

109TH CONGRESS
1ST SESSION

S. 1565

To restrict the use of abusive tax shelters and offshore tax havens to inappropriately avoid Federal taxation, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JULY 29, 2005

Mr. LEVIN (for himself, Mr. COLEMAN, and Mr. OBAMA) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To restrict the use of abusive tax shelters and offshore tax havens to inappropriately avoid Federal taxation, and for other purposes.

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

3 **SECTION 1. SHORT TITLE; ETC.**

4 (a) SHORT TITLE.—This Act may be cited as the
5 “Tax Shelter and Tax Haven Reform Act of 2005”.

6 (b) AMENDMENT OF 1986 CODE.—Except as other-
7 wise expressly provided, whenever in this Act an amend-
8 ment or repeal is expressed in terms of an amendment
9 to, or repeal of, a section or other provision, the reference

1 shall be considered to be made to a section or other provi-
 2 sion of the Internal Revenue Code of 1986.

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

Sec. 1. Short title; etc.

TITLE I—STRENGTHENING TAX SHELTER PENALTIES

Sec. 101. Penalty for promoting abusive tax shelters.

Sec. 102. Penalty for aiding and abetting the understatement of tax liability.

TITLE II—PREVENTING ABUSIVE TAX SHELTERS

Sec. 201. Prohibited fee arrangement.

Sec. 202. Preventing tax shelter activities by financial institutions.

Sec. 203. Information sharing for enforcement purposes.

Sec. 204. Disclosure of information to Congress.

Sec. 205. Tax opinion standards for tax practitioners.

Sec. 206. Whistleblower reforms.

Sec. 207. Denial of deduction for certain fines, penalties, and other amounts.

Sec. 208. Sense of the Senate on tax enforcement priorities.

TITLE III—REQUIRING ECONOMIC SUBSTANCE

Sec. 301. Clarification of economic substance doctrine.

Sec. 302. Penalty for understatements attributable to transactions lacking economic substance, etc.

Sec. 303. Denial of deduction for interest on underpayments attributable to noneconomic substance transactions.

TITLE IV—DETECTING UNCOOPERATIVE TAX HAVENS

Sec. 401. Disclosing payments to persons in uncooperative tax havens.

Sec. 402. Detering uncooperative tax havens by restricting allowable tax benefits.

Sec. 403. Doubling of certain penalties, fines, and interest on underpayments related to certain offshore financial arrangements.

Sec. 404. Treasury regulations on foreign tax credit.

1 **TITLE I—STRENGTHENING TAX**
2 **SHELTER PENALTIES**

3 **SEC. 101. PENALTY FOR PROMOTING ABUSIVE TAX SHEL-**
4 **TERS.**

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

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

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

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

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

18 “(1) AMOUNT OF PENALTY.—The amount of
19 the penalty imposed by subsection (a) shall not ex-
20 ceed the greater of—

21 “(A) 150 percent of the gross income de-
22 rived (or to be derived) from such activity by
23 the person or persons subject to such penalty,
24 and

1 “(B) if readily subject to calculation, the
2 total amount of underpayment by the taxpayer
3 (including penalties, interest, and taxes) in con-
4 nection with such activity.

5 “(2) CALCULATION OF PENALTY.—The penalty
6 amount determined under paragraph (1) shall be
7 calculated with respect to each instance of an activ-
8 ity described in subsection (a), each instance in
9 which income was derived by the person or persons
10 subject to such penalty, and each person who par-
11 ticipated in such an activity.

12 “(3) LIABILITY FOR PENALTY.—If more than 1
13 person is liable under subsection (a) with respect to
14 such activity, all such persons shall be jointly and
15 severally liable for the penalty under such sub-
16 section.

17 “(c) PENALTY NOT DEDUCTIBLE.—The payment of
18 any penalty imposed under this section or the payment
19 of any amount to settle or avoid the imposition of such
20 penalty shall not be considered an ordinary and necessary
21 expense in carrying on a trade or business for purposes
22 of this title and shall not be deductible by the person who
23 is subject to such penalty or who makes such payment.”.

24 (b) CONFORMING AMENDMENT.—Section 6700(a) is
25 amended by striking the last sentence.

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

4 **SEC. 102. PENALTY FOR AIDING AND ABETTING THE UN-**
5 **DERSTATEMENT OF TAX LIABILITY.**

6 (a) IN GENERAL.—Section 6701(a) (relating to im-
7 position of penalty) is amended—

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

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

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

17 (b) AMOUNT OF PENALTY.—Subsection (b) of section
18 6701 (relating to penalties for aiding and abetting under-
19 statement of tax liability) is amended to read as follows:

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

22 “(1) AMOUNT OF PENALTY.—The amount of
23 the penalty imposed by subsection (a) shall not ex-
24 ceed the greater of—

1 “(A) 150 percent of the gross income de-
2 rived (or to be derived) from such aid, assist-
3 ance, procurement, or advice provided by the
4 person or persons subject to such penalty, and

5 “(B) if readily subject to calculation, the
6 total amount of underpayment by the taxpayer
7 (including penalties, interest, and taxes) in con-
8 nection with the understatement of the liability
9 for tax.

10 “(2) CALCULATION OF PENALTY.—The penalty
11 amount determined under paragraph (1) shall be
12 calculated with respect to each instance of aid, as-
13 sistance, procurement, or advice described in sub-
14 section (a), each instance in which income was de-
15 rived by the person or persons subject to such pen-
16 alty, and each person who made such an understate-
17 ment of the liability for tax.

