

108TH CONGRESS
1ST SESSION

H. R. 2046

To amend the Internal Revenue Code of 1986 to rebuild America through
job creation.

IN THE HOUSE OF REPRESENTATIVES

MAY 9, 2003

Mr. RANGEL (for himself, Mr. ANDREWS, Mr. BACA, Mr. BELL, Mr. BLUMENAUER, Mr. BROWN of Ohio, Mrs. CHRISTENSEN, Mr. CUMMINGS, Mr. DAVIS of Illinois, Mr. DELAHUNT, Ms. DELAURO, Mr. ENGEL, Ms. ESHOO, Mr. ETHERIDGE, Mr. GUTIERREZ, Mr. HILL, Mr. HOLT, Mr. HONDA, Mr. HOYER, Mr. LANTOS, Ms. LEE, Mr. LEVIN, Mr. MCGOVERN, Mr. MENENDEZ, Mr. MICHAUD, Ms. MILLENDER-MCDONALD, Mr. GEORGE MILLER of California, Mr. OBERSTAR, Mr. ORTIZ, Mr. PALLONE, Ms. PELOSI, Mr. PRICE of North Carolina, Mr. ROTHMAN, Mr. RYAN of Ohio, Mr. SABO, Mr. SANDLIN, Ms. SLAUGHTER, Mrs. JONES of Ohio, Ms. WATERS, Mr. WAXMAN, and Mr. BALLANCE) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to rebuild
America through job creation.

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; REFERENCES; TABLE OF CON-**
4 **TENTS.**

5 (a) SHORT TITLE.—This Act may be cited as the
6 “Jobs and Growth Reconciliation Tax Act of 2003”.

1 (b) AMENDMENT OF 1986 CODE.—Except as other-
 2 wise expressly provided, whenever in this Act an amend-
 3 ment or repeal is expressed in terms of an amendment
 4 to, or repeal of, a section or other provision, the reference
 5 shall be considered to be made to a section or other provi-
 6 sion of the Internal Revenue Code of 1986.

7 (c) TABLE OF CONTENTS.—The table of contents of
 8 this Act is as follows:

Sec. 1. Short title; references; table of contents.

TITLE I—IMMEDIATE STIMULUS AND JOB CREATION

Subtitle A—Family Tax Relief

Sec. 101. Acceleration of increase in child tax credit.

Sec. 102. Increase in standard deduction for married taxpayers filing joint re-
 turns accelerated.

Sec. 103. Acceleration of 10-percent individual income tax rate bracket expan-
 sion.

Sec. 104. Acceleration of elimination of marriage penalty in earned income
 credit.

Subtitle B—Incentives to Hire the Long-Term Unemployed

Sec. 111. Incentives to hire the long-term unemployed.

Subtitle C—Extension of Unemployment Benefits

Sec. 121. Short title.

PART I—TEMPORARY EXTENDED UNEMPLOYMENT COMPENSATION

Sec. 131. References.

Sec. 132. Extension of the Temporary Extended Unemployment Compensation
 Act of 2002.

Sec. 133. Entitlement to additional weeks of temporary extended unemployment
 compensation.

Sec. 134. Extended benefit periods.

PART II—UNEMPLOYMENT BENEFITS FOR INDIVIDUALS QUALIFYING BASED ON PART-TIME WORK OR AN ALTERNATIVE BASE PERIOD

Sec. 141. Federal-State agreements.

Sec. 142. Payments to States having agreements under this part.

Sec. 143. Financing provisions.

Sec. 144. Definitions.

Sec. 145. Applicability.

PART III—ENHANCED UNEMPLOYMENT BENEFITS

- Sec. 151. Federal-State agreements.
- Sec. 152. Payments to States having agreements under this part.
- Sec. 153. Definitions.
- Sec. 154. Applicability.

Subtitle D—Trust Fund to Meet Nation’s Pressing Needs

- Sec. 161. Trust fund to meet nation’s pressing needs.

TITLE II—LONG-TERM JOB CREATION AND GROWTH

- Sec. 201. Increase and extension of bonus depreciation.
- Sec. 202. Increased expensing for small business.
- Sec. 203. Deduction relating to income attributable to United States production activities.

TITLE III—FISCAL RESPONSIBILITY AND PROVISIONS
ADDRESSING CORPORATE ABUSE

Subtitle A— General Provisions

- Sec. 301. Freeze of top individual income tax rates.
- Sec. 302. Restoration of phaseouts of deductions for personal exemptions and of itemized deductions.
- Sec. 303. Repeal of exclusion for extraterritorial income.

Subtitle B—Abusive Tax Shelter Shutdown and Taxpayer Accountability

PART I—PROVISIONS DESIGNED TO CURTAIL TAX SHELTERS

- Sec. 311. Clarification of economic substance doctrine.
- Sec. 312. Penalty for failing to disclose reportable transaction.
- Sec. 313. Accuracy-related penalty for listed transactions and other reportable transactions having a significant tax avoidance purpose.
- Sec. 314. Penalty for understatements attributable to transactions lacking economic substance, etc.
- Sec. 315. Modifications of substantial understatement penalty for nonreportable transactions.
- Sec. 316. Tax shelter exception to confidentiality privileges relating to taxpayer communications.
- Sec. 317. Disclosure of reportable transactions.
- Sec. 318. Modifications to penalty for failure to register tax shelters.
- Sec. 319. Modification of penalty for failure to maintain lists of investors.
- Sec. 320. Modification of actions to enjoin certain conduct related to tax shelters and reportable transactions.
- Sec. 321. Understatement of taxpayer’s liability by income tax return preparer.
- Sec. 322. Penalty on failure to report interests in foreign financial accounts.
- Sec. 323. Frivolous tax submissions.
- Sec. 324. Regulation of individuals practicing before the department of treasury.
- Sec. 325. Penalty on promoters of tax shelters.
- Sec. 326. Statute of limitations for taxable years for which listed transactions not reported.
- Sec. 327. Denial of deduction for interest on underpayments attributable to nondisclosed reportable and noneconomic substance transactions.

PART II—OTHER PROVISIONS

- Sec. 331. Limitation on transfer or importation of built-in losses.
 Sec. 332. Disallowance of certain partnership loss transfers.
 Sec. 333. No reduction of basis under section 734 in stock held by partnership in corporate partner.
 Sec. 334. Repeal of special rules for fasits.
 Sec. 335. Expanded disallowance of deduction for interest on convertible debt.
 Sec. 336. Expanded authority to disallow tax benefits under section 269.
 Sec. 337. Modifications of certain rules relating to controlled foreign corporations.
 Sec. 338. Basis for determining loss always reduced by nontaxed portion of dividends.
 Sec. 339. Affirmation of consolidated return regulation authority.

Subtitle C—Prevention of Corporate Expatriation To Avoid United States
Income Tax

- Sec. 341. Prevention of corporate expatriation to avoid United States income tax.

Subtitle D—Inclusion in Gross Income of Funded Deferred Compensation of
Corporate Insiders

- Sec. 351. Inclusion in gross income of funded deferred compensation of corporate insiders.

1 **TITLE I—IMMEDIATE STIMULUS**
 2 **AND JOB CREATION**
 3 **Subtitle A—Family Tax Relief**

4 **SEC. 101. ACCELERATION OF INCREASE IN CHILD TAX**
 5 **CREDIT.**

- 6 (a) IN GENERAL.—The items relating to calendar
 7 years 2001 through 2008 in the table contained in para-
 8 graph (2) of section 24(a) (relating to per child amount)
 9 are amended to read as follows:

“2003 thru 2009	\$800
2010 or thereafter	1,000”.

- 10 (b) ACCELERATION OF INCREASE IN REFUNDABLE
 11 PORTION OF CREDIT.—

1 (1) IN GENERAL.—Clause (i) of section
2 24(d)(1)(B) is amended to read as follows:

3 “(i) 15 percent of so much of the tax-
4 payer’s earned income (within the meaning
5 of section 32) which is taken into account
6 in computing taxable income for the tax-
7 able year as exceeds \$7,500, or”.

8 (2) CONFORMING AMENDMENT.—Paragraph (3)
9 of section 24(d) is amended—

10 (A) by striking “\$10,000” and inserting
11 “\$7,500”, and

12 (B) by striking “2000” and inserting
13 “2002”.

14 (c) EFFECTIVE DATES.—The amendments made by
15 this section shall apply to taxable years beginning after
16 December 31, 2002.

17 **SEC. 102. INCREASE IN STANDARD DEDUCTION FOR MAR-**
18 **RIED TAXPAYERS FILING JOINT RETURNS AC-**
19 **CELERATED.**

20 (a) IN GENERAL.—Subparagraph (A) of section
21 63(c)(2), as amended by the Economic Growth and Tax
22 Relief Reconciliation Act of 2001, is amended by striking
23 “the applicable percentage of” and inserting “twice”.

24 (b) CONFORMING AMENDMENTS.—

1 section (f)(3) by substituting ‘2003’ for
2 ‘1992’ in subparagraph (B) thereof.”

3 (c) EFFECTIVE DATE.—

4 (1) IN GENERAL.—The amendments made by
5 this section shall apply to taxable years beginning
6 after December 31, 2002.

7 (2) TABLES FOR 2003.—The Secretary of the
8 Treasury shall modify each table which has been
9 prescribed under section 1(f) of the Internal Rev-
10 enue Code of 1986 for taxable years beginning in
11 2003 and which relates to the amendment made by
12 this section to reflect such amendment.

13 **SEC. 104. ACCELERATION OF ELIMINATION OF MARRIAGE**
14 **PENALTY IN EARNED INCOME CREDIT.**

15 (a) IN GENERAL.—Subparagraph (B) of section
16 32(b)(2) is amended to read as follows:

17 “(B) JOINT RETURNS.—In the case of a
18 joint return filed by an eligible individual and
19 such individual’s spouse, the phaseout amount
20 determined under subparagraph (A) shall be in-
21 creased by \$3,000.”

22 (b) CONFORMING AMENDMENT.—Clause (ii) of sec-
23 tion 32(j)(1)(B) is amended by striking “2007” and in-
24 serting “2002”.

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

4 **Subtitle B—Incentives to Hire the**
5 **Long-Term Unemployed**

6 **SEC. 111. INCENTIVES TO HIRE THE LONG-TERM UNEM-**
7 **EMPLOYED.**

8 (a) IN GENERAL.—Paragraph (1) of section 51(d)
9 (relating to members of targeted groups) is amended by
10 striking “or” at the end of subparagraph (G), by striking
11 the period at the end of subparagraph (H) and inserting
12 “, or”, and by adding at the end the following new sub-
13 paragraph:

14 “(I) a qualified long-term unemployed indi-
15 vidual.”

16 (b) QUALIFIED LONG-TERM UNEMPLOYED INDI-
17 VIDUAL.—Subsection (d) of section 51 is amended by re-
18 designating paragraphs (10), (11), and (12) as para-
19 graphs (11), (12), and (13), respectively, and by inserting
20 after paragraph (9) the following new paragraph:

21 “(10) QUALIFIED LONG-TERM UNEMPLOYED
22 INDIVIDUAL.—

23 “(A) IN GENERAL.—The term ‘qualified
24 long-term unemployed individual’ means any in-

1 dividual who is certified by the designated local
2 agency—

3 “(i) as having exhausted, during the
4 1-year period ending on the hiring date, all
5 rights to regular unemployment compensa-
6 tion under State or Federal law, and

7 “(ii) as having a hiring date which is
8 during the 1-year period beginning on the
9 date of the enactment of this paragraph.

10 Subsection (c)(4) shall not apply to any quali-
11 fied long-term unemployed individual.

12 “(B) EXHAUSTION OF BENEFITS.—For
13 purposes of subparagraph (A), an individual
14 shall be deemed to have exhausted such individ-
15 ual’s rights to regular compensation when—

16 “(i) no payments of regular com-
17 pensation can be made under such law be-
18 cause such individual has received all reg-
19 ular compensation available to such indi-
20 vidual based on employment or wages dur-
21 ing such individual’s base period, or

22 “(ii) such individual’s rights to such
23 compensation have been terminated by rea-
24 son of the expiration of the benefit year
25 with respect to which such rights existed.”

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to individuals who begin work for
3 the employer after the date of the enactment of this Act.

4 **Subtitle C—Extension of**
5 **Unemployment Benefits**

6 **SEC. 121. SHORT TITLE.**

7 This subtitle may be cited as the “Unemployment
8 Benefits Extension Act”.

9 **PART I—TEMPORARY EXTENDED**
10 **UNEMPLOYMENT COMPENSATION**

11 **SEC. 131. REFERENCES.**

12 Except as otherwise expressly provided, whenever in
13 this part an amendment is expressed in terms of an
14 amendment to a section or other provision, the reference
15 shall be considered to be made to a section or other provi-
16 sion of the Temporary Extended Unemployment Com-
17 pensation Act of 2002 (Public Law 107–147; 26 U.S.C.
18 3304 note).

19 **SEC. 132. EXTENSION OF THE TEMPORARY EXTENDED UN-**
20 **EMPLOYMENT COMPENSATION ACT OF 2002.**

21 (a) EXTENSION OF PROGRAM.—Section 208 is
22 amended to read as follows:

1 **“SEC. 208. APPLICABILITY.**

2 “(a) IN GENERAL.—Subject to subsection (b), an
3 agreement entered into under this title shall apply to
4 weeks of unemployment—

5 “(1) beginning after the date on which such
6 agreement is entered into; and

7 “(2) ending before March 1, 2004.

8 “(b) TRANSITION.—In the case of an individual who
9 is receiving temporary extended unemployment compensa-
10 tion for the week which immediately precedes the first day
11 of the week that includes March 1, 2004, temporary ex-
12 tended unemployment compensation shall continue to be
13 payable to such individual for any week thereafter from
14 the account from which such individual received com-
15 pensation for the week immediately preceding that termi-
16 nation date. No compensation shall be payable by reason
17 of the preceding sentence for any week beginning after Oc-
18 tober 31, 2004.”.

