

108TH CONGRESS  
1ST SESSION

# S. 1937

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

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IN THE SENATE OF THE UNITED STATES

NOVEMBER 24, 2003

Mr. BAUCUS (for himself, Mr. GRASSLEY, Mr. DASCHLE, Mr. CONRAD, and Mr. GRAHAM of Florida) introduced the following bill; which was read twice and referred to the Committee on Finance

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## 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(e).

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 sserting “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-  
 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           (2) REPORTING REQUIREMENTS.—Section 6041  
 2           (relating to information at source) is amended by  
 3           adding at the end the following new subsection:

4           “(f) SECTION TO APPLY TO PUNITIVE DAMAGES  
 5           COMPENSATION.—This section shall apply to payments by  
 6           a person to or on behalf of another person as insurance  
 7           or otherwise by reason of the other person’s liability (or  
 8           agreement) to pay punitive damages.”.

9           (3) CONFORMING AMENDMENT.—The table of  
 10          sections for part II of subchapter B of chapter 1 is  
 11          amended by adding at the end the following new  
 12          item:

“Sec. 91. Punitive damages compensated by insurance or otherwise.”.

13          (c) EFFECTIVE DATE.—The amendments made by  
 14          this section shall apply to damages paid or incurred on  
 15          or after the date of the enactment of this Act.

16   **SEC. 205. INCREASE IN CRIMINAL MONETARY PENALTY**  
 17                           **LIMITATION FOR THE UNDERPAYMENT OR**  
 18                           **OVERPAYMENT OF TAX DUE TO FRAUD.**

19          (a) IN GENERAL.—Section 7206 (relating to fraud  
 20          and false statements) is amended—

21               (1) by striking “Any person who—” and insert-  
 22               ing “(a) IN GENERAL.—Any person who—”, and

23               (2) by adding at the end the following new sub-  
 24               section:

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           (d) 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           (e) 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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