

108TH CONGRESS
1ST SESSION

H. R. 2896

To amend the Internal Revenue Code of 1986 to remove impediments in such Code and make our manufacturing, service, and high-technology businesses and workers more competitive and productive both at home and abroad.

IN THE HOUSE OF REPRESENTATIVES

JULY 25, 2003

Mr. THOMAS introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to remove impediments in such Code and make our manufacturing, service, and high-technology businesses and workers more competitive and productive both at home and abroad.

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 “American Jobs Creation Act of 2003”.

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

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

4 (c) TABLE OF CONTENTS.—

Sec. 1. Short title; etc.

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Sec. 1001. Reduced corporate income tax rate for small corporations.

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Sec. 1011. Extension and modification of research credit.

Subtitle C—Incentives to Reinvest Foreign Earnings in United States

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Subtitle D—Small Business Expensing

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Subtitle E—Depreciation

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Sec. 1042. Recovery period for depreciation of certain leasehold improvements and restaurant property.

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Subtitle G—Alternative Minimum Tax Relief

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Sec. 1071. Members of family treated as 1 shareholder.

Sec. 1072. Increase in number of eligible shareholders to 100.

Sec. 1073. Expansion of bank S corporation eligible shareholders to include IRAs.

Sec. 1074. Disregard of unexercised powers of appointment in determining potential current beneficiaries of ESBT.

Sec. 1075. Transfer of suspended losses incident to divorce, etc.

- Sec. 1076. Use of passive activity loss and at-risk amounts by qualified subchapter S trust income beneficiaries.
- Sec. 1077. Exclusion of investment securities income from passive income test for bank S corporations.
- Sec. 1078. Treatment of qualifying director shares.
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- Sec. 1113. Reduction to 2 foreign tax credit baskets.
- Sec. 1114. 10-year foreign tax credit carryforward.
- Sec. 1115. Look-thru rules to apply to dividends from noncontrolled section 902 corporations.
- Sec. 1116. Attribution of stock ownership through partnerships to apply in determining section 902 and 960 credits.
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- Sec. 1118. Application of uniform capitalization rules to foreign persons.
- Sec. 1119. United States property not to include certain assets acquired by dealers in ordinary course of trade or business.
- Sec. 1120. Treatment of certain dividends of regulated investment companies.
- Sec. 1121. Election not to use average exchange rate for foreign tax paid other than in functional currency.
- Sec. 1122. Repeal of withholding tax on dividends from certain foreign corporations.

TITLE II—PROVISIONS TO REDUCE TAX AVOIDANCE THROUGH CORPORATE EARNINGS STRIPPING AND EXPATRIATION

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- Sec. 2002. Tax treatment of expatriated entities and their foreign parents.
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- Sec. 3011. Penalty on failure to report interests in foreign financial accounts.
- Sec. 3012. Regulation of individuals practicing before the department of the treasury.

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- Sec. 3021. Treatment of stripped interests in bond and preferred stock funds, etc.
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- Sec. 3025. No reduction of basis under section 734 in stock held by partnership in corporate partner.
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- Sec. 3027. Limitation on transfer of built-in losses on REMIC residuals.
- Sec. 3028. Clarification of banking business for purposes of determining investment of earnings in United States property.
- Sec. 3029. Clarification of exemption from tax for small property and casualty insurance companies.
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- Sec. 4001. Repeal of exclusion for extraterritorial income.
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1 **TITLE I—CORPORATE REFORM**
2 **AND GROWTH INCENTIVES**
3 **Subtitle A—Reduction in Corporate**
4 **Income Tax Rates**

5 **SEC. 1001. REDUCED CORPORATE INCOME TAX RATE FOR**
6 **SMALL CORPORATIONS.**

7 (a) IN GENERAL.—Subsection (b) of section 11 (re-
8 lating to tax imposed on corporations) is amended by re-
9 designating paragraph (2) as paragraph (4) and by strik-
10 ing paragraph (1) and inserting the following new para-
11 graphs:

12 “(1) IN GENERAL.—The amount of the tax im-
13 posed by subsection (a) shall be the sum of—

14 “(A) 15 percent of so much of the taxable
15 income as does not exceed \$50,000,

16 “(B) 25 percent of so much of the taxable
17 income as exceeds \$50,000 but does not exceed
18 \$75,000,

19 “(C) 33 percent (32 percent for taxable
20 years beginning after December 31, 2009) of so
21 much of the taxable income as exceeds \$75,000
22 but does not exceed the applicable amount,

23 “(D) in the case of taxable years beginning
24 before January 1, 2012, 34 percent of so much

1 of the taxable income as exceeds the applicable
2 amount but does not exceed \$10,000,000, and

3 “(E) 35 percent of so much of the taxable
4 income as exceeds \$10,000,000.

5 “(2) PHASEOUT OF LOWER RATES FOR CER-
6 TAIN TAXPAYERS.—

7 “(A) IN GENERAL.—In the case of a corpora-
8 tion which has taxable income in excess of the appli-
9 cable amount for any taxable year, the amount of
10 tax determined under paragraph (1) for such taxable
11 year shall be increased by the lesser of (i) 5 percent
12 of such excess, or (ii) maximum increase amount.

13 “(B) HIGHER INCOME CORPORATIONS.—In the
14 case of a corporation which has taxable income in
15 excess of \$10,000,000, the amount of the tax deter-
16 mined under the foregoing provisions of this para-
17 graph shall be increased by an additional amount
18 equal to the lesser of (i) 3 percent of such excess,
19 or (ii) \$100,000.

20 “(3) DEFINITIONS.—For purposes of this sub-
21 section—

22

“In the case of any taxable year beginning during:	The applicable amount is:	The maximum increase amount is:
2005, 2006, 2007, or 2008	\$1,000,000	\$21,000
2009	\$2,000,000	\$31,000
2010 and 2011	\$5,000,000	\$110,250

“In the case of any taxable year beginning during:	The applicable amount is:	The maximum increase amount is:
2012 and thereafter	\$10,000,000	\$210,250.”

1 (b) EFFECTIVE DATE.—The amendment made by
2 this section shall apply to taxable years beginning after
3 December 31, 2004.

4 **Subtitle B—Extension and** 5 **Modification of Research Credit**

6 **SEC. 1011. EXTENSION AND MODIFICATION OF RESEARCH** 7 **CREDIT.**

8 (a) EXTENSION OF RESEARCH CREDIT.—

9 (1) IN GENERAL.—Subparagraph (B) of section
10 41(h)(1) (relating to credit for increasing research
11 activities) is amended by striking “June 30, 2004”
12 and inserting “December 31, 2007”.

13 (2) CONFORMING AMENDMENT.—Subparagraph
14 (D) of section 45C(b)(1) is amended by striking
15 “June 30, 2004” and inserting “December 31,
16 2007”.

17 (3) EFFECTIVE DATE.—The amendments made
18 by this subsection shall apply to amounts paid or in-
19 curred after the date of the enactment of this Act.

20 (b) ALTERNATIVE SIMPLIFIED CREDIT FOR QUALI-
21 FIED RESEARCH EXPENSES.—

22 (1) IN GENERAL.—Subsection (c) of section 41
23 (relating to base amount) is amended by redesignig-

1 nating paragraphs (5) and (6) as paragraphs (6)
2 and (7), respectively, and by inserting after para-
3 graph (4) the following new paragraph:

4 “(5) ELECTION OF ALTERNATIVE SIMPLIFIED
5 CREDIT.—

6 “(A) IN GENERAL.—At the election of the
7 taxpayer, the credit determined under sub-
8 section (a)(1) shall be equal to 12 percent of so
9 much of the qualified research expenses for the
10 taxable year as exceeds 60 percent of the aver-
11 age qualified research expenses for the base pe-
12 riod years.

13 “(B) SPECIAL RULE IN CASE OF NO
14 QUALIFIED RESEARCH EXPENSES IN AT LEAST
15 1 BASE PERIOD YEAR.—

16 “(i) TAXPAYERS TO WHICH SUBPARA-
17 GRAPH APPLIES.—The credit under this
18 paragraph shall be determined under this
19 subparagraph if the taxpayer has no quali-
20 fied research expenses in any one of the
21 base period years.

22 “(ii) CREDIT RATE.—The credit de-
23 termined under this subparagraph shall be
24 equal to 6 percent of the qualified research
25 expenses for the taxable year.

1 “(C) BASE PERIOD YEARS.—The base pe-
2 riod years with respect to a taxable year for
3 which the credit under this paragraph is being
4 determined are the 3 taxable years—

5 “(i) which are among the 5 most re-
6 cent taxable years ending before such tax-
7 able year, and

8 “(ii) which are determined by dis-
9 regarding—

10 “(I) 1 taxable year for which the
11 qualified research expenses are the
12 largest, and

13 “(II) 1 taxable year for which
14 such expenses are the smallest.

15 Rules similar to the rules of subparagraphs (A)
16 and (B) of section 41(f)(3) shall apply for pur-
17 poses of this subparagraph.

18 “(D) ELECTION.—An election under this
19 paragraph shall apply to the taxable year for
20 which made and all succeeding taxable years
21 unless revoked with the consent of the Sec-
22 retary. An election under this paragraph may
23 not be made for any taxable year to which an
24 election under paragraph (4) applies.

1 “(E) APPLICATION OF PARAGRAPH.—An
2 election under this paragraph may be in effect
3 only for taxable years beginning after June 30,
4 2004, and before January 1, 2007.”.

5 (2) COORDINATION WITH ELECTION OF ALTER-
6 NATIVE INCREMENTAL CREDIT.—

7 (1) IN GENERAL.—Section 41(c)(4)(B) (relat-
8 ing to election) is amended by adding at the end the
9 following: “An election under this paragraph may
10 not be made for any taxable year to which an elec-
11 tion under paragraph (5) applies.”.

12 (2) TRANSITION RULE.—In the case of an elec-
13 tion under section 41(c)(4) of the Internal Revenue
14 Code of 1986 which applies to the taxable year
15 which includes the date of the enactment of this Act,
16 such election shall be treated as revoked with the
17 consent of the Secretary of the Treasury if the tax-
18 payer makes an election under section 41(c)(5) of
19 such Code (as added by subsection (a)) for such
20 year.

21 (3) EFFECTIVE DATE.—The amendments made
22 by this subsection shall apply to taxable years begin-
23 ning after June 30, 2004.

1 **Subtitle C—Incentives to Reinvest**
2 **Foreign Earnings in United States**

3 **SEC. 1021. TEMPORARY DEDUCTION BY UNITED STATES**
4 **SHAREHOLDERS FOR DIVIDENDS RECEIVED**
5 **FROM CONTROLLED FOREIGN CORPORA-**
6 **TIONS.**

7 (a) IN GENERAL.—Subpart F of part III of sub-
8 chapter N of chapter 1 (relating to controlled foreign cor-
9 porations) is amended by adding at the end the following
10 new section:

11 **“SEC. 965. TEMPORARY DIVIDENDS RECEIVED DEDUCTION.**

12 “(a) DEDUCTION.—

13 “(1) IN GENERAL.—In the case of a corpora-
14 tion which is a United States shareholder, there
15 shall be allowed as a deduction an amount equal to
16 80 percent of the dividends—

17 “(A) which are received by such share-
18 holder from controlled foreign corporations dur-
19 ing the election period, and

20 “(B) which are includible in gross income
21 for the taxable year which includes such period.

22 “(2) DIVIDENDS PAID INDIRECTLY FROM CON-
23 TROLLED FOREIGN CORPORATIONS.—If, within the
24 election period, a United States shareholder receives
25 a dividend from a controlled foreign corporation

1 which is excluded from gross income under section
2 959(a), such dividend shall be treated for purposes
3 of this section as meeting the requirements of para-
4 graph (1)(B) to the extent of any amount included
5 in income by such United States shareholder under
6 section 951(a)(1)(A) as a result of any dividend paid
7 during the election period to—

8 “(A) such controlled foreign corporation
9 from another controlled foreign corporation that
10 is in a chain of ownership described in section
11 958(a), or

12 “(B) any other controlled foreign corpora-
13 tion in such chain of ownership, but only to the
14 extent of distributions described in section
15 959(b) which are made during the election pe-
16 riod to the controlled foreign corporation from
17 which such United States shareholder received
18 such dividend.

19 “(b) LIMITATIONS.—

20 “(1) LIMITATION TO EARNINGS OTHERWISE
21 PERMANENTLY REINVESTED OUTSIDE THE UNITED
22 STATES.—The amount of dividends taken into ac-
23 count under subsection (a) shall not exceed the
24 amount shown on the applicable financial statement
25 as earnings permanently reinvested outside the

1 United States. If there is no such statement or such
2 statement fails to show a specific amount of such
3 earnings, such amount shall be treated as being
4 zero.

5 “(2) DIVIDENDS MUST BE EXTRAORDINARY.—
6 The amount of dividends taken into account under
7 subsection (a) shall not exceed the excess (if any)
8 of—

9 “(A) the dividends received during the tax-
10 able year by such shareholder from controlled
11 foreign corporations, over

12 “(B) the annual average for the base pe-
13 riod years of—

14 “(i) the dividends received during
15 each base period year by such shareholder
16 from such corporations, and

17 “(ii) the amounts includible in such
18 shareholder’s gross income for each base
19 period year under section 951(a)(1)(B) (or
20 which would have been included but for
21 section 959(a)(2)) with respect to such
22 corporations.

23 The amount taken into account under clause (i)
24 for any base period year shall not include any
25 dividend which is not includible in gross income

1 by reason of an amount described in clause (ii)
2 with respect to a prior taxable year.

3 “(3) REQUIREMENT TO INVEST IN UNITED
4 STATES.—Subsection (a) shall not apply to any divi-
5 dend received by a United States shareholder unless
6 the amount of the dividend is invested in the United
7 States pursuant to a plan describing the expendi-
8 tures to be made with such amount—

9 “(A) which, before the dividend is received,
10 is approved by the president or chief executive
11 officer of such shareholder, and

12 “(B) which is approved by the Board of
13 Directors (or management committee) of such
14 shareholder no later than its first meeting on or
15 after the date the dividend is received.

16 “(c) DEFINITIONS AND SPECIAL RULES.—For pur-
17 poses of this section—

18 “(1) ELECTION PERIOD.—The term ‘election
19 period’ means—

20 “(A) if this section applies to the tax-
21 payer’s last taxable year beginning before the
22 date of the enactment of this section, any 6-
23 month or shorter period during such year which
24 is after the date of the enactment of this sec-
25 tion and which is selected by the taxpayer, and

1 “(B) if this section applies to the tax-
2 payer’s first taxable year beginning on or after
3 such date, the 1st 6 months of such taxable
4 year.

5 “(2) APPLICABLE FINANCIAL STATEMENT.—
6 The term ‘applicable financial statement’ means the
7 most recently audited financial statement (including
8 notes and other documents which accompany such
9 statement)—

10 “(A) which is certified on or before March
11 31, 2003, as being prepared in accordance with
12 generally accepted accounting principles, and

13 “(B) which is used for the purposes of a
14 statement or report—

15 “(i) to creditors,

16 “(ii) to shareholders, or

17 “(iii) for any other substantial nontax
18 purpose.

19 In the case of a corporation required to file a finan-
20 cial statement with the Securities and Exchange
21 Commission, such term means the most recent such
22 statement filed on or before March 31, 2003.

23 “(3) BASE PERIOD YEARS.—The base period
24 years are the 3 taxable years—

1 “(A) which are among the 5 most recent
2 taxable years ending on or before March 31,
3 2003, and

4 “(B) which are determined by dis-
5 regarding—

6 “(i) 1 taxable year for which the sum
7 of the amounts described in clauses (i) and
8 (ii) of subsection (b)(2)(B) is the largest,
9 and

10 “(ii) 1 taxable year for which such
11 sum is the smallest.

12 Rules similar to the rules of subparagraphs (A) and
13 (B) of section 41(f)(3) shall apply for purposes of
14 this paragraph.

15 “(d) DENIAL OF FOREIGN TAX CREDIT.—

16 “(1) IN GENERAL.—No credit shall be allowed
17 under section 901 for any taxes paid or accrued (or
18 treated as paid or accrued) with respect to the de-
19 ductible portion of any dividend received during the
20 election period or of any amount described in sub-
21 section (a)(2). No deduction shall be allowed under
22 this chapter for any tax for which credit is not al-
23 lowable by reason of the preceding sentence.

24 “(2) DEDUCTIBLE PORTION.—For purposes of
25 paragraph (1), unless the taxpayer otherwise speci-

1 fies, the deductible portion of any dividend is the
2 amount which bears the same ratio to the amount
3 of such dividend as the amount allowed as a deduc-
4 tion under subsection (a) for the taxable year bears
5 to the amount described in subsection (b)(2)(A) for
6 such year.

7 “(e) INCREASE IN TAX ON INCLUDED AMOUNTS NOT
8 REDUCED BY CREDITS, ETC.—

9 “(1) IN GENERAL.—Any tax under this chapter
10 by reason of nondeductible CFC dividends shall not
11 be treated as tax imposed by this chapter for pur-
12 poses of determining—

13 “(A) the amount of any credit allowable
14 under this chapter, or

15 “(B) the amount of the tax imposed by
16 section 55.

17 Subparagraph (A) shall not apply to the credit
18 under section 53 or to the credit under section 27(a)
19 with respect to taxes attributable to such dividends.

20 “(2) INCLUSIONS MAY NOT BE OFFSET BY NET
21 OPERATING LOSSES.—

22 “(A) IN GENERAL.—The taxable income of
23 any United States shareholder for any taxable
24 year shall in no event be less than the amount

1 of nondeductible CFC dividends received during
2 such year.

3 “(B) COORDINATION WITH SECTION 172.—

4 The nondeductible CFC dividends for any tax-
5 able year shall not be taken into account—

6 “(i) in determining under section 172
7 the amount of any net operating loss for
8 such taxable year, and

9 “(ii) in determining taxable income
10 for such taxable year for purposes of the
11 2nd sentence of section 172(b)(2).

12 “(3) NONDEDUCTIBLE CFC DIVIDENDS.—For
13 purposes of this subsection, the term ‘nondeductible
14 CFC dividends’ means the excess of the amount of
15 dividends taken into account under subsection (a)
16 over the deduction allowed under subsection (a) for
17 such dividends.

18 “(f) FAILURE TO MAINTAIN AVERAGE PAYOUT
19 RATE.—

20 “(1) IN GENERAL.—If, during any of the 10
21 taxable years beginning after the taxable year for
22 which a deduction is allowed under this section, the
23 average described in subsection (b)(2)(B) for the
24 base period years exceeds the amount described in
25 subsection (b)(2)(A) for the taxable year, the tax im-

1 posed by this chapter for the taxable year of such
2 excess shall be increased by an amount equal to the
3 sum of—

4 “(A) the increase in tax which would result
5 if such deduction (as reduced by any previous
6 reductions under this subsection) were reduced
7 (but not below zero) by 80 percent of such ex-
8 cess, and

9 “(B) interest at the underpayment rate,
10 determined as if the amount described in para-
11 graph (1) were an underpayment for the tax-
12 able year for which the deduction was allowed.

13 “(2) CARRYOVER OF EXCESS DIVIDENDS.—If,
14 for any of such 10 taxable years, the amount de-
15 scribed in subsection (b)(2)(A) for such taxable year
16 exceeds the average described in subsection
17 (b)(2)(B) for the base period years, such excess shall
18 be treated for purposes of this subsection as a divi-
19 dend received during the following taxable year.

20 “(g) ELECTION.—This section shall apply for the tax-
21 payer’s first taxable year beginning on or after the date
22 of the enactment of this section if the taxpayer elects its
23 application for such taxable year. The taxpayer may elect
24 to apply this section to the taxpayer’s last taxable year

1 beginning before the date of the enactment of this section
 2 in lieu of such first taxable year.”

3 (b) ALTERNATIVE MINIMUM TAX.—Subparagraph
 4 (C) of section 56(g)(4) is amended by adding at the end
 5 the following new clause:

6 “(v) SPECIAL RULE FOR CERTAIN DIS-
 7 TRIBUTIONS FROM CONTROLLED FOREIGN
 8 CORPORATIONS.—Clause (i) shall not apply
 9 to any deduction allowable under section
 10 965.”.

11 (c) CLERICAL AMENDMENT.—The table of sections
 12 for subpart F of part III of subchapter N of chapter 1
 13 is amended by adding at the end the following new item:

“Sec. 965. Temporary dividends received deduction.”.

14 (d) EFFECTIVE DATE.—The amendments made by
 15 this section shall apply to taxable years ending on or after
 16 the date of the enactment of this Act.

17 **Subtitle D—Small Business**
 18 **Expensing**

19 **SEC. 1031. 2-YEAR EXTENSION OF INCREASED EXPENSING**
 20 **FOR SMALL BUSINESS.**

21 Subsections (b), (c), and (d) of section 179 (as
 22 amended by the Jobs and Growth Tax Relief Reconcili-
 23 ation Act of 2003) are each amended by striking “2006”
 24 each place it appears and inserting “2008”.

1 **Subtitle E—Depreciation**

2 **SEC. 1041. 1-YEAR EXTENSION OF BONUS DEPRECIATION.**

3 (a) 50-PERCENT BONUS DEPRECIATION.—Section
4 168(k)(4) (as amended by the Jobs and Growth Tax Relief
5 Reconciliation Act of 2003) is amended—

6 (1) by striking “January 1, 2005” each place
7 it appears and inserting “January 1, 2006”, and

8 (2) by striking “January 1, 2006” in subpara-
9 graph (B)(iii) (as in effect before the amendment
10 made by paragraph (1)) and inserting “January 1,
11 2007”.

12 (b) 30-PERCENT BONUS DEPRECIATION.—Section
13 168(k)(2) (as so amended) is amended—

14 (1) by striking “January 1, 2005” each place
15 it appears and inserting “January 1, 2006”, and

16 (2) by striking “January 1, 2006” in subpara-
17 graph (A)(iv) (as in effect before the amendment
18 made by paragraph (1)) and inserting “January 1,
19 2007”.

20 (c) CONFORMING AMENDMENT.—The subsection
21 heading for section 168(k) (as so amended) is amended
22 by striking “JANUARY 1, 2005” and inserting “JANUARY
23 1, 2006”.

1 **SEC. 1042. RECOVERY PERIOD FOR DEPRECIATION OF CER-**
2 **TAIN LEASEHOLD IMPROVEMENTS AND RES-**
3 **TAURANT PROPERTY.**

4 (a) 20-YEAR RECOVERY PERIOD.—Paragraph (3) of
5 section 168(e) (relating to classification of certain prop-
6 erty) is amended by adding after subparagraph (E) the
7 following new subparagraph:

8 “(F) 20-YEAR PROPERTY.—The term ‘20-
9 year property’ includes—

10 “(i) any qualified leasehold improvement
11 property placed in service, and

12 “(ii) any qualified restaurant property
13 placed in service.

14 (b) QUALIFIED LEASEHOLD IMPROVEMENT PROP-
15 erty.—Subsection (e) of section 168 is amended by add-
16 ing at the end the following new paragraph:

17 “(6) QUALIFIED LEASEHOLD IMPROVEMENT
18 PROPERTY.—The term ‘qualified leasehold improve-
19 ment property’ has the meaning given such term in
20 section 168(k)(3) except that the following special
21 rules shall apply:

22 “(A) IMPROVEMENTS MADE BY LESSOR.—
23 In the case of an improvement made by the per-
24 son who was the lessor of such improvement
25 when such improvement was placed in service,
26 such improvement shall be qualified leasehold

1 improvement property (if at all) only so long as
2 such improvement is held by such person.

3 “(B) EXCEPTION FOR CHANGES IN FORM
4 OF BUSINESS.—Property shall not cease to be
5 qualified leasehold improvement property under
6 subparagraph (A) by reason of—

7 “(i) death,

8 “(ii) a transaction to which section
9 381(a) applies,

10 “(iii) a mere change in the form of
11 conducting the trade or business so long as
12 the property is retained in such trade or
13 business as qualified leasehold improve-
14 ment property and the taxpayer retains a
15 substantial interest in such trade or busi-
16 ness,

17 “(iv) the acquisition of such property
18 in an exchange described in section 1031,
19 1033, 1038, or 1039 to the extent that the
20 basis of such property includes an amount
21 representing the adjusted basis of other
22 property owned by the taxpayer or a re-
23 lated person, or

24 “(v) the acquisition of such property
25 by the taxpayer in a transaction described

1 in section 332, 351, 361, 721, or 731 (or
2 the acquisition of such property by the tax-
3 payer from the transferee or acquiring cor-
4 poration in a transaction described in such
5 section), to the extent that the basis of the
6 property in the hands of the taxpayer is
7 determined by reference to its basis in the
8 hands of the transferor or distributor.

9 “(C) RELATED PERSON.—For purposes of
10 this paragraph, a person (hereafter in this sub-
11 paragraph referred to as the ‘related person’) is
12 related to any person if the related person bears
13 a relationship to such person specified in sec-
14 tion 267(b) or 707(b)(1), or the related person
15 and such person are engaged in trades or busi-
16 nesses under common control (within the mean-
17 ing of subsections (a) and (b) of section 52).”.

18 (c) QUALIFIED RESTAURANT PROPERTY.—Sub-
19 section (e) of section 168 (as amended by subsection (b))
20 is further amended by adding at the end the following new
21 paragraph:

22 “(7) QUALIFIED RESTAURANT PROPERTY.—The
23 term ‘qualified restaurant property’ means any sec-
24 tion 1250 property which is a building (or any addi-
25 tion or improvement to such building) if more than

1 50 percent of the building’s square footage is de-
2 voted to preparation of, and seating for on-premises
3 consumption of, prepared meals.”.

4 (d) REQUIREMENT TO USE STRAIGHT LINE METH-
5 OD.—

6 (1) Paragraph (3) of section 168(b) is amended
7 by adding at the end the following new subpara-
8 graphs:

9 “(G) Qualified leasehold improvement
10 property described in subsection (e)(6).

11 “(H) Qualified restaurant property de-
12 scribed in subsection (e)(7).”.

13 (2) Subparagraph (A) of section 168(b)(2) is
14 amended by inserting before the comma “not re-
15 ferred to in paragraph (3)”.

16 (e) ALTERNATIVE SYSTEM.—The table contained in
17 section 168(g)(3)(B) is amended by adding at the end the
18 following new items:

“(F)(i)	39
“(F)(ii)	39”.

19 (f) EFFECTIVE DATE.—The amendments made by
20 this section shall apply to property placed in service after
21 the date of the enactment of this Act.

1 **SEC. 1043. SHORTER RECOVERY PERIODS FOR MANUFAC-**
 2 **TURING PROPERTY.**

3 (a) IN GENERAL.—Paragraph (3) of section 168(e),
 4 as amended by section 1042, is amended by adding after
 5 subparagraph (F) the following new subparagraph:

6 “(G) MANUFACTURING PROPERTY.—

7 “(i) IN GENERAL.—

8 “(I) Manufacturing property
 9 which would (but for this subpara-
 10 graph) be 10-year property shall be
 11 treated as 7-year property.

12 “(II) Manufacturing property
 13 which would (but for this subpara-
 14 graph) be 7-year property shall be
 15 treated as 5-year property.

16 “(III) Manufacturing property
 17 which would (but for this subpara-
 18 graph) be 5-year property shall be
 19 treated as 3-year property.

20 “(ii) MANUFACTURING PROPERTY.—

21 For purposes of this subparagraph, the
 22 term ‘manufacturing property’ means—

23 “(I) property used in an activity
 24 which is manufacturing within the
 25 meaning of codes 31–33 of the North

1 American Industry Classification Sys-
2 tem (2002), and

3 “(II) property treated as manu-
4 facturing property by regulations pre-
5 scribed by the Secretary.”

6 (b) EFFECTIVE DATE.—The amendment made by
7 this section shall apply to property placed in service after
8 the date of the enactment of this Act.