19 (b) EFFECTIVE DATE.—The amendment made by
20 this section shall take effect as if included in the enact-
21 ment of the Temporary Extended Unemployment Com-
22 pensation Act of 2002 (Public Law 107–147; 116 Stat.
23 21).

1 **SEC. 133. ENTITLEMENT TO ADDITIONAL WEEKS OF TEM-**
2 **PORARY EXTENDED UNEMPLOYMENT COM-**
3 **PENSATION.**

4 (a) WEEKS OF TEUC AMOUNTS.—Paragraph (1) of
5 section 203(b) is amended to read as follows:

6 “(1) IN GENERAL.—The amount established in
7 an account under subsection (a) shall be equal to 26
8 times the individual’s weekly benefit amount for the
9 benefit year.”.

10 (b) WEEKS OF TEUC-X AMOUNTS.—Section
11 203(c)(1) is amended by striking “an amount equal to the
12 amount originally established in such account (as deter-
13 mined under subsection (b)(1))” and inserting “7 times
14 the individual’s weekly benefit amount for the benefit
15 year”.

16 (c) EFFECTIVE DATE.—

17 (1) IN GENERAL.—The amendments made by
18 this section—

19 (A) shall take effect as if included in the
20 enactment of the Temporary Extended Unem-
21 ployment Compensation Act of 2002 (Public
22 Law 107–147; 116 Stat. 21); but

23 (B) shall apply only with respect to weeks
24 of unemployment beginning on or after the date
25 of enactment of this Act, subject to paragraph
26 (2).

1 (2) SPECIAL RULES.—In the case of an indi-
2 vidual for whom a temporary extended unemploy-
3 ment account was established before the date of en-
4 actment of this Act, the Temporary Extended Un-
5 employment Compensation Act of 2002 (as amended
6 by this part) shall be applied subject to the fol-
7 lowing:

8 (A) Any amounts deposited in the individ-
9 ual’s temporary extended unemployment com-
10 pensation account by reason of section 203(c)
11 of such Act (commonly known as “TEUC–X
12 amounts”) before the date of enactment of this
13 Act shall be treated as amounts deposited by
14 reason of section 203(b) of such Act (commonly
15 known as “TEUC amounts”), as amended by
16 subsection (a).

17 (B) For purposes of determining whether
18 the individual is eligible for any TEUC–X
19 amounts under such Act, as amended by this
20 part—

21 (i) any determination made under sec-
22 tion 203(c) of such Act before the applica-
23 tion of the amendments made by this part
24 shall be disregarded; and

1 (ii) any such determination shall in-
2 stead be made by applying section 203(c)
3 of such Act, as amended by this part—

4 (I) as of the time that all
5 amounts established in such account
6 in accordance with section 203(b) of
7 such Act (as amended by this part,
8 and including any amounts described
9 in subparagraph (A)) are in fact ex-
10 hausted, except that

11 (II) if such individual's account
12 was both augmented by and exhausted
13 of all TEUC-X amounts before the
14 date of enactment of this Act, such
15 determination shall be made as if ex-
16 haustion (as described in section
17 203(c)(1) of such Act) had not oc-
18 curred until such date of enactment.

19 **SEC. 134. EXTENDED BENEFIT PERIODS.**

20 (a) APPLICATION OF REVISED RATE OF INSURED
21 UNEMPLOYMENT.—Section 207 is amended—

22 (1) by striking “In” and inserting “(a) IN GEN-
23 ERAL.—In”; and

24 (2) by adding at the end the following:

1 “(b) INSURED UNEMPLOYMENT RATE.—For pur-
2 poses of carrying out section 203(c) with respect to weeks
3 of unemployment beginning on or after the date of enact-
4 ment of this subsection, the term ‘rate of insured unem-
5 ployment’, as used in section 203(d) of the Federal-State
6 Extended Unemployment Compensation Act of 1970 (26
7 U.S.C. 3304 note), has the meaning given such term
8 under section 203(e)(1) of such Act, except that individ-
9 uals exhausting their right to regular compensation during
10 the most recent 3 calendar months for which data are
11 available before the close of the period for which such rate
12 is being determined shall be taken into account as if they
13 were individuals filing claims for regular compensation for
14 each week during the period for which such rate is being
15 determined, and section 203(d)(1)(A) of such Act shall be
16 applied by substituting ‘either (or both)’ for ‘each.’”.

17 (b) ADDITIONAL EXTENDED BENEFIT PERIOD TRIG-
18 GER.—

19 (1) IN GENERAL.—Section 203(c) is amended
20 by adding at the end the following:

21 “(3) ADDITIONAL EXTENDED BENEFIT PERIOD
22 TRIGGER.—

23 “(A) IN GENERAL.—Effective with respect
24 to compensation for weeks of unemployment be-
25 ginning on or after the date of enactment of

1 this paragraph, an agreement under this title
2 shall provide that, in addition to any other ex-
3 tended benefit period trigger, for purposes of
4 beginning or ending any extended benefit period
5 under this section—

6 “(i) there is a State ‘on’ indicator for
7 a week if—

8 “(I) the average rate of total un-
9 employment in such State (seasonally
10 adjusted) for the period consisting of
11 the most recent 3 months for which
12 data for all States are published be-
13 fore the close of such week equals or
14 exceeds 6 percent; and

15 “(II) the average rate of total
16 unemployment in such State (season-
17 ally adjusted) for the 3-month period
18 referred to in subclause (I) equals or
19 exceeds 110 percent of such average
20 rate for either (or both) of the cor-
21 responding 3-month periods ending in
22 the 2 preceding calendar years; and

23 “(ii) there is a State ‘off’ indicator for
24 a week if either the requirements of sub-

1 clause (I) or (II) of clause (i) are not satis-
2 fied.

3 “(B) NO EFFECT ON OTHER DETERMINA-
4 TIONS.—Notwithstanding the provisions of any
5 agreement described in subparagraph (A), any
6 week for which there would otherwise be a
7 State ‘on’ indicator shall continue to be such a
8 week and shall not be determined to be a week
9 for which there is a State ‘off’ indicator.

10 “(C) DETERMINATIONS MADE BY THE
11 SECRETARY.—For purposes of this subsection,
12 determinations of the rate of total unemploy-
13 ment in any State for any period (and of any
14 seasonal adjustment) shall be made by the Sec-
15 retary.”.

16 (2) CONFORMING AMENDMENT.—Section
17 203(c)(1) is amended by inserting “or (3)” after
18 “paragraph (2)”.

19 **PART II—UNEMPLOYMENT BENEFITS FOR INDI-**
20 **VIDUALS QUALIFYING BASED ON PART-TIME**
21 **WORK OR AN ALTERNATIVE BASE PERIOD**

22 **SEC. 141. FEDERAL-STATE AGREEMENTS.**

23 (a) IN GENERAL.—Any State which desires to do so
24 may enter into and participate in an agreement under this
25 part with the Secretary of Labor (hereinafter in this part

1 referred to as the “Secretary”). Any State which is a party
2 to an agreement under this part may, upon providing 30
3 days’ written notice to the Secretary, terminate such
4 agreement.

5 (b) PROVISIONS OF AGREEMENT.—

6 (1) IN GENERAL.—Any agreement under sub-
7 section (a) shall provide that the State agency of the
8 State will make payments of regular compensation
9 to individuals in amounts and to the extent that they
10 would be determined if the State law were applied
11 with the modifications described in paragraph (2).

12 (2) MODIFICATIONS DESCRIBED.—The modi-
13 fications described in this paragraph are as follows:

14 (A) In the case of an individual who is not
15 eligible for regular compensation under the
16 State law because of the use of a definition of
17 base period that does not count wages earned
18 in the most recently completed calendar quar-
19 ter, eligibility for compensation under this part
20 shall be determined by applying a base period
21 ending at the close of the most recently com-
22 pleted calendar quarter.

23 (B) In the case of an individual who is not
24 eligible for regular compensation under the
25 State law because such individual does not meet

1 requirements relating to availability for work,
2 active search for work, or refusal to accept
3 work, because such individual is seeking, or is
4 available for, less than full-time work, com-
5 pensation under this part shall not be denied by
6 such State to an otherwise eligible individual
7 who seeks less than full-time work or fails to
8 accept full-time work.

9 (c) COORDINATION RULE.—The modifications de-
10 scribed in subsection (b)(2) shall also apply in determining
11 the amount of benefits payable under any Federal law to
12 the extent that those benefits are determined by reference
13 to regular compensation payable under the State law of
14 the State involved.

15 **SEC. 142. PAYMENTS TO STATES HAVING AGREEMENTS**
16 **UNDER THIS PART.**

17 (a) GENERAL RULE.—There shall be paid to each
18 State which has entered into an agreement under this part
19 an amount equal to—

20 (1) 100 percent of any regular compensation
21 made payable to individuals by such State by virtue
22 of the modifications which are described in section
23 141(b)(2) and deemed to be in effect with respect to
24 such State pursuant to section 141(b)(1), and

25 (2) 100 percent of any regular compensation—

1 (A) which is paid to individuals by such
2 State by reason of the fact that its State law
3 contains provisions comparable to the modifica-
4 tions described in section 141(b)(2), but only

5 (B) to the extent that those amounts
6 would, if such amounts were instead payable by
7 virtue of the State law's being deemed to be so
8 modified pursuant to section 141(b)(1), have
9 been reimbursable under paragraph (1).

10 (b) DETERMINATION OF AMOUNT.—Sums under sub-
11 section (a) payable to any State by reason of such State
12 having an agreement under this part shall be payable, ei-
13 ther in advance or by way of reimbursement (as may be
14 determined by the Secretary), in such amounts as the Sec-
15 retary estimates the State will be entitled to receive under
16 this part for each calendar month, reduced or increased,
17 as the case may be, by any amount by which the Secretary
18 finds that the Secretary's estimates for any prior calendar
19 month were greater or less than the amounts which should
20 have been paid to the State. Such estimates may be made
21 on the basis of such statistical, sampling, or other method
22 as may be agreed upon by the Secretary and the State
23 agency of the State involved.

24 (c) ADMINISTRATIVE AND OTHER EXPENSES.—
25 There is hereby appropriated out of the employment secu-

1 rity administration account of the Unemployment Trust
2 Fund (as established by section 901(a) of the Social Secu-
3 rity Act) \$500,000,000 to reimburse States for the costs
4 of the administration of agreements under this part (in-
5 cluding any improvements in technology in connection
6 therewith) and to provide reemployment services to unem-
7 ployment compensation claimants in States having agree-
8 ments under this part. Each State's share of the amount
9 appropriated by the preceding sentence shall be deter-
10 mined by the Secretary according to the factors described
11 in section 302(a) of the Social Security Act and certified
12 by the Secretary to the Secretary of the Treasury.

13 **SEC. 143. FINANCING PROVISIONS.**

14 (a) IN GENERAL.—Funds in the extended unemploy-
15 ment compensation account (as established by section
16 905(a) of the Social Security Act), and the Federal unem-
17 ployment account (as established by section 904(g) of the
18 Social Security Act), of the Unemployment Trust Fund
19 shall be used, in accordance with subsection (b), for the
20 making of payments (described in section 142(a)) to
21 States having agreements entered into under this part.

22 (b) CERTIFICATION.—The Secretary shall from time
23 to time certify to the Secretary of the Treasury for pay-
24 ment to each State the sums described in section 142(a)
25 which are payable to such State under this part. The Sec-

1 retary of the Treasury, prior to audit or settlement by the
2 General Accounting Office, shall make payments to the
3 State in accordance with such certification by transfers
4 from the extended unemployment compensation account
5 (or, to the extent that there are insufficient funds in that
6 account, from the Federal unemployment account) to the
7 account of such State in the Unemployment Trust Fund.

8 **SEC. 144. DEFINITIONS.**

9 For purposes of this part:

10 (1) IN GENERAL.—The terms “compensation”,
11 “regular compensation”, “base period”, “State”,
12 “State agency”, “State law”, and “week” have the
13 respective meanings given such terms under section
14 205 of the Federal-State Extended Unemployment
15 Compensation Act of 1970, subject to paragraph
16 (2).

17 (2) STATE LAW AND REGULAR COMPENSA-
18 TION.—In the case of a State entering into an
19 agreement under this part—

20 (A) “State law” shall be considered to
21 refer to the State law of such State, applied in
22 conformance with the modifications described in
23 section 201(b)(2), and

24 (B) “regular compensation” shall be con-
25 sidered to refer to such compensation, deter-

1 mined under its State law (applied in the man-
2 ner described in subparagraph (A)),
3 except as otherwise provided or where the context
4 clearly indicates otherwise.

5 **SEC. 145. APPLICABILITY.**

6 An agreement entered into under this part shall apply
7 to weeks of unemployment—

8 (1) beginning after the date on which such
9 agreement is entered into, and

10 (2) ending before July 1, 2004.

11 **PART III—ENHANCED UNEMPLOYMENT**

12 **BENEFITS**

13 **SEC. 151. FEDERAL-STATE AGREEMENTS.**

14 (a) **IN GENERAL.**—Any State which desires to do so
15 may enter into and participate in an agreement under this
16 part with the Secretary of Labor (hereinafter in this part
17 referred to as the “Secretary”). Any State which is a party
18 to an agreement under this part may, upon providing 30
19 days’ written notice to the Secretary, terminate such
20 agreement.

21 (b) **PROVISIONS OF AGREEMENT.**—

22 (1) **IN GENERAL.**—Any agreement under sub-
23 section (a) shall provide that the State agency of the
24 State will make payments of regular compensation
25 to individuals in amounts and to the extent that they

1 would be determined if the State law were applied
2 with the modification described in paragraph (2).

3 (2) MODIFICATION DESCRIBED.—The modifica-
4 tion described in this paragraph is that the amount
5 of regular compensation (including dependents' al-
6 lowances) payable for any week shall be equal to the
7 amount determined under the State law (before the
8 application of this paragraph), plus an additional—

9 (A) 15 percent, or

10 (B) \$25,

11 whichever is greater.

