

107TH CONGRESS
2^D SESSION

H. R. 5095

To amend the Internal Revenue Code of 1986 to improve and simplify compliance with the internal revenue laws, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JULY 11, 2002

Mr. THOMAS (for himself, Mr. MCCRERY, Mrs. JOHNSON of Connecticut, and Mr. HOUGHTON) 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 improve and simplify compliance with the internal revenue laws, and for other purposes.

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

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

4 (a) SHORT TITLE.—This Act may be cited as the
5 “American Competitiveness and Corporate Accountability
6 Act of 2002”.

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

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

4 (c) TABLE OF CONTENTS.—

Sec. 1. Short title; etc.

TITLE I—PROVISIONS RELATING TO TAX SHELTERS

Subtitle A—Taxpayer-Related Provisions

- Sec. 101. Clarification of economic substance doctrine.
- Sec. 102. Penalty for failing to disclose reportable transactions.
- Sec. 103. Accuracy-related penalty for listed transactions, other reportable transactions having a significant tax avoidance purpose, etc.
- Sec. 104. Penalty for understatements attributable to transactions lacking economic substance, etc.
- Sec. 105. Tax shelter exception to confidentiality privileges relating to taxpayer communications.
- Sec. 106. Disallowance of certain partnership loss transfers.
- Sec. 107. Modifications of substantial understatement penalty for nonreportable transactions.

Subtitle B—Promoter-Related Provisions

- Sec. 111. Disclosure of reportable transactions.
- Sec. 112. Failure to furnish information regarding reportable transactions.
- Sec. 113. Modification of penalty for failure to maintain lists of investors.
- Sec. 114. Modification of actions to enjoin certain conduct related to tax shelters and reportable transactions.
- Sec. 115. Penalty on failure to report interests in foreign financial accounts.
- Sec. 116. Frivolous tax submissions.
- Sec. 117. Regulation of individuals practicing before the Department of the Treasury.
- Sec. 118. Penalty on promoters of tax shelters.

Subtitle C—Other Provisions

- Sec. 121. Treatment of stripped interests in bond and preferred stock funds, etc.
- Sec. 122. Minimum holding period for foreign tax credit on withholding taxes on income other than dividends.
- Sec. 123. Affirmation of consolidated return regulation authority.

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

- Sec. 201. Reduction in potential for earnings stripping by further limiting deduction for interest on certain indebtedness.
- Sec. 202. Tax treatment of expatriated entities.
- Sec. 203. Excise tax on stock compensation of insiders in expatriated corporations.
- Sec. 204. Reporting of taxable mergers and acquisitions.

Sec. 205. Studies.

TITLE III—SIMPLIFICATION OF RULES RELATING TO THE
TAXATION OF UNITED STATES BUSINESSES OPERATING ABROAD

Subtitle A—Treatment of Controlled Foreign Corporations

- Sec. 301. Repeal of CFC rules on foreign base company sales and service income.
- Sec. 302. Look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company income rules.
- Sec. 303. Look-thru treatment for sales of partnership interests.
- Sec. 304. Repeal of foreign personal holding company rules and foreign investment company rules.
- Sec. 305. Clarification of treatment of pipeline transportation income.
- Sec. 306. Determination of foreign personal holding company income with respect to transactions in commodities.
- Sec. 307. Effective date.

Subtitle B—Provisions Relating to Foreign Tax Credit

- Sec. 311. Interest expense allocation rules.
- Sec. 312. Recharacterization of overall domestic loss.
- Sec. 313. Reduction to 3 foreign tax credit baskets.
- Sec. 314. 10-year foreign tax credit carryforward.
- Sec. 315. Repeal of limitation of foreign tax credit under alternative minimum tax.
- Sec. 316. Look-thru rules to apply to dividends from noncontrolled section 902 corporations.
- Sec. 317. Attribution of stock ownership through partnerships to apply in determining section 902 and 960 credits.

Subtitle C—Other Provisions

- Sec. 321. Application of uniform capitalization rules to foreign persons.
- Sec. 322. United States property not to include certain assets acquired by dealers in ordinary course of trade or business.
- Sec. 323. Treatment of certain dividends of regulated investment companies.
- Sec. 324. Election not to use average exchange rate for foreign tax paid other than in functional currency.
- Sec. 325. Repeal of withholding tax on dividends from certain foreign corporations.
- Sec. 326. Increase in expensing under section 179.
- Sec. 327. Repeal of exclusion for extraterritorial income.
- Sec. 328. Repeal of FSC transitional rules.

TITLE IV—OTHER PROVISIONS

- Sec. 401. Extension of Internal Revenue Service user fees.
- Sec. 402. Extension of customs user fees.
- Sec. 403. Inclusion in gross income of funded deferred compensation of corporate insiders.
- Sec. 404. Simplification of excise tax imposed on bows and arrows.
- Sec. 405. Exclusion from gross income for interest on overpayments of income tax by individuals.

Sec. 406. Deposits made to suspend running of interest on potential underpayments.

Sec. 407. Partial payment of tax liability in installment agreements.

Sec. 408. Extension of transfers of excess pension assets to retiree health accounts.

Sec. 409. Clarification of rules for payment of estimated tax for certain deemed asset sales.

1 **TITLE I—PROVISIONS RELATING**
 2 **TO TAX SHELTERS**
 3 **Subtitle A—Taxpayer-Related**
 4 **Provisions**

5 **SEC. 101. CLARIFICATION OF ECONOMIC SUBSTANCE DOC-**
 6 **TRINE.**

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

10 “(m) CLARIFICATION OF ECONOMIC SUBSTANCE
 11 DOCTRINE; ETC.—

12 “(1) GENERAL RULES.—

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

17 “(B) DEFINITION OF ECONOMIC SUB-
 18 STANCE.—For purposes of subparagraph (A), a
 19 transaction has economic substance only if—

20 “(i) the transaction changes in a
 21 meaningful way (apart from Federal in-

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

3 “(ii) the taxpayer has a substantial
4 nontax purpose for entering into such
5 transaction and the transaction is a rea-
6 sonable means of accomplishing such pur-
7 pose.

8 “(2) ECONOMIC SUBSTANCE DOCTRINE.—For
9 purposes of this subsection, the term ‘economic sub-
10 stance doctrine’ means the common law doctrine
11 under which tax benefits under subtitle A with re-
12 spect to a transaction are not allowable if the trans-
13 action does not have economic substance or lacks a
14 business purpose.

15 “(3) REGULATIONS.—The Secretary shall pre-
16 scribe such regulations as may be appropriate to
17 carry out the purposes of this subsection, including
18 regulations on the application of this subsection to
19 transactions involving tax-indifferent parties.”

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

1 **SEC. 102. PENALTY FOR FAILING TO DISCLOSE REPORT-**
2 **ABLE TRANSACTIONS.**

3 (a) IN GENERAL.—Part I of subchapter B of chapter
4 68 (relating to assessable penalties) is amended by insert-
5 ing after section 6707 the following new section:

6 **“SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE REPORT-**
7 **ABLE TRANSACTION INFORMATION WITH RE-**
8 **TURN.**

9 “(a) IMPOSITION OF PENALTY.—Any person who
10 fails to include on any return or statement any informa-
11 tion with respect to a reportable transaction which is re-
12 quired under section 6011 to be included with such return
13 or statement shall pay a penalty in the amount determined
14 under subsection (b).

15 “(b) AMOUNT OF PENALTY.—

16 “(1) IN GENERAL.—Except as provided in para-
17 graph (2), the amount of the penalty under sub-
18 section (a) shall be—

19 “(A) \$10,000 in the case of a natural per-
20 son, and

21 “(B) \$50,000 in any other case.

22 “(2) LISTED TRANSACTION.—The amount of
23 the penalty under subsection (a) with respect to a
24 listed transaction shall be—

25 “(A) \$100,000 in the case of a natural
26 person, and

1 “(B) \$200,000 in any other case.

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

3 “(1) REPORTABLE TRANSACTION.—The term
4 ‘reportable transaction’ means any transaction with
5 respect to which information is required to be in-
6 cluded with a return or statement because, as deter-
7 mined under regulations prescribed under section
8 6011, such transaction is of a type which the Sec-
9 retary determines as having a potential for tax
10 avoidance or evasion.

11 “(2) LISTED TRANSACTION.—The term ‘listed
12 transaction’ means a reportable transaction which is
13 the same as, or similar to, a transaction specifically
14 identified by the Secretary as a tax avoidance trans-
15 action for purposes of section 6011.

16 “(d) AUTHORITY TO RESCIND PENALTY.—

17 “(1) IN GENERAL.—The Commissioner of In-
18 ternal Revenue may rescind all or any portion of any
19 penalty imposed by this section with respect to any
20 violation if—

21 “(A) the violation is with respect to a re-
22 portable transaction other than a listed trans-
23 action,

1 “(B) the person on whom the penalty is
2 imposed has a history of complying with the re-
3 quirements of this title,

4 “(C) it is shown that the violation is due
5 to an unintentional mistake of fact,

6 “(D) imposing the penalty would be
7 against equity and good conscience, and

8 “(E) rescinding the penalty would promote
9 compliance with the requirements of this title
10 and effective tax administration.

11 “(2) DISCRETION.—The exercise of authority
12 under paragraph (1) shall be at the sole discretion
13 of the Commissioner and may be delegated only to
14 the head of the Office of Tax Shelter Analysis. The
15 Commissioner, in his sole discretion, may establish a
16 procedure to determine if a penalty should be re-
17 ferred to the Commissioner or the head of such Of-
18 fice for a determination under paragraph (1).

19 “(3) NO APPEAL.—Notwithstanding any other
20 provision of law, any determination under this sub-
21 section may not be reviewed in any administrative or
22 judicial proceeding.

23 “(4) RECORDS.—If a penalty is rescinded under
24 paragraph (1), the Commissioner shall place in the
25 file in the Office of the Commissioner the opinion of

1 the Commissioner or the head of the Office of Tax
2 Shelter Analysis with respect to the determination,
3 including—

4 “(A) the reasons for the rescission, and

5 “(B) the amount of the penalty rescinded.

6 “(e) COORDINATION WITH OTHER PENALTIES.—The
7 penalty imposed by this section shall be in addition to any
8 other penalty imposed by this title.”

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

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

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

17 (d) REPORT.—The Commissioner of Internal Rev-
18 enue shall annually report to the Committee on Ways and
19 Means of the House of Representatives and the Committee
20 on Finance of the Senate—

21 (1) a summary of the total number and aggre-
22 gate amount of penalties imposed, and rescinded,
23 under section 6707A of the Internal Revenue Code
24 of 1986, and

1 (2) a description of each penalty rescinded
2 under section 6707(c) of such Code and the reasons
3 therefor.

4 **SEC. 103. ACCURACY-RELATED PENALTY FOR LISTED**
5 **TRANSACTIONS, OTHER REPORTABLE TRANS-**
6 **ACTIONS HAVING A SIGNIFICANT TAX AVOID-**
7 **ANCE PURPOSE, ETC.**

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

11 **“SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PEN-**
12 **ALTY ON UNDERSTATEMENTS WITH RESPECT**
13 **TO REPORTABLE TRANSACTIONS.**

14 “(a) IMPOSITION OF PENALTY.—If a taxpayer has a
15 reportable transaction understatement for any taxable
16 year, there shall be added to the tax an amount equal to
17 20 percent of the amount of such understatement.

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

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

22 “(A) the product of—

23 “(i) the amount of the increase (if
24 any) in taxable income which results from
25 a difference between the proper tax treat-

1 ment of an item to which this section ap-
2 plies and the taxpayer’s treatment of such
3 item (as shown on the taxpayer’s return of
4 tax), and

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

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

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

21 “(2) ITEMS TO WHICH SECTION APPLIES.—This
22 section shall apply to any item which is attributable
23 to—

24 “(A) any listed transaction, and

1 “(B) any reportable transaction (other
2 than a listed transaction) if a significant pur-
3 pose of such transaction is the avoidance or
4 evasion of Federal income tax.

5 “(c) HIGHER PENALTY FOR NONDISCLOSED TRANS-
6 ACTIONS.—Subsection (a) shall be applied by substituting
7 ‘30 percent’ for ‘20 percent’ with respect to the portion
8 of any reportable transaction understatement with respect
9 to which the requirement of section 6664(d)(2)(A) is not
10 met.

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

16 “(e) SPECIAL RULES.—

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

20 “(A) the amount of such understatement
21 (determined without regard to this paragraph)
22 shall be increased by the aggregate amount of
23 reportable transaction understatements and
24 noneconomic substance transaction understate-
25 ments for purposes of determining whether

1 such understatement is a substantial under-
2 statement under section 6662(d)(1), and

3 “(B) the addition to tax under section
4 6662(a) shall apply only to the excess of the
5 amount of the substantial understatement (if
6 any) after the application of subparagraph (A)
7 over the aggregate amount of reportable trans-
8 action understatements and noneconomic sub-
9 stance transaction understatements.

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

12 “(A) APPLICATION OF FRAUD PENALTY.—
13 References to an underpayment in section 6663
14 shall be treated as including references to a re-
15 portable transaction understatement and non-
16 economic substance transaction understate-
17 ments.

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

22 “(3) SPECIAL RULE FOR AMENDED RE-
23 TURNS.—Except as provided in regulations, in no
24 event shall any tax treatment included with an
25 amendment or supplement to a return of tax be

1 taken into account in determining the amount of any
2 reportable transaction understatement or non-
3 economic substance transaction understatement if
4 the amendment or supplement is filed after the ear-
5 lier of the date the taxpayer is first contacted by the
6 Secretary regarding the examination of the return or
7 such other date as is specified by the Secretary.

8 “(4) NONECONOMIC SUBSTANCE TRANSACTION
9 UNDERSTATEMENT.—For purposes of this sub-
10 section, the term ‘noneconomic substance trans-
11 action understatement’ has the meaning given to
12 such term by section 6662B(c).”

13 (b) DETERMINATION OF OTHER UNDERSTATE-
14 MENTS.—Subparagraph (A) of section 6662(d)(2) is
15 amended by adding at the end the following flush sen-
16 tence:

17 “The excess under the preceding sentence shall
18 be determined without regard to items to which
19 section 6662A applies and without regard to
20 items with respect to which a penalty is im-
21 posed by section 6662B.”

22 (c) REASONABLE CAUSE EXCEPTION.—

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

1 “(d) REASONABLE CAUSE EXCEPTION FOR REPORT-
2 ABLE TRANSACTION UNDERSTATEMENTS.—

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

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

12 “(A) the relevant facts affecting the tax
13 treatment of the item are adequately disclosed
14 in accordance with the regulations prescribed
15 under section 6011,

16 “(B) there is or was substantial authority
17 for such treatment, and

18 “(C) the taxpayer reasonably believed that
19 such treatment was more likely than not the
20 proper treatment.

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

23 “(A) IN GENERAL.—A taxpayer shall be
24 treated as having a reasonable belief with re-

1 spect to the tax treatment of an item only if
2 such belief—

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

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

13 “(B) CERTAIN OPINIONS MAY NOT BE RE-
14 LIED UPON.—

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

19 “(I) the tax advisor is described
20 in clause (ii), or

21 “(II) the opinion is described in
22 clause (iii).

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

1 “(I) is a material advisor (within
2 the meaning of section 6111(b)(1))
3 and participates in the organization,
4 management, promotion, or sale of
5 the transaction or is related (within
6 the meaning of section 267(b) or
7 707(b)(1)) to any person who so par-
8 ticipates,

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

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

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

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

1 “(I) is based on unreasonable
2 factual or legal assumptions (includ-
3 ing assumptions as to future events),

4 “(II) unreasonably relies on rep-
5 resentations, statements, findings, or
6 agreements of the taxpayer or any
7 other person,

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

10 “(IV) fails to meet any other re-
11 quirement as the Secretary may pre-
12 scribe.”

13 (2) CONFORMING AMENDMENTS.—

14 (A) Paragraph (1) of section 6664(c) is
15 amended by striking “this part” and inserting
16 “section 6662 or 6663”.

17 (B) The heading for subsection (c) of sec-
18 tion 6664 is amended by inserting “FOR UN-
19 DERPAYMENTS” after “EXCEPTION”.

20 (d) REDUCTION IN PENALTY FOR SUBSTANTIAL UN-
21 DERSTATEMENT OF INCOME TAX NOT TO APPLY TO TAX
22 SHELTERS.—Subparagraph (C) of section 6662(d)(2) (re-
23 lating to substantial understatement of income tax) is
24 amended to read as follows:

1 “(C) REDUCTION NOT TO APPLY TO TAX
2 SHELTERS.—

3 “(i) IN GENERAL.—Subparagraph (B)
4 shall not apply to any item attributable to
5 a tax shelter.

6 “(ii) TAX SHELTER.—For purposes of
7 clause (i), the term ‘tax shelter’ means—

8 “(I) a partnership or other enti-
9 ty,

10 “(II) any investment plan or ar-
11 rangement, or

12 “(III) any other plan or arrange-
13 ment,

14 if a significant purpose of such partner-
15 ship, entity, plan, or arrangement is the
16 avoidance or evasion of Federal income
17 tax.”

18 (e) CONFORMING AMENDMENTS.—

19 (1) Sections 461(i)(3)(C), 1274(b)(3), and
20 7525(b) are each amended by striking “section
21 6662(d)(2)(C)(iii)” and inserting “section
22 6662(d)(2)(C)(ii)”.

23 (2) The heading for section 6662 is amended to
24 read as follows:

1 **“SEC. 6662. IMPOSITION OF ACCURACY-RELATED PENALTY**
 2 **ON UNDERPAYMENTS.”**

3 (3) The table of sections for part II of sub-
 4 chapter A of chapter 68 is amended by striking the
 5 item relating to section 6662 and inserting the fol-
 6 lowing new items:

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

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

7 (f) **EFFECTIVE DATE.**—The amendments made by
 8 this section shall apply to taxable years ending after the
 9 date of the enactment of this Act.

10 **SEC. 104. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
 11 **UTABLE TO TRANSACTIONS LACKING ECO-**
 12 **NOMIC SUBSTANCE, ETC.**

13 (a) **IN GENERAL.**—Subchapter A of chapter 68 is
 14 amended by inserting after section 6662A the following
 15 new section:

16 **“SEC. 6662B. PENALTY FOR UNDERSTATEMENTS ATTRIB-**
 17 **UTABLE TO TRANSACTIONS LACKING ECO-**
 18 **NOMIC SUBSTANCE, ETC.**

19 “(a) **IMPOSITION OF PENALTY.**—If a taxpayer has an
 20 noneconomic substance transaction understatement for
 21 any taxable year, there shall be added to the tax an
 22 amount equal to 40 percent of the amount of such under-
 23 statement.

1 “(b) REDUCTION OF PENALTY FOR DISCLOSED
2 TRANSACTIONS.—Subsection (a) shall be applied by sub-
3 stituting ‘20 percent’ for ‘40 percent’ with respect to the
4 portion of any noneconomic substance transaction under-
5 statement with respect to which the relevant facts affect-
6 ing the tax treatment of the item are adequately disclosed
7 in accordance with the regulations prescribed under sec-
8 tion 6011.

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

11 “(1) IN GENERAL.—The term ‘noneconomic
12 substance transaction understatement’ means any
13 amount which would be an understatement under
14 section 6662A(b)(1) if such section only applied to
15 items attributable to noneconomic substance trans-
16 actions.