9 **Subtitle F—5-Year Carryback of**
10 **Certain Net Operating Losses**

11 **SEC. 1051. 5-YEAR CARRYBACK OF CERTAIN NET OPER-**
12 **ATING LOSSES.**

13 (a) IN GENERAL.—Subparagraph (H) of section
14 172(b)(1) is amended—

15 (1) by inserting “5-YEAR CARRYBACK OF CER-
16 TAIN LOSSES.—” after “(H)”, and

17 (2) by striking “or 2002” and inserting “,
18 2002, or 2003”.

19 (b) TEMPORARY SUSPENSION OF LIMITATION ON AL-
20 TERNATIVE MINIMUM TAXABLE INCOME FOR CERTAIN

21 NOL CARRYBACKS.—Subclause (I) of section
22 56(d)(1)(A)(ii) is amended—

23 (1) by striking “or 2002” and inserting “,
24 2002, or 2003”, and

1 (2) by striking “and 2002” and inserting “,
2 2002, or 2003”.

3 (c) TECHNICAL CORRECTIONS.—

4 (1) Subparagraph (H) of section 172(b)(1) is
5 amended by striking “a taxpayer which has”.

6 (2) Section 102(c)(2) of the Job Creation and
7 Worker Assistance Act of 2002 (Public Law 107–
8 147) is amended by striking “before January 1,
9 2003” and inserting “after December 31, 1990”.

10 (3)(A) Subclause (I) of section 56(d)(1)(A)(i) is
11 amended by striking “attributable to carryovers”.

12 (B) Subclause (I) of section 56(d)(1)(A)(ii) is
13 amended—

14 (i) by striking “for taxable years” and in-
15 serting “from taxable years”, and

16 (ii) by striking “carryforwards” and insert-
17 ing “carryovers”.

18 (d) EFFECTIVE DATES.—

19 (1) IN GENERAL.—Except as provided in para-
20 graph (2), the amendments made by this section
21 shall apply to net operating losses for taxable years
22 ending after December 31, 2002.

23 (2) TECHNICAL CORRECTIONS.—The amend-
24 ments made by subsection (c) shall take effect as if
25 included in the amendments made by section 102 of

1 the Job Creation and Worker Assistance Act of
2 2002.

3 (3) ELECTION.—In the case of a net operating
4 loss for a taxable year ending during 2003—

5 (A) any election made under section
6 172(b)(3) of such Code may (notwithstanding
7 such section) be revoked before November 1,
8 2003, and

9 (B) any election made under section 172(j)
10 of such Code shall (notwithstanding such sec-
11 tion) be treated as timely made if made before
12 November 1, 2003.

13 **Subtitle G—Alternative Minimum**
14 **Tax Relief**

15 **SEC. 1061. NET OPERATING LOSSES AND FOREIGN TAX**

16 **CREDIT UNDER ALTERNATIVE MINIMUM TAX.**

17 (a) NET OPERATING LOSSES.—Subparagraph (A) of
18 section 56(d)(1) is amended to read as follows:

19 “(A) the amount of such deduction shall
20 not exceed the alternative minimum taxable in-
21 come determined without regard to such deduc-
22 tion, and”.

23 (b) FOREIGN TAX CREDIT.—

24 (1) Subsection (a) of section 59 is amended by
25 striking paragraph (2) and by redesignating para-

1 graphs (3) and (4) as paragraphs (2) and (3), re-
2 spectively.

3 (2) Section 53(d)(1)(B)(i)(II) of such Code is
4 amended by striking “and if section 59(a)(2) did not
5 apply”.

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

9 **SEC. 1062. EXPANSION OF EXEMPTION FROM ALTERNATIVE**
10 **MINIMUM TAX FOR SMALL CORPORATIONS.**

11 (a) IN GENERAL.—Subparagraphs (A) and (B) of
12 section 55(e)(1) are each amended by striking
13 “\$7,500,000” each place it appears and inserting
14 “\$15,000,000”.

15 (b) EFFECTIVE DATE.—The amendment made by
16 this section shall apply to taxable years beginning after
17 December 31, 2003.

18 **SEC. 1063. REDUCTION IN AMOUNT OF DEPRECIATION SUB-**
19 **JECT TO ALTERNATIVE MINIMUM TAX.**

20 (a) IN GENERAL.—Clause (ii) of section 56(a)(1)(A)
21 is amended—

22 (1) by striking “150-PERCENT” in the heading
23 and inserting “175-PERCENT”, and

24 (2) by striking “150 percent” in the text and
25 inserting “175 percent”.

1 (b) EFFECTIVE DATE.—The amendment made by
2 this section shall apply to property placed in service after
3 December 31, 2005.

4 **Subtitle H—S Corporation Reform**
5 **and Simplification**

6 **SEC. 1071. MEMBERS OF FAMILY TREATED AS 1 SHARE-**
7 **HOLDER.**

8 (a) IN GENERAL.—Paragraph (1) of section 1361(c)
9 (relating to special rules for applying subsection (b)) is
10 amended to read as follows:

11 “(1) MEMBERS OF FAMILY TREATED AS 1
12 SHAREHOLDER.—

13 “(A) IN GENERAL.—For purpose of sub-
14 section (b)(1)(A)—

15 “(i) except as provided in clause (ii),
16 a husband and wife (and their estates)
17 shall be treated as 1 shareholder, and

18 “(ii) in the case of a family with re-
19 spect to which an election is in effect
20 under subparagraph (E), all members of
21 the family shall be treated as 1 share-
22 holder.

23 “(B) MEMBERS OF THE FAMILY.—For
24 purpose of subparagraph (A)(ii), the term
25 ‘members of the family’ means the common an-

1 cestor, lineal descendants of the common ances-
2 tor and the spouses (or former spouses) of such
3 lineal descendants or common ancestor.

4 “(C) COMMON ANCESTOR.—For purposes
5 of this paragraph, an individual shall not be
6 considered a common ancestor if, as of the later
7 of the effective date of this paragraph or the
8 time the election under section 1362(a) is
9 made, the individual is more than 3 generations
10 removed from the youngest generation of share-
11 holders.

12 “(D) EFFECT OF ADOPTION, ETC.—In de-
13 termining whether any relationship specified in
14 subparagraph (B) or (C) exists, the rules of
15 section 152(b)(2) shall apply.

16 “(E) ELECTION.—An election under sub-
17 paragraph (A)(ii)—

18 “(i) must be made with the consent of
19 shareholders (including those that are fam-
20 ily members) holding in the aggregate
21 more than one-half of the shares of stock
22 in the corporation on the day the election
23 is made,

24 “(ii) in the case of—

1 “(I) an electing small business
2 trust, shall be made by the trustee of
3 the trust, and

4 “(II) a qualified subchapter S
5 trust, shall be made by the beneficiary
6 of the trust,

7 “(iii) under regulations, shall remain
8 in effect until terminated, and

9 “(iv) shall apply only with respect to
10 1 family in any corporation.”.

11 (b) RELIEF FROM INADVERTENT INVALID ELECTION
12 OR TERMINATION.—Section 1362(f) (relating to inad-
13 vertent invalid elections or terminations), as amended by
14 section 1079, is amended—

15 (1) by inserting “or under section
16 1361(e)(1)(A)(ii)” after “section 1361(b)(3)(B)(ii)”
17 in paragraph (1), and

18 (2) by inserting “or under section
19 1361(e)(1)(E)(iii)” after “section 1361(b)(3)(C)” in
20 paragraph (1)(B).

21 (c) EFFECTIVE DATES.—

22 (1) SUBSECTION (a).—The amendment made by
23 subsection (a) shall apply to taxable years beginning
24 after December 31, 2003.

1 (2) SUBSECTION (b).—The amendments made
2 by subsection (b) shall apply to elections and termi-
3 nations made after December 31, 2003.

4 **SEC. 1072. INCREASE IN NUMBER OF ELIGIBLE SHARE-**
5 **HOLDERS TO 100.**

6 (a) IN GENERAL.—Section 1361(b)(1)(A) (defining
7 small business corporation) is amended by striking “75”
8 and inserting “100”.

9 (b) EFFECTIVE DATE.—The amendment made by
10 this section shall apply to taxable years beginning after
11 December 31, 2003.

12 **SEC. 1073. EXPANSION OF BANK S CORPORATION ELIGIBLE**
13 **SHAREHOLDERS TO INCLUDE IRAS.**

14 (a) IN GENERAL.—Section 1361(c)(2)(A) (relating to
15 certain trusts permitted as shareholders) is amended by
16 inserting after clause (v) the following new clause:

17 “(vi) In the case of a corporation
18 which is a bank (as defined in section
19 581), a trust which constitutes an indi-
20 vidual retirement account under section
21 408(a), including one designated as a Roth
22 IRA under section 408A, but only to the
23 extent of the stock held by such trust in
24 such bank as of the date of the enactment
25 of this clause.”.

1 (b) TREATMENT AS SHAREHOLDER.—Section
2 1361(c)(2)(B) (relating to treatment as shareholders) is
3 amended by adding at the end the following new clause:

4 “(vi) In the case of a trust described
5 in clause (vi) of subparagraph (A), the in-
6 dividual for whose benefit the trust was
7 created shall be treated as a shareholder.”.

8 (c) SALE OF BANK STOCK IN IRA RELATING TO S
9 CORPORATION ELECTION EXEMPT FROM PROHIBITED
10 TRANSACTION RULES.—Section 4975(d) (relating to ex-
11 emptions) is amended by striking “or” at the end of para-
12 graph (14), by striking the period at the end of paragraph
13 (15) and inserting “; or”, and by adding at the end the
14 following new paragraph:

15 “(16) a sale of stock held by a trust which con-
16 stitutes an individual retirement account under sec-
17 tion 408(a) to the individual for whose benefit such
18 account is established if—

19 “(A) such stock is in a bank (as defined in
20 section 581),

21 “(B) such stock is held by such trust as of
22 the date of the enactment of this paragraph,

23 “(C) such sale is pursuant to an election
24 under section 1362(a) by such bank,

1 “(D) such sale is for fair market value at
2 the time of sale (as established by an inde-
3 pendent appraiser) and the terms of the sale
4 are otherwise at least as favorable to such trust
5 as the terms that would apply on a sale to an
6 unrelated party,

7 “(E) such trust does not pay any commis-
8 sions, costs, or other expenses in connection
9 with the sale, and

10 “(F) the stock is sold in a single trans-
11 action for cash not later than 120 days after
12 the S corporation election is made.”.

13 (d) CONFORMING AMENDMENT.—Section 512(e)(1)
14 is amended by inserting “1361(c)(2)(A)(vi) or” before
15 “1361(c)(6)”.

16 (e) EFFECTIVE DATE.—The amendments made by
17 this section shall take effect on the date of the enactment
18 of this Act.

19 **SEC. 1074. DISREGARD OF UNEXERCISED POWERS OF AP-**
20 **POINTMENT IN DETERMINING POTENTIAL**
21 **CURRENT BENEFICIARIES OF ESBT.**

22 (a) IN GENERAL.—Section 1361(e)(2) (defining po-
23 tential current beneficiary) is amended—

24 (1) by inserting “(determined without regard to
25 any power of appointment to the extent such power

1 is not exercised during such period)” after “of the
2 trust” in the first sentence, and

3 (2) by striking “60-day” in the second sentence
4 and inserting “1-year”.

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

8 **SEC. 1075. TRANSFER OF SUSPENDED LOSSES INCIDENT TO**
9 **DIVORCE, ETC.**

10 (a) IN GENERAL.—Section 1366(d)(2) (relating to
11 indefinite carryover of disallowed losses and deductions)
12 is amended to read as follows:

13 “(2) INDEFINITE CARRYOVER OF DISALLOWED
14 LOSSES AND DEDUCTIONS.—

15 “(A) IN GENERAL.—Except as provided in
16 subparagraph (B), any loss or deduction which
17 is disallowed for any taxable year by reason of
18 paragraph (1) shall be treated as incurred by
19 the corporation in the succeeding taxable year
20 with respect to that shareholder.

21 “(B) TRANSFERS OF STOCK BETWEEN
22 SPOUSES OR INCIDENT TO DIVORCE.—In the
23 case of any transfer described in section 1041
24 of stock of an S corporation, any loss or deduc-
25 tion described in subparagraph (A) with respect

1 such stock shall be treated as incurred by the
2 corporation in the succeeding taxable year with
3 respect to the transferee.”

4 (b) **EFFECTIVE DATE.**—The amendment made by
5 this section shall apply to taxable years beginning after
6 December 31, 2003.

7 **SEC. 1076. USE OF PASSIVE ACTIVITY LOSS AND AT-RISK**
8 **AMOUNTS BY QUALIFIED SUBCHAPTER S**
9 **TRUST INCOME BENEFICIARIES.**

10 (a) **IN GENERAL.**—Section 1361(d)(1) (relating to
11 special rule for qualified subchapter S trust) is amended—

12 (1) by striking “and” at the end of subpara-
13 graph (A),

14 (2) by striking the period at the end of sub-
15 paragraph (B) and inserting “, and”, and

16 (3) by adding at the end the following new sub-
17 paragraph:

18 “(C) for purposes of applying sections 465
19 and 469 to the beneficiary of the trust, the dis-
20 position of the S corporation stock by the trust
21 shall be treated as a disposition by such bene-
22 ficiary.”.

23 (b) **EFFECTIVE DATE.**—The amendments made by
24 this section shall apply to transfers made after December
25 31, 2003.

1 **SEC. 1077. EXCLUSION OF INVESTMENT SECURITIES IN-**
2 **COME FROM PASSIVE INCOME TEST FOR**
3 **BANK S CORPORATIONS.**

4 (a) IN GENERAL.—Section 1362(d)(3) (relating to
5 where passive investment income exceeds 25 percent of
6 gross receipts for 3 consecutive taxable years and corpora-
7 tion has accumulated earnings and profits) is amended by
8 adding at the end the following new subparagraph:

9 “(F) EXCEPTION FOR BANKS; ETC.—In
10 the case of a bank (as defined in section 581)
11 or a bank holding company (as defined in sec-
12 tion 246A(c)(3)(B)(ii)), the term ‘passive in-
13 vestment income’ shall not include—

14 “(i) interest income earned by such
15 bank or bank holding company, or

16 “(ii) dividends on assets required to
17 be held by such bank or bank holding com-
18 pany, including stock in the Federal Re-
19 serve Bank, the Federal Home Loan Bank,
20 or the Federal Agricultural Mortgage
21 Bank or participation certificates issued by
22 a Federal Intermediate Credit Bank.”.

23 (b) EFFECTIVE DATE.—The amendment made by
24 this section shall apply to taxable years beginning after
25 December 31, 2003.

1 **SEC. 1078. TREATMENT OF QUALIFYING DIRECTOR**
2 **SHARES.**

3 (a) IN GENERAL.—Section 1361 (defining S corpora-
4 tion) is amended by adding at the end the following new
5 subsection:

6 “(f) TREATMENT OF QUALIFYING DIRECTOR
7 SHARES.—

8 “(1) IN GENERAL.—For purposes of this sub-
9 chapter—

10 “(A) qualifying director shares shall not be
11 treated as a second class of stock, and

12 “(B) no person shall be treated as a share-
13 holder of the corporation by reason of holding
14 qualifying director shares.

15 “(2) QUALIFYING DIRECTOR SHARES DE-
16 FINED.—For purposes of this subsection, the term
17 ‘qualifying director shares’ means any shares of
18 stock in a bank (as defined in section 581) or in a
19 bank holding company registered as such with the
20 Federal Reserve System—

21 “(A) which are required to be held by an
22 individual under applicable Federal or State law
23 in order to permit such individual to serve as
24 a director, and

25 “(B) which are subject to an agreement
26 pursuant to which the holder is required to dis-

1 pose of the shares of stock upon termination of
2 the holder's status as a director at the same
3 price as the individual acquired such shares of
4 stock.

5 “(3) DISTRIBUTIONS.—A distribution (not in
6 part or full payment in exchange for stock) made by
7 the corporation with respect to qualifying director
8 shares shall be includible as ordinary income of the
9 holder and deductible to the corporation as an ex-
10 pense in computing taxable income under section
11 1363(b) in the year such distribution is received.”.

12 (b) CONFORMING AMENDMENT.—Section 1366(a) is
13 amended by adding at the end the following new para-
14 graph:

15 “(3) ALLOCATION WITH RESPECT TO QUALI-
16 FYING DIRECTOR SHARES.—The holders of quali-
17 fying director shares (as defined in section 1361(f))
18 shall not, with respect to such shares of stock, be al-
19 located any of the items described in paragraph
20 (1).”.

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

1 **SEC. 1079. RELIEF FROM INADVERTENTLY INVALID QUALI-**
2 **FIED SUBCHAPTER S SUBSIDIARY ELECTIONS**
3 **AND TERMINATIONS.**

4 (a) IN GENERAL.—Section 1362(f) (relating to inad-
5 vertent invalid elections or terminations) is amended—

6 (1) by inserting “or under section
7 1361(b)(3)(B)(ii)” after “subsection (a)” in para-
8 graph (1),

9 (2) by inserting “or under section
10 1361(b)(3)(C)” after “subsection (d)” in paragraph
11 (1)(B),

12 (3) by inserting “or a qualified subchapter S
13 subsidiary, as the case may be” after “small busi-
14 ness corporation” in paragraph (3)(A),

15 (4) by inserting “or a qualified subchapter S
16 subsidiary, as the case may be” after “S corpora-
17 tion” in paragraph (4), and

18 (5) by inserting “or a qualified subchapter S
19 subsidiary, as the case may be” after “S corpora-
20 tion” in the matter following paragraph (4).

21 (b) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to taxable years beginning after
23 December 31, 2003.

1 **SEC. 1080. INFORMATION RETURNS FOR QUALIFIED SUB-**
 2 **CHAPTER S SUBSIDIARIES.**

3 (a) IN GENERAL.—Section 1361(b)(3)(A) (relating
 4 to treatment of certain wholly owned subsidiaries) is
 5 amended by inserting “and in the case of information re-
 6 turns required under part III of subchapter A of chapter
 7 61” after “Secretary”.

8 (b) EFFECTIVE DATE.—The amendment made by
 9 this section shall apply to taxable years beginning after
 10 December 31, 2003.

11 **Subtitle I—Protecting Employee**
 12 **Benefits**

13 **SEC. 1091. TREATMENT OF NONQUALIFIED DEFERRED**
 14 **COMPENSATION PLANS.**

15 (a) IN GENERAL.—Subpart A of part I of subchapter
 16 D of chapter 1 is amended by adding at the end the fol-
 17 lowing new section:

18 **“SEC. 409A. INCLUSION IN GROSS INCOME OF DEFERRED**
 19 **COMPENSATION UNDER NONQUALIFIED DE-**
 20 **FERRED COMPENSATION PLANS.**

21 **“(a) RULES RELATING TO CONSTRUCTIVE RE-**
 22 **CEIPT.—**

23 **“(1) IN GENERAL.—**

24 **“(A) GROSS INCOME INCLUSION.—**In the
 25 case of a nonqualified deferred compensation
 26 plan, all compensation deferred under the plan

1 for all taxable years (to the extent not subject
2 to a substantial risk of forfeiture and not pre-
3 viously included in gross income) shall be in-
4 cludible in gross income for the taxable year
5 unless at all times during the taxable year the
6 plan meets the requirements of paragraphs (2),
7 (3), and (4) and is operated in accordance with
8 such requirements.

9 “(B) INTEREST ON TAX LIABILITY PAY-
10 ABLE WITH RESPECT TO PREVIOUSLY DE-
11 FERRED COMPENSATION.—

12 “(i) IN GENERAL.—If compensation is
13 required to be included in gross income
14 under subparagraph (A) for a taxable year,
15 the tax imposed by this chapter for such
16 taxable year shall be increased by the
17 amount of interest determined under
18 clause (ii).

19 “(ii) INTEREST.—For purposes of
20 clause (i), the interest determined under
21 this clause for any taxable year is the
22 amount of interest at the underpayment
23 rate plus 1 percentage point on the under-
24 payments that would have occurred had
25 the deferred compensation been includible

1 in gross income for the taxable year in
2 which first deferred or, if later, the first
3 taxable in which such deferred compensa-
4 tion is not subject to a substantial risk of
5 forfeiture.

6 “(2) DISTRIBUTIONS.—

7 “(A) IN GENERAL.—The requirements of
8 this paragraph are met if the plan provides that
9 compensation deferred under the plan may not
10 be distributed earlier than—

11 “(i) separation from service (except as
12 provided in subparagraph (B)(i)),

13 “(ii) disability (as defined by section
14 223(d) of the Social Security Act),

15 “(iii) death,

16 “(iv) a specified time (or pursuant to
17 a fixed schedule) specified under the plan
18 as of the date of the deferral of such com-
19 pensation,

20 “(v) to the extent provided by the
21 Secretary, a change in the ownership or ef-
22 fective control of the corporation, or in the
23 ownership of a substantial portion of the
24 assets of the corporation, or

1 “(vi) the occurrence of an unforesee-
2 able emergency.

3 “(B) SPECIAL RULES.—

4 “(i) SPECIFIED EMPLOYEES.—In the
5 case of specified employees, the require-
6 ment of subparagraph (A)(i) is met only if
7 distributions may not be made earlier than
8 6 months after the date of separation from
9 service. For purposes of the preceding sen-
10 tence, a specified employee is a key em-
11 ployee (as defined in section 416(i)) of a
12 corporation the stock in which is publicly
13 traded on an established securities market
14 or otherwise.

15 “(ii) UNFORESEEABLE EMER-
16 GENCY.—For purposes of subparagraph
17 (A)(vi)—

18 “(I) IN GENERAL.—The term
19 ‘unforeseeable emergency’ means a se-
20 vere financial hardship to the partici-
21 pant resulting from a sudden and un-
22 expected illness or accident of the par-
23 ticipant or of a dependent (as defined
24 in section 152(a)) of the participant,
25 loss of the participant’s property due

1 to casualty, or other similar extraor-
2 dinary and unforeseeable cir-
3 cumstances arising as a result of
4 events beyond the control of the par-
5 ticipant.

6 “(II) LIMITATION ON DISTRIBUTU-
7 TIONS.—The requirement of subpara-
8 graph (A)(vi) is met only if, as deter-
9 mined under regulations of the Sec-
10 retary, the amounts distributed with
11 respect to an emergency do not exceed
12 the amounts necessary to satisfy such
13 emergency plus amounts necessary to
14 pay taxes reasonably anticipated as a
15 result of the distribution, after taking
16 into account the extent to which such
17 hardship is or may be relieved
18 through reimbursement or compensa-
19 tion by insurance or otherwise or by
20 liquidation of the participant’s assets
21 (to the extent the liquidation of such
22 assets would not itself cause severe fi-
23 nancial hardship).

24 “(3) ACCELERATION OF BENEFITS.—The re-
25 quirements of this paragraph are met if the plan

1 does not permit the acceleration of the time or
2 schedule under paragraph (2)(A)(iv).

3 “(4) ELECTIONS.—

4 “(A) IN GENERAL.—The requirements of
5 this paragraph are met if the requirements of
6 subparagraphs (B) and (C) are met.

7 “(B) INITIAL DEFERRAL DECISION.—The
8 requirements of this subparagraph are met if
9 the plan provides that compensation earned
10 during a taxable year may be deferred at the
11 employee’s election only if the election to defer
12 such compensation is made during the pre-
13 ceding taxable year or at such other time as
14 provided in regulations. In the case of the first
15 year in which an employee becomes eligible to
16 participate in the plan, such election may be
17 made with respect to services to be performed
18 subsequent to the election within 30 days after
19 the date the employee becomes eligible to par-
20 ticipate in such plan.

21 “(C) CHANGES IN TIME AND FORM OF DIS-
22 TRIBUTION.—The requirements of this subpara-
23 graph are met if, in the case of a plan which
24 permits under a subsequent election a delay in
25 a payment distributable under paragraph

1 (2)(A)(iv) or a change in the form of pay-
2 ment—

3 “(i) such election may not be made
4 less than 12 months prior to the date of
5 the first scheduled payment under para-
6 graph (2)(A)(iv), and

7 “(ii) the plan requires that payments
8 with respect to which such election is made
9 be deferred for a period of not less than 5
10 years from the date of such election.

11 “(b) RULES RELATING TO FUNDING.—

12 “(1) OFFSHORE PROPERTY IN A TRUST.—In
13 the case of assets set aside (directly or indirectly) in
14 a trust (or other arrangement determined by the
15 Secretary) for purposes of paying deferred com-
16 pensation under a nonqualified deferred compensa-
17 tion plan, for purposes of section 83 such assets
18 shall be treated as property transferred in connec-
19 tion with the performance of services whether or not
20 such assets are available to satisfy claims of general
21 creditors—

22 “(A) at the time set aside if such assets
23 are located outside of the United States, or

1 “(B) at the time transferred if such assets
2 are subsequently transferred outside of the
3 United States.

4 “(2) EMPLOYER’S FINANCIAL HEALTH.—In the
5 case of a nonqualified deferred compensation plan,
6 there is a transfer of property within the meaning
7 of section 83 as of the earlier of—

8 “(A) the date on which the plan first pro-
9 vides that assets will become restricted to the
10 provision of benefits under the plan in connec-
11 tion with a change in the employer’s financial
12 health, or

13 “(B) the date on which assets are so re-
14 stricted.

15 “(3) INCOME INCLUSION FOR OFFSHORE
16 TRUSTS AND EMPLOYER’S FINANCIAL HEALTH.—For
17 each taxable year that assets treated as transferred
18 under this subsection remain set aside in a trust or
19 other arrangement subject to paragraph (1) or (2),
20 any increase in value in, or earnings with respect to,
21 such assets shall be treated as an additional transfer
22 of property under this subsection (to the extent not
23 previously included in income).

24 “(4) INTEREST ON TAX LIABILITY PAYABLE
25 WITH RESPECT TO TRANSFERRED PROPERTY.—

1 “(A) IN GENERAL.—If amounts are re-
2 quired to be included in gross income by reason
3 of paragraph (1) or (2) for a taxable year, the
4 tax imposed by this chapter for such taxable
5 year shall be increased by the amount of inter-
6 est determined under subparagraph (B).

7 “(B) INTEREST.—The interest determined
8 under this subparagraph for any taxable year is
9 the amount of interest at the underpayment
10 rate plus 1 percentage point on the underpay-
11 ments that would have occurred had the
12 amounts so required to be included in gross in-
13 come by paragraph (1) or (2) been includible in
14 gross income for the taxable year in which such
15 assets were first set aside (directly or indi-
16 rectly) in a trust (or other arrangement deter-
17 mined by the Secretary) for purposes of the
18 nonqualified deferred compensation plan.

19 “(c) NO INFERENCE ON EARLIER INCOME INCLU-
20 SION.—Nothing in this section shall be construed to pre-
21 vent the inclusion of amounts in gross income under any
22 other provision of this chapter or any other rule of law
23 earlier than the time provided in this section.

24 “(d) OTHER DEFINITIONS AND SPECIAL RULES.—
25 For purposes of this section—

1 “(1) NONQUALIFIED DEFERRED COMPENSA-
2 TION PLAN.—The term ‘nonqualified deferred com-
3 pensation plan’ means any plan that provides for the
4 deferral of compensation, other than—

5 “(A) a qualified employer plan, and

6 “(B) any bona fide vacation leave, sick
7 leave, compensatory time, disability pay, or
8 death benefit plan.

9 “(2) QUALIFIED EMPLOYER PLAN.—The term
10 ‘qualified employer plan’ means—

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

14 “(B) any eligible deferred compensation
15 plan (within the meaning of section 457(b)) of
16 an employer described in section 457(e)(1)(A).

17 “(3) PLAN INCLUDES ARRANGEMENTS, ETC.—
18 The term ‘plan’ includes any agreement or arrange-
19 ment, including an agreement or arrangement that
20 includes one person.

21 “(4) SUBSTANTIAL RISK OF FORFEITURE.—The
22 rights of a person to compensation are subject to a
23 substantial risk of forfeiture if such person’s rights
24 to such compensation are conditioned upon the fu-

1 ture performance of substantial services by any indi-
2 vidual.

3 “(5) TREATMENT OF EARNINGS.—References to
4 deferred compensation shall be treated as including
5 references to income (whether actual or notional) at-
6 tributable to such compensation or such income.