12 (c) NONREDUCTION RULE.—Each agreement shall
13 provide that such agreement shall not apply (or shall cease
14 to apply) upon a determination by the Secretary that the
15 method governing the computation of regular compensa-
16 tion under the State law of that State has been modified
17 in a way such that—

18 (1) the average weekly amount of regular com-
19 pensation which will be payable during the period of
20 the agreement (determined disregarding the modi-
21 fication described in subsection (b)(2)) will be less
22 than

23 (2) the average weekly amount of regular com-
24 pensation which would otherwise have been payable

1 during such period under the State law, as in effect
2 on September 11, 2001.

3 (d) COORDINATION RULE.—The modification de-
4 scribed in subsection (b)(2) shall also apply in determining
5 the amount of benefits payable under any Federal law to
6 the extent that those benefits are determined by reference
7 to regular compensation payable under the State law of
8 the State involved.

9 **SEC. 152. PAYMENTS TO STATES HAVING AGREEMENTS**
10 **UNDER THIS PART.**

11 (a) GENERAL RULE.—There shall be paid to each
12 State which has entered into an agreement under this part
13 an amount equal to 100 percent of any regular compensa-
14 tion made payable to individuals by such State by virtue
15 of the modification described in section 151(b)(2) and
16 deemed to be in effect with respect to such State pursuant
17 to section 151(b)(1).

18 (b) DETERMINATION OF AMOUNT.—Sums under sub-
19 section (a) payable to any State by reason of such State
20 having an agreement under this part shall be payable, ei-
21 ther in advance or by way of reimbursement (as may be
22 determined by the Secretary), in such amounts as the Sec-
23 retary estimates the State will be entitled to receive under
24 this part for each calendar month, reduced or increased,
25 as the case may be, by any amount by which the Secretary

1 finds that the Secretary's estimates for any prior calendar
2 month were greater or less than the amounts which should
3 have been paid to the State. Such estimates may be made
4 on the basis of such statistical, sampling, or other method
5 as may be agreed upon by the Secretary and the State
6 agency of the State involved.

7 **SEC. 153. DEFINITIONS.**

8 For purposes of this part:

9 (1) IN GENERAL.—The terms “compensation”,
10 “regular compensation”, “extended compensation”,
11 “additional compensation”, “benefit year”, “base pe-
12 riod”, “State”, “State agency”, “State law”, and
13 “week” have the respective meanings given such
14 terms under section 205 of the Federal-State Ex-
15 tended Unemployment Compensation Act of 1970,
16 subject to paragraph (2).

17 (2) STATE LAW AND REGULAR COMPENSA-
18 TION.—In the case of a State entering into an
19 agreement under this part—

20 (A) “State law” shall be considered to
21 refer to the State law of such State, applied in
22 conformance with the modification described in
23 section 151(b)(2), subject to section 151(c),
24 and

1 (B) “regular compensation” shall be con-
2 sidered to refer to such compensation, deter-
3 mined under its State law (applied in the man-
4 ner described in subparagraph (A)),
5 except as otherwise provided or where the context
6 clearly indicates otherwise.

7 **SEC. 154. APPLICABILITY.**

8 (a) IN GENERAL.—An agreement entered into under
9 this part shall apply to weeks of unemployment—

10 (1) beginning after the date on which such
11 agreement is entered into, and

12 (2) ending before January 1, 2004.

13 **Subtitle D—Trust Fund to Meet**
14 **Nation’s Pressing Needs**

15 **SEC. 161. TRUST FUND TO MEET NATION’S PRESSING**
16 **NEEDS.**

17 (a) CREATION OF TRUST FUND.—There is estab-
18 lished in the Treasury of the United States a trust fund
19 to be known as the ‘Pressing Domestic Needs Trust
20 Fund’, consisting of such amounts as may be transferred
21 to the Trust Fund as provided in this section.

22 (b) TRANSFERS TO FUND.—There are hereby trans-
23 ferred from the general Fund of the Treasury to the
24 Pressing Domestic Needs Trust Fund so much of the ad-
25 ditional amounts received in the Treasury by reason of the

1 amendments made by title III of this Act as does not ex-
2 ceed—

3 (1) \$18,000,000,000 to be used for increasing
4 Federal matching funds under medicaid, and

5 (2) \$26,000,000,000 to be used for infrastruc-
6 ture improvements, homeland security, community
7 development, and education.

8 (c) EXPENDITURES.—Amounts in the Pressing Do-
9 mestic Needs Trust Fund shall be available, as provided
10 by appropriation Acts, for purposes and in the amount
11 specified in subsection (b).

12 **Subtitle D—Trust Fund to Meet**
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17 lished in the Treasury of the United States a trust fund
18 to be known as the ‘Pressing Domestic Needs Trust
19 Fund’, consisting of such amounts as may be transferred
20 to the Trust Fund as provided in this section.

21 (b) TRANSFERS TO FUND.—There are hereby trans-
22 ferred from the general Fund of the Treasury to the
23 Pressing Domestic Needs Trust Fund so much of the ad-
24 ditional amounts received in the Treasury by reason of the

1 amendments made by title III of this Act as does not ex-
2 ceed—

3 (1) \$18,000,000,000 to be used for increasing
4 Federal matching funds under medicaid, and

5 (2) \$26,000,000,000 to be used for infrastruc-
6 ture improvements, homeland security, community
7 development, and education.

8 (c) EXPENDITURES.—Amounts in the Pressing Do-
9 mestic Needs Trust Fund shall be available, as provided
10 by appropriation Acts, for purposes and in the amount
11 specified in subsection (b).

12 **TITLE II—LONG-TERM JOB** 13 **CREATION AND GROWTH**

14 **SEC. 201. INCREASE AND EXTENSION OF BONUS DEPRECIATION.** 15 **TION.**

16 (a) IN GENERAL.—Section 168(k) (relating to special
17 allowance for certain property acquired after September
18 10, 2001, and before September 11, 2004) is amended by
19 adding at the end the following new paragraph:

20 “(4) 50-PERCENT BONUS DEPRECIATION FOR
21 CERTAIN PROPERTY.—

22 “(A) IN GENERAL.—In the case of 50-per-
23 cent bonus depreciation property—

1 “(i) paragraph (1)(A) shall be applied
2 by substituting ‘50 percent’ for ‘30 per-
3 cent’, and

4 “(ii) except as provided in paragraph
5 (2)(C), such property shall be treated as
6 qualified property for purposes of this sub-
7 section.

8 “(B) 50-PERCENT BONUS DEPRECIATION
9 PROPERTY.—For purposes of this subsection,
10 the term ‘50-percent bonus depreciation prop-
11 erty’ means property described in paragraph
12 (2)(A)(i)—

13 “(i) the original use of which com-
14 mences with the taxpayer after April 30,
15 2003,

16 “(ii) which is acquired by the taxpayer
17 after April 30, 2003, and before May 1,
18 2004, but only if no written binding con-
19 tract for the acquisition was in effect be-
20 fore May 1, 2003, and

21 “(iii) which is placed in service by the
22 taxpayer before January 1, 2005, or, in
23 the case of property described in para-
24 graph (2)(B) (as modified by subpara-

1 graph (C) of this paragraph), before Janu-
2 ary 1, 2006.

3 “(C) SPECIAL RULES.—Rules similar to
4 the rules of subparagraphs (B) and (D) of
5 paragraph (2) shall apply for purposes of this
6 paragraph; except that reference to September
7 10, 2001, shall be treated as references to April
8 30, 2003.

9 “(D) AUTOMOBILES.—Paragraph (2)(E)
10 shall be applied by substituting ‘\$9,200’ for
11 ‘\$4,600’ in the case of 50-percent bonus depre-
12 ciation property.

13 “(E) ELECTION OF 30 PERCENT BONUS.—
14 If a taxpayer makes an election under this sub-
15 paragraph with respect to any class of property
16 for any taxable year, subparagraph (A)(i) shall
17 not apply to all property in such class placed in
18 service during such taxable year.”

19 (b) MODIFICATION TO 30-PERCENT BONUS DEPRE-
20 CIATION PROPERTY.—

21 (1) PORTION OF BASIS TAKEN INTO AC-
22 COUNT.—Subparagraphs (B)(ii) and (D)(i) of sec-
23 tion 168(k)(2) are each amended by striking “Sep-
24 tember 11, 2004” each place it appears and insert-
25 ing “January 1, 2005”.

1 (2) ELECTION.—Clause (iii) of section
2 168(k)(2)(C) is amended by adding at the end the
3 following: “The preceding sentence shall be applied
4 separately with respect to property treated as quali-
5 fied property by paragraph (4) and other qualified
6 property.”

7 (3) ACQUISITION DATE.—Clause (iii) of section
8 168(k)(2)(A) is amended by striking “September 11,
9 2004” each place it appears and inserting “January
10 1, 2005”.

11 (c) CONFORMING AMENDMENTS.—

12 (1) The subsection heading for section 168(k) is
13 amended by striking “SEPTEMBER 11, 2004” and
14 inserting “JANUARY 1, 2005”.

15 (2) The heading for clause (i) of section
16 1400L(b)(2)(C) is amended by striking “30-PER-
17 CENT ADDITIONAL ALLOWABLE PROPERTY” and in-
18 serting “BONUS DEPRECIATION PROPERTY UNDER
19 SECTION 168(k)”.

20 (d) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to taxable years ending after the
22 date of the enactment of this Act.

1 **SEC. 202. INCREASED EXPENSING FOR SMALL BUSINESS.**

2 (a) IN GENERAL.—Paragraph (1) of section 179(b)
3 (relating to dollar limitation) is amended to read as fol-
4 lows:

5 “(1) DOLLAR LIMITATION.—The aggregate cost
6 which may be taken into account under subsection
7 (a) for any taxable year shall not exceed \$25,000
8 (\$75,000 in the case of taxable years beginning in
9 2003 or 2004).”.

10 (b) EFFECTIVE DATE.—The amendment made by
11 this section shall apply to taxable years beginning after
12 December 31, 2002.

13 **SEC. 203. DEDUCTION RELATING TO INCOME ATTRIB-**
14 **UTABLE TO UNITED STATES PRODUCTION**
15 **ACTIVITIES.**

16 (a) IN GENERAL.—Part VIII of subchapter B of
17 chapter 1 (relating to special deductions for corporations)
18 is amended by adding at the end the following new section:

19 **“SEC. 250. INCOME ATTRIBUTABLE TO DOMESTIC PRODUC-**
20 **TION ACTIVITIES.**

21 “(a) IN GENERAL.—In the case of a corporation,
22 there shall be allowed as a deduction an amount equal to
23 10 percent of the qualified production activities income of
24 the corporation for the taxable year.

25 “(b) PHASEIN.—In the case of taxable years begin-
26 ning in 2006, 2007, 2008 or 2009, subsection (a) shall

1 be applied by substituting for the percentage contained
 2 therein the transition percentage determined under the
 3 following table:

“Taxable years beginning in:	The transition percentage is:
2006	1
2007	2
2008	4
2009	9

4 “(c) QUALIFIED PRODUCTION ACTIVITIES IN-
 5 COME.—For purposes of this section, the term ‘qualified
 6 production activities income’ means the product of—

7 “(1) the portion of the modified taxable income
 8 of the taxpayer which is attributable to domestic
 9 production activities, and

10 “(2) the domestic/foreign fraction.

11 “(d) DETERMINATION OF INCOME ATTRIBUTABLE
 12 TO DOMESTIC PRODUCTION ACTIVITIES.—For purposes
 13 of this section—

14 “(1) IN GENERAL.—The portion of the modified
 15 taxable income which is attributable to domestic pro-
 16 duction activities is so much of the modified taxable
 17 income for the taxable year as does not exceed—

18 “(A) the taxpayer’s domestic production
 19 gross receipts for such taxable year, reduced by

20 “(B) the sum of—

21 “(i) the costs of goods sold that are
 22 allocable to such receipts,

1 “(ii) other deductions, expenses, or
2 losses directly allocable to such receipts,
3 and

4 “(iii) a ratable portion of other deduc-
5 tions, expenses, and losses that are not di-
6 rectly allocable to such receipts or another
7 class of income.

8 “(2) ALLOCATION METHOD.—Except as pro-
9 vided in regulations, allocations under clauses (ii)
10 and (iii) of paragraph (1)(B) shall be made under
11 the principles used in determining the portion of tax-
12 able income from sources within and without the
13 United States.

14 “(3) SPECIAL RULE.—

15 “(A) For purposes of determining costs
16 under clause (i) of paragraph (1)(B), any item
17 or service brought into the United States with-
18 out a transfer price meeting the requirements
19 of section 482 shall be treated as acquired by
20 purchase, and its cost shall be treated as not
21 less than its value when it entered the United
22 States. A similar rule shall apply in determining
23 the adjusted basis of leased or rented property
24 where the lease or rental gives rise to domestic
25 production gross receipts.

1 “(B) In the case of any property described
2 in subparagraph (A) that had been exported by
3 the taxpayer for further manufacture, the in-
4 crease in cost (or adjusted basis) under sub-
5 paragraph (A) shall not exceed the difference
6 between the value of the property when ex-
7 ported and the value of the property when
8 brought back into the United States after the
9 further manufacture.

10 “(4) MODIFIED TAXABLE INCOME.—The term
11 ‘modified taxable income’ means taxable income
12 computed without regard to the deduction allowable
13 under this section.

14 “(e) DOMESTIC PRODUCTION GROSS RECEIPTS.—
15 For purposes of this section—

16 “(1) IN GENERAL.—The term ‘domestic produc-
17 tion gross receipts’ means the gross receipts of the
18 taxpayer which are derived from—

19 “(A) any sale, exchange, or other disposi-
20 tion of, or

21 “(B) any lease, rental or license of,
22 qualifying production property which was manufac-
23 tured, produced, grown, or extracted in whole or in
24 significant part by the taxpayer within the United
25 States.

1 “(2) SPECIAL RULE.—The term ‘domestic pro-
2 duction gross receipts’ includes gross receipts of the
3 taxpayer from the sale, exchange, or other disposi-
4 tion of replacement parts if—

5 “(A) such parts are sold by the taxpayer
6 as replacement parts for qualified production
7 property produced or manufactured in whole or
8 significant part by the taxpayer in the United
9 States, and

10 “(B) the taxpayer (or a related party)
11 owns the designs for such parts.

