

108TH CONGRESS
1ST SESSION

H. R. 3650

To amend the Internal Revenue Code of 1986 to curtail the use of tax shelters, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 25, 2003

Mr. EMANUEL 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 curtail the use of tax shelters, and for other purposes.

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

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

4 (a) **SHORT TITLE.**—This Act may be cited as the
5 “Tax Shelter Transparency and Enforcement Act”.

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

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

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

Sec. 1. Short title; amendment of 1986 Code; table of contents.

TITLE I—PROVISIONS DESIGNED TO CURTAIL TAX SHELTERS

- Sec. 101. Clarification of economic substance doctrine.
- Sec. 102. Penalty for failing to disclose reportable transaction.
- Sec. 103. Accuracy-related penalty for listed transactions and other reportable transactions having a significant tax avoidance purpose.
- Sec. 104. Penalty for understatements attributable to transactions lacking economic substance, etc.
- Sec. 105. Modifications of substantial understatement penalty for nonreportable transactions.
- Sec. 106. Tax shelter exception to confidentiality privileges relating to taxpayer communications.
- Sec. 107. Disclosure of reportable transactions.
- Sec. 108. Modifications to penalty for failure to register tax shelters.
- Sec. 109. Modification of penalty for failure to maintain lists of investors.
- Sec. 110. Modification of actions to enjoin certain conduct related to tax shelters and reportable transactions.
- Sec. 111. Understatement of taxpayer's liability by income tax return preparer.
- Sec. 112. Penalty on failure to report interests in foreign financial accounts.
- Sec. 113. Frivolous tax submissions.
- Sec. 114. Regulation of individuals practicing before the Department of Treasury.
- Sec. 115. Penalty on promoters of tax shelters.
- Sec. 116. Statute of limitations for taxable years for which required listed transactions not reported.
- Sec. 117. Denial of deduction for interest on underpayments attributable to nondisclosed reportable and noneconomic substance transactions.
- Sec. 118. Authorization of appropriations for tax law enforcement.

TITLE II—OTHER CORPORATE GOVERNANCE PROVISIONS

- Sec. 201. Affirmation of consolidated return regulation authority.
- Sec. 202. Signing of corporate tax returns by chief executive officer.
- Sec. 203. Denial of deduction for certain fines, penalties, and other amounts.
- Sec. 204. Disallowance of deduction for punitive damages.
- Sec. 205. Increase in criminal monetary penalty limitation for the underpayment or overpayment of tax due to fraud.

TITLE III—ENRON-RELATED TAX SHELTER PROVISIONS

- Sec. 301. Limitation on transfer or importation of built-in losses.
- Sec. 302. No reduction of basis under section 734 in stock held by partnership in corporate partner.
- Sec. 303. Repeal of special rules for FASITs.
- Sec. 304. Expanded disallowance of deduction for interest on convertible debt.

Sec. 305. Expanded authority to disallow tax benefits under section 269.

Sec. 306. Modification of interaction between subpart F and passive foreign investment company rules.

1 **TITLE I—PROVISIONS DESIGNED**
 2 **TO CURTAIL TAX SHELTERS**

3 **SEC. 101. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**
 4 **TRINE.**

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

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

10 “(1) GENERAL RULES.—

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

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

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

22 “(I) the transaction changes in a
 23 meaningful way (apart from Federal

1 tax effects) the taxpayer's economic
2 position, and

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

8 In applying subclause (II), a purpose of
9 achieving a financial accounting benefit
10 shall not be taken into account in deter-
11 mining whether a transaction has a sub-
12 stantial nontax purpose if the origin of
13 such financial accounting benefit is a re-
14 duction of income tax.

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

20 “(I) the present value of the rea-
21 sonably expected pre-tax profit from
22 the transaction is substantial in rela-
23 tion to the present value of the ex-
24 pected net tax benefits that would be

1 allowed if the transaction were re-
2 spected, and

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

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

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

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

1 sonably expected that at least 50 percent of the
2 offering will be placed with tax-indifferent par-
3 ties.

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

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

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

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

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

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

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

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

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

21 “(I) depreciation,

22 “(II) any tax credit, or

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

1 “(ii) subclause (II) of paragraph
2 (1)(B)(ii) shall be disregarded in deter-
3 mining whether any of such benefits are al-
4 lowable.

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

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

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

20 **SEC. 102. PENALTY FOR FAILING TO DISCLOSE REPORT-**
21 **ABLE TRANSACTION.**

22 (a) IN GENERAL.—Part I of subchapter B of chapter
23 68 (relating to assessable penalties) is amended by insert-
24 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 OR STATEMENT.**

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 graphs (2) and (3), the amount of the penalty under
13 subsection (a) shall be \$50,000.

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

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

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

21 “(i) a large entity, or

22 “(ii) a high net worth individual,
23 the penalty under paragraph (1) or (2) shall be
24 twice the amount determined without regard to
25 this paragraph.

1 “(B) LARGE ENTITY.—For purposes of
2 subparagraph (A), the term ‘large entity’
3 means, with respect to any taxable year, a per-
4 son (other than a natural person) with gross re-
5 ceipts in excess of \$10,000,000 for the taxable
6 year in which the reportable transaction occurs
7 or the preceding taxable year. Rules similar to
8 the rules of paragraph (2) and subparagraphs
9 (B), (C), and (D) of paragraph (3) of section
10 448(c) shall apply for purposes of this subpara-
11 graph.

12 “(C) HIGH NET WORTH INDIVIDUAL.—For
13 purposes of subparagraph (A), the term ‘high
14 net worth individual’ means, with respect to a
15 reportable transaction, a natural person whose
16 net worth exceeds \$2,000,000 immediately be-
17 fore the transaction.

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

19 “(1) REPORTABLE TRANSACTION.—The term
20 ‘reportable transaction’ means any transaction with
21 respect to which information is required to be in-
22 cluded with a return or statement because, as deter-
23 mined under regulations prescribed under section
24 6011, such transaction is of a type which the Sec-

1 retary determines as having a potential for tax
2 avoidance or evasion.