7 “(e) REGULATIONS.—The Secretary shall prescribe
8 such regulations as may be necessary or appropriate to
9 carry out the purposes of this section, including regula-
10 tions—

11 “(1) providing for the determination of
12 amounts of deferral in the case of a nonqualified de-
13 ferred compensation plan which is a defined benefit
14 plan,

15 “(2) relating to changes in the ownership and
16 control of a corporation or assets of a corporation
17 for purposes of subsection (a)(2)(A)(v),

18 “(3) exempting arrangements from the applica-
19 tion of subsection (b) if such arrangements will not
20 result in an improper deferral of United States tax
21 and will not result in assets being effectively beyond
22 the reach of creditors,

23 “(4) defining financial health for purposes of
24 subsection (b)(2), and

1 “(5) disregarding a substantial risk of for-
2 feiture in cases where necessary to carry out the
3 purposes of this section.”.

4 (b) W-2 FORMS.—

5 (1) IN GENERAL.—Subsection (a) of section
6 6051 (relating to receipts for employees) is amended
7 by striking “and”, by striking the period at the end
8 of paragraph (11) and inserting “, and”, and by in-
9 serting after paragraph (11) the following new para-
10 graph:

11 “(12) the total amount of deferrals under a
12 nonqualified deferred compensation plan (within the
13 meaning of section 409A(d)).”.

14 (2) THRESHOLD.—Subsection (a) of section
15 6051 is amended by adding at the end the following:
16 “‘In the case of the amounts required to be shown
17 by paragraph (12), the Secretary may (by regula-
18 tion) establish a minimum amount of deferrals below
19 which paragraph (12) does not apply.’”.

20 (c) CONFORMING AND CLERICAL AMENDMENTS.—

21 (1) Section 414(b) is amended by inserting
22 “409A,” after “408(p),”.

23 (2) Section 414(c) is amended by inserting
24 “409A,” after “408(p),”.

1 (3) The table of sections for such subpart A is
2 amended by adding at the end the following new
3 item:

 “Sec. 409A. Inclusion in gross income of deferred compensation
 under nonqualified deferred compensation plans.”.

4 (d) **EFFECTIVE DATE.**—The amendments made by
5 this section shall apply to amounts deferred in taxable
6 years beginning after December 31, 2003.

7 **SEC. 1092. EXCLUSION OF INCENTIVE STOCK OPTIONS AND**
8 **EMPLOYEE STOCK PURCHASE PLAN STOCK**
9 **OPTIONS FROM WAGES.**

10 (a) **EXCLUSION FROM EMPLOYMENT TAXES.**—

11 (1) **SOCIAL SECURITY TAXES.**—

12 (A) Section 3121(a) (relating to definition
13 of wages) is amended by striking “or” at the
14 end of paragraph (20), by striking the period at
15 the end of paragraph (21) and inserting “; or”,
16 and by inserting after paragraph (21) the fol-
17 lowing new paragraph:

18 “(22) remuneration on account of—

19 “(A) a transfer of a share of stock to any
20 individual pursuant to an exercise of an incen-
21 tive stock option (as defined in section 422(b))
22 or under an employee stock purchase plan (as
23 defined in section 423(b)), or

1 “(B) any disposition by the individual of
2 such stock.”.

3 (B) Section 209(a) of the Social Security
4 Act is amended by striking “or” at the end of
5 paragraph (17), by striking the period at the
6 end of paragraph (18) and inserting “; or”, and
7 by inserting after paragraph (18) the following
8 new paragraph:

9 “(19) Remuneration on account of—

10 “(A) a transfer of a share of stock to any
11 individual pursuant to an exercise of an incen-
12 tive stock option (as defined in section 422(b)
13 of the Internal Revenue Code of 1986) or under
14 an employee stock purchase plan (as defined in
15 section 423(b) of such Code), or

16 “(B) any disposition by the individual of
17 such stock.”.

18 (2) RAILROAD RETIREMENT TAXES.—Sub-
19 section (e) of section 3231 is amended by adding at
20 the end the following new paragraph:

21 “(11) QUALIFIED STOCK OPTIONS.—The term
22 ‘compensation’ shall not include any remuneration
23 on account of—

24 “(A) a transfer of a share of stock to any
25 individual pursuant to an exercise of an incen-

1 tive stock option (as defined in section 422(b))
2 or under an employee stock purchase plan (as
3 defined in section 423(b)), or

4 “(B) any disposition by the individual of
5 such stock.”.

6 (3) UNEMPLOYMENT TAXES.—Section 3306(b)
7 (relating to definition of wages) is amended by strik-
8 ing “or” at the end of paragraph (16), by striking
9 the period at the end of paragraph (17) and insert-
10 ing “; or”, and by inserting after paragraph (17) the
11 following new paragraph:

12 “(18) remuneration on account of—

13 “(A) a transfer of a share of stock to any
14 individual pursuant to an exercise of an incen-
15 tive stock option (as defined in section 422(b))
16 or under an employee stock purchase plan (as
17 defined in section 423(b)), or

18 “(B) any disposition by the individual of
19 such stock.”.

20 (b) WAGE WITHHOLDING NOT REQUIRED ON DIS-
21 QUALIFYING DISPOSITIONS.—Section 421(b) (relating to
22 effect of disqualifying dispositions) is amended by adding
23 at the end the following new sentence: “No amount shall
24 be required to be deducted and withheld under chapter

1 24 with respect to any increase in income attributable to
2 a disposition described in the preceding sentence.”.

3 (c) WAGE WITHHOLDING NOT REQUIRED ON COM-
4 PENSATION WHERE OPTION PRICE IS BETWEEN 85 PER-
5 CENT AND 100 PERCENT OF VALUE OF STOCK.—Section
6 423(c) (relating to special rule where option price is be-
7 tween 85 percent and 100 percent of value of stock) is
8 amended by adding at the end the following new sentence:
9 “No amount shall be required to be deducted and withheld
10 under chapter 24 with respect to any amount treated as
11 compensation under this subsection.”.

12 (d) EFFECTIVE DATE.—The amendments made by
13 this section shall apply to stock acquired pursuant to op-
14 tions exercised after the date of the enactment of this Act.

15 **SEC. 1093. EXTENSION OF TRANSFERS OF EXCESS PENSION**
16 **ASSETS TO RETIREE HEALTH ACCOUNTS.**

17 Paragraph (5) of section 420(b) (relating to expira-
18 tion) is amended by striking “December 31, 2005” and
19 inserting “December 31, 2013”.

20 **Subtitle J—Treatment of Active**
21 **Income**

22 **SEC. 1101. REPEAL OF CFC RULES ON FOREIGN BASE COM-**
23 **PANY SALES AND SERVICES INCOME.**

24 (a) IN GENERAL.—Subsection (a) of section 954 (re-
25 lating to foreign base company income) is amended by

1 striking paragraphs (2) and (3) and by redesignating
2 paragraphs (4) and (5) as paragraphs (2) and (3), respec-
3 tively.

4 (b) CERTAIN SALES.—Paragraph (1) of section
5 954(c) is amended by adding at the end the following new
6 subparagraph:

7 “(H) CERTAIN SALES.—Income (whether
8 in the form of profits, commissions, fees, or
9 otherwise) derived in connection with the pur-
10 chase of personal property from a related per-
11 son and its sale to any person, the sale of per-
12 sonal property to any person on behalf of a re-
13 lated person, the purchase of personal property
14 from any person and its sale to a related per-
15 son, or the purchase of personal property from
16 any person on behalf of a related person if—

17 “(i) the property which is purchased
18 (or in the case of property sold on behalf
19 of a related person, the property which is
20 sold) is manufactured, produced, grown, or
21 extracted in the United States, and

22 “(ii) the property is sold for use, con-
23 sumption, or disposition in the United
24 States, or, in the case of property pur-
25 chased on behalf of a related person, is

1 purchased for use, consumption, or disposi-
2 tion in the United States.”

3 (c) CONFORMING AMENDMENTS.—

4 (1) Clause (iii) of section 952(c)(1)(B) is
5 amended by striking subclauses (III) and (IV) and
6 by redesignating subclauses (V) and (VI) as sub-
7 clauses (III) and (IV), respectively.

8 (2) Section 953(c)(6)(A) is amended by striking
9 “section 954(d)(3)” and inserting “section
10 954(b)(9)”.

11 (3) Subsection (b) of section 954 is amended by
12 adding at the end the following new paragraph:

13 “(9) RELATED PERSON DEFINED.—For pur-
14 poses of this subsection, a person is a related person
15 with respect to a controlled foreign corporation if—

16 “(A) such person is an individual, corpora-
17 tion, partnership, trust, or estate which con-
18 trols, or is controlled by, the controlled foreign
19 corporation, or

20 “(B) such person is a corporation, partner-
21 ship, trust, or estate which is controlled by the
22 same person or persons which control the con-
23 trolled foreign corporation.

24 For purposes of the preceding sentence, control
25 means, with respect to a corporation, the ownership,

1 directly or indirectly, of stock possessing more than
2 50 percent of the total voting power of all classes of
3 stock entitled to vote or of the total value of stock
4 of such corporation. In the case of a partnership,
5 trust, or estate, control means the ownership, di-
6 rectly or indirectly, of more than 50 percent (by
7 value) of the beneficial interests in such partnership,
8 trust, or estate. For purposes of this paragraph,
9 rules similar to the rules of section 958 shall apply.”

10 (4) Paragraph (5) of section 954(b) is amended
11 by striking “the foreign base company sales income,
12 the foreign base company services income,”.

13 (5) Section 954 is amended by striking sub-
14 sections (d) and (e).

15 (6) Sections 552(c)(2), 861(c)(2)(B),
16 904(d)(2)(H), 953(e), 955(b), 958(b), 971(f),
17 988(e)(3)(C), 1297(b)(2), 1298(d)(3), and
18 1298(e)(2)(B) are each amended by striking
19 “954(d)(3)” each place it appears and inserting
20 “954(b)(9)”.

21 (d) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to taxable years of foreign corpora-
23 tions beginning after December 31, 2005, and to taxable
24 years of United States shareholders with or within which
25 such taxable years of foreign corporations end.

1 **SEC. 1102. EXTENSION OF EXCEPTION OF ACTIVE FINANC-**
2 **ING INCOME FROM FOREIGN PERSONAL**
3 **HOLDING COMPANY INCOME.**

4 (a) **INSURANCE INCOME.**—Section 953(e)(10) is
5 amended—

6 (1) by striking “January 1, 2007” and insert-
7 ing “January 1, 2008”, and

8 (2) by striking “December 31, 2006” and in-
9 serting “December 31, 2007”.

10 (b) **ACTIVE CONDUCT OF BANKING, FINANCING, OR**
11 **SIMILAR BUSINESSES.**—Paragraph (9) of section 954(h)
12 (relating to special rule for income derived in the active
13 conduct of banking, financing, or similar business) is
14 amended by striking “January 1, 2007” and inserting
15 “January 1, 2008”.

16 **SEC. 1103. LOOK-THRU TREATMENT OF PAYMENTS BE-**
17 **TWEEN RELATED CONTROLLED FOREIGN**
18 **CORPORATIONS UNDER FOREIGN PERSONAL**
19 **HOLDING COMPANY INCOME RULES.**

20 Subsection (c) of section 954 is amended by adding
21 after paragraph (3) the following new paragraph:

22 “(4) **LOOK-THRU IN THE CASE OF RELATED**
23 **CONTROLLED FOREIGN CORPORATIONS.**—For pur-
24 poses of this subsection, dividends, interest, rents,
25 and royalties received or accrued from a controlled
26 foreign corporation which is a related person (as de-

1 fined in subsection (b)(9)) shall not be treated as
2 foreign personal holding company income to the ex-
3 tent attributable or properly allocable (determined
4 under rules similar to the rules of subparagraphs
5 (C) and (D) of section 904(d)(3)) to income of the
6 related person which is not subpart F income (as de-
7 fined in section 952). The Secretary shall prescribe
8 such regulations as may be appropriate to prevent
9 the abuse of the purposes of this paragraph.”

10 **SEC. 1104. LOOK-THRU TREATMENT FOR SALES OF PART-**
11 **NERSHIP INTERESTS.**

12 Section 954(c) (defining foreign personal holding
13 company income) is amended by adding after paragraph
14 (4) the following new paragraph:

15 “(5) LOOK-THRU RULE FOR CERTAIN PARTNER-
16 SHIP SALES.—

17 “(A) IN GENERAL.—In the case of any
18 sale by a controlled foreign corporation of an
19 interest in a partnership with respect to which
20 such corporation is a 25-percent owner, such
21 corporation shall be treated for purposes of this
22 subsection as selling the proportionate share of
23 the assets of the partnership attributable to
24 such interest.

1 “(B) 25-PERCENT OWNER.—For purposes
2 of this paragraph, the term ‘25-percent owner’
3 means a controlled foreign corporation which
4 owns (within the meaning of section 958(a)) 25
5 percent or more of the capital or profits interest
6 in the partnership.”

7 **SEC. 1105. REPEAL OF FOREIGN PERSONAL HOLDING COM-**
8 **PANY RULES AND FOREIGN INVESTMENT**
9 **COMPANY RULES.**

10 (a) GENERAL RULE.—The following provisions are
11 hereby repealed:

12 (1) Part III of subchapter G of chapter 1 (re-
13 lating to foreign personal holding companies).

14 (2) Section 1246 (relating to gain on foreign in-
15 vestment company stock).

16 (3) Section 1247 (relating to election by foreign
17 investment companies to distribute income cur-
18 rently).

19 (b) EXEMPTION OF FOREIGN CORPORATIONS FROM
20 PERSONAL HOLDING COMPANY RULES.—

21 (1) IN GENERAL.—Subsection (c) of section
22 542 (relating to exceptions) is amended—

23 (A) by striking paragraph (5) and insert-
24 ing the following:

25 “(5) a foreign corporation,”

1 (B) by striking paragraphs (7) and (10)
2 and by redesignating paragraphs (8) and (9) as
3 paragraphs (7) and (8), respectively,

4 (C) by inserting “and” at the end of para-
5 graph (7) (as so redesignated), and

6 (D) by striking “; and” at the end of para-
7 graph (8) (as so redesignated) and inserting a
8 period.

9 (2) TREATMENT OF INCOME FROM PERSONAL
10 SERVICE CONTRACTS.—Paragraph (1) of section
11 954(c) is amended by adding at the end the fol-
12 lowing new subparagraph:

13 “(I) PERSONAL SERVICE CONTRACTS.—

14 “(i) Amounts received under a con-
15 tract under which the corporation is to fur-
16 nish personal services if—

17 “(I) some person other than the
18 corporation has the right to designate
19 (by name or by description) the indi-
20 vidual who is to perform the services,
21 or

22 “(II) the individual who is to per-
23 form the services is designated (by
24 name or by description) in the con-
25 tract, and

1 “(ii) amounts received from the sale
2 or other disposition of such a contract.

3 This subparagraph shall apply with respect to
4 amounts received for services under a particular
5 contract only if at some time during the taxable
6 year 25 percent or more in value of the out-
7 standing stock of the corporation is owned, di-
8 rectly or indirectly, by or for the individual who
9 has performed, is to perform, or may be des-
10 ignated (by name or by description) as the one
11 to perform, such services.”

12 (c) CONFORMING AMENDMENTS.—

13 (1) Clause (iii) of section 1(h)(11)(C) is amend-
14 ed by striking “a foreign personal holding company
15 (as defined in section 552), a foreign investment
16 company (as defined in section 1246(b)), or”.

17 (2) Paragraph (2) of section 171(e) is amend-
18 ed—

19 (A) by striking “, or by a foreign personal
20 holding company, as defined in section 552”,
21 and

22 (B) by striking “, or foreign personal hold-
23 ing company”.

24 (3) Paragraph (2) of section 245(a) is amended
25 by striking “foreign personal holding company or”.

1 (4) Section 312 is amended by striking sub-
2 section (j).

3 (5) Subsection (m) of section 312 is amended
4 by striking “, a foreign investment company (within
5 the meaning of section 1246(b)), or a foreign per-
6 sonal holding company (within the meaning of sec-
7 tion 552)”.

8 (6) Subsection (e) of section 443 is amended by
9 striking paragraph (3) and by redesignating para-
10 graphs (4) and (5) as paragraphs (3) and (4), re-
11 spectively.

12 (7) Subparagraph (B) of section 465(c)(7) is
13 amended by adding “or” at the end of clause (i), by
14 striking clause (ii), and by redesignating clause (iii)
15 as clause (ii).

16 (8) Paragraph (1) of section 543(b) is amended
17 by inserting “and” at the end of subparagraph (A),
18 by striking “, and” at the end of subparagraph (B)
19 and inserting a period, and by striking subparagraph
20 (C).

21 (9) Paragraph (1) of section 562(b) is amended
22 by striking “or a foreign personal holding company
23 described in section 552”.

24 (10) Section 563 is amended—

25 (A) by striking subsection (c),

1 (B) by redesignating subsection (d) as sub-
2 section (e), and

3 (C) by striking “subsection (a), (b), or (c)”
4 in subsection (e) (as so redesignated) and in-
5 serting “subsection (a) or (b)”.

6 (11) Subsection (d) of section 751 is amended
7 by adding “and” at the end of paragraph (2), by
8 striking paragraph (3), by redesignating paragraph
9 (4) as paragraph (3), and by striking “paragraph
10 (1), (2), or (3)” in paragraph (3) (as so redesi-
11 gnated) and inserting “paragraph (1) or (2)”.

12 (12) Paragraph (2) of section 864(d) is amend-
13 ed by striking subparagraph (A) and by redesi-
14 gnating subparagraphs (B) and (C) as subparagraphs
15 (A) and (B), respectively.

16 (13)(A) Subparagraph (A) of section 898(b)(1)
17 is amended to read as follows:

18 “(A) which is treated as a controlled for-
19 eign corporation for any purpose under subpart
20 F of part III of this subchapter, and”.

21 (B) Subparagraph (B) of section 898(b)(2) is
22 amended by striking “and sections 551(f) and 554,
23 whichever are applicable,”.

24 (C) Paragraph (3) of section 898(b) is amended
25 to read as follows:

1 “(3) UNITED STATES SHAREHOLDER.—The
2 term ‘United States shareholder’ has the meaning
3 given to such term by section 951(b), except that, in
4 the case of a foreign corporation having related per-
5 son insurance income (as defined in section
6 953(c)(2)), the Secretary may treat any person as a
7 United States shareholder for purposes of this sec-
8 tion if such person is treated as a United States
9 shareholder under section 953(c)(1).”

10 (D) Subsection (c) of section 898 is amended to
11 read as follows:

12 “(c) DETERMINATION OF REQUIRED YEAR.—

13 “(1) IN GENERAL.—The required year is—

14 “(A) the majority U.S. shareholder year,

15 or

16 “(B) if there is no majority U.S. share-
17 holder year, the taxable year prescribed under
18 regulations.

19 “(2) 1-MONTH DEFERRAL ALLOWED.—A speci-
20 fied foreign corporation may elect, in lieu of the tax-
21 able year under paragraph (1)(A), a taxable year be-
22 ginning 1 month earlier than the majority U.S.
23 shareholder year.

24 “(3) MAJORITY U.S. SHAREHOLDER YEAR.—

1 “(A) IN GENERAL.—For purposes of this
2 subsection, the term ‘majority U.S. shareholder
3 year’ means the taxable year (if any) which, on
4 each testing day, constituted the taxable year
5 of—

6 “(i) each United States shareholder
7 described in subsection (b)(2)(A), and

8 “(ii) each United States shareholder
9 not described in clause (i) whose stock was
10 treated as owned under subsection
11 (b)(2)(B) by any shareholder described in
12 such clause.

13 “(B) TESTING DAY.—The testing days
14 shall be—

15 “(i) the first day of the corporation’s
16 taxable year (determined without regard to
17 this section), or

18 “(ii) the days during such representa-
19 tive period as the Secretary may pre-
20 scribe.”

21 (14) Clause (ii) of section 904(d)(2)(A) is
22 amended to read as follows:

23 “(ii) CERTAIN AMOUNTS INCLUDED.—
24 Except as provided in clause (iii), the term
25 ‘passive income’ includes, except as pro-

1 vided in subparagraph (E)(iii) or para-
2 graph (3)(I), any amount includible in
3 gross income under section 1293 (relating
4 to certain passive foreign investment com-
5 panies).”

6 (15)(A) Subparagraph (A) of section 904(g)(1)
7 is amended by adding “or” at the end of clause (i),
8 by striking clause (ii), and by redesignating clause
9 (iii) as clause (ii).

10 (B) The paragraph heading of paragraph (2) of
11 section 904(g) is amended by striking “FOREIGN
12 PERSONAL HOLDING OR”.

13 (16) Section 951 is amended by striking sub-
14 sections (c) and (d) and by redesignating subsections
15 (e) and (f) as subsections (c) and (d), respectively.

16 (17) Paragraph (3) of section 989(b) is amend-
17 ed by striking “, 551(a),”.

18 (18) Paragraph (5) of section 1014(b) is
19 amended by inserting “and before January 1,
20 2004,” after “August 26, 1937,”.

21 (19) Subsection (a) of section 1016 is amended
22 by striking paragraph (13).

23 (20)(A) Paragraph (3) of section 1212(a) is
24 amended to read as follows:

1 “(3) SPECIAL RULES ON CARRYBACKS.—A net
2 capital loss of a corporation shall not be carried
3 back under paragraph (1)(A) to a taxable year—

4 “(A) for which it is a regulated investment
5 company (as defined in section 851), or

6 “(B) for which it is a real estate invest-
7 ment trust (as defined in section 856).”

8 (B) The amendment made by subparagraph (A)
9 shall apply to taxable years beginning after Decem-
10 ber 31, 2005.

11 (21) Section 1223 is amended by striking para-
12 graph (10) and by redesignating the following para-
13 graphs accordingly.

14 (22) Subsection (d) of section 1248 is amended
15 by striking paragraph (5) and by redesignating
16 paragraphs (6) and (7) as paragraphs (5) and (6),
17 respectively.

18 (23) Paragraph (2) of section 1260(c) is
19 amended by striking subparagraphs (H) and (I) and
20 by redesignating subparagraph (J) as subparagraph
21 (H).

22 (24)(A) Subparagraph (F) of section
23 1291(b)(3) is amended by striking “551(d), 959(a),”
24 and inserting “959(a)”.

1 (B) Subsection (e) of section 1291 is amended
2 by inserting “(as in effect on the day before the date
3 of the enactment of the American Jobs Creation Act
4 of 2003)” after “section 1246”.

5 (25) Paragraph (2) of section 1294(a) is
6 amended to read as follows:

7 “(2) ELECTION NOT PERMITTED WHERE
8 AMOUNTS OTHERWISE INCLUDIBLE UNDER SECTION
9 951.—The taxpayer may not make an election under
10 paragraph (1) with respect to the undistributed
11 PFIC earnings tax liability attributable to a quali-
12 fied electing fund for the taxable year if any amount
13 is includible in the gross income of the taxpayer
14 under section 951 with respect to such fund for such
15 taxable year.”

16 (26) Section 6035 is hereby repealed.

17 (27) Subparagraph (D) of section 6103(e)(1) is
18 amended by striking clause (iv) and redesignating
19 clauses (v) and (vi) as clauses (iv) and (v), respec-
20 tively.

21 (28) Subparagraph (B) of section 6501(e)(1) is
22 amended to read as follows:

23 “(B) CONSTRUCTIVE DIVIDENDS.—If the
24 taxpayer omits from gross income an amount
25 properly includible therein under section

1 951(a), the tax may be assessed, or a pro-
2 ceeding in court for the collection of such tax
3 may be done without assessing, at any time
4 within 6 years after the return was filed.”

5 (29) Subsection (a) of section 6679 is amend-
6 ed—

7 (A) by striking “6035, 6046, and 6046A”
8 in paragraph (1) and inserting “6046 and
9 6046A”, and

10 (B) by striking paragraph (3).

11 (30) Sections 170(f)(10)(A), 508(d), 4947, and
12 4948(c)(4) are each amended by striking
13 “556(b)(2),” each place it appears.

14 (31) The table of parts for subchapter G of
15 chapter 1 is amended by striking the item relating
16 to part III.

17 (32) The table of sections for part IV of sub-
18 chapter P of chapter 1 is amended by striking the
19 items relating to sections 1246 and 1247.

20 (33) The table of sections for subpart A of part
21 III of subchapter A of chapter 61 is amended by
22 striking the item relating to section 6035.

1 **SEC. 1106. CLARIFICATION OF TREATMENT OF PIPELINE**
2 **TRANSPORTATION INCOME.**

3 Section 954(g)(1) (defining foreign base company oil
4 related income) is amended by striking “or” at the end
5 of subparagraph (A), by striking the period at the end
6 of subparagraph (B) and inserting “, or”, and by inserting
7 after subparagraph (B) the following new subparagraph:

8 “(C) the pipeline transportation of oil or
9 gas within such foreign country.”

10 **SEC. 1107. DETERMINATION OF FOREIGN PERSONAL HOLD-**
11 **ING COMPANY INCOME WITH RESPECT TO**
12 **TRANSACTIONS IN COMMODITIES.**

13 (a) IN GENERAL.—Clauses (i) and (ii) of section
14 954(e)(1)(C) (relating to commodity transactions) are
15 amended to read as follows:

16 “(i) arise out of commodity hedging
17 transactions (as defined in paragraph
18 (6)(A)),

19 “(ii) are active business gains or
20 losses from the sale of commodities, but
21 only if substantially all of the controlled
22 foreign corporation’s commodities are
23 property described in paragraph (1), (2),
24 or (8) of section 1221(a), or”.

1 (b) DEFINITION AND SPECIAL RULES.—Subsection
2 (c) of section 954 is amended by adding after paragraph
3 (5) the following new paragraph:

4 “(6) DEFINITION AND SPECIAL RULES RELAT-
5 ING TO COMMODITY TRANSACTIONS.—

6 “(A) COMMODITY HEDGING TRANS-
7 ACTIONS.—For purposes of paragraph
8 (1)(C)(i), the term ‘commodity hedging trans-
9 action’ means any transaction with respect to a
10 commodity if such transaction—

11 “(i) is a hedging transaction as de-
12 fined in section 1221(b)(2), determined—

13 “(I) without regard to subpara-
14 graph (A)(ii) thereof,

15 “(II) by applying subparagraph
16 (A)(i) thereof by substituting ‘ordi-
17 nary property or property described in
18 section 1231(b)’ for ‘ordinary prop-
19 erty’, and

20 “(III) by substituting ‘controlled
21 foreign corporation’ for ‘taxpayer’
22 each place it appears, and

23 “(ii) is clearly identified as such in ac-
24 cordance with section 1221(a)(7).

1 “(B) REGULATIONS.—The Secretary shall
2 prescribe such regulations as are appropriate to
3 carry out the purposes of paragraph (1)(C) in
4 the case of transactions involving related par-
5 ties.”

6 (c) EFFECTIVE DATE.—The amendments made by
7 this section shall apply to transactions entered into after
8 December 31, 2004.

9 **SEC. 1108. REPEAL OF CFC RULES ON FOREIGN BASE COM-**
10 **PANY SHIPPING INCOME.**

11 (a) ELIMINATION OF FOREIGN BASE COMPANY SHIP-
12 PING INCOME.—Section 954 (relating to foreign base com-
13 pany income), as amended by section 1101, is amended—

14 (1) by striking paragraph (2) of subsection (a)
15 (relating to foreign base company shipping income),
16 and

17 (2) by striking subsection (f) (relating to for-
18 eign base company shipping income).

19 (b) SAFE HARBOR FOR CERTAIN LEASING ACTIVI-
20 TIES.—Subparagraph (A) of section 954(c)(2) is amended
21 by adding at the end the following new sentence: “For
22 purposes of the preceding sentence, rents derived from
23 leasing an aircraft or vessel in foreign commerce shall not
24 fail to be treated as derived in the active conduct of a
25 trade or business if, as determined under regulations pre-

1 scribed by the Secretary, the active leasing expenses are
2 not less than 10 percent of the profit on the lease.”