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

20 “(A) the transaction lacks economic sub-
21 stance (within the meaning of section 7701(m)),
22 or

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

1 “(3) EXCEPTION FOR PERSONAL TRANS-
 2 ACTIONS OF INDIVIDUALS.—In the case of an indi-
 3 vidual, such term shall not include any transaction
 4 other than a transaction entered into in connection
 5 with a trade or business or an activity engaged in
 6 for the production of income.

7 “(d) COORDINATION WITH OTHER PENALTIES.—

8 “(1) IN GENERAL.—Except as otherwise pro-
 9 vided in this part, the penalty imposed by this sec-
 10 tion shall be in addition to any other penalty im-
 11 posed by this title.

12 “(2) CROSS REFERENCE.—

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

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

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

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

1 **SEC. 105. TAX SHELTER EXCEPTION TO CONFIDENTIALITY**
2 **PRIVILEGES RELATING TO TAXPAYER COM-**
3 **MUNICATIONS.**

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

7 “(b) SECTION NOT TO APPLY TO COMMUNICATIONS
8 REGARDING TAX SHELTERS.—The privilege under sub-
9 section (a) shall not apply to any written communication
10 which is—

11 “(1) between a federally authorized tax practi-
12 tioner and—

13 “(A) any person,

14 “(B) any director, officer, employee, agent,
15 or representative of the person, or

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

18 “(2) in connection with the promotion of the di-
19 rect or indirect participation of the person in any
20 tax shelter (as defined in section
21 6662(d)(2)(C)(ii)).”

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

1 **SEC. 106. DISALLOWANCE OF CERTAIN PARTNERSHIP LOSS**
2 **TRANSFERS.**

3 (a) TREATMENT OF CONTRIBUTED PROPERTY WITH
4 BUILT-IN LOSS.—Paragraph (1) of section 704(c) is
5 amended by striking “and” at the end of subparagraph
6 (A), by striking the period at the end of subparagraph
7 (B) and inserting “, and”, and by adding at the end the
8 following:

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

11 “(i) such built-in loss shall be taken
12 into account only in determining the
13 amount of items allocated to the contrib-
14 uting partner, and

15 “(ii) except as provided in regulations,
16 in determining the amount of items allo-
17 cated to other partners, the basis of the
18 contributed property in the hands of the
19 partnership shall be treated as being equal
20 to its fair market value immediately after
21 the contribution.

22 For purposes of subparagraph (C), the term ‘built-
23 in loss’ means the excess of the adjusted basis of the
24 property over its fair market value immediately after
25 the contribution.”

1 (b) ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-
2 erty ON TRANSFER OF PARTNERSHIP INTEREST IF
3 THERE IS SUBSTANTIAL BUILT-IN LOSS.—

4 (1) ADJUSTMENT REQUIRED.—Subsection (a)
5 of section 743 (relating to optional adjustment to
6 basis of partnership property) is amended by insert-
7 ing before the period “or unless the partnership has
8 a substantial built-in loss immediately after such
9 transfer”.

10 (2) ADJUSTMENT.—Subsection (b) of section
11 743 is amended by inserting “or with respect to
12 which there is a substantial built-in loss immediately
13 after such transfer” after “section 754 is in effect”.

14 (3) SUBSTANTIAL BUILT-IN LOSS.—Section 743
15 is amended by adding at the end the following new
16 subsection:

17 “(d) SUBSTANTIAL BUILT-IN LOSS.—

18 “(1) IN GENERAL.—For purposes of this sec-
19 tion, a partnership has a substantial built-in loss
20 with respect to a transfer of an interest in a part-
21 nership if—

22 “(A) the transferee partner’s proportionate
23 share of the adjusted basis of the partnership
24 property exceeds the basis of such partner’s in-
25 terest in the partnership, and

1 “(B) such excess exceeds the greater of—

2 “(i) \$250,000, or

3 “(ii) 10 percent of the basis of such
4 partner’s interest in the partnership.

5 “(2) REGULATIONS.—The Secretary shall pre-
6 scribe such regulations as may be appropriate to
7 carry out the purposes of paragraph (1) and section
8 734(d), including regulations aggregating related
9 partnerships and disregarding property acquired by
10 the partnership in an attempt to avoid such pur-
11 poses.”

12 (4) CLERICAL AMENDMENTS.—

13 (A) The section heading for section 743 is
14 amended to read as follows:

15 **“SEC. 743. ADJUSTMENT TO BASIS OF PARTNERSHIP PROP-**
16 **ERTY WHERE SECTION 754 ELECTION OR**
17 **SUBSTANTIAL BUILT-IN LOSS.”**

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

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

22 (c) **ADJUSTMENT TO BASIS OF UNDISTRIBUTED**
23 **PARTNERSHIP PROPERTY IF THERE IS SUBSTANTIAL**
24 **BASIS REDUCTION.—**

1 (1) ADJUSTMENT REQUIRED.—Subsection (a)
2 of section 734 (relating to optional adjustment to
3 basis of undistributed partnership property) is
4 amended by inserting before the period “or unless
5 there is a substantial basis reduction”.

6 (2) ADJUSTMENT.—Subsection (b) of section
7 734 is amended by inserting “or unless there is a
8 substantial basis reduction” after “section 754 is in
9 effect”.

10 (3) SUBSTANTIAL BASIS REDUCTION.—Section
11 734 is amended by adding at the end the following
12 new subsection:

13 “(d) SUBSTANTIAL BASIS REDUCTION.—

14 “(1) IN GENERAL.—For purposes of this sec-
15 tion, there is a substantial basis reduction with re-
16 spect to a distribution if the sum of the amounts de-
17 scribed in subparagraphs (A) and (B) of subsection
18 (b)(2) exceeds the greater of \$250,000 or 10 percent
19 of the aggregate adjusted basis of partnership prop-
20 erty immediately after the distribution.

21 “(2) REGULATIONS.—

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

22 (4) CLERICAL AMENDMENTS.—

23 (A) The section heading for section 734 is
24 amended to read as follows:

1 **“SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED**
 2 **PARTNERSHIP PROPERTY WHERE SECTION**
 3 **754 ELECTION OR SUBSTANTIAL BASIS RE-**
 4 **DUCTION.”**

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

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

9 (d) **EFFECTIVE DATES.**—

10 (1) **SUBSECTION (a).**—The amendment made
 11 by subsection (a) shall apply to contributions made
 12 after the date of the enactment of this Act.

13 (2) **SUBSECTION (b).**—The amendments made
 14 by subsection (b) shall apply to transfers after the
 15 date of the enactment of this Act.

16 (3) **SUBSECTION (c).**—The amendments made
 17 by subsection (c) shall apply to distributions after
 18 the date of the enactment of this Act.

19 **SEC. 107. MODIFICATIONS OF SUBSTANTIAL UNDERSTATE-**
 20 **MENT PENALTY FOR NONREPORTABLE**
 21 **TRANSACTIONS.**

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

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

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

11 “(ii) \$10,000,000.”

12 (b) REDUCTION FOR UNDERSTATEMENT OF TAX-
13 PAYER DUE TO POSITION OF TAXPAYER OR DISCLOSED
14 ITEM.—Section 6662(d)(2)(B)(i) (relating to substantial
15 authority) is amended to read as follows:

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

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

1 **Subtitle B—Promoter-Related**
2 **Provisions**

3 **SEC. 111. DISCLOSURE OF REPORTABLE TRANSACTIONS.**

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

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

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

11 “(1) information identifying and describing the
12 transaction,

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

15 “(3) such other information as the Secretary
16 may prescribe.

17 Such return shall be filed not later than the date specified
18 by the Secretary.

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

20 “(1) MATERIAL ADVISOR.—

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

23 “(i) who provides any material aid,
24 assistance, or advice with respect to orga-
25 nizing, promoting, selling, implementing,

1 or carrying out any reportable transaction,
2 and

3 “(ii) who directly or indirectly derives
4 gross income in excess of the threshold
5 amount (or such other amount as may be
6 prescribed by the Secretary) for such ad-
7 vice or assistance.

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

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

14 “(ii) \$250,000 in any other case.

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

18 “(c) REGULATIONS.—The Secretary may prescribe
19 regulations which provide—

20 “(1) that only 1 person shall be required to
21 meet the requirements of subsection (a) in cases in
22 which 2 or more persons would otherwise be re-
23 quired to meet such requirements,

24 “(2) exemptions from the requirements of this
25 section, and

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

3 (b) CONFORMING AMENDMENTS.—

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

 “Sec. 6111. Disclosure of reportable transactions.”

7 (2) So much of section 6112 as precedes sub-
8 section (c) thereof is amended to read as follows:

9 **“SEC. 6112. MATERIAL ADVISORS OF REPORTABLE TRANS-**
10 **ACTIONS MUST KEEP LISTS OF ADVISEES,**
11 **ETC.**

12 “(a) IN GENERAL.—Each material advisor (as de-
13 fined in section 6111) with respect to any reportable
14 transaction (as defined in section 6707A(c)) shall (wheth-
15 er or not required to file a return under section 6111 with
16 respect to such transaction) maintain (in such manner as
17 the Secretary may by regulations prescribe) a list—

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

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

23 (3) Section 6112 is amended—

24 (A) by redesignating subsection (c) as sub-
25 section (b),

1 (B) by inserting “written” before “re-
2 quest” in subsection (b)(1) (as so redesign-
3 nated), and

4 (C) by striking “shall prescribe” in sub-
5 section (b)(2) (as so redesignated) and inserting
6 “may prescribe”.

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

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

10 (5)(A) The heading for section 6708 is amend-
11 ed to read as follows:

12 **“SEC. 6708. FAILURE TO MAINTAIN LISTS OF ADVISEES**
13 **WITH RESPECT TO REPORTABLE TRANS-**
14 **ACTIONS.”**

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

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

18 (c) **EFFECTIVE DATE.**—The amendments made by
19 this section shall apply to transactions with respect to
20 which material aid, assistance, or advice referred to in sec-
21 tion 6111(b)(1)(A)(i) of the Internal Revenue Code of
22 1986 (as added by this section) is provided after the date
23 of the enactment of this Act.

1 **SEC. 112. FAILURE TO FURNISH INFORMATION REGARDING**
2 **REPORTABLE TRANSACTIONS.**

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

6 **“SEC. 6707. FAILURE TO FURNISH INFORMATION REGARD-**
7 **ING REPORTABLE TRANSACTIONS.**

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

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

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

17 “(b) AMOUNT OF PENALTY.—

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

21 “(2) LISTED TRANSACTIONS.—The penalty im-
22 posed under subsection (a) with respect to any listed
23 transaction shall be an amount equal to the greater
24 of—

25 “(A) \$200,000, or

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

6 Subparagraph (B) shall be applied by substituting
7 ‘75 percent’ for ‘50 percent’ in the case of an inten-
8 tional failure or act described in subsection (a).

9 “(c) RESCISSION AUTHORITY.—The provisions of
10 section 6707A(d) (relating to authority of Commissioner
11 to rescind penalty) shall apply to any penalty imposed
12 under this section.

13 “(d) REPORTABLE AND LISTED TRANSACTIONS.—
14 For purposes of this section, the terms ‘reportable trans-
15 action’ and ‘listed transaction’ have the respective mean-
16 ings given to such terms by section 6707A(c).”

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

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

1 **SEC. 113. MODIFICATION OF PENALTY FOR FAILURE TO**
2 **MAINTAIN LISTS OF INVESTORS.**

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

5 “(a) IMPOSITION OF PENALTY.—

6 “(1) IN GENERAL.—If any person who is re-
7 quired to maintain a list under section 6112(a) fails
8 to make such list available upon written request to
9 the Secretary in accordance with section 6112(b)
10 within 20 business days after the date of such re-
11 quest, such person shall pay a penalty of \$10,000
12 for each day of such failure after such 20th day.

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

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

20 **SEC. 114. MODIFICATION OF ACTIONS TO ENJOIN CERTAIN**
21 **CONDUCT RELATED TO TAX SHELTERS AND**
22 **REPORTABLE TRANSACTIONS.**

23 (a) IN GENERAL.—Section 7408 (relating to action
24 to enjoin promoters of abusive tax shelters, etc.) is amend-
25 ed by redesignating subsection (c) as subsection (d) and

1 by striking subsections (a) and (b) and inserting the fol-
2 lowing new subsections:

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

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

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

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

20 the court may enjoin such person from engaging in such
21 conduct or in any other activity subject to penalty under
22 this title.

23 “(c) **SPECIFIED CONDUCT.**—For purposes of this
24 section, the term ‘specified conduct’ means any action, or

1 failure to take action, subject to penalty under section
2 6700, 6701, 6707, or 6708.”

3 (b) CONFORMING AMENDMENTS.—

4 (1) The heading for section 7408 is amended to
5 read as follows:

6 **“SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RE-**
7 **LATED TO TAX SHELTERS AND REPORTABLE**
8 **TRANSACTIONS.”**

9 (2) The table of sections for subchapter A of
10 chapter 67 is amended by striking the item relating
11 to section 7408 and inserting the following new
12 item:

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

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

16 **SEC. 115. PENALTY ON FAILURE TO REPORT INTERESTS IN**
17 **FOREIGN FINANCIAL ACCOUNTS.**

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

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

22 “(A) PENALTY AUTHORIZED.—The Sec-
23 retary of the Treasury may impose a civil
24 money penalty on any person who violates, or

1 causes any violation of, any provision of section
2 5314.

3 “(B) AMOUNT OF PENALTY.—

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

8 “(ii) REASONABLE CAUSE EXCEP-
9 TION.—No penalty shall be imposed under
10 subparagraph (A) with respect to any vio-
11 lation if—

12 “(I) such violation was due to
13 reasonable cause, and

14 “(II) the amount of the trans-
15 action or the balance in the account
16 at the time of the transaction was
17 properly reported.

18 “(C) WILLFUL VIOLATIONS.—In the case
19 of any person willfully violating, or willfully
20 causing any violation of, any provision of sec-
21 tion 5314—

22 “(i) the maximum penalty under sub-
23 paragraph (B)(i) shall be increased to the
24 greater of—

25 “(I) \$25,000, or

1 “(II) the amount (not exceeding
2 \$100,000) determined under subpara-
3 graph (D), and

4 “(ii) subparagraph (B)(ii) shall not
5 apply.

6 “(D) AMOUNT.—The amount determined
7 under this subparagraph is—

8 “(i) in the case of a violation involving
9 a transaction, the amount of the trans-
10 action, or

11 “(ii) in the case of a violation involv-
12 ing a failure to report the existence of an
13 account or any identifying information re-
14 quired to be provided with respect to an
15 account, the balance in the account at the
16 time of the violation.”

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

20 **SEC. 116. FRIVOLOUS TAX SUBMISSIONS.**

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

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

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

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

3 “(A) does not contain information on
4 which the substantial correctness of the self-as-
5 sessment may be judged, or

6 “(B) contains information that on its face
7 indicates that the self-assessment is substan-
8 tially incorrect; and

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

10 “(A) is due to a position which is frivolous,
11 or

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

14 “(b) CIVIL PENALTY FOR SPECIFIED FRIVOLOUS
15 SUBMISSIONS.—

16 “(1) IMPOSITION OF PENALTY.—Except as pro-
17 vided in paragraph (3), any person who submits a
18 specified frivolous submission shall pay a penalty of
19 \$5,000.

20 “(2) SPECIFIED FRIVOLOUS SUBMISSION.—For
21 purposes of this section—

22 “(A) SPECIFIED FRIVOLOUS SUBMIS-
23 SION.—The term ‘specified frivolous submis-
24 sion’ means a specified submission if any por-
25 tion of such submission—

1 “(i) is based on a position which is
2 frivolous, or

3 “(ii) reflects a desire to delay or im-
4 pede the administration of Federal tax
5 laws.

6 “(B) SPECIFIED SUBMISSION.—The term
7 ‘specified submission’ means—

8 “(i) a request for a hearing under—

9 “(I) section 6320 (relating to no-
10 tice and opportunity for hearing upon
11 filing of notice of lien), or

12 “(II) section 6330 (relating to
13 notice and opportunity for hearing be-
14 fore levy), and

15 “(ii) an application under—

16 “(I) section 6159 (relating to
17 agreements for payment of tax liabil-
18 ity in installments),

19 “(II) section 7122 (relating to
20 compromises), or

21 “(III) section 7811 (relating to
22 taxpayer assistance orders).

23 “(3) OPPORTUNITY TO WITHDRAW SUBMIS-
24 SION.—If the Secretary provides a person with no-
25 tice that a submission is a specified frivolous sub-

1 mission and such person withdraws such submission
2 within 30 days after such notice, the penalty im-
3 posed under paragraph (1) shall not apply with re-
4 spect to such submission.

5 “(c) REDUCTION OF PENALTY.—The Secretary may
6 reduce the amount of any penalty imposed under this sec-
7 tion if the Secretary determines that such reduction would
8 promote compliance with and administration of the Fed-
9 eral tax laws.

10 “(d) PENALTIES IN ADDITION TO OTHER PEN-
11 ALTIES.—The penalties imposed by this section shall be
12 in addition to any other penalty provided by law.”

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

“Sec. 6702. Frivolous tax submissions.”

17 (c) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to submissions made and issues
19 raised after the date of the enactment of this Act.

20 **SEC. 117. REGULATION OF INDIVIDUALS PRACTICING BE-**
21 **FORE THE DEPARTMENT OF THE TREASURY.**

22 (a) CENSURE; IMPOSITION OF PENALTY.—

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

1 (A) by inserting “, or censure,” after “De-
2 partment”, and

3 (B) by adding at the end the following new
4 flush sentence:

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

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

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

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

1 transaction plan or arrangement, or other plan or arrange-
 2 ment, which is of a type which the Secretary determines
 3 as having a potential for tax avoidance or evasion.”

4 **SEC. 118. PENALTY ON PROMOTERS OF TAX SHELTERS.**

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

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

17 **Subtitle C—Other Provisions**

18 **SEC. 121. TREATMENT OF STRIPPED INTERESTS IN BOND**

19 **AND PREFERRED STOCK FUNDS, ETC.**

20 (a) IN GENERAL.—Section 1286 (relating to tax
 21 treatment of stripped bonds) is amended by redesignating
 22 subsection (f) as subsection (g) and by inserting after sub-
 23 section (e) the following new subsection:

24 “(f) TREATMENT OF STRIPPED INTERESTS IN BOND
 25 AND PREFERRED STOCK FUNDS, ETC.—In the case of an

1 account or entity substantially all of the assets of which
2 consist of bonds, preferred stock, or a combination thereof,
3 the Secretary may by regulations provide that rules simi-
4 lar to the rules of this section and 305(e), as appropriate,
5 shall apply to interests in such account or entity to which
6 (but for this subsection) this section or section 305(e), as
7 the case may be, would not apply.”

8 (b) CROSS REFERENCE.—Subsection (e) of section
9 305 is amended by adding at the end the following new
10 paragraph:

11 “(7) CROSS REFERENCE.—

**“For treatment of stripped interests in certain ac-
counts or entities holding preferred stock, see sec-
tion 1286(f).”**

12 (c) EFFECTIVE DATE.—The amendments made by
13 this section shall apply to purchases and dispositions after
14 the date of the enactment of this Act.