3 “(2) LISTED TRANSACTION.—Except as pro-
4 vided in regulations, the term ‘listed transaction’
5 means a reportable transaction which is the same as,
6 or substantially similar to, a transaction specifically
7 identified by the Secretary as a tax avoidance trans-
8 action for purposes of section 6011.

9 “(d) AUTHORITY TO RESCIND PENALTY.—

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

14 “(A) the violation is with respect to a re-
15 portable transaction other than a listed trans-
16 action,

17 “(B) the person on whom the penalty is
18 imposed has a history of complying with the re-
19 quirements of this title,

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

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

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

4 “(2) DISCRETION.—The exercise of authority
5 under paragraph (1) shall be at the sole discretion
6 of the Commissioner and may be delegated only to
7 the head of the Office of Tax Shelter Analysis. The
8 Commissioner, in the Commissioner’s sole discretion,
9 may establish a procedure to determine if a penalty
10 should be referred to the Commissioner or the head
11 of such Office for a determination under paragraph
12 (1).

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

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

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

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

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

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

6 “(A) a summary of the total number and
7 aggregate amount of penalties imposed, and re-
8 scinded, under this section, and

9 “(B) a description of each penalty re-
10 scinded under this subsection and the reasons
11 therefor.

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

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

19 “(2) which—

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

22 “(B) is required to pay a penalty under
23 section 6662A with respect to any reportable
24 transaction at a rate prescribed under section
25 6662A(c), or

1 “(C) is required to pay a penalty under
2 section 6662B with respect to any noneconomic
3 substance transaction,
4 the requirement to pay such penalty shall be disclosed in
5 such reports filed by such person for such periods as the
6 Secretary shall specify. Failure to make a disclosure in
7 accordance with the preceding sentence shall be treated
8 as a failure to which the penalty under subsection (b)(2)
9 applies.

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

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

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

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

1 **SEC. 103. ACCURACY-RELATED PENALTY FOR LISTED**
2 **TRANSACTIONS AND OTHER REPORTABLE**
3 **TRANSACTIONS HAVING A SIGNIFICANT TAX**
4 **AVOIDANCE PURPOSE.**

5 (a) IN GENERAL.—Subchapter A of chapter 68 is
6 amended by inserting after section 6662 the following new
7 section:

8 **“SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PEN-**
9 **ALTY ON UNDERSTATEMENTS WITH RESPECT**
10 **TO REPORTABLE TRANSACTIONS.**

11 “(a) IMPOSITION OF PENALTY.—If a taxpayer has a
12 reportable transaction understatement for any taxable
13 year, there shall be added to the tax an amount equal to
14 20 percent of the amount of such understatement.

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

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

19 “(A) the product of—

20 “(i) the amount of the increase (if
21 any) in taxable income which results from
22 a difference between the proper tax treat-
23 ment of an item to which this section ap-
24 plies and the taxpayer’s treatment of such
25 item (as shown on the taxpayer’s return of
26 tax), and

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

4 “(B) the amount of the decrease (if any)
5 in the aggregate amount of credits determined
6 under subtitle A which results from a difference
7 between the taxpayer’s treatment of an item to
8 which this section applies (as shown on the tax-
9 payer’s return of tax) and the proper tax treat-
10 ment of such item.

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

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

20 “(A) any listed transaction, and

21 “(B) any reportable transaction (other
22 than a listed transaction) if a significant pur-
23 pose of such transaction is the avoidance or
24 evasion of Federal income tax.

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

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

8 “(2) RULES APPLICABLE TO ASSERTION AND
9 COMPROMISE OF PENALTY.—

10 “(A) IN GENERAL.—Only upon the ap-
11 proval by the Chief Counsel for the Internal
12 Revenue Service or the Chief Counsel’s delegate
13 at the national office of the Internal Revenue
14 Service may a penalty to which paragraph (1)
15 applies be included in a 1st letter of proposed
16 deficiency which allows the taxpayer an oppor-
17 tunity for administrative review in the Internal
18 Revenue Service Office of Appeals. If such a
19 letter is provided to the taxpayer, only the Com-
20 missioner of Internal Revenue may compromise
21 all or any portion of such penalty.

22 “(B) APPLICABLE RULES.—The rules of
23 paragraphs (2), (3), (4), and (5) of section
24 6707A(d) shall apply for purposes of subpara-
25 graph (A).

1 “(d) DEFINITIONS OF REPORTABLE AND LISTED
2 TRANSACTIONS.—For purposes of this section, the terms
3 ‘reportable transaction’ and ‘listed transaction’ have the
4 respective meanings given to such terms by section
5 6707A(c).

6 “(e) SPECIAL RULES.—

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

10 “(A) the amount of such understatement
11 (determined without regard to this paragraph)
12 shall be increased by the aggregate amount of
13 reportable transaction understatements and
14 noneconomic substance transaction understate-
15 ments for purposes of determining whether
16 such understatement is a substantial under-
17 statement under section 6662(d)(1), and

18 “(B) the addition to tax under section
19 6662(a) shall apply only to the excess of the
20 amount of the substantial understatement (if
21 any) after the application of subparagraph (A)
22 over the aggregate amount of reportable trans-
23 action understatements and noneconomic sub-
24 stance transaction understatements.

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

3 “(A) APPLICATION OF FRAUD PENALTY.—

4 References to an underpayment in section 6663
5 shall be treated as including references to a re-
6 portable transaction understatement and a non-
7 economic substance transaction understatement.

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

12 “(3) SPECIAL RULE FOR AMENDED RE-
13 TURNS.—Except as provided in regulations, in no
14 event shall any tax treatment included with an
15 amendment or supplement to a return of tax be
16 taken into account in determining the amount of any
17 reportable transaction understatement or non-
18 economic substance transaction understatement if
19 the amendment or supplement is filed after the ear-
20 lier of the date the taxpayer is first contacted by the
21 Secretary regarding the examination of the return or
22 such other date as is specified by the Secretary.

23 “(4) NONECONOMIC SUBSTANCE TRANS-
24 ACTION UNDERSTATEMENT.—For purposes of
25 this subsection, the term ‘noneconomic sub-

1 stance transaction understatement’ has the
2 meaning given such term by section 6662B(c).