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

23 (c) PENALTY NOT DEDUCTIBLE.—Section 6701 is
24 amended by adding at the end the following new sub-
25 section:

1 the Commission shall, in consultation with the Inter-
2 nal Revenue Service, develop examination techniques
3 to detect potential violations of section 6700 or 6701
4 of the Internal Revenue Code of 1986, by depository
5 institutions, brokers, dealers, and investment advis-
6 ers, as appropriate.

7 (2) FREQUENCY.—Not less frequently than
8 once in each 2-year period, each of the Federal
9 banking agencies and the Commission shall imple-
10 ment the examination techniques developed under
11 paragraph (1) with respect to each of the depository
12 institutions, brokers, dealers, or investment advisers
13 subject to their enforcement authority. Such exam-
14 ination shall, to the extent possible, be combined
15 with any examination by such agency otherwise re-
16 quired or authorized by Federal law.

17 (b) REPORT TO INTERNAL REVENUE SERVICE.—In
18 any case in which an examination conducted under this
19 section with respect to a financial institution or other enti-
20 ty reveals a potential violation, such agency shall promptly
21 notify the Internal Revenue Service of such potential viola-
22 tion for investigation and enforcement by the Internal
23 Revenue Service in accordance with applicable provisions
24 of law.

1 (c) REPORT TO CONGRESS.—The Federal banking
2 agencies and the Commission shall submit a joint written
3 report to Congress in 2007 and 2010 on their progress
4 in preventing violations of sections 6700 and 6701 of the
5 Internal Revenue Code of 1986, by depository institutions,
6 brokers, dealers, and investment advisers, as appropriate.

7 (d) DEFINITIONS.—For purposes of this section—

8 (1) the terms “broker”, “dealer”, and “invest-
9 ment adviser” have the same meanings as in section
10 3 of the Securities Exchange Act of 1934 (15 U.S.C.
11 78c);

12 (2) the term “Commission” means the Securi-
13 ties and Exchange Commission;

14 (3) the term “depository institution” has the
15 same meaning as in section 3(c) of the Federal De-
16 posit Insurance Act (12 U.S.C. 1813(c));

17 (4) the term “Federal banking agencies” has
18 the same meaning as in section 3(q) of the Federal
19 Deposit Insurance Act (12 U.S.C. 1813(q)); and

20 (5) the term “Secretary” means the Secretary
21 of the Treasury.

22 **SEC. 203. INFORMATION SHARING FOR ENFORCEMENT**
23 **PURPOSES.**

24 (a) PROMOTION OF PROHIBITED TAX SHELTERS OR
25 TAX AVOIDANCE SCHEMES.—Section 6103(h) (relating to

1 disclosure to certain Federal officers and employees for
2 purposes of tax administration, etc.) is amended by adding
3 at the end the following new paragraph:

4 “(7) DISCLOSURE OF RETURNS AND RETURN
5 INFORMATION RELATED TO PROMOTION OF PROHIB-
6 ITED TAX SHELTERS OR TAX AVOIDANCE
7 SCHEMES.—

8 “(A) WRITTEN REQUEST.—Upon receipt
9 by the Secretary of a written request which
10 meets the requirements of subparagraph (B)
11 from the head of the United States Securities
12 and Exchange Commission, an appropriate
13 Federal banking agency as defined under sec-
14 tion 1813(q) of title 12, United States Code, or
15 the Public Company Accounting Oversight
16 Board, a return or return information shall be
17 disclosed to such requestor’s officers and em-
18 ployees who are personally and directly engaged
19 in an investigation, examination, or proceeding
20 by such requestor to evaluate, determine, penal-
21 ize, or deter conduct by a financial institution,
22 issuer, or public accounting firm, or associated
23 person, in connection with a potential or actual
24 violation of section 6700 (promotion of abusive
25 tax shelters), 6701 (aiding and abetting under-

1 statement of tax liability), or activities related
2 to promoting or facilitating inappropriate tax
3 avoidance or tax evasion. Such disclosure shall
4 be solely for use by such officers and employees
5 in such investigation, examination, or pro-
6 ceeding.

7 “(B) REQUIREMENTS.—A request meets
8 the requirements of this subparagraph if it sets
9 forth—

10 “(i) the nature of the investigation,
11 examination, or proceeding,

12 “(ii) the statutory authority under
13 which such investigation, examination, or
14 proceeding is being conducted,

15 “(iii) the name or names of the finan-
16 cial institution, issuer, or public accounting
17 firm to which such return information re-
18 lates,

19 “(iv) the taxable period or periods to
20 which such return information relates, and

21 “(v) the specific reason or reasons
22 why such disclosure is, or may be, relevant
23 to such investigation, examination or pro-
24 ceeding.

1 “(C) FINANCIAL INSTITUTION.—For the
2 purposes of this paragraph, the term ‘financial
3 institution’ means a depository institution, for-
4 eign bank, insured institution, industrial loan
5 company, broker, dealer, investment company,
6 investment advisor, or other entity subject to
7 regulation or oversight by the United States Se-
8 curities and Exchange Commission or an appro-
9 priate Federal banking agency.”.