12 “(3) RELATED PARTY.—The term ‘related
13 party’ means any corporation which is a member of
14 the taxpayer’s expanded affiliated group.

15 “(f) QUALIFYING PRODUCTION PROPERTY.—For
16 purposes of this section—

17 “(1) IN GENERAL.—Except as otherwise pro-
18 vided in this paragraph, the term ‘qualifying produc-
19 tion property’ means—

20 “(A) any tangible personal property,

21 “(B) any computer software, and

22 “(C) any films, tapes, records, or similar
23 reproductions.

1 “(2) EXCLUSIONS FROM QUALIFYING PRODUC-
2 TION PROPERTY.—The term ‘qualifying production
3 property’ shall not include—

4 “(A) consumable property that is sold,
5 leased, or licensed by the taxpayer as an inte-
6 gral part of the provision of services,

7 “(B) oil or gas (or any primary product
8 thereof),

9 “(C) electricity,

10 “(D) water supplied by pipeline to the con-
11 sumer,

12 “(E) any unprocessed timber which is
13 softwood,

14 “(F) utility services, or

15 “(G) any property (not described in para-
16 graph (1)(B)) which is a film, tape, recording,
17 book, magazine, newspaper, or similar property
18 the market for which is primarily topical or oth-
19 erwise essentially transitory in nature.

20 For purposes of subparagraph (E), the term ‘un-
21 processed timber’ means any log, cant, or similar
22 form of timber.

23 “(g) DOMESTIC/FOREIGN FRACTION.—For purposes
24 of this section—

1 “(1) IN GENERAL.—The term ‘domestic/foreign
2 fraction’ means a fraction—

3 “(A) the numerator of which is the value
4 of the domestic production of the taxpayer, and

5 “(B) the denominator of which is the value
6 of the worldwide production of the taxpayer.

7 “(2) VALUE OF DOMESTIC PRODUCTION.—The
8 value of domestic production is the excess of—

9 “(A) the domestic production gross re-
10 ceipts, over

11 “(B) the cost of purchased inputs allocable
12 to such receipts that are deductible under this
13 chapter for the taxable year.

14 “(3) PURCHASED INPUTS.—

15 “(A) IN GENERAL.—Purchased inputs are
16 any of the following items acquired by pur-
17 chase:

18 “(i) Services (other than services of
19 employees) used in manufacture, produc-
20 tion, growth, or extraction activities.

21 “(ii) Items consumed in connection
22 with such activities.

23 “(iii) Items incorporated as part of
24 the property being manufactured, pro-
25 duced, grown, or extracted.

1 “(B) SPECIAL RULE.—Rules similar to the
2 rules of subsection (d)(3) shall apply for pur-
3 poses of this subsection.

4 “(4) VALUE OF WORLDWIDE PRODUCTION.—

5 “(A) IN GENERAL.—The value of world-
6 wide production shall be determined under the
7 principles of paragraph (2), except that—

8 “(i) worldwide production gross re-
9 ceipts shall be taken into account, and

10 “(ii) paragraph (3)(B) shall not apply.

11 “(B) WORLDWIDE PRODUCTION GROSS RE-
12 CEIPTS.—The worldwide production gross re-
13 ceipts is the amount that would be determined
14 under subsection (e) if such subsection were ap-
15 plied without any reference to the United
16 States.

17 “(5) SPECIAL RULE FOR AFFILIATED
18 GROUPS.—

19 “(A) IN GENERAL.—In the case of a tax-
20 payer that is a member of an expanded affili-
21 ated group, the domestic/foreign fraction shall
22 be the amount determined under the preceding
23 provisions of this subsection by treating all
24 members of such group as a single corporation.

1 “(B) EXPANDED AFFILIATED GROUP.—

2 The term ‘expanded affiliated group’ means an
3 affiliated group as defined in section 1504(a),
4 determined—

5 “(i) by substituting ‘50 percent’ for
6 ‘80 percent’ each place it appears, and

7 “(ii) without regard to paragraphs
8 (2), (3), and (4) of section 1504(b).

9 “(h) DEFINITIONS AND SPECIAL RULES.—

10 “(1) UNITED STATES.—For purposes of this
11 section, the term ‘United States’ includes the Com-
12 monwealth of Puerto Rico and any other possession
13 of the United States.

14 “(2) SPECIAL RULE FOR PARTNERSHIPS.—For
15 purposes of this section, a corporation’s distributive
16 share of any partnership item shall be taken into ac-
17 count as if directly realized by the corporation.

18 “(3) COORDINATION WITH MINIMUM TAX.—The
19 deduction under this section shall be allowed for
20 purposes of the tax imposed by section 55; except
21 that for purposes of section 55, alternative minimum
22 taxable income shall be taken into account in deter-
23 mining the deduction under this section.

1 “(2) APPLICATION OF SECTION 15.—Section 15
2 of the Internal Revenue Code of 1986 shall apply to
3 the amendments made by this section as if they were
4 changes in a rate of tax.

5 **TITLE III—FISCAL RESPONSIBILITY AND PROVISIONS AD-**
6 **DRESSING CORPORATE**
7 **ABUSE**

8 **Subtitle A— General Provisions**

9 **SEC. 301. FREEZE OF TOP INDIVIDUAL INCOME TAX RATES.**

10 (a) FREEZE OF TOP INDIVIDUAL INCOME TAX
11 RATES.—Paragraph (2) of section 1(i) (relating to reduc-
12 tions in rates after June 30, 2001) is amended—

13 (1) in the column for the highest rate—

14 (A) by striking “37.6” and inserting
15 “38.6”, and

16 (B) by striking “35.0” and inserting
17 “38.6”, and

18 (2) in the column for the next highest rate—

19 (A) by striking “34.0” and inserting
20 “35.0”, and

21 (B) by striking “33.0” and inserting
22 “35.0”.
23

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

4 (c) RESTORATION OF RATE REDUCTIONS IF FUNDS
5 NOT COMMITTED TO MEET NATION'S PRESSING
6 NEEDS.—

7 (1) IN GENERAL.—On December 31, 2003, the
8 Director of the Office of Management and Budget
9 shall determine whether there is a noncommitted
10 balance in the Pressing Domestic Needs Trust Fund
11 (established by section 161 of this Act). If such a
12 noncommitted balance is determined, the Secretary
13 of the Treasury shall reduce the rates otherwise ap-
14 plicable under the amendment made by subsection
15 (a) so that the total revenue raised by such amend-
16 ment is reduced by the amount of such noncom-
17 mitted balance.

18 (2) NONCOMMITTED BALANCE.—For purposes
19 of paragraph (1), the noncommitted balance of the
20 trust fund is the portion of the amounts in the trust
21 fund which are not committed to meeting the press-
22 ing needs specified in section 161.

23 (d) RESTORATION OF RATE REDUCTIONS IF BAL-
24 ANCED BUDGET.—The amendments made by this section
25 shall cease to apply to any taxable year beginning after

1 a calendar year if there is no deficit in the Federal budget
2 for the fiscal year ending in such calendar year.

3 **SEC. 302. RESTORATION OF PHASEOUTS OF DEDUCTIONS**
4 **FOR PERSONAL EXEMPTIONS AND OF**
5 **ITEMIZED DEDUCTIONS.**

6 (a) PHASEOUT OF PERSONAL EXEMPTIONS.—Para-
7 graph (3) of section 151(d) is amended by striking sub-
8 paragraphs (E) and (F).

9 (b) PHASEOUT OF ITEMIZED DEDUCTIONS.—Section
10 68 (relating to overall limitation on itemized deductions)
11 is amended by striking subsections (f) and (g).

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

15 **SEC. 303. REPEAL OF EXCLUSION FOR EXTRATERRITORIAL**
16 **INCOME.**

17 (a) IN GENERAL.—Section 114 is hereby repealed.

18 (b) CONFORMING AMENDMENTS.—

19 (1) Subpart E of part III of subchapter N of
20 chapter 1 (relating to qualifying foreign trade in-
21 come) is hereby repealed.

22 (2) The table of subparts for such part III is
23 amended by striking the item relating to subpart E.

1 (3) The table of sections for part III of sub-
2 chapter B of chapter 1 is amended by striking the
3 item relating to section 114.

4 (c) EFFECTIVE DATE.—

5 (1) IN GENERAL.—The amendments made by
6 this section shall apply to transactions occurring
7 after the date of the enactment of this Act.

8 (2) BINDING CONTRACTS.—The amendments
9 made by this section shall not apply to any trans-
10 action in the ordinary course of a trade or business
11 which occurs pursuant to a binding contract—

12 (A) which is between the taxpayer and a
13 person who is not a related person (as defined
14 in section 943(b)(3) of such Code, as in effect
15 on the day before the date of the enactment of
16 this Act), and

17 (B) which is in effect on April 11, 2003,
18 and at all times thereafter.

19 For purposes of this paragraph, a binding contract
20 shall include a purchase option, renewal option, or
21 replacement option which is included in such con-
22 tract.

23 (d) REVOCATION OF SECTION 943(e) ELECTIONS.—

24 (1) IN GENERAL.—In the case of a corporation
25 that elected to be treated as a domestic corporation

1 under section 943(e) of the Internal Revenue Code
2 of 1986 (as in effect on the day before the date of
3 the enactment of this Act)—

4 (A) the corporation may revoke such elec-
5 tion, effective as of the date of the enactment
6 of this Act, and

7 (B) if the corporation does revoke such
8 election—

9 (i) such corporation shall be treated
10 as a domestic corporation transferring (as
11 of the date of the enactment of this Act)
12 all of its property to a foreign corporation
13 in connection with an exchange described
14 in section 354 of the Internal Revenue
15 Code of 1986, and

16 (ii) no gain or loss shall be recognized
17 on such transfer.

18 (2) EXCEPTION.—Subparagraph (B)(ii) of
19 paragraph (1) shall not apply to gain on any asset
20 held by the revoking corporation if—

21 (A) the basis of such asset is determined
22 in whole or in part by reference to the basis of
23 such asset in the hands of the person from
24 whom the revoking corporation acquired such
25 asset,

1 (B) the asset was acquired by transfer (not
2 as a result of the election under section 943(e)
3 of such Code) occurring on or after the 1st day
4 on which its election under section 943(e) of
5 such Code was effective, and

6 (C) a principal purpose of the acquisition
7 was the reduction or avoidance of tax.

8 (e) GENERAL TRANSITION.—

9 (1) IN GENERAL.—In the case of a taxable year
10 ending after the date of the enactment of this Act
11 and beginning before January 1, 2009, for purposes
12 of chapter 1 of such Code, each current FSC/ETI
13 beneficiary shall be allowed a deduction equal to the
14 transition amount determined under this subsection
15 with respect to such beneficiary for such year.

16 (2) CURRENT FSC/ETI BENEFICIARY.—The
17 term “current FSC/ETI beneficiary” means any cor-
18 poration which entered into one or more transactions
19 during its taxable year beginning in calendar year
20 2001 with respect to which FSC/ETI benefits were
21 allowable.

22 (3) TRANSITION AMOUNT.—For purposes of
23 this subsection—

24 (A) IN GENERAL.—The transition amount
25 applicable to any current FSC/ETI beneficiary

1 for any taxable year is the phaseout percentage
 2 of the adjusted base period amount.

3 (B) PHASEOUT PERCENTAGE.—

4 (i) IN GENERAL.—In the case of a
 5 taxpayer using the calendar year as its
 6 taxable year, the phaseout percentage shall
 7 be determined under the following table:

“Years:	The phaseout percentage is:
2004 and 2005	100
2006	75
2007	75
2008	50
2009 and thereafter	0

8 (ii) SPECIAL RULE FOR 2003.—The
 9 phaseout percentage for 2003 shall be the
 10 amount that bears the same ratio to 100
 11 percent as the number of days after the
 12 date of the enactment of this Act bears to
 13 365.

14 (iii) SPECIAL RULE FOR FISCAL YEAR
 15 TAXPAYERS.—In the case of a taxpayer
 16 not using the calendar year as its taxable
 17 year, the phaseout percentage is the
 18 weighted average of the phaseout percent-
 19 ages determined under the preceding provi-
 20 sions of this paragraph with respect to cal-
 21 endar years any portion of which is in-
 22 cluded in the taxpayer’s taxable year. The

1 weighted average shall be determined on
 2 the basis of the respective portions of the
 3 taxable year in each calendar year.

4 (4) ADJUSTED BASE PERIOD AMOUNT.—

5 For purposes of this subsection—

6 (A) IN GENERAL.—In the case of a
 7 taxpayer using the calendar year as its
 8 taxable year, the adjusted base period
 9 amount for any taxable year is the base
 10 period amount multiplied by the applicable
 11 percentage, as determined in the following
 12 table:

“Years:	The applicable percentage is:
2003	100
2004	100
2005	105
2006	110
2007	115
2008	120
2009 and thereafter	0

13 (B) BASE PERIOD AMOUNT.—The
 14 base period amount is the aggregate FSC/
 15 ETI benefits for the taxpayer’s taxable
 16 year beginning in calendar year 2001.

17 (C) SPECIAL RULES FOR FISCAL YEAR
 18 TAXPAYERS, ETC.—Rules similar to rules
 19 of clauses (ii) and (iii) of paragraph (3)(B)
 20 shall apply for purposes of this paragraph.

1 (5) FSC/ETI BENEFIT.—For purposes of this
2 subsection, the term “FSC/ETI benefit” means—

3 (A) amounts excludable from gross income
4 under section 114 of such Code, and

5 (B) the exempt foreign trade income of re-
6 lated foreign sales corporations from property
7 acquired from the taxpayer (determined without
8 regard to section 923(a)(5) of such Code (relat-
9 ing to special rule for military property), as in
10 effect on the day before the date of the enact-
11 ment of the FSC Repeal and Extraterritorial
12 Income Exclusion Act of 2000).