3 “(5) CROSS REFERENCE.—

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

4 (b) DETERMINATION OF OTHER UNDERSTATE-
5 MENTS.—Subparagraph (A) of section 6662(d)(2) is
6 amended by adding at the end the following flush sen-
7 tence:

8 “The excess under the preceding sentence shall
9 be determined without regard to items to which
10 section 6662A applies and without regard to
11 items with respect to which a penalty is im-
12 posed by section 6662B.”.

13 (c) REASONABLE CAUSE EXCEPTION.—

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

16 “(d) REASONABLE CAUSE EXCEPTION FOR REPORT-
17 ABLE TRANSACTION UNDERSTATEMENTS.—

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

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

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

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

10 “(C) the taxpayer reasonably believed that
11 such treatment was more likely than not the
12 proper treatment.

13 A taxpayer failing to adequately disclose in accord-
14 ance with section 6011 shall be treated as meeting
15 the requirements of subparagraph (A) if the penalty
16 for such failure was rescinded under section
17 6707A(d).

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

20 “(A) IN GENERAL.—A taxpayer shall be
21 treated as having a reasonable belief with re-
22 spect to the tax treatment of an item only if
23 such belief—

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

4 “(ii) relates solely to the taxpayer’s
5 chances of success on the merits of such
6 treatment and does not take into account
7 the possibility that a return will not be au-
8 dited, such treatment will not be raised on
9 audit, or such treatment will be resolved
10 through settlement if it is raised.

11 “(B) CERTAIN OPINIONS MAY NOT BE RE-
12 LIED UPON.—

13 “(i) IN GENERAL.—An opinion of a
14 tax advisor may not be relied upon to es-
15 tablish the reasonable belief of a taxpayer
16 if—

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

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

21 “(ii) DISQUALIFIED TAX ADVISORS.—
22 A tax advisor is described in this clause if
23 the tax advisor—

24 “(I) is a material advisor (within
25 the meaning of section 6111(b)(1))

1 who participates in the organization,
2 management, promotion, or sale of
3 the transaction or who is related
4 (within the meaning of section 267(b)
5 or 707(b)(1)) to any person who so
6 participates,

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

10 “(III) has a fee arrangement
11 with respect to the transaction which
12 is contingent on all or part of the in-
13 tended tax benefits from the trans-
14 action being sustained, or

15 “(IV) as determined under regu-
16 lations prescribed by the Secretary,
17 has a disqualifying financial interest
18 with respect to the transaction.

19 “(iii) DISQUALIFIED OPINIONS.—For
20 purposes of clause (i), an opinion is dis-
21 qualified if the opinion—

22 “(I) is based on unreasonable
23 factual or legal assumptions (includ-
24 ing assumptions as to future events),

1 “(II) unreasonably relies on rep-
2 resentations, statements, findings, or
3 agreements of the taxpayer or any
4 other person,

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

7 “(IV) fails to meet any other re-
8 quirement as the Secretary may pre-
9 scribe.”.

10 (2) CONFORMING AMENDMENT.—The heading
11 for subsection (c) of section 6664 is amended by in-
12 serting “FOR UNDERPAYMENTS” after “EXCEP-
13 TION”.

14 (d) CONFORMING AMENDMENTS.—

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

18 (2) Paragraph (3) of section 1274(b) is amend-
19 ed—

20 (A) by striking “(as defined in section
21 6662(d)(2)(C)(iii))” in subparagraph (B)(i),
22 and

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

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

3 “(i) a partnership or other entity,

4 “(ii) any investment plan or arrange-
5 ment, or

6 “(iii) any other plan or arrangement,
7 if a significant purpose of such partnership, en-
8 tity, plan, or arrangement is the avoidance or
9 evasion of Federal income tax.”.

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

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

14 (5) Subsection (b) of section 7525 is amended
15 by striking “section 6662(d)(2)(C)(iii)” and insert-
16 ing “section 1274(b)(3)(C)”.

17 (6)(A) The heading for section 6662 is amend-
18 ed to read as follows:

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

21 (B) The table of sections for part II of sub-
22 chapter A of chapter 68 is amended by striking the
23 item relating to section 6662 and inserting the fol-
24 lowing new items:

 “Sec. 6662. Imposition of accuracy-related penalty on underpay-
 ments.

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

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

4 **SEC. 104. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
5 **UTABLE TO TRANSACTIONS LACKING ECO-**
6 **NOMIC SUBSTANCE, ETC.**

7 (a) IN GENERAL.—Subchapter A of chapter 68 is
8 amended by inserting after section 6662A the following
9 new section:

10 **“SEC. 6662B. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
11 **UTABLE TO TRANSACTIONS LACKING ECO-**
12 **NOMIC SUBSTANCE, ETC.**

13 “(a) IMPOSITION OF PENALTY.—If a taxpayer has an
14 noneconomic substance transaction understatement for
15 any taxable year, there shall be added to the tax an
16 amount equal to 40 percent of the amount of such under-
17 statement.

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

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

3 “(1) IN GENERAL.—The term ‘noneconomic
4 substance transaction understatement’ means any
5 amount which would be an understatement under
6 section 6662A(b)(1) if section 6662A were applied
7 by taking into account items attributable to non-
8 economic substance transactions rather than items
9 to which section 6662A would apply without regard
10 to this paragraph.

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

14 “(A) there is a lack of economic substance
15 (within the meaning of section 7701(n)(1)) for
16 the transaction giving rise to the claimed ben-
17 efit or the transaction was not respected under
18 section 7701(n)(2), or

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

21 “(d) RULES APPLICABLE TO COMPROMISE OF PEN-
22 ALTY.—

23 “(1) IN GENERAL.—If the 1st letter of pro-
24 posed deficiency which allows the taxpayer an oppor-
25 tunity for administrative review in the Internal Rev-

1 enue Service Office of Appeals has been sent with
 2 respect to a penalty to which this section applies,
 3 only the Commissioner of Internal Revenue may
 4 compromise all or any portion of such penalty.

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

8 “(e) COORDINATION WITH OTHER PENALTIES.—Ex-
 9 cept as otherwise provided in this part, the penalty im-
 10 posed by this section shall be in addition to any other pen-
 11 alty imposed by this title.