10 (b) FINANCIAL AND ACCOUNTING FRAUD INVESTIGA-
11 TIONS.—Section 6103(i) (relating to disclosure to Federal
12 officers or employees for administration of Federal laws
13 not relating to tax administration) is amended by adding
14 at the end the following new paragraph:

15 “(9) DISCLOSURE OF RETURNS AND RETURN
16 INFORMATION FOR USE IN FINANCIAL AND AC-
17 COUNTING FRAUD INVESTIGATIONS.—

18 “(A) WRITTEN REQUEST.—Upon receipt
19 by the Secretary of a written request which
20 meets the requirements of subparagraph (B)
21 from the head of the United States Securities
22 and Exchange Commission or the Public Com-
23 pany Accounting Oversight Board, a return or
24 return information shall be disclosed to such re-
25 questor’s officers and employees who are per-

1 sonally and directly engaged in an investigation,
2 examination, or proceeding by such requester to
3 evaluate the accuracy of a financial statement
4 or report or to determine whether to require a
5 restatement, penalize, or deter conduct by an
6 issuer, investment company, or public account-
7 ing firm, or associated person, in connection
8 with a potential or actual violation of auditing
9 standards or prohibitions against false or mis-
10 leading statements or omissions in financial
11 statements or reports. Such disclosure shall be
12 solely for use by such officers and employees in
13 such investigation, examination, or proceeding.

14 “(B) REQUIREMENTS.—A request meets
15 the requirements of this subparagraph if it sets
16 forth—

17 “(i) the nature of the investigation,
18 examination, or proceeding,

19 “(ii) the statutory authority under
20 which such investigation, examination, or
21 proceeding is being conducted,

22 “(iii) the name or names of the issuer,
23 investment company, or public accounting
24 firm to which such return information re-
25 lates,

1 “(iv) the taxable period or periods to
2 which such return information relates, and
3 “(v) the specific reason or reasons
4 why such disclosure is, or may be, relevant
5 to such investigation, examination or pro-
6 ceeding.”.

7 (c) EFFECTIVE DATE.—The amendments made by
8 this section shall apply to disclosures and to information
9 and document requests made after the date of the enact-
10 ment of this Act.

11 **SEC. 204. DISCLOSURE OF INFORMATION TO CONGRESS.**

12 (a) DISCLOSURE BY TAX RETURN PREPARER.—

13 (1) IN GENERAL.—Subparagraph (B) of section
14 7216(b)(1) (relating to disclosures) is amended to
15 read as follows:

16 “(B) pursuant to any 1 of the following
17 documents, if clearly identified:

18 “(i) The order of any Federal, State,
19 or local court of record.

20 “(ii) A subpoena issued by a Federal
21 or State grand jury.

22 “(iii) An administrative order, sum-
23 mons, or subpoena which is issued in the
24 performance of its duties by—

1 “(I) any Federal agency, includ-
2 ing Congress or any committee or
3 subcommittee thereof, or

4 “(II) any State agency, body, or
5 commission charged under the laws of
6 the State or a political subdivision of
7 the State with the licensing, registra-
8 tion, or regulation of tax return pre-
9 parers.”.

10 (2) EFFECTIVE DATE.—The amendment made
11 by this subsection shall apply to disclosures made
12 after the date of the enactment of this Act pursuant
13 to any document in effect on or after such date.

14 (b) DISCLOSURE BY SECRETARY.—Paragraph (2) of
15 section 6104(a) (relating to inspection of applications for
16 tax exemption or notice of status) is amended to read as
17 follows:

18 “(2) INSPECTION BY CONGRESS.—

19 “(A) IN GENERAL.—Upon receipt of a
20 written request from a committee or sub-
21 committee of Congress, copies of documents re-
22 lated to a determination by the Secretary to
23 grant, deny, revoke, or restore an organization’s
24 exemption from taxation under section 501
25 shall be provided to such committee or sub-

1 committee, including any application, notice of
2 status, or supporting information provided by
3 such organization to the Internal Revenue Serv-
4 ice; any letter, analysis, or other document pro-
5 duced by or for the Internal Revenue Service
6 evaluating, determining, explaining, or relating
7 to the tax exempt status of such organization
8 (other than returns, unless such returns are
9 available to the public under this section or sec-
10 tion 6103 or 6110); and any communication be-
11 tween the Internal Revenue Service and any
12 other party relating to the tax exempt status of
13 such organization.

14 “(B) ADDITIONAL INFORMATION.—Section
15 6103(f) shall apply with respect to—

16 “(i) the application for exemption of
17 any organization described in subsection
18 (c) or (d) of section 501 which is exempt
19 from taxation under section 501(a) for any
20 taxable year and any application referred
21 to in subparagraph (B) of subsection
22 (a)(1) of this section, and

23 “(ii) any other papers which are in
24 the possession of the Secretary and which
25 relate to such application,

1 as if such papers constituted returns.”.

2 (c) EFFECTIVE DATE.—The amendments made by
3 this section shall apply to disclosures and to information
4 and document requests made after the date of the enact-
5 ment of this Act.

6 **SEC. 205. TAX OPINION STANDARDS FOR TAX PRACTI-**
7 **TIONERS.**

8 Section 330(d) of title 31, United States Code, is
9 amended to read as follows:

10 “(d) The Secretary of the Treasury shall impose
11 standards applicable to the rendering of written advice
12 with respect to any listed transaction or any entity, plan,
13 arrangement, or other transaction which has a potential
14 for tax avoidance or evasion. Such standards shall ad-
15 dress, but not be limited to, the following issues:

16 “(1) Independence of the practitioner issuing
17 such written advice from persons promoting, mar-
18 keting, or recommending the subject of the advice.

19 “(2) Collaboration among practitioners, or be-
20 tween a practitioner and other party, which could re-
21 sult in such collaborating parties having a joint fi-
22 nancial interest in the subject of the advice.

23 “(3) Avoidance of conflicts of interest which
24 would impair auditor independence.

1 “(4) For written advice issued by a firm, stand-
2 ards for reviewing the advice and ensuring the con-
3 sensus support of the firm for positions taken.