13 In determining the FSC/ETI benefit there shall be
14 excluded any amount attributable to a transaction
15 with respect to which the taxpayer is the lessor un-
16 less the leased property was manufactured or pro-
17 duced in whole or in part by the taxpayer.

18 (6) SPECIAL RULE FOR FARM COOPERATIVES.—

19 Under regulations prescribed by the Secretary, de-
20 terminations under this subsection with respect to
21 an organization described in section 943(g)(1) of
22 such Code, as in effect on the day before the date
23 of the enactment of this Act, shall be made at the
24 cooperative level and the purposes of this subsection

1 shall be carried out by excluding amounts from the
2 gross income of its patrons.

3 (7) CERTAIN RULES TO APPLY.—Rules similar
4 to the rules of section 41(f) of such Code shall apply
5 for purposes of this subsection.

6 (8) COORDINATION WITH BINDING CONTRACT
7 RULE.—The deduction determined under paragraph
8 (1) for any taxable year shall be reduced by the
9 phaseout percentage of any FSC/ETI benefit real-
10 ized for the taxable year by reason of subsection
11 (c)(2). The preceding sentence shall not apply to any
12 FSC/ETI benefit attributable to a transaction de-
13 scribed in the last sentence of paragraph (5).

14 (9) SPECIAL RULE FOR TAXABLE YEAR WHICH
15 INCLUDES DATE OF ENACTMENT.—In the case of a
16 taxable year which includes the date of the enact-
17 ment of this Act, the deduction allowed under this
18 subsection to any current FSC/ETI beneficiary shall
19 in no event exceed—

20 (A) 100 percent of such beneficiary's ad-
21 justed base period amount for calendar year
22 2003, reduced by

23 (B) the aggregate FSC/ETI benefits of
24 such beneficiary with respect to transactions oc-

1 curring during the portion of the taxable year
 2 ending on the date of the enactment of this Act.

3 **Subtitle B—Abusive Tax Shelter**
 4 **Shutdown and Taxpayer Ac-**
 5 **countability**

6 **PART I—PROVISIONS DESIGNED TO CURTAIL TAX**
 7 **SHELTERS**

8 **SEC. 311. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**
 9 **TRINE.**

10 (a) IN GENERAL.—Section 7701 is amended by re-
 11 designating subsection (m) as subsection (n) and by in-
 12 serting after subsection (l) the following new subsection:

13 “(m) CLARIFICATION OF ECONOMIC SUBSTANCE
 14 DOCTRINE; ETC.—

15 “(1) GENERAL RULES.—

16 “(A) IN GENERAL.—In applying the eco-
 17 nomic substance doctrine, the determination of
 18 whether a transaction has economic substance
 19 shall be made as provided in this paragraph.

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

22 “(i) IN GENERAL.—A transaction has
 23 economic substance only if—

24 “(I) the transaction changes in a
 25 meaningful way (apart from Federal

1 tax effects and, if there is any Federal
2 tax effects, also apart from any for-
3 eign, State, or local tax effects) the
4 taxpayer’s economic position, and

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

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

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

22 “(II) the reasonably expected
23 pre-tax profit from the transaction ex-
24 ceeds a risk-free rate of return.

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

6 “(2) SPECIAL RULES FOR TRANSACTIONS WITH
7 TAX-INDIFFERENT PARTIES.—

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

24 “(B) ARTIFICIAL INCOME SHIFTING AND
25 BASIS ADJUSTMENTS.—The form of a trans-

1 action with a tax-indifferent party shall not be
2 respected if—

3 “(i) it results in an allocation of in-
4 come or gain to the tax-indifferent party in
5 excess of such party’s economic income or
6 gain, or

7 “(ii) it results in a basis adjustment
8 or shifting of basis on account of over-
9 stating the income or gain of the tax-indif-
10 ferent party.

11 “(3) DEFINITIONS AND SPECIAL RULES.—For
12 purposes of this subsection—

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

20 “(B) TAX-INDIFFERENT PARTY.—The
21 term ‘tax-indifferent party’ means any person
22 or entity not subject to tax imposed by subtitle
23 A. A person shall be treated as a tax-indifferent
24 party with respect to a transaction if the items
25 taken into account with respect to the trans-

1 action have no substantial impact on such per-
2 son’s liability under subtitle A.

3 “(C) SUBSTANTIAL NONTAX PURPOSE.—In
4 applying subclause (II) of paragraph (1)(B)(i),
5 a purpose of achieving a financial accounting
6 benefit shall not be taken into account in deter-
7 mining whether a transaction has a substantial
8 nontax purpose if the origin of such financial
9 accounting benefit is a reduction of income tax.

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

16 “(E) TREATMENT OF LESSORS.—In apply-
17 ing subclause (I) of paragraph (1)(B)(ii) to the
18 lessor of tangible property subject to a lease,
19 the expected net tax benefits shall not include
20 the benefits of depreciation, or any tax credit,
21 with respect to the leased property and sub-
22 clause (II) of paragraph (1)(B)(ii) shall be dis-
23 regarded in determining whether any of such
24 benefits are allowable.

1 tion with respect to a reportable transaction which is re-
2 quired under section 6011 to be included with such return
3 or statement shall pay a penalty in the amount determined
4 under subsection (b).

5 “(b) AMOUNT OF PENALTY.—

6 “(1) IN GENERAL.—Except as provided in para-
7 graphs (2) and (3), the amount of the penalty under
8 subsection (a) shall be \$50,000.

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

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

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

16 “(i) a large entity, or

17 “(ii) a high net worth individual,

18 the penalty under paragraph (1) or (2) shall be
19 twice the amount determined without regard to
20 this paragraph.

21 “(B) LARGE ENTITY.—For purposes of
22 subparagraph (A), the term ‘large entity’
23 means, with respect to any taxable year, a per-
24 son (other than a natural person) with gross re-
25 cepts in excess of \$10,000,000 for the taxable

1 year in which the reportable transaction occurs
2 or the preceding taxable year. Rules similar to
3 the rules of paragraph (2) and subparagraphs
4 (B), (C), and (D) of paragraph (3) of section
5 448(c) shall apply for purposes of this subpara-
6 graph.

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

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

14 “(1) REPORTABLE TRANSACTION.—The term
15 ‘reportable transaction’ means any transaction with
16 respect to which information is required to be in-
17 cluded with a return or statement because, as deter-
18 mined under regulations prescribed under section
19 6011, such transaction is of a type which the Sec-
20 retary determines as having a potential for tax
21 avoidance or evasion.

22 “(2) LISTED TRANSACTION.—Except as pro-
23 vided in regulations, the term ‘listed transaction’
24 means a reportable transaction which is the same as,
25 or substantially similar to, a transaction specifically

1 identified by the Secretary as a tax avoidance trans-
2 action for purposes of section 6011.

3 “(d) AUTHORITY TO RESCIND PENALTY.—

4 “(1) IN GENERAL.—The Commissioner of In-
5 ternal Revenue may rescind all or any portion of any
6 penalty imposed by this section with respect to any
7 violation if—

8 “(A) the violation is with respect to a re-
9 reportable transaction other than a listed trans-
10 action,

11 “(B) the person on whom the penalty is
12 imposed has a history of complying with the re-
13 quirements of this title,

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

16 “(D) imposing the penalty would be
17 against equity and good conscience, and

18 “(E) rescinding the penalty would promote
19 compliance with the requirements of this title
20 and effective tax administration.

21 “(2) DISCRETION.—The exercise of authority
22 under paragraph (1) shall be at the sole discretion
23 of the Commissioner and may be delegated only to
24 the head of the Office of Tax Shelter Analysis. The
25 Commissioner, in the Commissioner’s sole discretion,

1 may establish a procedure to determine if a penalty
2 should be referred to the Commissioner or the head
3 of such Office for a determination under paragraph
4 (1).

5 “(3) NO APPEAL.—Notwithstanding any other
6 provision of law, any determination under this sub-
7 section may not be reviewed in any administrative or
8 judicial proceeding.

9 “(4) RECORDS.—If a penalty is rescinded under
10 paragraph (1), the Commissioner shall place in the
11 file in the Office of the Commissioner the opinion of
12 the Commissioner or the head of the Office of Tax
13 Shelter Analysis with respect to the determination,
14 including—

15 “(A) the facts and circumstances of the
16 transaction,

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

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

19 “(5) REPORT.—The Commissioner shall each
20 year report to the Committee on Ways and Means
21 of the House of Representatives and the Committee
22 on Finance of the Senate—

23 “(A) a summary of the total number and
24 aggregate amount of penalties imposed, and re-
25 scinded, under this section, and

1 “(B) a description of each penalty re-
2 scinded under this subsection and the reasons
3 therefor.

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

6 “(1) which is required to file periodic reports
7 under section 13 or 15(d) of the Securities Ex-
8 change Act of 1934 or is required to be consolidated
9 with another person for purposes of such reports,
10 and

11 “(2) which—

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

14 “(B) is required to pay a penalty under
15 section 6662A with respect to any reportable
16 transaction at a rate prescribed under section
17 6662A(c), or

18 “(C) is required to pay a penalty under
19 section 6662B with respect to any noneconomic
20 substance transaction,

21 the requirement to pay such penalty shall be disclosed in
22 such reports filed by such person for such periods as the
23 Secretary shall specify. Failure to make a disclosure in
24 accordance with the preceding sentence shall be treated

1 as a failure to which the penalty under subsection (b)(2)
2 applies.

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

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

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

10 (c) EFFECTIVE DATE.—The amendments made by
11 this section shall apply to returns and statements the due
12 date for which is after the date of the enactment of this
13 Act.

14 **SEC. 313. ACCURACY-RELATED PENALTY FOR LISTED**
15 **TRANSACTIONS AND OTHER REPORTABLE**
16 **TRANSACTIONS HAVING A SIGNIFICANT TAX**
17 **AVOIDANCE PURPOSE.**

18 (a) IN GENERAL.—Subchapter A of chapter 68 is
19 amended by inserting after section 6662 the following new
20 section:

1 **“SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PEN-**
2 **ALTY ON UNDERSTATEMENTS WITH RESPECT**
3 **TO REPORTABLE TRANSACTIONS.**

4 “(a) IMPOSITION OF PENALTY.—If a taxpayer has a
5 reportable transaction understatement for any taxable
6 year, there shall be added to the tax an amount equal to
7 20 percent of the amount of such understatement.

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

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

12 “(A) the product of—

13 “(i) the amount of the increase (if
14 any) in taxable income which results from
15 a difference between the proper tax treat-
16 ment of an item to which this section ap-
17 plies and the taxpayer’s treatment of such
18 item (as shown on the taxpayer’s return of
19 tax), and

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

23 “(B) the amount of the decrease (if any)
24 in the aggregate amount of credits determined
25 under subtitle A which results from a difference
26 between the taxpayer’s treatment of an item to

1 which this section applies (as shown on the tax-
2 payer’s return of tax) and the proper tax treat-
3 ment of such item.

4 For purposes of subparagraph (A), any reduction of
5 the excess of deductions allowed for the taxable year
6 over gross income for such year, and any reduction
7 in the amount of capital losses which would (without
8 regard to section 1211) be allowed for such year,
9 shall be treated as an increase in taxable income.

10 “(2) ITEMS TO WHICH SECTION APPLIES.—This
11 section shall apply to any item which is attributable
12 to—

13 “(A) any listed transaction, and

14 “(B) any reportable transaction (other
15 than a listed transaction) if a significant pur-
16 pose of such transaction is the avoidance or
17 evasion of Federal income tax.

18 “(c) HIGHER PENALTY FOR NONDISCLOSED LISTED
19 AND OTHER AVOIDANCE TRANSACTIONS.—

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

1 “(2) RULES APPLICABLE TO COMPROMISE OF
2 PENALTY.—

3 “(A) IN GENERAL.—If the 1st letter of
4 proposed deficiency which allows the taxpayer
5 an opportunity for administrative review in the
6 Internal Revenue Service Office of Appeals has
7 been sent with respect to a penalty to which
8 paragraph (1) applies, only the Commissioner
9 of Internal Revenue may compromise all or any
10 portion of such penalty.

11 “(B) APPLICABLE RULES.—The rules of
12 paragraphs (3), (4), and (5) of section
13 6707A(d) shall apply for purposes of subpara-
14 graph (A).

15 “(d) DEFINITIONS OF REPORTABLE AND LISTED
16 TRANSACTIONS.—For purposes of this section, the terms
17 ‘reportable transaction’ and ‘listed transaction’ have the
18 respective meanings given to such terms by section
19 6707A(c).

20 “(e) SPECIAL RULES.—

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

24 “(A) the amount of such understatement
25 (determined without regard to this paragraph)

1 shall be increased by the aggregate amount of
2 reportable transaction understatements and
3 noneconomic substance transaction understate-
4 ments for purposes of determining whether
5 such understatement is a substantial under-
6 statement under section 6662(d)(1), and

7 “(B) the addition to tax under section
8 6662(a) shall apply only to the excess of the
9 amount of the substantial understatement (if
10 any) after the application of subparagraph (A)
11 over the aggregate amount of reportable trans-
12 action understatements and noneconomic sub-
13 stance transaction understatements.

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

16 “(A) APPLICATION OF FRAUD PENALTY.—
17 References to an underpayment in section 6663
18 shall be treated as including references to a re-
19 portable transaction understatement and a non-
20 economic substance transaction understatement.

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

1 “(3) SPECIAL RULE FOR AMENDED RE-
2 TURNS.—Except as provided in regulations, in no
3 event shall any tax treatment included with an
4 amendment or supplement to a return of tax be
5 taken into account in determining the amount of any
6 reportable transaction understatement or non-
7 economic substance transaction understatement if
8 the amendment or supplement is filed after the ear-
9 lier of the date the taxpayer is first contacted by the
10 Secretary regarding the examination of the return or
11 such other date as is specified by the Secretary.

12 “(4) NONECONOMIC SUBSTANCE TRANS-
13 ACTION UNDERSTATEMENT.—For purposes of
14 this subsection, the term ‘noneconomic sub-
15 stance transaction understatement’ has the
16 meaning given such term by section 6662B(c).

