

River and portions of the San Gabriel Mountains for potential inclusion in the National Parks Service system.

The bill will direct the National Park Service to study the area and its natural, historic, scenic, recreational, and national significance.

If deemed appropriate, I plan to introduce a bill that will officially designate the area. Thus, laying the groundwork for open space preservation, environmental revitalization, curbing urban sprawl, and giving communities of color the option of experiencing more than car horns and skyscrapers.

Currently, there are only five national recreation areas near urban centers. Such urban parks combine scarce spaces with the preservation of significant historic resources and important natural areas in locations that can provide outdoor recreation for large numbers of people. The population growth in California, as you know, is projected to double in over the next 40 years. It is of critical importance to plan for the future of open space.

Study after study find that open space creates high property values, more community-oriented events, and safer environments for our families. It is estimated that there are less than one-half acre square space per 1,000 residents in low-income areas, and up to 1.7 acres in West Los Angeles. Yet, three to four acres of open space per 1,000 residents is what is recommended by our Park Service.

After the 1992 riots in Los Angeles, nearly 77 percent of neighborhood residents when asked what they felt was most important felt that improved parks and recreation facilities was absolutely critical and important to the restoration of their communities.

There is a growing concern that poor planning has resulted in the loss of too much open space in the San Gabriel Valley and in the foothills of the San Gabriel Mountains. The threat of the total buildout of the last remnants of open space has increased concern about the cumulative impacts of that buildout on what little remains of our natural resources.

This concern has reached a critical mass, sparking community action to form local conservancies. In fact, I was a partner in helping to establish one of the largest urban conservancies in the State of California effecting well over 6 million people.

There is a need out there to provide open space. People in my community and across the country want to see that there is some preservation and some area for families to recreate. As a California State Senator, I was proud to have introduced that piece of legislation last year.

There are over 30 local community governments and organizing groups that are now waiting for us to move ahead at the Federal level to create this park service area.

Mr. Speaker, I would like to insert the following editorial published on

May 30, 2001 of the San Gabriel Valley Tribune.

It is time for the Federal Government to offer the next step for protection and revitalization in the San Gabriel Valley. This study is the first step in accomplishing that venture.

[From the San Gabriel Valley Tribune, May 30, 2001]

#### OUR VIEW: BUSH SHOULD JOIN SOLIS PARK PLAN

The president was in town this week visiting Camp Pendleton and meeting with Gov. Gray Davis in Los Angeles on energy issues. Some say President George W. Bush should use this visit to improve his standing on the environment, an issue dear to Golden Staters. Specifically, he should support Rep. Hilda Solis' idea to declare the San Gabriel River—and 2,000 acres around it—a national recreation area.

Solis, who has not formalized her idea, but rather is sending it up as a trial balloon, wants to siphon federal dollars into making the river a national park. Last year, \$1.38 billion was available through the National Park Service. While we support the preservation and maintenance of more traditional national parks, we believe the feds should change direction and provide for creation of closer-in, urban green spaces.

Efforts are under way to restore the 29-mile San Gabriel River, which runs from the Angeles National Forest to the beach. Our river, and our forest for that matter, are visited by just as many people as many national parks—eight million a year visit the Angeles, which includes the river's West Fork and the East Fork regions. Creating more urban recreation areas can be more important than preserving chunks of wild lands in remote parts of the country because these are closer to millions of people who need a green space to de-stress, relax and get away from the burdens of everyday life.

In addition, it seems as if the new San Gabriel and Lower Los Angeles Rivers and Mountain Conservancy started by Solis and Sally Havice is stalled, but it's nothing that a little federal momentum could not kick start.

We would like to see an education center, more bike trails and more river access for hikers, horseback riders, birders, mountain bikers, picnickers and all.

Likewise, to the west, the Arroyo Seco should be restored. The Arroyo Seco Foundation and North East Trees are working on a plan to make the river that runs through Pasadena, South Pasadena to Los Angeles a place of beauty instead of a concrete channel off-limits to visitors.

These are projects that are not about saving a species of frog or fish but rather, about saving a quality of life for almost 2 million San Gabriel Valley residents who increasingly spend more time in their cars in traffic than in nature. Many have come here from Mexico, as the new census figures show, living in poorer and middle-class neighborhoods of South El Monte, El Monte, Pico Rivera, Northwest Pasadena, El Sereno, Azusa and Duarte and rarely go beyond the streets where they live.

Most do not have the means to travel to Yosemite, Mammoth Lakes and other spots that are favorites of the Valley's more well-to-do population. Hence, more than 75 percent of those who visit the East Fork, Whittier Narrows, Marrano Beach and Santa Fe Dam are Latino.

The Bush Administration can't miss this chance to start working on an urban, national park that will benefit Latinos in California.

It's an opportunity for Bush to improve his image in the state and at the same time

work with Democrat Solis in a bipartisan effort. Sounds like win-win-win to us.

#### INTRODUCTION OF ABUSIVE TAX SHELTER SHUTDOWN ACT

The SPEAKER pro tempore. Under the Speaker's announced policy of January 3, 2001, the gentleman from Texas (Mr. DOGGETT) is recognized during morning hour debates for 5 minutes.

Mr. DOGGETT. Mr. Speaker, most of us can appreciate the feeling of the fellow who declared, "I am proud to be paying taxes, but I could be just as proud for half the money!"

Some taxpayers have, in fact, discovered a way to get out for half the money by exploiting abusive tax avoidance schemes, gimmicks, and tax shelters. For the millions of Americans who are paying their fair share of taxes, it is long past time to plug some of the loopholes and eliminate the tax inequities that threaten public confidence in our tax system.

Today, together with the gentleman from New York (Mr. RANGEL), the ranking member of the Committee on Ways and Means and a number of my Democratic colleagues on the committee, I am introducing the Abusive Tax Shelter Shutdown Act to address these concerns.