4 “(5) Reliance on reasonable factual representa-
5 tions by the taxpayer and other parties.

6 “(6) Appropriateness of the fees charged by the
7 practitioner for the written advice.

8 “(7) Preventing practitioners and firms from
9 aiding or abetting the understatement of tax liability
10 by clients.

11 “(8) Banning the promotion of potentially abu-
12 sive or illegal tax shelters.”.

13 **SEC. 206. WHISTLEBLOWER REFORMS.**

14 (a) IN GENERAL.—Section 7623 (relating to ex-
15 penses of detection of underpayments and fraud, etc.) is
16 amended—

17 (1) by striking “The Secretary” and inserting

18 “(a) IN GENERAL.—The Secretary”,

19 (2) by striking “and” at the end of paragraph

20 (1) and inserting “or”,

21 (3) by striking “(other than interest)”, and

22 (4) by adding at the end the following new sub-
23 sections:

24 “(b) AWARDS TO WHISTLEBLOWERS.—

1 “(1) IN GENERAL.—If the Secretary proceeds
2 with any administrative or judicial action described
3 in subsection (a) based on information brought to
4 the Secretary’s attention by an individual, such indi-
5 vidual shall, subject to paragraph (2), receive as an
6 award at least 15 percent but not more than 30 per-
7 cent of the collected proceeds (including penalties,
8 interest, additions to tax, and additional amounts)
9 resulting from the action (including any related ac-
10 tions) or from any settlement in response to such ac-
11 tion. The determination of the amount of such
12 award by the Whistleblower Office shall depend upon
13 the extent to which the individual substantially con-
14 tributed to such action, and shall be determined at
15 the sole discretion of the Whistleblower Office.

16 “(2) AWARD IN CASE OF LESS SUBSTANTIAL
17 CONTRIBUTION.—

18 “(A) IN GENERAL.—In the event the ac-
19 tion described in paragraph (1) is one which the
20 Whistleblower Office determines to be based
21 principally on disclosures of specific allegations
22 (other than information provided by the indi-
23 vidual described in paragraph (1)) resulting
24 from a judicial or administrative hearing, from
25 a governmental report, hearing, audit, or inves-

1 tigation, or from the news media, the Whistle-
2 blower Office may award such sums as it con-
3 siders appropriate, but in no case more than 10
4 percent of the collected proceeds (including pen-
5 alties, interest, additions to tax, and additional
6 amounts) resulting from the action (including
7 any related actions) or from any settlement in
8 response to such action, taking into account the
9 significance of the individual’s information and
10 the role of such individual and any legal rep-
11 resentative of such individual in contributing to
12 such action.

13 “(B) NONAPPLICATION OF PARAGRAPH
14 WHERE INDIVIDUAL IS ORIGINAL SOURCE OF
15 INFORMATION.—Subparagraph (A) shall not
16 apply if the information resulting in the initi-
17 ation of the action described in paragraph (1)
18 was originally provided by the individual de-
19 scribed in paragraph (1).

20 “(3) APPLICATION OF THIS SUBSECTION.—This
21 subsection shall apply with respect to any action—

22 “(A) against any taxpayer, but in the case
23 of any individual, only if such individual’s gross
24 income exceeds \$200,000 for any taxable year
25 subject to such action, and

1 “(B) if the tax, penalties, interest, addi-
2 tions to tax, and additional amounts in dispute
3 exceed \$20,000.

4 “(4) ADDITIONAL RULES.—

5 “(A) NO CONTRACT NECESSARY.—No con-
6 tract with the Internal Revenue Service is nec-
7 essary for any individual to receive an award
8 under this subsection.

9 “(B) REPRESENTATION.—Any individual
10 described in paragraph (1) or (2) may be rep-
11 resented by counsel.

12 “(C) AWARD NOT SUBJECT TO INDIVIDUAL
13 ALTERNATIVE MINIMUM TAX.—No award re-
14 ceived under this subsection shall be included in
15 gross income for purposes of determining alter-
16 native minimum taxable income.

17 “(c) WHISTLEBLOWER OFFICE.—

18 “(1) IN GENERAL.—There is established in the
19 Internal Revenue Service an office to be known as
20 the ‘Whistleblower Office’ which—

21 “(A) shall analyze information received
22 from any individual described in subsection (b)
23 and either investigate the matter itself or assign
24 it to the appropriate Internal Revenue Service
25 office,

1 “(B) shall monitor any action taken with
2 respect to such matter,

3 “(C) shall inform such individual that it
4 has accepted the individual’s information for
5 further review,

6 “(D) may require such individual and any
7 legal representative of such individual to not
8 disclose any information so provided,

9 “(E) may ask for additional assistance
10 from such individual or any legal representative
11 of such individual, and

12 “(F) shall determine the amount to be
13 awarded to such individual under subsection
14 (b).

15 “(2) FUNDING FOR OFFICE.—From the
16 amounts available for expenditure under subsection
17 (a), the Whistleblower Office shall be credited with
18 an amount equal to the awards made under sub-
19 section (b). These funds shall be used to maintain
20 the Whistleblower Office and also to reimburse other
21 Internal Revenue Service offices for related costs,
22 such as costs of investigation and collection.

23 “(3) REQUEST FOR ASSISTANCE.—

24 “(A) IN GENERAL.—Any assistance re-
25 quested under paragraph (1)(E) shall be under

1 the direction and control of the Whistleblower
2 Office or the office assigned to investigate the
3 matter under subparagraph (A). To the extent
4 the disclosure of any returns or return informa-
5 tion to the individual or legal representative is
6 required for the performance of such assistance,
7 such disclosure shall be pursuant to a contract
8 entered into between the Secretary and the re-
9 cipients of such disclosure subject to section
10 6103(n).

