IN CERTAIN CASES.—Sub-  
6 clause (II) of clause (ii) shall be applied by  
7 substituting ‘50 percent’ for ‘80 percent’  
8 with respect to any nominally foreign cor-  
9 poration if—

10 “(I) such corporation does not  
11 have substantial business activities  
12 (when compared to the total business  
13 activities of the expanded affiliated  
14 group) in the foreign country in which  
15 or under the law of which the corpora-  
16 tion is created or organized, and

17 “(II) the stock of the corporation  
18 is publicly traded and the principal  
19 market for the public trading of such  
20 stock is in the United States.

21 “(iv) PARTNERSHIP TRANSACTIONS.—  
22 The term ‘corporate expatriation trans-  
23 action’ includes any transaction if—

24 “(I) a nominally foreign corpora-  
25 tion (referred to in this subparagraph

1 as the ‘acquiring corporation’) ac-  
2 quires, as a result of such transaction,  
3 directly or indirectly properties consti-  
4 tuting a trade or business of a domes-  
5 tic partnership,

6 “(II) immediately after the trans-  
7 action, more than 80 percent of the  
8 stock (by vote or value) of the acquir-  
9 ing corporation is held by former  
10 partners of the domestic partnership  
11 or related foreign partnerships (deter-  
12 mined without regard to stock of the  
13 acquiring corporation which is sold in  
14 a public offering related to the trans-  
15 action), and

16 “(III) the acquiring corporation  
17 meets the requirements of subclauses  
18 (I) and (II) of clause (iii).

19 “(v) SPECIAL RULES.—For purposes  
20 of this subparagraph—

21 “(I) a series of related trans-  
22 actions shall be treated as 1 trans-  
23 action, and

24 “(II) stock held by members of  
25 the expanded affiliated group which

1 includes the acquiring corporation  
2 shall not be taken into account in de-  
3 termining ownership.

4 “(vi) OTHER DEFINITIONS.—For pur-  
5 poses of this subparagraph—

6 “(I) NOMINALLY FOREIGN COR-  
7 PORATION.—The term ‘nominally for-  
8 eign corporation’ means any corpora-  
9 tion which would (but for this sub-  
10 paragraph) be treated as a foreign  
11 corporation.

12 “(II) EXPANDED AFFILIATED  
13 GROUP.—The term ‘expanded affili-  
14 ated group’ means an affiliated group  
15 (as defined in section 1504(a) without  
16 regard to section 1504(b)).

17 “(III) RELATED FOREIGN PART-  
18 NERSHIP.—A foreign partnership is  
19 related to a domestic partnership if  
20 they are under common control (with-  
21 in the meaning of section 482), or  
22 they shared the same trademark or  
23 tradename.”.

24 (b) EFFECTIVE DATES.—

1           (1) IN GENERAL.—The amendment made by  
2 this section shall apply to corporate expatriation  
3 transactions completed after September 11, 2001.

4           (2) SPECIAL RULE.—The amendment made by  
5 this section shall also apply to corporate expatriation  
6 transactions completed on or before September 11,  
7 2001, but only with respect to taxable years of the  
8 acquiring corporation beginning after December 31,  
9 2003.

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