With the Bush administration already dipping into the Medicare trust fund to pay for its many undertakings, we face a challenge. To implement a patients' bill of rights, to ensure that the dipping into the Medicare trust fund does not extend to an invasion of the Social Security trust fund, and to provide reasonable tax relief, we must ensure that lower tax revenues are offset. We must secure what are known around this House as "pay-for's" to pay for the enactment of any new initiatives.

With the bill that we are introducing today, we say: what better place to start than with the high rollers who are cheating and gaming our tax system.

This new bill represents a refinement of legislation that I originally introduced in 1999. The Washington Post, the Los Angeles Times, and several other newspapers have already endorsed that initiative. The abuses that it addresses were first brought to my attention by a constituent in Austin who directed my attention to this Forbes magazine. Forbes, which proudly proclaims itself "the capitalist tool," did a cover story called "Tax Shelter Hustlers" with a fellow in a fedora on the cover, and stated, "Respectable accountants are peddling dicey corporate loopholes." Inside, that cover story begins, "Respectable tax professionals and respectable corporate clients are exploiting the exotica of modern corporate finance to indulge in extravagant tax dodging schemes."

Forbes reported that Big 5 accounting firms require staffers, in one case, to come up with at least one new corporate tax dodge per week. The literal

hustling of these improper tax avoidance schemes is so commonplace that the representative of one major Texas-based multinational indicated that he gets a cold call every day from someone hawking such shelters.

As Stefan Tucker, former Chair of the American Bar Association Tax Section, a group comprised of 20,000 tax lawyers across the country, told the Senate Finance Committee: “[T]he concerns being voiced about corporate tax shelters are very real; these concerns are not hollow or misplaced, as some would assert. We deal with corporate and other major taxpayer clients every day who are bombarded, on a regular and continuous basis, with ideas or ‘products’ of questionable merit.”

Two years later, we have this sequel from *Forbes* which raises the question, “How to cheat on your taxes?” It concludes that the marketing of push-the-edge and over-the-edge tax shelters “represent the most striking evidence of the decline in [tax] compliance” in our country today. The “outrageous shelters” that it reports about in its cover story are literally “tearing this country’s tax system apart.” It raises the question that more and more taxpayers are asking: “Am I a chump for paying what I owe?”

Here is basically what this bill seeks to do: First, it seeks to stop these schemes that have no “economic substance.” That is, deals that are done not to achieve economic gain in a competitive marketplace or for other legitimate business reasons but to generate losses that offer a way to avoid the tax collector.

Second, it prevents tax cheats from buying the equivalent of a “get-out-of-jail-free” card to protect themselves in the unlikely event that they get caught. Some fancy legal opinion cannot be used as insurance against penalties for tax underpayments on transactions that have no economic substance.

Third, the bill increases and tightens penalties for tax dodging so that there is at least some downside risk to cheating.

Fourth, it requires the promoters and hustlers who market tax shelters to share a little of the penalty themselves with the offending taxpayer.

Fifth, it punishes the lawyers who write “penalty insurance” opinions that any reasonable person would know are unjustified.

Sixth, it penalizes those who fail to follow the disclosure rules. It recognizes that too often secrecy is the growth hormone for these complex tax-cheating shelter gimmicks.

Seventh, it expands the types of tax shelters that must be registered with the IRS, thereby facilitating tax enforcement.

Finally, it targets a few of what some might view as “attractive nuisances.” That is, tax code provisions that are particularly subject to manipulation and misuse.

Battling these shelters one at a time, through years of costly litigation, has not prevented the steady growth in abusive practices. Indeed, the creativity and speed with which new and more complicated tax shelters are devised is remarkable. Following judicial and administrative rulings, tax shelters are repackaged and remarketed with creative titles like sequels to bad movies.

One type of gimmickery, called LILLO, has been used by an American company, which rents a Swiss town hall, not for any gathering, but only to rent it immediately back to the Swiss. The corporation takes a deduction from current taxable income for the total rental expense, while deferring income from its “re-rental” until far into the future. Within months of Treasury shutting down such abusive LILLO transactions, products were soon being sold as the “Son of LILLO,” with only a modicum of difference from the previous version.

I have modified this legislation to take into account the comments that were raised at a November 1999 Committee on Ways and Means hearing. I have incorporated recommendations from the American Bar Association tax section, and bipartisan suggestions from leaders of the Senate Finance Committee last year. This bill has been carefully designed to curtail egregious behavior without impacting legitimate business deals.

Most of these refinements have had a very plain purpose: eliminate the excuse for inaction. This bill should now be acceptable to everyone but most blatant shelter hustlers. But that may not be the case.

Treasury Secretary Paul O’Neill recently gave an interview to a London newspaper in which he favored eliminating corporate taxation. If that is the ultimate objective, if he just waits a little while maintaining the same attitude of indifference in the face of rapidly proliferating shelter schemes it may eventually be accomplished. This will leave just a few “corporate chumps” paying anything close to their fair share.

Most taxpayers realize that if someone in the corporate towers or just down the street is not paying their fair share, you and I, and the others who play by the rules, must pay more to pick up the slack. And that slack, that loss of revenue to abusive tax shelters, is not estimated to exceed \$10 billion per year.

And that lost revenue could be put to better use. The bipartisan leaders of the managed care reform bill in the last Congress relied upon this proposal to offset any reduced federal revenues associated with adopting the Patients Bill of Rights. Although blocked procedurally, Representative CHARLIE NORWOOD (R-GA) got it right in telling the House Rules Committee, “There is a large difference in what you call a tax increase and stopping bogus tax shelters. That is really two different

things. They aren’t just asking them to pay more taxes, we are trying to keep them from cheating the system.”

Today, we sponsors of this legislation offer a constructive way of correcting abusive tax shelters, described by former Treasury Secretary Larry Summers as “the most serious compliance issue threatening the American tax system.” Battling corporate tax cheats is not a partisan issue, it is a question of fundamental fairness. This Congress should promptly respond.