12 “(f) CROSS REFERENCES.—

**“(1) For coordination of penalty with understatement-
 statements under section 6662 and other special rules,
 see section 6662A(e).**

**“(2) For reporting of penalty imposed under this
 section to the Securities and Exchange Commission,
 see section 6707A(e).”.**

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

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

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

1 **SEC. 105. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-**
2 **MENT PENALTY FOR NONREPORTABLE**
3 **TRANSACTIONS.**

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

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

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

17 “(ii) \$10,000,000.”

18 (b) REDUCTION FOR UNDERSTATEMENT OF TAX-
19 PAYER DUE TO POSITION OF TAXPAYER OR DISCLOSED
20 ITEM.—

21 (1) IN GENERAL.—Section 6662(d)(2)(B)(i)
22 (relating to substantial authority) is amended to
23 read as follows:

24 “(i) the tax treatment of any item by
25 the taxpayer if the taxpayer had reason-

1 able belief that the tax treatment was more
2 likely than not the proper treatment, or”.

3 (2) CONFORMING AMENDMENT.—Section
4 6662(d) is amended by adding at the end the fol-
5 lowing new paragraph:

6 “(3) SECRETARIAL LIST.—For purposes of this
7 subsection, section 6664(d)(2), and section
8 6694(a)(1), the Secretary may prescribe a list of po-
9 sitions for which the Secretary believes there is not
10 substantial authority or there is no reasonable belief
11 that the tax treatment is more likely than not the
12 proper tax treatment. Such list (and any revisions
13 thereof) shall be published in the Federal Register
14 or the Internal Revenue Bulletin.”.

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

18 **SEC. 106. TAX SHELTER EXCEPTION TO CONFIDENTIALITY**
19 **PRIVILEGES RELATING TO TAXPAYER COM-**
20 **MUNICATIONS.**

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

24 “(b) SECTION NOT TO APPLY TO COMMUNICATIONS
25 REGARDING TAX SHELTERS.—The privilege under sub-

1 section (a) shall not apply to any written communication
2 which is—

3 “(1) between a federally authorized tax practi-
4 tioner and—

5 “(A) any person,

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

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

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

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

16 **SEC. 107. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

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

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

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

24 “(1) information identifying and describing the
25 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 for such aid, assistance, or advice.

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

21 “(i) \$50,000 in the case of a report-
22 able transaction substantially all of the tax
23 benefits from which are provided to nat-
24 ural persons, and

25 “(ii) \$250,000 in any other case.

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

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

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

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

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

14 (b) CONFORMING AMENDMENTS.—

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

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

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

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

22 “(a) IN GENERAL.—Each material advisor (as de-
23 fined in section 6111) with respect to any reportable
24 transaction (as defined in section 6707A(e)) shall main-

tain, in such manner as the Secretary may by regulations prescribe, a list—

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

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

This section shall apply without regard to whether a material advisor is required to file a return under section 6111 with respect to such transaction.”.

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

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

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

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

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

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

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

1 **“SEC. 6708. FAILURE TO MAINTAIN LISTS OF ADVISEES**
2 **WITH RESPECT TO REPORTABLE TRANS-**
3 **ACTIONS.”.**

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

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

7 (c) **REQUIRED DISCLOSURE NOT SUBJECT TO CLAIM**
8 **OF CONFIDENTIALITY.**—Subparagraph (A) of section
9 6112(b)(1), as redesignated by subsection (b)(2)(B), is
10 amended by adding at the end the following new flush sen-
11 tence:

12 “For purposes of this section, the identity of any
13 person on such list shall not be privileged.”.

14 (d) **EFFECTIVE DATE.**—

15 (1) **IN GENERAL.**—Except as provided in para-
16 graph (2), the amendments made by this section
17 shall apply to transactions with respect to which ma-
18 terial aid, assistance, or advice referred to in section
19 6111(b)(1)(A)(i) of the Internal Revenue Code of
20 1986 (as added by this section) is provided after the
21 date of the enactment of this Act.

22 (2) **NO CLAIM OF CONFIDENTIALITY AGAINST**
23 **DISCLOSURE.**—The amendment made by subsection
24 (c) shall take effect as if included in the amend-

1 ments made by section 142 of the Deficit Reduction
2 Act of 1984.

3 **SEC. 108. MODIFICATIONS TO PENALTY FOR FAILURE TO**
4 **REGISTER TAX SHELTERS.**

5 (a) IN GENERAL.—Section 6707 (relating to failure
6 to furnish information regarding tax shelters) is amended
7 to read as follows:

8 **“SEC. 6707. FAILURE TO FURNISH INFORMATION REGARD-**
9 **ING REPORTABLE TRANSACTIONS.**

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

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

15 “(2) files false or incomplete information with
16 the Secretary with respect to such transaction,
17 such person shall pay a penalty with respect to such return
18 in the amount determined under subsection (b).

19 “(b) AMOUNT OF PENALTY.—

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

23 “(2) LISTED TRANSACTIONS.—The penalty im-
24 posed under subsection (a) with respect to any listed

1 transaction shall be an amount equal to the greater
2 of—

3 “(A) \$200,000, or

4 “(B) 50 percent of the gross income de-
5 rived by such person with respect to aid, assist-
6 ance, or advice which is provided with respect
7 to the listed transaction before the date the re-
8 turn including the transaction is filed under
9 section 6111.

10 Subparagraph (B) shall be applied by substituting
11 ‘75 percent’ for ‘50 percent’ in the case of an inten-
12 tional failure or act described in subsection (a).

13 “(c) CERTAIN RULES TO APPLY.—The provisions of
14 section 6707A(d) shall apply to any penalty imposed under
15 this section.

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

20 (b) CLERICAL AMENDMENT.—The item relating to
21 section 6707 in the table of sections for part I of sub-
22 chapter B of chapter 68 is amended by striking “tax shel-
23 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. 109. 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
13 6112(b)(1)(A) within 20 business days after the
14 date of the Secretary’s request, such person shall
15 pay a penalty of \$10,000 for each day of such fail-
16 ure after such 20th day.

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

21 (b) EFFECTIVE DATE.—The amendment made by
22 this section shall apply to requests made after the date
23 of the enactment of this Act.