3 (c) CONFORMING AMENDMENTS.—

4 (1) Section 952(c)(1)(B)(iii) is amended by
5 striking subclause (I) and redesignating subclauses
6 (II) through (VI) as subclauses (I) through (V), re-
7 spectively.

8 (2) Subsection (b) of section 954 is amended—

9 (A) by striking “the foreign base shipping
10 income,” in paragraph (5),

11 (B) by striking paragraphs (6) and (7),
12 and

13 (C) by redesignating paragraph (8) as
14 paragraph (6).

15 **SEC. 1109. EFFECTIVE DATE.**

16 Except as otherwise provided in this subtitle, the
17 amendments made by this subtitle shall apply to taxable
18 years of foreign corporations beginning after December
19 31, 2004, and to taxable years of United States share-
20 holders with or within which such taxable years of foreign
21 corporations end.

1 **Subtitle K—Reduction of Double**
2 **Taxation of Corporate Earnings**

3 **SEC. 1111. INTEREST EXPENSE ALLOCATION RULES.**

4 (a) ELECTION TO ALLOCATE ON WORLDWIDE
5 BASIS.— Section 864 is amended by redesignating sub-
6 section (f) as subsection (g) and by inserting after sub-
7 section (e) the following new subsection:

8 “(f) ELECTION TO ALLOCATE INTEREST, ETC. ON
9 WORLDWIDE BASIS.—For purposes of this subchapter, at
10 the election of the worldwide affiliated group—

11 “(1) ALLOCATION AND APPORTIONMENT OF IN-
12 TEREST EXPENSE.—

13 “(A) IN GENERAL.—The taxable income of
14 each domestic corporation which is a member of
15 a worldwide affiliated group shall be determined
16 by allocating and apportioning interest expense
17 of each member as if all members of such group
18 were a single corporation.

19 “(B) TREATMENT OF WORLDWIDE AFFILI-
20 ATED GROUP.—The taxable income of the do-
21 mestic members of a worldwide affiliated group
22 from sources outside the United States shall be
23 determined by allocating and apportioning the
24 interest expense of such domestic members to

1 such income in an amount equal to the excess
2 (if any) of—

3 “(i) the total interest expense of the
4 worldwide affiliated group multiplied by
5 the ratio which the foreign assets of the
6 worldwide affiliated group bears to all the
7 assets of the worldwide affiliated group,
8 over

9 “(ii) the interest expense of all foreign
10 corporations which are members of the
11 worldwide affiliated group to the extent
12 such interest expense of such foreign cor-
13 porations would have been allocated and
14 apportioned to foreign source income if
15 this subsection were applied to a group
16 consisting of all the foreign corporations in
17 such worldwide affiliated group.

18 “(C) WORLDWIDE AFFILIATED GROUP.—
19 For purposes of this paragraph, the term
20 ‘worldwide affiliated group’ means a group con-
21 sisting of—

22 “(i) the includible members of an af-
23 filiated group (as defined in section
24 1504(a), determined without regard to

1 paragraphs (2) and (4) of section
2 1504(b)), and

3 “(ii) all controlled foreign corpora-
4 tions in which such members in the aggre-
5 gate meet the ownership requirements of
6 section 1504(a)(2) either directly or indi-
7 rectly through applying paragraph (2) of
8 section 958(a) or through applying rules
9 similar to the rules of such paragraph to
10 stock owned directly or indirectly by do-
11 mestic partnerships, trusts, or estates.

12 “(2) ALLOCATION AND APPORTIONMENT OF
13 OTHER EXPENSES.—Expenses other than interest
14 which are not directly allocable or apportioned to
15 any specific income producing activity shall be allo-
16 cated and apportioned as if all members of the affili-
17 ated group were a single corporation. For purposes
18 of the preceding sentence, the term ‘affiliated group’
19 has the meaning given such term by section 1504
20 (determined without regard to paragraph (4) of sec-
21 tion 1504(b)).

22 “(3) TREATMENT OF TAX-EXEMPT ASSETS;
23 BASIS OF STOCK IN NONAFFILIATED 10-PERCENT
24 OWNED CORPORATIONS.—The rules of paragraphs
25 (3) and (4) of subsection (e) shall apply for purposes

1 of this subsection; except that paragraph (4) shall be
2 applied on worldwide affiliated group basis.

3 “(4) TREATMENT OF CERTAIN FINANCIAL IN-
4 STITUTIONS.—

5 “(A) IN GENERAL.—For purposes of para-
6 graph (1), any corporation described in sub-
7 paragraph (B) shall be treated as an includible
8 corporation for purposes of section 1504 only
9 for purposes of applying this subsection sepa-
10 rately to corporations so described.

11 “(B) DESCRIPTION.—A corporation is de-
12 scribed in this subparagraph if—

13 “(i) such corporation is a financial in-
14 stitution described in section 581 or 591,

15 “(ii) the business of such financial in-
16 stitution is predominantly with persons
17 other than related persons (within the
18 meaning of subsection (d)(4)) or their cus-
19 tomers, and

20 “(iii) such financial institution is re-
21 quired by State or Federal law to be oper-
22 ated separately from any other entity
23 which is not such an institution.

1 “(C) TREATMENT OF BANK HOLDING COM-
2 PANIES.—To the extent provided in regula-
3 tions—

4 “(i) a bank holding company (within
5 the meaning of section 2(a) of the Bank
6 Holding Company Act of 1956), and

7 “(ii) any subsidiary of a financial in-
8 stitution described in section 581 or 591 or
9 of any bank holding company if such sub-
10 sidiary is predominantly engaged (directly
11 or indirectly) in the active conduct of a
12 banking, financing, or similar business,
13 shall be treated as a corporation described in
14 subparagraph (B).

15 “(5) ELECTION TO EXPAND FINANCIAL INSTI-
16 TUTION GROUP OF WORLDWIDE GROUP.—

17 “(A) IN GENERAL.—If a worldwide affili-
18 ated group elects the application of this sub-
19 section, all financial corporations which—

20 “(i) are members of such worldwide
21 affiliated group, but

22 “(ii) are not corporations described in
23 paragraph (4)(B),

24 shall be treated as described in paragraph
25 (4)(B) for purposes of applying paragraph

1 (4)(A). This subsection (other than this para-
2 graph) shall apply to any such group in the
3 same manner as this subsection (other than this
4 paragraph) applies to the pre-election worldwide
5 affiliated group of which such group is a part.

6 “(B) FINANCIAL CORPORATION.—For pur-
7 poses of this paragraph, the term ‘financial cor-
8 poration’ means any corporation if at least 80
9 percent of its gross income is income described
10 in section 904(d)(2)(D)(ii) and the regulations
11 thereunder which is derived from transactions
12 with persons who are not related (within the
13 meaning of section 267(b) or 707(b)(1)) to the
14 corporation. For purposes of the preceding sen-
15 tence, there shall be disregarded any item of in-
16 come or gain from a transaction or series of
17 transactions a principal purpose of which is the
18 qualification of any corporation as a financial
19 corporation.

20 “(C) ANTIABUSE RULES.—In the case of a
21 corporation which is a member of an electing fi-
22 nancial institution group, to the extent that
23 such corporation—

24 “(i) distributes dividends or makes
25 other distributions with respect to its stock

1 after the date of the enactment of this
2 paragraph to any member of the pre-elec-
3 tion worldwide affiliated group (other than
4 to a member of the electing financial insti-
5 tution group) in excess of the greater of—

6 “(I) its average annual dividend
7 (expressed as a percentage of current
8 earnings and profits) during the 5-
9 taxable-year period ending with the
10 taxable year preceding the taxable
11 year, or

12 “(II) 25 percent of its average
13 annual earnings and profits for such
14 5-taxable-year period, or

15 “(ii) deals with any person in any
16 manner not clearly reflecting the income of
17 the corporation (as determined under prin-
18 ciples similar to the principles of section
19 482),

20 an amount of indebtedness of the electing fi-
21 nancial institution group equal to the excess
22 distribution or the understatement or overstate-
23 ment of income, as the case may be, shall be re-
24 characterized (for the taxable year and subse-
25 quent taxable years) for purposes of this para-

1 graph as indebtedness of the worldwide affili-
2 ated group (excluding the electing financial in-
3 stitution group). If a corporation has not been
4 in existence for 5 taxable years, this subpara-
5 graph shall be applied with respect to the pe-
6 riod it was in existence.

7 “(D) ELECTION.—An election under this
8 paragraph with respect to any financial institu-
9 tion group may be made only by the common
10 parent of the pre-election worldwide affiliated
11 group and may be made only for the first tax-
12 able year beginning after December 31, 2005,
13 in which such affiliated group includes 1 or
14 more financial corporations. Such an election,
15 once made, shall apply to all financial corpora-
16 tions which are members of the electing finan-
17 cial institution group for such taxable year and
18 all subsequent years unless revoked with the
19 consent of the Secretary.

20 “(E) DEFINITIONS RELATING TO
21 GROUPS.—For purposes of this paragraph—

22 “(i) PRE-ELECTION WORLDWIDE AF-
23 FILLATED GROUP.—The term ‘pre-election
24 worldwide affiliated group’ means, with re-
25 spect to a corporation, the worldwide affili-

1 ated group of which such corporation
2 would (but for an election under this para-
3 graph) be a member for purposes of apply-
4 ing paragraph (1).

5 “(ii) ELECTING FINANCIAL INSTITU-
6 TION GROUP.—The term ‘electing financial
7 institution group’ means the group of cor-
8 porations to which this subsection applies
9 separately by reason of the application of
10 paragraph (4)(A) and which includes fi-
11 nancial corporations by reason of an elec-
12 tion under subparagraph (A).

13 “(F) REGULATIONS.—The Secretary shall
14 prescribe such regulations as may be appro-
15 priate to carry out this subsection, including
16 regulations—

17 “(i) providing for the direct allocation
18 of interest expense in other circumstances
19 where such allocation would be appropriate
20 to carry out the purposes of this sub-
21 section,

22 “(ii) preventing assets or interest ex-
23 pense from being taken into account more
24 than once, and

1 “(iii) dealing with changes in mem-
2 bers of any group (through acquisitions or
3 otherwise) treated under this paragraph as
4 an affiliated group for purposes of this
5 subsection.

6 “(6) ELECTION.—An election to have this sub-
7 section apply with respect to any worldwide affiliated
8 group may be made only by the common parent of
9 the domestic affiliated group referred to in para-
10 graph (1)(C) and may be made only for the first
11 taxable year beginning after December 31, 2005, in
12 which a worldwide affiliated group exists which in-
13 cludes such affiliated group and at least one foreign
14 corporation. Such an election, once made, shall apply
15 to such common parent and all other corporations
16 which are members of such worldwide affiliated
17 group for such taxable year and all subsequent years
18 unless revoked with the consent of the Secretary.”.

19 (b) EXPANSION OF REGULATORY AUTHORITY.—
20 Paragraph (7) of section 864(e) is amended—

21 (1) by inserting before the comma at the end of
22 subparagraph (B) “and in other circumstances
23 where such allocation would be appropriate to carry
24 out the purposes of this subsection”, and

1 “(A) the amount of such loss (to the extent
2 not used under this paragraph in prior taxable
3 years), or

4 “(B) 50 percent of the taxpayer’s taxable
5 income from sources within the United States
6 for such succeeding taxable year,
7 shall be treated as income from sources without the
8 United States (and not as income from sources with-
9 in the United States).

10 “(2) OVERALL DOMESTIC LOSS DEFINED.—For
11 purposes of this subsection—

12 “(A) IN GENERAL.—The term ‘overall do-
13 mestic loss’ means any domestic loss to the ex-
14 tent such loss offsets taxable income from
15 sources without the United States for the tax-
16 able year or for any preceding taxable year by
17 reason of a carryback. For purposes of the pre-
18 ceding sentence, the term ‘domestic loss’ means
19 the amount by which the gross income for the
20 taxable year from sources within the United
21 States is exceeded by the sum of the deductions
22 properly apportioned or allocated thereto (deter-
23 mined without regard to any carryback from a
24 subsequent taxable year).

1 “(B) TAXPAYER MUST HAVE ELECTED
2 FOREIGN TAX CREDIT FOR YEAR OF LOSS.—
3 The term ‘overall domestic loss’ shall not in-
4 clude any loss for any taxable year unless the
5 taxpayer chose the benefits of this subpart for
6 such taxable year.

7 “(3) CHARACTERIZATION OF SUBSEQUENT IN-
8 COME.—

9 “(A) IN GENERAL.—Any income from
10 sources within the United States that is treated
11 as income from sources without the United
12 States under paragraph (1) shall be allocated
13 among and increase the income categories in
14 proportion to the loss from sources within the
15 United States previously allocated to those in-
16 come categories.

17 “(B) INCOME CATEGORY.—For purposes of
18 this paragraph, the term ‘income category’ has
19 the meaning given such term by subsection
20 (f)(5)(E)(i).

21 “(4) COORDINATION WITH SUBSECTION (f).—
22 The Secretary shall prescribe such regulations as
23 may be necessary to coordinate the provisions of this
24 subsection with the provisions of subsection (f).”

25 (b) CONFORMING AMENDMENTS.—

1 (1) Section 535(d)(2) is amended by striking
2 “section 904(g)(6)” and inserting “section
3 904(h)(6)”.

4 (2) Subparagraph (A) of section 936(a)(2) is
5 amended by striking “section 904(f)” and inserting
6 “subsections (f) and (g) of section 904”.

7 (c) EFFECTIVE DATE.—The amendments made by
8 this section shall apply to losses for taxable years begin-
9 ning after December 31, 2004.

10 **SEC. 1113. REDUCTION TO 2 FOREIGN TAX CREDIT BAS-**
11 **KETS.**

12 (a) IN GENERAL.—Paragraph (1) of section 904(d)
13 (relating to separate application of section with respect to
14 certain categories of income) is amended to read as fol-
15 lows:

16 “(1) IN GENERAL.—The provisions of sub-
17 sections (a), (b), and (c) and sections 902, 907, and
18 960 shall be applied separately with respect to—

19 “(A) passive category income, and

20 “(B) general category income.”

21 (b) CATEGORIES.—Paragraph (2) of section 904(d)
22 is amended by striking subparagraph (B), by redesignig-
23 nating subparagraph (A) as subparagraph (B), and by in-
24 serting before subparagraph (B) (as so redesignated) the
25 following new subparagraph:

1 “(A) CATEGORIES.—

2 “(i) PASSIVE CATEGORY INCOME.—

3 The term ‘passive category income’ means
4 passive income and specified passive cat-
5 egory income.

6 “(ii) GENERAL CATEGORY INCOME.—

7 The term ‘general category income’ means
8 income other than passive category in-
9 come.”

10 (c) SPECIFIED PASSIVE CATEGORY INCOME.—Sub-
11 paragraph (B) of section 904(d)(2), as so redesignated,
12 is amended by adding at the end the following new clause:

13 “(v) SPECIFIED PASSIVE CATEGORY
14 INCOME.—The term ‘specified passive cat-
15 egory income’ means—

16 “(I) dividends from a DISC or
17 former DISC (as defined in section
18 992(a)) to the extent such dividends
19 are treated as income from sources
20 without the United States,

21 “(II) taxable income attributable
22 to foreign trade income (within the
23 meaning of section 923(b)), and

24 “(III) distributions from a FSC
25 (or a former FSC) out of earnings

1 and profits attributable to foreign
2 trade income (within the meaning of
3 section 923(b)) or interest or carrying
4 charges (as defined in section
5 927(d)(1)) derived from a transaction
6 which results in foreign trade income
7 (as defined in section 923(b)).”

8 (d) TREATMENT OF FINANCIAL SERVICES.—Para-
9 graph (2) of section 904(d) is amended by striking sub-
10 paragraph (D), by redesignating subparagraph (C) as sub-
11 paragraph (D), and by inserting before subparagraph (D)
12 (as so redesignated) the following new subparagraph:

13 “(C) TREATMENT OF FINANCIAL SERVICES
14 INCOME AND COMPANIES.—

15 “(i) IN GENERAL.—Financial services
16 income shall be treated as general category
17 income in the case of—

18 “(I) a member of a financial
19 services group, and

20 “(II) any other person if such
21 person is predominantly engaged in
22 the active conduct of a banking, insur-
23 ance, financing, or similar business.

24 “(ii) FINANCIAL SERVICES GROUP.—
25 The term ‘financial services group’ means

1 any affiliated group (as defined in section
2 1504(a) without regard to paragraphs (2)
3 and (3) of section 1504(b)) which is pre-
4 dominantly engaged in the active conduct
5 of a banking, insurance, financing, or simi-
6 lar business. In determining whether such
7 a group is so engaged, there shall be taken
8 into account only the income of members
9 of the group that are—

10 “(I) United States corporations,

11 or

12 “(II) controlled foreign corpora-
13 tions in which such United States cor-
14 porations own, directly or indirectly,
15 at least 80 percent of the total voting
16 power and value of the stock.

17 “(iii) PASS-THRU ENTITIES.—The
18 Secretary shall by regulation specify for
19 purposes of this subparagraph the treat-
20 ment of financial services income received
21 or accrued by partnerships and by other
22 pass-thru entities which are not members
23 of a financial services group.”

24 (e) CONFORMING AMENDMENTS.—

1 (1) Clause (iii) of section 904(d)(2)(B) (relating
2 to exceptions from passive income), as so redesign-
3 nated, is amended by striking subclause (I) and by
4 redesignating subclauses (II) and (III) as subclauses
5 (I) and (II), respectively.

6 (2) Clause (i) of section 904(d)(2)(D) (defining
7 financial services income), as so redesignated, is
8 amended by adding “or” at the end of subclause (I)
9 and by striking subclauses (II) and (III) and insert-
10 ing the following new subclause:

11 “(II) passive income (determined
12 without regard to subparagraph
13 (B)(iii)(II)).”

14 (3) Section 904(d)(2)(D) (defining financial
15 services income), as so redesignated, is amended by
16 striking clause (iii).

17 (4) Paragraph (3) of section 904(d) is amended
18 to read as follows:

19 “(3) LOOK-THRU IN CASE OF CONTROLLED
20 FOREIGN CORPORATIONS.—

21 “(A) IN GENERAL.—Except as otherwise
22 provided in this paragraph, dividends, interest,
23 rents, and royalties received or accrued by the
24 taxpayer from a controlled foreign corporation
25 in which the taxpayer is a United States share-

1 holder shall not be treated as passive category
2 income.

3 “(B) SUBPART F INCLUSIONS.—Any
4 amount included in gross income under section
5 951(a)(1)(A) shall be treated as passive cat-
6 egory income to the extent the amount so in-
7 cluded is attributable to passive category in-
8 come.

9 “(C) INTEREST, RENTS, AND ROYAL-
10 TIES.—Any interest, rent, or royalty which is
11 received or accrued from a controlled foreign
12 corporation in which the taxpayer is a United
13 States shareholder shall be treated as passive
14 category income to the extent it is properly allo-
15 cable (under regulations prescribed by the Sec-
16 retary) to passive category income of the con-
17 trolled foreign corporation.

18 “(D) DIVIDENDS.—Any dividend paid out
19 of the earnings and profits of any controlled
20 foreign corporation in which the taxpayer is a
21 United States shareholder shall be treated as
22 passive category income in proportion to the
23 ratio of—

1 “(i) the portion of the earnings and
2 profits attributable to passive category in-
3 come, to

4 “(ii) the total amount of earnings and
5 profits.

6 “(E) LOOK-THRU APPLIES ONLY WHERE
7 SUBPART F APPLIES.—If a controlled foreign
8 corporation meets the requirements of section
9 954(b)(3)(A) (relating to de minimis rule) for
10 any taxable year, for purposes of this para-
11 graph, none of its foreign base company income
12 (as defined in section 954(a) without regard to
13 section 954(b)(5)) and none of its gross insur-
14 ance income (as defined in section
15 954(b)(3)(C)) for such taxable year shall be
16 treated as passive category income, except that
17 this sentence shall not apply to any income
18 which (without regard to this sentence) would
19 be treated as financial services income. Solely
20 for purposes of applying subparagraph (D),
21 passive income of a controlled foreign corpora-
22 tion shall not be treated as passive category in-
23 come if the requirements of section 954(b)(4)
24 are met with respect to such income.

1 “(F) COORDINATION WITH HIGH-TAXED
2 INCOME PROVISIONS.—

3 “(i) In determining whether any in-
4 come of a controlled foreign corporation is
5 passive category income, subclause (II) of
6 paragraph (2)(B)(iii) shall not apply.

7 “(ii) Any income of the taxpayer
8 which is treated as passive category income
9 under this paragraph shall be so treated
10 notwithstanding any provision of para-
11 graph (2); except that the determination of
12 whether any amount is high-taxed income
13 shall be made after the application of this
14 paragraph.”

15 (5) TREATMENT OF INCOME TAX BASE DIF-
16 FERENCES.—Paragraph (2) of section 904(d) is
17 amended by redesignating subparagraphs (H) and
18 (I) as subparagraphs (I) and (J), respectively, and
19 by inserting after subparagraph (G) the following
20 new subparagraph:

21 “(H) TREATMENT OF INCOME TAX BASE
22 DIFFERENCES.—Tax imposed under the law of
23 a foreign country or possession of the United
24 States on an amount which does not constitute
25 income under United States tax principles shall

1 be treated as imposed on income described in
2 paragraph (1)(B).”

3 (6) Paragraph (3) of section 904(d) is amended
4 by striking subparagraph (H) and by redesignating
5 subparagraph (I) as subparagraph (H).

6 (7) Paragraph (2) of section 904(d) is amended
7 by adding at the end the following new subpara-
8 graph:

9 “(K) TRANSITIONAL RULES FOR 2005
10 CHANGES.—For purposes of paragraph (1)—

11 “(i) taxes carried from any taxable
12 year beginning before January 1, 2005, to
13 any taxable year beginning on or after
14 such date, with respect to any item of in-
15 come, shall be treated as described in the
16 subparagraph of paragraph (1) in which
17 such income would be described were such
18 taxes paid or accrued in a taxable year be-
19 ginning on or after such date, and

20 “(ii) the Secretary may by regulations
21 provide for the allocation of any carryback
22 of taxes with respect to income to such a
23 taxable year for purposes of allocating such
24 income among the separate categories in
25 effect for such taxable year.”.

1 (8) Section 904(j)(3)(A)(i) is amended by strik-
2 ing “subsection (d)(2)(A)” and inserting “subsection
3 (d)(2)(B)”.

4 (f) EFFECTIVE DATE.—The amendments made by
5 this section shall apply to taxable years beginning after
6 December 31, 2004.

7 **SEC. 1114. 10-YEAR FOREIGN TAX CREDIT CARRYFORWARD.**

8 (a) GENERAL RULE.—Section 904(c) (relating to
9 carryback and carryover of excess tax paid) is amended
10 by striking “in the first, second, third, fourth, or fifth”
11 and inserting “in any of the first 10”.

12 (b) EXCESS EXTRACTION TAXES.—Paragraph (1) of
13 section 907(f) is amended by striking “in the first, second,
14 third, fourth, or fifth” and inserting “in any of the first
15 10”.

16 (c) EFFECTIVE DATE.—The amendments made by
17 this section shall apply to excess foreign taxes which (with-
18 out regard to the amendments made by this section) may
19 be carried to any taxable year beginning after December
20 31, 2004.

1 **SEC. 1115. LOOK-THRU RULES TO APPLY TO DIVIDENDS**
2 **FROM NONCONTROLLED SECTION 902 COR-**
3 **PORATIONS.**

4 (a) IN GENERAL.—Section 904(d)(4) (relating to
5 look-thru rules apply to dividends from noncontrolled sec-
6 tion 902 corporations) is amended to read as follows:

7 “(4) LOOK-THRU APPLIES TO DIVIDENDS FROM
8 NONCONTROLLED SECTION 902 CORPORATIONS.—

9 “(A) IN GENERAL.—For purposes of this
10 subsection, any dividend from a noncontrolled
11 section 902 corporation with respect to the tax-
12 payer shall be treated as income described in a
13 subparagraph of paragraph (1) in proportion to
14 the ratio of—

15 “(i) the portion of earnings and prof-
16 its attributable to income described in such
17 subparagraph, to

18 “(ii) the total amount of earnings and
19 profits.

20 “(B) SPECIAL RULES.—For purposes of
21 this paragraph—

22 “(i) EARNINGS AND PROFITS.—

23 “(I) IN GENERAL.—The rules of
24 section 316 shall apply.

25 “(II) REGULATIONS.—The Sec-
26 retary may prescribe regulations re-

1 regarding the treatment of distributions
2 out of earnings and profits for periods
3 before the taxpayer's acquisition of
4 the stock to which the distributions
5 relate.

6 “(ii) INADEQUATE SUBSTAN-
7 TIATION.—If the Secretary determines that
8 the proper subparagraph of paragraph (1)
9 in which a dividend is described has not
10 been substantiated, such dividend shall be
11 treated as income described in paragraph
12 (1)(A).

13 “(iii) LOOK-THRU WITH RESPECT TO
14 CARRYFORWARDS OF CREDIT.—Rules simi-
15 lar to subparagraph (A) also shall apply to
16 any carryforward under subsection (c)
17 from a taxable year beginning before Janu-
18 ary 1, 2003, of tax allocable to a dividend
19 from a noncontrolled section 902 corpora-
20 tion with respect to the taxpayer. The Sec-
21 retary may by regulations provide for the
22 allocation of any carryback of tax allocable
23 to a dividend from a noncontrolled section
24 902 corporation to such a taxable year for
25 purposes of allocating such dividend among

1 the separate categories in effect for such
2 taxable year.

3 “(iv) COORDINATION WITH HIGH-
4 TAXED INCOME PROVISIONS.—Rules simi-
5 lar to the rules of paragraph (3)(F) shall
6 apply for purposes of this paragraph.”.

7 (b) CONFORMING AMENDMENTS.—

8 (1) Section 904(d)(2)(E) is amended—

9 (A) by inserting “or (4)” after “paragraph
10 (3)” in clause (i), and

11 (B) by striking clauses (ii) and (iv) and by
12 redesignating clause (iii) as clause (ii).

13 (2) Clause (i) of section 864(d)(5)(A) is amend-
14 ed to read as follows:

15 “(i) Subclause (I) of section
16 904(d)(2)(B)(iii).”

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

20 **SEC. 1116. ATTRIBUTION OF STOCK OWNERSHIP THROUGH**
21 **PARTNERSHIPS TO APPLY IN DETERMINING**
22 **SECTION 902 AND 960 CREDITS.**

23 (a) IN GENERAL.—Subsection (c) of section 902 is
24 amended by redesignating paragraph (7) as paragraph (8)

1 and by inserting after paragraph (6) the following new
2 paragraph:

3 “(7) CONSTRUCTIVE OWNERSHIP THROUGH
4 PARTNERSHIPS.—Stock owned, directly or indirectly,
5 by or for a partnership shall be considered as being
6 owned proportionately by its partners. Stock consid-
7 ered to be owned by a person by reason of the pre-
8 ceding sentence shall, for purposes of applying such
9 sentence, be treated as actually owned by such per-
10 son. The Secretary may prescribe such regulations
11 as may be necessary to carry out the purposes of
12 this paragraph, including rules to account for special
13 partnership allocations of dividends, credits, and
14 other incidents of ownership of stock in determining
15 proportionate ownership.”

16 (b) CLARIFICATION OF COMPARABLE ATTRIBUTION
17 UNDER SECTION 901(b)(5).—Paragraph (5) of section
18 901(b) is amended by striking “any individual” and in-
19 serting “any person”.

20 (c) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to taxes of foreign corporations
22 for taxable years of such corporations beginning after the
23 date of the enactment of this Act.

1 **SEC. 1117. CLARIFICATION OF TREATMENT OF CERTAIN**
2 **TRANSFERS OF INTANGIBLE PROPERTY.**

3 (a) **IN GENERAL.**—Subparagraph (C) of section
4 367(d)(2) is amended by adding at the end the following
5 new sentence: “For purposes of applying section 904(d),
6 any such amount shall be treated in the same manner as
7 if such amount were a royalty.”