TECHNICAL EXPLANATION OF H.R. , THE  
“ABUSIVE TAX SHELTER SHUTDOWN ACT OF  
2001”

#### TITLE I—CLARIFICATION OF ECONOMIC SUBSTANCE DOCTRINE (SEC. 101)

##### PRESENT LAW

##### *In general*

The Internal Revenue Code (“Code”) provides specific rules regarding the computation of taxable income, including the amount, timing, and character of items of income, gain, loss and deductions. These rules are designed to provide for the computation of taxable income in a manner that provides for a degree of specificity to both taxpayers and the government. Taxpayers generally may plan their transactions in reliance on these rules to determine the federal income tax consequences arising from the transactions.

Notwithstanding the presence of these rules for determining tax liability, the claimed tax results of a particular transaction may be challenged by the Secretary of the Treasury. For example, the Code grants the Secretary various authority to challenge tax results that would result in an abuse of these rules or the avoidance or evasion of tax (Secs. 269, 446, 482, 7701(1)). Further, the Secretary can challenge a tax result by applying the so-called “economic substance doctrine.” This doctrine has been applied by the courts to deny unwarranted and unintended tax benefits in transactions whose undertaking does not result in a meaningful change to the taxpayer’s economic position other than a purported reduction in federal income tax. Closely related doctrines also applied by the courts (sometimes interchangeable with the economic substance doctrine) include the so-called “sham transaction doctrine” and the “business purpose doctrine”. (See, for example, *Knetsch v. United States*, 364 U.S. 361 (1960) denying interest deductions on a “sham transaction” whose only purpose was to create the deductions.) Also, the Secretary can argue that the substance of a transaction is different from the form in which the taxpayer has structured and reported the transaction and therefore, the taxpayer applied the improper rules to determine the tax consequences. Similarly, the Secretary may invoke the “step-transaction doctrine” to treat a series of formally separate “steps” as a single transaction if the steps are integrated, interdependent, and focused on a particular result.

##### *Economic substance doctrine*

The economic substance doctrine is a common law doctrine denying tax benefits in transactions which, apart from their claimed tax benefits, have little economic significance.

The seminal authority for the economic substance doctrine is the Supreme Court and Second Circuit decisions in *Gregory v. Helvering* (293 U.S. 465 (1935), *aff’d* 69 F.2d 809 (2d Cir. 1934)). In that case, a transitory subsidiary was used to effectuate a tax-advantaged distribution form a corporation. Notwithstanding that the transaction satisfied

the literal definition of a tax-free reorganization, the courts denied the intended benefits of the transactions, stating: "The purpose of the [reorganization] section is plain enough, men [and women] engaged in enterprises—industrial, commercial, financial, or an other—might wish to consolidate, or divide, to add to, or subtract from, their holdings. Such transactions were not to be considered 'realizing' and profit, because the collective interests still remained in solution. But the underlying presupposition is plain that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand, not as an ephemeral incident, egregious to its prosecution. To dodge the shareholder's taxes is not one of the transactions contemplated as corporate 'reorganizations'." (69 F.2d at 811).

The economic substance doctrine was applied in the case of *Goldstein v. Commissioner* (364 F.2d 734 (2d Cir. 1966)) involving a taxpayer who borrowed to acquire Treasury securities. Under the law then in effect, she was able to deduct a substantial amount of prepaid interest. Notwithstanding that the Code allowed a deduction for the prepaid interest, the Court disallowed the deduction stating: "this provision [sec. 163(a)] should not be construed to permit an interest deduction when it objectively appears that a taxpayer has borrowed funds in order to engage in a transaction that has no substance or purpose other than to obtain the tax benefit of an interest deduction."

Likewise in *Shelton v. Commissioner* (94 T.C. 738 (1990)), a taxpayer borrowed money to purchase Treasury bills. Under the law at that time, the interest on the borrowing was deductible, but interest on the Treasury bills did not have to be accrued currently. The taxpayer deducted the interest on the borrowing currently and deferred the interest income. The court, as in the *Goldstein* case, disallowed the interest deduction because the transaction lacked economic substance. Similarly, the economic substance doctrine has been applied to disallow losses in cases where taxpayers invested in commodity straddles (*Yosha v. Commissioner*, 861 F.2d 494 (7th Cir. 1988)).

Recently, the courts have applied the economic substance doctrine to deny the benefits of an intricate plan principally designed to create losses by investing in a partnership holding debt instruments that were sold for contingent installment notes. Both the Tax Court and the Court of Appeals for the Third Circuit held that the transaction lacked economic substance and thus disallowed the "artificial loss" (*ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998), *aff'd* 73 T.C.M. 2189 (1997)). The Tax Court opinion stated: "the transaction must be rationally related to a useful nontax purpose that is plausible in light of the taxpayer's conduct and useful in the light of the taxpayer's economic situation and intentions. Both the utility of the stated purpose and the rationality of the means chosen to effectuate it must be evaluated in accordance with the commercial practices in the relevant industry . . . A rational relationship between purpose and means ordinarily will not be found unless there was a reasonable expectation that the nontax benefits would at least be commensurate with the transaction costs."

Courts have likewise denied the tax benefits in cases involving the misuse of seller-financed corporate-owned life insurance (*Winn-Dixie Stores, Inc. v. Commissioner*, 113 T.C. No. 21 (1999); *American Electric Power Inc. v. United States* (S.D. Ohio, No. C2-99-724, Feb. 20, 2001)) and foreign tax credits (*Compaq Computer Corp. v. Commissioner*, 113 T.C. No. 17 (1999)). However, see *IES Industries v. United States*, 2001 U.S. App. LEXIS 12881 (8th Cir. June 14, 2001) for a contrary deci-

sion) in transactions the court determined were lacking economic substance.