11 “(B) FUNDING OF ASSISTANCE.—From
12 the funds made available to the Whistleblower
13 Office under paragraph (2), the Whistleblower
14 Office may reimburse the costs incurred by any
15 legal representative in providing assistance de-
16 scribed in subparagraph (A).”.

17 (b) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to information provided on or after
19 the date of the enactment of this Act.

20 **SEC. 207. DENIAL OF DEDUCTION FOR CERTAIN FINES,**
21 **PENALTIES, AND OTHER AMOUNTS.**

22 (a) IN GENERAL.—Subsection (f) of section 162 (re-
23 lating to trade or business expenses) is amended to read
24 as follows:

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

1 “(1) IN GENERAL.—Except as provided in para-
2 graph (2), no deduction otherwise allowable shall be
3 allowed under this chapter for any amount paid or
4 incurred (whether by suit, agreement, or otherwise)
5 to, or at the direction of, a government or entity de-
6 scribed in paragraph (4) in relation to the violation
7 of any law or the investigation or inquiry by such
8 government or entity into the potential violation of
9 any law.

10 “(2) EXCEPTION FOR AMOUNTS CONSTITUTING
11 RESTITUTION.—Paragraph (1) shall not apply to
12 any amount which—

13 “(A) the taxpayer establishes constitutes
14 restitution (including remediation of property)
15 for damage or harm caused by or which may be
16 caused by the violation of any law or the poten-
17 tial violation of any law, and

18 “(B) is identified as restitution in the
19 court order or settlement agreement.

20 Identification pursuant to subparagraph (B) alone
21 shall not satisfy the requirement under subpara-
22 graph (A). This paragraph shall not apply to any
23 amount paid or incurred as reimbursement to the
24 government or entity for the costs of any investiga-
25 tion or litigation.

1 “(3) EXCEPTION FOR AMOUNTS PAID OR IN-
2 CURRED AS THE RESULT OF CERTAIN COURT OR-
3 DERS.—Paragraph (1) shall not apply to any
4 amount paid or incurred by order of a court in a
5 suit in which no government or entity described in
6 paragraph (4) is a party.

7 “(4) CERTAIN NONGOVERNMENTAL REGU-
8 LATORY ENTITIES.—An entity is described in this
9 paragraph if it is—

10 “(A) a nongovernmental entity which exer-
11 cises self-regulatory powers (including imposing
12 sanctions) in connection with a qualified board
13 or exchange (as defined in section 1256(g)(7)),
14 or

15 “(B) to the extent provided in regulations,
16 a nongovernmental entity which exercises self-
17 regulatory powers (including imposing sanc-
18 tions) as part of performing an essential gov-
19 ernmental function.

20 “(5) EXCEPTION FOR TAXES DUE.—Paragraph
21 (1) shall not apply to any amount paid or incurred
22 as taxes due.”.

23 (b) EFFECTIVE DATE.—The amendment made by
24 this section shall apply to amounts paid or incurred on
25 or after the date of the enactment of this Act, except that

1 such amendment shall not apply to amounts paid or in-
2 curred under any binding order or agreement entered into
3 before such date. Such exception shall not apply to an
4 order or agreement requiring court approval unless the ap-
5 proval was obtained before such date.

6 **SEC. 208. SENSE OF THE SENATE ON TAX ENFORCEMENT**
7 **PRIORITIES.**

8 It is the sense of the Senate that additional funds
9 should be appropriated for Internal Revenue Service en-
10 forcement efforts and that the Internal Revenue Service
11 should devote proportionately more of its enforcement
12 funds—

13 (1) to combat the promotion of abusive tax
14 shelters for corporations and high net worth individ-
15 uals and the aiding and abetting of tax evasion,

16 (2) to stop accounting, law, and financial firms
17 involved in such promotion and aiding and abetting,
18 and

19 (3) to combat the use of offshore financial ac-
20 counts to conceal taxable income.

1 **TITLE III—REQUIRING**
 2 **ECONOMIC SUBSTANCE**

3 **SEC. 301. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**
 4 **TRINE.**

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

8 “(o) CLARIFICATION OF ECONOMIC SUBSTANCE
 9 DOCTRINE; ETC.—

10 “(1) GENERAL RULES.—

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

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

20 “(i) IN GENERAL.—A transaction has
 21 economic substance only if—

22 “(I) the transaction changes in a
 23 meaningful way (apart from Federal
 24 tax effects) the taxpayer’s economic
 25 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 In applying subclause (II), a purpose of
7 achieving a financial accounting benefit
8 shall not be taken into account in deter-
9 mining whether a transaction has a sub-
10 stantial nontax purpose if the origin of
11 such financial accounting benefit is a re-
12 duction of income tax.

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

18 “(I) the present value of the rea-
19 sonably expected pre-tax profit from
20 the transaction is substantial in rela-
21 tion to the present value of the ex-
22 pected net tax benefits that would be
23 allowed if the transaction were re-
24 spected, and

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

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

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

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

1 offering will be placed with tax-indifferent par-
2 ties.

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

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

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

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

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

24 “(B) TAX-INDIFFERENT PARTY.—The
25 term ‘tax-indifferent party’ means any person

1 or entity not subject to tax imposed by subtitle
2 A. A person shall be treated as a tax-indifferent
3 party with respect to a transaction if the items
4 taken into account with respect to the trans-
5 action have no substantial impact on such per-
6 son's liability under subtitle A.