8 (b) **EFFECTIVE DATE.**—The amendment made by
9 this section shall apply to amounts treated as received pur-
10 suant to section 367(d)(2) of the Internal Revenue Code
11 of 1986 on or after August 5, 1997.

12 **SEC. 1118. APPLICATION OF UNIFORM CAPITALIZATION**
13 **RULES TO FOREIGN PERSONS.**

14 (a) **IN GENERAL.**—Section 263A(c) (relating to ex-
15 ceptions) is amended by adding at the end the following
16 new paragraph:

17 “(7) **FOREIGN PERSONS.**—Except for purposes
18 of applying sections 871(b)(1) and 882(a)(1), this
19 section shall not apply to any taxpayer who is not
20 a United States person if such taxpayer capitalizes
21 costs of produced property or property acquired for
22 resale by applying the method used to ascertain the
23 income, profit, or loss for purposes of reports or
24 statements to shareholders, partners, other propri-
25 etors, or beneficiaries, or for credit purposes.”

26 (b) **EFFECTIVE DATE.**—

1 (1) IN GENERAL.—The amendment made by
2 subsection (a) shall apply to taxable years beginning
3 after December 31, 2004.

4 (2) CHANGE IN METHOD OF ACCOUNTING.—In
5 the case of any taxpayer required by the amendment
6 made by this section to change its method of ac-
7 counting for its first taxable year beginning after
8 December 31, 2004—

9 (A) such change shall be treated as initi-
10 ated by the taxpayer,

11 (B) such change shall be treated as made
12 with the consent of the Secretary of the Treas-
13 ury, and

14 (C) the net amount of the adjustments re-
15 quired to be taken into account by the taxpayer
16 under section 481 of the Internal Revenue Code
17 of 1986 shall be taken into account in such first
18 year.

19 **SEC. 1119. UNITED STATES PROPERTY NOT TO INCLUDE**
20 **CERTAIN ASSETS ACQUIRED BY DEALERS IN**
21 **ORDINARY COURSE OF TRADE OR BUSINESS.**

22 (a) IN GENERAL.—Section 956(c)(2) (relating to ex-
23 ceptions from property treated as United States property)
24 is amended by striking “and” at the end of subparagraph
25 (J), by striking the period at the end of subparagraph (K)

1 and inserting “; and”, and by adding at the end the fol-
2 lowing new subparagraph:

3 “(L) securities acquired and held by a con-
4 trolled foreign corporation in the ordinary
5 course of its business as a dealer in securities
6 if—

7 “(i) the dealer accounts for the securi-
8 ties as securities held primarily for sale to
9 customers in the ordinary course of busi-
10 ness, and

11 “(ii) the dealer disposes of the securi-
12 ties (or such securities mature while held
13 by the dealer) within a period consistent
14 with the holding of securities for sale to
15 customers in the ordinary course of busi-
16 ness.”

17 (b) CONFORMING AMENDMENT.—Section 956(e)(2)
18 is amended by striking “and (K)” in the last sentence and
19 inserting “, (K), and (L)”.

20 (c) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to taxable years of foreign corpora-
22 tions beginning after December 31, 2004, and to taxable
23 years of United States shareholders with or within which
24 such taxable years of foreign corporations end.

1 **SEC. 1120. TREATMENT OF CERTAIN DIVIDENDS OF REGU-**
2 **LATED INVESTMENT COMPANIES.**

3 (a) TREATMENT OF CERTAIN DIVIDENDS.—

4 (1) NONRESIDENT ALIEN INDIVIDUALS.—Sec-
5 tion 871 (relating to tax on nonresident alien indi-
6 viduals) is amended by redesignating subsection (k)
7 as subsection (l) and by inserting after subsection (j)
8 the following new subsection:

9 “(k) EXEMPTION FOR CERTAIN DIVIDENDS OF REG-
10 ULATED INVESTMENT COMPANIES.—

11 “(1) INTEREST-RELATED DIVIDENDS.—

12 “(A) IN GENERAL.—Except as provided in
13 subparagraph (B), no tax shall be imposed
14 under paragraph (1)(A) of subsection (a) on
15 any interest-related dividend received from a
16 regulated investment company.

17 “(B) EXCEPTIONS.—Subparagraph (A)
18 shall not apply—

19 “(i) to any interest-related dividend
20 received from a regulated investment com-
21 pany by a person to the extent such divi-
22 dend is attributable to interest (other than
23 interest described in subparagraph (E) (i)
24 or (iii)) received by such company on in-
25 debtedness issued by such person or by any
26 corporation or partnership with respect to

1 which such person is a 10-percent share-
2 holder,

3 “(ii) to any interest-related dividend
4 with respect to stock of a regulated invest-
5 ment company unless the person who
6 would otherwise be required to deduct and
7 withhold tax from such dividend under
8 chapter 3 receives a statement (which
9 meets requirements similar to the require-
10 ments of subsection (h)(5)) that the bene-
11 ficial owner of such stock is not a United
12 States person, and

13 “(iii) to any interest-related dividend
14 paid to any person within a foreign coun-
15 try (or any interest-related dividend pay-
16 ment addressed to, or for the account of,
17 persons within such foreign country) dur-
18 ing any period described in subsection
19 (h)(6) with respect to such country.

20 Clause (iii) shall not apply to any dividend with
21 respect to any stock which was acquired on or
22 before the date of the publication of the Sec-
23 retary’s determination under subsection (h)(6).

24 “(C) INTEREST-RELATED DIVIDEND.—For
25 purposes of this paragraph, an interest-related

1 dividend is any dividend (or part thereof) which
2 is designated by the regulated investment com-
3 pany as an interest-related dividend in a writ-
4 ten notice mailed to its shareholders not later
5 than 60 days after the close of its taxable year.
6 If the aggregate amount so designated with re-
7 spect to a taxable year of the company (includ-
8 ing amounts so designated with respect to divi-
9 dends paid after the close of the taxable year
10 described in section 855) is greater than the
11 qualified net interest income of the company for
12 such taxable year, the portion of each distribu-
13 tion which shall be an interest-related dividend
14 shall be only that portion of the amounts so
15 designated which such qualified net interest in-
16 come bears to the aggregate amount so des-
17 ignated.

18 “(D) QUALIFIED NET INTEREST IN-
19 COME.—For purposes of subparagraph (C), the
20 term ‘qualified net interest income’ means the
21 qualified interest income of the regulated in-
22 vestment company reduced by the deductions
23 properly allocable to such income.

24 “(E) QUALIFIED INTEREST INCOME.—For
25 purposes of subparagraph (D), the term ‘quali-

1 fied interest income’ means the sum of the fol-
2 lowing amounts derived by the regulated invest-
3 ment company from sources within the United
4 States:

5 “(i) Any amount includible in gross
6 income as original issue discount (within
7 the meaning of section 1273) on an obliga-
8 tion payable 183 days or less from the date
9 of original issue (without regard to the pe-
10 riod held by the company).

11 “(ii) Any interest includible in gross
12 income (including amounts recognized as
13 ordinary income in respect of original issue
14 discount or market discount or acquisition
15 discount under part V of subchapter P and
16 such other amounts as regulations may
17 provide) on an obligation which is in reg-
18 istered form; except that this clause shall
19 not apply to—

20 “(I) any interest on an obligation
21 issued by a corporation or partnership
22 if the regulated investment company
23 is a 10-percent shareholder in such
24 corporation or partnership, and

1 “(II) any interest which is treat-
2 ed as not being portfolio interest
3 under the rules of subsection (h)(4).

4 “(iii) Any interest referred to in sub-
5 section (i)(2)(A) (without regard to the
6 trade or business of the regulated invest-
7 ment company).

8 “(iv) Any interest-related dividend in-
9 cludable in gross income with respect to
10 stock of another regulated investment com-
11 pany.

12 “(F) 10-PERCENT SHAREHOLDER.—For
13 purposes of this paragraph, the term ‘10-per-
14 cent shareholder’ has the meaning given such
15 term by subsection (h)(3)(B).

16 “(2) SHORT-TERM CAPITAL GAIN DIVIDENDS.—

17 “(A) IN GENERAL.—Except as provided in
18 subparagraph (B), no tax shall be imposed
19 under paragraph (1)(A) of subsection (a) on
20 any short-term capital gain dividend received
21 from a regulated investment company.

22 “(B) EXCEPTION FOR ALIENS TAXABLE
23 UNDER SUBSECTION (a)(2).—Subparagraph (A)
24 shall not apply in the case of any nonresident

1 alien individual subject to tax under subsection
2 (a)(2).

3 “(C) SHORT-TERM CAPITAL GAIN DIVI-
4 DEND.—For purposes of this paragraph, a
5 short-term capital gain dividend is any dividend
6 (or part thereof) which is designated by the reg-
7 ulated investment company as a short-term cap-
8 ital gain dividend in a written notice mailed to
9 its shareholders not later than 60 days after the
10 close of its taxable year. If the aggregate
11 amount so designated with respect to a taxable
12 year of the company (including amounts so des-
13 igned with respect to dividends paid after the
14 close of the taxable year described in section
15 855) is greater than the qualified short-term
16 gain of the company for such taxable year, the
17 portion of each distribution which shall be a
18 short-term capital gain dividend shall be only
19 that portion of the amounts so designated
20 which such qualified short-term gain bears to
21 the aggregate amount so designated.

22 “(D) QUALIFIED SHORT-TERM GAIN.—For
23 purposes of subparagraph (C), the term ‘quali-
24 fied short-term gain’ means the excess of the
25 net short-term capital gain of the regulated in-

1 vestment company for the taxable year over the
2 net long-term capital loss (if any) of such com-
3 pany for such taxable year. For purposes of this
4 subparagraph—

5 “(i) the net short-term capital gain of
6 the regulated investment company shall be
7 computed by treating any short-term cap-
8 ital gain dividend includible in gross in-
9 come with respect to stock of another regu-
10 lated investment company as a short-term
11 capital gain, and

12 “(ii) the excess of the net short-term
13 capital gain for a taxable year over the net
14 long-term capital loss for a taxable year (to
15 which an election under section 4982(e)(4)
16 does not apply) shall be determined with-
17 out regard to any net capital loss or net
18 short-term capital loss attributable to
19 transactions after October 31 of such year,
20 and any such net capital loss or net short-
21 term capital loss shall be treated as arising
22 on the 1st day of the next taxable year.

23 To the extent provided in regulations, clause
24 (ii) shall apply also for purposes of computing

1 the taxable income of the regulated investment
2 company.”

3 (2) FOREIGN CORPORATIONS.—Section 881 (re-
4 lating to tax on income of foreign corporations not
5 connected with United States business) is amended
6 by redesignating subsection (e) as subsection (f) and
7 by inserting after subsection (d) the following new
8 subsection:

9 “(e) TAX NOT TO APPLY TO CERTAIN DIVIDENDS
10 OF REGULATED INVESTMENT COMPANIES.—

11 “(1) INTEREST-RELATED DIVIDENDS.—

12 “(A) IN GENERAL.—Except as provided in
13 subparagraph (B), no tax shall be imposed
14 under paragraph (1) of subsection (a) on any
15 interest-related dividend (as defined in section
16 871(k)(1)) received from a regulated investment
17 company.

18 “(B) EXCEPTION.—Subparagraph (A)
19 shall not apply—

20 “(i) to any dividend referred to in sec-
21 tion 871(k)(1)(B), and

22 “(ii) to any interest-related dividend
23 received by a controlled foreign corporation
24 (within the meaning of section 957(a)) to
25 the extent such dividend is attributable to

1 interest received by the regulated invest-
2 ment company from a person who is a re-
3 lated person (within the meaning of section
4 864(d)(4)) with respect to such controlled
5 foreign corporation.

6 “(C) TREATMENT OF DIVIDENDS RE-
7 CEIVED BY CONTROLLED FOREIGN CORPORA-
8 TIONS.—The rules of subsection (c)(5)(A) shall
9 apply to any interest-related dividend received
10 by a controlled foreign corporation (within the
11 meaning of section 957(a)) to the extent such
12 dividend is attributable to interest received by
13 the regulated investment company which is de-
14 scribed in clause (ii) of section 871(k)(1)(E)
15 (and not described in clause (i) or (iii) of such
16 section).

17 “(2) SHORT-TERM CAPITAL GAIN DIVIDENDS.—
18 No tax shall be imposed under paragraph (1) of sub-
19 section (a) on any short-term capital gain dividend
20 (as defined in section 871(k)(2)) received from a
21 regulated investment company.”

22 (3) WITHHOLDING TAXES.—

23 (A) Section 1441(c) (relating to excep-
24 tions) is amended by adding at the end the fol-
25 lowing new paragraph:

1 “(12) CERTAIN DIVIDENDS RECEIVED FROM
2 REGULATED INVESTMENT COMPANIES.—

3 “(A) IN GENERAL.—No tax shall be re-
4 quired to be deducted and withheld under sub-
5 section (a) from any amount exempt from the
6 tax imposed by section 871(a)(1)(A) by reason
7 of section 871(k).

8 “(B) SPECIAL RULE.—For purposes of
9 subparagraph (A), clause (i) of section
10 871(k)(1)(B) shall not apply to any dividend
11 unless the regulated investment company knows
12 that such dividend is a dividend referred to in
13 such clause. A similar rule shall apply with re-
14 spect to the exception contained in section
15 871(k)(2)(B).”

16 (B) Section 1442(a) (relating to with-
17 holding of tax on foreign corporations) is
18 amended—

19 (i) by striking “and the reference in
20 section 1441(c)(10)” and inserting “the
21 reference in section 1441(c)(10)”, and

22 (ii) by inserting before the period at
23 the end the following: “, and the references
24 in section 1441(c)(12) to sections 871(a)
25 and 871(k) shall be treated as referring to

1 sections 881(a) and 881(e) (except that for
2 purposes of applying subparagraph (A) of
3 section 1441(c)(12), as so modified, clause
4 (ii) of section 881(e)(1)(B) shall not apply
5 to any dividend unless the regulated invest-
6 ment company knows that such dividend is
7 a dividend referred to in such clause)”).

8 (b) ESTATE TAX TREATMENT OF INTEREST IN CER-
9 TAIN REGULATED INVESTMENT COMPANIES.—Section
10 2105 (relating to property without the United States for
11 estate tax purposes) is amended by adding at the end the
12 following new subsection:

13 “(d) STOCK IN A RIC.—

14 “(1) IN GENERAL.—For purposes of this sub-
15 chapter, stock in a regulated investment company
16 (as defined in section 851) owned by a nonresident
17 not a citizen of the United States shall not be
18 deemed property within the United States in the
19 proportion that, at the end of the quarter of such in-
20 vestment company’s taxable year immediately pre-
21 ceding a decedent’s date of death (or at such other
22 time as the Secretary may designate in regulations),
23 the assets of the investment company that were
24 qualifying assets with respect to the decedent bore
25 to the total assets of the investment company.

1 “(2) QUALIFYING ASSETS.—For purposes of
2 this subsection, qualifying assets with respect to a
3 decedent are assets that, if owned directly by the de-
4 cedent, would have been—

5 “(A) amounts, deposits, or debt obligations
6 described in subsection (b) of this section,

7 “(B) debt obligations described in the last
8 sentence of section 2104(c), or

9 “(C) other property not within the United
10 States.”

11 (c) TREATMENT OF REGULATED INVESTMENT COM-
12 PANIES UNDER SECTION 897.—

13 (1) Paragraph (1) of section 897(h) is amended
14 by striking “REIT” each place it appears and in-
15 serting “qualified investment entity”.

16 (2) Paragraphs (2) and (3) of section 897(h)
17 are amended to read as follows:

18 “(2) SALE OF STOCK IN DOMESTICALLY CON-
19 TROLLED ENTITY NOT TAXED.—The term ‘United
20 States real property interest’ does not include any
21 interest in a domestically controlled qualified invest-
22 ment entity.

23 “(3) DISTRIBUTIONS BY DOMESTICALLY CON-
24 TROLLED QUALIFIED INVESTMENT ENTITIES.—In
25 the case of a domestically controlled qualified invest-

1 ment entity, rules similar to the rules of subsection
2 (d) shall apply to the foreign ownership percentage
3 of any gain.”

4 (3) Subparagraphs (A) and (B) of section
5 897(h)(4) are amended to read as follows:

6 “(A) QUALIFIED INVESTMENT ENTITY.—

7 The term ‘qualified investment entity’ means
8 any real estate investment trust and any regu-
9 lated investment company.

10 “(B) DOMESTICALLY CONTROLLED.—The

11 term ‘domestically controlled qualified invest-
12 ment entity’ means any qualified investment en-
13 tity in which at all times during the testing pe-
14 riod less than 50 percent in value of the stock
15 was held directly or indirectly by foreign per-
16 sons.”

17 (4) Subparagraphs (C) and (D) of section
18 897(h)(4) are each amended by striking “REIT”
19 and inserting “qualified investment entity”.

20 (5) The subsection heading for subsection (h) of
21 section 897 is amended by striking “REITS” and
22 inserting “CERTAIN INVESTMENT ENTITIES”.

23 (d) EFFECTIVE DATE.—

24 (1) IN GENERAL.—Except as otherwise pro-
25 vided in this subsection, the amendments made by

1 this section shall apply to dividends with respect to
2 taxable years of regulated investment companies be-
3 ginning after the date of the enactment of this Act.

4 (2) ESTATE TAX TREATMENT.—The amend-
5 ment made by subsection (b) shall apply to estates
6 of decedents dying after the date of the enactment
7 of this Act.

8 (3) CERTAIN OTHER PROVISIONS.—The amend-
9 ments made by subsection (c) (other than paragraph
10 (1) thereof) shall take effect on the date of the en-
11 actment of this Act.

12 **SEC. 1121. ELECTION NOT TO USE AVERAGE EXCHANGE**
13 **RATE FOR FOREIGN TAX PAID OTHER THAN**
14 **IN FUNCTIONAL CURRENCY.**

15 (a) IN GENERAL.—Paragraph (1) of section 986(a)
16 (relating to determination of foreign taxes and foreign cor-
17 poration’s earnings and profits) is amended by redesign-
18 ating subparagraph (D) as subparagraph (E) and by in-
19 serting after subparagraph (C) the following new subpara-
20 graph:

21 “(D) ELECTIVE EXCEPTION FOR TAXES
22 PAID OTHER THAN IN FUNCTIONAL CUR-
23 RENCY.—

24 “(i) IN GENERAL.—At the election of
25 the taxpayer, subparagraph (A) shall not

1 apply to any foreign income taxes the li-
2 ability for which is denominated in any
3 currency other than in the taxpayer's func-
4 tional currency.

5 “(ii) APPLICATION TO QUALIFIED
6 BUSINESS UNITS.—An election under this
7 subparagraph may apply to foreign income
8 taxes attributable to a qualified business
9 unit in accordance with regulations pre-
10 scribed by the Secretary.

11 “(iii) ELECTION.—Any such election
12 shall apply to the taxable year for which
13 made and all subsequent taxable years un-
14 less revoked with the consent of the Sec-
15 retary.”

16 (b) EFFECTIVE DATE.—The amendment made by
17 this section shall apply to taxable years beginning after
18 December 31, 2004.

19 **SEC. 1122. REPEAL OF WITHHOLDING TAX ON DIVIDENDS**
20 **FROM CERTAIN FOREIGN CORPORATIONS.**

21 (a) IN GENERAL.—Paragraph (2) of section 871(i)
22 (relating to tax not to apply to certain interest and divi-
23 dends) is amended by adding at the end the following new
24 subparagraph:

1 “(D) Dividends paid by a foreign corpora-
2 tion which are treated under section
3 861(a)(2)(B) as income from sources within the
4 United States.”.

5 (b) EFFECTIVE DATE.—The amendment made by
6 this section shall apply to payments made after December
7 31, 2004.

8 **TITLE II—PROVISIONS TO RE-**
9 **DUCE TAX AVOIDANCE**
10 **THROUGH CORPORATE EARN-**
11 **INGS STRIPPING AND EXPA-**
12 **TRIATION**

13 **SEC. 2001. REDUCTION IN POTENTIAL FOR EARNINGS**
14 **STRIPPING BY FURTHER LIMITING DEDUC-**
15 **TION FOR INTEREST ON CERTAIN INDEBTED-**
16 **NESS.**

17 (a) REDUCTION IN POTENTIAL FOR EARNINGS
18 STRIPPING.—Paragraphs (1) and (2) of section 163(j) are
19 amended to read as follows:

20 “(1) LIMITATION.—

21 “(A) IN GENERAL.—In the case of a cor-
22 poration, no deduction shall be allowed under
23 this chapter for disqualified interest paid or ac-
24 crued during the taxable year.

1 “(B) MAXIMUM DISALLOWANCE.—The
2 amount disallowed under subparagraph (A)
3 shall not exceed the sum of—

4 “(i) the corporation’s excess interest
5 expense for the taxable year, and

6 “(ii) the corporation’s excess related
7 party interest expense for such year.

8 In no event shall the disallowance under sub-
9 paragraph (A) reduce the deduction for dis-
10 qualified interest below an amount equal to 25
11 percent of adjusted taxable income (35 percent
12 in the case of the first taxable year beginning
13 after December 31, 2003).

14 “(C) DISALLOWED AMOUNT CARRIED TO
15 SUCCEEDING TAXABLE YEAR.—

16 “(i) IN GENERAL.—Any amount dis-
17 allowed under subparagraph (A) for any
18 taxable year shall be treated as paid or ac-
19 crued in the succeeding taxable year and in
20 the 2nd through 10th succeeding taxable
21 years to the extent not previously taken
22 into account under this subparagraph.

23 “(ii) LIMITATION ON AMOUNT CAR-
24 RIED TO YEAR.—A carryforward amount
25 may not be taken into account for any

1 such succeeding taxable year to the extent
2 that such amount, when added to amounts
3 carried to such succeeding taxable year
4 from taxable years preceding the taxable
5 year from which the amount is being car-
6 ried forward, would result in (or increase)
7 a disallowance under subparagraph (A).

8 “(iii) CARRYOVER APPLIED SEPA-
9 RATELY TO CATEGORIES OF DISQUALIFIED
10 INTEREST.—Clauses (i) and (ii) shall be
11 applied separately to disqualified interest
12 described in paragraph (3)(A) and to dis-
13 qualified interest described in paragraph
14 (3)(B). For purposes of this subparagraph,
15 any amount disallowed under subpara-
16 graph (A) for any taxable year shall be
17 treated as disqualified interest described in
18 paragraph (3)(A) to the extent thereof and
19 then as disqualified interest described in
20 paragraph (3)(B).

21 “(2) EXCESS INTEREST EXPENSE; EXCESS RE-
22 LATED PARTY INTEREST EXPENSE.—For purposes
23 of this subsection—

1 “(A) EXCESS INTEREST EXPENSE.—The
2 term ‘excess interest expense’ means the excess
3 (if any) of—

4 “(i) the corporation’s net interest ex-
5 pense, over

6 “(ii) 50 percent of the adjusted tax-
7 able income of the corporation.

8 “(B) EXCESS RELATED PARTY INTEREST
9 EXPENSE.—The term ‘excess related party in-
10 terest expense’ means the excess (if any) of—

11 “(i) the lesser of—

12 “(I) the amount of disqualified
13 interest described in paragraph
14 (3)(A), or

15 “(II) the corporation’s net inter-
16 est expense, over

17 “(ii) 25 percent (35 percent in the
18 case of the first taxable year beginning
19 after December 31, 2003) of the adjusted
20 taxable income of the corporation.”

21 (b) MAINTENANCE OF CURRENT LAW FOR INTEREST
22 PAID BY TAXABLE REIT SUBSIDIARIES TO REIT.—

23 (1) EXCEPTION FROM 163(J).—Paragraph (3) of
24 section 163(j) is amended by inserting “and” at the
25 end of subparagraph (A), by striking “, and” at the

1 end of subparagraph (B) and inserting a period, and
2 by striking subparagraph (C).

3 (2) DISALLOWANCE.—Section 856 is amended
4 by adding at the end the following new subsection:

5 “(m) LIMITATION ON DEDUCTION FOR INTEREST ON
6 CERTAIN INDEBTEDNESS OF TAXABLE REIT SUB-
7 SIDIARY.—

8 “(1) LIMITATION.—

9 “(A) IN GENERAL.—If this subsection ap-
10 plies to any taxable REIT subsidiary for any
11 taxable year, no deduction shall be allowed
12 under this chapter for disqualified interest paid
13 or accrued by such subsidiary during such tax-
14 able year. The amount disallowed under the
15 preceding sentence shall not exceed the subsidi-
16 ary’s excess interest expense for the taxable
17 year.

18 “(B) DISALLOWED AMOUNT CARRIED TO
19 SUCCEEDING TAXABLE YEAR.—Any amount dis-
20 allowed under subparagraph (A) for any taxable
21 year shall be treated as disqualified interest
22 paid or accrued in the succeeding taxable year
23 (and clause (ii) of paragraph (2)(A) shall not
24 apply for purposes of applying this subsection
25 to the amount so treated).

1 “(2) SUBSIDIARIES TO WHICH SUBSECTION AP-
2 PLIES.—

3 “(A) IN GENERAL.—This subsection shall
4 apply to any taxable REIT subsidiary for any
5 taxable year if—

6 “(i) such subsidiary has excess inter-
7 est expense for such taxable year, and

8 “(ii) the ratio of debt to equity of
9 such subsidiary as of the close of such tax-
10 able year (or on any other day during the
11 taxable year as the Secretary may by regu-
12 lations prescribe) exceeds 1.5 to 1.

13 “(B) EXCESS INTEREST EXPENSE.—

14 “(i) IN GENERAL.—For purposes of
15 this subsection, the term ‘excess interest
16 expense’ means the excess (if any) of—

17 “(I) the taxable REIT subsidi-
18 ary’s net interest expense, over

19 “(II) the sum of 50 percent of
20 the adjusted taxable income of the
21 subsidiary plus any excess limitation
22 carryforward under clause (ii).

23 “(ii) EXCESS LIMITATION
24 CARRYFORWARD.—If a taxable REIT sub-
25 sidiary has an excess limitation for any

1 taxable year, the amount of such excess
2 limitation shall be an excess limitation
3 carryforward to the 1st succeeding taxable
4 year and to the 2nd and 3rd succeeding
5 taxable years to the extent not previously
6 taken into account under this clause. The
7 amount of such a carryforward taken into
8 account for any such succeeding taxable
9 year shall not exceed the excess interest
10 expense for such succeeding taxable year
11 (determined without regard to the
12 carryforward from the taxable year of such
13 excess limitation).

14 “(iii) EXCESS LIMITATION.—For pur-
15 poses of clause (ii), the term ‘excess limita-
16 tion’ means the excess (if any) of—

17 “(I) 50 percent of the adjusted
18 taxable income of the subsidiary, over

19 “(II) the subsidiary’s net interest
20 expense.

21 “(C) RATIO OF DEBT TO EQUITY.—For
22 purposes of this paragraph, the term ‘ratio of
23 debt to equity’ means the ratio which the total
24 indebtedness of the subsidiary bears to the sum
25 of its money and all other assets reduced (but

1 not below zero) by such total indebtedness. The
2 rules of section 163(j)(6)(E) shall apply for
3 purposes of the preceding sentence.

4 “(3) DISQUALIFIED INTEREST.—For purposes
5 of this subsection, the term ‘disqualified interest’
6 means any interest paid or accrued (directly or indi-
7 rectly) by a taxable REIT subsidiary of a real estate
8 investment trust to such trust.

9 “(4) OTHER RULES TO APPLY.—Rules similar
10 to the rules of paragraphs (7), (8), and (9) of sec-
11 tion 163(j) shall apply for purposes of this sub-
12 section.”

13 (c) EFFECTIVE DATE.—

14 (1) IN GENERAL.—Except as otherwise pro-
15 vided in this subsection, the amendments made by
16 this section shall apply to taxable years beginning
17 after December 31, 2003.