17 “(5) CROSS REFERENCE.—

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

18 (b) DETERMINATION OF OTHER UNDERSTATE-
19 MENTS.—Subparagraph (A) of section 6662(d)(2) is
20 amended by adding at the end the following flush sen-
21 tence:

22 “The excess under the preceding sentence shall
23 be determined without regard to items to which
24 section 6662A applies and without regard to

1 items with respect to which a penalty is im-
2 posed by section 6662B.”

3 (c) REASONABLE CAUSE EXCEPTION.—

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

6 “(d) REASONABLE CAUSE EXCEPTION FOR REPORT-
7 ABLE TRANSACTION UNDERSTATEMENTS.—

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

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

17 “(A) the relevant facts affecting the tax
18 treatment of the item are adequately disclosed
19 in accordance with the regulations prescribed
20 under section 6011,

21 “(B) there is or was substantial authority
22 for such treatment, and

23 “(C) the taxpayer reasonably believed that
24 such treatment was more likely than not the
25 proper treatment.

1 A taxpayer failing to adequately disclose in accord-
2 ance with section 6011 shall be treated as meeting
3 the requirements of subparagraph (A) if the penalty
4 for such failure was rescinded under section
5 6707A(d).

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

8 “(A) IN GENERAL.—A taxpayer shall be
9 treated as having a reasonable belief with re-
10 spect to the tax treatment of an item only if
11 such belief—

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

15 “(ii) relates solely to the taxpayer’s
16 chances of success on the merits of such
17 treatment and does not take into account
18 the possibility that a return will not be au-
19 dited, such treatment will not be raised on
20 audit, or such treatment will be resolved
21 through settlement if it is raised.

22 “(B) CERTAIN OPINIONS MAY NOT BE RE-
23 LIED UPON.—

24 “(i) IN GENERAL.—An opinion of a
25 tax advisor may not be relied upon to es-

1 tablish the reasonable belief of a taxpayer
2 if—

3 “(I) the tax advisor is described
4 in clause (ii), or

5 “(II) the opinion is described in
6 clause (iii).

7 “(ii) DISQUALIFIED TAX ADVISORS.—
8 A tax advisor is described in this clause if
9 the tax advisor—

10 “(I) is a material advisor (within
11 the meaning of section 6111(b)(1))
12 who participates in the organization,
13 management, promotion, or sale of
14 the transaction or who is related
15 (within the meaning of section 267(b)
16 or 707(b)(1)) to any person who so
17 participates,

18 “(II) is compensated directly or
19 indirectly by a material advisor with
20 respect to the transaction,

21 “(III) has a fee arrangement
22 with respect to the transaction which
23 is contingent on all or part of the in-
24 tended tax benefits from the trans-
25 action being sustained, or

1 “(IV) as determined under regu-
2 lations prescribed by the Secretary,
3 has a continuing financial interest
4 with respect to the transaction.

5 “(iii) DISQUALIFIED OPINIONS.—For
6 purposes of clause (i), an opinion is dis-
7 qualified if the opinion—

8 “(I) is based on unreasonable
9 factual or legal assumptions (includ-
10 ing assumptions as to future events),

11 “(II) unreasonably relies on rep-
12 resentations, statements, findings, or
13 agreements of the taxpayer or any
14 other person,

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

17 “(IV) fails to meet any other re-
18 quirement as the Secretary may pre-
19 scribe.”

20 (2) CONFORMING AMENDMENT.—The heading
21 for subsection (c) of section 6664 is amended by in-
22 sserting “FOR UNDERPAYMENTS” after “EXCEP-
23 TION”.

24 (d) CONFORMING AMENDMENTS.—

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

4 (2) Paragraph (3) of section 1274(b) is amend-
5 ed—

6 (A) by striking “(as defined in section
7 6662(d)(2)(C)(iii))” in subparagraph (B)(i),
8 and

9 (B) by adding at the end the following new
10 subparagraph:

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

13 “(i) a partnership or other entity,

14 “(ii) any investment plan or arrange-
15 ment, or

16 “(iii) any other plan or arrangement,
17 if a significant purpose of such partnership, en-
18 tity, plan, or arrangement is the avoidance or
19 evasion of Federal income tax.”

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

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

1 **“SEC. 6662B. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
2 **UTABLE TO TRANSACTIONS LACKING ECO-**
3 **NOMIC SUBSTANCE, ETC.**

4 “(a) IMPOSITION OF PENALTY.—If a taxpayer has an
5 noneconomic substance transaction understatement for
6 any taxable year, there shall be added to the tax an
7 amount equal to 40 percent of the amount of such under-
8 statement.

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

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

18 “(1) IN GENERAL.—The term ‘noneconomic
19 substance transaction understatement’ means any
20 amount which would be an understatement under
21 section 6662A(b)(1) if section 6662A were applied
22 by taking into account items attributable to non-
23 economic substance transactions rather than items
24 to which section 6662A would apply without regard
25 to this paragraph.

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

4 “(A) there is a lack of economic substance
5 (within the meaning of section 7701(m)(1)) for
6 the transaction giving rise to the claimed tax
7 benefit or the transaction was not respected
8 under section 7701(m)(2), or

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

11 “(d) RULES APPLICABLE TO COMPROMISE OF PEN-
12 ALTY.—

13 “(1) IN GENERAL.—If the 1st letter of pro-
14 posed deficiency which allows the taxpayer an oppor-
15 tunity for administrative review in the Internal Rev-
16 enue Service Office of Appeals has been sent with
17 respect to a penalty to which this section applies,
18 only the Commissioner of Internal Revenue may
19 compromise all or any portion of such penalty.

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

23 “(e) COORDINATION WITH OTHER PENALTIES.—Ex-
24 cept as otherwise provided in this part, the penalty im-

1 posed by this section shall be in addition to any other pen-
 2 alty imposed by this title.

3 “(f) CROSS REFERENCES.—

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

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

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

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

8 (c) EFFECTIVE DATE.—The amendments made by
 9 this section shall apply to transactions entered into after
 10 February 13, 2003.

11 **SEC. 315. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-**
 12 **MENT PENALTY FOR NONREPORTABLE**
 13 **TRANSACTIONS.**

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

17 “(B) SPECIAL RULE FOR CORPORA-
 18 TIONS.—In the case of a corporation other than
 19 an S corporation or a personal holding company
 20 (as defined in section 542), there is a substan-
 21 tial understatement of income tax for any tax-

1 able year if the amount of the understatement
2 for the taxable year exceeds the lesser of—

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

6 “(ii) \$10,000,000.”

7 (b) REDUCTION FOR UNDERSTATEMENT OF TAX-
8 PAYER DUE TO POSITION OF TAXPAYER OR DISCLOSED
9 ITEM.—

10 (1) IN GENERAL.—Section 6662(d)(2)(B)(i)
11 (relating to substantial authority) is amended to
12 read as follows:

13 “(i) the tax treatment of any item by
14 the taxpayer if the taxpayer had reason-
15 able belief that the tax treatment was more
16 likely than not the proper treatment, or”.

17 (2) CONFORMING AMENDMENT.—Section
18 6662(d) is amended by adding at the end the fol-
19 lowing new paragraph:

20 “(3) SECRETARIAL LIST.—For purposes of this
21 subsection, section 6664(d)(2), and section
22 6694(a)(1), the Secretary may prescribe a list of po-
23 sitions for which the Secretary believes there is not
24 substantial authority or there is no reasonable belief
25 that the tax treatment is more likely than not the

1 proper tax treatment. Such list (and any revisions
2 thereof) shall be published in the Federal Register
3 or the Internal Revenue Bulletin.”

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

7 **SEC. 316. TAX SHELTER EXCEPTION TO CONFIDENTIALITY**
8 **PRIVILEGES RELATING TO TAXPAYER COM-**
9 **MUNICATIONS.**

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

13 “(b) SECTION NOT TO APPLY TO COMMUNICATIONS
14 REGARDING TAX SHELTERS.—The privilege under sub-
15 section (a) shall not apply to any written communication
16 which is—

17 “(1) between a federally authorized tax practi-
18 tioner and—

19 “(A) any person,

20 “(B) any director, officer, employee, agent,
21 or representative of the person, or

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

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

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

7 **SEC. 317. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

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

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

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

15 “(1) information identifying and describing the
16 transaction,

17 “(2) information describing any potential tax
18 benefits expected to result from the transaction, and

19 “(3) such other information as the Secretary
20 may prescribe.

21 Such return shall be filed not later than the date specified
22 by the Secretary.

23 “(b) DEFINITIONS.—For purposes of this section—

24 “(1) MATERIAL ADVISOR.—

1 “(A) IN GENERAL.—The term ‘material
2 advisor’ means any person—

3 “(i) who provides any material aid,
4 assistance, or advice with respect to orga-
5 nizing, promoting, selling, implementing,
6 or carrying out any reportable transaction,
7 and

8 “(ii) who directly or indirectly derives
9 gross income in excess of the threshold
10 amount for such aid, assistance, or advice.

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

13 “(i) \$50,000 in the case of a report-
14 able transaction substantially all of the tax
15 benefits from which are provided to nat-
16 ural persons, and

17 “(ii) \$250,000 in any other case.

18 “(2) REPORTABLE TRANSACTION.—The term
19 ‘reportable transaction’ has the meaning given to
20 such term by section 6707A(c).

21 “(c) REGULATIONS.—The Secretary may prescribe
22 regulations which provide—

23 “(1) that only 1 person shall be required to
24 meet the requirements of subsection (a) in cases in

1 which 2 or more persons would otherwise be re-
2 quired to meet such requirements,

3 “(2) exemptions from the requirements of this
4 section, and

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

7 (b) CONFORMING AMENDMENTS.—

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

“Sec. 6111. Disclosure of reportable transactions.”

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

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

15 “(a) IN GENERAL.—Each material advisor (as de-
16 fined in section 6111) with respect to any reportable
17 transaction (as defined in section 6707A(c)) shall main-
18 tain, in such manner as the Secretary may by regulations
19 prescribe, a list—

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

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

1 This section shall apply without regard to whether a mate-
2 rial advisor is required to file a return under section 6111
3 with respect to such transaction.”

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

6 (C) Section 6112(b), as redesignated by sub-
7 paragraph (B), is amended—

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

10 (ii) by striking “shall prescribe” in para-
11 graph (2) and inserting “may prescribe”.

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

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

15 (3)(A) The heading for section 6708 is amend-
16 ed to read as follows:

17 **“SEC. 6708. FAILURE TO MAINTAIN LISTS OF ADVISEES**
18 **WITH RESPECT TO REPORTABLE TRANS-**
19 **ACTIONS.”**

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

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

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to transactions with respect to
3 which material aid, assistance, or advice referred to in sec-
4 tion 6111(b)(1)(A)(i) of the Internal Revenue Code of
5 1986 (as added by this section) is provided after the date
6 of the enactment of this Act.

7 **SEC. 318. MODIFICATIONS TO PENALTY FOR FAILURE TO**
8 **REGISTER TAX SHELTERS.**

9 (a) IN GENERAL.—Section 6707 (relating to failure
10 to furnish information regarding tax shelters) is amended
11 to read as follows:

12 **“SEC. 6707. FAILURE TO FURNISH INFORMATION REGARD-**
13 **ING REPORTABLE TRANSACTIONS.**

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

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

19 “(2) files false or incomplete information with
20 the Secretary with respect to such transaction,

21 such person shall pay a penalty with respect to such return
22 in the amount determined under subsection (b).

23 “(b) AMOUNT OF PENALTY.—

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

4 “(2) LISTED TRANSACTIONS.—The penalty im-
5 posed under subsection (a) with respect to any listed
6 transaction shall be an amount equal to the greater
7 of—

8 “(A) \$200,000, or

9 “(B) 50 percent of the gross income de-
10 rived by such person with respect to aid, assist-
11 ance, or advice which is provided with respect
12 to the reportable transaction before the date the
13 return including the transaction is filed under
14 section 6111.

15 Subparagraph (B) shall be applied by substituting
16 ‘75 percent’ for ‘50 percent’ in the case of an inten-
17 tional failure or act described in subsection (a).

18 “(c) RESCISSION AUTHORITY.—The provisions of
19 section 6707A(d) (relating to authority of Commissioner
20 to rescind penalty) shall apply to any penalty imposed
21 under this section.

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

1 (b) CLERICAL AMENDMENT.—The item relating to
2 section 6707 in the table of sections for part I of sub-
3 chapter B of chapter 68 is amended by striking “tax shel-
4 ters” and inserting “reportable transactions”.

5 (c) EFFECTIVE DATE.—The amendments made by
6 this section shall apply to returns the due date for which
7 is after the date of the enactment of this Act.

8 **SEC. 319. MODIFICATION OF PENALTY FOR FAILURE TO**
9 **MAINTAIN LISTS OF INVESTORS.**

10 (a) IN GENERAL.—Subsection (a) of section 6708 is
11 amended to read as follows:

12 “(a) IMPOSITION OF PENALTY.—

13 “(1) IN GENERAL.—If any person who is re-
14 quired to maintain a list under section 6112(a) fails
15 to make such list available upon written request to
16 the Secretary in accordance with section
17 6112(b)(1)(A) within 20 business days after the
18 date of the Secretary’s request, such person shall
19 pay a penalty of \$10,000 for each day of such fail-
20 ure after such 20th day.

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

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

4 **SEC. 320. MODIFICATION OF ACTIONS TO ENJOIN CERTAIN**
5 **CONDUCT RELATED TO TAX SHELTERS AND**
6 **REPORTABLE TRANSACTIONS.**

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

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

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

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

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

5 the court may enjoin such person from engaging in such
6 conduct or in any other activity subject to penalty under
7 this title.

8 “(c) SPECIFIED CONDUCT.—For purposes of this
9 section, the term ‘specified conduct’ means any action, or
10 failure to take action, subject to penalty under section
11 6700, 6701, 6707, or 6708.”