1 **SEC. 110. MODIFICATION OF ACTIONS TO ENJOIN CERTAIN**
2 **CONDUCT RELATED TO TAX SHELTERS AND**
3 **REPORTABLE TRANSACTIONS.**

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

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

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

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

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

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

4 “(c) SPECIFIED CONDUCT.—For purposes of this
5 section, the term ‘specified conduct’ means any action, or
6 failure to take action, subject to penalty under section
7 6700, 6701, 6707, or 6708.”.

8 (b) CONFORMING AMENDMENTS.—

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

11 **“SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RE-**
12 **LATED TO TAX SHELTERS AND REPORTABLE**
13 **TRANSACTIONS.”.**

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

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

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

1 **SEC. 111. UNDERSTATEMENT OF TAXPAYER'S LIABILITY BY**
2 **INCOME TAX RETURN PREPARER.**

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

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

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

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

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

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

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

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

1 **SEC. 112. PENALTY ON FAILURE TO REPORT INTERESTS IN**
2 **FOREIGN FINANCIAL ACCOUNTS.**

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

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

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

12 “(B) AMOUNT OF PENALTY.—

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

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

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

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

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

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

8 “(I) \$25,000, or

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

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

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

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

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

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

4 **SEC. 113. FRIVOLOUS TAX SUBMISSIONS.**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 “(ii) an application under—

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

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

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

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

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

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

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

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

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

8 (1) FRIVOLOUS REQUESTS DISREGARDED.—

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

12 “(g) FRIVOLOUS REQUESTS FOR HEARING, ETC.—

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

20 (2) PRECLUSION FROM RAISING FRIVOLOUS

21 ISSUES AT HEARING.—Section 6330(c)(4) is amend-
22 ed—

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

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

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

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

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

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

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

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

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

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

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

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

“Sec. 6702. Frivolous tax submissions.”.

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

19 **SEC. 114. REGULATION OF INDIVIDUALS PRACTICING BE-**
 20 **FORE THE DEPARTMENT OF TREASURY.**

21 (a) CENSURE; IMPOSITION OF PENALTY.—

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

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

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

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

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

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

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

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

3 **SEC. 115. PENALTY ON PROMOTERS OF TAX SHELTERS.**

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

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

16 **SEC. 116. STATUTE OF LIMITATIONS FOR TAXABLE YEARS**
17 **FOR WHICH REQUIRED LISTED TRANS-**
18 **ACTIONS NOT REPORTED.**

19 (a) IN GENERAL.—Section 6501(c) (relating to ex-
20 ceptions) is amended by adding at the end the following
21 new paragraph:

22 “(10) LISTED TRANSACTIONS.—If a taxpayer
23 fails to include on any return or statement for any
24 taxable year any information with respect to a listed
25 transaction (as defined in section 6707A(c)(2))

1 which is required under section 6011 to be included
2 with such return or statement, the time for assess-
3 ment of any tax imposed by this title with respect
4 to such transaction shall not expire before the date
5 which is 1 year after the earlier of—

6 “(A) the date on which the Secretary is
7 furnished the information so required; or

8 “(B) the date that a material advisor (as
9 defined in section 6111) meets the requirements
10 of section 6112 with respect to a request by the
11 Secretary under section 6112(b) relating to
12 such transaction with respect to such tax-
13 payer.”.

14 (b) EFFECTIVE DATE.—The amendment made by
15 this section shall apply to taxable years with respect to
16 which the period for assessing a deficiency did not expire
17 before the date of the enactment of this Act.

18 **SEC. 117. DENIAL OF DEDUCTION FOR INTEREST ON UN-**
19 **DERPAYMENTS ATTRIBUTABLE TO NONDIS-**
20 **CLOSED REPORTABLE AND NONECONOMIC**
21 **SUBSTANCE TRANSACTIONS.**

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

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

7 “(1) the portion of any reportable transaction
8 understatement (as defined in section 6662A(b))
9 with respect to which the requirement of section
10 6664(d)(2)(A) is not met, or

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

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

16 **SEC. 118. AUTHORIZATION OF APPROPRIATIONS FOR TAX**
17 **LAW ENFORCEMENT.**

18 There is authorized to be appropriated \$300,000,000
19 for each fiscal year beginning after September 30, 2003,
20 for the purpose of carrying out tax law enforcement to
21 combat tax avoidance transactions and other tax shelters,
22 including the use of offshore financial accounts to conceal
23 taxable income.

1 **TITLE II—OTHER CORPORATE**
2 **GOVERNANCE PROVISIONS**

3 **SEC. 201. AFFIRMATION OF CONSOLIDATED RETURN REGU-**
4 **LATION AUTHORITY.**

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

12 (b) RESULT NOT OVERTURNED.—Notwithstanding
13 subsection (a), the Internal Revenue Code of 1986 shall
14 be construed by treating Treasury regulation § 1.1502–
15 20(c)(1)(iii) (as in effect on January 1, 2001) as being
16 inapplicable to the type of factual situation in 255 F.3d
17 1357 (Fed. Cir. 2001).

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

21 **SEC. 202. SIGNING OF CORPORATE TAX RETURNS BY CHIEF**
22 **EXECUTIVE OFFICER.**

23 (a) IN GENERAL.—Section 6062 (relating to signing
24 of corporation returns) is amended by inserting after the
25 first sentence the following new sentences: “The return

1 of a corporation with respect to income shall also include
2 a declaration signed by the chief executive officer of such
3 corporation (or other such officer of the corporation as
4 the Secretary may designate if the corporation does not
5 have a chief executive officer), under penalties of perjury,
6 that the chief executive officer ensures that such return
7 complies with this title and that the chief executive officer
8 was provided reasonable assurance of the accuracy of all
9 material aspects of such return. The preceding sentence
10 shall not apply to any return of a regulated investment
11 company (within the meaning of section 851).”.

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

15 **SEC. 203. DENIAL OF DEDUCTION FOR CERTAIN FINES,**
16 **PENALTIES, AND OTHER AMOUNTS.**

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

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

21 “(1) IN GENERAL.—Except as provided in para-
22 graph (2), no deduction otherwise allowable shall be
23 allowed under this chapter for any amount paid or
24 incurred (whether by suit, agreement, or otherwise)
25 to, or at the direction of, a government or entity de-

1 scribed in paragraph (4) in relation to the violation
2 of any law or the investigation or inquiry by such
3 government or entity into the potential violation of
4 any law.