15 **SEC. 122. MINIMUM HOLDING PERIOD FOR FOREIGN TAX**

16 **CREDIT ON WITHHOLDING TAXES ON INCOME**

17 **OTHER THAN DIVIDENDS.**

18 (a) IN GENERAL.—Section 901 is amended by redес-
19 ignating subsection (l) as subsection (m) and by inserting
20 after subsection (k) the following new subsection:

21 “(l) MINIMUM HOLDING PERIOD FOR WITHHOLDING
22 TAXES ON GAIN AND INCOME OTHER THAN DIVIDENDS
23 ETC.—

1 “(1) IN GENERAL.—In no event shall a credit
2 be allowed under subsection (a) for any withholding
3 tax (as defined in subsection (k)) on any item of in-
4 come or gain with respect to any property if—

5 “(A) such property is held by the recipient
6 of the item for 15 days or less during the 30-
7 day period beginning on the date which is 15
8 days before the date on which the right to re-
9 ceive payment of such item arises, or

10 “(B) to the extent that the recipient of the
11 item is under an obligation (whether pursuant
12 to a short sale or otherwise) to make related
13 payments with respect to positions in substan-
14 tially similar or related property.

15 This paragraph shall not apply to any dividend to
16 which subsection (k) applies.

17 “(2) EXCEPTION FOR TAXES PAID BY DEAL-
18 ERS.—

19 “(A) IN GENERAL.—Paragraph (1) shall
20 not apply to any qualified tax with respect to
21 any property held in the active conduct in a for-
22 eign country of a business as a dealer in such
23 property.

24 “(B) QUALIFIED TAX.—For purposes of
25 subparagraph (A), the term ‘qualified tax’

1 means a tax paid to a foreign country (other
2 than the foreign country referred to in subpara-
3 graph (A)) if—

4 “(i) the item to which such tax is at-
5 tributable is subject to taxation on a net
6 basis by the country referred to in sub-
7 paragraph (A), and

8 “(ii) such country allows a credit
9 against its net basis tax for the full
10 amount of the tax paid to such other for-
11 eign country.

12 “(C) DEALER.—For purposes of subpara-
13 graph (A), the term ‘dealer’ means—

14 “(i) with respect to a security, any
15 person to whom paragraphs (1) and (2) of
16 subsection (k) would not apply by reason
17 of paragraph (4) thereof if such security
18 were stock, and

19 “(ii) with respect to any other prop-
20 erty, any person with respect to whom
21 such property is described in section
22 1221(a)(1).

23 “(D) REGULATIONS.—The Secretary may
24 prescribe such regulations as may be appro-
25 priate to carry out this paragraph, including

1 regulations to prevent the abuse of the excep-
2 tion provided by this paragraph and to treat
3 other taxes as qualified taxes.

4 “(3) EXCEPTIONS.—The Secretary may by reg-
5 ulation provide that paragraph (1) shall not apply to
6 property where the Secretary determines that the
7 application of paragraph (1) to such property is not
8 necessary to carry out the purposes of this sub-
9 section.

10 “(4) CERTAIN RULES TO APPLY.—Rules similar
11 to the rules of paragraphs (5), (6), and (7) of sub-
12 section (k) shall apply for purposes of this sub-
13 section.

14 “(5) DETERMINATION OF HOLDING PERIOD.—
15 Holding periods shall be determined for purposes of
16 this subsection without regard to section 1235 or
17 any similar rule.”

18 (b) CONFORMING AMENDMENT.—The heading of
19 subsection (k) of section 901 is amended by inserting “ON
20 DIVIDENDS” after “TAXES”.

21 (c) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to amounts paid or accrued more
23 than 30 days after the date of the enactment of this Act.

1 **SEC. 123. AFFIRMATION OF CONSOLIDATED RETURN REGU-**
2 **LATION AUTHORITY.**

3 (a) **IN GENERAL.**—Section 1502 is amended by add-
4 ing at the end the following new sentence: “In carrying
5 out the preceding sentence, the Secretary may prescribe
6 rules that are different from the provisions of chapter 1
7 that would apply if such corporations filed separate re-
8 turns.”.

9 (b) **RESULT NOT OVERTURNED.**—Notwithstanding
10 the amendment made by subsection (a), the Internal Rev-
11 enue Code of 1986 shall be construed by treating Treasury
12 Regulation § 1.1502-20(e)(1)(iii) (as in effect on January
13 1, 2001) as being inapplicable to the factual situation in
14 *Rite Aid Corporation and Subsidiary Corporations v.*
15 *United States*, 255 F.3d 1357 (Fed. Cir. 2001).

16 (c) **EFFECTIVE DATE.**—This section, and the amend-
17 ment made by this section, shall apply to taxable years
18 beginning before, on, or after the date of the enactment
19 of this Act.

1 **TITLE II—PROVISIONS TO RE-**
2 **DUCE TAX AVOIDANCE**
3 **THROUGH CORPORATE EARN-**
4 **INGS STRIPPING AND EXPA-**
5 **TRIATION**

6 **SEC. 201. REDUCTION IN POTENTIAL FOR EARNINGS STRIP-**
7 **PING BY FURTHER LIMITING DEDUCTION**
8 **FOR INTEREST ON CERTAIN INDEBTEDNESS.**

9 (a) REDUCTION IN POTENTIAL FOR EARNINGS
10 STRIPPING.—

11 (1) IN GENERAL.—Paragraphs (1) and (2) of
12 section 163(j) are amended to read as follows:

13 “(1) LIMITATION.—

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

18 “(B) MAXIMUM DISALLOWANCE.—

19 “(i) IN GENERAL.—Except as pro-
20 vided in clause (ii), the amount disallowed
21 under subparagraph (A) shall not exceed
22 the corporation’s excess overall interest ex-
23 pense for the taxable year.

24 “(ii) CORPORATIONS WHICH ARE
25 MEMBERS OF WORLDWIDE AFFILIATED

1 GROUP.—In the case of a corporation
2 which is a member of a worldwide affili-
3 ated group, the amount disallowed under
4 subparagraph (A) shall not exceed the
5 greater of—

6 “(I) the corporation’s excess
7 overall interest expense for the taxable
8 year, or

9 “(II) the corporation’s excess do-
10 mestic disqualified interest for such
11 year.

12 “(C) DISALLOWED AMOUNT CARRIED TO
13 SUCCEEDING TAXABLE YEAR.—Any amount dis-
14 allowed under subparagraph (A) for any taxable
15 year shall be treated as disqualified interest
16 paid or accrued in the succeeding taxable year
17 and in the 2nd through 5th succeeding taxable
18 years to the extent not previously taken into ac-
19 count under this subparagraph. The amount of
20 such a carryforward taken into account for any
21 such succeeding taxable year shall not exceed—

22 “(i) the excess (if any) of—

23 “(I) 35 percent of the adjusted
24 taxable income of the corporation for
25 such succeeding taxable year, over

1 “(II) the corporation’s net inter-
2 est expense for such succeeding tax-
3 able year, reduced by

4 “(ii) amounts carried to such suc-
5 ceeding taxable year from taxable years
6 preceding the taxable year from which the
7 amount is being carried forward.

8 “(D) SPECIAL RULES FOR CARRYOVER.—

9 “(i) NO CARRYOVER OF EXCESS DO-
10 MESTIC DISQUALIFIED INTEREST.—In the
11 case of a corporation which is a member of
12 a worldwide affiliated group, the amount
13 disallowed under subparagraph (A) for any
14 taxable year which may be treated as pro-
15 vided in subparagraph (C) shall not exceed
16 the excess (if any) of the amount dis-
17 allowed over the amount described in sub-
18 paragraph (B)(ii)(II) for such year.

19 “(ii) NO CARRYOVER TO YEAR FOR
20 WHICH AMOUNT DISALLOWED.—No
21 amount may be carried under this sub-
22 paragraph to any taxable year for which
23 any amount is disallowed under subpara-
24 graph (A).

1 “(2) EXCESS INTEREST EXPENSE.—For pur-
2 poses of this subsection—

3 “(A) EXCESS OVERALL INTEREST EX-
4 PENSE.—The term ‘excess overall interest ex-
5 pense’ means the excess (if any) of—

6 “(i) the corporation’s net interest ex-
7 pense, over

8 “(ii) 35 percent of the adjusted tax-
9 able income of the corporation.

10 “(B) EXCESS DOMESTIC DISQUALIFIED IN-
11 TEREST.—The term ‘excess domestic disquali-
12 fied interest’ means the product of—

13 “(i) the disqualified interest paid or
14 accrued by the corporation during the tax-
15 able year, and

16 “(ii) the corporation’s dispro-
17 portionate domestic related-party indebtedness
18 percentage.”

19 (2) DISPROPORTIONATE DOMESTIC RELATED-
20 PARTY INDEBTEDNESS PERCENTAGE.—Subsection
21 (j) of section 163 is amended by redesignating para-
22 graphs (6), (7), and (8) as paragraphs (7), (8), and
23 (9), respectively, and by inserting after paragraph
24 (5) the following new paragraph:

1 “(6) DISPROPORTIONATE DOMESTIC RELATED-
2 PARTY INDEBTEDNESS PERCENTAGE.—For purposes
3 of this subsection—

4 “(A) IN GENERAL.—The term ‘dispropor-
5 tionate domestic related-party indebtedness per-
6 centage’ means, for any taxable year, the per-
7 centage (but not greater than 100 percent)
8 which, as of the close of such taxable year (or
9 on any other day during the taxable year as the
10 Secretary may by regulations prescribe)—

11 “(i) the disproportionate indebtedness
12 of the corporation, bears to

13 “(ii) the related-party indebtedness of
14 the corporation.

15 “(B) DISPROPORTIONATE INDEBTED-
16 NESS.—The term ‘disproportionate indebted-
17 ness’ means the amount by which the total in-
18 debtedness of the corporation exceeds the
19 amount which bears the same ratio to the total
20 indebtedness of the worldwide affiliated group
21 as—

22 “(i) the money and all other assets of
23 the corporation, bears to

1 “(ii) the money and all other assets of
2 the worldwide affiliated group of which
3 such corporation is a member.

4 For purposes of determining the money and
5 other assets, and indebtedness, of a worldwide
6 affiliated group, all members of the same world-
7 wide affiliated group shall be treated as 1 cor-
8 poration.

9 “(C) RELATED-PARTY INDEBTEDNESS.—
10 The term ‘related-party indebtedness’ means
11 any indebtedness of the corporation if the inter-
12 est on such indebtedness is disqualified interest.

13 “(D) WORLDWIDE AFFILIATED GROUP.—

14 “(i) IN GENERAL.—Except as pro-
15 vided in clause (ii), the term ‘worldwide af-
16 filiated group’ means an affiliated group as
17 defined in section 1504(a), determined
18 without regard to paragraphs (2), (3), and
19 (4) of section 1504(b).

20 “(ii) TREATMENT OF CERTAIN FINAN-
21 CIAL INSTITUTIONS.—

22 “(I) IN GENERAL.—All financial
23 corporations (as defined in section
24 864(e)(6)(B)) which are members of a
25 worldwide affiliated group shall be

1 treated as a separate worldwide affli-
2 ated group (and not as part of any
3 other worldwide affiliated group) for
4 purposes of applying this subsection.

5 “(II) DETERMINATION OF DO-
6 MESTIC DEBT AND ASSETS.—For pur-
7 poses of this paragraph, all such fi-
8 nancial corporations which are mem-
9 bers of the same affiliated group (as
10 defined in section 1504(a), determined
11 without regard to paragraph (2) of
12 section 1504(b)) shall be treated as 1
13 corporation.

14 “(E) DETERMINATION OF DEBT AND AS-
15 SETS.—For purposes of this paragraph—

16 “(i) the amount taken into account
17 with respect to any asset shall be the ad-
18 justed basis thereof for purposes of deter-
19 mining gain,

20 “(ii) the amount taken into account
21 with respect to any indebtedness with
22 original issue discount shall be its issue
23 price plus the portion of the original issue
24 discount previously accrued as determined
25 under the rules of section 1272 (deter-

1 mined without regard to subsection (a)(7)
2 or (b)(4) thereof), and

3 “(iii) there shall be such other adjust-
4 ments as the Secretary may by regulations
5 prescribe.”

6 (3) CONFORMING AMENDMENT.—Paragraph (9)
7 of section 163(j), as redesignated by paragraph (2),
8 is amended by inserting “or worldwide affiliated
9 group” after “an affiliated group”.

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

12 (1) EXCEPTION FROM 163(J).—Paragraph (3) of
13 section 163(j) is amended by inserting “and” at the
14 end of subparagraph (A), by striking “, and” at the
15 end of subparagraph (B) and inserting a period, and
16 by striking subparagraph (C).

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

19 “(m) LIMITATION ON DEDUCTION FOR INTEREST ON
20 CERTAIN INDEBTEDNESS OF TAXABLE REIT SUB-
21 SIDIARY.—

22 “(1) LIMITATION.—

23 “(A) IN GENERAL.—If this subsection ap-
24 plies to any taxable REIT subsidiary for any
25 taxable year, no deduction shall be allowed

1 under this chapter for disqualified interest paid
2 or accrued by such subsidiary during such tax-
3 able year. The amount disallowed under the
4 preceding sentence shall not exceed the subsidi-
5 ary's excess interest expense for the taxable
6 year.

7 “(B) DISALLOWED AMOUNT CARRIED TO
8 SUCCEEDING TAXABLE YEAR.—Any amount dis-
9 allowed under subparagraph (A) for any taxable
10 year shall be treated as disqualified interest
11 paid or accrued in the succeeding taxable year
12 (and clause (ii) of paragraph (2)(A) shall not
13 apply for purposes of applying this subsection
14 to the amount so treated).

15 “(2) SUBSIDIARIES TO WHICH SUBSECTION AP-
16 PLIES.—

17 “(A) IN GENERAL.—This subsection shall
18 apply to any taxable REIT subsidiary for any
19 taxable year if—

20 “(i) such subsidiary has excess inter-
21 est expense for such taxable year, and

22 “(ii) the ratio of debt to equity of
23 such subsidiary as of the close of such tax-
24 able year (or on any other day during the

1 taxable year as the Secretary may by regu-
2 lations prescribe) exceeds 1.5 to 1.

3 “(B) EXCESS INTEREST EXPENSE.—

4 “(i) IN GENERAL.—For purposes of
5 this subsection, the term ‘excess interest
6 expense’ means the excess (if any) of—

7 “(I) the taxable REIT subsidi-
8 ary’s net interest expense, over

9 “(II) the sum of 50 percent of
10 the adjusted taxable income of the
11 subsidiary plus any excess limitation
12 carryforward under clause (ii).

13 “(ii) EXCESS LIMITATION
14 CARRYFORWARD.—If a taxable REIT sub-
15 sidiary has an excess limitation for any
16 taxable year, the amount of such excess
17 limitation shall be an excess limitation
18 carryforward to the 1st succeeding taxable
19 year and to the 2nd and 3rd succeeding
20 taxable years to the extent not previously
21 taken into account under this clause. The
22 amount of such a carryforward taken into
23 account for any such succeeding taxable
24 year shall not exceed the excess interest
25 expense for such succeeding taxable year

1 (determined without regard to the
2 carryforward from the taxable year of such
3 excess limitation).

4 “(iii) EXCESS LIMITATION.—For pur-
5 poses of clause (ii), the term ‘excess limita-
6 tion’ means the excess (if any) of—

7 “(I) 50 percent of the adjusted
8 taxable income of the subsidiary, over

9 “(II) the subsidiary’s net interest
10 expense.

11 “(C) RATIO OF DEBT TO EQUITY.—For
12 purposes of this paragraph, the term ‘ratio of
13 debt to equity’ means the ratio which the total
14 indebtedness of the subsidiary bears to the sum
15 of its money and all other assets reduced (but
16 not below zero) by such total indebtedness. The
17 rules of section 163(j)(6)(E) shall apply for
18 purposes of the preceding sentence.

19 “(3) DISQUALIFIED INTEREST.—For purposes
20 of this subsection, the term ‘disqualified interest’
21 means any interest paid or accrued (directly or indi-
22 rectly) by a taxable REIT subsidiary of a real estate
23 investment trust to such trust.

24 “(4) OTHER RULES TO APPLY.—Rules similar
25 to the rules of paragraphs (7), (8), and (9) of sec-

1 tion 163(j) shall apply for purposes of this sub-
2 section.”

3 (c) EFFECTIVE DATE.—

4 (1) IN GENERAL.—Except as otherwise pro-
5 vided in this subsection, the amendments made by
6 this section shall apply to taxable years beginning
7 after December 31, 2003.

8 (2) EARLIER EFFECTIVE DATE WITH RESPECT
9 TO EXPATRIATED CORPORATIONS, ETC.—The
10 amendments made by this section shall apply to tax-
11 able years ending after March 20, 2002, in the case
12 of a taxpayer which is—

13 (A) a surrogate foreign corporation, as de-
14 fined in section 7874(b) of the Internal Rev-
15 enue Code of 1986 (as added by section 202),

16 (B) a corporation which would be a surro-
17 gate foreign corporation (as so defined) if “De-
18 cember 31, 1996” were substituted for “March
19 20, 2002” in such section 7874(b), and

20 (C) any corporation which is an expatri-
21 ated entity (as defined in such section 7874(b))
22 with respect to a corporation described in sub-
23 paragraph (A) or (B).

24 (3) EARLIER EFFECTIVE DATE FOR RECENT
25 DEBT.—

1 (A) IN GENERAL.—Subject to subpara-
2 graph (B), the amendments made by this sec-
3 tion shall also apply to taxable years ending
4 after July 10, 2002, and beginning before the
5 first taxable year to which such amendments
6 would (without regard to this paragraph) apply.

7 (B) APPLICATION ONLY TO RECENT
8 DEBT.—In the case of a taxable year to which
9 the amendments made by this section apply
10 solely by reason of this paragraph, the increase
11 in the amount disallowed under section 163(j)
12 of the Internal Revenue Code of 1986 by reason
13 of such amendments shall not exceed the
14 amount of disqualified interest for such year on
15 indebtedness incurred after July 10, 2002.

16 (4) LIMITATION ON CARRYOVER OF DIS-
17 ALLOWED INTEREST.—For purposes of applying sec-
18 tion 163(j)(1)(C) of the Internal Revenue Code of
19 1986 (as added by this section), amounts carried to
20 any taxable year beginning after December 31,
21 2003, shall be treated as disallowed for the most re-
22 cent taxable year beginning on or before such date.

1 **SEC. 202. TAX TREATMENT OF EXPATRIATED ENTITIES AND**
2 **THEIR FOREIGN PARENTS.**

3 (a) IN GENERAL.—Subchapter C of chapter 80 (re-
4 lating to provisions affecting more than one subtitle) is
5 amended by adding at the end the following new section:

6 **“SEC. 7874. RULES RELATING TO EXPATRIATED ENTITIES**
7 **AND THEIR FOREIGN PARENTS.**

8 “(a) INVERTED CORPORATIONS TREATED AS DOMES-
9 TIC CORPORATIONS.—

10 “(1) IN GENERAL.—If a foreign incorporated
11 entity is treated as an inverted domestic corporation,
12 then, notwithstanding section 7701(a)(4), such enti-
13 ty shall be treated for purposes of this title as a do-
14 mestic corporation.

15 “(2) EXCEPTION.—Paragraph (1) shall not
16 apply for purposes of determining under section 367
17 whether any shareholder recognizes gain in connec-
18 tion with the acquisition.