12 (b) CONFORMING AMENDMENTS.—

13 (1) The heading for section 7408 is amended to
14 read as follows:

15 **“SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RE-**
16 **LATED TO TAX SHELTERS AND REPORTABLE**
17 **TRANSACTIONS.”**

18 (2) The table of sections for subchapter A of
19 chapter 67 is amended by striking the item relating
20 to section 7408 and inserting the following new
21 item:

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

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

1 **SEC. 321. 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. 322. 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 TIONNo 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. 323. 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 (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.”

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. 325. 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. 326. STATUTE OF LIMITATIONS FOR TAXABLE YEARS**
17 **FOR WHICH LISTED TRANSACTIONS NOT RE-**
18 **PORTED.**

19 (a) IN GENERAL.—Section 6501(e)(1) (relating to
20 substantial omission of items for income taxes) is amended
21 by adding at the end the following new subparagraph:

22 “(C) LISTED TRANSACTIONS.—If a tax-
23 payer fails to include on any return or state-
24 ment for any taxable year any information with
25 respect to a listed transaction (as defined in

1 section 6707A(c)(2)) which is required under
2 section 6011 to be included with such return or
3 statement, the tax for such taxable year may be
4 assessed, or a proceeding in court for collection
5 of such tax may be begun without assessment,
6 at any time within 6 years after the time the
7 return is filed. This subparagraph shall not
8 apply to any taxable year if the time for assess-
9 ment or beginning the proceeding in court has
10 expired before the time a transaction is treated
11 as a listed transaction under section 6011.”

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

16 **SEC. 327. DENIAL OF DEDUCTION FOR INTEREST ON UN-**
17 **DERPAYMENTS ATTRIBUTABLE TO NONDIS-**
18 **CLOSED REPORTABLE AND NONECONOMIC**
19 **SUBSTANCE TRANSACTIONS.**

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

24 “(m) INTEREST ON UNPAID TAXES ATTRIBUTABLE
25 TO NONDISCLOSED REPORTABLE TRANSACTIONS AND

1 NONECONOMIC SUBSTANCE TRANSACTIONS.—No deduc-
 2 tion shall be allowed under this chapter for any interest
 3 paid or accrued under section 6601 on any underpayment
 4 of tax which is attributable to—

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

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

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

15 **PART II—OTHER PROVISIONS**

16 **SEC. 331. LIMITATION ON TRANSFER OR IMPORTATION OF** 17 **BUILT-IN LOSSES.**

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

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

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

24 “(A) IN GENERAL.—If in any transaction
 25 described in subsection (a) or (b) there would

1 (but for this subsection) be an importation of a
2 net built-in loss, the basis of each property de-
3 scribed in subparagraph (B) which is acquired
4 in such transaction shall (notwithstanding sub-
5 sections (a) and (b)) be its fair market value
6 immediately after such transaction.

7 “(B) PROPERTY DESCRIBED.—For pur-
8 poses of subparagraph (A), property is de-
9 scribed in this paragraph if—

10 “(i) gain or loss with respect to such
11 property is not subject to tax under this
12 subtitle in the hands of the transferor im-
13 mediately before the transfer, and

14 “(ii) gain or loss with respect to such
15 property is subject to such tax in the
16 hands of the transferee immediately after
17 such transfer.

18 In any case in which the transferor is a part-
19 nership, the preceding sentence shall be applied
20 by treating each partner in such partnership as
21 holding such partner’s proportionate share of
22 the property of such partnership.

23 “(C) IMPORTATION OF NET BUILT-IN
24 LOSS.—For purposes of subparagraph (A),
25 there is an importation of a net built-in loss in

1 a transaction if the transferee's aggregate ad-
2 justed bases of property described in subpara-
3 graph (B) which is transferred in such trans-
4 action would (but for this paragraph) exceed
5 the fair market value of such property imme-
6 diately after such transaction."

7 "(2) LIMITATION ON TRANSFER OF BUILT-IN
8 LOSSES IN SECTION 351 TRANSACTIONS.—

9 "(A) IN GENERAL.—If—

10 "(i) property is transferred in any
11 transaction which is described in sub-
12 section (a) and which is not described in
13 paragraph (1) of this subsection, and

14 "(ii) the transferee's aggregate ad-
15 justed bases of the property so transferred
16 would (but for this paragraph) exceed the
17 fair market value of such property imme-
18 diately after such transaction,

19 then, notwithstanding subsection (a), the trans-
20 feree's aggregate adjusted bases of the property
21 so transferred shall not exceed the fair market
22 value of such property immediately after such
23 transaction.

24 "(B) ALLOCATION OF BASIS REDUC-
25 TION.—The aggregate reduction in basis by

1 reason of subparagraph (A) shall be allocated
2 among the property so transferred in proportion
3 to their respective built-in losses immediately
4 before the transaction.

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

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

18 “(1) IN GENERAL.—If property is received by a
19 corporate distributee in a distribution in a complete
20 liquidation to which section 332 applies (or in a
21 transfer described in section 337(b)(1)), the basis of
22 such property in the hands of such distributee shall
23 be the same as it would be in the hands of the trans-
24 feror; except that the basis of such property in the
25 hands of such distributee shall be the fair market

1 value of the property at the time of the distribu-
2 tion—

3 “(A) in any case in which gain or loss is
4 recognized by the liquidating corporation with
5 respect to such property, or

6 “(B) in any case in which the liquidating
7 corporation is a foreign corporation, the cor-
8 porate distributee is a domestic corporation,
9 and the corporate distributee’s aggregate ad-
10 justed bases of property described in section
11 362(e)(1)(B) which is distributed in such liq-
12 uidation would (but for this subparagraph) ex-
13 ceed the fair market value of such property im-
14 mediately after such liquidation.”

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

18 **SEC. 332. DISALLOWANCE OF CERTAIN PARTNERSHIP LOSS**

19 **TRANSFERS.**

20 (a) TREATMENT OF CONTRIBUTED PROPERTY WITH
21 BUILT-IN LOSS.—Paragraph (1) of section 704(c) is
22 amended by striking “and” at the end of subparagraph
23 (A), by striking the period at the end of subparagraph
24 (B) and inserting “, and”, and by adding at the end the
25 following:

1 “(C) if any property so contributed has a
2 built-in loss—

3 “(i) such built-in loss shall be taken
4 into account only in determining the
5 amount of items allocated to the contrib-
6 uting partner, and

7 “(ii) except as provided in regulations,
8 in determining the amount of items allo-
9 cated to other partners, the basis of the
10 contributed property in the hands of the
11 partnership shall be treated as being equal
12 to its fair market value immediately after
13 the contribution.

14 For purposes of subparagraph (C), the term ‘built-
15 in loss’ means the excess of the adjusted basis of the
16 property (determined without regard to subpara-
17 graph (C)(ii)) over its fair market value immediately
18 after the contribution.”

19 (b) ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-
20 ERTY ON TRANSFER OF PARTNERSHIP INTEREST IF
21 THERE IS SUBSTANTIAL BUILT-IN LOSS.—

22 (1) ADJUSTMENT REQUIRED.—Subsection (a)
23 of section 743 (relating to optional adjustment to
24 basis of partnership property) is amended by insert-
25 ing before the period “or unless the partnership has

1 a substantial built-in loss immediately after such
2 transfer”.

3 (2) ADJUSTMENT.—Subsection (b) of section
4 743 is amended by inserting “or with respect to
5 which there is a substantial built-in loss immediately
6 after such transfer” after “section 754 is in effect”.

7 (3) SUBSTANTIAL BUILT-IN LOSS.—Section 743
8 is amended by adding at the end the following new
9 subsection:

10 “(d) SUBSTANTIAL BUILT-IN LOSS.—

11 “(1) IN GENERAL.—For purposes of this sec-
12 tion, a partnership has a substantial built-in loss
13 with respect to a transfer of an interest in a part-
14 nership if the transferee partner’s proportionate
15 share of the adjusted basis of the partnership prop-
16 erty exceeds by more than \$250,000 the basis of
17 such partner’s interest in the partnership.

18 “(2) REGULATIONS.—The Secretary shall pre-
19 scribe such regulations as may be appropriate to
20 carry out the purposes of paragraph (1) and section
21 734(d), including regulations aggregating related
22 partnerships and disregarding property acquired by
23 the partnership in an attempt to avoid such pur-
24 poses.”

25 (4) CLERICAL AMENDMENTS.—

1 (A) The section heading for section 743 is
2 amended to read as follows:

3 **“SEC. 743. ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-**
4 **ERTY WHERE SECTION 754 ELECTION OR**
5 **SUBSTANTIAL BUILT-IN LOSS.”**

6 (B) The table of sections for subpart C of
7 part II of subchapter K of chapter 1 is amend-
8 ed by striking the item relating to section 743
9 and inserting the following new item:

“Sec. 743. Adjustment to basis of partnership property where sec-
tion 754 election or substantial built-in loss.”

10 (c) **ADJUSTMENT TO BASIS OF UNDISTRIBUTED**
11 **PARTNERSHIP PROPERTY IF THERE IS SUBSTANTIAL**
12 **BASIS REDUCTION.—**

13 (1) **ADJUSTMENT REQUIRED.—**Subsection (a)
14 of section 734 (relating to optional adjustment to
15 basis of undistributed partnership property) is
16 amended by inserting before the period “or unless
17 there is a substantial basis reduction”.

18 (2) **ADJUSTMENT.—**Subsection (b) of section
19 734 is amended by inserting “or unless there is a
20 substantial basis reduction” after “section 754 is in
21 effect”.

22 (3) **SUBSTANTIAL BASIS REDUCTION.—**Section
23 734 is amended by adding at the end the following
24 new subsection:

1 “(d) SUBSTANTIAL BASIS REDUCTION.—

2 “(1) IN GENERAL.—For purposes of this sec-
3 tion, there is a substantial basis reduction with re-
4 spect to a distribution if the sum of the amounts de-
5 scribed in subparagraphs (A) and (B) of subsection
6 (b)(2) exceeds \$250,000.

7 “(2) REGULATIONS.—

“For regulations to carry out this subsection, see
section 743(d)(2).”

8 (4) CLERICAL AMENDMENTS.—

9 (A) The section heading for section 734 is
10 amended to read as follows:

11 **“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED**
12 **PARTNERSHIP PROPERTY WHERE SECTION**
13 **754 ELECTION OR SUBSTANTIAL BASIS RE-**
14 **DUCTION.”**

15 (B) The table of sections for subpart B of
16 part II of subchapter K of chapter 1 is amend-
17 ed by striking the item relating to section 734
18 and inserting the following new item:

“Sec. 734. Adjustment to basis of undistributed partnership prop-
erty where section 754 election or substantial basis
reduction.”

19 (d) EFFECTIVE DATES.—

20 (1) SUBSECTION (a).—The amendment made
21 by subsection (a) shall apply to contributions made
22 after the date of the enactment of this Act.

1 (2) SUBSECTION (b).—The amendments made
2 by subsection (b) shall apply to transfers after the
3 date of the enactment of this Act.

4 (3) SUBSECTION (c).—The amendments made
5 by subsection (c) shall apply to distributions after
6 the date of the enactment of this Act.

7 **SEC. 333. NO REDUCTION OF BASIS UNDER SECTION 734 IN**
8 **STOCK HELD BY PARTNERSHIP IN COR-**
9 **PORATE PARTNER.**

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

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

16 “(1) no allocation may be made to stock in a
17 corporation which is a partner in the partnership,
18 and

19 “(2) any amount not allocable to stock by rea-
20 son of paragraph (1) shall be allocated under sub-
21 section (a) to other partnership property.

22 Gain shall be recognized to the partnership to the extent
23 that the amount required to be allocated under paragraph
24 (2) to other partnership property exceeds the aggregate

1 adjusted basis of such other property immediately before
2 the allocation required by paragraph (2).”

3 (b) **EFFECTIVE DATE.**—The amendment made by
4 this section shall apply to distributions after the date of
5 the enactment of this Act.

6 **SEC. 334. REPEAL OF SPECIAL RULES FOR FASITS.**

7 (a) **IN GENERAL.**—Part V of subchapter M of chap-
8 ter 1 (relating to financial asset securitization investment
9 trusts) is hereby repealed.

10 (b) **CONFORMING AMENDMENTS.**—

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

14 (2) Clause (ii) of section 382(l)(4)(B) is amend-
15 ed by striking “a REMIC to which part IV of sub-
16 chapter M applies, or a FASIT to which part V of
17 subchapter M applies,” and inserting “or a REMIC
18 to which part IV of subchapter M applies,”.

19 (3) Paragraph (1) of section 582(c) is amended
20 by striking “, and any regular interest in a
21 FASIT,”.

22 (4) Subparagraph (E) of section 856(c)(5) is
23 amended by striking the last sentence.

24 (5) Paragraph (5) of section 860G(a) is amend-
25 ed by adding “and” at the end of subparagraph (B),

1 by striking “, and” at the end of subparagraph (C)
2 and inserting a period, and by striking subparagraph
3 (D).

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

7 (7) Subparagraph (C) of section 7701(a)(19) is
8 amended by adding “and” at the end of clause (ix),
9 by striking “, and” at the end of clause (x) and in-
10 serting a period, and by striking clause (xi).

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

14 (c) EFFECTIVE DATE.—

15 (1) IN GENERAL.—Except as provided in para-
16 graph (2), the amendments made by this section
17 shall apply to taxable years beginning after Decem-
18 ber 31, 2003.

19 (2) EXCEPTION FOR EXISTING FASITS.—

20 (A) IN GENERAL.—Paragraph (1) shall not
21 apply to any FASIT in existence on the date of
22 the enactment of this Act.

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. 335. 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) CONFORMING AMENDMENT.—Paragraph (3) of
12 section 163(l) is amended by striking “or a related party”
13 in the material preceding subparagraph (A) and inserting
14 “or any other person”.