5 “(2) EXCEPTION FOR AMOUNTS CONSTITUTING
6 RESTITUTION.—Paragraph (1) shall not apply to
7 any amount which the taxpayer establishes con-
8 stitutes restitution for damage or harm caused by
9 the violation of any law or the potential violation of
10 any law. This paragraph shall not apply to any
11 amount paid or incurred as reimbursement to the
12 government or entity for the costs of any investiga-
13 tion or litigation.

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

20 “(4) CERTAIN NONGOVERNMENTAL REGU-
21 LATORY ENTITIES.—An entity is described in this
22 paragraph if it is—

23 “(A) a nongovernmental entity which exer-
24 cises self-regulatory powers (including imposing
25 sanctions) in connection with a qualified board

1 or exchange (as defined in section 1256(g)(7)),
2 or

3 “(B) to the extent provided in regulations,
4 a nongovernmental entity which exercises self-
5 regulatory powers (including imposing sanc-
6 tions) as part of performing an essential gov-
7 ernmental function.”.

8 (b) EFFECTIVE DATE.—The amendment made by
9 this section shall apply to amounts paid or incurred after
10 April 27, 2003, except that such amendment shall not
11 apply to amounts paid or incurred under any binding
12 order or agreement entered into on or before April 27,
13 2003. Such exception shall not apply to an order or agree-
14 ment requiring court approval unless the approval was ob-
15 tained on or before April 27, 2003.

16 **SEC. 204. DISALLOWANCE OF DEDUCTION FOR PUNITIVE**
17 **DAMAGES.**

18 (a) DISALLOWANCE OF DEDUCTION.—

19 (1) IN GENERAL.—Section 162(g) (relating to
20 treble damage payments under the antitrust laws) is
21 amended by adding at the end the following new
22 paragraph:

23 “(2) PUNITIVE DAMAGES.—No deduction shall
24 be allowed under this chapter for any amount paid
25 or incurred for punitive damages in connection with

1 any judgment in, or settlement of, any action. This
2 paragraph shall not apply to punitive damages de-
3 scribed in section 104(c).”.

4 (2) CONFORMING AMENDMENTS.—

5 (A) Section 162(g) is amended—

6 (i) by striking “If” and inserting:

7 “(1) TREBLE DAMAGES.—If”, and

8 (ii) by redesignating paragraphs (1)

9 and (2) as subparagraphs (A) and (B), re-

10 spectively.

11 (B) The heading for section 162(g) is

12 amended by inserting “OR PUNITIVE DAM-

13 AGES” after “LAWS”.

14 (b) INCLUSION IN INCOME OF PUNITIVE DAMAGES

15 PAID BY INSURER OR OTHERWISE.—

16 (1) IN GENERAL.—Part II of subchapter B of

17 chapter 1 (relating to items specifically included in

18 gross income) is amended by adding at the end the

19 following new section:

20 **“SEC. 91. PUNITIVE DAMAGES COMPENSATED BY INSUR-**

21 **ANCE OR OTHERWISE.**

22 “Gross income shall include any amount paid to or

23 on behalf of a taxpayer as insurance or otherwise by rea-

24 son of the taxpayer’s liability (or agreement) to pay puni-

25 tive damages.”.

1 “(b) INCREASE IN MONETARY LIMITATION FOR UN-
2 DERPAYMENT OR OVERPAYMENT OF TAX DUE TO
3 FRAUD.—If any portion of any underpayment (as defined
4 in section 6664(a)) or overpayment (as defined in section
5 6401(a)) of tax required to be shown on a return is attrib-
6 utable to fraudulent action described in subsection (a), the
7 applicable dollar amount under subsection (a) shall in no
8 event be less than an amount equal to such portion. A
9 rule similar to the rule under section 6663(b) shall apply
10 for purposes of determining the portion so attributable.”.

11 (b) INCREASE IN PENALTIES.—

12 (1) ATTEMPT TO EVADE OR DEFEAT TAX.—

13 Section 7201 is amended—

14 (A) by striking “\$100,000” and inserting
15 “\$250,000”,

16 (B) by striking “\$500,000” and inserting
17 “\$1,000,000”, and

18 (C) by striking “5 years” and inserting
19 “10 years”.

20 (2) WILLFUL FAILURE TO FILE RETURN, SUP-
21 PLY INFORMATION, OR PAY TAX.—Section 7203 is
22 amended—

23 (A) in the first sentence—

24 (i) by striking “misdemeanor” and in-
25 serting “felony”, and

1 (ii) by striking “1 year” and inserting
2 “10 years”, and
3 (B) by striking the third sentence.

4 (3) FRAUD AND FALSE STATEMENTS.—Section
5 7206(a) (as redesignated by subsection (a)) is
6 amended—

7 (A) by striking “\$100,000” and inserting
8 “\$250,000”,

9 (B) by striking “\$500,000” and inserting
10 “\$1,000,000”, and

11 (C) by striking “3 years” and inserting “5
12 years”.

13 (c) EFFECTIVE DATE.—The amendments made by
14 this section shall apply to underpayments and overpay-
15 ments attributable to actions occurring after the date of
16 the enactment of this Act.

17 **TITLE III—ENRON-RELATED TAX**
18 **SHELTER PROVISIONS**

19 **SEC. 301. LIMITATION ON TRANSFER OR IMPORTATION OF**
20 **BUILT-IN LOSSES.**

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

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

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

3 “(A) IN GENERAL.—If in any transaction
4 described in subsection (a) or (b) there would
5 (but for this subsection) be an importation of a
6 net built-in loss, the basis of each property de-
7 scribed in subparagraph (B) which is acquired
8 in such transaction shall (notwithstanding sub-
9 sections (a) and (b)) be its fair market value
10 immediately after such transaction.

11 “(B) PROPERTY DESCRIBED.—For pur-
12 poses of subparagraph (A), property is de-
13 scribed in this subparagraph if—

14 “(i) gain or loss with respect to such
15 property is not subject to tax under this
16 subtitle in the hands of the transferor im-
17 mediately before the transfer, and

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

22 In any case in which the transferor is a part-
23 nership, the preceding sentence shall be applied
24 by treating each partner in such partnership as

1 holding such partner's proportionate share of
2 the property of such partnership.