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

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

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

19 “(I) depreciation,

20 “(II) any tax credit, or

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

24 “(ii) subclause (II) of paragraph
25 (1)(B)(ii) shall be disregarded in deter-

1 mining whether any of such benefits are al-
2 lowable.

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

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

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

18 **SEC. 302. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
19 **UTABLE TO TRANSACTIONS LACKING ECO-**
20 **NOMIC SUBSTANCE, ETC.**

21 (a) IN GENERAL.—Subchapter A of chapter 68 is
22 amended by inserting after section 6662A the following
23 new section:

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(o)(1)) for
6 the transaction giving rise to the claimed ben-
7 efit or the transaction was not respected under
8 section 7701(o)(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 (2) and (3) of section 6707A(d) shall apply
22 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 understatements
 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) COORDINATION WITH OTHER UNDERSTATE-
 5 MENTS AND PENALTIES.—

6 (1) The second sentence of section
 7 6662(d)(2)(A) is amended by inserting “and without
 8 regard to items with respect to which a penalty is
 9 imposed by section 6662B” before the period at the
 10 end.

11 (2) Subsection (e) of section 6662A is amend-
 12 ed—

13 (A) in paragraph (1), by inserting “and
 14 noneconomic substance transaction understate-
 15 ments” after “reportable transaction under-
 16 statements” both places it appears,

17 (B) in paragraph (2)(A), by inserting “and
 18 a noneconomic substance transaction under-
 19 statement” after “reportable transaction under-
 20 statement”,

21 (C) in paragraph (2)(B), by inserting
 22 “6662B or” before “6663”,

1 (D) in paragraph (2)(C)(i), by inserting
2 “or section 6662B” before the period at the
3 end,

4 (E) in paragraph (2)(C)(ii), by inserting
5 “and section 6662B” after “This section”,

6 (F) in paragraph (3), by inserting “or non-
7 economic substance transaction understatement”
8 after “reportable transaction understatement”,
9 and

10 (G) by adding at the end the following new
11 paragraph:

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 (3) Subsection (e) of section 6707A is amend-
18 ed—

19 (A) by striking “or” at the end of subpara-
20 graph (B), and

21 (B) by striking subparagraph (C) and in-
22 serting the following new subparagraphs:

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

1 “(D) is required to pay a penalty under
 2 section 6662(h) with respect to any transaction
 3 and would (but for section 6662A(e)(2)(C))
 4 have been subject to penalty under section
 5 6662A at a rate prescribed under section
 6 6662A(e) or under section 6662B,”.

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

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

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

14 **SEC. 303. DENIAL OF DEDUCTION FOR INTEREST ON UN-**
 15 **DERPAYMENTS ATTRIBUTABLE TO NON-**
 16 **ECONOMIC SUBSTANCE TRANSACTIONS.**

17 (a) IN GENERAL.—Section 163(m) (relating to inter-
 18 est on unpaid taxes attributable to nondisclosed reportable
 19 transactions) is amended—

20 (1) by striking “attributable” and all that fol-
 21 lows and inserting the following: “attributable to—
 22 “(1) the portion of any reportable transaction
 23 understatement (as defined in section 6662A(b))

1 with respect to which the requirement of section
2 6664(d)(2)(A) is not met, or

3 “(2) any noneconomic substance transaction
4 understatement (as defined in section 6662B(c)).”,
5 and

6 (2) by inserting “**AND NONECONOMIC SUB-**
7 **STANCE TRANSACTIONS**” after “**TRANS-**
8 **ACTIONS**”.

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

13 **TITLE IV—DETECTING** 14 **UNCOOPERATIVE TAX HAVENS**

15 **SEC. 401. DISCLOSING PAYMENTS TO PERSONS IN UNCO-** 16 **OPERATIVE TAX HAVENS.**

17 (a) IN GENERAL.—Subpart A of part III of sub-
18 chapter A of chapter 61 is amended by inserting after sec-
19 tion 6038C the following new section:

20 **“SEC. 6038D. DETECTING UNCOOPERATIVE TAX HAVENS** 21 **THROUGH LISTING AND REPORTING RE-** 22 **QUIREMENTS.**

23 “(a) IN GENERAL.—Each United States person who
24 transfers money or other property directly or indirectly to
25 any uncooperative tax haven, to any financial institution

1 licensed by or operating in any uncooperative tax haven,
2 or to any person who is a resident of any uncooperative
3 tax haven shall furnish to the Secretary, at such time and
4 in such manner as the Secretary shall by regulation pre-
5 scribe, such information with respect to such transfer as
6 the Secretary may require.

7 “(b) EXCEPTIONS.—Subsection (a) shall not apply to
8 a transfer by a United States person if the amount of
9 money (and the fair market value of property) transferred
10 is less than \$10,000. Related transfers shall be treated
11 as 1 transfer for purposes of this subsection.

12 “(c) UNCOOPERATIVE TAX HAVEN.—For purposes of
13 this section—

14 “(1) IN GENERAL.—The term ‘uncooperative
15 tax haven’ means any foreign jurisdiction which is
16 identified on a list maintained by the Secretary
17 under paragraph (2) as being a jurisdiction—

18 “(A) which imposes no or nominal taxation
19 either generally or on specified classes of in-
20 come, and

21 “(B) has corporate, business, bank, or tax
22 secrecy or confidentiality rules and practices, or
23 has ineffective information exchange practices
24 which, in the judgment of the Secretary, effec-
25 tively limit or restrict the ability of the United

1 States to obtain information relevant to the en-
2 forcement of this title.

3 “(2) MAINTENANCE OF LIST.—Not later than
4 November 1 of each calendar year, the Secretary
5 shall issue a list of foreign jurisdictions which the
6 Secretary determines qualify as uncooperative tax
7 havens under paragraph (1).