18 (2) EARLIER EFFECTIVE DATE WITH RESPECT
19 TO EXPATRIATED CORPORATIONS, ETC.—The
20 amendments made by this section shall apply to tax-
21 able years ending after March 4, 2003, in the case
22 of a taxpayer which is—

23 (A) a surrogate foreign corporation, as de-
24 fined in section 7874(a)(2)(B) of the Internal

1 Revenue Code of 1986, as added by section
2 2002,

3 (B) a corporation which would be a surro-
4 gate foreign corporation (as so defined) if “De-
5 cember 31, 1996” were substituted for “March
6 4, 2003” in such section 7874(a), and

7 (C) any corporation which is an expatri-
8 ated entity (as defined in such section 7874(a))
9 with respect to a corporation described in sub-
10 paragraph (A) or (B).

11 In applying such amendments to a taxpayer de-
12 scribed in the preceding sentence, subparagraph (B)
13 of section 163(j)(2) of such Code, as amended by
14 this section, shall be applied by substituting “25
15 percent” for “35 percent”.

16 (3) LIMITATION ON CARRYOVER OF DIS-
17 ALLOWED INTEREST.—

18 (A) IN GENERAL.—Except in the case of a
19 taxpayer described in paragraph (2), for pur-
20 poses of applying section 163(j)(1)(C) of the
21 Internal Revenue Code of 1986 (as added by
22 this section), amounts carried from a taxable
23 year beginning before January 1, 2004, to any
24 taxable year beginning after December 31,
25 2003, shall be treated as disqualified interest

1 described in section 163(j)(3)(B) of such Code
 2 which is disallowed for the most recent taxable
 3 year beginning before January 1, 2004.

4 (B) EXPATRIATED CORPORATIONS.—In the
 5 case of a taxpayer described in paragraph (2),
 6 a rule similar to the rule of subparagraph (A)
 7 shall apply to amounts carried from a taxable
 8 year beginning before March 5, 2003.

9 **SEC. 2002. TAX TREATMENT OF EXPATRIATED ENTITIES**
 10 **AND THEIR FOREIGN PARENTS.**

11 (a) IN GENERAL.—Subchapter C of chapter 80 (re-
 12 lating to provisions affecting more than one subtitle) is
 13 amended by adding at the end the following new section:

14 **“SEC. 7874. RULES RELATING TO EXPATRIATED ENTITIES**
 15 **AND THEIR FOREIGN PARENTS.**

16 “(a) TAX ON INVERSION GAIN OF EXPATRIATED EN-
 17 TITIES.—

18 “(1) IN GENERAL.—The taxable income of an
 19 expatriated entity for any taxable year which in-
 20 cludes any portion of the applicable period shall in
 21 no event be less than the inversion gain of the entity
 22 for the taxable year.

23 “(2) EXPATRIATED ENTITY.—For purposes of
 24 this subsection—

1 “(A) IN GENERAL.—The term ‘expatriated
2 entity’ means—

3 “(i) the domestic corporation or part-
4 nership referred to in subparagraph (B)(i)
5 with respect to which a foreign corporation
6 is a surrogate foreign corporation, and

7 “(ii) any United States person who is
8 related (within the meaning of section
9 267(b) or 707(b)(1)) to a domestic cor-
10 poration or partnership described in clause
11 (i).

12 “(B) SURROGATE FOREIGN CORPORA-
13 TION.—A foreign corporation shall be treated
14 as a surrogate foreign corporation if, pursuant
15 to a plan (or a series of related transactions)—

16 “(i) the entity completes after March
17 4, 2003, the direct or indirect acquisition
18 of substantially all of the properties held
19 directly or indirectly by a domestic cor-
20 poration or substantially all of the prop-
21 erties constituting a trade or business of a
22 domestic partnership, and

23 “(ii) after the acquisition at least 60
24 percent of the stock (by vote or value) of
25 the entity is held—

1 “(I) in the case of an acquisition
2 with respect to a domestic corpora-
3 tion, by former shareholders of the
4 domestic corporation by reason of
5 holding stock in the domestic corpora-
6 tion, or

7 “(II) in the case of an acquisition
8 with respect to a domestic partner-
9 ship, by former partners of the do-
10 mestic partnership by reason of hold-
11 ing a capital or profits interest in the
12 domestic partnership.

13 An entity otherwise described in clause (i) with
14 respect to any domestic corporation or partner-
15 ship trade or business shall be treated as not so
16 described if, on or before March 4, 2003, such
17 entity acquired directly or indirectly more than
18 half of the properties held directly or indirectly
19 by such corporation or more than half of the
20 properties constituting such partnership trade
21 or business, as the case may be.

22 “(b) DEFINITIONS AND SPECIAL RULES.—

23 “(1) EXPANDED AFFILIATED GROUP.—The
24 term ‘expanded affiliated group’ means an affiliated
25 group as defined in section 1504(a) but without re-

1 gard to section 1504(b)(3), except that section
2 1504(a) shall be applied by substituting ‘more than
3 50 percent’ for ‘at least 80 percent’ each place it ap-
4 pears.

5 “(2) CERTAIN STOCK DISREGARDED.—There
6 shall not be taken into account in determining own-
7 ership under subsection (a)(2)(B)(ii)—

8 “(A) stock held by members of the ex-
9 panded affiliated group which includes the for-
10 eign corporation, or

11 “(B) stock of such foreign corporation
12 which is sold in a public offering related to the
13 acquisition described in subsection (a)(2)(B)(i).

14 “(4) PLAN DEEMED IN CERTAIN CASES.—If a
15 foreign corporation acquires directly or indirectly
16 substantially all of the properties of a domestic cor-
17 poration or partnership during the 4-year period be-
18 ginning on the date which is 2 years before the own-
19 ership requirements of subsection (a)(2)(B)(ii) are
20 met, such actions shall be treated as pursuant to a
21 plan.

22 “(5) CERTAIN TRANSFERS DISREGARDED.—The
23 transfer of properties or liabilities (including by con-
24 tribution or distribution) shall be disregarded if such

1 transfers are part of a plan a principal purpose of
2 which is to avoid the purposes of this section.

3 “(6) SPECIAL RULE FOR RELATED PARTNER-
4 SHIPS.—For purposes of applying subsection
5 (a)(2)(B)(ii) to the acquisition of a trade or business
6 of a domestic partnership, except as provided in reg-
7 ulations, all partnerships which are under common
8 control (within the meaning of section 482) shall be
9 treated as 1 partnership.

10 “(7) REGULATIONS.—The Secretary shall pre-
11 scribe such regulations as may be appropriate to de-
12 termine whether a corporation is a surrogate foreign
13 corporation, including regulations—

14 “(A) to treat warrants, options, contracts
15 to acquire stock, convertible debt interests, and
16 other similar interests as stock, and

17 “(B) to treat stock as not stock.

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

20 “(1) APPLICABLE PERIOD.—The term ‘applica-
21 ble period’ means the period—

22 “(A) beginning on the first date properties
23 are acquired as part of the acquisition described
24 in subsection (a)(2)(B)(i), and

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

4 “(2) INVERSION GAIN.—The term ‘inversion
5 gain’ means the income or gain recognized by reason
6 of the transfer during the applicable period of stock
7 or other properties by an expatriated entity, and any
8 income received or accrued during the applicable pe-
9 riod by reason of a license of any property by an ex-
10 patriated entity —

11 “(A) as part of the acquisition described in
12 subsection (a)(2)(B)(i), or

13 “(B) after such acquisition if the transfer
14 or license is to a foreign related person.

15 Subparagraph (B) shall not apply to property de-
16 scribed in section 1221(a)(1) in the hands of the ex-
17 patriated entity.

18 “(4) FOREIGN RELATED PERSON.—The term
19 ‘foreign related person’ means, with respect to any
20 expatriated entity, a foreign person which—

21 “(A) is related (within the meaning of sec-
22 tion 267(b) or 707(b)(1)) to such entity, or

23 “(B) is under the same common control
24 (within the meaning of section 482) as such en-
25 tity.

1 “(d) SPECIAL RULES.—

2 “(1) CREDITS NOT ALLOWED AGAINST TAX ON
3 INVERSION GAIN.—Credits (other than the credit al-
4 lowed by section 901) shall be allowed against the
5 tax imposed by this chapter on an expatriated entity
6 for any taxable year described in subsection (a) only
7 to the extent such tax exceeds the product of—

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

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

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

15 “(2) SPECIAL RULES FOR PARTNERSHIPS.—In
16 the case of an expatriated entity which is a partner-
17 ship—

18 “(A) subsection (a)(1) shall apply at the
19 partner rather than the partnership level,

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

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

1 “(ii) gain recognized for the taxable
2 year by the partner by reason of the trans-
3 fer during the applicable period of any
4 partnership interest of the partner in such
5 partnership to the surrogate foreign cor-
6 poration, and

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

11 “(3) COORDINATION WITH SECTION 172 AND
12 MINIMUM TAX.—Rules similar to the rules of para-
13 graphs (3) and (4) of section 860E(a) shall apply
14 for purposes of subsection (a).

15 “(4) STATUTE OF LIMITATIONS.—

16 “(A) IN GENERAL.—The statutory period
17 for the assessment of any deficiency attrib-
18 utable to the inversion gain of any taxpayer for
19 any pre-inversion year shall not expire before
20 the expiration of 3 years from the date the Sec-
21 retary is notified by the taxpayer (in such man-
22 ner as the Secretary may prescribe) of the ac-
23 quisition described in subsection (a)(2)(B)(i) to
24 which such gain relates and such deficiency
25 may be assessed before the expiration of such

1 3-year period notwithstanding the provisions of
2 any other law or rule of law which would other-
3 wise prevent such assessment.

4 “(B) PRE-INVERSION YEAR.—For purposes
5 of subparagraph (A), the term ‘pre-inversion
6 year’ means any taxable year if—

7 “(i) any portion of the applicable pe-
8 riod is included in such taxable year, and

9 “(ii) such year ends before the taxable
10 year in which the acquisition described in
11 subsection (a)(2)(B)(i) is completed.

12 “(f) SPECIAL RULE FOR TREATIES.—Nothing in sec-
13 tion 894 or 7852(d) or in any other provision of law shall
14 be construed as permitting an exemption, by reason of any
15 treaty obligation of the United States heretofore or here-
16 after entered into, from the provisions of this section.

17 “(g) REGULATIONS.—The Secretary shall provide
18 such regulations as are necessary to carry out this section,
19 including regulations providing for such adjustments to
20 the application of this section as are necessary to prevent
21 the avoidance of the purposes of this section, including the
22 avoidance of such purposes through—

23 “(1) the use of related persons, pass-through or
24 other noncorporate entities, or other intermediaries,
25 or

1 “(2) transactions designed to have persons
2 cease to be (or not become) members of expanded
3 affiliated groups or related persons.”.

4 (b) CONFORMING AMENDMENT.—The table of sec-
5 tions for subchapter C of chapter 80 is amended by adding
6 at the end the following new item:

“Sec. 7874. Rules relating to expatriated entities and their for-
 eign parents.”

7 (c) EFFECTIVE DATE.—The amendments made by
8 this section shall apply to taxable years ending after
9 March 4, 2003.

10 **SEC. 2003. EXCISE TAX ON STOCK COMPENSATION OF IN-**
11 **SIDERS IN EXPATRIATED CORPORATIONS.**

12 (a) IN GENERAL.—Subtitle D is amended by insert-
13 ing after chapter 44 end the following new chapter:

14 **“CHAPTER 45—PROVISIONS RELATING TO**
15 **EXPATRIATED ENTITIES**

“Sec. 4985. Stock compensation of insiders in expatriated cor-
 porations.

16 **“SEC. 4985. STOCK COMPENSATION OF INSIDERS IN EXPA-**
17 **TRATED CORPORATIONS.**

18 “(a) IMPOSITION OF TAX.—In the case of an indi-
19 vidual who is a disqualified individual with respect to any
20 expatriated corporation, there is hereby imposed on such
21 person a tax equal to 15 percent of the value (determined
22 under subsection (b)) of the specified stock compensation

1 held (directly or indirectly) by or for the benefit of such
2 individual or a member of such individual's family (as de-
3 fined in section 267) at any time during the 12-month
4 period beginning on the date which is 6 months before
5 the expatriation date.

6 “(b) VALUE.—For purposes of subsection (a)—

7 “(1) IN GENERAL.—The value of specified stock
8 compensation shall be—

9 “(A) in the case of a stock option (or other
10 similar right) or a stock appreciation right, the
11 fair value of such option or right, and

12 “(B) in any other case, the fair market
13 value of such compensation.

14 “(2) DATE FOR DETERMINING VALUE.—The
15 determination of value shall be made—

16 “(A) in the case of specified stock com-
17 pensation held on the expatriation date, on such
18 date,

19 “(B) in the case of such compensation
20 which is canceled during the 6 months before
21 the expatriation date, on the day before such
22 cancellation, and

23 “(C) in the case of such compensation
24 which is granted after the expatriation date, on
25 the date such compensation is granted.

1 “(c) TAX TO APPLY ONLY IF SHAREHOLDER GAIN
2 RECOGNIZED.—Subsection (a) shall apply to any disquali-
3 fied individual with respect to an expatriated corporation
4 only if gain (if any) on any stock in such corporation is
5 recognized in whole or part by any shareholder by reason
6 of the acquisition referred to in section 7874(a)(2)(B)(i)
7 with respect to such corporation.

8 “(d) EXCEPTION WHERE GAIN RECOGNIZED ON
9 COMPENSATION.—Subsection (a) shall not apply to—

10 “(1) any stock option which is exercised on the
11 expatriation date or during the 6-month period be-
12 fore such date and to the stock acquired in such ex-
13 ercise, and

14 “(2) any specified stock compensation which is
15 sold, exchanged, distributed or cashed-out during
16 such period in a transaction in which gain or loss is
17 recognized in full.

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

19 “(1) DISQUALIFIED INDIVIDUAL.—The term
20 ‘disqualified individual’ means, with respect to a cor-
21 poration, any individual who, at any time during the
22 12-month period beginning on the date which is 6
23 months before the expatriation date—

24 “(A) is subject to the requirements of sec-
25 tion 16(a) of the Securities Exchange Act of

1 1934 with respect to such corporation or any
2 member of the expanded affiliated group which
3 includes such corporation, or

4 “(B) would be subject to such require-
5 ments if such corporation or member were an
6 issuer of equity securities referred to in such
7 section.

8 “(2) EXPATRIATED CORPORATION; EXPATRIA-
9 TION DATE.—

10 “(A) EXPATRIATED CORPORATION.—The
11 term ‘expatriated corporation’ means any cor-
12 poration which is an expatriated entity (as de-
13 fined in section 7874(a)(2)). Such term in-
14 cludes any predecessor or successor of such a
15 corporation.

16 “(B) EXPATRIATION DATE.—The term ‘ex-
17 patriation date’ means, with respect to a cor-
18 poration, the date on which the corporation
19 first becomes an expatriated corporation.

20 “(3) SPECIFIED STOCK COMPENSATION.—

21 “(A) IN GENERAL.—The term ‘specified
22 stock compensation’ means payment (or right
23 to payment) granted by the expatriated cor-
24 poration (or by any member of the expanded af-
25 filiated group which includes such corporation)

1 to any person in connection with the perform-
2 ance of services by a disqualified individual for
3 such corporation or member if the value of such
4 payment or right is based on (or determined by
5 reference to) the value (or change in value) of
6 stock in such corporation (or any such mem-
7 ber).

8 “(B) EXCEPTIONS.—Such term shall not
9 include—

10 “(i) any option to which part II of
11 subchapter D of chapter 1 applies, or

12 “(ii) any payment or right to payment
13 from a plan referred to in section
14 280G(b)(6).

15 “(4) EXPANDED AFFILIATED GROUP.—The
16 term ‘expanded affiliated group’ means an affiliated
17 group (as defined in section 1504(a) without regard
18 to section 1504(b)(3)); except that section 1504(a)
19 shall be applied by substituting ‘more than 50 per-
20 cent’ for ‘at least 80 percent’ each place it appears.

21 “(f) SPECIAL RULES.—For purposes of this sec-
22 tion—

23 “(1) CANCELLATION OF RESTRICTION.—The
24 cancellation of a restriction which by its terms will
25 never lapse shall be treated as a grant.

1 “(2) PAYMENT OR REIMBURSEMENT OF TAX BY
2 CORPORATION TREATED AS SPECIFIED STOCK COM-
3 PENSATION.—Any payment of the tax imposed by
4 this section directly or indirectly by the expatriated
5 corporation or by any member of the expanded affili-
6 ated group which includes such corporation—

7 “(A) shall be treated as specified stock
8 compensation, and

9 “(B) shall not be allowed as a deduction
10 under any provision of chapter 1.

11 “(3) CERTAIN RESTRICTIONS IGNORED.—
12 Whether there is specified stock compensation, and
13 the value thereof, shall be determined without regard
14 to any restriction other than a restriction which by
15 its terms will never lapse.

16 “(4) PROPERTY TRANSFERS.—Any transfer of
17 property shall be treated as a payment and any right
18 to a transfer of property shall be treated as a right
19 to a payment.

20 “(5) OTHER ADMINISTRATIVE PROVISIONS.—
21 For purposes of subtitle F, any tax imposed by this
22 section shall be treated as a tax imposed by subtitle
23 A.

1 “(g) REGULATIONS.—The Secretary shall prescribe
2 such regulations as may be necessary or appropriate to
3 carry out the purposes of this section.”

4 (b) DENIAL OF DEDUCTION.—

5 (1) IN GENERAL.—Paragraph (6) of section
6 275(a) is amended by inserting “45,” before “46,”.

7 (2) \$1,000,000 LIMIT ON DEDUCTIBLE COM-
8 PENSATION REDUCED BY PAYMENT OF EXCISE TAX
9 ON SPECIFIED STOCK COMPENSATION.—Paragraph
10 (4) of section 162(m) is amended by adding at the
11 end the following new subparagraph:

12 “(G) COORDINATION WITH EXCISE TAX ON
13 SPECIFIED STOCK COMPENSATION.—The dollar
14 limitation contained in paragraph (1) with re-
15 spect to any covered employee shall be reduced
16 (but not below zero) by the amount of any pay-
17 ment (with respect to such employee) of the tax
18 imposed by section 4985 directly or indirectly
19 by the expatriated corporation (as defined in
20 such section) or by any member of the ex-
21 panded affiliated group (as defined in such sec-
22 tion) which includes such corporation.”

23 (c) CONFORMING AMENDMENTS.—

24 (1) The last sentence of section 3121(v)(2)(A)
25 is amended by inserting before the period “or to any

1 specified stock compensation (as defined in section
2 4985) on which tax is imposed by section 4985”.

3 (2) The table of chapters for subtitle D is
4 amended by inserting after the item relating to
5 chapter 44 the following new item:

“Chapter 45. Provisions relating to expatriated entities.”

6 (d) **EFFECTIVE DATE.**—The amendments made by
7 this section shall take effect on March 4, 2003; except that
8 periods before such date shall not be taken into account
9 in applying the periods in subsections (a) and (e)(1) of
10 section 4985 of the Internal Revenue Code of 1986, as
11 added by this section.

12 **SEC. 2004. REINSURANCE OF UNITED STATES RISKS IN**
13 **FOREIGN JURISDICTIONS.**

14 (a) **IN GENERAL.**—Section 845(a) (relating to alloca-
15 tion in case of reinsurance agreement involving tax avoid-
16 ance or evasion) is amended by striking “source and char-
17 acter” and inserting “amount, source, or character”.

18 (b) **EFFECTIVE DATE.**—The amendments made by
19 this section shall apply to any risk reinsured after the date
20 of the enactment of this Act.

21 **SEC. 2005. REVISION OF TAX RULES ON EXPATRIATION OF**
22 **INDIVIDUALS.**

23 (a) **EXPATRIATION TO AVOID TAX.**—

1 (1) IN GENERAL.—Subsection (a) of section
2 877 (relating to treatment of expatriates) is amend-
3 ed to read as follows:

4 “(a) TREATMENT OF EXPATRIATES.—

5 “(1) IN GENERAL.—Every nonresident alien in-
6 dividual to whom this section applies and who, with-
7 in the 10-year period immediately preceding the
8 close of the taxable year, lost United States citizen-
9 ship shall be taxable for such taxable year in the
10 manner provided in subsection (b) if the tax imposed
11 pursuant to such subsection (after any reduction in
12 such tax under the last sentence of such subsection)
13 exceeds the tax which, without regard to this section,
14 is imposed pursuant to section 871.

15 “(2) INDIVIDUALS SUBJECT TO THIS SEC-
16 TION.—This section shall apply to any individual
17 if—

18 “(A) the average annual net income tax
19 (as defined in section 38(c)(1)) of such indi-
20 vidual for the period of 5 taxable years ending
21 before the date of the loss of United States citi-
22 zenship is greater than \$122,000,

23 “(B) the net worth of the individual as of
24 such date is \$2,000,000 or more, or

1 “(C) such individual fails to certify under
2 penalty of perjury that he has met the require-
3 ments of this title for the 5 preceding taxable
4 years or fails to submit such evidence of such
5 compliance as the Secretary may require.

6 In the case of the loss of United States citizenship
7 in any calendar year after 2003, such \$122,000
8 amount shall be increased by an amount equal to
9 such dollar amount multiplied by the cost-of-living
10 adjustment determined under section 1(f)(3) for
11 such calendar year by substituting ‘2002’ for ‘1992’
12 in subparagraph (B) thereof. Any increase under the
13 preceding sentence shall be rounded to the nearest
14 multiple of \$1,000.”.

15 (2) REVISION OF EXCEPTIONS FROM ALTER-
16 NATIVE TAX.—Subsection (c) of section 877 (relat-
17 ing to tax avoidance not presumed in certain cases)
18 is amended to read as follows:

19 “(c) EXCEPTIONS.—

20 “(1) IN GENERAL.—Subparagraphs (A) and
21 (B) of subsection (a)(2) shall not apply to an indi-
22 vidual described in paragraph (2) or (3).

23 “(2) DUAL CITIZENS.—

24 “(A) IN GENERAL.—An individual is de-
25 scribed in this paragraph if—

1 “(i) the individual became at birth a
2 citizen of the United States and a citizen
3 of another country and continues to be a
4 citizen of such other country, and

5 “(ii) the individual has had no sub-
6 stantial contacts with the United States.

7 “(B) SUBSTANTIAL CONTACTS.—An indi-
8 vidual shall be treated as having no substantial
9 contacts with the United States only if the indi-
10 vidual—

11 “(i) was never a resident of the
12 United States (as defined in section
13 7701(b)),

14 “(ii) has never held a United States
15 passport, and

16 “(iii) was not present in the United
17 States for more than 30 days during any
18 calendar year which is 1 of the 10 calendar
19 years preceding the individual’s loss of
20 United States citizenship.

21 “(3) CERTAIN MINORS.—An individual is de-
22 scribed in this paragraph if—

23 “(A) the individual became at birth a cit-
24 izen of the United States,

1 “(B) neither parent of such individual was
2 a citizen of the United States at the time of
3 such birth,

4 “(C) the individual’s loss of United States
5 citizenship occurs before such individual attains
6 age 18½, and

7 “(D) the individual was not present in the
8 United States for more than 30 days during
9 any calendar year which is 1 of the 10 calendar
10 years preceding the individual’s loss of United
11 States citizenship.”.

12 (3) CONFORMING AMENDMENT.—Section
13 2107(a) is amended to read as follows:

14 “(a) TREATMENT OF EXPATRIATES.—A tax com-
15 puted in accordance with the table contained in section
16 2001 is hereby imposed on the transfer of the taxable es-
17 tate, determined as provided in section 2106, of every de-
18 cedent nonresident not a citizen of the United States if
19 the date of death occurs during a taxable year with respect
20 to which the decedent is subject to tax under section
21 877(b).”.

22 (b) SPECIAL RULES FOR DETERMINING WHEN AN
23 INDIVIDUAL IS NO LONGER A UNITED STATES CITIZEN
24 OR LONG-TERM RESIDENT.—Section 7701 (relating to
25 definitions) is amended by redesignating subsection (n) as

1 subsection (o) and by inserting after subsection (m) the
2 following new subsection:

3 “(n) SPECIAL RULES FOR DETERMINING WHEN AN
4 INDIVIDUAL IS NO LONGER A UNITED STATES CITIZEN
5 OR LONG-TERM RESIDENT.—An individual who would
6 (but for this subsection) cease to be treated as a citizen
7 or resident of the United States shall continue to be treat-
8 ed as a citizen or resident of the United States, as the
9 case may be, until such individual—

10 “(1) gives notice of an expatriating act or ter-
11 mination of residency (with the requisite intent to
12 relinquish citizenship or terminate residency) to the
13 Secretary of State or the Secretary of Homeland Se-
14 curity, and

15 “(2) provides a statement in accordance with
16 section 6039G.”.

17 (c) PHYSICAL PRESENCE IN THE UNITED STATES
18 FOR MORE THAN 30 DAYS.—Section 877 (relating to ex-
19 patriation to avoid tax) is amended by adding at the end
20 the following new subsection:

21 “(g) PHYSICAL PRESENCE.—

22 “(1) IN GENERAL.—This section shall not apply
23 to any individual to whom this section would other-
24 wise apply for any taxable year during the 10-year
25 period referred to in subsection (a) in which such in-

1 dividual is physically present in the United States at
2 any time on more than 30 days in the calendar year
3 ending in such taxable year, and such individual
4 shall be treated for purposes of this title as a citizen
5 or resident of the United States, as the case may be,
6 for such taxable year.

7 “(2) EXCEPTION.—

8 “(A) IN GENERAL.—In the case of an indi-
9 vidual described in any of the following sub-
10 paragraphs of this paragraph, a day of physical
11 presence in the United States shall be dis-
12 regarded if the individual is performing services
13 in the United States on such day for an em-
14 ployer. The preceding sentence shall not apply
15 if—

16 “(i) such employer is related (within
17 the meaning of section 267 and 707) to
18 such individual, or

19 “(ii) such employer fails to meet such
20 requirements as the Secretary may pre-
21 scribe by regulations to prevent the avoid-
22 ance of the purposes of this paragraph.

23 Not more than 30 days during any calendar
24 year may be disregarded under this subpara-
25 graph.

1 “(B) INDIVIDUALS WITH TIES TO OTHER
2 COUNTRIES.—An individual is described in this
3 subparagraph if—

4 “(i) the individual becomes (not later
5 than the close of a reasonable period after
6 loss of United States citizenship or termi-
7 nation of residency) a citizen or resident of
8 the country in which—

9 “(I) such individual was born,

10 “(II) if such individual is mar-
11 ried, such individual’s spouse was
12 born, or

13 “(III) either of such individual’s
14 parents were born, and

15 “(ii) the individual becomes fully lia-
16 ble for income tax in such country.

17 “(C) MINIMAL PRIOR PHYSICAL PRESENCE
18 IN THE UNITED STATES.—An individual is de-
19 scribed in this subparagraph if, for each year in
20 the 10-year period ending on the date of loss of
21 United States citizenship or termination of resi-
22 dency, the individual was physically present in
23 the United States for 30 days or less. The rule
24 of section 7701(b)(3)(D)(ii) shall apply for pur-
25 poses of this subparagraph.”.

1 (d) TRANSFERS SUBJECT TO GIFT TAX.—

2 (1) IN GENERAL.—Subsection (a) of section
3 2501 (relating to taxable transfers) is amended by
4 striking paragraph (4), by redesignating paragraph
5 (5) as paragraph (4), and by striking paragraph (3)
6 and inserting the following new paragraph:

7 “(3) EXCEPTION.—

8 “(A) CERTAIN INDIVIDUALS.—Paragraph
9 (2) shall not apply in the case of a donor to
10 whom section 877(b) applies for the taxable
11 year which includes the date of the transfer.

12 “(B) CREDIT FOR FOREIGN GIFT TAXES.—
13 The tax imposed by this section solely by reason
14 of this paragraph shall be credited with the
15 amount of any gift tax actually paid to any for-
16 eign country in respect of any gift which is tax-
17 able under this section solely by reason of this
18 paragraph.”