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

18 **SEC. 336. EXPANDED AUTHORITY TO DISALLOW TAX BENE-**
19 **FITS UNDER SECTION 269.**

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

23 “(a) IN GENERAL.—If—

24 “(1)(A) any person acquires stock in a corpora-
25 tion, or

1 “(B) any corporation acquires, directly or indi-
 2 rectly, property of another corporation and the basis
 3 of such property, in the hands of the acquiring cor-
 4 poration, is determined by reference to the basis in
 5 the hands of the transferor corporation, and

6 “(2) the principal purpose for which such acqui-
 7 sition was made is evasion or avoidance of Federal
 8 income tax by securing the benefit of a deduction,
 9 credit, or other allowance,

10 then the Secretary may disallow such deduction, credit,
 11 or other allowance.”

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

15 **SEC. 337. MODIFICATIONS OF CERTAIN RULES RELATING**
 16 **TO CONTROLLED FOREIGN CORPORATIONS.**

17 (a) LIMITATION ON EXCEPTION FROM PFIC RULES
 18 FOR UNITED STATES SHAREHOLDERS OF CONTROLLED
 19 FOREIGN CORPORATIONS.—Paragraph (2) of section
 20 1297(e) (relating to passive investment company) is
 21 amended by adding at the end the following flush sen-
 22 tence:

23 “Such term shall not include any period if there is
 24 only a remote likelihood of an inclusion in gross in-

1 come under section 951(a)(1)(A)(i) of subpart F in-
2 come of such corporation for such period.”

3 (b) DETERMINATION OF PRO RATA SHARE OF SUB-
4 PART F INCOME.—Subsection (a) of section 951 (relating
5 to amounts included in gross income of United States
6 shareholders) is amended by adding at the end the fol-
7 lowing new paragraph:

8 “(4) SPECIAL RULES FOR DETERMINING PRO
9 RATA SHARE OF SUBPART F INCOME.—The pro rata
10 share under paragraph (2) shall be determined by
11 disregarding—

12 “(A) any rights lacking substantial eco-
13 nomic effect, and

14 “(B) stock owned by a shareholder who is
15 a tax-indifferent party (as defined in section
16 7701(m)(3)) if the amount which would (but
17 for this paragraph) be allocated to such share-
18 holder does not reflect such shareholder’s eco-
19 nomic share of the earnings and profits of the
20 corporation.”

21 (c) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to taxable years on controlled for-
23 eign corporation beginning after February 13, 2003, and
24 to taxable years of United States shareholder in which or

1 with which such taxable years of controlled foreign cor-
 2 porations end.

3 **SEC. 338. BASIS FOR DETERMINING LOSS ALWAYS RE-**
 4 **DUCED BY NONTAXED PORTION OF DIVI-**
 5 **DENDS.**

6 (a) IN GENERAL.—Section 1059 (relating to cor-
 7 porate shareholder’s basis in stock reduced by nontaxed
 8 portion of extraordinary dividends) is amended by redesi-
 9 gnating subsection (g) as subsection (h) and by inserting
 10 after subsection (f) the following new subsection:

11 “(g) BASIS FOR DETERMINING LOSS ALWAYS RE-
 12 DUCED BY NONTAXED PORTION OF DIVIDENDS.—The
 13 basis of stock in a corporation (for purposes of deter-
 14 mining loss) shall be reduced by the nontaxed portion of
 15 any dividend received with respect to such stock if this
 16 section does not otherwise apply to such dividend.”

17 (b) EFFECTIVE DATE.—The amendment made by
 18 this section shall apply to dividends received after the date
 19 of the enactment of this Act.

20 **SEC. 339. AFFIRMATION OF CONSOLIDATED RETURN REGU-**
 21 **LATION AUTHORITY.**

22 (a) IN GENERAL.—Section 1502 (relating to consoli-
 23 dated return regulations) is amended by adding at the end
 24 the following new sentence: “In prescribing such regula-
 25 tions, the Secretary may prescribe rules applicable to cor-

1 porations filing consolidated returns under section 1501
2 that are different from other provisions of this title that
3 would apply if such corporations filed separate returns.”

4 (b) RESULT NOT OVERTURNED.—Notwithstanding
5 subsection (a), the Internal Revenue Code of 1986 shall
6 be construed by treating Treasury regulation § 1.1502–
7 20(c)(1)(iii) (as in effect on January 1, 2001) as being
8 inapplicable to the type of factual situation in 255 F.3d
9 1357 (Fed. Cir. 2001).

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

13 **Subtitle C—Prevention of Cor-**
14 **porate Expatriation To Avoid**
15 **United States Income Tax**

16 **SEC. 341. PREVENTION OF CORPORATE EXPATRIATION TO**
17 **AVOID UNITED STATES INCOME TAX.**

18 (a) IN GENERAL.—Paragraph (4) of section 7701(a)
19 (defining domestic) is amended to read as follows:

20 “(4) DOMESTIC.—

21 “(A) IN GENERAL.—Except as provided in
22 subparagraph (B), the term ‘domestic’ when ap-
23 plied to a corporation or partnership means cre-
24 ated or organized in the United States or under
25 the law of the United States or of any State

1 unless, in the case of a partnership, the Sec-
2 retary provides otherwise by regulations.

3 “(B) CERTAIN CORPORATIONS TREATED
4 AS DOMESTIC.—

5 “(i) IN GENERAL.—The acquiring cor-
6 poration in a corporate expatriation trans-
7 action shall be treated as a domestic cor-
8 poration.

9 “(ii) CORPORATE EXPATRIATION
10 TRANSACTION.—For purposes of this sub-
11 paragraph, the term ‘corporate expatria-
12 tion transaction’ means any transaction
13 if—

14 “(I) a nominally foreign corpora-
15 tion (referred to in this subparagraph
16 as the ‘acquiring corporation’) ac-
17 quires, as a result of such transaction,
18 directly or indirectly substantially all
19 of the properties held directly or indi-
20 rectly by a domestic corporation, and

21 “(II) immediately after the trans-
22 action, more than 80 percent of the
23 stock (by vote or value) of the acquir-
24 ing corporation is held by former
25 shareholders of the domestic corpora-

1 tion by reason of holding stock in the
2 domestic corporation.

3 “(iii) LOWER STOCK OWNERSHIP RE-
4 QUIREMENT IN CERTAIN CASES.—Sub-
5 clause (II) of clause (ii) shall be applied by
6 substituting ‘50 percent’ for ‘80 percent’
7 with respect to any nominally foreign cor-
8 poration if—

9 “(I) such corporation does not
10 have substantial business activities
11 (when compared to the total business
12 activities of the expanded affiliated
13 group) in the foreign country in which
14 or under the law of which the corpora-
15 tion is created or organized, and

16 “(II) the stock of the corporation
17 is publicly traded and the principal
18 market for the public trading of such
19 stock is in the United States.

20 “(iv) PARTNERSHIP TRANSACTIONS.—
21 The term ‘corporate expatriation trans-
22 action’ includes any transaction if—

23 “(I) a nominally foreign corpora-
24 tion (referred to in this subparagraph
25 as the ‘acquiring corporation’) ac-

1 quires, as a result of such transaction,
2 directly or indirectly properties consti-
3 tuting a trade or business of a domes-
4 tic partnership,

5 “(II) immediately after the trans-
6 action, more than 80 percent of the
7 stock (by vote or value) of the acquir-
8 ing corporation is held by former
9 partners of the domestic partnership
10 or related foreign partnerships (deter-
11 mined without regard to stock of the
12 acquiring corporation which is sold in
13 a public offering related to the trans-
14 action), and

15 “(III) the acquiring corporation
16 meets the requirements of subclauses
17 (I) and (II) of clause (iii).

18 “(v) SPECIAL RULES.—For purposes
19 of this subparagraph—

20 “(I) a series of related trans-
21 actions shall be treated as 1 trans-
22 action, and

23 “(II) stock held by members of
24 the expanded affiliated group which
25 includes the acquiring corporation

1 shall not be taken into account in de-
2 termining ownership.

3 “(vi) OTHER DEFINITIONS.—For pur-
4 poses of this subparagraph—

5 “(I) NOMINALLY FOREIGN COR-
6 PORATION.—The term ‘nominally for-
7 eign corporation’ means any corpora-
8 tion which would (but for this sub-
9 paragraph) be treated as a foreign
10 corporation.

11 “(II) EXPANDED AFFILIATED
12 GROUP.—The term ‘expanded affili-
13 ated group’ means an affiliated group
14 (as defined in section 1504(a) without
15 regard to section 1504(b)).

16 “(III) RELATED FOREIGN PART-
17 NERSHIP.—A foreign partnership is
18 related to a domestic partnership if
19 they are under common control (with-
20 in the meaning of section 482), or
21 they shared the same trademark or
22 tradename.”

23 (b) EFFECTIVE DATES.—

1 (1) IN GENERAL.—The amendment made by
2 this section shall apply to corporate expatriation
3 transactions completed after September 11, 2001.

4 (2) SPECIAL RULE.—The amendment made by
5 this section shall also apply to corporate expatriation
6 transactions completed on or before September 11,
7 2001, but only with respect to taxable years of the
8 acquiring corporation beginning after December 31,
9 2003.

10 **Subtitle D—Inclusion in Gross In-**
11 **come of Funded Deferred Com-**
12 **ensation of Corporate Insiders**

13 **SEC. 351. INCLUSION IN GROSS INCOME OF FUNDED DE-**
14 **FERRED COMPENSATION OF CORPORATE IN-**
15 **SIDERS.**

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

19 **“SEC. 409A. INCLUSION IN GROSS INCOME OF FUNDED DE-**
20 **FERRED COMPENSATION OF CORPORATE IN-**
21 **SIDERS.**

22 “(a) IN GENERAL.—If an employer maintains a fund-
23 ed deferred compensation plan—

24 “(1) compensation of any disqualified individual
25 which is deferred under such funded deferred com-

1 pensation plan shall be included in the gross income
2 of the disqualified individual or beneficiary for the
3 1st taxable year in which there is no substantial risk
4 of forfeiture of the rights to such compensation, and

5 “(2) the tax treatment of any amount made
6 available under the plan to a disqualified individual
7 or beneficiary shall be determined under section 72
8 (relating to annuities, etc.).

9 “(b) FUNDED DEFERRED COMPENSATION PLAN.—
10 For purposes of this section—

11 “(1) IN GENERAL.—The term ‘funded deferred
12 compensation plan’ means any plan providing for the
13 deferral of compensation unless—

14 “(A) the employee’s rights to the com-
15 pensation deferred under the plan are no great-
16 er than the rights of a general creditor of the
17 employer, and

18 “(B) all amounts set aside (directly or in-
19 directly) for purposes of paying the deferred
20 compensation, and all income attributable to
21 such amounts, remain (until made available to
22 the participant or other beneficiary) solely the
23 property of the employer (without being re-
24 stricted to the provision of benefits under the
25 plan), and

1 “(C) the amounts referred to in subpara-
2 graph (B) are available to satisfy the claims of
3 the employer’s general creditors at all times
4 (not merely after bankruptcy or insolvency).

5 Such term shall not include a qualified employer
6 plan.

7 “(2) SPECIAL RULES.—

8 “(A) EMPLOYEE’S RIGHTS.—A plan shall
9 be treated as failing to meet the requirements
10 of paragraph (1)(A) unless—

11 “(i) the compensation deferred under
12 the plan is payable only upon separation
13 from service, death, or at a specified time
14 (or pursuant to a fixed schedule), and

15 “(ii) the plan does not permit the ac-
16 celeration of the time such deferred com-
17 pensation is payable by reason of any
18 event.

19 If the employer and employee agree to a modi-
20 fication of the plan that accelerates the time for
21 payment of any deferred compensation, then all
22 compensation previously deferred under the
23 plan shall be includible in gross income for the
24 taxable year during which such modification
25 takes effect and the taxpayer shall pay interest

1 at the underpayment rate on the underpay-
2 ments that would have occurred had the de-
3 ferred compensation been includible in gross in-
4 come on the earliest date that there is no sub-
5 stantial risk of forfeiture of the rights to such
6 compensation.

7 “(B) CREDITOR’S RIGHTS.—A plan shall
8 be treated as failing to meet the requirements
9 of paragraph (1)(B) with respect to amounts
10 set aside in a trust unless—

11 “(i) the employee has no beneficial in-
12 terest in the trust,

13 “(ii) assets in the trust are available
14 to satisfy claims of general creditors at all
15 times (not merely after bankruptcy or in-
16 solvency), and

17 “(iii) there is no factor that would
18 make it more difficult for general creditors
19 to reach the assets in the trust than it
20 would be if the trust assets were held di-
21 rectly by the employer in the United
22 States.

23 Except as provided in regulations prescribed by
24 the Secretary, such a factor shall include the lo-
25 cation of the trust outside the United States.

1 “(c) DISQUALIFIED INDIVIDUAL.—For purposes of
2 this section, the term ‘disqualified individual’ means, with
3 respect to a corporation, any individual—

4 “(1) who is subject to the requirements of sec-
5 tion 16(a) of the Securities Exchange Act of 1934
6 with respect to such corporation, or

7 “(2) who would be subject to such requirements
8 if such corporation were an issuer of equity securi-
9 ties referred to in such section.

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

12 “(1) QUALIFIED EMPLOYER PLAN.—The term
13 ‘qualified employer plan’ means—

14 “(A) any plan, contract, pension, account,
15 or trust described in subparagraph (A) or (B)
16 of section 219(g)(5), and

17 “(B) any other plan of an organization ex-
18 empt from tax under subtitle A.

19 “(2) PLAN INCLUDES ARRANGEMENTS, ETC.—
20 The term ‘plan’ includes any agreement or arrange-
21 ment.

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

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

3 “(4) TREATMENT OF EARNINGS.—Except for
4 purposes of subsection (a)(1) and the last sentence
5 of (b)(2)(A), references to deferred compensation
6 shall be treated as including references to income at-
7 tributable to such compensation or such income.”

8 (b) CLERICAL AMENDMENT.—The table of sections
9 for such subpart A is amended by adding at the end the
10 following new item:

 “Sec. 409A. Inclusion in gross income of funded deferred com-
 pensation of corporate insiders.”

11 (b) EFFECTIVE DATE.—The amendments made by
12 this section shall apply to amounts deferred after July 10,
13 2002.

○