8 “(3) INEFFECTIVE INFORMATION EXCHANGE
9 PRACTICES.—For purposes of paragraph (1), a juris-
10 diction shall be deemed to have ineffective informa-
11 tion exchange practices if the Secretary determines
12 that during any taxable year ending in the 12-month
13 period preceding the issuance of the list under para-
14 graph (2)—

15 “(A) the exchange of information between
16 the United States and such jurisdiction was in-
17 adequate to prevent evasion or avoidance of
18 United States income tax by United States per-
19 sons or to enable the United States effectively
20 to enforce this title, or

21 “(B) such jurisdiction was identified by an
22 intergovernmental group or organization of
23 which the United States is a member as unco-
24 operative with international tax enforcement or

1 information exchange and the United States
2 concurs in the determination.

3 “(d) PENALTY FOR FAILURE TO FILE INFORMA-
4 TION.—If a United States person fails to furnish the infor-
5 mation required by subsection (a) with respect to any
6 transfer within the time prescribed therefor (including ex-
7 tensions), such United States person shall pay (upon no-
8 tice and demand by the Secretary and in the same manner
9 as tax) an amount equal to 20 percent of the amount of
10 such transfer.

11 “(e) SIMPLIFIED REPORTING.—The Secretary may
12 by regulations provide for simplified reporting under this
13 section for United States persons making large volumes
14 of similar payments.

15 “(f) REGULATIONS.—The Secretary shall prescribe
16 such regulations as may be necessary or appropriate to
17 carry out the purposes of this section.”.

18 (b) CLERICAL AMENDMENT.—The table of sections
19 for such subpart A is amended by inserting after the item
20 relating to section 6038C the following new item:

“Sec. 6038D. Deterring uncooperative tax havens through listing and reporting requirements.”.

21 (c) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to transfers after the date which
23 is 180 days after the date of the enactment of this Act.

1 **SEC. 402. DETERRING UNCOOPERATIVE TAX HAVENS BY**
2 **RESTRICTING ALLOWABLE TAX BENEFITS.**

3 (a) **LIMITATION ON DEFERRAL.—**

4 (1) **IN GENERAL.—**Subsection (a) of section
5 952 (defining subpart F income) is amended by
6 striking “and” at the end of paragraph (4), by strik-
7 ing the period at the end of paragraph (5) and in-
8 serting “, and”, and by inserting after paragraph
9 (5) the following new paragraph:

10 “(6) an amount equal to the applicable fraction
11 (as defined in subsection (e)) of the income of such
12 corporation other than income which—

13 “(A) is attributable to earnings and profits
14 of the foreign corporation included in the gross
15 income of a United States person under section
16 951 (other than by reason of this paragraph or
17 paragraph (3)(A)(i)), or

18 “(B) is described in subsection (b).”.

19 (2) **APPLICABLE FRACTION.—**Section 952 is
20 amended by adding at the end the following new
21 subsection:

22 “(e) **IDENTIFIED TAX HAVEN INCOME WHICH IS**
23 **SUBPART F INCOME.—**

24 “(1) **IN GENERAL.—**For purposes of subsection
25 (a)(6), the term ‘applicable fraction’ means the frac-
26 tion—

1 “(A) the numerator of which is the aggregate
2 identified tax haven income for the taxable
3 year, and

4 “(B) the denominator of which is the aggregate
5 income for the taxable year which is
6 from sources outside the United States.

7 “(2) IDENTIFIED TAX HAVEN INCOME.—For
8 purposes of paragraph (1), the term ‘identified tax
9 haven income’ means income for the taxable year
10 which is attributable to a foreign jurisdiction for any
11 period during which such jurisdiction has been identified
12 as an uncooperative tax haven under section
13 6038D(c).

14 “(3) REGULATIONS.—The Secretary shall prescribe
15 regulations similar to the regulations issued
16 under section 999(c) to carry out the purposes of
17 this subsection.”.

18 (b) DENIAL OF FOREIGN TAX CREDIT.—Section 901
19 (relating to taxes of foreign countries and of possessions
20 of United States) is amended by redesignating subsection
21 (m) as subsection (n) and by inserting after subsection
22 (l) the following new subsection:

23 “(m) REDUCTION OF FOREIGN TAX CREDIT, ETC.,
24 FOR IDENTIFIED TAX HAVEN INCOME.—

1 “(1) IN GENERAL.—Notwithstanding any other
2 provision of this part—

3 “(A) no credit shall be allowed under sub-
4 section (a) for any income, war profits, or ex-
5 cess profits taxes paid or accrued (or deemed
6 paid under section 902 or 960) to any foreign
7 jurisdiction if such taxes are with respect to in-
8 come attributable to a period during which such
9 jurisdiction has been identified as an unco-
10 operative tax haven under section 6038D(c),
11 and

12 “(B) subsections (a), (b), (c), and (d) of
13 section 904 and sections 902 and 960 shall be
14 applied separately with respect to all income of
15 a taxpayer attributable to periods described in
16 subparagraph (A) with respect to all such juris-
17 dictions.

18 “(2) TAXES ALLOWED AS A DEDUCTION, ETC.—
19 Sections 275 and 78 shall not apply to any tax
20 which is not allowable as a credit under subsection
21 (a) by reason of this subsection.