19 (2) TRANSFERS OF CERTAIN STOCK.—Sub-
20 section (a) of section 2501 is amended by adding at
21 the end the following new paragraph:

22 “(5) TRANSFERS OF CERTAIN STOCK.—

23 “(A) IN GENERAL.—In the case of a trans-
24 fer of stock in a foreign corporation described
25 in subparagraph (B) by a donor to whom sec-

1 tion 877(b) applies for the taxable year which
2 includes the date of the transfer—

3 “(i) section 2511(a) shall be applied
4 without regard to whether such stock is
5 situated within the United States, and

6 “(ii) the value of such stock for pur-
7 poses of this chapter shall be its U.S.-asset
8 value determined under subparagraph (C).

9 “(B) FOREIGN CORPORATION DE-
10 SCRIBED.—A foreign corporation is described in
11 this subparagraph with respect to a donor if—

12 “(i) the donor owned (within the
13 meaning of section 958(a)) at the time of
14 such transfer 10 percent or more of the
15 total combined voting power of all classes
16 of stock entitled to vote of the foreign cor-
17 poration, and

18 “(ii) such donor owned (within the
19 meaning of section 958(a)), or is consid-
20 ered to have owned (by applying the own-
21 ership rules of section 958(b)), at the time
22 of such transfer, more than 50 percent
23 of—

1 “(I) the total combined voting
2 power of all classes of stock entitled
3 to vote of such corporation, or

4 “(II) the total value of the stock
5 of such corporation.

6 “(C) U.S.-ASSET VALUE.—For purposes of
7 subparagraph (A), the U.S.-asset value of stock
8 shall be the amount which bears the same ratio
9 to the fair market value of such stock at the
10 time of transfer as—

11 “(i) the fair market value (at such
12 time) of the assets owned by such foreign
13 corporation and situated in the United
14 States, bears to

15 “(ii) the total fair market value (at
16 such time) of all assets owned by such for-
17 eign corporation.”

18 (e) ENHANCED INFORMATION REPORTING FROM IN-
19 DIVIDUALS LOSING UNITED STATES CITIZENSHIP.—

20 (1) IN GENERAL.—Subsection (a) of section
21 6039G is amended to read as follows:

22 “(a) IN GENERAL.—Notwithstanding any other pro-
23 vision of law, any individual to whom section 877(b) ap-
24 plies for any taxable year shall provide a statement for

1 such taxable year which includes the information described
2 in subsection (b).”.

3 (2) INFORMATION TO BE PROVIDED.—Sub-
4 section (b) of section 6039G is amended to read as
5 follows:

6 “(b) INFORMATION TO BE PROVIDED.—Information
7 required under subsection (a) shall include—

8 “(1) the taxpayer’s TIN,

9 “(2) the mailing address of such individual’s
10 principal foreign residence,

11 “(3) the foreign country in which such indi-
12 vidual is residing,

13 “(4) the foreign country of which such indi-
14 vidual is a citizen,

15 “(5) information detailing the income, assets,
16 and liabilities of such individual,

17 “(6) the number of days during any portion of
18 which that the individual was physically present in
19 the United States during the taxable year, and

20 “(7) such other information as the Secretary
21 may prescribe.”.

22 (3) INCREASE IN PENALTY.—Subsection (d) of
23 section 6039G is amended to read as follows:

24 “(d) PENALTY.—If—

1 “(1) an individual is required to file a state-
2 ment under subsection (a) for any taxable year, and

3 “(2) fails to file such a statement with the Sec-
4 retary on or before the date such statement is re-
5 quired to be filed or fails to include all the informa-
6 tion required to be shown on the statement or in-
7 cludes incorrect information,

8 such individual shall pay a penalty of \$10,000 unless it
9 is shown that such failure is due to reasonable cause and
10 not to willful neglect.”.

11 (4) CONFORMING AMENDMENT.—Section
12 6039G is amended by striking subsections (c), (f),
13 and (g) and by redesignating subsections (d) and (e)
14 as subsection (c) and (d), respectively.

15 (f) EFFECTIVE DATE.—The amendments made by
16 this section shall apply to individuals who expatriate after
17 February 27, 2003.

18 **SEC. 2006. REPORTING OF TAXABLE MERGERS AND ACQUI-**
19 **SITIONS.**

20 (a) IN GENERAL.—Subpart B of part III of sub-
21 chapter A of chapter 61 is amended by inserting after sec-
22 tion 6043 the following new section:

23 **“SEC. 6043A. TAXABLE MERGERS AND ACQUISITIONS.**

24 “(a) IN GENERAL.—According to the forms or regu-
25 lations prescribed by the Secretary, the acquiring corpora-

1 tion in any taxable acquisition shall make a return setting
2 forth—

3 “(1) a description of the acquisition,

4 “(2) the name and address of each shareholder
5 of the acquired corporation who is required to recog-
6 nize gain (if any) as a result of the acquisition,

7 “(3) the amount of money and the fair market
8 value of other property transferred to each such
9 shareholder as part of such acquisition, and

10 “(4) such other information as the Secretary
11 may prescribe.

12 To the extent provided by the Secretary, the requirements
13 of this section applicable to the acquiring corporation shall
14 be applicable to the acquired corporation and not to the
15 acquiring corporation.

16 “(b) NOMINEES.—According to the forms or regula-
17 tions prescribed by the Secretary—

18 “(1) REPORTING.—Any person who holds stock
19 as a nominee for another person shall furnish in the
20 manner prescribed by the Secretary to such other
21 person the information provided by the corporation
22 under subsection (d).

23 “(2) REPORTING TO NOMINEES.—In the case of
24 stock held by any person as a nominee, references in
25 this section (other than in subsection (c)) to a share-

1 holder shall be treated as a reference to the nomi-
2 nee.

3 “(c) TAXABLE ACQUISITION.—For purposes of this
4 section, the term ‘taxable acquisition’ means any acquisi-
5 tion by a corporation of stock in or property of another
6 corporation if any shareholder of the acquired corporation
7 is required to recognize gain (if any) as a result of such
8 acquisition.

9 “(d) STATEMENTS TO BE FURNISHED TO SHARE-
10 HOLDERS.—According to the forms or regulations pre-
11 scribed by the Secretary, every person required to make
12 a return under subsection (a) shall furnish to each share-
13 holder whose name is required to be set forth in such re-
14 turn a written statement showing—

15 “(1) the name, address, and phone number of
16 the information contact of the person required to
17 make such return,

18 “(2) the information required to be shown on
19 such return with respect to such shareholder, and

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

22 The written statement required under the preceding sen-
23 tence shall be furnished to the shareholder on or before
24 January 31 of the year following the calendar year during
25 which the taxable acquisition occurred.”

1 (b) ASSESSABLE PENALTIES.—

2 (1) Subparagraph (B) of section 6724(d)(1)
3 (relating to definitions) is amended by redesignating
4 clauses (ii) through (xvii) as clauses (iii) through
5 (xviii), respectively, and by inserting after clause (i)
6 the following new clause:

7 “(ii) section 6043A(a) (relating to re-
8 turns relating to taxable mergers and ac-
9 quisitions),”.

10 (2) Paragraph (2) of section 6724(d) is amend-
11 ed by redesignating subparagraphs (F) through
12 (AA) as subparagraphs (G) through (BB), respec-
13 tively, and by inserting after subparagraph (E) the
14 following new subparagraph:

15 “(F) subsections (b) and (d) of section
16 6043A (relating to returns relating to taxable
17 mergers and acquisitions).”.

18 (c) CLERICAL AMENDMENT.—The table of sections
19 for subpart B of part III of subchapter A of chapter 61
20 is amended by inserting after the item relating to section
21 6043 the following new item:

“Sec. 6043A. Returns relating to taxable mergers and acqui-
sitions.”.

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

1 **SEC. 2007. STUDIES.**

2 (a) **TRANSFER PRICING RULES.**—The Secretary of
3 the Treasury or the Secretary’s delegate shall conduct a
4 study regarding the effectiveness of current transfer pric-
5 ing rules and compliance efforts in ensuring that cross-
6 border transfers and other related-party transactions, par-
7 ticularly transactions involving intangible assets, service
8 contracts, or leases cannot be used improperly to shift in-
9 come out of the United States. The study shall include
10 a review of the contemporaneous documentation and pen-
11 alty rules under section 6662 of the Internal Revenue
12 Code of 1986, a review of the regulatory and administra-
13 tive guidance implementing the principles of section 482
14 of such Code to transactions involving intangible property
15 and services and to cost-sharing arrangements, and an ex-
16 amination of whether increased disclosure of cross-border
17 transactions should be required. The study shall set forth
18 specific recommendations to address all abuses identified
19 in the study. Not later than June 30, 2004, such Sec-
20 retary or delegate shall submit to the Congress a report
21 of such study.

22 (b) **INCOME TAX TREATIES.**—The Secretary of the
23 Treasury or the Secretary’s delegate shall conduct a study
24 of United States income tax treaties to identify any inap-
25 propriate reductions in United States withholding tax that
26 provide opportunities for shifting income out of the United

1 States, and to evaluate whether existing anti-abuse mecha-
 2 nisms are operating properly. The study shall include spe-
 3 cific recommendations to address all inappropriate uses of
 4 tax treaties. Not later than December 31, 2003, such Sec-
 5 retary or delegate shall submit to the Congress a report
 6 of such study.

7 (c) **IMPACT OF CORPORATE EXPATRIATION PROVI-**
 8 **SIONS.**—The Secretary of the Treasury or the Secretary’s
 9 delegate shall conduct a study of the impact of the provi-
 10 sions of this title on earnings stripping and corporate ex-
 11 patriation. The study shall include such recommendations
 12 as such Secretary or delegate may have to improve the
 13 impact of such provisions in carrying out the purposes of
 14 this title. Not later than December 31, 2005, such Sec-
 15 retary or delegate shall submit to the Congress a report
 16 of such study.

17 **TITLE III—PROVISIONS**
 18 **RELATING TO TAX SHELTERS**
 19 **Subtitle A—Taxpayer-Related**
 20 **Provisions**

21 **SEC. 3001. PENALTY FOR FAILING TO DISCLOSE REPORT-**
 22 **ABLE TRANSACTIONS.**

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

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

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

10 “(b) AMOUNT OF PENALTY.—

11 “(1) IN GENERAL.—Except as provided in para-
12 graph (2), the amount of the penalty under sub-
13 section (a) shall be—

14 “(A) \$10,000 in the case of a natural per-
15 son, and

16 “(B) \$50,000 in any other case.

17 “(2) LISTED TRANSACTION.—The amount of
18 the penalty under subsection (a) with respect to a
19 listed transaction shall be—

20 “(A) \$100,000 in the case of a natural
21 person, and

22 “(B) \$200,000 in any other case.

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

24 “(1) REPORTABLE TRANSACTION.—The term
25 ‘reportable transaction’ means any transaction with
26 respect to which information is required to be in-

1 cluded with a return or statement because, as deter-
2 mined under regulations prescribed under section
3 6011, such transaction is of a type which the Sec-
4 retary determines as having a potential for tax
5 avoidance or evasion.

6 “(2) LISTED TRANSACTION.—The term ‘listed
7 transaction’ means a reportable transaction which is
8 the same as, or substantially similar to, a trans-
9 action specifically identified by the Secretary as a
10 tax avoidance transaction for purposes of section
11 6011.

12 “(d) AUTHORITY TO RESCIND PENALTY.—

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

17 “(A) the violation is with respect to a re-
18 portable transaction other than a listed trans-
19 action, and

20 “(B) rescinding the penalty would promote
21 compliance with the requirements of this title
22 and effective tax administration.

23 “(2) NO JUDICIAL APPEAL.—Notwithstanding
24 any other provision of law, any determination under

1 this subsection may not be reviewed in any judicial
2 proceeding.

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

9 “(A) a statement of the facts and cir-
10 cumstances relating to the violation,

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

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

13 “(e) COORDINATION WITH OTHER PENALTIES.—The
14 penalty imposed by this section shall be in addition to any
15 other penalty imposed by this title.”

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

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

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

1 (d) REPORT.—The Commissioner of Internal Rev-
 2 enue shall annually report to the Committee on Ways and
 3 Means of the House of Representatives and the Committee
 4 on Finance of the Senate—

5 (1) a summary of the total number and aggre-
 6 gate amount of penalties imposed, and rescinded,
 7 under section 6707A of the Internal Revenue Code
 8 of 1986, and

9 (2) a description of each penalty rescinded
 10 under section 6707(c) of such Code and the reasons
 11 therefor.

12 **SEC. 3002. ACCURACY-RELATED PENALTY FOR LISTED**
 13 **TRANSACTIONS, OTHER REPORTABLE TRANS-**
 14 **ACTIONS HAVING A SIGNIFICANT TAX AVOID-**
 15 **ANCE PURPOSE, ETC.**

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

19 **“SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PEN-**
 20 **ALTY ON UNDERSTATEMENTS WITH RESPECT**
 21 **TO REPORTABLE TRANSACTIONS.**

22 “(a) IMPOSITION OF PENALTY.—If a taxpayer has a
 23 reportable transaction understatement for any taxable
 24 year, there shall be added to the tax an amount equal to
 25 20 percent of the amount of such understatement.

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

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

5 “(A) the product of—

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

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

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

23 For purposes of subparagraph (A), any reduction of
24 the excess of deductions allowed for the taxable year
25 over gross income for such year, and any reduction

1 in the amount of capital losses which would (without
2 regard to section 1211) be allowed for such year,
3 shall be treated as an increase in taxable income.

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

7 “(A) any listed transaction, and

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

12 “(c) HIGHER PENALTY FOR NONDISCLOSED TRANS-
13 ACTIONS.—Subsection (a) shall be applied by substituting
14 ‘30 percent’ for ‘20 percent’ with respect to the portion
15 of any reportable transaction understatement with respect
16 to which the requirement of section 6664(d)(2)(A) is not
17 met.

18 “(d) DEFINITIONS OF REPORTABLE AND LISTED
19 TRANSACTIONS.—For purposes of this section, the terms
20 ‘reportable transaction’ and ‘listed transaction’ have the
21 respective meanings given to such terms by section
22 6707A(c).

23 “(e) SPECIAL RULES.—

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

4 “(A) the amount of such understatement
5 (determined without regard to this paragraph)
6 shall be increased by the aggregate amount of
7 reportable transaction understatements for pur-
8 poses of determining whether such understate-
9 ment is a substantial understatement under
10 section 6662(d)(1), and

11 “(B) the addition to tax under section
12 6662(a) shall apply only to the excess of the
13 amount of the substantial understatement (if
14 any) after the application of subparagraph (A)
15 over the aggregate amount of reportable trans-
16 action understatements.

17 “(2) COORDINATION WITH OTHER PEN-
18 ALTIES.—

19 “(A) APPLICATION OF FRAUD PENALTY.—
20 References to an underpayment in section 6663
21 shall be treated as including references to a re-
22 portable transaction understatement.

23 “(B) NO DOUBLE PENALTY.—This section
24 shall not apply to any portion of an understate-

1 ment on which a penalty is imposed under sec-
2 tion 6663.”

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

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

17 “The excess under the preceding sentence shall
18 be determined without regard to items to which
19 section 6662A applies.”

20 (c) REASONABLE CAUSE EXCEPTION.—

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

23 “(d) REASONABLE CAUSE EXCEPTION FOR REPORT-
24 ABLE TRANSACTION UNDERSTATEMENTS.—

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

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

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

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

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

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

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

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

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

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

15 “(B) CERTAIN OPINIONS MAY NOT BE RE-
16 LIED UPON.—

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

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

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

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

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

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

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

20 “(IV) as determined under regu-
21 lations prescribed by the Secretary,
22 has a disqualifying financial interest
23 with respect to the transaction.

1 “(iii) DISQUALIFIED OPINIONS.—For
2 purposes of clause (i), an opinion is dis-
3 qualified if the opinion—

4 “(I) is based on unreasonable
5 factual or legal assumptions (includ-
6 ing assumptions as to future events),

7 “(II) unreasonably relies on rep-
8 resentations, statements, findings, or
9 agreements of the taxpayer or any
10 other person,

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

13 “(IV) fails to meet any other re-
14 quirement as the Secretary may pre-
15 scribe.”

16 (2) CONFORMING AMENDMENTS.—

17 (A) Paragraph (1) of section 6664(c) is
18 amended by striking “this part” and inserting
19 “section 6662 or 6663”.

20 (B) The heading for subsection (c) of sec-
21 tion 6664 is amended by inserting “FOR UN-
22 DERPAYMENTS” after “EXCEPTION”.

23 (d) REDUCTION IN PENALTY FOR SUBSTANTIAL UN-
24 DERSTATEMENT OF INCOME TAX NOT TO APPLY TO TAX
25 SHELTERS.—Subparagraph (C) of section 6662(d)(2) (re-

1 lating to substantial understatement of income tax) is
2 amended to read as follows:

3 “(C) REDUCTION NOT TO APPLY TO TAX
4 SHELTERS.—

5 “(i) IN GENERAL.—Subparagraph (B)
6 shall not apply to any item attributable to
7 a tax shelter.

8 “(ii) TAX SHELTER.—For purposes of
9 clause (i), the term ‘tax shelter’ means—

10 “(I) a partnership or other enti-
11 ty,

12 “(II) any investment plan or ar-
13 rangement, or

14 “(III) any other plan or arrange-
15 ment,

16 if a significant purpose of such partner-
17 ship, entity, plan, or arrangement is the
18 avoidance or evasion of Federal income
19 tax.”

20 (e) CONFORMING AMENDMENTS.—

21 (1) Sections 461(i)(3)(C), 1274(b)(3), and
22 7525(b) are each amended by striking “section
23 6662(d)(2)(C)(iii)” and inserting “section
24 6662(d)(2)(C)(ii)”.

1 (2) The heading for section 6662 is amended to
2 read as follows:

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

5 (3) The table of sections for part II of sub-
6 chapter A of chapter 68 is amended by striking the
7 item relating to section 6662 and inserting the fol-
8 lowing new items:

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

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

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

12 **SEC. 3003. TAX SHELTER EXCEPTION TO CONFIDENTIALITY**
13 **PRIVILEGES RELATING TO TAXPAYER COM-**
14 **MUNICATIONS.**

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

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

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

1 “(A) any person,

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

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

6 “(2) in connection with the promotion of the di-
7 rect or indirect participation of the person in any
8 tax shelter (as defined in section
9 6662(d)(2)(C)(ii)).”

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

13 **SEC. 3004. STATUTE OF LIMITATIONS FOR TAXABLE YEARS**
14 **FOR WHICH REQUIRED LISTED TRANS-**
15 **ACTIONS NOT REPORTED.**

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

19 “(10) LISTED TRANSACTIONS.—If a taxpayer
20 fails to include on any return or statement for any
21 taxable year any information with respect to a listed
22 transaction (as defined in section 6707A(c)(2))
23 which is required under section 6011 to be included
24 with such return or statement, the time for assess-
25 ment of any tax imposed by this title with respect

1 to such transaction shall not expire before the date
2 which is 1 year after the earlier of—

3 “(A) the date on which the Secretary is
4 furnished the information so required, or

5 “(B) the date that a material advisor (as
6 defined in section 6111) meets the requirements
7 of section 6112 with respect to a request by the
8 Secretary under section 6112(b) relating to
9 such transaction with respect to such tax-
10 payer.”

11 (b) EFFECTIVE DATE.—The amendment made by
12 this section shall apply to taxable years with respect to
13 which the period for assessing a deficiency did not expire
14 before July 24, 2003.

15 **SEC. 3005. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

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

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

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

23 “(1) information identifying and describing the
24 transaction,

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

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

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

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

8 “(1) MATERIAL ADVISOR.—

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

11 “(i) who provides any material aid,
12 assistance, or advice with respect to orga-
13 nizing, managing, promoting, selling, im-
14 plementing, or carrying out any reportable
15 transaction, and

16 “(ii) who directly or indirectly derives
17 gross income in excess of the threshold
18 amount (or such other amount as may be
19 prescribed by the Secretary) for such ad-
20 vice or assistance.

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

23 “(i) \$50,000 in the case of a report-
24 able transaction substantially all of the tax

1 benefits from which are provided to nat-
2 ural persons, and

3 “(ii) \$250,000 in any other case.

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

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

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

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

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

17 (b) CONFORMING AMENDMENTS.—

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

 “Sec. 6111. Disclosure of reportable transactions.”

21 (2) So much of section 6112 as precedes sub-
22 section (c) thereof is amended to read as follows:

1 **“SEC. 6112. MATERIAL ADVISORS OF REPORTABLE TRANS-**
2 **ACTIONS MUST KEEP LISTS OF ADVISEES,**
3 **ETC.**

4 “(a) IN GENERAL.—Each material advisor (as de-
5 fined in section 6111) with respect to any reportable
6 transaction (as defined in section 6707A(c)) shall (wheth-
7 er or not required to file a return under section 6111 with
8 respect to such transaction) maintain (in such manner as
9 the Secretary may by regulations prescribe) a list—

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

13 “(2) containing such other information as the
14 Secretary may by regulations require.”

15 (3) Section 6112 is amended—

16 (A) by redesignating subsection (c) as sub-
17 section (b),

18 (B) by inserting “written” before “re-
19 quest” in subsection (b)(1) (as so redesign-
20 nated), and

21 (C) by striking “shall prescribe” in sub-
22 section (b)(2) (as so redesignated) and inserting
23 “may prescribe”.

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

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

1 (5)(A) The heading for section 6708 is amend-
2 ed to read as follows:

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

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

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

9 (c) **REQUIRED DISCLOSURE NOT SUBJECT TO CLAIM**
10 **OF CONFIDENTIALITY.**—Paragraph (1) of section
11 6112(b), as redesignated by subsection (b), is amended by
12 adding at the end the following new flush sentence:

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

15 (d) **EFFECTIVE DATE.**—

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

1 (2) NO CLAIM OF CONFIDENTIALITY AGAINST
2 DISCLOSURE.—The amendment made by subsection
3 (c) shall take effect as if included in the amend-
4 ments made by section 142 of the Deficit Reduction
5 Act of 1984.

6 **SEC. 3006. FAILURE TO FURNISH INFORMATION REGARD-**
7 **ING REPORTABLE TRANSACTIONS.**

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

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

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

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

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

22 “(b) AMOUNT OF PENALTY.—

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

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

5 “(A) \$200,000, or

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

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

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

18 “(d) REPORTABLE AND LISTED TRANSACTIONS.—
19 For purposes of this section, the terms ‘reportable trans-
20 action’ and ‘listed transaction’ have the respective mean-
21 ings given to such terms by section 6707A(c).”

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

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

4 **SEC. 3007. MODIFICATION OF PENALTY FOR FAILURE TO**
5 **MAINTAIN LISTS OF INVESTORS.**

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

8 “(a) IMPOSITION OF PENALTY.—

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

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

20 “(3) LIMITATION ON AUTHORITY TO COM-
21 PROMISE PENALTY.—If the 1st letter of proposed
22 deficiency which allows the taxpayer an opportunity
23 for administrative review in the Internal Revenue
24 Service Office of Appeals has been sent with respect
25 to a penalty imposed by this section, only the Com-

1 missioner of Internal Revenue may compromise all
2 or any portion of such penalty.”

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

6 **SEC. 3008. PENALTY ON PROMOTERS OF TAX SHELTERS.**

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

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

19 **SEC. 3009. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-**
20 **MENT PENALTY FOR NONREPORTABLE**
21 **TRANSACTIONS.**

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

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

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

11 “(ii) \$10,000,000.”

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

15 **SEC. 3010. MODIFICATION OF ACTIONS TO ENJOIN CERTAIN**
16 **CONDUCT RELATED TO TAX SHELTERS AND**
17 **REPORTABLE TRANSACTIONS.**

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

23 “(a) AUTHORITY TO SEEK INJUNCTION.—A civil ac-
24 tion in the name of the United States to enjoin any person
25 from further engaging in specified conduct may be com-

1 menced at the request of the Secretary. Any action under
2 this section shall be brought in the district court of the
3 United States for the district in which such person resides,
4 has his principal place of business, or has engaged in spec-
5 ified conduct. The court may exercise its jurisdiction over
6 such action (as provided in section 7402(a)) separate and
7 apart from any other action brought by the United States
8 against such person.

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

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

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

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

18 “(c) SPECIFIED CONDUCT.—For purposes of this
19 section, the term ‘specified conduct’ means any action, or
20 failure to take action, subject to penalty under section
21 6700, 6701, 6707, or 6708.”

22 (b) CONFORMING AMENDMENTS.—

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

1 **“SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RE-**
2 **LATED TO TAX SHELTERS AND REPORTABLE**
3 **TRANSACTIONS.”**

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

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

8 (c) **EFFECTIVE DATE.**—The amendment made by
9 this section shall take effect on the day after the date of
10 the enactment of this Act.

11 **SEC. 3011. PENALTY ON FAILURE TO REPORT INTERESTS**
12 **IN FOREIGN FINANCIAL ACCOUNTS.**

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

15 “(5) **FOREIGN FINANCIAL AGENCY TRANS-**
16 **ACTION VIOLATION.**—

17 “(A) **PENALTY AUTHORIZED.**—The Sec-
18 retary of the Treasury may impose a civil
19 money penalty on any person who violates, or
20 causes any violation of, any provision of section
21 5314.

22 “(B) **AMOUNT OF PENALTY.**—

23 “(i) **IN GENERAL.**—Except as pro-
24 vided in subparagraph (C), the amount of

1 any civil penalty imposed under subpara-
2 graph (A) shall not exceed \$5,000.

3 “(ii) REASONABLE CAUSE EXCEP-
4 TION.—No penalty shall be imposed under
5 subparagraph (A) with respect to any vio-
6 lation if—

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

9 “(II) the amount of the trans-
10 action or the balance in the account
11 at the time of the transaction was
12 properly reported.

13 “(C) WILLFUL VIOLATIONS.—In the case
14 of any person willfully violating, or willfully
15 causing any violation of, any provision of sec-
16 tion 5314—

17 “(i) the maximum penalty under sub-
18 paragraph (B)(i) shall be increased to the
19 greater of—

20 “(I) \$25,000, or

21 “(II) the amount (not exceeding
22 \$100,000) determined under subpara-
23 graph (D), and

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

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

3 “(i) in the case of a violation involving
4 a transaction, the amount of the trans-
5 action, or

6 “(ii) in the case of a violation involv-
7 ing a failure to report the existence of an
8 account or any identifying information re-
9 quired to be provided with respect to an
10 account, the balance in the account at the
11 time of the violation.”

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

15 **SEC. 3012. REGULATION OF INDIVIDUALS PRACTICING BE-**
16 **FORE THE DEPARTMENT OF THE TREASURY.**

17 (a) CENSURE; IMPOSITION OF PENALTY.—

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

20 (A) by inserting “, or censure,” after “De-
21 partment”, and

22 (B) by adding at the end the following new
23 flush sentence:

24 “The Secretary may impose a monetary penalty on any
25 representative described in the preceding sentence. If the

1 representative was acting on behalf of an employer or any
2 firm or other entity in connection with the conduct giving
3 rise to such penalty, the Secretary may impose a monetary
4 penalty on such employer, firm, or entity if it knew, or
5 reasonably should have known, of such conduct. Such pen-
6 alty shall not exceed the gross income derived (or to be
7 derived) from the conduct giving rise to the penalty. Any
8 such penalty imposed on an individual may be in addition
9 to, or in lieu of, any suspension, disbarment, or censure
10 of such individual.”

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

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

17 “(d) Nothing in this section or in any other provision
18 of law shall be construed to limit the authority of the Sec-
19 retary of the Treasury to impose standards applicable to
20 the rendering of written advice with respect to any entity,
21 transaction plan or arrangement, or other plan or arrange-
22 ment, which is of a type which the Secretary determines
23 as having a potential for tax avoidance or evasion.”