#### *Business purpose doctrine*

The courts use the business purpose doctrine (in combination with economic substance) as part of a two-prong test for determining whether a transaction should be disregarded for tax purposes: (1) the taxpayer was motivated by no business purpose other than obtaining tax benefits in entering the transaction, and (2) the transaction lacks economic substance (*Rice's Toyota World*, 752 F.2d 89, 91 (1985)). In essence a transaction will be respected for tax purposes if it has "economic substance or encouraged by business or regulatory realities, is imbued with tax-independent consideration, and is not shaped solely by tax-avoidance features that have meaningless label attached." (*Frank Lyon Co. v. Commissioner*, 435 U.S. 561 (1978)).

#### EXPLANATION OF PROVISION

##### *In general*

Under the bill, the economic substance doctrine is made uniform and is enhanced. The bill provides that in applying the economic substance doctrine, a transaction will be treated as having economic substance only if the transaction changes in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position, and the transaction has a substantial nontax purpose which would be reasonably accomplished by the transaction. This aspect of the bill clarifies the judicial application of the economic substance doctrine and would overturn the results in certain court cases, such as the result in *IES Industries* (see above). The bill provides that if a profit potential is relied on to demonstrate that a transaction results in a meaningful change in economic position (and therefore has economic substance), the present value of the reasonably expected pre-tax profit must be substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected. The potential for a profit not in excess of a risk-free rate of return will not satisfy the test. In determining pre-tax profit, fees and other transaction expenses and foreign taxes are treated as expenses.

Under the bill, a taxpayer may rely on factors other than profit potential for a transaction to have a meaningful change in the taxpayer's economic position; the bill merely sets forth a minimum profit potential if that test is relied on to demonstrate a meaningful change in economic position.

In applying the profit test to the lessor of tangible property, depreciation and tax credits (such as the rehabilitation tax credit and the low income housing tax credit) are not to be taken into account in measuring tax benefits. Thus, a traditional leveraged lease is not affected by the bill to the extent it meets the present law standards.

Except as the bill otherwise specifically provides, judicial doctrines disallowing tax benefits for lack of economic substance, business purpose, or similar reasons will continue to apply as under present law.

##### *Transactions with tax-indifferent parties*

The bill also provides special rules for transactions with tax-indifferent parties. For this purpose, a tax-indifferent party means any person or entity not subject to Federal income tax, or any person to whom an item would have no substantial impact on its income tax liability, for example, by reasons of its method of accounting (such as mark-to-market). Under these rules, the form of a financing transaction will not be respected if the present value of the tax deductions to be claimed is substantially in excess of the present value of the anticipated economic returns to the lender. Also, the

form of a transaction with a tax-indifferent party in excess of the tax-indifferent party's economic gain or income or if it results in the shifting of basis on account of overstating the income or gain of the tax-indifferent party.

#### EFFECTIVE DATE

The provision applies to transactions after the date of enactment.

#### TITLE II—PENALTIES

##### *1. Modifications to accuracy-related penalty (sec. 201)*

###### PRESENT LAW

A 20-percent penalty applies to any portion of an underpayment of income tax required to be shown on a return to the extent that it is attributable to negligence or to a substantial understatement of income tax. For purposes of the penalty, an understatement is considered "substantial" if it exceeds the greater of (1) 10 percent of the tax required to be shown on the return, or (2) \$5,000 (\$10,000 in the case of a C corporation that is not a personal holding company).

The penalty does not apply if there was reasonable cause for the understatement and the taxpayer acted in good faith with respect to the understatement. In addition, except in the case of a tax shelter, the substantial understatement penalty does not apply if there was substantial authority for the tax treatment of an item or if there was adequate disclosure of the item and reasonable basis for the treatment of the item. In the case of a tax shelter of a noncorporate taxpayer, the substantial authority exception applies if the taxpayer reasonably believed that the claimed treatment was more likely than not the proper treatment. For this purpose, a tax shelter means a partnership or other entity, plan or arrangement, if a significant purpose of the entity, plan or arrangement was the avoidance or evasion of Federal income tax.

#### EXPLANATION OF PROVISION

##### *Enhanced penalty for disallowed noneconomic tax attributes*

The bill increases the accuracy-related penalty for underpayments attributable to disallowed noneconomic tax attributes. The rate of the penalty is increased to 40 percent unless the taxpayer discloses to the Secretary of the Treasury or his delegate such information as the Secretary shall prescribe with respect to such transaction. No exceptions (including the reasonable cause exception) to the imposition of the penalty will apply in the case of disallowed noneconomic tax attributes.

The enhanced penalty applies to the extent that the underpayment is attributable to the disallowance of any tax benefit because of a lack of economic substance (as provided by the bill), because the transaction was not respected under the rules added by the bill relating to transactions with tax-indifferent parties, because of a lack of business purpose or because the form of the transaction does not reflect its substance, or because of any similar rule of law disregarding meaningless transactions whose undertaking were not in the furtherance of a legitimate business or economic purpose.

##### *Modifications to substantial understatement penalty*

The bill makes several modifications to the substantial understatement penalty. First, the bill treats an understatement as substantial if it exceeds \$500,000, regardless of whether it exceeds 10 percent of the taxpayer's total tax liability. Second, the bill treats tax shelters of noncorporate taxpayers the same as the present law treatment of corporate tax shelter; thus the exception from the penalty for substantial authority (under section 6662(b)(2)(B)(i)) will not apply.

Third, the bill provides that the determination of the amount of underpayment shall not be less than the amount that would be determined if the items not attributable to a tax shelter or to a transaction having disallowed noneconomic tax attributes (discussed below) were treated as being correct. Finally, an underpayment may not be reduced by reason of filing an amended return after the taxpayer is first contacted by the IRS regarding the examination of its return.

#### EFFECTIVE DATE

The enhanced penalty applies to transactions after the date of enactment. The modifications to the substantial understatement penalty apply to taxable years ending after the date of enactment.