3 “(C) IMPORTATION OF NET BUILT-IN
4 LOSS.—For purposes of subparagraph (A),
5 there is an importation of a net built-in loss in
6 a transaction if the transferee's aggregate ad-
7 justed bases of property described in subpara-
8 graph (B) which is transferred in such trans-
9 action would (but for this paragraph) exceed
10 the fair market value of such property imme-
11 diately after such transaction.”

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

14 “(A) IN GENERAL.—If—

15 “(i) property is transferred by a
16 transferor in any transaction which is de-
17 scribed in subsection (a) and which is not
18 described in paragraph (1) of this sub-
19 section, and

20 “(ii) the transferee's aggregate ad-
21 justed bases of such property so trans-
22 ferred would (but for this paragraph) ex-
23 ceed the fair market value of such property
24 immediately after such transaction,

1 then, notwithstanding subsection (a), the trans-
2 feree's aggregate adjusted bases of the property
3 so transferred shall not exceed the fair market
4 value of such property immediately after such
5 transaction.

6 “(B) ALLOCATION OF BASIS REDUC-
7 TION.—The aggregate reduction in basis by
8 reason of subparagraph (A) shall be allocated
9 among the property so transferred in proportion
10 to their respective built-in losses immediately
11 before the transaction.

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

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

1 “(1) IN GENERAL.—If property is received by a
2 corporate distributee in a distribution in a complete
3 liquidation to which section 332 applies (or in a
4 transfer described in section 337(b)(1)), the basis of
5 such property in the hands of such distributee shall
6 be the same as it would be in the hands of the trans-
7 feror; except that the basis of such property in the
8 hands of such distributee shall be the fair market
9 value of the property at the time of the distribu-
10 tion—

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

14 “(B) in any case in which the liquidating
15 corporation is a foreign corporation, the cor-
16 porate distributee is a domestic corporation,
17 and the corporate distributee’s aggregate ad-
18 justed bases of property described in section
19 362(e)(1)(B) which is distributed in such liq-
20 uidation would (but for this subparagraph) ex-
21 ceed the fair market value of such property im-
22 mediately after such liquidation.”.

23 (c) EFFECTIVE DATE.—The amendments made by
24 this section shall apply to transactions after February 13,
25 2003.

1 **SEC. 302. NO REDUCTION OF BASIS UNDER SECTION 734 IN**
2 **STOCK HELD BY PARTNERSHIP IN COR-**
3 **PORATE PARTNER.**

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

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

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

15 “(2) any amount not allocable to stock by rea-
16 son of paragraph (1) shall be allocated under sub-
17 section (a) to other partnership property in such
18 manner as the Secretary may prescribe.

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

24 (b) EFFECTIVE DATE.—The amendment made by
25 this section shall apply to distributions after February 13,
26 2003.

1 **SEC. 303. REPEAL OF SPECIAL RULES FOR FASITS.**

2 (a) IN GENERAL.—Part V of subchapter M of chap-
3 ter 1 (relating to financial asset securitization investment
4 trusts) is hereby repealed.

5 (b) CONFORMING AMENDMENTS.—

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

9 (2) Clause (ii) of section 382(l)(4)(B) is amend-
10 ed by striking “a REMIC to which part IV of sub-
11 chapter M applies, or a FASIT to which part V of
12 subchapter M applies,” and inserting “or a REMIC
13 to which part IV of subchapter M applies,”.

14 (3) Paragraph (1) of section 582(e) is amended
15 by striking “, and any regular interest in a
16 FASIT,”.

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

19 (5)(A) Section 860G(a)(1) is amended by add-
20 ing at the end the following new sentence: “An inter-
21 est shall not fail to qualify as a regular interest sole-
22 ly because the specified principal amount of the reg-
23 ular interest (or the amount of interest accrued on
24 the regular interest) can be reduced as a result of
25 the nonoccurrence of 1 or more contingent payments
26 with respect to any reverse mortgage loan held by

1 the REMIC if, on the startup day for the REMIC,
2 the sponsor reasonably believes that all principal and
3 interest due under the regular interest will be paid
4 at or prior to the liquidation of the REMIC.”.

5 (B) The last sentence of section 860G(a)(3) is
6 amended by inserting “, and any reverse mortgage
7 loan (and each balance increase on such loan meet-
8 ing the requirements of subparagraph (A)(iii)) shall
9 be treated as an obligation secured by an interest in
10 real property” before the period at the end.

11 (6) Paragraph (3) of section 860G(a) is amend-
12 ed by adding “and” at the end of subparagraph (B),
13 by striking “, and” at the end of subparagraph (C)
14 and inserting a period, and by striking subparagraph
15 (D).

16 (7) Section 860G(a)(3), as amended by para-
17 graph (6), is amended by adding at the end the fol-
18 lowing new sentence: “For purposes of subparagraph
19 (A), if more than 50 percent of the obligations
20 transferred to, or purchased by, the REMIC are
21 originated by the United States or any State (or any
22 political subdivision, agency, or instrumentality of
23 the United States or any State) and are principally
24 secured by an interest in real property, then each
25 obligation transferred to, or purchased by, the

1 REMIC shall be treated as secured by an interest in
2 real property.”.

3 (8)(A) Section 860G(a)(3)(A) is amended by
4 striking “or” at the end of clause (i), by inserting
5 “or” at the end of clause (ii), and by inserting after
6 clause (ii) the following new clause:

7 “(iii) represents an increase in the
8 principal amount under the original terms
9 of an obligation described in clause (i) or
10 (ii) if such increase—

11 “(I) is attributable to an advance
12 made to the obligor pursuant to the
13 original terms of the obligation,

14 “(II) occurs after the startup
15 day, and

16 “(III) is purchased by the
17 REMIC pursuant to a fixed price con-
18 tract in effect on the startup day.”.