1 **Subtitle B—Other Provisions**

2 **SEC. 3021. TREATMENT OF STRIPPED INTERESTS IN BOND**
3 **AND PREFERRED STOCK FUNDS, ETC.**

4 (a) IN GENERAL.—Section 1286 (relating to tax
5 treatment of stripped bonds) is amended by redesignating
6 subsection (f) as subsection (g) and by inserting after sub-
7 section (e) the following new subsection:

8 “(f) TREATMENT OF STRIPPED INTERESTS IN BOND
9 AND PREFERRED STOCK FUNDS, ETC.—In the case of an
10 account or entity substantially all of the assets of which
11 consist of bonds, preferred stock, or a combination thereof,
12 the Secretary may by regulations provide that rules simi-
13 lar to the rules of this section and 305(e), as appropriate,
14 shall apply to interests in such account or entity to which
15 (but for this subsection) this section or section 305(e), as
16 the case may be, would not apply.”

17 (b) CROSS REFERENCE.—Subsection (e) of section
18 305 is amended by adding at the end the following new
19 paragraph:

20 “(7) CROSS REFERENCE.—

**“For treatment of stripped interests in certain ac-
 counts or entities holding preferred stock, see sec-
 tion 1286(f).”**

21 (c) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to purchases and dispositions after
23 the date of the enactment of this Act.

1 **SEC. 3022. MINIMUM HOLDING PERIOD FOR FOREIGN TAX**
2 **CREDIT ON WITHHOLDING TAXES ON INCOME**
3 **OTHER THAN DIVIDENDS.**

4 (a) IN GENERAL.—Section 901 is amended by redesh-
5 ignating subsection (l) as subsection (m) and by inserting
6 after subsection (k) the following new subsection:

7 “(l) MINIMUM HOLDING PERIOD FOR WITHHOLDING
8 TAXES ON GAIN AND INCOME OTHER THAN DIVIDENDS
9 ETC.—

10 “(1) IN GENERAL.—In no event shall a credit
11 be allowed under subsection (a) for any withholding
12 tax (as defined in subsection (k)) on any item of in-
13 come or gain with respect to any property if—

14 “(A) such property is held by the recipient
15 of the item for 15 days or less during the 30-
16 day period beginning on the date which is 15
17 days before the date on which the right to re-
18 ceive payment of such item arises, or

19 “(B) to the extent that the recipient of the
20 item is under an obligation (whether pursuant
21 to a short sale or otherwise) to make related
22 payments with respect to positions in substan-
23 tially similar or related property.

24 This paragraph shall not apply to any dividend to
25 which subsection (k) applies.

1 “(2) EXCEPTION FOR TAXES PAID BY DEAL-
2 ERS.—

3 “(A) IN GENERAL.—Paragraph (1) shall
4 not apply to any qualified tax with respect to
5 any property held in the active conduct in a for-
6 eign country of a business as a dealer in such
7 property.

8 “(B) QUALIFIED TAX.—For purposes of
9 subparagraph (A), the term ‘qualified tax’
10 means a tax paid to a foreign country (other
11 than the foreign country referred to in subpara-
12 graph (A)) if—

13 “(i) the item to which such tax is at-
14 tributable is subject to taxation on a net
15 basis by the country referred to in sub-
16 paragraph (A), and

17 “(ii) such country allows a credit
18 against its net basis tax for the full
19 amount of the tax paid to such other for-
20 eign country.

21 “(C) DEALER.—For purposes of subpara-
22 graph (A), the term ‘dealer’ means—

23 “(i) with respect to a security, any
24 person to whom paragraphs (1) and (2) of
25 subsection (k) would not apply by reason

1 of paragraph (4) thereof if such security
2 were stock, and

3 “(ii) with respect to any other prop-
4 erty, any person with respect to whom
5 such property is described in section
6 1221(a)(1).

7 “(D) REGULATIONS.—The Secretary may
8 prescribe such regulations as may be appro-
9 priate to carry out this paragraph, including
10 regulations to prevent the abuse of the excep-
11 tion provided by this paragraph and to treat
12 other taxes as qualified taxes.

13 “(3) EXCEPTIONS.—The Secretary may by reg-
14 ulation provide that paragraph (1) shall not apply to
15 property where the Secretary determines that the
16 application of paragraph (1) to such property is not
17 necessary to carry out the purposes of this sub-
18 section.

19 “(4) CERTAIN RULES TO APPLY.—Rules similar
20 to the rules of paragraphs (5), (6), and (7) of sub-
21 section (k) shall apply for purposes of this sub-
22 section.

23 “(5) DETERMINATION OF HOLDING PERIOD.—
24 Holding periods shall be determined for purposes of

1 this subsection without regard to section 1235 or
2 any similar rule.”

3 (b) CONFORMING AMENDMENT.—The heading of
4 subsection (k) of section 901 is amended by inserting “ON
5 DIVIDENDS” after “TAXES”.

6 (c) EFFECTIVE DATE.—The amendments made by
7 this section shall apply to amounts paid or accrued more
8 than 30 days after the date of the enactment of this Act.

9 **SEC. 3023. AFFIRMATION OF CONSOLIDATED RETURN REG-**
10 **ULATION AUTHORITY.**

11 (a) IN GENERAL.—Section 1502 is amended by add-
12 ing at the end the following new sentence: “In carrying
13 out the preceding sentence, the Secretary may prescribe
14 rules that are different from the provisions of chapter 1
15 that would apply if such corporations filed separate re-
16 turns.”.

17 (b) RESULT NOT OVERTURNED.—Notwithstanding
18 the amendment made by subsection (a), the Internal Rev-
19 enue Code of 1986 shall be construed by treating Treasury
20 Regulation § 1.1502-20(e)(1)(iii) (as in effect on January
21 1, 2001) as being inapplicable to the factual situation in
22 Rite Aid Corporation and Subsidiary Corporations v.
23 United States, 255 F.3d 1357 (Fed. Cir. 2001).

24 (c) EFFECTIVE DATE.—This section, and the amend-
25 ment made by this section, shall apply to taxable years

1 beginning before, on, or after the date of the enactment
2 of this Act.

3 **SEC. 3024. DISALLOWANCE OF CERTAIN PARTNERSHIP**
4 **LOSS TRANSFERS.**

5 (a) TREATMENT OF CONTRIBUTED PROPERTY WITH
6 BUILT-IN LOSS.—Paragraph (1) of section 704(c) is
7 amended by striking “and” at the end of subparagraph
8 (A), by striking the period at the end of subparagraph
9 (B) and inserting “, and”, and by adding at the end the
10 following:

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

13 “(i) such built-in loss shall be taken
14 into account only in determining the
15 amount of items allocated to the contrib-
16 uting partner, and

17 “(ii) except as provided in regulations,
18 in determining the amount of items allo-
19 cated to other partners, the basis of the
20 contributed property in the hands of the
21 partnership shall be treated as being equal
22 to its fair market value at the time of con-
23 tribution.

24 For purposes of subparagraph (C), the term ‘built-
25 in loss’ means the excess of the adjusted basis of the

1 property (determined without regard to subpara-
2 graph (C)(ii)) over its fair market value at the time
3 of contribution.”

4 (b) ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-
5 erty ON TRANSFER OF PARTNERSHIP INTEREST IF
6 THERE IS SUBSTANTIAL BUILT-IN LOSS.—

7 (1) ADJUSTMENT REQUIRED.—Subsection (a)
8 of section 743 (relating to optional adjustment to
9 basis of partnership property) is amended by insert-
10 ing before the period “or unless the partnership has
11 a substantial built-in loss immediately after such
12 transfer”.

13 (2) ADJUSTMENT.—Subsection (b) of section
14 743 is amended by inserting “or with respect to
15 which there is a substantial built-in loss immediately
16 after such transfer” after “section 754 is in effect”.

17 (3) SUBSTANTIAL BUILT-IN LOSS.—Section 743
18 is amended by adding at the end the following new
19 subsection:

20 “(d) SUBSTANTIAL BUILT-IN LOSS.—

21 “(1) IN GENERAL.—For purposes of this sec-
22 tion, a partnership has a substantial built-in loss
23 with respect to a transfer of an interest in a part-
24 nership if the partnership’s adjusted basis in the

1 partnership property exceeds by more than \$250,000
2 the fair market value of such property.

3 “(2) REGULATIONS.—The Secretary shall pre-
4 scribe such regulations as may be appropriate to
5 carry out the purposes of paragraph (1) and section
6 734(d), including regulations aggregating related
7 partnerships and disregarding property acquired by
8 the partnership in an attempt to avoid such pur-
9 poses.”

10 (4) CLERICAL AMENDMENTS.—

11 (A) The section heading for section 743 is
12 amended to read as follows:

13 **“SEC. 743. ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-**
14 **ERTY WHERE SECTION 754 ELECTION OR**
15 **SUBSTANTIAL BUILT-IN LOSS.”**

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

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

20 (c) ADJUSTMENT TO BASIS OF UNDISTRIBUTED
21 PARTNERSHIP PROPERTY IF THERE IS SUBSTANTIAL
22 BASIS REDUCTION.—

23 (1) ADJUSTMENT REQUIRED.—Subsection (a)
24 of section 734 (relating to optional adjustment to

1 basis of undistributed partnership property) is
2 amended by inserting before the period “or unless
3 there is a substantial basis reduction”.

4 (2) ADJUSTMENT.—Subsection (b) of section
5 734 is amended by inserting “or unless there is a
6 substantial basis reduction” after “section 754 is in
7 effect”.

8 (3) SUBSTANTIAL BASIS REDUCTION.—Section
9 734 is amended by adding at the end the following
10 new subsection:

11 “(d) SUBSTANTIAL BASIS REDUCTION.—

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

17 “(2) REGULATIONS.—

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

18 (4) CLERICAL AMENDMENTS.—

19 (A) The section heading for section 734 is
20 amended to read as follows:

1 **“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED**
 2 **PARTNERSHIP PROPERTY WHERE SECTION**
 3 **754 ELECTION OR SUBSTANTIAL BASIS RE-**
 4 **DUCTION.”**

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

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

9 (d) **EFFECTIVE DATES.**—

10 (1) **SUBSECTION (a).**—The amendment made
 11 by subsection (a) shall apply to contributions made
 12 after the date of the enactment of this Act.

13 (2) **SUBSECTION (b).**—The amendments made
 14 by subsection (b) shall apply to transfers after the
 15 date of the enactment of this Act.

16 (3) **SUBSECTION (c).**—The amendments made
 17 by subsection (c) shall apply to distributions after
 18 the date of the enactment of this Act.

19 **SEC. 3025. NO REDUCTION OF BASIS UNDER SECTION 734 IN**
 20 **STOCK HELD BY PARTNERSHIP IN COR-**
 21 **PORATE PARTNER.**

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

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

5 “(1) no allocation may be made to stock in a
6 corporation (or any person related (within the mean-
7 ing of sections 267(b) and 707(b)(1)) to such cor-
8 poration) which is a partner in the partnership, and

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

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

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

20 **SEC. 3026. REPEAL OF SPECIAL RULES FOR FASITS.**

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

24 (b) CONFORMING AMENDMENTS.—

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

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

9 (3) Paragraph (1) of section 582(e) is amended
10 by striking “, and any regular interest in a
11 FASIT,”.

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

14 (5) Paragraph (5) of section 860G(a) is amend-
15 ed by adding “and” at the end of subparagraph (B),
16 by striking “, and” at the end of subparagraph (C)
17 and inserting a period, and by striking subparagraph
18 (D).

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

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

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

4 (c) EFFECTIVE DATE.—

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

9 (2) EXCEPTION FOR EXISTING FASITS.—The
10 amendments made by this section shall not apply to
11 any FASIT in existence on the date of the enact-
12 ment of this Act to the extent that any regular in-
13 terest issued by the FASIT before such date con-
14 tinues to remain outstanding in accordance with the
15 original terms of issuance of such interest.

16 **SEC. 3027. LIMITATION ON TRANSFER OF BUILT-IN LOSSES**
17 **ON REMIC RESIDUALS.**

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

21 “(e) LIMITATION ON TRANSFER OF BUILT-IN
22 LOSSES ON REMIC RESIDUALS IN SECTION 351 TRANS-
23 ACTIONS.—If—

1 (b) EFFECTIVE DATE.—The amendment made by
2 this section shall take effect on the date of the enactment
3 of this Act.

4 **SEC. 3029. CLARIFICATION OF EXEMPTION FROM TAX FOR**
5 **SMALL PROPERTY AND CASUALTY INSUR-**
6 **ANCE COMPANIES.**

7 (a) IN GENERAL.—Section 501(c)(15)(A) is amended
8 to read as follows:

9 “(A) Insurance companies (as defined in
10 section 816(a)) other than life (including inter-
11 insurers and reciprocal underwriters) if—

12 “(i) the gross receipts for the taxable
13 year do not exceed \$600,000, and

14 “(ii) more than 50 percent of such
15 gross receipts consist of premiums.”.

16 (b) CONTROLLED GROUP RULE.—Section
17 501(c)(15)(C) is amended by inserting “, except that in
18 applying section 1563 for purposes of section
19 831(b)(2)(B)(ii), subparagraphs (B) and (C) of section
20 1563(b)(2) shall be disregarded” before the period at the
21 end.

22 (c) CONFORMING AMENDMENT.—Clause (i) of sec-
23 tion 831(b)(2)(A) is amended by striking “exceed
24 \$350,000 but”.

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

4 **SEC. 3030. DEFINITION OF INSURANCE COMPANY FOR SEC-**
5 **TION 831.**

6 (a) IN GENERAL.—Section 831 is amended by redess-
7 ignating subsection (c) as subsection (d) and by inserting
8 after subsection (b) the following new subsection:

9 “(c) INSURANCE COMPANY DEFINED.—For purposes
10 of this section, the term ‘insurance company’ has the
11 meaning given to such term by section 816(a).”

12 (b) EFFECTIVE DATE.—The amendment made by
13 this section shall apply to taxable years beginning after
14 December 31, 2003.

15 **SEC. 3031. QUALIFIED TAX COLLECTION CONTRACTS.**

16 (a) CONTRACT REQUIREMENTS.—

17 (1) IN GENERAL.—Subchapter A of chapter 64
18 (relating to collection) is amended by adding at the
19 end the following new section:

20 **“SEC. 6306. QUALIFIED TAX COLLECTION CONTRACTS.**

21 “(a) IN GENERAL.—Nothing in any provision of law
22 shall be construed to prevent the Secretary from entering
23 into a qualified tax collection contract.

1 “(b) QUALIFIED TAX COLLECTION CONTRACT.—For
2 purposes of this section, the term ‘qualified tax collection
3 contract’ means any contract which—

4 “(1) is for the services of any person (other
5 than an officer or employee of the Treasury Depart-
6 ment) to locate and contact any taxpayer specified
7 by the Secretary, to request payment from such tax-
8 payer of an amount of Federal tax specified by the
9 Secretary, and to obtain financial information speci-
10 fied by the Secretary with respect to such taxpayer,

11 “(2) prohibits each person providing such serv-
12 ices under such contract from committing any act or
13 omission which employees of the Internal Revenue
14 Service are prohibited from committing in the per-
15 formance of similar services,

16 “(3) prohibits subcontractors from—

17 “(A) having contacts with taxpayers,

18 “(B) providing quality assurance services,

19 and

20 “(C) composing debt collection notices, and

21 “(4) permits subcontracts to perform other
22 services only with the approval of the Secretary.

23 “(c) FEES.—The Secretary may retain and use an
24 amount not in excess of 25 percent of the amount collected
25 under any qualified tax collection contract for the costs

1 of services performed under such contract. The Secretary
2 shall keep adequate records regarding amounts so retained
3 and used. The amount credited as paid by any taxpayer
4 shall be determined without regard to this subsection.

5 “(d) NO FEDERAL LIABILITY.—The United States
6 shall not be liable for any act or omission of any person
7 performing services under a qualified tax collection con-
8 tract.

9 “(e) APPLICATION OF FAIR DEBT COLLECTION
10 PRACTICES ACT.—The provisions of the Fair Debt Collec-
11 tion Practices Act (15 U.S.C. 1692 et seq.) shall apply
12 to any qualified tax collection contract, except to the ex-
13 tent superseded by section 6304, section 7602(c), or by
14 any other provision of this title.

15 “(f) CROSS REFERENCES.—

16 “(1) For damages for certain unauthorized col-
17 lection actions by persons performing services under
18 a qualified tax collection contract, see section
19 7433A.

20 “(2) For application of Taxpayer Assistance
21 Orders to persons performing services under a quali-
22 fied tax collection contract, see section 7811(a)(4).”.

23 (2) CONFORMING AMENDMENTS.—

24 (A) Section 7809(a) is amended by insert-
25 ing “6306,” before “7651”.

1 (B) The table of sections for subchapter A
2 of chapter 64 is amended by adding at the end
3 the following new item:

“Sec. 6306. Qualified Tax Collection Contracts.”.

4 (b) CIVIL DAMAGES FOR CERTAIN UNAUTHORIZED
5 COLLECTION ACTIONS BY PERSONS PERFORMING SERV-
6 ICES UNDER QUALIFIED TAX COLLECTION CON-
7 TRACTS.—

8 (1) IN GENERAL.—Subchapter B of chapter 76
9 (relating to proceedings by taxpayers and third par-
10 ties) is amended by inserting after section 7433 the
11 following new section:

12 **“SEC. 7433A. CIVIL DAMAGES FOR CERTAIN UNAUTHOR-**
13 **IZED COLLECTION ACTIONS BY PERSONS**
14 **PERFORMING SERVICES UNDER QUALIFIED**
15 **TAX COLLECTION CONTRACTS.**

16 “(a) IN GENERAL.—Subject to the modifications pro-
17 vided by subsection (b), section 7433 shall apply to the
18 acts and omissions of any person performing services
19 under a qualified tax collection contract (as defined in sec-
20 tion 6306(b)) to the same extent and in the same manner
21 as if such person were an employee of the Internal Rev-
22 enue Service.

23 “(b) MODIFICATIONS.—For purposes of subsection
24 (a)—

1 “(1) Any civil action brought under section
2 7433 by reason of this section shall be brought
3 against the person who entered into the qualified tax
4 collection contract with the Secretary and shall not
5 be brought against the United States.

6 “(2) Such person and not the United States
7 shall be liable for any damages and costs determined
8 in such civil action.

9 “(3) Such civil action shall not be an exclusive
10 remedy with respect to such person.

11 “(4) Subsections (c), (d)(1), and (e) of section
12 7433 shall not apply.”.

13 (2) CLERICAL AMENDMENT.—The table of sec-
14 tions for subchapter B of chapter 76 is amended by
15 inserting after the item relating to section 7433 the
16 following new item:

“Sec. 7433A. Civil damages for certain unauthorized collection ac-
tions by persons performing services under a quali-
fied tax collection contract.”.

17 (c) APPLICATION OF TAXPAYER ASSISTANCE OR-
18 DERS TO PERSONS PERFORMING SERVICES UNDER A
19 QUALIFIED TAX COLLECTION CONTRACT.—Section 7811
20 (relating to taxpayer assistance orders) is amended by
21 adding at the end the following new subsection:

22 “(g) APPLICATION TO PERSONS PERFORMING SERV-
23 ICES UNDER A QUALIFIED TAX COLLECTION CON-
24 TRACT.—Any order issued or action taken by the National

1 Taxpayer Advocate pursuant to this section shall apply to
2 persons performing services under a qualified tax collec-
3 tion contract (as defined in section 6306(b)) to the same
4 extent and in the same manner as such order or action
5 applies to the Secretary.”.

6 (d) INELIGIBILITY OF INDIVIDUALS WHO COMMIT
7 MISCONDUCT TO PERFORM UNDER CONTRACT.—Section
8 1203 of the Internal Revenue Service Restructuring Act
9 of 1998 (relating to termination of employment for mis-
10 conduct) is amended by adding at the end the following
11 new subsection:

12 “(e) INDIVIDUALS PERFORMING SERVICES UNDER A
13 QUALIFIED TAX COLLECTION CONTRACT.— An individual
14 shall cease to be permitted to perform any services under
15 any qualified tax collection contract (as defined in section
16 6306(b) of the Internal Revenue Code of 1986) if there
17 is a final determination by the Secretary of the Treasury
18 under such contract that such individual committed any
19 act or omission described under subsection (b) in connec-
20 tion with the performance of such services.”.

21 (e) EFFECTIVE DATE.—The amendments made to
22 this section shall take effect on the date of the enactment
23 of this Act.

1 **TITLE IV—TRADE ENHANCE-**
2 **MENT AND COMPLIANCE PRO-**
3 **VISIONS**

4 **SEC. 4001. REPEAL OF EXCLUSION FOR**
5 **EXTRATERRITORIAL INCOME.**

6 (a) IN GENERAL.—Section 114 is hereby repealed.

7 (b) CONFORMING AMENDMENTS.—

8 (1) Subpart E of part III of subchapter N of
9 chapter 1 (relating to qualifying foreign trade in-
10 come) is hereby repealed.

11 (2) The table of subparts for such part III is
12 amended by striking the item relating to subpart E.

13 (3) The table of sections for part III of sub-
14 chapter B of chapter 1 is amended by striking the
15 item relating to section 114.

16 (c) EFFECTIVE DATE.—Except as provided in sub-
17 section (d), the amendments made by this section shall
18 apply to transactions after December 31, 2003.

19 (d) TRANSITIONAL RULE FOR 2004 AND 2005.—

20 (1) IN GENERAL.—In the case of transactions
21 during 2004 and 2005, the amount includible in
22 gross income by reason of the amendments made by
23 this section shall not exceed the applicable percent-
24 age of the amount which would have been so in-
25 cluded but for this subsection.

1 (2) APPLICABLE PERCENTAGE.—For purposes
2 of paragraph (1), the applicable percentage shall be
3 as follows:

4 (A) For 2004, the applicable percentage
5 shall be 35 percent.

6 (B) For 2005, the applicable percentage
7 shall be 65 percent.

8 (e) REVOCATION OF ELECTION TO BE TREATED AS
9 DOMESTIC CORPORATION.—If, during the 1-year period
10 beginning on the date of the enactment of this Act, a cor-
11 poration for which an election is in effect under section
12 943(e) of the Internal Revenue Code of 1986 revokes such
13 election, no gain or loss shall be recognized with respect
14 to property treated as transferred under clause (ii) of sec-
15 tion 943(e)(4)(B) of such Code to the extent such prop-
16 erty—

17 (1) was treated as transferred under clause (i)
18 thereof, or

19 (2) was acquired during a taxable year to which
20 such election applies and before May 1, 2003, in the
21 ordinary course of its trade or business.

22 The Secretary of the Treasury (or such Secretary's dele-
23 gate) may prescribe such regulations as may be necessary
24 to prevent the abuse of the purposes of this subsection.

1 **SEC. 4002. COBRA FEES.**

2 (a) USE OF MERCHANDISE PROCESSING FEE.—Sec-
3 tion 13031(f) of the Consolidated Omnibus Budget Rec-
4 onciliation Act of 1985 (19 U.S.C. 58c(f)) is amended—

5 (1) in paragraph (1), by aligning subparagraph
6 (B) with subparagraph (A); and

7 (2) in paragraph (2), by striking “commercial
8 operations” and all that follows through “proc-
9 essing” and inserting “customs revenue functions as
10 defined in section 415 of the Homeland Security Act
11 of 2002 (other than functions performde by the Of-
12 fice of International Affairs referred to in section
13 415(8) of that Act), and for automation (including
14 the Automation Commercial Environment computer
15 system), and for no other purpose. To the extent
16 that funds in the Customs User Fee Account are in-
17 sufficient to pay the costs of such customs revenue
18 functions, customs duties in an amount equal to the
19 amount of such insufficiency shall be available, to
20 the extent provided for in appropriations Acts, to
21 pay the costs of such customs revenue functions in
22 the amount of such insufficiency, and shall be avail-
23 able for no other purpose. The provisions of the first
24 and second sentences of this paragraph specifying
25 the purposes for which amounts in the Customs
26 User Fee Account may be made available shall not

1 be superseded except by a provision of law which
2 specifically modifies or supersedes such provisions.”.

3 (b) REIMBURSEMENT OF APPROPRIATIONS FROM
4 COBRA FEES.—Section 13031(f)(3) of the Consolidated
5 Omnibus Budget Reconciliation Act of 1985 (19 U.S.C.
6 58c(f)(3)) is amended by adding at the end the following:
7 “(E) Nothing in this paragraph shall be construed
8 to preclude the use of appropriated funds, from sources
9 other than the fees collected under subsection (a), to pay
10 the costs set forth in clauses (i), (ii), and (iii) of subpara-
11 graph (A).”.

12 (c) SENSE OF CONGRESS; EFFECTIVE PERIOD FOR
13 COLLECTING FEES; STANDARD FOR SETTING FEES.—

14 (1) SENSE OF CONGRESS.—The Congress finds
15 that—

16 (A) the fees set forth in paragraphs (1)
17 through (8) of subsection (a) of section 13031
18 of the Consolidated Omnibus Budget Reconcili-
19 ation Act of 1985 have been reasonably related
20 to the costs of providing customs services in
21 connection with the activities or items for which
22 the fees have been charged under such para-
23 graphs; and

24 (B) the fees collected under such para-
25 graphs have not exceeded, in the aggregate, the

1 amounts paid for the costs described in sub-
2 section (f)(3)(A) incurred in providing customs
3 services in connection with the activities or
4 items for which the fees were charged under
5 such paragraphs.

6 (2) EFFECTIVE PERIOD; STANDARD FOR SET-
7 TING FEES.—Section 13031(j)(3) of the Consoli-
8 dated Omnibus Budget Reconciliation Act of 1985 is
9 amended to read as follows:

10 “(3)(A) Fees may not be charged under paragraphs
11 (9) and (10) of subsection (a) after September 30, 2013.

12 “(B)(i) Subject to clause (ii), Fees may not be
13 charged under paragraphs (1) through (8) of subsection
14 (a) after September 30, 2006.

15 “(ii) In fiscal year 2006 and in each succeeding fiscal
16 year for which fees under paragraphs (1) through (8) of
17 subsection (a) are authorized—

18 “(I) the Secretary of the Treasury shall charge
19 fees under each such paragraph in amounts that are
20 reasonably related to the costs of providing customs
21 services in connection with the activity or item for
22 which the fee is charged under such paragraph;

23 “(II) the amount of fees collected under such
24 paragraphs may not exceed, in the aggregate, the
25 amounts paid in that fiscal year for the costs de-

1 scribed in subsection (f)(3)(A) incurred in providing
2 customs services in connection with the activity or
3 item for which the fees are charged under such
4 paragraphs;

5 “(III) a fee may not be collected under any
6 such paragraph except to the extent such fee will be
7 expended to pay the costs described in subsection
8 (f)(3)(A) incurred in providing customs services in
9 connection with the activity or item for which the fee
10 is charged under such paragraph; and

11 “(IV) any fee collected under any such para-
12 graph shall be available for expenditure only to pay
13 the costs described in subsection (f)(3)(A) incurred
14 in providing customs services in connection with the
15 activity or item for which the fee is charged under
16 such paragraph.”.

17 (d) CLERICAL AMENDMENTS.—Section 13031 of the
18 Consolidated Omnibus Budget Reconciliation Act of 1985
19 is amended—

20 (1) in subsection (a)(5)(B), by striking “\$1.75”
21 and inserting “\$1.75.”;

22 (2) in subsection (b)—

23 (A) in paragraph (1)(A), by aligning clause

24 (iii) with clause (ii);

1 (B) in paragraph (7), by striking “para-
2 graphs” and inserting “paragraph”; and

3 (C) in paragraph (9), by aligning subpara-
4 graph (B) with subparagraph (A); and

5 (3) in subsection (e)(2), by aligning subpara-
6 graph (B) with subparagraph (A).

7 (e) STUDY OF ALL FEES COLLECTED BY DEPART-
8 MENT OF HOMELAND SECURITY.—The Secretary of the
9 Treasury shall conduct a study of all the fees collected
10 by the Department of Homeland Security, and shall sub-
11 mit to the Congress, not later than September 30, 2005,
12 a report containing the recommendations of the Secretary
13 on—

14 (1) what fees should be eliminated;

15 (2) what the rate of fees retained should be;

16 and

17 (3) any other recommendations with respect to
18 the fees that the Secretary considers appropriate.

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