#### 2. Promoter penalties (sec. 202)

##### PRESENT LAW

Any person who (1) organizes any partnership, entity, plan, or arrangement, or (2) participates in the sale of any interest in such a structure, and makes or furnishes a statement (or causes another to make or furnish a statement) with respect to any material tax benefit attributable to the arrangement or structure that the person knows (or has reason to know) is false or fraudulent is subject to a penalty. The amount of the penalty is equal to the lesser of (1) \$1,000 or (2) 100 percent of the gross income derived by the promoter from each activity (sec. 6700(a)). There is no statute of limitations on the assessment of a penalty under section 6700 (*Capozzi v. Commissioner*, 980 F.2d 872 (2nd Cir. 1992); *Lamb v. Commissioner*, 977 F.2d 1296 (8th Cir. 1992)).

##### EXPLANATION OF PROVISION

The bill imposes a penalty on any substantial promoter of a tax avoidance strategy if the strategy fails to satisfy any of the judicial doctrines that may be applied in the disallowance of noneconomic tax attributes (as described in section 201 of the bill).

A tax avoidance strategy means any entity, plan, arrangement, or transaction a significant purpose of which is the avoidance or evasion of Federal income tax. A substantial promoter means any person (and any related person) who participates in the promotion, offering, or sale of a tax avoidance strategy to more than one potential participant and for which the person expects to receive aggregate fees in excess of \$500,000.

The IRS can assess a penalty on a promoter independent of the taxpayer's audit, and the promoter can challenge the penalty prior to a final determination with respect to the taxpayer's disallowed tax benefit. The promoter can challenge the imposition of the penalty in court independent of any litigation with the taxpayer.

The amount of the penalty equals 100 percent of the gross income derived (or to be derived) by the promoter from the strategy. This would include contingent fees, rebated fees, and fees that are structured as an interest in the transaction. Coordination rules are provided to avoid the imposition of multiple penalties on promoters (i.e., the penalty does not apply if a penalty is imposed on the substantial promoter for promoting an abusive tax shelter under present-law section 6700(a)). As under present-law section 6700, there is not statute of limitations on the assessment of the penalty.

The bill also increases the present-law promoter penalty to the greater of \$1,000 or 100 percent of the gross income derived (or to be derived) by the promoter from each activity.

#### EFFECTIVE DATE

The penalty for promoting tax avoidance strategies applies with respect to any interest in a tax avoidance strategy that is offered after the date of enactment. The in-

crease in the present-law penalty for promoting abusive tax shelters applies to transactions after the date of enactment.

#### 3. Modifications to the aiding and abetting penalty (sec. 203)

##### PRESENT LAW

A penalty is imposed on any person who aids, assists in, procures, or advises with respect to the preparation or presentation of any return or other document if (1) the person knows (or has reason to believe) that the return or other document will be used in connection with any material matter arising under the tax laws, and (2) the person knows that if the portion of the return or other document were so used, an understatement of the tax liability would result (sec. 6701). An exception is provided for individuals who furnish mechanical assistance with respect to a document.

The amount of the penalty is \$1,000 for each return or other document (\$10,000 in the case of returns and documents relating to the tax of a corporation).

##### EXPLANATION OF PROVISION

The bill modifies the aiding and abetting penalty as it relates to any person who offers an opinion regarding the tax treatment of an item attributable to a tax shelter or any other transaction involving a noneconomic tax attribute.

Under the bill, a penalty is imposed on any person who is involved in the creation, sale, implementation, management, or reporting of a tax shelter, or of any partnership, entity, plan or arrangement that involves the disallowance of a noneconomic tax attribute (as described in section 201 of the bill), but only if (1) the person opines, advises, or indicates that the taxpayer's treatment of an item attributable to such a transaction would more likely than not prevail or not give rise to a penalty, and (2) the opinion, advice, or indication is unreasonable. If the opinion involved a higher standard (for example, a "should opinion"), and the opinion was unreasonable, then the person who offered the opinion would be subject to the proposed penalty. An opinion would be considered unreasonable if a reasonably prudent and careful person under similar circumstances would not have offered such an opinion.

The amount of the penalty is 100 percent of the gross proceeds derived by the person from the transaction. In addition, upon the imposition of this penalty, the Secretary is required to notify the IRS Director of Practice and any appropriate State licensing authority of the penalty and the circumstances under which it was imposed. Also, the Secretary must publish the identity of the person and the fact that the penalty was imposed on the person.

#### EFFECTIVE DATE

The provision applies to transactions entered into after date of enactment.

#### 4. Penalty for failure to maintain list of investors (sec. 204)

##### PRESENT LAW

Any person who organizes a potentially abusive tax shelter or who sells an interest in such a shelter must maintain a list that identifies each person who purchased an interest in the shelter (sec. 6112). A potentially abusive tax shelter means (i) any tax shelter with respect to which registration is required under section 6111, and (ii) any entity, investment plan or arrangement, or any other plan or arrangement that is of a type that has a potential for tax avoidance or evasion and that is designated in regulations issued by the Secretary. The investor list must include the name, address and taxpayer identification number of each purchaser, as

well as any other information that the Secretary may require. The lists must generally be maintained for seven years.

The penalty for any failure to meet any of the requirements of this provision if \$50 for each person with respect to whom there is a failure, up to a maximum of \$50,000 in any calendar year. The penalty is not imposed where the failure is due to reasonable cause and not due to willful neglect. This penalty is in addition to any other penalty provided by law.

##### EXPLANATION OF PROVISION

The bill increases the penalty for the failure to maintain investor lists in connection with the sale of interests in a tax shelter (as defined in section 6662(d)(2)(C)(iii) or in any partnership, entity, plan or arrangement that involves the disallowance of a noneconomic tax attribute (as described in section 201 of the bill). In these cases, the penalty is equal to the greater of 50 percent of the gross proceeds derived (or to be derived) from each person with respect to which there was a failure (with no maximum limitation).