19 “(3) INVERTED DOMESTIC CORPORATION.—For
20 purposes of this section, a foreign incorporated enti-
21 ty shall be treated as an inverted domestic corpora-
22 tion if, pursuant to a plan (or a series of related
23 transactions)—

24 “(A) the entity completes after March 20,
25 2002, the direct or indirect acquisition of sub-
26 stantially all of the properties held directly or

1 indirectly by a domestic corporation or substan-
2 tially all of the properties constituting a trade
3 or business of a domestic partnership,

4 “(B) after the acquisition at least 80 per-
5 cent of the stock (by vote or value) of the entity
6 is held—

7 “(i) in the case of an acquisition with
8 respect to a domestic corporation, by
9 former shareholders of the domestic cor-
10 poration by reason of holding stock in the
11 domestic corporation, or

12 “(ii) in the case of an acquisition with
13 respect to a domestic partnership, by
14 former partners of the domestic partner-
15 ship by reason of holding a capital or prof-
16 its interest in the domestic partnership,
17 and

18 “(C) the expanded affiliated group which
19 after the acquisition includes the entity does
20 not have substantial business activities in the
21 foreign country in which or under the law of
22 which the entity is created or organized when
23 compared to the total business activities of such
24 expanded affiliated group.

1 “(4) TERMINATION.—This subsection shall not
2 apply to any acquisition completed after March 20,
3 2005.

4 “(b) TAX ON INVERSION GAIN OF EXPATRIATED EN-
5 TITIES.—

6 “(1) IN GENERAL.—The taxable income of an
7 expatriated entity for any taxable year which in-
8 cludes any portion of the applicable period shall in
9 no event be less than the inversion gain of the entity
10 for the taxable year.

11 “(2) EXPATRIATED ENTITY.—For purposes of
12 this subsection—

13 “(A) IN GENERAL.—The term ‘expatriated
14 entity’ means—

15 “(i) the domestic corporation or part-
16 nership referred to in subparagraph (B)(i)
17 with respect to which a foreign incor-
18 porated entity is a surrogate foreign cor-
19 poration, and

20 “(ii) any United States person who is
21 related (within the meaning of section
22 267(b) or 707(b)(1)) to a domestic cor-
23 poration or partnership described in clause
24 (i).

1 “(B) SURROGATE FOREIGN CORPORA-
2 TION.—A foreign incorporated entity shall be
3 treated as a surrogate foreign corporation if,
4 pursuant to a plan (or a series of related trans-
5 actions)—

6 “(i) the entity completes after March
7 20, 2002, the direct or indirect acquisition
8 of substantially all of the properties held
9 directly or indirectly by a domestic cor-
10 poration or substantially all of the prop-
11 erties constituting a trade or business of a
12 domestic partnership, and

13 “(ii) after the acquisition at least 60
14 percent of the stock (by vote or value) of
15 the entity is held—

16 “(I) in the case of an acquisition
17 with respect to a domestic corpora-
18 tion, by former shareholders of the
19 domestic corporation by reason of
20 holding stock in the domestic corpora-
21 tion, or

22 “(II) in the case of an acquisition
23 with respect to a domestic partner-
24 ship, by former partners of the do-
25 mestic partnership by reason of hold-

1 ing a capital or profits interest in the
2 domestic partnership.

3 The term ‘surrogate foreign corporation’ shall
4 not include an inverted domestic corporation.

5 “(c) GENERAL DEFINITIONS AND SPECIAL RULES.—

6 “(1) FOREIGN INCORPORATED ENTITY.—For
7 purposes of this section, the term ‘foreign incor-
8 porated entity’ means any entity which is, or but for
9 subsection (a) would be, treated as a foreign cor-
10 poration for purposes of this title.

11 “(2) EXPANDED AFFILIATED GROUP.—The
12 term ‘expanded affiliated group’ means an affiliated
13 group as defined in section 1504(a) but without re-
14 gard to section 1504(b), except that section 1504(a)
15 shall be applied by substituting ‘more than 50 per-
16 cent’ for ‘at least 80 percent’ each place it appears.

17 “(3) CERTAIN STOCK DISREGARDED.—There
18 shall not be taken into account in determining own-
19 ership under subsections (a)(3)(B) and
20 (b)(2)(B)(ii)—

21 “(i) stock held by members of the ex-
22 panded affiliated group which includes the
23 foreign incorporated entity, or

24 “(ii) stock of such foreign incor-
25 porated entity which is sold in a public of-

1 fering related to the acquisition described
2 in subsection (a)(3)(A) or (b)(2)(B)(i), re-
3 spectively.

4 “(4) PLAN DEEMED IN CERTAIN CASES.—If a
5 foreign incorporated entity acquires directly or indi-
6 rectly substantially all of the properties of a domes-
7 tic corporation or partnership during the 4-year pe-
8 riod beginning on the date which is 2 years before
9 the ownership requirements of subsections (a)(3)(B)
10 and (b)(2)(B)(ii) are met, such actions shall be
11 treated as pursuant to a plan.

12 “(5) CERTAIN TRANSFERS DISREGARDED.—The
13 transfer of properties or liabilities (including by con-
14 tribution or distribution) shall be disregarded if such
15 transfers are part of a plan a principal purpose of
16 which is to avoid the purposes of this section.

17 “(6) SPECIAL RULE FOR RELATED PARTNER-
18 SHIPS.—For purposes of applying subsections
19 (a)(3)(B) and (b)(2)(B)(ii) to the acquisition of a
20 domestic partnership, except as provided in regula-
21 tions, all partnerships which are under common con-
22 trol (within the meaning of section 482) shall be
23 treated as 1 partnership.

24 “(7) REGULATIONS.—The Secretary shall pre-
25 scribe such regulations as may be appropriate to de-

1 termine whether a corporation is an inverted domes-
2 tic corporation or surrogate foreign corporation, in-
3 cluding regulations—

4 “(A) to treat warrants, options, contracts
5 to acquire stock, convertible debt interests, and
6 other similar interests as stock, and

7 “(B) to treat stock as not stock.

8 “(d) DEFINITIONS RELATING TO TAX ON INVERSION
9 GAIN.—For purposes of subsection (b)—

10 “(1) APPLICABLE PERIOD.—The term ‘applica-
11 ble period’ means the period—

12 “(A) beginning on the first date properties
13 are acquired as part of the acquisition described
14 in subsection (b)(2)(B)(i), and

15 “(B) ending on the date which is 10 years
16 after the last date properties are acquired as
17 part of such acquisition.

18 “(2) INVERSION GAIN.—The term ‘inversion
19 gain’ means the income or gain recognized by reason
20 of the transfer during the applicable period of stock
21 or other properties by an expatriated entity, and any
22 income received or accrued during the applicable pe-
23 riod by reason of a license of any property by an ex-
24 patriated entity —

1 “(A) as part of the acquisition described in
2 subsection (b)(2)(B)(i), or

3 “(B) after such acquisition if the transfer
4 is to a foreign related person.

5 Subparagraph (B) shall not apply to property de-
6 scribed in section 1221(a)(1) in the hands of the ex-
7 patriated entity.

8 “(4) FOREIGN RELATED PERSON.—The term
9 ‘foreign related person’ means, with respect to any
10 expatriated entity, a foreign person which—

11 “(A) is related (within the meaning of sec-
12 tion 267(b) or 707(b)(1)) to such entity, or

13 “(B) is under the same common control
14 (within the meaning of section 482) as such en-
15 tity.

16 “(e) SPECIAL RULES RELATING TO TAX ON INVER-
17 SION GAIN.—

18 “(1) CREDITS NOT ALLOWED AGAINST TAX ON
19 INVERSION GAIN.—Credits (other than the credit al-
20 lowed by section 901) shall be allowed against the
21 tax imposed by this chapter on an expatriated entity
22 for any taxable year described in subsection (b) only
23 to the extent such tax exceeds the product of—

24 “(A) the amount of the inversion gain for
25 the taxable year, and

1 “(B) the highest rate of tax specified in
2 section 11(b)(1).

3 For purposes of determining the credit allowed by
4 section 901, inversion gain shall be treated as from
5 sources within the United States.

6 “(2) SPECIAL RULES FOR PARTNERSHIPS.—In
7 the case of an expatriated entity which is a
8 partnership—

9 “(A) subsection (b) shall apply at the part-
10 ner rather than the partnership level,

11 “(B) the inversion gain of any partner for
12 any taxable year shall be equal to the sum of—

13 “(i) the partner’s distributive share of
14 inversion gain of the partnership for such
15 taxable year, plus

16 “(ii) gain recognized for the taxable
17 year by the partner by reason of the trans-
18 fer during the applicable period of any
19 partnership interest of the partner in such
20 partnership to the surrogate foreign cor-
21 poration, and

22 “(C) the highest rate of tax specified in
23 the rate schedule applicable to the partner
24 under this chapter shall be substituted for the
25 rate of tax referred to in paragraph (1).

1 “(3) COORDINATION WITH SECTION 172 AND
2 MINIMUM TAX.—Rules similar to the rules of para-
3 graphs (3) and (4) of section 860E(a) shall apply
4 for purposes of subsection (b).

5 “(4) STATUTE OF LIMITATIONS.—

6 “(A) IN GENERAL.—The statutory period
7 for the assessment of any deficiency attrib-
8 utable to the inversion gain of any taxpayer for
9 any pre-inversion year shall not expire before
10 the expiration of 3 years from the date the Sec-
11 retary is notified by the taxpayer (in such man-
12 ner as the Secretary may prescribe) of the ac-
13 quisition described in subsection (b)(2)(B)(i) to
14 which such gain relates and such deficiency
15 may be assessed before the expiration of such
16 3-year period notwithstanding the provisions of
17 any other law or rule of law which would other-
18 wise prevent such assessment.

19 “(B) PRE-INVERSION YEAR.—For purposes
20 of subparagraph (A), the term ‘pre-inversion
21 year’ means any taxable year if—

22 “(i) any portion of the applicable pe-
23 riod is included in such taxable year, and

1 “(ii) such year ends before the taxable
2 year in which the acquisition described in
3 subsection (b)(2)(B)(i) is completed.

4 “(f) SPECIAL RULE FOR TREATIES.—Nothing in sec-
5 tion 894 or 7852(d) or in any other provision of law shall
6 be construed as permitting an exemption, by reason of any
7 treaty obligation of the United States heretofore or here-
8 after entered into, from the provisions of this section.

9 “(g) REGULATIONS.—The Secretary shall provide
10 such regulations as are necessary to carry out this section,
11 including regulations providing for such adjustments to
12 the application of this section as are necessary to prevent
13 the avoidance of the purposes of this section, including the
14 avoidance of such purposes through—

15 “(1) the use of related persons, pass-through or
16 other noncorporate entities, or other intermediaries,
17 or

18 “(2) transactions designed to have persons
19 cease to be (or not become) members of expanded
20 affiliated groups or related persons.”.

21 “(b) CONFORMING AMENDMENT.—The table of sec-
22 tions for subchapter C of chapter 80 is amended by adding
23 at the end the following new item:

 “Sec. 7874. Rules relating to expatriated entities and their for-
 eign parents.”

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to taxable years ending after
3 March 20, 2002.

4 **SEC. 203. EXCISE TAX ON STOCK COMPENSATION OF INSID-**
5 **ERS IN EXPATRIATED CORPORATIONS.**

6 (a) IN GENERAL.—Subtitle D is amended by adding
7 at the end the following new chapter:

8 **“CHAPTER 48—STOCK COMPENSATION OF**
9 **INSIDERS IN EXPATRIATED CORPORA-**
10 **TIONS**

“Sec. 5000A. Stock compensation of insiders in expatriated cor-
porations.

11 **“SEC. 5000A. STOCK COMPENSATION OF INSIDERS IN EXPA-**
12 **TRIATED CORPORATIONS.**

13 “(a) IMPOSITION OF TAX.—In the case of an indi-
14 vidual who is a disqualified individual with respect to any
15 expatriated corporation, there is hereby imposed on such
16 person a tax equal to 20 percent of the value (determined
17 under subsection (b)) of the specified stock compensation
18 held (directly or indirectly) by or for the benefit of such
19 individual or a member of such individual’s family (as de-
20 fined in section 267) at any time during the 12-month
21 period beginning on the date which is 6 months before
22 the expatriation date.

23 “(b) VALUE.—For purposes of subsection (a)—

1 “(1) IN GENERAL.—The value of specified stock
2 compensation shall be—

3 “(A) in the case of a stock option, the fair
4 value of such option, and

5 “(B) in any other case, the fair market
6 value of such compensation.

7 “(2) DATE FOR DETERMINING VALUE.—The
8 determination of value shall be made—

9 “(A) in the case of specified stock com-
10 pensation held on the expatriation date, on such
11 date,

12 “(B) in the case of such compensation
13 which is canceled during the 6 months before
14 the expatriation date, on the day before such
15 cancellation, and

16 “(C) in the case of such compensation
17 which is granted after the expatriation date, on
18 the date such compensation is granted.

19 “(c) TAX TO APPLY ONLY IF SHAREHOLDER GAIN
20 RECOGNIZED.—Subsection (a) shall apply to any disquali-
21 fied individual with respect to an expatriated corporation
22 only if gain (if any) on any stock in such corporation is
23 recognized in whole or part by any shareholder by reason
24 of the acquisition referred to in section 7874(b)(2)(B)(i)

1 (determined by substituting ‘July 10, 2002’ for ‘March
2 20, 2002’) with respect to such corporation.

3 “(d) EXCEPTION WHERE GAIN RECOGNIZED ON
4 COMPENSATION.—Subsection (a) shall not apply to—

5 “(1) any stock option which is exercised on the
6 expatriation date or during the 6-month period be-
7 fore such date and to the stock acquired in such ex-
8 ercise, and

9 “(2) any stock option or stock which is sold or
10 exchanged during such period in a transaction in
11 which gain or loss is recognized in full.

12 “(e) DEFINITIONS.—For purposes of this section—

13 “(1) DISQUALIFIED INDIVIDUAL.—The term
14 ‘disqualified individual’ means, with respect to a cor-
15 poration, any individual who, at any time during the
16 12-month period beginning on the date which is 6
17 months before the expatriation date—

18 “(A) is subject to the requirements of sec-
19 tion 16(a) of the Securities Exchange Act of
20 1934 with respect to such corporation or any
21 member of the expanded affiliated group which
22 includes such corporation, or

23 “(B) would be subject to such require-
24 ments if such corporation or member were an

1 issuer of equity securities referred to in such
2 section.

3 “(2) EXPATRIATED CORPORATION; EXPATRIA-
4 TION DATE.—

5 “(A) EXPATRIATED CORPORATION.—The
6 term ‘expatriated corporation’ means any cor-
7 poration which would be an expatriated entity
8 (as defined in section 7874(b)(2)) if—

9 “(i) section 7874(b)(2)(B) were ap-
10 plied by substituting ‘July 10, 2002’ for
11 ‘March 20, 2002’, and

12 “(ii) the last sentence of section
13 7874(b)(2)(B) did not apply.

14 Such term includes any predecessor or suc-
15 cessor of such a corporation.

16 “(B) EXPATRIATION DATE.—The term ‘ex-
17 patriation date’ means, with respect to a cor-
18 poration, the date on which the corporation
19 first becomes an expatriated corporation.

20 “(3) SPECIFIED STOCK COMPENSATION.—

21 “(A) IN GENERAL.—The term ‘specified
22 stock compensation’ means payment (or right
23 to payment) granted by the expatriated cor-
24 poration (or by any member of the expanded af-
25 filiated group which includes such corporation)

1 to any person in connection with the perform-
2 ance of services by a disqualified individual for
3 such corporation or member if the value of such
4 payment or right is based on (or determined by
5 reference to) the value (or change in value) of
6 stock in such corporation (or any such mem-
7 ber).

8 “(B) EXCEPTIONS.—Such term shall not
9 include—

10 “(i) any option to which part II of
11 subchapter D of chapter 1 applies, or

12 “(ii) any payment or right to payment
13 from a plan referred to in section
14 280G(b)(6).

15 “(4) EXPANDED AFFILIATED GROUP.—The
16 term ‘expanded affiliated group’ means an affiliated
17 group (as defined in section 1504(a) without regard
18 to section 1504(b)); except that section 1504(a)
19 shall be applied by substituting ‘more than 50 per-
20 cent’ for ‘at least 80 percent’ each place it appears.

21 “(f) SPECIAL RULES.—For purposes of this
22 section—

23 “(1) CANCELLATION OF RESTRICTION.—The
24 cancellation of a restriction which by its terms will
25 never lapse shall be treated as a grant.

1 “(2) PAYMENT OR REIMBURSEMENT OF TAX BY
2 CORPORATION TREATED AS SPECIFIED STOCK COM-
3 PENSATION.—Any payment of the tax imposed by
4 this section directly or indirectly by the expatriated
5 corporation or by any member of the expanded affili-
6 ated group which includes such corporation—

7 “(A) shall be treated as specified stock
8 compensation, and

9 “(B) shall not be allowed as a deduction
10 under any provision of chapter 1.

11 “(3) CERTAIN RESTRICTIONS IGNORED.—
12 Whether there is specified stock compensation, and
13 the value thereof, shall be determined without regard
14 to any restriction other than a restriction which by
15 its terms will never lapse.

16 “(4) PROPERTY TRANSFERS.—Any transfer of
17 property shall be treated as a payment and any right
18 to a transfer of property shall be treated as a right
19 to a payment.

20 “(5) OTHER ADMINISTRATIVE PROVISIONS.—
21 For purposes of subtitle F, any tax imposed by this
22 section shall be treated as a tax imposed by subtitle
23 A.

1 “(g) REGULATIONS.—The Secretary shall prescribe
2 such regulations as may be necessary or appropriate to
3 carry out the purposes of this section.”

4 (b) DENIAL OF DEDUCTION.—

5 (1) IN GENERAL.—Paragraph (6) of section
6 275(a) is amended by inserting “48,” after “46,”.

7 (2) \$1,000,000 LIMIT ON DEDUCTIBLE COM-
8 PENSATION REDUCED BY PAYMENT OF EXCISE TAX
9 ON SPECIFIED STOCK COMPENSATION.—Paragraph
10 (4) of section 162(m) is amended by adding at the
11 end the following new subparagraph:

12 “(G) COORDINATION WITH EXCISE TAX ON
13 SPECIFIED STOCK COMPENSATION.—The dollar
14 limitation contained in paragraph (1) with re-
15 spect to any covered employee shall be reduced
16 (but not below zero) by the amount of any pay-
17 ment (with respect to such employee) of the tax
18 imposed by section 5000A directly or indirectly
19 by the expatriated corporation (as defined in
20 such section) or by any member of the ex-
21 panded affiliated group (as defined in such sec-
22 tion) which includes such corporation.”

23 (c) CONFORMING AMENDMENTS.—

24 (1) The last sentence of section 3121(v)(2)(A)
25 is amended by inserting before the period “or to any

1 specified stock compensation (as defined in section
2 5000A) on which tax is imposed by section 5000A”.

3 (2) The table of chapters for subtitle D is
4 amended by adding at the end the following new
5 item:

“Chapter 48. Stock compensation of insiders in expatriated cor-
porations.”

6 (d) **EFFECTIVE DATE.**—The amendments made by
7 this section shall take effect on July 11, 2002; except that
8 periods before such date shall not be taken into account
9 in applying the periods in subsections (a) and (e)(1) of
10 section 5000A of the Internal Revenue Code of 1986, as
11 added by this section.

12 **SEC. 204. REPORTING OF TAXABLE MERGERS AND ACQUISI-**
13 **TIONS.**

14 (a) **IN GENERAL.**—Subpart B of part III of sub-
15 chapter A of chapter 61 is amended by inserting after sec-
16 tion 6043 the following new section:

17 **“SEC. 6043A. TAXABLE MERGERS AND ACQUISITIONS.**

18 “(a) **IN GENERAL.**—The acquiring corporation in any
19 taxable acquisition shall make a return (according to the
20 forms or regulations prescribed by the Secretary) setting
21 forth—

22 “(1) a description of the acquisition,

1 “(2) the name and address of each shareholder
2 of the acquired corporation who is required to recog-
3 nize gain (if any) as a result of the acquisition,

4 “(3) the amount of money and the fair market
5 value of other property transferred to each such
6 shareholder as part of such acquisition, and

7 “(4) such other information as the Secretary
8 may prescribe.