22 “(3) REGULATIONS.—The Secretary shall pre-
23 scribe such regulations as may be necessary or ap-
24 propriate to carry out the purposes of this sub-
25 section, including regulations which treat income

1 paid through 1 or more entities as derived from a
2 foreign jurisdiction to which this subsection applies
3 if such income was, without regard to such entities,
4 derived from such jurisdiction.”.

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

8 **SEC. 403. DOUBLING OF CERTAIN PENALTIES, FINES, AND**
9 **INTEREST ON UNDERPAYMENTS RELATED TO**
10 **CERTAIN OFFSHORE FINANCIAL ARRANGE-**
11 **MENTS.**

12 (a) DETERMINATION OF PENALTY.—

13 (1) IN GENERAL.—Notwithstanding any other
14 provision of law, in the case of an applicable tax-
15 payer—

16 (A) the determination as to whether any
17 interest or applicable penalty is to be imposed
18 with respect to any arrangement described in
19 paragraph (2), or to any underpayment of Fed-
20 eral income tax attributable to items arising in
21 connection with any such arrangement, shall be
22 made without regard to the rules of subsections
23 (b), (c), and (d) of section 6664 of the Internal
24 Revenue Code of 1986, and

1 (B) if any such interest or applicable pen-
2 alty is imposed, the amount of such interest or
3 penalty shall be equal to twice that determined
4 without regard to this section.

5 (2) APPLICABLE TAXPAYER.—For purposes of
6 this subsection—

7 (A) IN GENERAL.—The term “applicable
8 taxpayer” means a taxpayer which—

9 (i) has underreported its United
10 States income tax liability with respect to
11 any item which directly or indirectly in-
12 volves—

13 (I) any financial arrangement
14 which in any manner relies on the use
15 of an offshore payment mechanism
16 (including credit, debit, or charge
17 cards) issued by a bank or other enti-
18 ty in a foreign jurisdiction, or

19 (II) any offshore financial ar-
20 rangement (including any arrange-
21 ment with foreign banks, financial in-
22 stitutions, corporations, partnerships,
23 trusts, or other entities), and

24 (ii) has not signed a closing agree-
25 ment pursuant to the Voluntary Offshore

1 Compliance Initiative established by the
2 Department of the Treasury under Rev-
3 enue Procedure 2003–11 or voluntarily
4 disclosed its participation in such arrange-
5 ment by notifying the Internal Revenue
6 Service of such arrangement prior to the
7 issue being raised by the Internal Revenue
8 Service during an examination.

9 (B) AUTHORITY TO WAIVE.—The Sec-
10 retary of the Treasury or the Secretary’s dele-
11 gate may waive the application of paragraph (1)
12 for any taxpayer if the Secretary or the Sec-
13 retary’s delegate determines that—

14 (i) the use of such offshore payment
15 mechanism or financial arrangement was
16 incidental to the transaction,

17 (ii) in the case of a trade or business,
18 such use took place in the ordinary course
19 of the trade or business of the taxpayer,
20 and

21 (iii) such waiver would serve the pub-
22 lic interest.

23 (C) ISSUES RAISED.—For purposes of sub-
24 paragraph (A)(ii), an item shall be treated as

1 an issue raised during an examination if the in-
2 dividual examining the return—

3 (i) communicates to the taxpayer
4 knowledge about the specific item, or

5 (ii) has made a request to the tax-
6 payer for information and the taxpayer
7 could not make a complete response to
8 that request without giving the examiner
9 knowledge of the specific item.

10 (b) DEFINITIONS AND RULES.—For purposes of this
11 section—

12 (1) APPLICABLE PENALTY.—The term “appli-
13 cable penalty” means any penalty, addition to tax,
14 or fine imposed under chapter 68 of the Internal
15 Revenue Code of 1986.

16 (2) FEES AND EXPENSES.—The Secretary of
17 the Treasury may retain and use an amount not in
18 excess of 25 percent of all additional interest, pen-
19 alties, additions to tax, and fines collected under this
20 section to be used for enforcement and collection ac-
21 tivities of the Internal Revenue Service. The Sec-
22 retary shall keep adequate records regarding
23 amounts so retained and used. The amount credited
24 as paid by any taxpayer shall be determined without
25 regard to this paragraph.

1 (c) **REPORT BY SECRETARY.**—The Secretary shall
2 each year conduct a study and report to Congress on the
3 implementation of this section during the preceding year,
4 including statistics on the number of taxpayers affected
5 by such implementation and the amount of interest and
6 applicable penalties asserted, waived, and assessed during
7 such preceding year.

8 (d) **EFFECTIVE DATE.**—The provisions of this sec-
9 tion shall apply to interest, penalties, additions to tax, and
10 fines with respect to any taxable year if, as of the date
11 of the enactment of this Act, the assessment of any tax,
12 penalty, or interest with respect to such taxable year is
13 not prevented by the operation of any law or rule of law.

14 **SEC. 404. TREASURY REGULATIONS ON FOREIGN TAX**
15 **CREDIT.**

16 (a) **IN GENERAL.**—Section 901 (relating to taxes of
17 foreign countries and of possessions of United States), as
18 amended by section 402, is amended by redesignating sub-
19 section (n) as subsection (o) and by inserting after sub-
20 section (m) the following new subsection:

21 “(n) **REGULATIONS.**—The Secretary may prescribe
22 regulations disallowing a credit under subsection (a) for
23 all or a portion of any foreign tax, or allocating a foreign
24 tax among 2 or more persons, in cases where the foreign
25 tax is imposed on any person in respect of income of an-

1 other person or in other cases involving the inappropriate
2 separation of the foreign tax from the related foreign in-
3 come.”.

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

○