#### EFFECTIVE DATE

The increased penalty applies to transactions entered into after date of enactment.

#### 5. Penalty for failure to disclose reportable transactions (sec. 205)

##### PRESENT LAW

A taxpayer must file a return or statement in accordance with the forms and regulations prescribed by the Secretary (including any required information). (See Section 6011). In February 2000, the Treasury Department issued temporary and proposed regulations under section 6011 that require corporate taxpayers to include in their tax return information with respect to certain large transactions with characteristics that may be indicative of tax shelter activity.

Specifically, the regulations require the disclosure of information with respect to "reportable transactions." There are two categories of reportable transactions. The first category covers transactions that are the same as (or substantially similar to) tax avoidance transactions the IRS has identified in published guidance (a "listed" transaction) and that are expected to reduce a corporation's income tax liability by more than \$1 million in any year or by more than \$2 million for any combination of years. (Treas. Reg. sec. 1.6011-4T(b)(2) and -(b)(4)). The second category covers transactions that are expected to reduce a corporation's income tax liability by more than \$5 million in any single year or \$10 million for any combination of years and that exhibit at least two of six enumerated characteristics. (Treas. Reg. sec. 1.6011-4T(b)(3) and -(b)(4)).

There is no penalty for failing to adequately disclose a reportable transaction. However, the nondisclosure could indicate that the taxpayer has not acted in "good faith" with respect to the underpayment. (T.D.8877).

##### EXPLANATION OF PROVISION

The bill imposes a penalty for failing to disclose the required information with respect to a reportable transaction (unless the failure was due to reasonable cause and not due to willful neglect). The amount of the penalty is equal to the greater of (1) five percent of any increase in Federal income tax which results from a difference between the taxpayer's treatment of the items attributable to the reportable transaction and the proper tax treatment of such items, or (2) \$100,000. If the failure to disclose relates to a listed transaction (or a substantially similar transaction), the percentage rate is increased to 10 percent of any increase in tax from the transaction (or, if greater, \$100,000).

The penalty for failure to disclose information with respect to a reportable transaction is in addition to any accuracy-related penalty that may be imposed on the taxpayer.

#### EFFECTIVE DATE

The provision applies to transactions entered into after date of enactment.

#### 6. Registration of certain tax shelters offered to non-corporate participants (sec. 206)

##### PRESENT LAW

A promoter of a confidential corporate tax shelter is required to register the tax shelter with the IRS (sec. 6111(d)). Registration is required not later than the next business day after the day when the tax shelter is first offered to potential users. For this purpose, a confidential corporate tax shelter includes any entity, plan, arrangement or transaction (1) a significant purpose of which is the avoidance or evasion of Federal income tax for a direct or indirect participant that is a corporation, (2) that is offered to any potential participant under conditions of confidentiality, and (3) for which the tax shelter promoters may receive aggregate fees in excess of \$100,000.

The penalty for failing to timely register a confidential corporate tax shelter is the greater of \$10,000 or 50 percent of the fees payable to any promoter with respect to offerings prior to the date of late registration unless due to reasonable cause (sec. 6707(a)(3)). Intentional disregard of the requirement to register increases the 50-percent penalty to 75 percent of the applicable fees.

#### EXPLANATION OF PROVISION

The bill deletes the requirement that a direct or indirect participant must be a corporation. Thus, the provision extends the present-law registration requirements to include a promoter of any confidential tax shelter (regardless of the participant). The penalty for failing to timely register a confidential tax shelter remains unchanged (i.e., the greater of \$10,000 or 50 percent of the fees payable to any promoter with respect to offerings prior to the date of late registration).

#### EFFECTIVE DATE

The provision applies to any tax shelter interest that is offered to potential participants after the date of enactment.

#### TITLE III—LIMITATIONS ON IMPORTATION AND TRANSFER OF BUILT-IN LOSSES

##### 1. Limitation on importation of built-in losses (sec. 301)

##### PRESENT LAW

Under present law, the basis of property received by a corporation in a tax-free incorporation, reorganization, or liquidation of a subsidiary corporation is the same as the adjusted basis in the hands of the transferor, adjusted for gain or loss recognized by the transferor (Secs. 334(b) and 362(a) and (b)). If a person or entity that is not subject to U.S. income tax transfers property with an adjusted basis higher than its fair market value to a corporation that is subject to U.S. income tax, the "built-in" loss would be imported into the U.S. tax system, and the transferee corporation would be able to recognize the loss in computing its U.S. income tax.

#### EXPLANATION OF PROVISION

The bill provides that if a net built-in loss is imported into the U.S. in a tax-free organization or reorganization from persons not subject to U.S. tax, the basis of all properties so transferred will be their fair market value. A similar rule will apply in the case of the tax-free liquidation by a domestic corporation of its foreign subsidiary.

Under the bill, a net built-in loss is considered imported into the U.S. if the aggregate

adjusted bases of property received by a transferee corporation subject to U.S. tax from persons not subject to U.S. tax with respect to the property exceeds the fair market value of the properties transferred. Thus, for example, if in a tax-free incorporation, some properties are received by a corporation from U.S. persons, and some properties are relieved from foreign persons not subject to U.S. tax, this provision applies to the aggregate properties relieved from the foreign persons. In the case of a transfer by a partnership (either domestic or foreign), this provision applies as if the properties had been transferred by each of the partners in proportion to their interests in the partnership.

#### EFFECTIVE DATE

The provision applies to transactions after the date of enactment.