9 To the extent provided by the Secretary, the requirements
10 of this section applicable to the acquiring corporation shall
11 be applicable to the acquired corporation and not to the
12 acquiring corporation.

13 “(b) NOMINEE REPORTING.—Any person who holds
14 stock as a nominee for another person shall furnish in the
15 manner prescribed by the Secretary to such other person
16 the information provided by the corporation under sub-
17 section (d).

18 “(c) TAXABLE ACQUISITION.—For purposes of this
19 section, the term ‘taxable acquisition’ means any acquisi-
20 tion by a corporation of stock in or property of another
21 corporation if any shareholder of the acquired corporation
22 is required to recognize gain (if any) as a result of such
23 acquisition.

24 “(d) STATEMENTS TO BE FURNISHED TO SHARE-
25 HOLDERS.—Every person required to make a return under

1 subsection (a) shall furnish to each shareholder whose
2 name is required to be set forth in such return a written
3 statement showing—

4 “(1) the name, address, and phone number of
5 the information contact of the person required to
6 make such return,

7 “(2) the information required to be shown on
8 such return with respect to such shareholder, and

9 “(3) such other information as the Secretary
10 may prescribe.

11 The written statement required under the preceding sen-
12 tence shall be furnished to the shareholder on or before
13 January 31 of the year following the calendar year during
14 which the taxable acquisition occurred.”

15 (b) ASSESSABLE PENALTIES.—

16 (1) Subparagraph (B) of section 6724(d)(1)
17 (relating to definitions) is amended by redesignating
18 clauses (ii) through (xvii) as clauses (iii) through
19 (xviii), respectively, and by inserting after clause (i)
20 the following new clause:

21 “(ii) section 6043A(a) (relating to re-
22 turns relating to taxable mergers and ac-
23 quisitions),”.

24 (2) Paragraph (2) of section 6724(d) is amend-
25 ed by redesignating subparagraphs (F) through

1 (AA) as subparagraphs (G) through (BB), respec-
2 tively, and by inserting after subparagraph (E) the
3 following new subparagraph:

4 “(F) subsections (b) and (d) of section
5 6043A (relating to returns relating to taxable
6 mergers and acquisitions).”.

7 (c) CLERICAL AMENDMENT.—The table of sections
8 for subpart B of part III of subchapter A of chapter 61
9 is amended by inserting after the item relating to section
10 6043 the following new item:

“Sec. 6043A. Returns relating to taxable mergers and acqui-
sitions.”.

11 (d) EFFECTIVE DATE.—The amendments made by
12 this section shall apply to acquisitions after the date of
13 the enactment of this Act.

14 **SEC. 205. STUDIES.**

15 (a) TRANSFER PRICING RULES.—The Secretary of
16 the Treasury or the Secretary’s delegate shall conduct a
17 study regarding the effectiveness of current transfer pric-
18 ing rules and compliance efforts in ensuring that cross-
19 border transfers and other related-party transactions, par-
20 ticularly transactions involving intangible assets, service
21 contracts, or leases cannot be used improperly to shift in-
22 come out of the United States. The study shall include
23 a review of the contemporaneous documentation and pen-
24 alty rules under section 6662 of the Internal Revenue

1 Code of 1986, a review of the regulatory and administra-
2 tive guidance implementing the principles of section 482
3 of such Code to transactions involving intangible property
4 and services and to cost-sharing arrangements and an ex-
5 amination of whether increased disclosure of cross-border
6 transactions should be required. The study shall set forth
7 specific recommendations to address all abuses identified
8 in the study. Not later than December 31, 2002, such Sec-
9 retary or delegate shall submit to the Congress a report
10 of such study.

11 (b) INCOME TAX TREATIES.—The Secretary of the
12 Treasury or the Secretary's delegate shall conduct a study
13 of United States income tax treaties to identify any inap-
14 propriate reductions in United States withholding tax that
15 provide opportunities for shifting income out of the United
16 States, and to evaluate whether existing anti-abuse mecha-
17 nisms are operating properly. The study shall include spe-
18 cific recommendations to address all inappropriate uses of
19 tax treaties. Not later than December 31, 2002, such Sec-
20 retary or delegate shall submit to the Congress a report
21 of such study.

22 (c) IMPACT OF EXPATRIATION PROVISIONS.—The
23 Secretary of the Treasury or the Secretary's delegate shall
24 conduct a study of the impact of the provisions of this
25 title on corporate earnings stripping and expatriation. The

1 study shall include such recommendations as such Sec-
2 retary or delegate may have to improve the impact of such
3 provisions in carrying out the purposes of this title. Not
4 later than December 31, 2004, such Secretary or delegate
5 shall submit to the Congress a report of such study.

6 **TITLE III—SIMPLIFICATION OF**
7 **RULES RELATING TO THE**
8 **TAXATION OF UNITED STATES**
9 **BUSINESSES OPERATING**
10 **ABROAD**

11 **Subtitle A—Treatment of**
12 **Controlled Foreign Corporations**

13 **SEC. 301. REPEAL OF CFC RULES ON FOREIGN BASE COM-**
14 **PANY SALES AND SERVICES INCOME.**

15 (a) IN GENERAL.—Subsection (a) of section 954 (re-
16 lating to foreign base company income) is amended by
17 striking paragraphs (2) and (3) and by redesignating
18 paragraphs (4) and (5) as paragraphs (2) and (3), respec-
19 tively.

20 (b) CERTAIN SALES.—Paragraph (1) of section
21 954(c) is amended by adding at the end the following new
22 subparagraph:

23 “(H) CERTAIN SALES.—Income (whether
24 in the form of profits, commissions, fees, or
25 otherwise) derived in connection with the pur-

1 chase of personal property from a related per-
2 son and its sale to any person, the sale of per-
3 sonal property to any person on behalf of a re-
4 lated person, the purchase of personal property
5 from any person and its sale to a related per-
6 son, or the purchase of personal property from
7 any person on behalf of a related person
8 where—

9 “(i) the property which is purchased
10 (or in the case of property sold on behalf
11 of a related person, the property which is
12 sold) is manufactured, produced, grown, or
13 extracted in the United States, and

14 “(ii) the property is sold for use, con-
15 sumption, or disposition in the United
16 States, or, in the case of property pur-
17 chased on behalf of a related person, is
18 purchased for use, consumption, or disposi-
19 tion in the United States.”

20 (c) CONFORMING AMENDMENTS.—

21 (1) Clause (iii) of section 952(c)(1)(B) is
22 amended by striking subclauses (III) and (IV) and
23 by redesignating subclauses (V) and (VI) as sub-
24 clauses (III) and (IV), respectively.

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

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

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

9 “(A) such person is an individual, corpora-
10 tion, partnership, trust, or estate which con-
11 trols, or is controlled by, the controlled foreign
12 corporation, or

13 “(B) such person is a corporation, partner-
14 ship, trust, or estate which is controlled by the
15 same person or persons which control the con-
16 trolled foreign corporation.

17 For purposes of the preceding sentence, control
18 means, with respect to a corporation, the ownership,
19 directly or indirectly, of stock possessing more than
20 50 percent of the total voting power of all classes of
21 stock entitled to vote or of the total value of stock
22 of such corporation. In the case of a partnership,
23 trust, or estate, control means the ownership, di-
24 rectly or indirectly, of more than 50 percent (by
25 value) of the beneficial interests in such partnership,

1 trust, or estate. For purposes of this paragraph,
2 rules similar to the rules of section 958 shall apply.”

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

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

8 (6) Sections 552(e)(2), 861(e)(2)(B),
9 904(d)(2)(H), 953(e), 955(b), 958(b), 971(f),
10 988(e)(3)(C), 1297(b)(2), 1298(d)(3), and
11 1298(e)(2)(B) are each amended by striking
12 “954(d)(3)” each place it appears and inserting
13 “954(b)(9)”.

14 **SEC. 302. LOOK-THRU TREATMENT OF PAYMENTS BE-**
15 **TWEEN RELATED CONTROLLED FOREIGN**
16 **CORPORATIONS UNDER FOREIGN PERSONAL**
17 **HOLDING COMPANY INCOME RULES.**

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

20 “(4) LOOK-THRU IN THE CASE OF RELATED
21 CONTROLLED FOREIGN CORPORATIONS.—For pur-
22 poses of this subsection, dividends, interest, rents,
23 and royalties received from a controlled foreign cor-
24 poration which is a related person (as defined in
25 subsection (b)(9)) shall not be treated as foreign

1 personal holding company income to the extent at-
2 tributable (determined under rules similar to the
3 rules of subparagraphs (C) and (D) of section
4 904(d)(3)) to income of the related person which is
5 not subpart F income (as defined in section 952).”

6 **SEC. 303. LOOK-THRU TREATMENT FOR SALES OF PART-**
7 **nership Interests.**

8 Section 954(c) (defining foreign personal holding
9 company income) is amended by adding after paragraph
10 (4) the following new paragraph:

11 “(5) LOOK-THROUGH RULE FOR CERTAIN
12 PARTNERSHIP SALES.—

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

21 “(B) 25-PERCENT OWNER.—For purposes
22 of this paragraph, the term ‘25-percent owner’
23 means a controlled foreign corporation which
24 owns 25 percent or more of the capital or prof-
25 its interest in the partnership. The constructive

1 ownership rules of section 958(b) shall apply
2 for purposes of the preceding sentence.”

3 **SEC. 304. REPEAL OF FOREIGN PERSONAL HOLDING COM-**
4 **PANY RULES AND FOREIGN INVESTMENT**
5 **COMPANY RULES.**

6 (a) GENERAL RULE.—The following provisions are
7 hereby repealed:

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

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

12 (3) Section 1247 (relating to election by foreign
13 investment companies to distribute income cur-
14 rently).

15 (b) EXEMPTION OF FOREIGN CORPORATIONS FROM
16 PERSONAL HOLDING COMPANY RULES.—

17 (1) IN GENERAL.—Subsection (c) of section
18 542 (relating to exceptions) is amended—

19 (A) by striking paragraph (5) and insert-
20 ing the following:

21 “(5) a foreign corporation,”

22 (B) by striking paragraphs (7) and (10)
23 and by redesignating paragraphs (8) and (9) as
24 paragraphs (7) and (8), respectively,

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

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

6 (2) TREATMENT OF INCOME FROM PERSONAL
7 SERVICE CONTRACTS.—Paragraph (1) of section
8 954(c) is amended by adding at the end the fol-
9 lowing new subparagraph:

10 “(H) PERSONAL SERVICE CONTRACTS.—

11 “(i) Amounts received under a con-
12 tract under which the corporation is to fur-
13 nish personal services; if some person other
14 than the corporation has the right to des-
15 ignate (by name or by description) the in-
16 dividual who is to perform the services, or
17 if the individual who is to perform the
18 services is designated (by name or by de-
19 scription) in the contract; and

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

22 This subparagraph shall apply with respect to
23 amounts received for services under a particular
24 contract only if at some time during the taxable
25 year 25 percent or more in value of the out-

1 standing stock of the corporation is owned, di-
2 rectly or indirectly, by or for the individual who
3 has performed, is to perform, or may be des-
4 ignated (by name or by description) as the one
5 to perform, such services.”

6 (c) CONFORMING AMENDMENTS.—

7 (1) Paragraph (2) of section 171(c) is
8 amended—

9 (A) by striking “, or by a foreign personal
10 holding company, as defined in section 552”,
11 and

12 (B) by striking “, or a foreign personal
13 holding company”.

14 (2) Paragraph (2) of section 245(a) is amended
15 by striking “foreign personal holding company or”

16 (3) Section 312 is amended by striking sub-
17 section (j).

18 (4) Subsection (m) of section 312 is amended
19 by striking “, a foreign investment company (within
20 the meaning of section 1246(b)), or a foreign per-
21 sonal holding company (within the meaning of sec-
22 tion 552)”.

23 (5) Subsection (e) of section 443 is amended by
24 striking paragraph (3) and by redesignating para-

1 graphs (4) and (5) as paragraphs (3) and (4), re-
2 spectively.

3 (6) Subparagraph (B) of section 465(c)(7) is
4 amended to by adding “or” at the end of clause (i),
5 by striking clause (ii), and by redesignating clause
6 (iii) as clause (ii).

7 (7) Paragraph (1) of section 543(b) is amended
8 by inserting “and” at the end of subparagraph (A),
9 by striking “, and” at the end of subparagraph (B)
10 and inserting a period, and by striking subparagraph
11 (C).

12 (8) Paragraph (1) of section 562(b) is amended
13 by striking “or a foreign personal holding company
14 described in section 552”.

15 (9) Section 563 is amended—

16 (A) by striking subsection (c),

17 (B) by redesignating subsection (d) as sub-
18 section (e), and

19 (C) by striking “subsection (a), (b), or (c)”
20 in subsection (e) (as so redesignated) and in-
21 serting “subsection (a) or (b)”.

22 (10) Subsection (d) of section 751 is amended
23 by adding “and” at the end of paragraph (2), by
24 striking paragraph (3), by redesignating paragraph
25 (4) as paragraph (3), and by striking “paragraph

1 (1), (2), or (3)” in paragraph (3) (as so redesignated) and inserting “paragraph (1) or (2)”.

3 (11) Paragraph (2) of section 864(d) is amended by striking subparagraph (A) and by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively.

7 (12)(A) Subparagraph (A) of section 898(b)(1) is amended to read as follows:

9 “(A) which is treated as a controlled foreign corporation for any purpose under subpart F of part III of this subchapter, and”.

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

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

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

1 (D) Subsection (c) of section 898 is amended to
2 read as follows:

3 “(c) DETERMINATION OF REQUIRED YEAR.—

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

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

6 or

7 “(B) if there is no majority U.S. share-
8 holder year, the taxable year prescribed under
9 regulations.

10 “(2) 1-MONTH DEFERRAL ALLOWED.—A speci-
11 fied foreign corporation may elect, in lieu of the tax-
12 able year under paragraph (1)(A), a taxable year be-
13 ginning 1 month earlier than the majority U.S.
14 shareholder year.

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

16 “(A) IN GENERAL.—For purposes of this
17 subsection, the term ‘majority U.S. shareholder
18 year’ means the taxable year (if any) which, on
19 each testing day, constituted the taxable year
20 of—

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

23 “(ii) each United States shareholder
24 not described in clause (i) whose stock was
25 treated as owned under subsection

1 (b)(2)(B) by any shareholder described in
2 such clause.

3 “(B) TESTING DAY.—The testing days
4 shall be—

5 “(i) the first day of the corporation’s
6 taxable year (determined without regard to
7 this section), or

8 “(ii) the days during such representa-
9 tive period as the Secretary may pre-
10 scribe.”

11 (13) Clause (ii) of section 904(d)(2)(A) is
12 amended to read as follows:

13 “(ii) CERTAIN AMOUNTS INCLUDED.—
14 Except as provided in clause (iii), the term
15 ‘passive income’ includes, except as pro-
16 vided in subparagraph (E)(iii) or para-
17 graph (3)(I), any amount includible in
18 gross income under section 1293 (relating
19 to certain passive foreign investment com-
20 panies).”

21 (14)(A) Subparagraph (A) of section 904(g)(1)
22 is amended by adding “or” at the end of clause (i),
23 by striking clause (ii), and by redesignating clause
24 (iii) as clause (ii).

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

4 (15) Section 951 is amended by striking sub-
5 sections (c) and (d) and by redesignating subsections
6 (e) and (f) as subsections (c) and (d), respectively.

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

9 (17) Paragraph (5) of section 1014(b) is
10 amended by inserting “and before January 1,
11 2003,” after “August 26, 1937,”.

12 (18) Subsection (a) of section 1016 is amended
13 by striking paragraph (13) and by redesignating the
14 following paragraphs accordingly.

15 (19)(A) Paragraph (3) of section 1212(a) is
16 amended to read as follows:

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

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

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

1 (B) The amendment made by subparagraph (A)
2 shall apply to taxable years beginning after Decem-
3 ber 31, 2004.

4 (20) Section 1223 is amended by striking para-
5 graph (10) and by redesignating the following para-
6 graphs accordingly.

7 (21) Subsection (d) of section 1248 is amended
8 by striking paragraph (5) and by redesignating
9 paragraphs (6) and (7) as paragraphs (5) and (6),
10 respectively.

11 (22) Paragraph (2) of section 1260(c) is
12 amended by striking subparagraphs (H) and (I) and
13 by redesignating subparagraph (J) as subparagraph
14 (H).

15 (23) Subparagraph (F) of section 1291(b)(3) is
16 amended by striking “551(d), 959(a),” and inserting
17 “959(a)”.

18 (24) Paragraph (2) of section 1294(a) is
19 amended to read as follows:

20 “(2) ELECTION NOT PERMITTED WHERE
21 AMOUNTS OTHERWISE INCLUDIBLE UNDER SECTION
22 951.—The taxpayer may not make an election under
23 paragraph (1) with respect to the undistributed
24 PFIC earnings tax liability attributable to a quali-
25 fied electing fund for the taxable year if any amount

1 is includible in the gross income of the taxpayer
2 under section 951 with respect to such fund for such
3 taxable year.”

4 (25) Section 6035 is hereby repealed.

5 (26) Subparagraph (D) of section 6103(e)(1) is
6 amended by striking clause (iv) and redesignating
7 clauses (v) and (vi) as clauses (iv) and (v), respec-
8 tively.

9 (27) Subparagraph (B) of section 6501(e)(1) is
10 amended to read as follows:

11 “(B) CONSTRUCTIVE DIVIDENDS.—If the
12 taxpayer omits from gross income an amount
13 properly includible therein under section
14 951(a), the tax may be assessed, or a pro-
15 ceeding in court for the collection of such tax
16 may be done without assessing, at any time
17 within 6 years after the return was filed.”

18 (28) Subsection (a) of section 6679 is
19 amended—

20 (A) by striking “6035, 6046, and 6046A”
21 in paragraph (1) and inserting “6046 and
22 6046A”, and

23 (B) by striking paragraph (3).

1 (29) Sections 170(f)(10)(A), 508(d), 4947, and
2 4948(e)(4) are each amended by striking
3 “556(b)(2),” each place it appears.

4 (30) The table of parts for subchapter G of
5 chapter 1 is amended by striking the item relating
6 to part III.

7 (31) The table of sections for part IV of sub-
8 chapter P of chapter 1 is amended by striking the
9 items relating to sections 1246 and 1247.

10 (32) The table of sections for subpart A of part
11 III of subchapter A of chapter 61 is amended by
12 striking the item relating to section 6035.

13 **SEC. 305. CLARIFICATION OF TREATMENT OF PIPELINE**
14 **TRANSPORTATION INCOME.**

15 Section 954(g)(1) (defining foreign base company oil
16 related income) is amended by striking “or” at the end
17 of subparagraph (A), by striking the period at the end
18 of subparagraph (B) and inserting “, or”, and by inserting
19 after subparagraph (B) the following new subparagraph:

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

1 **SEC. 306. DETERMINATION OF FOREIGN PERSONAL HOLD-**
2 **ING COMPANY INCOME WITH RESPECT TO**
3 **TRANSACTIONS IN COMMODITIES.**

4 (a) IN GENERAL.—Clauses (i) and (ii) of section
5 954(e)(1)(C) (relating to commodity transactions) are
6 amended to read as follows:

7 “(i) arise out of commodity hedging
8 transactions (as defined in paragraph
9 (6)(A)),

10 “(ii) are active business gains or
11 losses from the sale of commodities, but
12 only if substantially all of the controlled
13 foreign corporation’s commodities are
14 property described in paragraph (1), (2),
15 or (8) of section 1221(a), or”.