19 (B) Section 860G(a)(7)(B) is amended to read
20 as follows:

21 “(B) QUALIFIED RESERVE FUND.—For
22 purposes of subparagraph (A), the term ‘quali-
23 fied reserve fund’ means any reasonably re-
24 quired reserve to—

1 “(i) provide for full payment of ex-
2 penses of the REMIC or amounts due on
3 regular interests in the event of defaults on
4 qualified mortgages or lower than expected
5 returns on cash flow investments, or

6 “(ii) provide a source of funds for the
7 purchase of obligations described in clause
8 (ii) or (iii) of paragraph (3)(A).

9 The aggregate fair market value of the assets
10 held in any such reserve shall not exceed 50
11 percent of the aggregate fair market value of all
12 of the assets of the REMIC on the startup day,
13 and the amount of any such reserve shall be
14 promptly and appropriately reduced to the ex-
15 tent the amount held in such reserve is no
16 longer reasonably required for purposes speci-
17 fied in clause (i) or (ii) of paragraph (3)(A).”.

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

21 (10) Section 1272(a)(6)(B) is amended by add-
22 ing at the end the following new flush sentence:

23 “For purposes of clause (iii), the Secretary
24 shall prescribe regulations permitting the use of
25 a current prepayment assumption, determined

1 as of the close of the accrual period (or such
2 other time as the Secretary may prescribe dur-
3 ing the taxable year in which the accrual period
4 ends).”.

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

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

12 (c) EFFECTIVE DATE.—

13 (1) IN GENERAL.—Except as provided in para-
14 graph (2), the amendments made by this section
15 shall take effect on February 14, 2003.

16 (2) EXCEPTION FOR EXISTING FASITS.—

17 (A) IN GENERAL.—Paragraph (1) shall not
18 apply to any FASIT in existence on the date of
19 the enactment of this Act to the extent that
20 regular interests issued by the FASIT before
21 such date continue to remain outstanding in ac-
22 cordance with the original terms of issuance.

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

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

5 **SEC. 304. EXPANDED DISALLOWANCE OF DEDUCTION FOR**
6 **INTEREST ON CONVERTIBLE DEBT.**

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

11 (b) CAPITALIZATION ALLOWED WITH RESPECT TO
12 EQUITY OF PERSONS OTHER THAN ISSUER AND RE-
13 LATED PARTIES.—Section 163(l) is amended by redesignig-
14 nating paragraphs (4) and (5) as paragraphs (5) and (6)
15 and by inserting after paragraph (3) the following new
16 paragraph:

17 “(4) CAPITALIZATION ALLOWED WITH RESPECT
18 TO EQUITY OF PERSONS OTHER THAN ISSUER AND
19 RELATED PARTIES.—If the disqualified debt instru-
20 ment of a corporation is payable in equity held by
21 the issuer (or any related party) in any other person
22 (other than a related party), the basis of such equity
23 shall be increased by the amount not allowed as a
24 deduction by reason of paragraph (1) with respect to
25 the instrument.”.

1 (c) EXCEPTION FOR CERTAIN INSTRUMENTS ISSUED
2 BY DEALERS IN SECURITIES.—Section 163(l), as amend-
3 ed by subsection (b), is amended by redesignating para-
4 graphs (5) and (6) as paragraphs (6) and (7) and by in-
5 serting after paragraph (4) the following new paragraph:

6 “(5) EXCEPTION FOR CERTAIN INSTRUMENTS
7 ISSUED BY DEALERS IN SECURITIES.—For purposes
8 of this subsection, the term ‘disqualified debt instru-
9 ment’ does not include indebtedness issued by a
10 dealer in securities (or a related party) which is pay-
11 able in, or by reference to, equity (other than equity
12 of the issuer or a related party) held by such dealer
13 in its capacity as a dealer in securities. For purposes
14 of this paragraph, the term ‘dealer in securities’ has
15 the meaning given such term by section 475.”.

16 (c) CONFORMING AMENDMENTS.—Paragraph (3) of
17 section 163(l) is amended—

18 (1) by striking “or a related party” in the ma-
19 terial preceding subparagraph (A) and inserting “or
20 any other person”, and

21 (2) by striking “or interest” each place it ap-
22 pears.

23 (d) EFFECTIVE DATE.—The amendments made by
24 this section shall apply to debt instruments issued after
25 February 13, 2003.

1 **SEC. 305. EXPANDED AUTHORITY TO DISALLOW TAX BENE-**
2 **FITS UNDER SECTION 269.**

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

6 “(a) IN GENERAL.—If—

7 “(1)(A) any person or persons acquire, directly
8 or indirectly, control of a corporation, or

9 “(B) any corporation acquires, directly or indi-
10 rectly, property of another corporation and the basis
11 of such property, in the hands of the acquiring cor-
12 poration, is determined by reference to the basis in
13 the hands of the transferor corporation, and

14 “(2) the principal purpose for which such acqui-
15 sition was made is evasion or avoidance of Federal
16 income tax,

17 then the Secretary may disallow such deduction, credit,
18 or other allowance. For purposes of paragraph (1)(A),
19 control means the ownership of stock possessing at least
20 50 percent of the total combined voting power of all class-
21 es of stock entitled to vote or at least 50 percent of the
22 total value of all shares of all classes of stock of the cor-
23 poration.”.

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

1 **SEC. 306. MODIFICATION OF INTERACTION BETWEEN SUB-**
2 **PART F AND PASSIVE FOREIGN INVESTMENT**
3 **COMPANY RULES.**

4 (a) **LIMITATION ON EXCEPTION FROM PFIC RULES**
5 **FOR UNITED STATES SHAREHOLDERS OF CONTROLLED**
6 **FOREIGN CORPORATIONS.**—Paragraph (2) of section
7 1297(e) (relating to passive foreign investment company)
8 is amended by adding at the end the following flush sen-
9 tence:

10 “Such term shall not include any period if the
11 earning of subpart F income by such corpora-
12 tion during such period would result in only a
13 remote likelihood of an inclusion in gross in-
14 come under section 951(a)(1)(A)(i).”.

15 (b) **EFFECTIVE DATE.**—The amendment made by
16 this section shall apply to taxable years of controlled for-
17 eign corporations beginning after February 13, 2003, and
18 to taxable years of United States shareholders with or
19 within which such taxable years of controlled foreign cor-
20 porations end.

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