##### 2. Disallowance of partnership loss transfers (sec. 302)

##### PRESENT LAW

##### Contributions of property

Under present law, if a partner contributes property to a partnership, generally no gain or loss is recognized to the contributing partner at the time of contribution (Sec. 721). The partnership takes the property at an adjusted basis equal to the contributing partner's adjusted basis in the property (Sec. 723). The contributing partner increases its basis in its partnership interest by the adjusted basis of the contributed property (Sec. 722). Any items of partnership income, gain, loss and deduction with respect to the contributed property is allocated among the partners to take into account any built-in gain or loss at the time of the contribution (Sec. 704(c)(1)(A)). This rule is intended to prevent the transfer of built-in gain or loss from the contributing partner to the other partners by generally allocating items to the noncontributing partners based on the value of their contributions and by allocating to the contributing partner the remainder of each item. (Note: where there is an insufficient amount of an item to allocate to the noncontributing partners, Treasury regulations allow for reasonable allocations to remedy this insufficiency. Treas. Reg. sec. 1-704(c) and (d)).

If the contributing partner transfer its partnership interest, the built-in gain or loss will be allocated to the transferee partner as it would have been allocated to the contributing partner (Treas. Reg. sec. 1.704-3(a)(7)). If the contributing partner's interest is liquidated, there is no specific guidance preventing the allocation of the built-in loss to the remaining partners. Thus, it appears that losses can be "transferred" to other partners where the contributing partner no longer remains a partner.

##### Transfers of partnership interests

Under present law, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless the partnership has made a one-time election under section 754 to make basis adjustments (Sec. 743(a)). If an election is in effect, adjustments are made with respect to the transferee partner in order to account for the difference between the transferee partner's proportionate share of the adjusted basis of the partnership property and the transferee's basis in its partnership interest (Sec. 743(b)). These adjustments are intended to adjust the basis of partnership property to approximate the result of a direct purchase of the property by the transferee partner. Under these rules, if a partner purchases an interest in a partnership with an existing built-in loss and no election under section 754 in effect, the transferee partner may be allocated a share of the loss when the partnership disposes of the property (or depreciates the property).

##### Distributions of partnership property

With certain exceptions, partners may receive distributions of partnership property without recognition of gain or loss by either the partner or the partnership (Sec. 731 (a) and (b)). In the case of a distribution in liquidation of a partner's interest, the basis of the property distributed in the liquidation is equal to the partner's adjusted basis in its partnership interest (reduced by any money distributed in the transaction) (Sec. 732(b)). In a distribution other than in liquidation of a partner's interest, the distributee partner's basis in the distributed property is equal to the partnership's adjusted basis in the property immediately before the distribution, but not to exceed the partner's adjusted basis in the partnership interest (reduced by any money distributed in the same transaction) (Sec. 734(a)).

Adjustments to the basis of the partnership's undistributed properties are not required unless the partnership has made the election under section 754 to make basis adjustments (sec. 734(a)). If an election is in effect under section 754, adjustments are made by a partnership to increase or decrease the remaining partnership assets to reflect any increase or decrease in the adjusted basis of the distributed properties in the hands of the distributee partner (Sec. 734(b)). To the extent the adjusted basis of the distributed properties increases (or loss is recognized) the partnership's adjusted basis in its properties is decreased by a like amount; likewise, to the extent the adjusted basis of the distributed properties decrease (or gain is recognized), the partnership's adjusted basis in its properties is increased by a like amount. Under these rules, a partnership with no election in effect under section 754 may distribute property with an adjusted basis lower than the distributee partner's proportionate share of the adjusted basis of all partnership property and leave the remaining partners with a smaller net built-in gain or a larger net built-in loss than before the distribution.

#### DESCRIPTION OF PROVISION

##### Contributions of property

Under the bill, a built-in loss may be taken into account only by the contributing partner and not by other partners. Except as provided in regulations, in determining the amount of items allocated to partners other than the contributing partner, the basis of the contributed property shall be treated as the fair market value on the date of contribution. Thus, if the contributing partner's partnership interest is transferred or liquidated, the partnership's adjusted basis in the property will be based on its fair market value at the date of contribution, and the built-in loss will be eliminated. (Note: it is intended that a corporation succeeding to attributes of the contributing corporate partner under section 381 shall be treated in the same manner as the contributing partner).

##### Transfers of partnership interests

The bill provides that the basis adjustment rules under section 743 will be required in the case of the transfer of a partnership interest with respect to which there is a substantial built-in loss. For this purpose, a substantial built-in loss exists where the transferee partner's proportionate share of the adjusted basis of the partnership property exceeds 110 percent of the transferee partner's basis in the partnership interest in the partnership. Thus, for example, assume that partner A sells his partnership interest to B for its fair market value of \$100. Also assume that B's proportionate share of the adjusted basis of the partnership assets is \$120. Under the bill, section 743(b) will apply and require a \$20 decrease in the adjusted basis of the partnership assets with respect to B, so that B

would recognize no gain or loss if the partnership immediately sold all of its assets for their fair market value.

#### *Distribution of partnership property*

The bill provides that the basis adjustments under section 734 are required in the case of a distribution with respect to which there is a substantial basis reduction. A substantial basis reduction means a downward adjustment to the partnership assets (had a section 754 election been in effect) greater than 10 percent of the adjusted basis of the assets.

Thus, for example, assume that A and B each contributed \$25 to a newly formed partnership and C contributed \$50 and that the partnership purchased LMN stock for \$30 and XYZ stock for \$70. Assume that the value of each stock declined to \$10. Assume LMN stock is distributed to C in liquidation of its partnership interest. As under present law, the basis of LMN stock in C's hands if \$50. C would recognize a loss of \$40 if the LMN stock were sold for \$10.

Under the bill, there is a substantial basis adjustment because the \$20 increase in the adjusted basis of asset 1 (sec. 734(b)(2)(B)) is greater than 10 percent of the adjusted basis of partnership assets of \$70. Thus, the partnership would be required to decrease the basis of XYZ stock (under section 734(b)(2)) by \$20 (the amount by which the basis LMN stock was increased), leaving a basis of \$50. If the XYZ stock were then sold by the partnership for \$10, A and B would each recognize a loss of \$20.