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

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

21 “(A) COMMODITY HEDGING TRANS-
22 ACTIONS.—For purposes of paragraph
23 (1)(C)(i), the term ‘commodity hedging trans-
24 action’ means any transaction with respect to a
25 commodity if such transaction—

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

3 “(I) without regard to subpara-
4 graph (A)(ii) thereof,

5 “(II) by applying subparagraph
6 (A)(i) thereof by substituting ‘ordi-
7 nary property or property described in
8 section 1231(b)’ for ‘ordinary prop-
9 erty’, and

10 “(III) by substituting ‘controlled
11 foreign corporation’ for ‘taxpayer’
12 each place it appears, and

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

15 “(B) REGULATIONS.—The Secretary shall
16 prescribe such regulations as are appropriate to
17 carry out the purposes of paragraph (1)(C) in
18 the case of transactions involving related par-
19 ties.”

20 (c) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to transactions entered into on or
22 after the date of enactment of this Act.

23 **SEC. 307. EFFECTIVE DATE.**

24 Except as otherwise provided in this subtitle, the
25 amendments made by this subtitle shall apply to taxable

1 years of foreign corporations beginning after December
2 31, 2002, and taxable years of United States persons own-
3 ing stock in such corporations with or within which such
4 corporations' taxable years end.

5 **Subtitle B—Provisions Relating to** 6 **Foreign Tax Credit**

7 **SEC. 311. INTEREST EXPENSE ALLOCATION RULES.**

8 (a) ALLOCATION ON WORLDWIDE BASIS.—

9 (1) IN GENERAL.—Paragraphs (1) and (2) of
10 section 864(e) (relating to rules for allocating inter-
11 est, etc.) are amended to read as follows:

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

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

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

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

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

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

18 “(C) WORLDWIDE AFFILIATED GROUP.—
19 For purposes of this paragraph, the term
20 ‘worldwide affiliated group’ means an affiliated
21 group as defined in section 1504(a), determined
22 without regard to paragraphs (2), (3), and (4)
23 of section 1504(b).

24 “(2) ALLOCATION AND APPORTIONMENT OF
25 OTHER EXPENSES.—Expenses other than interest

1 which are not directly allocable or apportioned to
2 any specific income producing activity shall be allo-
3 cated and apportioned as if all members of the affili-
4 ated group were a single corporation. For purposes
5 of the preceding sentence, the term ‘affiliated group’
6 has the meaning given such term by section 1504
7 (determined without regard to paragraph (4) of sec-
8 tion 1504(b)).”

9 (2) CONFORMING AMENDMENTS.—

10 (A) Clauses (i) and (ii) of section
11 864(e)(4)(B) are each amended by striking “af-
12 filiated group” and inserting “worldwide affili-
13 ated group (as defined in paragraph (1)(C))”.

14 (B) Subsection (e) of section 864 is
15 amended by striking paragraph (6).

16 (b) TREATMENT OF FINANCIAL INSTITUTIONS.—

17 (1) TREATMENT AS SEPARATE WORLDWIDE
18 GROUP.—

19 (A) IN GENERAL.—Paragraph (5) of sec-
20 tion 864(e) is amended by striking so much of
21 such paragraph as precedes subparagraph (C),
22 by redesignating subparagraphs (C) and (D) as
23 subparagraphs (B) and (C), respectively, and
24 by inserting before subparagraph (B) (as so re-
25 designated) the following:

1 “(5) TREATMENT OF CERTAIN FINANCIAL IN-
2 STITUTIONS.—

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

9 (B) CONFORMING AMENDMENT.—Subpara-
10 graph (C) of section 864(e)(5), as redesignated
11 by subparagraph (A), is amended by striking
12 “subparagraph (C)” and inserting “subpara-
13 graph (B)”.

14 (2) ELECTION TO EXPAND FINANCIAL INSTITU-
15 TION GROUP OF WORLDWIDE GROUP.—Subsection
16 (e) of section 864 is amended by inserting after
17 paragraph (5) the following new paragraph:

18 “(6) ELECTION TO EXPAND FINANCIAL INSTI-
19 TUTION GROUP OF WORLDWIDE GROUP.—

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

23 “(i) are members of such worldwide
24 affiliated group, but

1 “(ii) are not corporations described in
2 paragraph (5)(B),
3 shall be treated as described in paragraph
4 (5)(B) for purposes of applying paragraph
5 (5)(A). This subsection (other than this para-
6 graph) shall apply to any such group in the
7 same manner as this subsection (other than this
8 paragraph) applies to the pre-election worldwide
9 affiliated group of which such group is a part.

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

24 “(C) ANTIABUSE RULES.—In the case of a
25 corporation which is a member of an electing fi-

1 nancial institution group, to the extent that
2 such corporation—

3 “(i) distributes dividends or makes
4 other distributions with respect to its stock
5 after the date of the enactment of this
6 paragraph to any member of the pre-elec-
7 tion worldwide affiliated group (other than
8 to a member of the electing financial insti-
9 tution group) in excess of the greater of—

10 “(I) its average annual dividend
11 (expressed as a percentage of current
12 earnings and profits) during the 5-
13 taxable-year period ending with the
14 taxable year preceding the taxable
15 year, or

16 “(II) 25 percent of its average
17 annual earnings and profits for such
18 5-taxable-year period, or

19 “(ii) deals with any person in any
20 manner not clearly reflecting the income of
21 the corporation (as determined under prin-
22 ciples similar to the principles of section
23 482),

24 an amount of indebtedness of the electing fi-
25 nancial institution group equal to the excess

1 distribution or the understatement or overstate-
2 ment of income, as the case may be, shall be re-
3 characterized (for the taxable year and subse-
4 quent taxable years) for purposes of this para-
5 graph as indebtedness of the worldwide affili-
6 ated group (excluding the electing financial in-
7 stitution group). If a corporation has not been
8 in existence for 5 taxable years, this subpara-
9 graph shall be applied with respect to the pe-
10 riod it was in existence.

11 “(D) ELECTION.—An election under this
12 paragraph with respect to any financial institu-
13 tion group may be made only by the common
14 parent of the pre-election worldwide affiliated
15 group and may be made only for the first tax-
16 able year beginning after December 31, 2002,
17 in which such affiliated group includes 1 or
18 more financial corporations. Such an election,
19 once made, shall apply to all financial corpora-
20 tions which are members of the electing finan-
21 cial institution group for such taxable year and
22 all subsequent years unless revoked with the
23 consent of the Secretary.

24 “(E) DEFINITIONS RELATING TO
25 GROUPS.—For purposes of this paragraph—

1 “(i) PRE-ELECTION WORLDWIDE AF-
2 FILIATED GROUP.—The term ‘pre-election
3 worldwide affiliated group’ means, with re-
4 spect to a corporation, the worldwide affili-
5 ated group of which such corporation
6 would (but for an election under this para-
7 graph) be a member for purposes of apply-
8 ing paragraph (1).

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

17 “(F) REGULATIONS.—The Secretary shall
18 prescribe such regulations as may be appro-
19 priate to carry out this subsection, including
20 regulations—

21 “(i) providing for the direct allocation
22 of interest expense in other circumstances
23 where such allocation would be appropriate
24 to carry out the purposes of this sub-
25 section,

1 “(ii) preventing assets or interest ex-
2 pense from being taken into account more
3 than once, and

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

9 (c) EXPANSION OF REGULATORY AUTHORITY.—
10 Paragraph (7) of section 864(e) is amended—

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

15 (2) by striking “and” at the end of subpara-
16 graph (E), by redesignating subparagraph (F) as
17 subparagraph (G), and by inserting after subpara-
18 graph (E) the following new subparagraph:

19 “(F) preventing assets or interest expense
20 from being taken into account more than once,
21 and”.

22 (e) EFFECTIVE DATE.—The amendments made by
23 this section shall apply to taxable years beginning after
24 December 31, 2002.

1 **SEC. 312. RECHARACTERIZATION OF OVERALL DOMESTIC**
2 **LOSS.**

3 (a) GENERAL RULE.—Section 904 is amended by re-
4 designating subsections (g), (h), (i), (j), and (k) as sub-
5 sections (h), (i), (j), (k), and (l) respectively, and by in-
6 serting after subsection (f) the following new subsection:

7 “(g) RECHARACTERIZATION OF OVERALL DOMESTIC
8 LOSS.—

9 “(1) GENERAL RULE.—For purposes of this
10 subpart and section 936, in the case of any taxpayer
11 who sustains an overall domestic loss for any taxable
12 year beginning after December 31, 2002, that por-
13 tion of the taxpayer’s taxable income from sources
14 within the United States for each succeeding taxable
15 year which is equal to the lesser of—

16 “(A) the amount of such loss (to the extent
17 not used under this paragraph in prior taxable
18 years), or

19 “(B) 50 percent of the taxpayer’s taxable
20 income from sources within the United States
21 for such succeeding taxable year,
22 shall be treated as income from sources without the
23 United States (and not as income from sources with-
24 in the United States).

25 “(2) OVERALL DOMESTIC LOSS DEFINED.—For
26 purposes of this subsection—

1 “(A) IN GENERAL.—The term ‘overall do-
2 mestic loss’ means any domestic loss to the ex-
3 tent such loss offsets taxable income from
4 sources without the United States for the tax-
5 able year or for any preceding taxable year by
6 reason of a carryback. For purposes of the pre-
7 ceding sentence, the term ‘domestic loss’ means
8 the amount by which the gross income for the
9 taxable year from sources within the United
10 States is exceeded by the sum of the deductions
11 properly apportioned or allocated thereto (deter-
12 mined without regard to any carryback from a
13 subsequent taxable year).

14 “(B) TAXPAYER MUST HAVE ELECTED
15 FOREIGN TAX CREDIT FOR YEAR OF LOSS.—
16 The term ‘overall domestic loss’ shall not in-
17 clude any loss for any taxable year unless the
18 taxpayer chose the benefits of this subpart for
19 such taxable year.

20 “(3) CHARACTERIZATION OF SUBSEQUENT IN-
21 COME.—

22 “(A) IN GENERAL.—Any income from
23 sources within the United States that is treated
24 as income from sources without the United
25 States under paragraph (1) shall be allocated

1 among and increase the income categories in
2 proportion to the loss from sources within the
3 United States previously allocated to those in-
4 come categories.

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

9 “(4) COORDINATION WITH SUBSECTION (f).—
10 The Secretary shall prescribe such regulations as
11 may be necessary to coordinate the provisions of this
12 subsection with the provisions of subsection (f).”

13 (b) CONFORMING AMENDMENTS.—

14 (1) Section 535(d)(2) is amended by striking
15 “section 904(g)(6)” and inserting “section
16 904(h)(6)”.

17 (2) Subparagraph (A) of section 936(a)(2) is
18 amended by striking “section 904(f)” and inserting
19 “subsections (f) and (g) of section 904”.

20 (c) EFFECTIVE DATE.—The amendments made by
21 this section shall apply to losses for taxable years begin-
22 ning after December 31, 2002.

23 **SEC. 313. REDUCTION TO 3 FOREIGN TAX CREDIT BASKETS.**

24 (a) IN GENERAL.—Paragraph (1) of section 904(d)
25 (relating to separate application of section with respect to

1 certain categories of income) is amended to read as fol-
2 lows:

3 “(1) IN GENERAL.—The provisions of sub-
4 sections (a), (b), and (c) and sections 902, 907, and
5 960 shall be applied separately with respect to in-
6 come described in each of the following items of in-
7 come:

8 “(A) passive income and other passive cat-
9 egory income,

10 “(B) financial services income, and

11 “(C) income other than income described
12 in subparagraph (A) or (B).”

13 (b) OTHER PASSIVE CATEGORY INCOME.—Subpara-
14 graph (A) of section 904(d)(2) is amended by adding at
15 the end the following new clause:

16 “(v) OTHER PASSIVE CATEGORY IN-
17 COME.—The term ‘other passive category
18 income’ means—

19 “(I) dividends from a DISC or
20 former DISC (as defined in section
21 992(a)) to the extent such dividends
22 are treated as income from sources
23 without the United States,

1 “(II) taxable income attributable
2 to foreign trade income (within the
3 meaning of section 923(b)), and

4 “(III) distributions from a FSC
5 (or a former FSC) out of earnings
6 and profits attributable to foreign
7 trade income (within the meaning of
8 section 923(b)) or interest or carrying
9 charges (as defined in section
10 927(d)(1)) derived from a transaction
11 which results in foreign trade income
12 (as defined in section 923(b)).”

13 (c) CONFORMING AMENDMENTS.—

14 (1) Paragraph (2) of section 904(d) is amended
15 by striking subparagraphs (B) and (D).

16 (2)(A) Subclause (III) of section
17 904(d)(2)(C)(i) is amended to read as follows:

18 “(III) high-taxed export financ-
19 ing interest.”

20 (B) Subparagraph (C) of section 904(d)(2) is
21 amended by adding at the end the following new
22 clause:

23 “(iv) HIGH-TAXED EXPORT FINANC-
24 ING INTEREST.—The term ‘high-taxed ex-

1 port financing interest' means any interest
2 if—

3 “(I) such interest is subject to a
4 withholding tax of a foreign country
5 or possession of the United States (or
6 other tax determined on a gross
7 basis), and

8 “(II) the rate of such tax appli-
9 cable to such interest is at least 5 per-
10 cent.

11 The Secretary may by regulations provide
12 that export financing interest (not other-
13 wise high-taxed export financing interest)
14 shall be treated as high-taxed export fi-
15 nancing interest where necessary to pre-
16 vent avoidance of the purposes of this sub-
17 paragraph, and a tax shall not be treated
18 as a withholding tax or other tax imposed
19 on a gross basis if such tax is in the na-
20 ture of a prepayment of a tax imposed on
21 a net basis.”

22 (3) Clause (iii) of section 904(d)(2)(C) is
23 amended to read as follows:

24 “(iii) EXCEPTIONS.—The term ‘finan-
25 cial services income’ does not include—

1 “(I) in the case of a corporation,
2 dividends from noncontrolled section
3 902 corporations out of earnings and
4 profits accumulated in taxable years
5 beginning before January 1, 2003,
6 and

7 “(II) any export financing inter-
8 est which is not high-taxed export fi-
9 nancing interest.”

10 (4) Subparagraph (E) of section 904(d)(2) is
11 amended by striking clause (ii) and by redesignating
12 clauses (iii) and (iv) as clauses (ii) and (iii), respec-
13 tively.

14 (5) Clause (i) of section 904(d)(3)(F) is amend-
15 ed to read as follows:

16 “(i) IN GENERAL.—Except as pro-
17 vided in clause (ii), the separate categories
18 are—

19 “(I) passive income and other
20 passive category income, and

21 “(II) financial services income.”

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

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

4 “(I) TRANSITIONAL RULE FOR 2002
5 CHANGES.—For purposes of paragraph (1),
6 taxes carried from any taxable year beginning
7 before January 1, 2003, to any taxable year be-
8 ginning on or after such date, with respect to
9 any item of income shall be treated as described
10 in the subparagraph of paragraph (1) in which
11 such income would be described were such taxes
12 paid or accrued in a taxable year beginning on
13 or after such date.”

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

17 **SEC. 314. 10-YEAR FOREIGN TAX CREDIT CARRYFORWARD.**

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

22 (b) EXCESS EXTRACTION TAXES.—Paragraph (1) of
23 section 907(f) is amended by striking “in the first, second,
24 third, fourth, or fifth” and inserting “in any of the first
25 10”.

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to excess foreign taxes which (with-
3 out regard to the amendments made by this section) may
4 be carried to any taxable year beginning after December
5 31, 2002.

6 **SEC. 315. REPEAL OF LIMITATION OF FOREIGN TAX CREDIT**
7 **UNDER ALTERNATIVE MINIMUM TAX.**

8 (a) IN GENERAL.—Section 59(a) (relating to alter-
9 native minimum tax foreign tax credit) is amended by
10 striking paragraph (2) and by redesignating paragraphs
11 (3) and (4) as paragraphs (2) and (3), respectively.

12 (b) CONFORMING AMENDMENT.—Section
13 53(d)(1)(B)(i)(II) is amended by striking “and if section
14 59(a)(2) did not apply”.

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

18 **SEC. 316. LOOK-THRU RULES TO APPLY TO DIVIDENDS**
19 **FROM NONCONTROLLED SECTION 902 COR-**
20 **PORATIONS.**

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

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

1 “(A) IN GENERAL.—For purposes of this
2 subsection, any dividend from a noncontrolled
3 section 902 corporation with respect to the tax-
4 payer shall be treated as income in a separate
5 category in proportion to the ratio of—

6 “(i) the portion of earnings and prof-
7 its attributable to income in such category,
8 to

9 “(ii) the total amount of earnings and
10 profits.

11 “(B) SPECIAL RULES.—For purposes of
12 this paragraph—

13 “(i) IN GENERAL.—Rules similar to
14 the rules of paragraph (3)(F) shall apply.

15 “(ii) EARNINGS AND PROFITS.—

16 “(I) IN GENERAL.—The rules of
17 section 316 shall apply.

18 “(II) REGULATIONS.—The Sec-
19 retary may prescribe regulations re-
20 garding the treatment of distributions
21 out of earnings and profits for periods
22 before the taxpayer’s acquisition of
23 the stock to which the distributions
24 relate.

1 “(iii) DIVIDENDS NOT ALLOCABLE TO
2 SEPARATE CATEGORY.—The portion of any
3 dividend from a noncontrolled section 902
4 corporation which is not treated as income
5 in a separate category under subparagraph
6 (A) shall be treated as a dividend to which
7 subparagraph (A) does not apply.

8 “(iv) LOOK-THRU WITH RESPECT TO
9 CARRYFORWARDS OF CREDIT.—Rules simi-
10 lar to subparagraph (A) also shall apply to
11 any carryforward under subsection (c)
12 from a taxable year beginning before Janu-
13 ary 1, 2003, of tax allocable to a dividend
14 from a noncontrolled section 902 corpora-
15 tion with respect to the taxpayer.”.

16 (b) CONFORMING AMENDMENTS.—

17 (1) Subparagraph (E) of section 904(d)(1), as
18 in effect both before and after the amendments
19 made by section 1105 of the Taxpayer Relief Act of
20 1997, is hereby repealed.

21 (2) Section 904(d)(2)(C)(iii), as so in effect, is
22 amended by striking subclause (II) and by redesignig-
23 nating subclause (III) as subclause (II).

1 ceding sentence shall, for purposes of applying such
2 sentence, be treated as actually owned by such per-
3 son. The Secretary may prescribe such regulations
4 as may be necessary to carry out the purposes of
5 this paragraph, including rules to account for special
6 partnership allocations of dividends, credits, and
7 other incidents of ownership of stock in determining
8 proportionate ownership.”

9 (b) EFFECTIVE DATE.—The amendment made by
10 this section shall apply to taxes of foreign corporations
11 for taxable years of such corporations beginning after De-
12 cember 31, 2002.

13 **Subtitle C—Other Provisions**

14 **SEC. 321. APPLICATION OF UNIFORM CAPITALIZATION** 15 **RULES TO FOREIGN PERSONS.**

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

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

1 statements to shareholders, partners, other propri-
2 etors, or beneficiaries, or for credit purposes.”

3 (b) **EFFECTIVE DATE.**—The amendment made by
4 subsection (a) shall apply to taxable years beginning after
5 December 31, 2002. Section 481 of the Internal Revenue
6 Code of 1986 shall not apply to any change in a method
7 of accounting by reason of such amendment.

8 **SEC. 322. UNITED STATES PROPERTY NOT TO INCLUDE**
9 **CERTAIN ASSETS ACQUIRED BY DEALERS IN**
10 **ORDINARY COURSE OF TRADE OR BUSINESS.**

11 (a) **IN GENERAL.**—Section 956(c)(2) (relating to ex-
12 ceptions from property treated as United States property)
13 is amended by striking “and” at the end of subparagraph
14 (J), by striking the period at the end of subparagraph (K)
15 and inserting “; and”, and by adding at the end the fol-
16 lowing new subparagraph:

17 “(L) securities acquired and held by a con-
18 trolled foreign corporation in the ordinary
19 course of its business as a dealer in securities
20 if (i) the dealer accounts for the securities as
21 securities held primarily for sale to customers
22 in the ordinary course of business, and (ii) the
23 dealer disposes of the securities (or such securi-
24 ties mature while held by the dealer) within a
25 period consistent with the holding of securities

1 for sale to customers in the ordinary course of
2 business.”

3 (b) CONFORMING AMENDMENT.—Section 956(c)(2)
4 is amended by striking “and (K)” in the last sentence and
5 inserting “, (K), and (L)”.

6 (c) EFFECTIVE DATE.—The amendments made by
7 this section shall apply to taxable years of foreign corpora-
8 tions beginning after December 31, 2002, and to taxable
9 years of United States shareholders with or within which
10 such taxable years of foreign corporations end.

11 **SEC. 323. TREATMENT OF CERTAIN DIVIDENDS OF REGU-**
12 **LATED INVESTMENT COMPANIES.**

13 (a) TREATMENT OF CERTAIN DIVIDENDS.—

14 (1) NONRESIDENT ALIEN INDIVIDUALS.—Sec-
15 tion 871 (relating to tax on nonresident alien indi-
16 viduals) is amended by redesignating subsection (k)
17 as subsection (l) and by inserting after subsection (j)
18 the following new subsection:

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

21 “(1) INTEREST-RELATED DIVIDENDS.—

22 “(A) IN GENERAL.—Except as provided in
23 subparagraph (B), no tax shall be imposed
24 under paragraph (1)(A) of subsection (a) on

1 any interest-related dividend received from a
2 regulated investment company.

3 “(B) EXCEPTIONS.—Subparagraph (A)
4 shall not apply—

5 “(i) to any interest-related dividend
6 received from a regulated investment com-
7 pany by a person to the extent such divi-
8 dend is attributable to interest (other than
9 interest described in subparagraph (E) (i)
10 or (iii)) received by such company on in-
11 debtedness issued by such person or by any
12 corporation or partnership with respect to
13 which such person is a 10-percent share-
14 holder,

15 “(ii) to any interest-related dividend
16 with respect to stock of a regulated invest-
17 ment company unless the person who
18 would otherwise be required to deduct and
19 withhold tax from such dividend under
20 chapter 3 receives a statement (which
21 meets requirements similar to the require-
22 ments of subsection (h)(5)) that the bene-
23 ficial owner of such stock is not a United
24 States person, and

1 “(iii) to any interest-related dividend
2 paid to any person within a foreign coun-
3 try (or any interest-related dividend pay-
4 ment addressed to, or for the account of,
5 persons within such foreign country) dur-
6 ing any period described in subsection
7 (h)(6) with respect to such country.

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

12 “(C) INTEREST-RELATED DIVIDEND.—For
13 purposes of this paragraph, an interest-related
14 dividend is any dividend (or part thereof) which
15 is designated by the regulated investment com-
16 pany as an interest-related dividend in a writ-
17 ten notice mailed to its shareholders not later
18 than 60 days after the close of its taxable year.
19 If the aggregate amount so designated with re-
20 spect to a taxable year of the company (includ-
21 ing amounts so designated with respect to divi-
22 dends paid after the close of the taxable year
23 described in section 855) is greater than the
24 qualified net interest income of the company for
25 such taxable year, the portion of each distribu-

1 tion which shall be an interest-related dividend
2 shall be only that portion of the amounts so
3 designated which such qualified net interest in-
4 come bears to the aggregate amount so des-
5 ignated.

6 “(D) QUALIFIED NET INTEREST IN-
7 COME.—For purposes of subparagraph (C), the
8 term ‘qualified net interest income’ means the
9 qualified interest income of the regulated in-
10 vestment company reduced by the deductions
11 properly allocable to such income.

12 “(E) QUALIFIED INTEREST INCOME.—For
13 purposes of subparagraph (D), the term ‘quali-
14 fied interest income’ means the sum of the fol-
15 lowing amounts derived by the regulated invest-
16 ment company from sources within the United
17 States:

18 “(i) Any amount includible in gross
19 income as original issue discount (within
20 the meaning of section 1273) on an obliga-
21 tion payable 183 days or less from the date
22 of original issue (without regard to the pe-
23 riod held by the company).

24 “(ii) Any interest includible in gross
25 income (including amounts recognized as

1 ordinary income in respect of original issue
2 discount or market discount or acquisition
3 discount under part V of subchapter P and
4 such other amounts as regulations may
5 provide) on an obligation which is in reg-
6 istered form; except that this clause shall
7 not apply to—

8 “(I) any interest on an obligation
9 issued by a corporation or partnership
10 if the regulated investment company
11 is a 10-percent shareholder in such
12 corporation or partnership, and

13 “(II) any interest which is treat-
14 ed as not being portfolio interest
15 under the rules of subsection (h)(4).

16 “(iii) Any interest referred to in sub-
17 section (i)(2)(A) (without regard to the
18 trade or business of the regulated invest-
19 ment company).

20 “(iv) Any interest-related dividend in-
21 cludable in gross income with respect to
22 stock of another regulated investment com-
23 pany.

24 “(F) 10-PERCENT SHAREHOLDER.—For
25 purposes of this paragraph, the term ‘10-per-

1 cent shareholder' has the meaning given such
2 term by subsection (h)(3)(B).

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

4 “(A) IN GENERAL.—Except as provided in
5 subparagraph (B), no tax shall be imposed
6 under paragraph (1)(A) of subsection (a) on
7 any short-term capital gain dividend received
8 from a regulated investment company.

9 “(B) EXCEPTION FOR ALIENS TAXABLE
10 UNDER SUBSECTION (a)(2).—In the case of divi-
11 dends received from a regulated investment
12 company before January 1, 2003, subparagraph
13 (A) shall not apply in the case of any non-
14 resident alien individual subject to tax under
15 subsection (a)(2).

16 “(C) SHORT-TERM CAPITAL GAIN DIVI-
17 DEND.—For purposes of this paragraph, a
18 short-term capital gain dividend is any dividend
19 (or part thereof) which is designated by the reg-
20 ulated investment company as a short-term cap-
21 ital gain dividend in a written notice mailed to
22 its shareholders not later than 60 days after the
23 close of its taxable year. If the aggregate
24 amount so designated with respect to a taxable
25 year of the company (including amounts so des-

1 ignated with respect to dividends paid after the
2 close of the taxable year described in section
3 855) is greater than the qualified short-term
4 gain of the company for such taxable year, the
5 portion of each distribution which shall be a
6 short-term capital gain dividend shall be only
7 that portion of the amounts so designated
8 which such qualified short-term gain bears to
9 the aggregate amount so designated.

10 “(D) QUALIFIED SHORT-TERM GAIN.—For
11 purposes of subparagraph (C), the term ‘quali-
12 fied short-term gain’ means the excess of the
13 net short-term capital gain of the regulated in-
14 vestment company for the taxable year over the
15 net long-term capital loss (if any) of such com-
16 pany for such taxable year. For purposes of this
17 subparagraph—

18 “(i) the net short-term capital gain of
19 the regulated investment company shall be
20 computed by treating any short-term cap-
21 ital gain dividend includible in gross in-
22 come with respect to stock of another regu-
23 lated investment company as a short-term
24 capital gain, and

1 “(ii) the excess of the net short-term
2 capital gain for a taxable year over the net
3 long-term capital loss for a taxable year (to
4 which an election under section 4982(e)(4)
5 does not apply) shall be determined with-
6 out regard to any net capital loss or net
7 short-term capital loss attributable to
8 transactions after October 31 of such year,
9 and any such net capital loss or net short-
10 term capital loss shall be treated as arising
11 on the 1st day of the next taxable year.

12 To the extent provided in regulations, clause
13 (ii) shall apply also for purposes of computing
14 the taxable income of the regulated investment
15 company.”

16 (2) FOREIGN CORPORATIONS.—Section 881 (re-
17 lating to tax on income of foreign corporations not
18 connected with United States business) is amended
19 by redesignating subsection (e) as subsection (f) and
20 by inserting after subsection (d) the following new
21 subsection:

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

24 “(1) INTEREST-RELATED DIVIDENDS.—

1 “(A) IN GENERAL.—Except as provided in
2 subparagraph (B), no tax shall be imposed
3 under paragraph (1) of subsection (a) on any
4 interest-related dividend (as defined in section
5 871(k)(1)) received from a regulated investment
6 company.

7 “(B) EXCEPTION.—Subparagraph (A)
8 shall not apply—

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

11 “(ii) to any interest-related dividend
12 received by a controlled foreign corporation
13 (within the meaning of section 957(a)) to
14 the extent such dividend is attributable to
15 interest received by the regulated invest-
16 ment company from a person who is a re-
17 lated person (within the meaning of section
18 864(d)(4)) with respect to such controlled
19 foreign corporation.

20 “(C) TREATMENT OF DIVIDENDS RE-
21 CEIVED BY CONTROLLED FOREIGN CORPORA-
22 TIONS.—The rules of subsection (c)(5)(A) shall
23 apply to any interest-related dividend received
24 by a controlled foreign corporation (within the
25 meaning of section 957(a)) to the extent such

1 dividend is attributable to interest received by
2 the regulated investment company which is de-
3 scribed in clause (ii) of section 871(k)(1)(E)
4 (and not described in clause (i) or (iii) of such
5 section).

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

11 (3) WITHHOLDING TAXES.—

12 (A) Section 1441(c) (relating to excep-
13 tions) is amended by adding at the end the fol-
14 lowing new paragraph:

15 “(12) CERTAIN DIVIDENDS RECEIVED FROM
16 REGULATED INVESTMENT COMPANIES.—

17 “(A) IN GENERAL.—No tax shall be re-
18 quired to be deducted and withheld under sub-
19 section (a) from any amount exempt from the
20 tax imposed by section 871(a)(1)(A) by reason
21 of section 871(k).

22 “(B) SPECIAL RULE.—For purposes of
23 subparagraph (A), clause (i) of section
24 871(k)(1)(B) shall not apply to any dividend
25 unless the regulated investment company knows

1 that such dividend is a dividend referred to in
2 such clause. A similar rule shall apply with re-
3 spect to the exception contained in section
4 871(k)(2)(B).”

5 (B) Section 1442(a) (relating to with-
6 holding of tax on foreign corporations) is
7 amended—

8 (i) by striking “and the reference in
9 section 1441(c)(10)” and inserting “the
10 reference in section 1441(c)(10)”, and

11 (ii) by inserting before the period at
12 the end the following: “, and the references
13 in section 1441(c)(12) to sections 871(a)
14 and 871(k) shall be treated as referring to
15 sections 881(a) and 881(e) (except that for
16 purposes of applying subparagraph (A) of
17 section 1441(c)(12), as so modified, clause
18 (ii) of section 881(e)(1)(B) shall not apply
19 to any dividend unless the regulated invest-
20 ment company knows that such dividend is
21 a dividend referred to in such clause)”.

22 (b) ESTATE TAX TREATMENT OF INTEREST IN CER-
23 TAIN REGULATED INVESTMENT COMPANIES.—Section
24 2105 (relating to property without the United States for

1 estate tax purposes) is amended by adding at the end the
2 following new subsection:

3 “(d) STOCK IN A RIC.—

4 “(1) IN GENERAL.—For purposes of this sub-
5 chapter, stock in a regulated investment company
6 (as defined in section 851) owned by a nonresident
7 not a citizen of the United States shall not be
8 deemed property within the United States in the
9 proportion that, at the end of the quarter of such in-
10 vestment company’s taxable year immediately pre-
11 ceding a decedent’s date of death (or at such other
12 time as the Secretary may designate in regulations),
13 the assets of the investment company that were
14 qualifying assets with respect to the decedent bore
15 to the total assets of the investment company.

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

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

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

24 “(C) other property not within the United
25 States.”

1 (c) TREATMENT OF REGULATED INVESTMENT COM-
2 PANIES UNDER SECTION 897.—

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

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

8 “(2) SALE OF STOCK IN DOMESTICALLY CON-
9 TROLLED ENTITY NOT TAXED.—The term ‘United
10 States real property interest’ does not include any
11 interest in a domestically controlled qualified invest-
12 ment entity.

13 “(3) DISTRIBUTIONS BY DOMESTICALLY CON-
14 TROLLED QUALIFIED INVESTMENT ENTITIES.—In
15 the case of a domestically controlled qualified invest-
16 ment entity, rules similar to the rules of subsection
17 (d) shall apply to the foreign ownership percentage
18 of any gain.”

19 (3) Subparagraphs (A) and (B) of section
20 897(h)(4) are amended to read as follows:

21 “(A) QUALIFIED INVESTMENT ENTITY.—
22 The term ‘qualified investment entity’ means
23 any real estate investment trust and any regu-
24 lated investment company.

1 “(B) DOMESTICALLY CONTROLLED.—The
2 term ‘domestically controlled qualified invest-
3 ment entity’ means any qualified investment en-
4 tity in which at all times during the testing pe-
5 riod less than 50 percent in value of the stock
6 was held directly or indirectly by foreign per-
7 sons.”

8 (4) Subparagraphs (C) and (D) of section
9 897(h)(4) are each amended by striking “REIT”
10 and inserting “qualified investment entity”.

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

14 (d) EFFECTIVE DATE.—

15 (1) IN GENERAL.—Except as otherwise pro-
16 vided in this subsection, the amendments made by
17 this section shall apply to dividends with respect to
18 taxable years of regulated investment companies be-
19 ginning after the date of the enactment of this Act.

20 (2) ESTATE TAX TREATMENT.—The amend-
21 ment made by subsection (b) shall apply to estates
22 of decedents dying after the date of the enactment
23 of this Act.

24 (3) CERTAIN OTHER PROVISIONS.—The amend-
25 ments made by subsection (c) (other than paragraph

1 (1) thereof) shall take effect on the date of the en-
2 actment of this Act.

3 **SEC. 324. ELECTION NOT TO USE AVERAGE EXCHANGE**
4 **RATE FOR FOREIGN TAX PAID OTHER THAN**
5 **IN FUNCTIONAL CURRENCY.**

6 (a) IN GENERAL.—Paragraph (1) of section 986(a)
7 (relating to determination of foreign taxes and foreign cor-
8 poration’s earnings and profits) is amended by redesi-
9 gnating subparagraph (D) as subparagraph (E) and by in-
10 serting after subparagraph (C) the following new subpara-
11 graph:

12 “(D) ELECTIVE EXCEPTION FOR TAXES
13 PAID OTHER THAN IN FUNCTIONAL CUR-
14 RENCY.—

15 “(i) IN GENERAL.—At the election of
16 the taxpayer, subparagraph (A) shall not
17 apply to any foreign income taxes the li-
18 ability for which is denominated in any
19 currency other than in the taxpayer’s func-
20 tional currency.

21 “(ii) APPLICATION TO QUALIFIED
22 BUSINESS UNITS.—An election under this
23 subparagraph may apply to foreign income
24 taxes attributable to a qualified business

1 unit in accordance with regulations pre-
2 scribed by the Secretary.

3 “(iii) ELECTION.—Any such election
4 shall apply to the taxable year for which
5 made and all subsequent taxable years un-
6 less revoked with the consent of the Sec-
7 retary.”

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

11 **SEC. 325. REPEAL OF WITHHOLDING TAX ON DIVIDENDS**
12 **FROM CERTAIN FOREIGN CORPORATIONS.**

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

17 “(D) Dividends paid by a foreign corpora-
18 tion.”.

19 (b) EFFECTIVE DATE.—The amendment made by
20 this section shall apply to payments made after December
21 31, 2002.

22 **SEC. 326. INCREASE IN EXPENSING UNDER SECTION 179.**

23 (a) INCREASE IN DOLLAR LIMITATIONS.—

1 (1) IN GENERAL.—Paragraph (1) of section
2 179(b) (relating to dollar limitation) is amended to
3 read as follows:

4 “(1) DOLLAR LIMITATION.—The aggregate cost
5 which may be taken into account under subsection
6 (a) for any taxable year shall not exceed \$25,000
7 (\$40,000 in the case of taxable years beginning after
8 December 31, 2012).”

9 (2) INCREASE IN PHASEOUT THRESHOLD.—
10 Paragraph (2) of section 179(b) is amended by in-
11 serting before the period “(\$325,000 in the case of
12 taxable years beginning after December 31, 2012).”.

13 (b) INFLATION ADJUSTMENTS.—

14 (1) IN GENERAL.—Subsection (b) of section
15 179 is amended by redesignating paragraphs (3) and
16 (4) as paragraphs (4) and (5), respectively, and by
17 inserting after paragraph (2) the following new
18 paragraph:

19 “(3) INFLATION ADJUSTMENT.—In the case of
20 any taxable year beginning in a calendar year after
21 2004, the dollar amounts contained in paragraphs
22 (1) and (2) which would (but for this paragraph)
23 apply to such taxable year shall be increased by an
24 amount equal to the product of—

25 “(A) such dollar amount, and

1 “(B) the cost-of-living adjustment deter-
2 mined under section 1(f)(3) for the calendar
3 year in which the taxable year begins, deter-
4 mined by substituting in subparagraph (B)
5 thereof—

6 “(i) ‘calendar year 2003’ for ‘calendar
7 year 1992’ with respect to the \$25,000
8 and \$200,000 amounts, and

9 “(ii) ‘calendar year 2011’ for ‘cal-
10 endar year 1992’ with respect to the
11 \$40,000 and \$325,000 amounts.

12 If any amount after adjustment under the preceding
13 sentence is not a multiple of \$1,000, such amount
14 shall be rounded to the next lowest multiple of
15 \$1,000.”

16 (2) CONFORMING AMENDMENT.—Subparagraph
17 (B) of section 179(b)(5), as redesignated by para-
18 graph (1), is amended by striking “paragraph (3)”
19 and inserting “paragraph (4)”.

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

23 **SEC. 327. REPEAL OF EXCLUSION FOR EXTRATERRITORIAL**
24 **INCOME.**

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

1 (b) CONFORMING AMENDMENTS.—

2 (1) Subpart E of part III of subchapter N of
3 chapter 1 (relating to qualifying foreign trade in-
4 come) is hereby repealed.

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

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

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

13 **SEC. 328. REPEAL OF FSC TRANSITIONAL RULES.**

14 (a) IN GENERAL.—Subsections (c) and (d) of section
15 5 of the FSC Repeal and Extraterritorial Income Exclu-
16 sion Act of 2000 are hereby repealed.

17 (b) EFFECTIVE DATE.—The amendment made by
18 this section shall apply to taxable years beginning after
19 the calendar year which includes the date of the enactment
20 of this Act.

1 **TITLE IV—OTHER PROVISIONS**

2 **SEC. 401. EXTENSION OF INTERNAL REVENUE SERVICE**

3 **USER FEES.**

4 (a) IN GENERAL.—Chapter 77 (relating to miscella-
5 neous provisions) is amended by adding at the end the
6 following new section:

7 **“SEC. 7527. INTERNAL REVENUE SERVICE USER FEES.**

8 “(a) GENERAL RULE.—The Secretary shall establish
9 a program requiring the payment of user fees for—

10 “(1) requests to the Internal Revenue Service
11 for ruling letters, opinion letters, and determination
12 letters, and

13 “(2) other similar requests.

14 “(b) PROGRAM CRITERIA.—

15 “(1) IN GENERAL.—The fees charged under the
16 program required by subsection (a)—

17 “(A) shall vary according to categories (or
18 subcategories) established by the Secretary,

19 “(B) shall be determined after taking into
20 account the average time for (and difficulty of)
21 complying with requests in each category (and
22 subcategory), and

23 “(C) shall be payable in advance.

24 “(2) EXEMPTIONS, ETC.—

1 “(A) IN GENERAL.—The Secretary shall
2 provide for such exemptions (and reduced fees)
3 under such program as the Secretary deter-
4 mines to be appropriate.

5 “(B) EXEMPTION FOR CERTAIN REQUESTS
6 REGARDING PENSION PLANS.—The Secretary
7 shall not require payment of user fees under
8 such program for requests for determination
9 letters with respect to the qualified status of a
10 pension benefit plan maintained solely by 1 or
11 more eligible employers or any trust which is
12 part of the plan. The preceding sentence shall
13 not apply to any request—

14 “(i) made after the later of—

15 “(I) the fifth plan year the pen-
16 sion benefit plan is in existence, or

17 “(II) the end of any remedial
18 amendment period with respect to the
19 plan beginning within the first 5 plan
20 years, or

21 “(ii) made by the sponsor of any pro-
22 totype or similar plan which the sponsor
23 intends to market to participating employ-
24 ers.

1 “(C) DEFINITIONS AND SPECIAL RULES.—

2 For purposes of subparagraph (B)—

3 “(i) PENSION BENEFIT PLAN.—The
4 term ‘pension benefit plan’ means a pen-
5 sion, profit-sharing, stock bonus, annuity,
6 or employee stock ownership plan.

7 “(ii) ELIGIBLE EMPLOYER.—The
8 term ‘eligible employer’ means an eligible
9 employer (as defined in section
10 408(p)(2)(C)(i)(I)) which has at least 1
11 employee who is not a highly compensated
12 employee (as defined in section 414(q))
13 and is participating in the plan. The deter-
14 mination of whether an employer is an eli-
15 gible employer under subparagraph (B)
16 shall be made as of the date of the request
17 described in such subparagraph.

18 “(iii) DETERMINATION OF AVERAGE
19 FEES CHARGED.—For purposes of any de-
20 termination of average fees charged, any
21 request to which subparagraph (B) applies
22 shall not be taken into account.

23 “(3) AVERAGE FEE REQUIREMENT.—The aver-
24 age fee charged under the program required by sub-

1 section (a) shall not be less than the amount deter-
 2 mined under the following table:

“Category	Average Fee
Employee plan ruling and opinion	\$250
Exempt organization ruling	\$350
Employee plan determination	\$300
Exempt organization determination	\$275
Chief counsel ruling	\$200.

3 “(c) **TERMINATION.**—No fee shall be imposed under
 4 this section with respect to requests made after December
 5 31, 2012.”

6 (b) **CONFORMING AMENDMENTS.**—

7 (1) The table of sections for chapter 77 is
 8 amended by adding at the end the following new
 9 item:

“Sec. 7527. Internal Revenue Service user fees.”.

10 (2) Section 10511 of the Revenue Act of 1987
 11 is repealed.

12 (3) Section 620 of the Economic Growth and
 13 Tax Relief Reconciliation Act of 2001 is repealed.

14 (c) **LIMITATIONS.**—Notwithstanding any other provi-
 15 sion of law, any fees collected pursuant to section 7527
 16 of the Internal Revenue Code of 1986, as added by sub-
 17 section (a), shall not be expended by the Internal Revenue
 18 Service unless provided by an appropriations Act.

19 (d) **EFFECTIVE DATE.**—The amendments made by
 20 this section shall apply to requests made after the date
 21 of the enactment of this Act.

1 **SEC. 402. EXTENSION OF CUSTOMS USER FEES.**

2 (a) IN GENERAL.—Section 13031(j)(3) of the Con-
3 solidated Omnibus Budget Reconciliation Act of 1985 (19
4 U.S.C. 58c(j)(3)) is amended by striking “September 30,
5 2003” and inserting “December 31, 2012”.

6 (b) CUSTOMS AUTOMATION FUND.—Section
7 13031(f) of the Consolidated Omnibus Budget Reconcili-
8 ation Act of 1985 (19 U.S.C. 58c(f)) is amended—

9 (1) in paragraph (1), by striking subparagraph
10 (B) and inserting the following:

11 “(B) amounts deposited into the Customs Com-
12 mercial Automation Account under paragraph (5).”;

13 (2) in paragraph (4), by striking “(other than
14 the excess fees determined by the Secretary under
15 paragraph (5))”; and

16 (3) by striking paragraph (5) and inserting the
17 following:

18 “(5)(A) There is created within the general fund of
19 the Treasury a separate account that shall be known as
20 the ‘Customs Commercial Automation Account’. In each
21 of fiscal years 2003, 2004, and 2005 there shall be depos-
22 ited into the Customs Commercial Automation Account
23 from fees collected under subsection (a)(9)(A),
24 \$350,000,000.

25 “(B) There is authorized to be appropriated from the
26 Customs Commercial Automation Account in fiscal years

1 2003 through 2005 such amounts as are available in that
2 Account for the development, establishment, and imple-
3 mentation of the Automated Commercial Environment
4 computer system for the processing of merchandise that
5 is entered or released. Amounts appropriated pursuant to
6 this subparagraph are authorized to remain available until
7 expended.

8 “(C) In adjusting the fee imposed by subsection
9 (a)(9)(A) for fiscal year 2006, the Secretary of the Treas-
10 ury shall reduce the amount estimated to be collected in
11 fiscal year 2006 by the amount by which total fees depos-
12 ited to the Customs Commercial Automation Account dur-
13 ing fiscal years 2003, 2004, and 2005 exceed total appro-
14 priations from that Account.”.

15 **SEC. 403. INCLUSION IN GROSS INCOME OF FUNDED DE-**
16 **FERRED COMPENSATION OF CORPORATE IN-**
17 **SIDERS.**

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

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

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

1 “(1) compensation of any disqualified individual
2 which is deferred under such funded deferred com-
3 pensation plan shall be included in the gross income
4 of the disqualified individual or beneficiary for the
5 1st taxable year in which there is no substantial risk
6 of forfeiture of the rights to such compensation, and

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

11 “(b) FUNDED DEFERRED COMPENSATION PLAN.—
12 For purposes of this section—

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

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

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

1 stricted to the provision of benefits under the
2 plan), and

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

7 Such term shall not include a qualified employer
8 plan.

9 “(2) SPECIAL RULES.—

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

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

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

21 If the employer and employee agree to a modi-
22 fication of the plan that accelerates the time for
23 payment of any deferred compensation, then all
24 compensation previously deferred under the
25 plan shall be includible in gross income for the

1 taxable year during which such modification
2 takes effect and the taxpayer shall pay interest
3 at the underpayment rate on the underpay-
4 ments that would have occurred had the de-
5 ferred compensation been includible in gross in-
6 come on the earliest date that there is no sub-
7 stantial risk of forfeiture of the rights to such
8 compensation.

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

13 “(i) the employee has no beneficial in-
14 terest in the trust,

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

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

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

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

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

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

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

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

17 “(A) any plan, contract, pension, account,
18 or trust described in subparagraph (A) or (B)
19 of section 219(g)(5), and

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

22 “(2) PLAN INCLUDES ARRANGEMENTS, ETC.—
23 The term ‘plan’ includes any agreement or arrange-
24 ment.

1 “(3) SUBSTANTIAL RISK OF FORFEITURE.—The
 2 rights of a person to compensation are subject to a
 3 substantial risk of forfeiture if such person’s rights
 4 to such compensation are conditioned upon the fu-
 5 ture performance of substantial services by any indi-
 6 vidual.

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

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

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

15 (b) EFFECTIVE DATE.—The amendments made by
 16 this section shall apply to amounts deferred after July 10,
 17 2002.

18 **SEC. 404. SIMPLIFICATION OF EXCISE TAX IMPOSED ON**
 19 **BOWS AND ARROWS.**

20 (a) BOWS.—Section 4161(b)(1) (relating to bows) is
 21 amended to read as follows:

22 “(1) BOWS.—

23 “(A) IN GENERAL.—There is hereby im-
 24 posed on the sale by the manufacturer, pro-

1 ducer, or importer of any bow which has a draw
2 weight of 30 pounds or more, a tax equal to 11
3 percent of the price for which so sold.

4 “(B) ARCHERY EQUIPMENT.—There is
5 hereby imposed on the sale by the manufac-
6 turer, producer, or importer—

7 “(i) of any part or accessory suitable
8 for inclusion in or attachment to a bow de-
9 scribed in subparagraph (A), and

10 “(ii) of any quiver or broadhead suit-
11 able for use with an arrow described in
12 paragraph (3),

13 a tax equal to 11 percent of the price for which
14 so sold.”.

15 (b) ARROWS.—Section 4161(b) (relating to bows and
16 arrows, etc.) is amended by redesignating paragraph (3)
17 as paragraph (4) and inserting after paragraph (2) the
18 following:

19 “(3) ARROWS.—

20 “(A) IN GENERAL.—There is hereby im-
21 posed on the sale by the manufacturer, pro-
22 ducer, or importer of any arrow, a tax equal to
23 12 percent of the price for which so sold.

24 “(B) EXCEPTION.—The tax imposed by
25 subparagraph (A) on an arrow shall not apply

1 if the arrow contains an arrow shaft subject to
2 the tax imposed by paragraph (2).

3 “(C) ARROW.—For purposes of this para-
4 graph, the term ‘arrow’ means any shaft de-
5 scribed in paragraph (2) to which additional
6 components are attached.”.

7 (c) CONFORMING AMENDMENT.—The heading of sec-
8 tion 4161(b)(2) (relating to arrows) is amended by strik-
9 ing “ARROWS.—” and inserting “ARROW COMPO-
10 NENTS.—”.

11 (d) EFFECTIVE DATE.—The amendments made by
12 this section shall apply to articles sold by the manufac-
13 turer, producer, or importer after December 31, 2001.

14 **SEC. 405. EXCLUSION FROM GROSS INCOME FOR INTEREST**
15 **ON OVERPAYMENTS OF INCOME TAX BY INDI-**
16 **VIDUALS.**

17 (a) IN GENERAL.—Part III of subchapter B of chap-
18 ter 1 (relating to items specifically excluded from gross
19 income) is amended by inserting after section 139 the fol-
20 lowing new section:

1 **“SEC. 139A. EXCLUSION FROM GROSS INCOME FOR INTER-**
2 **EST ON OVERPAYMENTS OF INCOME TAX BY**
3 **INDIVIDUALS.**

4 “(a) IN GENERAL.—In the case of an individual,
5 gross income shall not include interest paid under section
6 6611 on any overpayment of tax imposed by this subtitle.

7 “(b) EXCEPTION.—Subsection (a) shall not apply in
8 the case of a failure to claim items resulting in the over-
9 payment on the original return if the Secretary determines
10 that the principal purpose of such failure is to take advan-
11 tage of subsection (a).

12 “(c) SPECIAL RULE FOR DETERMINING MODIFIED
13 ADJUSTED GROSS INCOME.—For purposes of this title,
14 interest not included in gross income under subsection (a)
15 shall not be treated as interest which is exempt from tax
16 for purposes of sections 32(i)(2)(B) and 6012(d) or any
17 computation in which interest exempt from tax under this
18 title is added to adjusted gross income.”.

19 (b) CLERICAL AMENDMENT.—The table of sections
20 for part III of subchapter B of chapter 1 is amended by
21 inserting after the item relating to section 139 the fol-
22 lowing new item:

“Sec. 139A. Exclusion from gross income for interest on over-
payments of income tax by individuals.”.

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to interest received in calendar
3 years beginning after December 31, 2006.

4 **SEC. 406. DEPOSITS MADE TO SUSPEND RUNNING OF IN-**
5 **TEREST ON POTENTIAL UNDERPAYMENTS.**

6 (a) IN GENERAL.—Subchapter A of chapter 67 (re-
7 lating to interest on underpayments) is amended by add-
8 ing at the end the following new section:

9 **“SEC. 6603. DEPOSITS MADE TO SUSPEND RUNNING OF IN-**
10 **TEREST ON POTENTIAL UNDERPAYMENTS,**
11 **ETC.**

12 “(a) AUTHORITY TO MAKE DEPOSITS OTHER THAN
13 AS PAYMENT OF TAX.—A taxpayer may make a cash de-
14 posit with the Secretary which may be used by the Sec-
15 retary to pay any tax imposed under subtitle A or B or
16 chapter 41, 42, 43, or 44 which has not been assessed
17 at the time of the deposit. Such a deposit shall be made
18 in such manner as the Secretary shall prescribe.

19 “(b) NO INTEREST IMPOSED.—To the extent that
20 such deposit is used by the Secretary to pay tax, for pur-
21 poses of section 6601 (relating to interest on underpay-
22 ments), the tax shall be treated as paid when the deposit
23 is made.

24 “(c) RETURN OF DEPOSIT.—Except in a case where
25 the Secretary determines that collection of tax is in jeop-

1 ardy, the Secretary shall return to the taxpayer any
2 amount of the deposit (to the extent not used for a pay-
3 ment of tax) which the taxpayer requests in writing.

4 “(d) PAYMENT OF INTEREST.—

5 “(1) IN GENERAL.—For purposes of section
6 6611 (relating to interest on overpayments), a de-
7 posit which is returned to a taxpayer shall be treated
8 as a payment of tax for any period to the extent
9 (and only to the extent) attributable to a disputable
10 tax for such period. Under regulations prescribed by
11 the Secretary, rules similar to the rules of section
12 6611(b)(2) shall apply.

13 “(2) DISPUTABLE TAX.—

14 “(A) IN GENERAL.—For purposes of this
15 section, the term ‘disputable tax’ means the
16 amount of tax specified at the time of the de-
17 posit as the taxpayer’s reasonable estimate of
18 the maximum amount of any tax attributable to
19 disputable items.

20 “(B) SAFE HARBOR BASED ON 30-DAY
21 LETTER.—In the case of a taxpayer who has
22 been issued a 30-day letter, the maximum
23 amount of tax under subparagraph (A) shall
24 not be less than the amount of the proposed de-
25 ficiency specified in such letter.

1 “(3) OTHER DEFINITIONS.—For purposes of
2 paragraph (2)—

3 “(A) DISPUTABLE ITEM.—The term ‘dis-
4 putable item’ means any item of income, gain,
5 loss, deduction, or credit if the taxpayer—

6 “(i) has a reasonable basis for its
7 treatment of such item, and

8 “(ii) reasonably believes that the Sec-
9 retary also has a reasonable basis for dis-
10 allowing the taxpayer’s treatment of such
11 item.

12 “(B) 30-DAY LETTER.—The term ‘30-day
13 letter’ means the first letter of proposed defi-
14 ciency which allows the taxpayer an opportunity
15 for administrative review in the Internal Rev-
16 enue Service Office of Appeals.

17 “(4) RATE OF INTEREST.—The rate of interest
18 allowable under this subsection shall be the Federal
19 short-term rate determined under section 6621(b),
20 compounded daily.

21 “(e) USE OF DEPOSITS.—

22 “(1) PAYMENT OF TAX.—Except as otherwise
23 provided by the taxpayer, deposits shall be treated
24 as used for the payment of tax in the order depos-
25 ited.

1 “(B) RETURNS OF DEPOSITS.—Deposits shall
2 be treated as returned to the taxpayer on a last-in,
3 first-out basis.”.

4 (b) CLERICAL AMENDMENT.—The table of sections
5 for subchapter A of chapter 67 is amended by adding at
6 the end the following new item:

 “Sec. 6603. Deposits made to suspend running of interest on po-
 tential underpayments, etc.”.

7 (c) EFFECTIVE DATE.—

8 (1) IN GENERAL.—The amendments made by
9 this section shall apply to deposits made after the
10 date of the enactment of this Act.

11 (2) COORDINATION WITH DEPOSITS MADE
12 UNDER REVENUE PROCEDURE 84–58.—In the case of
13 an amount held by the Secretary of the Treasury or
14 his delegate on the date of the enactment of this Act
15 as a deposit in the nature of a cash bond deposit
16 pursuant to Revenue Procedure 84–58, the date that
17 the taxpayer identifies such amount as a deposit
18 made pursuant to section 6603 of the Internal Rev-
19 enue Code (as added by this Act) shall be treated as
20 the date such amount is deposited for purposes of
21 such section 6603.

22 **SEC. 407. PARTIAL PAYMENT OF TAX LIABILITY IN IN-**
23 **STALLMENT AGREEMENTS.**

24 (a) IN GENERAL.—

1 (1) Section 6159(a) (relating to authorization
2 of agreements) is amended—

3 (A) by striking “satisfy liability for pay-
4 ment of” and inserting “make payment on”,
5 and

6 (B) by inserting “full or partial” after “fa-
7 cilitate”.

8 (2) Section 6159(e) (relating to Secretary re-
9 quired to enter into installment agreements in cer-
10 tain cases) is amended in the matter preceding para-
11 graph (1) by inserting “full” before “payment”.

12 (b) REQUIREMENT TO REVIEW PARTIAL PAYMENT
13 AGREEMENTS EVERY TWO YEARS.—Section 6159 is
14 amended by redesignating subsections (d) and (e) as sub-
15 sections (e) and (f), respectively, and inserting after sub-
16 section (c) the following new subsection:

17 “(d) SECRETARY REQUIRED TO REVIEW INSTALL-
18 MENT AGREEMENTS FOR PARTIAL COLLECTION EVERY
19 TWO YEARS.—In the case of an agreement entered into
20 by the Secretary under subsection (a) for partial collection
21 of a tax liability, the Secretary shall review the agreement
22 at least once every 2 years.”.

23 (c) EFFECTIVE DATE.—The amendments made by
24 this section shall apply to agreements entered into on or
25 after the date of the enactment of this Act.

1 **SEC. 408. EXTENSION OF TRANSFERS OF EXCESS PENSION**
2 **ASSETS TO RETIREE HEALTH ACCOUNTS.**

3 Paragraph (5) of section 420(b) (relating to expira-
4 tion) is amended by striking “December 31, 2005” and
5 inserting “December 31, 2012”.

6 **SEC. 409. CLARIFICATION OF RULES FOR PAYMENT OF ES-**
7 **TIMATED TAX FOR CERTAIN DEEMED ASSET**
8 **SALES.**

9 (a) **IN GENERAL.**—Paragraph (13) of section 338(h)
10 (relating to tax on deemed sale not taken into account for
11 estimated tax purposes) is amended by adding at the end
12 the following: “The preceding sentence shall not apply
13 with respect to a qualified stock purchase for which an
14 election is made under paragraph (10).”.

15 (b) **EFFECTIVE DATE.**—The amendment made by
16 subsection (a) shall apply to transactions occurring after
17 the date of the enactment of this Act.

○