#### EFFECTIVE DATE

The provision applies to contributions, transfers, and distributions (as the case may be) after date of enactment.

#### RECESS

The SPEAKER pro tempore. There being no further requests for morning hour debates, pursuant to clause 12, rule I, the House will stand in recess until 10 a.m.

Accordingly (at 9 o'clock and 22 minutes a.m.) the House stood in recess until 10 a.m.

□ 1000

#### AFTER RECESS

The recess having expired, the House was called to order by the Speaker pro tempore (Mr. ISAKSON) at 10 a.m.

#### PRAYER

Rabbi Mitchell Wohlberg, Beth Tfiloh Congregation, Baltimore, Maryland, offered the following prayer:

I come from a tradition where Tuesdays are considered most propitious: weddings, moving to a new home, good things are to take place on Tuesday.

It goes all the way back to the first week of creation, where we note that, unlike other days of that first week, on the second day, on Monday, the Bible does not tell us "and God saw that it was good," while on the next day, the first Tuesday, two times it says, "and God saw that it was good."

According to the Talmud, this is because on the second day of the week the waters were parted. That symbolizes the division. That is no good. On

the first Tuesday, the third day of the week, the waters were brought together again, and that symbolizes unity, and that is doubly good.

In this spirit, we pray: Almighty God, may a unity of purpose bring together all the esteemed Members of the United States House of Representatives. Let all its Members realize that we can disagree without being disagreeable, that we can walk shoulder to shoulder without seeing eye to eye on every subject.

Together let us pray for the day which will witness the prophetic dream of a world in which none shall hurt, none shall destroy, for the Earth will be filled with the knowledge of Thee as the waters cover the sea.

And let us say Amen.

#### THE JOURNAL

The SPEAKER pro tempore. The Chair has examined the Journal of the last day's proceedings and announces to the House his approval thereof.

Pursuant to clause 1, rule I, the Journal stands approved.

#### PLEDGE OF ALLEGIANCE

The SPEAKER pro tempore. Will the gentleman from Nevada (Mr. GIBBONS) come forward and lead the House in the Pledge of Allegiance.

Mr. GIBBONS led the Pledge of Allegiance as follows:

I pledge allegiance to the Flag of the United States of America, and to the Republic for which it stands, one nation under God, indivisible, with liberty and justice for all.

#### WELCOME TO RABBI MITCHELL WOHLBERG

(Mr. CARDIN asked and was given permission to address the House for 1 minute and to revise and extend his remarks.)

Mr. CARDIN. Mr. Speaker, I feel privileged to know Rabbi Mitchell Wohlberg. Since 1978, he has been the spiritual leader of Beth Tfiloh congregation, the largest Orthodox Jewish congregation in Baltimore, the congregation of which I am a member.

Let me tell the Members a little bit about Rabbi Wohlberg. I have known Rabbi Wohlberg for many years and have often sought his guidance and counsel. He is a spellbinding speaker, and is famous for his thoughtful sermons that are able to clarify complicated issues.

Rabbi Wohlberg is also known for his involvement in the Jewish communal life. He has been a board member at The Associated Jewish Community Federation of Baltimore; a member of the executive committee of the Rabbinical Council of America, and is a recipient of the humanitarian award for the Louis Z. Brandeis District of the ZOA.

He comes from a committed and unique family where his father (of blessed memory) was and his two

brothers were and also are Rabbis, all ordained by the Yeshiva University. Rabbi Wohlberg is a driving force behind the Beth Tfiloh School, an outstanding Jewish day school in Baltimore.

I know all my colleagues will join me in thanking Rabbi Wohlberg for offering this morning's opening prayer.

#### PRIVATE CALENDAR

The SPEAKER pro tempore. This is the day for the call of the Private Calendar. The Clerk will call the first bill on the Private Calendar.

#### NANCY B. WILSON

The Clerk called the bill (H.R. 392) for the relief of Nancy B. Wilson.

Mr. COBLE. Mr. Speaker, I ask unanimous consent that the bill be passed over without prejudice.

The SPEAKER pro tempore. Is there objection to the request of the gentleman from North Carolina?

There was no objection.

#### RITA MIREMBE REVELL

The Clerk called the Senate bill (S. 560) for the relief of Rita Mirembé Revell (a.k.a. Margaret Rita Mirembé).

There being no objection, the Clerk read the Senate bill, as follows:

S. 560

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

#### SECTION 1. PERMANENT RESIDENT STATUS FOR RITA MIREMBE REVELL (A.K.A. MARGARET RITA MIREMBE).

(a) IN GENERAL.—Notwithstanding any other provision of law, for the purposes of the Immigration and Nationality Act (8 U.S.C. 1101 et seq.), Rita Mirembé Revell (a.k.a. Margaret Rita Mirembé) shall be held and considered to have been lawfully admitted to the United States for permanent residence as of the date of enactment of this Act, upon payment of the required visa fees not later than 2 years after the date of enactment of this Act.

(b) REDUCTION OF IMMIGRANT VISA NUMBERS.—Upon the granting of permanent residence to Rita Mirembé Revell (a.k.a. Margaret Rita Mirembé), the Secretary of State shall instruct the proper officer to reduce by the appropriate number, during the current or next following fiscal year, the total number of immigrant visas that are made available to natives of the country of the alien's birth under section 203(a) of the Immigration and Nationality Act (8 U.S.C. 1153(a)) or, if applicable, the total number of immigrant visas that are made available to natives of the country of the alien's birth under section 202(e) of such Act.

The Senate bill was ordered to be read a third time, was read the third time, and passed, and a motion to reconsider was laid on the table.

#### RABON LOWRY

The Clerk called the bill (H.R. 807) for the relief of Rabon Lowry of Pembroke, North Carolina.

There being no objection, the Clerk read the bill as follows: